

Re-Imagining the European Union

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Form Follows Function: Addressing the Substantive Shortcomings of EMU

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Current Reform Debate

- **European Finance Minister**

- Merging the Eurogroup president and president of the ESM Board of Governors with the Vice-President of the COM

- **European Monetary Fund**

- Transforming the ESM into an EMF

- **Eurozone Budget**

- **Eurozone Parliament**

Current Reform Debate

*“Whether it be the sweeping eagle in his flight, or the open apple-blossom, the toiling work-horse, the blithe swan, the branching oak, the winding stream at its base, the drifting clouds, over all the coursing sun, **form ever follows function**, and this is the law. Where function does not change, form does not change. The granite rocks, the ever-brooding hills, remain for ages; the lightning lives, comes into shape, and dies, in a twinkling.”*

Louis H. Sullivan, 'The Tall Office Building Artistically Considered', *Lippincott's Magazine* (March 1896), 403.

Function of EMU

Function of EMU

■ Article 119 TFEU

For the purposes set out in Article 3 of the Treaty on European Union, the activities of the Member States and the Union shall include, as provided in the Treaties, the adoption of an **economic policy** which is based on the **close coordination of Member States' economic policies**, on the **internal market** and on the definition of common objectives, and conducted in accordance with the principle of an **open market economy** with **free competition**.

Concurrently with the foregoing, and as provided in the Treaties and in accordance with the procedures set out therein, these activities shall include a **single currency**, the euro, and the definition and conduct of a single monetary policy and exchange-rate policy the **primary objective** of both of which shall be to maintain **price stability** and, without prejudice to this objective, to **support the general economic policies in the Union**, in accordance with the principle of an open market economy with free competition.

Function of EMU

- EMU complements the internal market
 - Internal market is a **customs union**, in which tariffs and quantitative restrictions on **goods** and **services** are prohibited (**free trade** area), **persons** and **capital** can freely move (**common market**) and **standards** in clearly defined policy areas **are harmonised** in accordance with legislative procedures.
 - Economic consequences **in theory**: Specialisation of national economies on the most competitive production of goods and services and free movement of labour and/or capital that is redundant to those national economies, in which labour and/or capital is scarce with an overall increase in welfare of the internal market due to trade.

Function of EMU

- EMU complements the internal market
 - Economic consequences **in practice**:
 - **Bigger national economies**: Reduction of cost-increasing barriers within the internal market for competitive products and services stemming from bigger diversified national economies with production chains (Germany, France, Italy)
 - **Smaller less diversified national economies**: Specialisation on 'comparative advantages' that allow for a fast growth:
 - **'Bubblish' economic activities**: Financial services (Ireland, Cyprus) and construction (Spain)
 - **Competition** on **lower** social and environmental **standards** for the production of goods and services (CEE)
 - **Free movement of labour** does not work and is even impeded by EU law (e.g. discrimination in relation to access to social benefits under the citizenship directive)

Function of EMU

- EMU creates a single currency
 - Single currency entails a supranationalised definition and conduct of **monetary policy**.
 - Monetary policy instruments are no longer available to compensate for economic over- or underperformance of single national economies
 - Macroeconomic imbalances **cannot** be balanced with **means of nominal devaluation or revaluation** but only with means of real devaluation or revaluation (i.e. increase/decrease of wages)
 - Wages are inflexible downwards with an increased unemployment as a consequence

Function of EMU

- EMU sets limits to public budgets
 - Avoiding excessive deficits
 - TFEU: not more than **3% of GDP** (excessive deficit)
 - SGP: not more than **1% of GDP** (medium-term budgetary objective)
 - Fiscal Compact: not more than **0.5% of GDP**
 - Refinancing of national public budgets on private markets
 - no monetary financing (Article 123 TFEU)
 - no automatic financial assistance by EU or other Member States (Article 125 TFEU)
 - full risk exposure to financial market operators
 - subject to 'market discipline' understood in a purely formal manner

