



Banking union and fiscal union in Europe: outlook and implications for global partners

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Outline

- Consequences of crisis for EMU construction
- Reinforcing EMU (focus on Banking Union)
- Implications of Banking Union for participants and partners

Consequences of crisis for EMU construction (1)

- EMU construction unique: single monetary policy, with co-ordinated but decentralised fiscal/structural policies
- Conventional wisdom that deep political integration required for durable currency union
- Was EMU construction flawed from the outset?

Consequences of crisis for EMU construction (2)

- Economic logic of EMU reflected both direct benefits of euro (e.g. macro-stability, lower transaction costs, enhanced financial-market liquidity) **and** indirect benefits (i.e. incentives for structural reform)
- Euro removed option of devaluation as means to avoid reform
- EMU construction ensured cost of "non-reform" could not be shifted to supra-national level

Consequences of crisis for EMU construction (3)

- In retrospect, several pre-conditions for the effective functioning of EMU construction...
 - *Member State compliance with a comprehensive rules-based policy coordination framework*
 - *Financial-market discipline to support policy co-ordination*
 - *Integrated financial stability architecture*
 - *Capacity to pool fiscal resources in support of monetary policy in response to specific shocks, notable financial shocks*

Consequences of crisis for EMU construction (4)

- ...but EMU launched in coincidence with "Great Moderation"...
- *Policy co-ordination framework proved inadequate*
- *Market discipline absent amid mispricing of risk*
- *Too slow progress in completing financial-stability architecture*
- *Concept of burden-sharing remained undefined in operational terms*
- ... resulting in deficiencies in crisis prevention and management

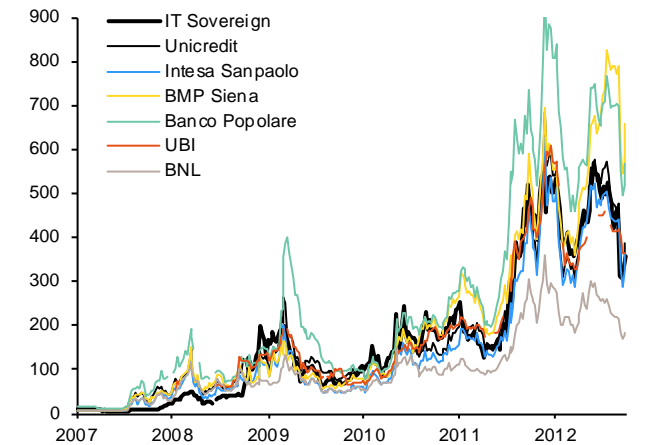
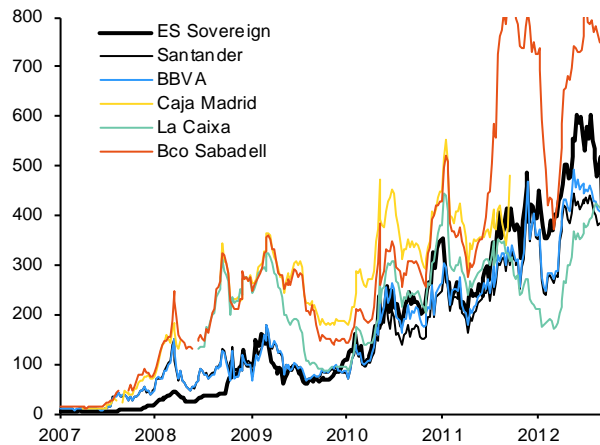
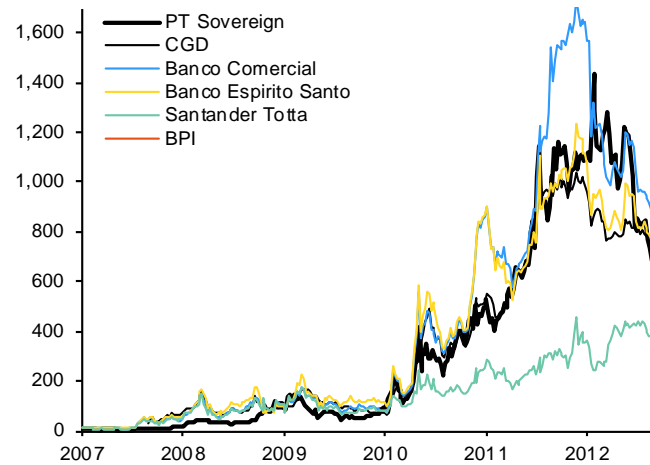
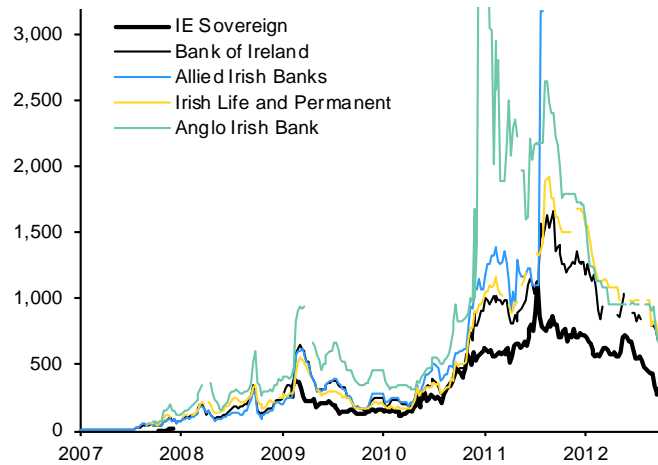
Reinforcing EMU (1)

