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A NEW APPROACH TO GOVERNANCE AND INTEGRATION IN EMU FOR AN OPTIMAL USE OF ECONOMIC POLICY FRAMEWORK - PRIORITY TO FINANCIAL UNION

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Abstract

This paper proposes a new approach to EMU governance and integration consisting of the following elements: (i) an optimal use of the existing EU institutional framework for economic, fiscal and financial policies is necessary and possible at each level of EMU integration that is politically feasible, in order to strengthen synergies between stability and growth policies, complete the single market, support public and private investment, and improve macroeconomic and fiscal coordination and surveillance, (ii) priority should be given to financial union which would facilitate the smooth transmission of monetary policy, enhance financial stability and economic growth and contribute to macroeconomic stabilization through private risk sharing, (iii) the drive to fiscal union should be focused on the creation of fiscal backstops to banking union, enhancing its solidity and credibility (iv) initiatives towards deeper EMU integration should be undertaken where there is strong evidence, within the EU and beyond, of their usefulness and for which widespread political support exists, maximizing benefits and avoiding controversial proposals, and (v) institutional strengthening and democratic accountability are indispensable elements for a successful EMU and should be pursued by following the "Community approach", based on the Treaties, in contrast to the "intergovernmental approach" increasingly used in recent years.

Keywords: Economic governance and integration in EMU, macroeconomic and fiscal adjustment in a monetary union, economic policy coordination, banking and capital markets union, European Stability Mechanism.

JEL-classification: E42; E44; E52; E61, F32; F33; F41; F45; G18; G28

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1. Introduction

This paper is the third piece of work on EMU by this author after the emergence of the sovereign debt crisis. In the first paper, in April 2012, the main conclusion was that the euro area as a whole would manage to contain and overcome the crisis and the hardest-hit peripheral economies may even become its star performers provided that they follow appropriate economic policies[1].

In the second, in March 2015, it was argued that the priority given to financial stability was appropriate but policies for stability and growth are necessary in EMU for durable stability and overall welfare, and require the setting up of the right policy priorities and consistent action at central and national level within an appropriate institutional framework. Also, crisis legacy problems such as the excessive government debt burden in some countries must be resolved[2].

The present work elaborates further on the issue of the “right policy priorities and appropriate institutional framework” and makes proposals aimed at improving economic governance and the integration process in EMU on the basis of the experience gained from developments and policies before and after the crisis.

2. Novel elements in the present study in relation to the literature and to recent proposals to completing EMU

Policymakers, academics and other analysts have advanced a large number of ideas aimed at improving governance and integration in EMU, including proposals to strengthen surveillance and coordinate economic and fiscal policy, issue Eurobonds, introduce a European unemployment benefit scheme, create a post of Minister of Finance and a budget for the euro area, and several others.

However, no sufficient attention has been paid in the literature to the importance of a systematic search for an optimal use of the existing EU legal framework - comprising

[1] Papaspyrou (2012)
[2] Papaspyrou (2015)

policies, mechanisms and institutions - and, also, a careful examination of priority action towards further EMU integration steps which would maximize benefits and avoid controversial initiatives and risk of reversals in the integration process.

This paper makes contributions in both above areas. Its central message is that a new approach is needed regarding EMU governance and integration, consisting of the following elements:

- An optimal use of the institutional framework for economic, fiscal and financial policies is necessary and possible at each level of EMU integration which is politically feasible.
- Priority should be given to financial union through the completion of ongoing projects, such as the banking union and capital markets union.
- The drive to fiscal union should be focused on the creation of fiscal backstops to the single resolution fund and the European deposit insurance scheme.
- Initiatives towards deeper EMU integration should be undertaken where there is strong evidence, within the EU and beyond, of their usefulness and for which widespread political support exists.
- Finally, institutional strengthening and democratic accountability are indispensable elements for a successful economic and monetary union.

How do the proposals in this paper compare to those in the Five Presidents' Report[3] on "Completing Europe's Economic and Monetary Union"?

The Five Presidents' Report, which is probably the most comprehensive and coherent approach to EMU integration after the global and sovereign debt crises, proposes parallel progress, in stages, towards economic union, financial union, fiscal union and political union (see Annex for the main elements of the report). However, parallel progress in all four areas may be an ideal objective but it would very probably face serious difficulties given the reluctance, even hostility, of public opinion in several member states towards higher degrees of fiscal and political integration. Moreover, certain integration steps are

[3] Report by J-C. Juncker in close cooperation with D. Tusk, J. Dijsselbloem, M. Draghi and M. Schultz on "Completing Europe's Economic and Monetary Union", 22.6.2015

considered more important at the current juncture for ensuring stability and growth in EMU. It is, therefore, necessary to be more explicit on the priorities for advancing towards EMU integration, stating clearly the criteria, and their justification, on which such a choice has been made. As stated above, a key proposal of this paper is that priority must be given to financial union, with some elements of fiscal union, as there is strong evidence about its usefulness in a number of areas (e.g. by strengthening financial sector stability, promoting the completion of the internal market, supporting the transmission of monetary policy and enhancing macroeconomic stabilization - see Section 4 below) and, also, enjoys broad political support.

3. An optimal approach to EMU governance and integration is necessary and possible.

The creation and activation of financial support mechanisms and the strengthening of macroeconomic, budgetary and financial rules, together with decisive ECB action in the summer of 2012[4], succeeded in containing the euro area sovereign debt crisis and stabilising financial markets.

However, concerns have been raised about the risk of a resurgence of the crisis as serious weaknesses of the European economy persist, the distance between policy objectives and outcomes remains wide, and political support for further integration is weak.