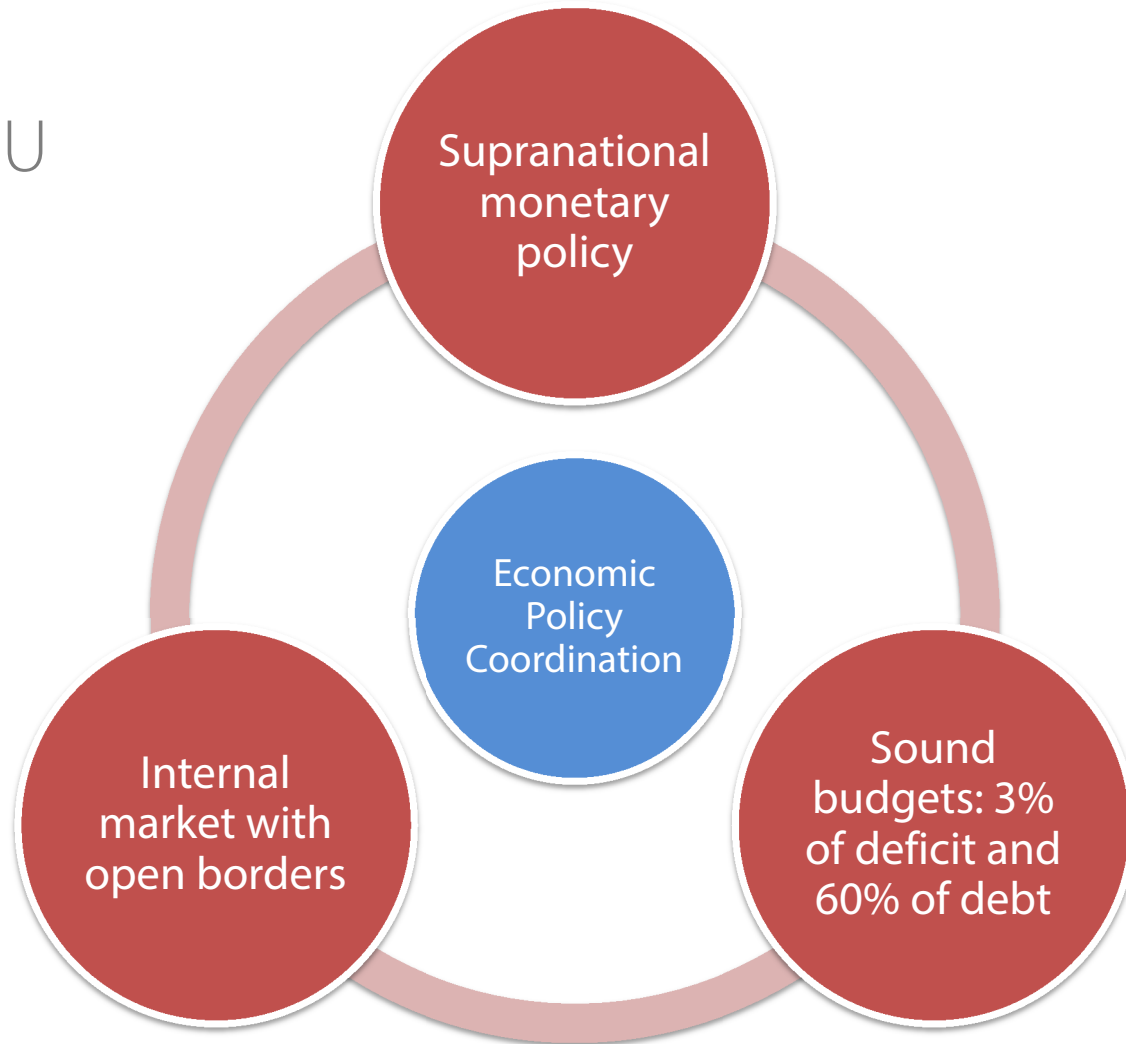
Function of EMU

■ Wrapping up

- Challenges for national policies in the internal market
 - Structural: Setting up the infrastructure to modernise national economies in order to keep up in the free competition of the internal market
 - Standard-setting: Implementing EU standards
- Challenges for national policies in the monetary union
 - Preparing for overreaction on financial markets with non-monetary policy means
 - Establishing mechanisms to address adjustments in the real economy (labour market policy and unemployment benefits scheme)
 - Establishing a fiscal capacity for times of declining private demand
- Challenges for national policies under the budget control
 - Sound budgets irrespective of the state of the national economy (procyclical)