- Medium-term dimension of EA crisis response focused on reinforcing the EMU construction
 - *Policy co-ordination framework strengthened and expanded*
 - *Acceleration in completing financial-stability architecture – Banking Union*
 - *Establishment of crisis management instruments: EFSF/EFSM/ESM*
 - *First steps toward "fiscal capacity" at EMU level*

Reinforcing EMU (2) – Banking Union

- Key reinforcement of EMU is the creation of Banking Union (BU)
- Rationale of BU is to address negative feedback loop between banks and national sovereigns via
 - *Neutrality in oversight*
 - *Readiness to resolve and allocate losses among private creditors*
 - *Possibility to mutualise remaining financial costs via common fiscal backstop*

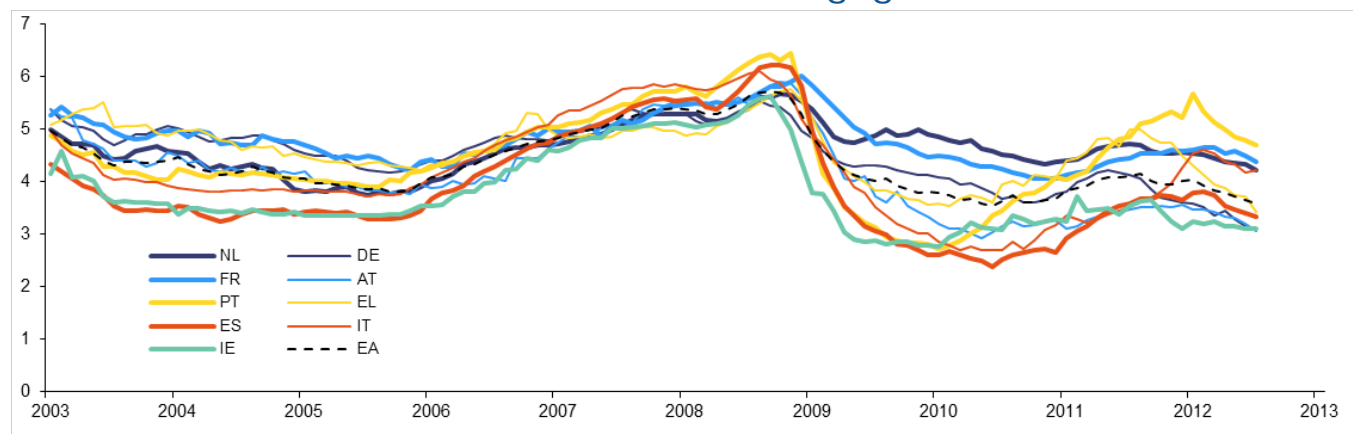
Fiscal – Financial interdependence: CDS spreads of sovereigns versus banks (bps)