Key weaknesses and shortcomings include the following:

- Low productivity and GDP growth rates and low capacity to implement structural reforms, high unemployment and government debt in several member countries and weaknesses in parts of the banking system.
- The objective of creating a single European market by 1992 remains unfulfilled two and a half decades later, while progress made in the past has been partly reversed, due to the crisis, as far as financial integration is concerned.

[4] When M. Draghi stated in July 2012, in London, that the ECB will do "whatever it takes to preserve the integrity of the euro area".

- Several years after the introduction of the macroeconomic imbalance procedure in 2011, current account surpluses in some member countries instead of being reduced are rising, contributing to unbalanced and deflation-prone policies in the euro area, as countries with current account deficits eliminated them through severe adjustments.

The existence of weaknesses should not, however, obscure the important achievements during the first decade of EMU and, also, progress made in economic adjustment and reform after the emergence of the global and the sovereign debt crises[5]. There is, however, a wide margin for improvements in economic performance within the existing institutional framework and in proceeding to appropriate steps towards further integration.

Drawing on the lessons of the past, the focus must now be on the optimal use of the institutional framework to design and implement economic policies at each level of EMU integration that is politically feasible, in order to enhance stability and growth. Success in such an effort would also enhance the credibility of the whole European project, in a period when public confidence in them is fading, and make thus the acceptance of further integration initiatives easier.

- It has to be noted that the pursuance of optimality is not a static concept i.e. does not concern only the current configuration of legal framework and policies, but must be sought at each level of EMU integration that is politically possible. This is a more ambitious and difficult exercise than constantly seeking further integration and the transfer of power to the centre instead of searching necessary, but difficult, ways to improve economic governance respecting the

[5] It is recalled that 18 million jobs were created in the euro area from its inception in 1999 until the emergence of the global crisis in 2008, 4 million more than in the US, in conditions of monetary stability. Also, external and fiscal deficits were drastically reduced in recent years in member countries most severely hit by the crisis while the unemployment rate in the euro area has fallen to 9.3% in April 2017, the lowest since March 2009 although still very high.

principle of subsidiarity[6], which is a key component of the European institutional framework.

Further steps towards economic and political integration must be well-founded and benefit from the necessary political support, otherwise they may create unnecessary diversion from the objective of improving the functioning of EMU and could, finally, be counterproductive.

3.1 Synergies and complementarities between stability and growth policies…

Appropriate policy action at central and national level would lead to a substantial improvement in economic governance within the existing legal framework i.e. without treaty changes. However, in a limited number of cases, as in the setting-up of fiscal backstops within the banking union project (see Section 4 below) limited treaty amendments may be needed.

A key element of the new approach to governance and integration is the importance given to synergies and complementarities that can be developed in the design and implementation of policies for growth and stability. While each policy instrument serves primarily one objective, according to Tinbergen's rule, they can also contribute to the achievement of other objectives.

- For example, the banking and capital markets union projects aim mainly at ensuring financial stability but at the same time contributing to financial integration and to the completion of the single market, thus, also serving the economic growth objective by making possible the attraction of FDI and the realization of economies of scale.

[6] Under the principle of subsidiarity (Article 5.3 of the Treaty on European Union) in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot but sufficiently be achieved by the Member States.

- Moreover, growth-friendly fiscal adjustment serves primarily the objective of sustainability of public finances but raises also the productive potential of the economy.
- Finally, implementation of structural reforms would facilitate economic adjustment and strengthen the performance and resilience of the economy ensuring thus financial stability in a sustainable way.

3.2 …and a better policy-mix, are essential elements for positive results…

Available evidence suggests that there is a wide margin for improvement in the policy-mix in advanced economies, and in the euro area in particular, a view shared by international organizations and other analysts. For example, in their latest reports both the IMF and the OECD argued that fiscal policy and structural policies should support overstretched monetary policy where there is fiscal space[7]. Even if fiscal space is limited or nonexistent, there is always the possibility to improve the composition of government spending and tax structures and promote growth-friendly fiscal adjustment and fiscal policies more generally (see Section 3.6 below). The phenomenon of overstretched monetary policies in major advanced economies, reflected in very low or negative policy rates (Chart 1), a sharp increase in the size of central banks' balance sheets and extensive recourse to unconventional measures, has its origin in the massive central bank intervention following the emergence of the global financial and economic crisis in order to avert the collapse of the world financial system.

In the euro area, the emergence of the sovereign debt crisis and the risk of collapse of the euro area in the most acute phase of the crisis necessitated more decisive intervention by the ECB through conventional and non-conventional monetary policy measures. However, there is increasing evidence that monetary policy cannot be a substitute for economic policy measures, not least because certain monetary policy instruments, such as the negative interest rates, may generate unwelcome side effects and may, thus, be

[7] OECD Economic Surveys, Euro Area, June 2016 and IMF, WEO, October 2016.

reaching their limits. It is, therefore, commonly understood now that fiscal and structural policies should assume a more important role in supporting economic recovery and enhancing the productive potential of the European economy.

Initiatives to strengthen economic policy coordination, in the context of the European Semester - the annual economic policy coordination cycle - at the euro area level and at member-country level must be intensified and become results-oriented. Such initiatives concern in particular the support of public and private investment, also through a growth-friendly fiscal consolidation strategy, the design and implementation of an appropriate fiscal stance for the euro area, and the effective, and symmetric, implementation of the macroeconomic imbalance procedure.

3.3 …while ECB's monetary policy capacity was strengthened by EU Court ruling on OMT[8]

The Outright Monetary Transactions programme - a bond-buying programme created by the ECB in 2012[9] in order to preserve the singleness of monetary policy in the euro area and ensure the transmission of the monetary policy stance to the real economy - despite having never been used - is widely credited with bringing the euro area back from the brink of collapse.

