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Monetary cooperation and monetary policy in the EU

Banking union, post-crisis developments

Lecture 6

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Banking union, post-crisis developments

Lecture 6

In this lecture you will learn about:

- The Four presidents' report on the future of the EMU
- The Blueprint for a Deep and Genuine EMU
- The banking union developed after the crisis
- The White Paper on the Future of Europe
- The Macron Plan for Europe
- The Meseberg Declaration

Four presidents' report

In June 2012, the presidents of the European Council, the Commission, the Eurogroup and the European Central Bank published a short report titled **"Towards a Genuine Economic and Monetary Union"**. In this report, they emphasised that the EMU should be solidified by deepening further. They envisaged:

- An **integrated financial framework** to ensure financial stability in the euro area;
- An **integrated budgetary framework** to ensure sound fiscal policy making at the national and European levels, encompassing coordination, joint decision-making, greater enforcement and commensurate steps towards common debt issuance;
- An **integrated economic policy framework** which has sufficient mechanisms to ensure that national and European policies are in place that promote sustainable growth, employment and competitiveness, and are compatible with the smooth functioning of EMU;
- Ensuring the necessary *democratic legitimacy and accountability* of decision-making within the EMU, based on the joint exercise of sovereignty for common policies and solidarity.

The report was followed by a blueprint published by the Commission in November 2012.

A Blueprint for a Deep and Genuine EMU - Launching a European debate

The Blueprint discussed the four presidents' proposals in further detail, and set out a roadmap for the time ahead (from November 2012 on):

- **Short term (6-18 months)**:
  - full deployment of the economic governance tools
  - adoption of the EU's next multiannual financial framework (2014-2020)

- Single Resolution Mechanism (SRM)

– **Medium term (18 months to 5 years)**:
  - further budgetary coordination
  - deeper policy coordination in taxation and employment
  - creation of a proper fiscal capacity

– **Long term (beyond 5 years)**:
  - progressive pooling of sovereignty, responsibility and solidarity competences to the European level
  - a deeply integrated economic and fiscal governance framework
  - consideration of the introduction of Stability Bonds

The banking union

The banking union is **an important step towards a genuine Economic and Monetary Union**. It allows for the **consistent application of EU banking rules** in the participating countries. The new decision-making procedures and tools help to create a **more transparent, unified and safer market for banks**.

The need for a banking union emerged from the financial crisis of 2008 and the subsequent sovereign debt crisis. It became clear that, especially in a monetary union such as the euro area, **problems caused by close links between public sector finances and the banking sector can easily spill over national borders and cause financial distress in other EU countries**.

Key pieces of the EU-wide financial reform puzzle

As the financial crisis evolved and turned into the Eurozone debt crisis in 2010/11, it became clear that, **for those countries which shared a currency and were even more interdependent, more had to be done**, in particular to break the vicious circle between banks and national finances.

The vicious circle between banks and national finances

That is why, **in June 2012, Heads of State and Government agreed to create a banking union, completing the Economic and Monetary Union**, and allowing for centralised application of EU-wide rules for banks in the euro area (and any non-euro Member States that would want to join).

The banking union will help to break the link between banks and sovereigns:

- **Banks will be stronger and more immune to shocks**: Common supervision will ensure effective enforcement of stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity. This will make EU banks more solid, strengthen their capacity to adequately manage risks linked to their activities and absorb losses they may incur.
- **Failing banks will be resolved without taxpayers money, limiting negative effects on governments' fiscal positions**: bank resolution will be financed by banks' shareholders and creditors and by a resolution fund financed by industry. Banks should not be bailed out and government fiscal position will not be weakened further.
- **Banks will no longer be "European in life but national in death"** as they will be supervised by a truly European mechanism and any failure will also be managed by a truly European mechanism.

Elements of the banking union

The banking union has two pillars:

- **Single Supervisory Mechanism (SSM)**
- **Single Resolution Mechanism (SRM)**

The two pillars rest on the foundation of the **single rulebook**, which applies to all EU countries.