Function of EMU

- Corner stones of EMU



Function of EMU

- EMU establishes the coordination of national economic policies
 - Economic policies of sovereign states that are bound to each in the internal market and the monetary union impact each other
 - EU legal framework for the conduct of national economic policies
 - **Pre-emption** when covered by exclusive Union competences (Article 2(1) TFEU) or shared competences that were exercised by the Union (Article 2(2) TFEU)
 - **Limitations** set by fundamental freedoms, free movement of citizens and competition law
 - **Supported** by Cohesion funds and investment activities of the EIB
 - Coordination without enforcement

Function of EMU

- Function of economic policy coordination in EMU
 - before the crisis: ensuring budgetary discipline
 - by means of sanctioning the non-achievement of nominal targets
 - after the crisis:
 - ensuring sound public budgets
 - by means of sanctioning the non-achievement of nominal targets
 - by protecting private refinancing of states against market overreactions
 - and addressing the conflicting demands of EU law in the economic policy coordination
 - Solving the sound budgets and shock-absorber dilemma
 - Solving the competitiveness and resilient national economies dilemma
 - Not solving these dilemmata will lead to economic and social divergence

Function of EMU

- Addressing the issue of market overreaction
 - Either: States remain exposed to market overreaction
 - Or: Establishing an instrument at central level that eliminates 'noise' on the financial markets
 - Mutualisation of debt (e.g. Eurobonds)
 - Pooling of debt (e.g. Sovereign Bond-backed Securities (SBBS))
 - Tranching common issuance (e.g. Accountability Bonds, Eurobills)
 - Restoring market access: the problem of legacy debt
 - European Redemption Fund

Function of EMU

- Addressing the sound budgets and shock-absorber dilemma
 - Either: Attenuating the budgetary objectives
 - Or: Establishing EU financed fiscal capacity to kick in in the event of a crisis
 - Automatic stabilisers: Reinsurance of national **unemployment benefits** schemes
 - Keeping up **investments**: Investment protection
 - **Fiscal policy**: Public financial means to replace declining private demand

Function of EMU

- Addressing the internal market and long-term adjustment costs dilemma
 - Objective: Structural changes in order to achieve sustainable economies instead of short-term growth (economic and social convergence)
 - Either: Allowing weaker national economies to close borders
 - Or: Economic policy coordination that includes capacity-building
 - Convergence instrument (funding for structural reforms, 'Convergence Code')
 - And: Establishing additional financial means for structural funds to attenuate costs of structural adjustments
 - Expanding Cohesion Funds significantly

Function of EMU

- Summary: Functions of EMU after the crisis
 - Ensure sound public budgets in order to prevent refinancing crises
 - Shield Member States against market overreaction when refinancing public budgets on private financial markets
 - Assist Member States when access to financial markets is closed
 - Enable Member States to compensate the lack of monetary policy instruments with means of fiscal policy
 - Streamline Member States' economic policies in order to prevent negative spill-over effects on other national economies within EU
 - Set incentives for Member States' economic policies to remedy 'internal market in practice' (economic and social convergence)

Form of EMU

Form of EMU

- If no change in function ...
 - ... no change in form is needed except for ...
 - closing the accountability gap:
 - ECB: Independence guarantee, Article 130 TFEU
 - ESM: Intergovernmental body, which is, in principle, *ex post* accountable, via the national finance ministers, to national Parliaments (of the creditor countries)
 - COM: still covered by the EU law framework ('Pringle') but this framework refers to the chapter on economic policy coordination, in which the COM is to be held account by the Council (no ordinary legislative procedures)
 - by including the ESM into EU law making it subject to the CJEU;
 - by merging the president of Eurogroup/ESM and the VP of the COM;
 - by strengthening the European Parliament (at least).

Form of EMU

- If change in function ...
 - ... change in form can be discussed in terms of:
 - Eurozone budget to finance additional financial instruments such as a convergence instrument or EUBS
 - which is financed by own resources (part of national taxes (VAT), own EU tax not possible)
 - which is financed by extra contributions from EZ countries earmarked for EZ expenses (enhanced cooperation in budget law is possible)
 - EMF that includes *ex ante* capacity-building
 - European Finance minister that is accountable
 - for the use of the EZ budget
 - for the management of the 'European Safe Asset'
 - for the management of the EMF, economic policy coordination and budgetary control
 - double-hat Parliamentary accountability (instead of EZ Parliamentary assembly)

Conclusions

Thank you for your attention

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