Reflection paper on the Deepening of the Economic and Monetary Union – ETUC assessment (ETUC position)

Adopted at the ETUC Executive Committee on 13-14 June 2017

All quotes, if not otherwise mentioned, are from the Reflection paper on the deepening of the economic and monetary union,
European Commission, 31 May 2017, available at:
https://ec.europa.eu/commission/publications/reflection-paper-deepening-economic-and-monetary-union_en

Introduction
"The euro is more than a currency." Indeed.

The euro is a monetary system, and a monetary system inevitably requires some kind of political commitment. It is therefore more than a currency as it represents the acceptance of a political unity as well as a bundle of values. It is the political institution which allows the realisation, in time, of decentralised economic choices.

The euro as a monetary system therefore encompasses a political choice. As such it must reflect a political vision which should be translated into economic terms, and into an economic governance framework. The political vision should reflect the core values of the Member States of the Economic and Monetary Union. In a globalising world, it creates a political space of freedom, equality, democracy and brotherhood which the Member States alone cannot longer safeguard.

Failure to establish a paradigm to enable the realisation of the political vision could require some fall-back solutions which would be detrimental to the political project. The architecture of the euro system should therefore establish a link between the European project, as a political objective, and national economic policies, as the means to reach a satisfactory state of affairs.

In other words, European economic governance must provide the tools for its political objective: the Union.

We think a European Treasury in charge of financing public investment in Europe by issuing common investment bonds, but without transfers, could do the job.

Reforming the governance framework of the European Economic and Monetary Union is urgent, including the targets and rules set under the Stability and Growth Pact regime. Failure to reform a system which does not answer people's needs and wishes cannot go on forever.

The measures suggested in the European Commission paper are interesting at least, and some are necessary. However, most of the proposals refer to the Capital Markets Union and the Banking Union which are already on track. The most important issues concerning the Economic and Monetary Union are open for discussion and therefore postponed, and are relegated to the end of the paper.

Failures of the current governance system

The Reflection paper states that "the euro is a success story on many levels" and that "important lessons have been drawn". This does not seem to be always and completely the case.

It should first be remembered that the financial crisis which hit the European Union in 2008 is first and foremost a private finance crisis. It was the irresponsibility of private actors in the banking and financial industries which allowed financial bubbles and imbalances to develop. The public debt crisis was a consequence of such short-termist behaviour on deregulated markets. Spain and Ireland were the perfect examples of private finance folly and public finance rigour.

However, the consequences of the crisis led to economic situations which were unmanageable within the current economic governance framework. In this respect, the lessons have not been drawn.

The fiscal rules embedded in the Stability and Growth Pact and its legislative apparatus are pro-cyclical and could not allow both well-functioning automatic stabilisers and the maintenance and development of private and public stocks of capital. In other words, the rules prevented the maintenance of decent public services and preparing for the future, in time of crisis. Furthermore, prohibiting investment and continuing to believe that wage increases, collective bargaining institutions, and regulations of the goods and labour markets constitute barriers to employment, brought the European economy to the verge of deflation, through aggregate demand constraints, and provoked even larger imbalances. The crisis became truly unmanageable, given the economic means and the policy limitations, in 2011-2012, after stimulus initiatives at Member State level were abandoned.

Interest rates for some Member States became increasingly high, or spreads on sovereign debts became significant. At this time, only a European institution could manage the problem, as a lender of last resort.

But the policy proposals put forward in no way allowed for recovery. The Greek issue is not yet solved, even if institutional measures have been put in place. And the European Stability Mechanism took the lead in raising bonds for lending to Member States experiencing difficulties with special facilities, but with conditionalities which could not allow a proper recovery.

Indeed, only a strong European will could deflect the financially profitable project to make Europe go up in smoke. And indeed, only a strong political sentence managed to do it: “The ECB is ready to do whatever it takes to preserve the euro.”[1]

However, while the European Central Bank is a European institution, it is not a democratic European institution. Therefore, the object of the Economic and Monetary Union is to set up the governance architecture which will allow the European political objective to be structured democratically over time, and the policy tools to reach this. The Euro as a monetary system should therefore represent the paramount European political objective, both geographically and in time, and its policy tools should support it.

Creating a European Treasury to raise bonds at European level for public investment[2], together with a targeted revision of the Stability and Growth Pact to allow Member States to invest, would be good tools for such a project.