SSM: As of November 2014, the Single Supervisory Mechanism is the new system of banking supervision for Europe. It comprises the **ECB** and the **national supervisory authorities** of the participating countries. The ECB **directly supervises** the 115 **significant banks** of the participating countries. These banks hold almost 82% of banking assets in the euro area. Banks that are not considered significant are known as **less significant** institutions. They **continue to be supervised by their national supervisors**, in close cooperation with the ECB. At any time the ECB can decide to directly supervise any one of these banks to ensure that high supervisory standards are applied consistently.

What makes a bank significant? The criteria for determining whether banks are considered significant - and therefore under the ECB's direct supervision - are set out in the SSM Regulation and the SSM Framework Regulation. To qualify as significant, banks must fulfil at least one of these criteria:

- **Size**: the total value of its assets exceeds €30 billion
- **Economic importance**: for the specific country or the EU economy as a whole
- **Cross-border activities**: the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%
- **Direct public finance assistance**: it has requested or received funding from the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF)

All euro area countries participate **automatically** in the SSM. **Other EU countries** that do not yet have the euro as their currency **can choose to participate**. To do so, their national supervisors enter into close cooperation with the ECB.

SRM: The main purpose of the Single Resolution Mechanism is to ensure the efficient resolution of failing banks with minimal costs for taxpayers and to the real economy. A Single Resolution Board will ensure swift decision-making procedures, allowing a bank to be resolved over a weekend. As a supervisor, the ECB will have an important role in deciding whether a bank is failing or likely to fail. A Single Resolution Fund, financed by contributions from banks, will be available to pay for resolution measures.

Single rulebook: This set of rules provides legal and administrative standards to regulate, supervise and govern the financial sector in all EU countries more efficiently. It includes rules on capital requirements, recovery and resolution processes and a system of harmonised national Deposit Guarantee Schemes. The package of EU laws under the single rulebook applies to all EU countries. The banking union ensures that these rules are implemented consistently across the euro area and in other participating countries.

Five presidents' report

In June 2015, the "five presidents" of the EU published a report titled "**Completing Europe's Economic and Monetary Union"**.

The five presidents were:

- **Jean-Claude Juncker**, President of the European Commission (2014-2019)
- **Donald Tusk**, President of the European Council (2014-2019)
- **Jeroen Dijsselbloem**, President of the Eurogroup (2013-2018)
- **Mario Draghi**, President of the ECB (2011-2019)
- **Martin Schulz**, President of the European Parliament (2012-2017)

They set out the objective of achieving progress in four areas:

1. A genuine **Economic Union** that ensures each economy has the structural features to prosper within the Monetary Union.
    a. Key words: convergence, prosperity, social cohesion
2. A **Financial Union** that guarantees the integrity of the common currency across the Monetary Union and increases risk-sharing with the private sector.
    a. Slogan: Integrated finance for an integrated economy
3. A **Fiscal Union** that delivers both fiscal sustainability and fiscal stabilisation.
    a. Slogan: An integrated framework for sound and integrated fiscal policies
4. A **Political Union** that provides the foundation for all of the above.
    a. Key words: Genuine EMU, democratic accountability, legitimacy, institutional strengthening

The **four pillars** of the **Economic Union** are:

1. Creation of a euro area system of Competitiveness Authorities;
2. Strengthened implementation of the Macroeconomic Imbalance Procedure;
3. Greater focus on employment and social performance;
4. Stronger coordination of economic policies within a revamped European Semester

The process would be organised in consecutive **stages**:

1. **Stage 1** (1 July 2015 - 30 June 2017): 'deepening by doing'
2. **Stage 2**: 'completing EMU'
3. **Final Stage** (at the latest by 2025): all steps fully in place

White Paper on the Future of Europe

On 1 March 2017, the European Commission published its **White Paper on the Future of Europe** in which five scenarios are outlined for the post-Brexit EU27 by 2025. Each scenario has an element related specifically to the EMU.

Scenario	'Carrying On'	'Nothing but the Single Market'	'Those Who Want More Do More'	'Doing Less More Efficiently'	'Doing Much More Together'
Effect on the EMU	Gradual establishment in the operation of the eurozone	The cooperation within the eurozone is limited	Gradual improvement, further deepening among those strengthening the cooperation	Consolidation of the eurozone, less economic policy coordination on the EU-27 level	Economic, financial and fiscal union

The second and the fourth scenarios received the most criticism – the former because it is actually the reversal of the integration and therefore would mean disintegration on the long run while the latter was criticised because it is hard to imagine how it should be understood on the level of policy-making, decision-making and everyday functioning.