Following a request by a number of German politicians and academics to the Federal Constitutional Court, the latter asked the Court of Justice of the EU whether the OMT programme was in conformity with EU law, before issuing its own judgment on whether the OMT programme breaches German law. The ruling[10] of the Court of Justice of the EU according to which "The OMT programme announced by the ECB in September 2012 is

[8] This section analyses the institutional importance of the clarification provided by the European Court and the German Institutional Court rulings on OMTs. The analysis of operational aspects and challenges of ECB's monetary policy is beyond the scope of this paper.

[9] The OMT programme was announced in August 2012 and its technical details were specified in September 2012.

[10] Court of Justice of the EU, Case C-62/14, 16 June 2016.

compatible with EU law" removed a major uncertainty about the capacity of the ECB to conduct its monetary policy using all available instruments[11].

The fact that the European Court set several conditions for the use of OMT should be seen rather as helpful and not as constraining the ECB as was interpreted by some commentators: it clarified the conditions for ECB action, limiting thus the probability of future conflicts regarding the scope and nature of ECB's actions in this context. Moreover, a necessary condition for activating OMT, or continuing it after having been initiated, is strict and effective conditionality attached to an appropriate economic programme under the European Stability Mechanism or the EFSF.

It is recalled that conditional central bank action/intervention is not something new in European monetary history. For example, in the European Monetary System arrangements, a central market intervention to defend the currency parities within the exchange rate mechanism was subject to the condition that such intervention would not put at risk the intervening central bank's mandate to ensure price stability. This was the reason why Bundesbank's intervention in the forex market to defend the DM-sterling pound parity rate stopped when the German central bank judged that such mandate was put at risk as there was not a symmetric commitment on the part of the UK authorities to raise interest rates at high enough levels to defend the DM-pound parity.

3.4 Initiatives to complete the Single Market and support public and private investment

In parallel with the setting-up of a new economic governance framework, EU institutions have undertaken several initiatives to support the fragile recovery of the European economy, including actions to re-invigorate the single market project, support public and private investment, reduce the administrative burden for companies and improve the business environment. There were also efforts to conclude bilateral trade agreements aimed to support growth and employment in Europe.

[11] One year after the EUCJ decision, the German Constitutional Court ruled also that the ECB did not exceed its mandate in launching OMT under the conditions set by the Court of Justice of the EU ruling.

The Single Market project

A major project, which would support economic recovery and enhance the growth potential of the European economy, is the completion of the single market, defined as the unified EU market of over 500 million people, without internal frontiers, where people, goods, services and capital - known as the “four freedoms” - can move freely. This project is even more important in the current period when the growth of global trade and demand for exports have decelerated considerably, a phenomenon which may last longer than generally assumed in the context of the rebalancing of the global economy.

The single market is the cornerstone of the European integration process and an important EU asset - the existence of the single market is the most important motivation for direct investment in EU countries from the rest of the world according to surveys[12] - which has generated significant benefits so far but whose potential remains largely unexploited. According to available evidence (see, for example, OECD[13]) the single market remains far from complete and there has even been a reversal of the integration process in the area of financial services, as a result of the global and the sovereign debt crises. However, since 2012, cross-border financial integration has been improving.

- Taking into account that 25 years after the initial target date, 1992, for the completion of single market it still remains unfinished, it is evident that more decisive action by the EU authorities, and cooperation on the part of the member states, are required in order to implement this major project which will generate growth and employment for the European economy. This is, in particular, the case of services - the most dynamic element of international trade - where slow implementation of the services directive was recorded several years after its adoption.[14]

[12] Vetter (2014).
[13] OECD Economic Surveys, European Union, June 2016.
[14] According to the European Commission publication “Assessment of the economic impact of the Services Directive – Update of the 2012 study”, 23.10.2015, “The pace of national reforms had slowed considerably compared to the period following the entry into force of the Services Directive….Member States where most reforms have taken place recently include those having implemented economic adjustment programmes or

Although there may be no direct restrictions on the four freedoms, there are numerous indirect obstacles, which require action by the European Commission, in its role as "the guardian of the treaties", to be removed.

There have been initiatives in recent years to reinvigorate the single market integration process notably by the decision to set up a banking union and more recently a capital markets union (see below) which are expected to contribute to financial integration and facilitate the implementation of the single market project in other areas as well.

Beyond legal action to remove impediments to the realization of the single market, initiatives are also required to facilitate market integration where technological changes and economic and political developments so require. Indeed, EU initiatives were undertaken in recent period to facilitate market integration including the "Digital Single Market" and the "Energy Union" projects.

According to European Commission estimates a fully functional **Digital Single Market** would promote innovation and bring additional growth of around 415 billion euros per year creating hundreds of thousands of new jobs. The **Energy Union** project aims to achieve the "triple" objective of energy security, decarbonisation and competitiveness, a target implying significant market opportunities for energy operators and technology providers, as the investment gap in the energy sector alone is estimated by the Commission at about 200 billion per year across the EU. An important share of energy union projects was financed through the European Fund for Strategic Investment (see below) during its first year of operation (June 2015-May 2016).

The Investment Plan for Europe

The Investment Plan for Europe was proposed in response to the large investment deficit since the beginning of the crisis. Its cornerstone, the European Fund for Strategic Investments (EFSI) is an initiative launched jointly by the European Commission, the

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reform agenda under market pressure. Thus, the three Member States where most services barriers have been abolished or partially reduced are Greece, Italy and Portugal".

European Investment Bank and the European Investment Fund in order to support investments and provide financing instruments for risky operations.

According to the European Commission[15], a year from its adoption, the Investment Plan for Europe has started to deliver tangible results thanks to the rapid set-up of all its components. The EFSI is already active in 26 Member States and is on track to deliver the objective of mobilizing at least 315 billion euros in additional investments in the real economy by mid-2018. More than 200,000 small and medium enterprises (SMEs) have access to new financing through the EFSI.