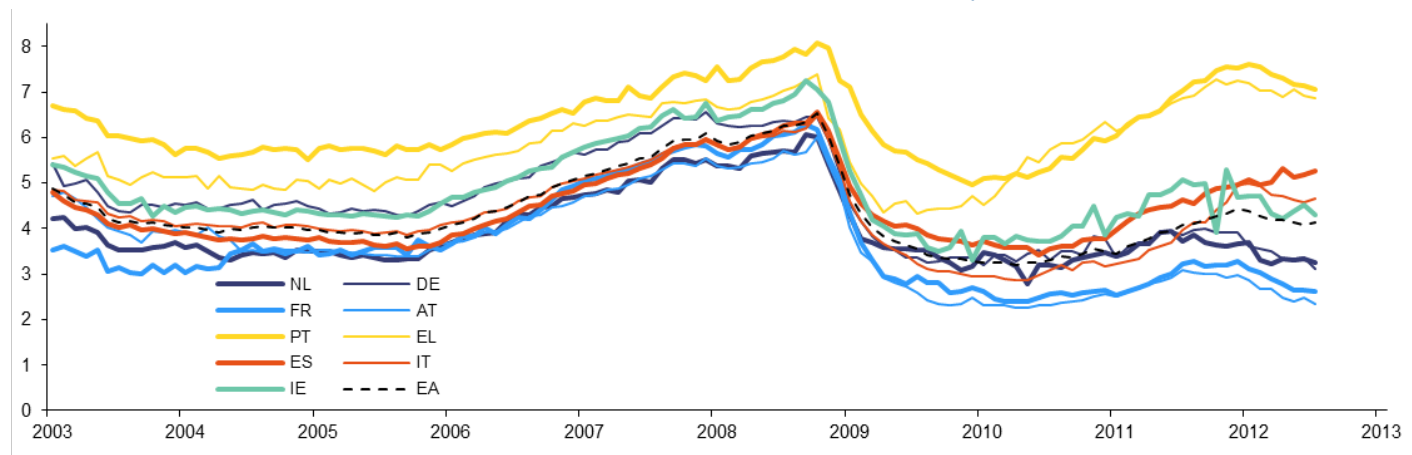


Financial sector fragmentation in the EA

Interest rates on mortgages, %



Interest rates on loans to SMEs, %



Note: Data for new loans.
Source: European Central Bank.

Reinforcing EMU (3) – Banking Union

- Main components of BU are inter-related...
 - *Single Supervisory Mechanism/Single rulebook*
 - *Common resolution framework with private funding*
 - *Common deposit insurance framework (later)*
 - *ESM as common backstop*
- ... and all are required to ensure coherence

Reinforcing EMU (4) – Banking Union

- Substantial progress on Single Supervisory Mechanism
- MS have reached general agreement that
 - *SSM focused on euro area but open to all MS*
 - *ECB conferred with specific tasks within SSM and directly supervises significant banks;*
 - *Strict separation of ECB monetary and supervisory responsibilities*
 - *National supervision of remaining banks integrated into SSM*
 - *Role of EBA will be preserved*
 - *SSM to be in place by March 2014*

Reinforcing EMU (5) – Next Steps

- Proposal for SSM will now be agreed with European Parliament
- Council and EP will proceed with co-decision procedures on Commission proposals relating to bank capital requirements and bank restructuring/resolution
- COM will bring forward legislative proposal for Single European Resolution Mechanism

Implications of Banking Union for participants

- BU a pooling of national sovereignty among participants
- Responsibility for effective prudential oversight, crisis management and associated fiscal costs will be shared
- Full co-operation among MS essential at all levels of BU
- Fiscal burden sharing is key to align MS incentives to co-operate, so must have agreement on "bailing-in" to limit potential size of burden

Implications of Banking Union for partners

- More resilient EMU within global financial system eases current crisis and reduces probability of future crises
- BU consistent with existence of Single Market, but not neutral in its effect
- Pooling of sovereignty in BU may imply changes in approach to risk management among public and private actors
- Any changes in dynamics of EU financial integration must be managed within Single Market

Thank you for your attention



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