Scenario Nr.3. ('Those who want more do more') can be considered as the most realistic one. It is in fact envisaging **differentiated integration**, or **'Europe à la carte'**.

Differentiated integration, Europe à la carte: This refers to the idea of a non-uniform method of European integration which allows EU countries to select policies, as if from a menu, and involve themselves fully in those policies. The EU would still have a minimum number of common objectives. However, different countries would integrate at different levels (variable geometry) or at different speeds (multi-speed). Europe 'à la carte' is already a reality with some countries being part of the Eurozone and others not.

'Variable-geometry' Europe is the term used to describe the idea of a method of differentiated integration in the European Union. It acknowledges that, particularly since the EU's membership almost doubled in under a decade, there may be irreconcilable differences among countries and that there should be a means to resolve such stalemates. It would enable groups of countries wishing to pursue a given goal to do so, while allowing those opposed to hold back.

'Multi-speed' Europe is the term used to describe the idea of a method of differentiated integration whereby common objectives are pursued by a group of EU countries both able and willing to advance, it being implied that the others will follow later.

The Macron Plan for Europe

In addition to the Commission, other also came up with plans regarding the future of the Eurozone. The **plan of French President Emmanuel Macron** may be considered as the most important one due to its ambitious contents and the (presumed) political support behind it.

The key elements of the Macron plan of 2017 were:

- the complete establishment of the **banking union**,
- progress in the establishment of the **capital markets union**,
- establishment of a **new European Monetary Fund**,
- the formation of the **Eurozone minister of budget and finance** position.

Especially the latter two generated vivid reactions since those would essentially mean the establishment of a Eurozone institutional system parallel with the EU institutions, or at least the initial steps towards such an establishment.

The Meseberg Declaration

In order to harmonise the French and German reform plans, **French President Emmanuel Macron** met **German Chancellor Angela Merkel** in June 2018, in the **Meseberg Palace** near Berlin. After their meeting, the two heads of state issued the so-called **Meseberg declaration** jointly, in which they made comments and recommendations concerning the EMU, among others.

- With regard to the **ESM**, the two heads of state recommend the amendment of the intergovernmental treaty, with the incorporation of a joint support, the improvement of the efficiency of the preventive measures, and increasing the role of the mechanism in the course of the evaluation and monitoring of the future programmes. According to them, in reforming the ESM, the framework of liquidity support and shall also be improved in case of bank bail-out, as well as the order of lending in case of assistance. On the longer term, the two heads of state recommend that the ESM Treaty be made part of EU law, and the fund be renamed possibly; however, they emphasise the principle of conditionality related to assistance, which shall not be foregone.
- The most important concept of the declaration related to the **banking union** is that the ESM would serve as the support for the single bank bail-out (Single Resolution), and this support (backstop) would be close to the extent of the Single Resolution Fund, and thereby it could replace the direct recapitalisation instrument. Otherwise, the joint declaration confirms the original itinerary for the establishment of the banking union.
- Calling the **Eurozone budget** by its name is a large step forward by the two heads of state, which they recommend to be launched in 2021 in order to ensure competitiveness, convergence and stability in the Eurozone. In their opinion, the common budget of the zone shall be developed taking into consideration the multiannual financial framework 2021-2027. The execution of the decisions on expenditures would belong to the power and responsibility of the European Commission – the Eurozone minister of finance (and