The Commission proposed to double the duration of the EFSI and its financial capacity to at least 500 billion by 2020[16] and has also tabled a number of initiatives to support investment and facilitate the financing of the economy. A structured dialogue with Member States was also initiated in order to remove national obstacles to investment in areas like insolvency, public procurement, judicial systems and the efficiency of public administration or sector specific regulations.

Independent analysts, while agreeing that the EFSI has been successful in attaining its quantitative objectives, have expressed doubts about the "additionality" criterion i.e. whether investments financed through the EFSI were indeed additional to those which would have been realized in the absence of the scheme. It was also argued[17] that the EFSI would, most probably, be disproportionally beneficial to the most developed areas, which are also those with the least need for investment supported at the European level.

The approval of the Investment Plan for Europe by the Council was in itself a positive sign of a new approach to tackling the investment deficit in Europe and that a number of additional innovative and risky projects were realized. As a consequence, this instrument

[15] See State of the Union address 2016, 14.9.2016.
[16] In December 2016 the ECOFIN agreed on the proposal and talks will start with the European Parliament.
[17] See Rubio et al. (2016).

should be strengthened and streamlined in order to finance more risky and innovative projects[18].

3.5 Current account imbalances: the importance of symmetric adjustment

The adoption of new EU legislation for the monitoring and correction of macroeconomic imbalances has been one of the most important economic governance reforms, as large and rising imbalances were one of the main causes of the crisis.

While there was considerable success in reducing, and even eliminating in some cases, fiscal and current account deficits since the emergence of the crisis, current account surpluses in a number of euro area countries are still sizeable and in certain cases have even increased as per cent of GDP (Chart 2).

Why are large and rising surpluses a major problem for EMU? Because they exert a deflationary impact on the euro area economies: as deficit countries are obliged – not least due to financial market pressures – to adjust by adopting restrictive policies, aggregate demand in the euro area is reduced, in the absence of an offsetting boost from surplus countries; deflationary pressures on the whole European economy are thus exerted. The current deflationary pressures and negative inflation rates in the euro area may not be unrelated to this phenomenon, although the primary cause has been the fall of energy prices. Also, current account surpluses with the rest of the world, as is the case with Germany and with the euro area as a whole, cause the euro to appreciate, adversely affecting competitiveness and economic growth[19].

The notable failure to correct current account surpluses reflects the asymmetric reaction of financial markets to current account deficits and surpluses, the limited and

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[18] An interesting proposal towards this direction is to reform the EFSI by creating a special instrument for areas of higher risk, acting more as a development rather than investment-oriented financial instrument (see Rinaldi et al, 2017).

[19] There are well-known theoretical arguments and empirical evidence of a positive correlation between current account surpluses and currency appreciation: see, e.g. Dornbusch R. and S.Fischer (1980) and De La Dehesa G. (2014).

indirect capacity of public authorities to exert influence on current account imbalances and, also, some reluctance on the part of the EU authorities to use available policy instruments in order to achieve correction of current account surpluses.

- Firstly, in the case of current account surpluses there is no financial market pressure, as in the case of current account deficits, in the form of rising borrowing costs and even lack of access to international financial markets, urging the countries concerned to take corrective measures;
- Secondly, current account surpluses are not under the direct influence of the public authorities as are, for example, fiscal imbalances and, therefore, they may take longer to be corrected.
- The European Commission has not designated countries with persistent current account surpluses as having broken the excessive macroeconomic imbalances rules, a situation that may bring financial sanctions in case of failure to correct imbalances.

It is fair to say that the Commission has made some efforts to urge Germany and other member countries with current account surpluses to increase domestic demand e.g. through investment in infrastructure and other growth-enhancing government expenditures. Also, international organisations, such the IMF and the OECD, have underlined the necessity and desirability for EMU, the world economy, and the surplus economies themselves, of action in this direction.

- However, as the results of such efforts remain limited, it is evident that further action must be undertaken, notably by enforcing existing rules on excessive macroeconomic imbalances, applying economic judgement but also determination in the case of prolonged and rising current account surpluses.

Box: The adjustment of the German economy in the post-DM era

The persistent current account surplus of Germany is related to the difficulties facing the German economy to find an appropriate economic adjustment model in the post-DM, euro era.

In the DM era, Germany's successful adjustment strategy was based on a trend appreciation of the DM vis-a-vis its main trading partners, which was offset by a rise in productivity, notably in the traded goods sectors, so that Germany preserved its competitiveness.

In the post-DM euro era this strategy obviously cannot work as the euro exchange rate is only partly affected by the performance of the German economy. There is, therefore, a need to find an equivalent to the DM-appreciation-cum-productivity rise model, not an easy task.

The wage moderation strategy adopted with success in the first decade of EMU has shown its limits as huge and rising current account surpluses have drawn the complaints of euro area partners and also of global economic partners because of Germany's and euro area surpluses with the rest of the world. The wage moderation strategy may work as far as competitiveness is concerned but it lacks the productivity-inciting exchange rate appreciation component of the DM era.

What could then be an equivalent to the DM era strategy? Probably an implicit or explicit agreement on a euro area nominal wage increases at the 2% ECB price stability medium-term objective could be an acceptable arrangement as it would contribute to the effort to avoid deflationary pressures, allowing at the same time the possibility to gain competitiveness advantages in case of real wage increases lower than productivity growth. Although in principle such an arrangement seems appropriate, it may prove difficult to work in practice as wage formation within the EU is the result of agreements between social partners. However, relatively high wage growth in Germany in the past two years[20] may suggest that market adjustment has started operating through a tight labour market.