Disagreements with some orientations of the Commission’s paper

The Economic and Monetary Union experiences imbalances. They deserve careful analysis of their determinants and developments. However, the policies demanded for

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[1] 1 Mario Draghi, Investment Conference in London, 26 July 2012, available at: https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html

[2] Mandatory for Eurozone Member States, with an opt-in option for the others.

dealing with them have been truly asymmetric. We think that many structural reforms put in place have had negative effects on growth and employment. In fact, we think that they had detrimental effects on global aggregate demand and therefore tended to perpetuate one of the roots of the crisis, namely, the decreasing trend in wages in proportion to GDP. Current accounts deficits indeed diminished, or even vanished, but imbalances persist.

We do not think that the European Union suffers from a lack of competitiveness, as the record global current account surplus reveals, but from a lack of internal demand due to low wages and low private investment, on one hand, and low public investment and public expenditure on the other. Both are manmade, both are consequences of flawed analyses of economic development.

We recognise that some institutional efforts have been made for the survival of the euro (especially the European Stability Mechanism), but we contest the economic objectives and policy tools which have been put forward. And this is why Europe is still not in a position to cope if a new crisis were to arise. As such, the euro system is not viable. Therefore, we do not agree with policy proposals which would conditionalize development and convergence processes on structural reforms, if they are supply-side measures only, as in the past.

20. Another flaw is the proposal concerning the Sovereign bond-backed securities (SBBS) as a means to increase the supply on capital markets, though banks portfolio diversification, and allow a decrease in interest rates for Member States. They would be a special kind of Eurobonds, however, securitised financial products. The idea would be to allow a debt agency to issue a special securitised debt instrument out of pooled sovereign bonds. This solution does not seem viable for two reasons. The first concerns the securitisation technique as such. As stated in the ETUC's position on the Capital Markets Union[3], we are very concerned by the relaunch of these securitised products in the financial spheres given their role in causing the 2008 crisis, in the United States, Spain and Ireland, for example. It allows banks to lighten or reduce their balance sheet exposure to avoid raising additional capital and disseminate financial risks to unregulated financial actors (supposedly more suited to taking risks). The second is more fundamental. SBBS are not proper Eurobonds. Without joint liability, it is logical for markets to differentiate across sovereign bonds by assigning country-specific risk premia. In this respect, we would still not reach a unique free-risk interest rate for the European Union, but would be back to interest rate differentials for Member States, especially in times of crisis. The lack of common responsibility through a slicing technique leaves the door open for spreads to widen again in times of stress (interest rates on sovereigns are widening). In this regard, the financial engineering of SBBS does not represent any innovation over the status quo. Even more, given the key which will be used to implement such financial products, it would surely leave some residual sovereign bonds. The net result is that the spread of unsecuritised debts could increase due to the collapse of collateral demand by banks, now satisfied by the senior tranches of SBBS.

In other words, the possibility to sell sovereign bonds in tranches, which is the object of the securitisation technique, will enable markets to differentiate risk on a geopolitical basis, and therefore dismantle the coordination and the will for unity of the European project.

Towards an ambitious revision of economic and monetary union

[3] *ETUC position on the Capital Markets Union, October 2016, available at:* *https://www.etuc.org/sites/www.etuc.org/files/document/files/adopted_13-en-etuc_position_on_cmu_oct_2016.pdf*

As a governance structure, the euro should incorporate both a lender of last resort as global backstop for the euro system and some policy tools to enable the economy to develop while avoiding creating the conditions for calling on a lender of last resort. In the end, the economic governance system should prevent Member States experiencing refinancing problems, and in the event, provide the policy tools to help them cope with this situation.

The two main obstacles to economic development in Europe lie in low or negative wage and investment – public and private – developments in Europe. And indeed, as stated in the European Commission's paper, "it is important to avoid pro-cyclical fiscal policies". However, the Stability and Growth Pact and its subsequent legislative apparatus do not allow for counter-cyclical policies in times of crisis. In addition, a flawed analysis of the crisis identified one of the cause of the imbalances in the European Union as a lack of competitiveness, and put forward policy recommendations which did not address the problem, but did the opposite.

In this respect, the European Investment Protection Scheme, conceived as a European Treasury, would be the most convenient and best-suited institutional reform proposed in the European Commission's paper.

The estimates of the hole in public and private investment in Europe are between €230 billion and €370 billion. Public investment both in the Euro area and the European Union has been continuously decreasing since 2009. This leaves room for manoeuvre for much needed additional investment. If funded by a European Treasury, this would allow Member States in difficult situations, especially in economic downturn, to avoid cutting public investment.