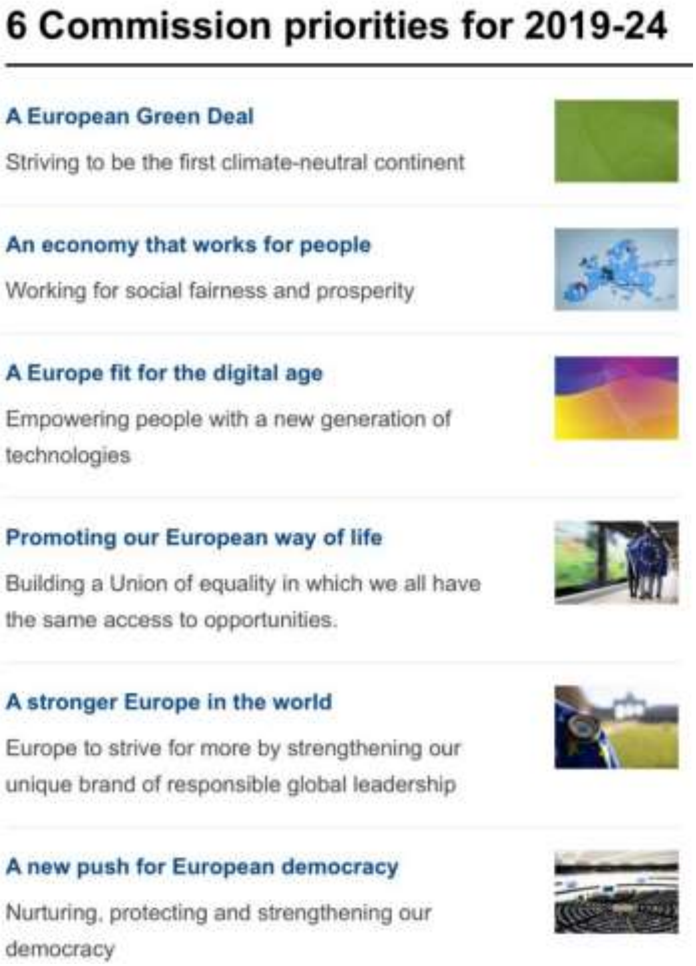
any kind of parallel institutional system) is therefore no longer included in the joint concept of the two heads of state.

The **ministers of finance of the Northern EU Member States** rushed to lessen the French-German reform spirit in a **joint declaration**.

- They start their critique by that the negotiations on the future of the EMU shall be conducted in the framework of an **inclusive process** – and those among the post-Brexit EU-27.
- They emphasise (consistently with the Commission) that **the EMU is a rule-based system**, and its strength and stability lies in that the rules are observed by everybody.
- They declare that the conversation shall be about initiatives which enjoy widespread social support in the Member States, and which actually contribute to the strength of the EMU.
- At the same time, they express their commitment to **finishing the construction of the banking union**, and they think it is possible that the **ESM develops into a European Monetary Fund (EMF) in the future**.

State of affairs in spring 2020

Source: ECB Annual Report 2019 (published on 7 May 2020).



The EMU is not among the von der Leyen Commission's priorities for 2019-2024.

The 2021-2027 multiannual financial framework has not been adopted yet.

Currently no non-Eurozone member state is under the ERM-II (except for Denmark that enjoys opt-out) so enlarging the Eurozone is not on the horizon for the next years.

Overall, the EMU remains an incomplete construct – for the time being…

THE END

Questions for self-study

1. When was the blueprint for a genuine EMU published?
2. What are the areas of single financial supervision in the Eurozone?
3. Which are the key pieces of the EU-wide 'financial reform puzzle'?
4. When was the decision on the creation of the banking union made? Who made this decision?
5. In what sense is the single rulebook the foundation of the banking union?
6. Which institution is the single supervisory authority in the banking union, as of November 2014?
7. What does the term Single Resolution refer to?
8. What anomalies is the completed banking union intended to resolve?

9. How does the vicious circle between banks and national finances build up? How will the banking union help to break this link?
10. Which are the three major tools of the banking union?
11. Who are the "five presidents" publishing their report on the EMU in June 2015?
12. What is the objective of the EMU in the five presidents' report?
13. Which are the three stages of completing the EMU in the five presidents' report?
14. Which are the four pillars of the Economic Union according to the five presidents' report?
15. How are the five scenarios in the White Paper on the Future of Europe related to the Economic and Monetary Union? What is differentiated integration (in general)?
16. Which were the main elements of the Macron Plan for Europe of 2017?
17. Who issued the Meseberg Declaration and when? Please present its most important statements and recommendations in relation to the EEMU. How did the finance ministers of the Nordic EU member states react to the declaration?

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