[20] In 2015 and 2016, nominal compensation per employee grew by 2.3% in Germany compared to a euro area average of 1.2% (European Economic Forecast, autumn 2016).

3.6 Fiscal surveillance and coordination: successes and weaknesses

Fiscal policy, including steps towards deeper fiscal integration, has probably been the area that attracted most attention by policymakers, academics and other analysts since the start of the EMU project.

However, in recent years, the focus has shifted from the drive towards fiscal union − which does not, at present, benefit from adequate political support in European capitals − to an effort to improve fiscal surveillance and coordination within the existing institutional framework. There were, in parallel, initiatives to establish a financial union, through the setting-up of a banking union and, subsequently, a capital markets union, projects which provide immediate and visible benefits and enjoy widespread political support (see below).

This shift of focus seems appropriate for both political reasons, as already noted, but also for practical ones i.e. to allow for an in depth analysis of the appropriate process and form of fiscal integration and political support for such an initiative. There has been criticism[21] that proposals for fiscal union have, often, not been supported by robust analysis but are essentially based on the argument that other mature federations have an important central fiscal stabilization function and, therefore, this should be also the case in the European EMU. Moreover, there are those who argue that a fiscal union is not indispensable for economic and monetary union to work[22].

- Nevertheless, there is almost a consensus that some fiscal union elements are necessary in order to achieve financial union, in particular in order to complete the banking union project (see section 4 below).

Evaluation of fiscal governance within the present institutional framework concerns essentially three issues: (i) whether fiscal surveillance has been adequate; (ii) whether the fiscal stance at euro area and national level has been appropriate; and (iii) whether fiscal adjustment, and public finances in general, have been growth friendly.

[21] See, for example, Feld and Osterloh (2013).
[22] See Eichengreen and Wyplosz (2016) and Gros (2013).

Fiscal surveillance: new rules seem to work but more simplification and transparency may be necessary

The framework within which fiscal surveillance is conducted in the EU and, in particular, the euro area is the Stability and Growth Pact (SGP), as reformed and strengthened by economic governance reforms in the aftermath of the crisis, notably through the 6-pack and the 2-pack legislation and the fiscal compact.

Criticism of EU fiscal surveillance concerned basically the question of whether the European Commission, which has responsibility to ensure respect of fiscal rules, applied the letter and the spirit of EU legislation in specific cases. In the first period after the crisis, the criticism was that the Commission, as part of the "troika' (European Commission, ECB and IMF), imposed excessive fiscal adjustment on member countries under EU/IMF programmes, notably on Greece. In the more recent period, criticism has focused on the leniency exhibited by the Commission towards member states which failed to take corrective measures to reduce fiscal deficits.

These two criticisms can be assessed as follows. In the first case the Commission had indeed been too severe, by imposing fiscal adjustment which provoked a deep recession and led to a sharp rise in the government debt ratio. However, such a judgment should be qualified: the Commission did not act alone and had to take into account IMF views. More importantly, there was the pressure of financial markets for rapid fiscal adjustment within a context of rising uncertainty about the stability of the whole euro area. Moreover, there was inadequate knowledge and analysis of adjustment in a monetary union from both the Commission and the IMF[23] as has been admitted, repeatedly, by the IMF, although not by the Commission.

In the second case, the Commission was probably right. An examination of all relevant elements suggests that the Commission applied the EU legislation allowing for flexibility in interpreting fiscal rules, depending on the situation[24]. Although Portugal and Spain had not

[23] See Papaspyrou (2015).
[24] EC Communication, "Making the best use of flexibility within the existing rules of the Stability and Growth Pact", COM (2015) 12, final, 13.1.2015.

taken the required measures to correct the fiscal deficit, there were sufficient arguments − adequate fiscal adjustment in recent past in adverse macroeconomic conditions, implementation of structural reforms with the potential to generate fiscal revenue − justifying Commission's recommendation not to impose financial sanctions (a fine of 0.2% of GDP was foreseen in the EU fiscal rules) and to extend the deadlines for corrective action accompanied by the commitment on the part of the countries concerned to take specific and appropriate measures. The Council was not bound by this recommendation, but chose to follow it[25].

More justified seems to be the criticism that EU fiscal rules are overly complicated and need some simplification. The Commission has, indeed, undertaken the commitment to clarifying the operation of the rules and increasing transparency in their application.

Fiscal stance: overly restrictive in 2011-2013 was normalized subsequently

Based on the assumption − which proved incorrect in most cases[26] − that the crisis in the euro area was of fiscal origin, the average euro area fiscal stance was overly restrictive in the period 2011-2013, as reflected by the change in the cyclically adjusted primary balance; since 2014 the stance has been broadly neutral (see Chart 3).

The drastic fiscal adjustment following the emergence of the crisis can be also attributed to the need to reassure financial markets about the determination, notably concerning countries severely hit by the crisis, to put order to fiscal and macroeconomic imbalances. With the benefit of hindsight we now know that overly restrictive macroeconomic and fiscal policies deepened the economic recession and, in some cases, raised the government debt ratio sharply aggravating the fiscal and financial crisis.

[25] However, the Council decision would not be without consequences for the countries concerned as the Commission would make proposals on the suspension of part of the commitments of ESI (European Structural and Investment) Funds for 2017, if Spain and Portugal did not demonstrate full compliance with the Pact.

[26] Only in Greece was the origin of the crisis fiscal imbalances (high government deficits and debt) in addition to the high current account deficit. Among the other crisis-hit countries, in Ireland, Portugal, Spain and Cyprus the fiscal situation was better than the euro area average and the cause of the crisis was mainly banking sector weaknesses (in Ireland, Spain and Cyprus) and of a mixed nature (external, fiscal and a high private sector indebtedness) in Portugal.