The Five Presidents' report requests such a stabilisation function to rest on the following guiding principles: It should not lead to permanent transfers between countries, nor should it undermine the incentives for sound fiscal policy-making at the national level.

Many studies conducted by international economic institutions are now sensitive and supportive of developing public investments. The IMF[4], the OECD[5] and the ECB[6] state that increased public infrastructure investment, especially following an economic crisis, can be beneficial to the economy by raising output in the short term, by boosting demand, and by raising productive capacities in the long run. In addition, all the studies find positive effects on debt to GDP ratios.

The principle would be to create a Treasury as a vehicle to pool future public investment spending in Europe and have it funded by proper European treasury securities. Member State governments would decide the total volume of public investment needed, for example 3% of the region's GDP, and its annual growth rate. To ensure that no debt mutualisation would take place, each Member State would be endowed with a grant in proportion to its share of total GDP for investment purposes only. Each Member State is then free to choose in what sectors to invest. Interest payments made by Member States' National Treasuries would follow the same rule, ensuring a non-mutualisation of debts.

The concept covering current expenditure would need to be redefined within the proposed scheme as new public investment (excluding investment launched under national financing) and would be covered by the Treasury. Member States would still be required to abide by all the rules of the Stability and Growth Pact, including recent flexibilities and further revision elements, but applied to current public expenditures only

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[4] *A. Abiad, D. Furceri & P. Topalova "Now Is a Good Time to Invest in Infrastructure", IMF direct, 2014.*

[5] *OECD Economic outlook, June 2016.*

[6] *Public investment in Europe, ECB Economic Bulletin, Issue 2/2016. ETUC/223/6Ic/KL/MM/aa 6*

(and nationally funded public investment) as public capital expenditures would form a separate capital budget funded through common Treasury securities. The Treasury turns the "golden rule" of sound public finances, that new public investment should be debt-financed, into the anchor of the European integration process. The Treasury would automatically withhold investment grants in case of non-compliance with the balanced (structural) budget rule as applied to current expenditures (and additional national capital expenditures) – and by the full amount of the target missed. Member States would thus have a very strong incentive not to miss out on the investment grant. Finally, the global volume of public investment could be revised upward in case of global recession giving extra margin of manoeuvre for automatic stabilisers to come into effect.

All current criteria and thresholds of the Stability and Growth Pact and Fiscal Compact must be revised to integrate the Treasury and debt financed public investment

Together with democratic controls ensured by the European Parliament, the Treasury could be placed under the responsibility of an EU finance minister.

In addition, a rainy-day fund could be part of the European Treasury. While the European Treasury would ensure global economic development, the rainy-day fund would ensure balanced economic development.

As it stands, the ETUC would seek for more clarifications on the European Unemployment Reinsurance Scheme suggested in the Commission's paper and continues to assess the issue with its affiliates.

Conclusion

As a first step, the ETUC requested a revision of the Stability and Growth Pact with regard to its pro-cyclicality and impact on public investment[7]. A European Treasury would also imply a revision of the Stability and Growth Pact and would ensure a minimum level of public investment in all Member States[8].

The bonds issued by the European Treasury would be a debt instrument designed to equal U.S. Treasury securities – a debt instrument the ECB can purchase for monetary policy and financial stability purposes. The interest rate would therefore be the general benchmark for the Union as the unique risk-free yield curve in Europe.

Such a framework would link the euro and its management, established in a centralised manner, to policy orientations established in time in a decentralised manner, allowing the survival of the euro and the implementation of the European project.

Deepening of the Economic and Monetary Union also entails a revision of the European Semester. The actual governance is focused too much on sound public finances and the reducing of deficits. If a welfare state vision of the Union, with an active role of the public sector, is put forward, this must be reflected in the governance criteria and the macro-economic scoreboard. A social dimension must mean ensuring fundamental rights, promoting collective bargaining and developing quality public services. It also means that there should be no more liberalisation of such services. Additionally, some kind of social and fiscal harmonization would be needed.

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[7] *ETUC position on the flexibilities within the Stability and Growth Pact, June 2016, available at: https://www.etuc.org/sites/www.etuc.org/files/document/files/en-position-flexibilities-stability-growth-pact.pdf*

[8] *ETUC Position Paper: A European Treasury for Public Investment, March 2017, available at: https://www.etuc.org/documents/etuc-position-paper-european-treasury-public-investment#.WTewnZCGPct*

Continuous improvement of the inclusion of social partners, in particular the trade unions, is key to a successful revised Economic Governance, particularly trough the European Semester and the Macroeconomic Dialogue.