A more consistent effort should be pursued by the EU institutions and national governments in the effort to improve the policy mix, to determine an appropriate euro area fiscal stance, supported by appropriate fiscal policies in member states, and taking advantage of the coordination mechanism offered by existing arrangements i.e. the European Semester and national budgetary procedures. This exercise would not be easy, given that the fiscal stance has to reconcile opposing objectives i.e. to stabilize economic activity whilst ensuring the sustainability of public finances and a declining path for general government debt ratios.

More growth-friendly fiscal policies are urgently needed

This is an area where the potential for an enhancement of economic growth and overall welfare is substantial, taking into account that economic resources absorbed by government revenue and expenditure is, on average, about 46% of GDP in the euro area.

Although the European Council has, repeatedly, underlined the need for growth-friendly fiscal adjustment and fiscal policies more generally, the economic reality proved more powerful as progress achieved in this area, if any, has been limited, as shown by several indicators:

- Public investment has fallen since the emergence of the crisis in a number of EU countries, particularly those that came under market pressure. Low levels of public investment if maintained over a prolonged period may lead to diminished long-run potential output[27];
- The tax systems of EU member states tend to be heavily reliant on labour taxes, which can depress both the supply and demand for labour. Moreover, the urgent need to improve public finances forced many member states to increase taxes, including taxes that are particularly detrimental to economic growth[28];
- The high tax burden, the modest GDP growth rates and high uncertainty about prospects led to a decline in private and total investment, notably in member

[27] ECB (2016).
[28] European Commission(2015).

countries severely hit by the crisis (for example in Greece total investment fell from 26% of GDP in 2007 to 11.7% in 2015 and in Portugal from 22.5% to 15% in the same period).

Even if fiscal space is not available, there is much room for action through improving the composition of government expenditure and revenue. Fiscal policy and fiscal reforms can positively affect growth through various channels including labour supply, investment in physical and human capital and total factor productivity.[29]

Institutions also matter. According to research, countries with stronger budgetary institutions tend to deliver a more growth-friendly fiscal adjustment[30]. In this context, national fiscal councils introduced in recent years by EU legislation can improve the sustainability of public finances and help promote economic growth.

4. Priority to financial union with some elements of fiscal union

The central role played by banks in the sovereign debt crisis – not least through the bank-sovereign nexus − shifted the focus of EMU governance and integration process towards banking union and capital markets union which are expected to:

- Strengthen financial stability in the euro area and in the whole EU mainly by centralised banking supervision and resolution;
- Contribute to the completion of the Single Market, enhancing the growth potential of the European economy;
- facilitate the smooth transmission of monetary policy across all member countries of the monetary union;
- Contribute to macroeconomic stabilization through private risk sharing.

At a theoretical level, banking union, involving centralized bank regulation, supervision and a deposit guarantee scheme, is probably the most important complement to an

[29] IMF (2015), OECD (2016).
[30] IMF (2014).

enhanced Optimum Currency Area theory for a successful EMU, as these issues were not treated by the OCA literature which focused initially on labour mobility, openness, and, subsequently, fiscal integration.[31]

4.1 Banking union

Substantial, but unequal, progress has been made in creating the three pillars for an effective banking union: a) a single supervisory mechanism (SSM), under the responsibility of the ECB, is already in place and operational as from November 2014; b) a single resolution mechanism (SRM) is also operational from 1 January 2016 and its basic component, the single resolution fund (SRF) was established through an intergovernmental agreement; and c) proposals for a European Deposit Insurance Scheme (EDIS) were tabled in November 2015 by the European Commission and are currently under examination within the EU legislative procedure.

However, important challenges remain for an effective banking union. The first challenge concerns the transition period, i.e. whether the institutional arrangements in place − such as the SRF which will reach maturity in 2023 − will be able to withstand major shocks similar to the global and the sovereign debt crises. The second challenge concerns objections to the establishment of the European deposit insurance scheme: for example, Germany argues that "risk reduction" (notably through a reduction of banks' holdings of their own sovereign) must precede "risk sharing" through EDIS. The third, and probably most difficult, challenge concerns the possibility to set up a fiscal backstop for both the single resolution fund and the European deposit insurance scheme. For the SRF, provisions referring to "alternative financing means" were introduced in the relevant Regulation[32] while no similar provisions exist in the EDIS legislative proposal.

[31] According to Krugman (2013) "…Traditional optimum currency area theory paid little attention to banking issues".
[32] Regulation (EU) No 806/2014 of the European Parliament and the Council, 15.7.2014.

- Experience from federal states such as the US shows that fiscal backstops give an indispensable guarantee to deposit insurance schemes, enabling them to withstand even major crises.[33]

It is evident from the above that despite the widespread support from public opinion and governments of the banking union project, important obstacles have to be overcome in order to achieve a functional and reliable banking union. However, as the banking union project meets the two indispensable criteria for a successful integration step (demonstrated usefulness and wide political support), it is expected that current objections to fiscal backstops will be overcome.[34]

4.2 Capital markets union

The objective of the capital markets union (CMU) is to diversify and amplify sources of finance and ensure that capital can move freely across borders in the single market and be put to productive use. The CMU also aims to create rewarding opportunities for institutional and retail investors in a more resilient, deeper and more competitive financial system.

In September 2015 the Commission adopted an "Action Plan on Building a Capital Markets Union" consisting of a programme of 33 actions and related measures aimed to establish the building blocks of an integrated capital market in the EU by 2019. The action plan is built around the following key priorities: creating more opportunities for investors, connecting financing to the real economy, fostering a stronger and more resilient financial system and deepening financial integration and increasing competition.

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[33] According to the ECB "…in order to further underpin the credibility of the EDIS and to effectively sever the bank/sovereign link at the national level, a fiscally neutral common public backstop for the EDIS should be established at the latest at the start of the full insurance stage" (Opinion of the ECB on the proposal to establish a European Deposit Insurance Scheme, 29.4.2016).

[34] Eichengreen and Wyplosz (2016) provide convincing arguments why focused fiscal union elements could be accepted by those not agreeing to a fully-fledged fiscal union: "first, banking stability is a valuable public good subject to sufficiently increasing returns that centralization of the deposit-insurance function is warranted, second, all member states, not least Greece, are required to implement the banking union's new resolution rules to limit taxpayers liability and, third, this is a limited and specific mutualisation of fiscal powers targeted at a specific financial problem intimately associated with monetary union, not the wholesale centralization of fiscal control at the level of the EU or the Eurozone".

The first measures taken in implementing the action plan included new rules to support investment by insurers and reinsurers in infrastructure projects, legislative proposals to restart securitization in Europe and to simplify prospectus requirements and reduce the burden for companies issuing shares and bonds. An assessment of the financial services legislation was also carried out to check that the legislative framework is working to support growth across the EU.

Although the CMU project does not include politically sensitive instruments such as the single deposit insurance and resolution schemes of the banking union, its effective implementation should overcome a number of obstacles and weaknesses, both regulatory and market originating.

- Actions to remove regulatory obstacles include the removal of direct and indirect impediments to capital movements within the EU (including differential tax treatment of investment products) and convergence of regulatory provisions and supervisory practices. A single capital markets supervisory authority may be needed, similar to the single supervisory mechanism for banking.
- Market-originating obstacles and weaknesses which have to be overcome include high costs for firms, especially SMEs, to tap market-based financing solutions, such as listed stock markets. Investors' costs are also high, as obtaining information on the creditworthiness of SMEs is time consuming. Moreover, some markets are underdeveloped or missing, such as that for crowdfunding, while harmonization of insolvency rules is also indispensable.[35]

4.3 Financial integration and private risk sharing

Integrated financial markets can increase welfare by enabling consumption smoothing, known as risk sharing, between countries. In a monetary union such as the euro area, private risk-sharing is particularly important because the single monetary policy is unable to address asymmetric shocks and a number of mechanisms that have the potential

[35] See PWC (2015).

to improve risk-sharing across countries − such as labour mobility and a European supra-national system of taxes and transfers − are not a realistic prospect (Constancio, 2016). Also the rules on fiscal deficits imposed by the Stability and Growth Pact will continue to set limits on national governments for smoothing large shocks.[36]

A recent European Commission study[37] provides updated estimates for cross-border channels for both the US and the euro area taking the observations from the global crisis period into account. It emerges from the study that around 75% of an asymmetric output shock gets smoothed in the US, the most important contribution coming from capital markets in the form of cross-border ownership of assets (around 45%), followed by credit markets (27%) and fiscal transfers (8%).

By contrast, only around 25% of an asymmetric shock is smoothed in the euro area. While cross-border fiscal insurance is virtually absent, the main reason for the substantial gap between the US and the euro area comes from the very limited degree of risk sharing through capital income flows between Member States (see Table 1).

In view of the above, enhancing private risk sharing in the euro area, especially through the completion of the Banking Union and the Capital Markets Union is a key policy priority. However, as is pointed out in the Five Presidents' Report[38], the closer integration of capital markets could create new risks to financial stability. This implies that there will be a need to expand and strengthen the available tools to manage such risks through macro-prudential policies and to strengthen the supervisory framework eventually through a single European capital markets supervisor, as was already noted in section 4.2 above.

4.4 European Stability Mechanism: a key instrument for crisis management

The main policy issues related to the European Stability Mechanism (ESM) are, firstly, its role in the euro area's crisis management as a provider of financial assistance to member

[36] Although the rationale of such rules is, indeed, to achieve sound public finances in order to create the margin for counter-cyclical fiscal policy, in case of large shocks such fiscal margin may not be sufficient.
[37] Nikolov (2016).
[38] Juncker (2015).

countries; secondly, its contribution to fiscal backstops to the European Deposit Insurance Scheme and the Single Resolution Fund and to direct bank recapitalization; and, thirdly, its potential role in the monitoring of EU fiscal rules, and even as a European Monetary Fund, as was recently proposed by European politicians.

The ESM is the main **crisis management instrument** for the euro area, providing financial assistance − associated with economic conditionality − to member-countries facing severe financing difficulties. In fulfilling its task, the ESM raises funds on the international capital markets and on-lends to the member-countries concerned at very low interest rate, reflecting its own excellent credit rating and very low borrowing costs.

- The ESM has accumulated considerable experience on the operation of international capital markets and should continue carrying out these duties. It is also contributing to other tasks, such as elaborating ways to alleviate the burden of the very high, as a per cent of GDP, Greek government debt through short-term, medium-term and long-term measures, implementing the relevant Eurogroup decision.[39] The ESM could also be involved in debt management issues in the context of an eventual Debt Redemption Fund as initially proposed by the German Council of Economic Experts in November 2011.

The ESM's mandate to contribute to the financial stability of the euro area, combined with its significant lending capacity[40], make it a suitable candidate to contribute to the creation of a **fiscal backstop** for the European Deposit Insurance Scheme and for the Single Resolution Fund by providing a credit line to a Single Deposit Insurance and Resolution Board (see Schoenmaker, 2015).

- The ESM could enhance its contribution to the **recapitalization of banks**, beyond the current restrictive conditions, as at present direct bank recapitalization by

[39] Eurogroup, May 2016. In the Eurogroup of 5.12.2016, the ESM presented short-term measures to alleviate Greek government debt which were endorsed by the Eurogroup. According to the ESM, the proposed measures would reduce the Greek government debt as a percentage of GDP by 21 percentage points through extension of maturities and by stabilizing interest rates.

[40] Out of the total lending capacity of 500 billion euros, about 75% is still available for lending, taking account the commitments to the three programmes in which the ESM was involved (Spain, Cyprus and Greece). However, a safety margin must be kept regarding ESM lending capacity to take account of unforeseen needs and emergencies.

the ESM may be used only as a last resort when all other instruments, including the bail-in mechanism, have been applied.

Regarding proposals[41] that the ESM assumes a role as guardian of EU fiscal rules − the justification of the proposal being that the European Commission was too lenient towards member states in cases of non-compliance with fiscal rules (see also 3.6 above) − it is considered unnecessary and counterproductive to proceed to such a move for two basic reasons:

- Firstly, the ESM, as an international agreement outside the EU legal framework, has not the political legitimacy to assume the role of the guardian of fiscal rules. The European Commission was assigned this role by the treaty and is accountable to the European Parliament and to the Council for its actions.
- Secondly, ESM competence lies mostly in its deep knowledge of the functioning of international financial markets and of raising funds at the best possible terms in order to finance member states' borrowing needs; it does not possess the required expertise for assuming the proposed additional duties of monitoring the implementation of economic programmes.

The above arguments imply that if (i) the ESM is incorporated into the EU legal system and (ii) the EU legislator considers that an institution exclusively dealing with the euro area would be more effective in carrying out economic surveillance tasks, notably those associated with economic adjustment programmes, then an enhanced role of the ESM along the above lines could be envisaged.

5. Institutional strengthening, democratic accountability and transparency: indispensable for a successful EMU

The common thread of the above principles is that they would contribute to improved governance in EMU in different but reinforcing ways.

[41] See W.Schaeuble, "EU at a crossroads", Globset Tatra Summit, Annual Speech on Europe, Bratislava 28.10.2016.

Democratic accountability and transparency imply that all interested parties have the opportunity to express their views on policy proposals and that the executive bodies give account of the results of their policy action. An argument is often advanced that if democratic procedures are by-passed, probably because they are lengthy and also because dominant views may be contested, decisions can more easily passed by those "who know better". This perception, besides being undemocratic, is also wrong on efficiency grounds as it disregards the fact that decisions and agreements that are the result of consultations and negotiations are usually more solid and lasting as they reflect the view and interests of all parties.

The strengthening of institutions means that economic and monetary integration would be implemented by European institutions having a mandate from EU treaties. This "Community approach" is in contrast with the "intergovernmental approach" that has been increasingly used in recent years, for example in the formation of the European Stability Mechanism, the Treaty on Stability, Coordination and Governance and the Single Resolution Fund.[42]

An area where the intergovernmental approach associated with a lack of transparency and accountability was more evident was the design and implementation of EU/IMF programmes, notably that concerning Greece. Although key targets of the first Greek economic programme were missed, resulting in much deeper economic recession and much higher government debt as a per cent of GDP than projected, no official explanations were given for the reasons of the failure and no European institution assumed responsibility. A European Parliament committee which examined EU/IMF economic programmes concluded that the EU/ECB/IMF "Troika" helped four EU countries through the crisis and prevented it

[42] As was noted in an earlier study (Papaspyrou 2015), the "intergovernmental approach" favours large and influential countries, and in the specific case of EU/IMF programmes creditor countries, while a "Community approach" would strengthen the relative weight of European Institutions, such as the European Commission which has the role of the guardian of the Treaties and was assigned the duty to promote the common Community interest.

from getting worse *"…but the flawed structure and working methods hindered national ownership and compromised transparency and accountability"*.[43]

Issues related to the management of the Greek programme may not be unconnected with the rising mistrust of European public opinion vis-à-vis the EU and the diminished popularity of the euro area among the EU member states, that are not in the euro area.[44] It is, therefore, urgent that this course of events be reversed in order for the European project to stand a chance to survive and thrive. A solution for the governance of EU/IMF programmes was proposed in a recent study (Papaspyrou, 2015): in order to avoid diffusion of responsibility, the European Commission should undertake responsibility for economic programmes and be accountable to the European Parliament and the Council for any errors and omissions while the IMF may participate as a consultant without contributing funds and without a veto power. In that way the IMF would feel totally free to form and express its views, acting in an "authority of knowledge" status.

In the Five Presidents' Report, proposals were put forward to enhance democratic accountability, notably through the involvement of the European Parliament and national parliaments in the European Semester and other policy discussions. It was also proposed to incorporate existing intergovernmental agreements among euro area member countries within the EU legal system.

In order to avoid a proliferation of institutions and diffusion of responsibility, an appropriate strategy would be to strengthen mandates of existing institutions, limiting the need for treaty amendments. Such a strategy was followed in the case of the ECB that assumed new duties in the banking union project, and should be expanded by assigning the duties of economic governance to the European Commission, strengthening of course its accountability and democratic control by the European Parliament, along the lines of the "Community approach" mentioned above.

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[43] European Parliament, Committee on Economic and Monetary Affairs, Report on the role and operations of the Troika with regard to the euro area programme countries, 28.2.2014.

[44] The statement of Belka (2014), Governor of Poland's central bank that "…*the bottom line here is that non-euro EU member states are probably here to stay – at least for the foreseeable future – and for good reasons so"* is rather representative of the current mood in most of non-euro area EU countries.

A more general issue concerns the ultimate objective of European integration. The federalist objective towards the United States of Europe is not on the agenda and such a discussion may even be counterproductive while other, more urgent, problems remain unresolved. A sound approach to integration issues is for Europe to provide evidence of effectiveness and usefulness in domains in which a European approach is necessary *par excellence*, such as the refugee and migrant crisis. However, reflection on the issues surrounding broader European integration is necessary and welcome and a number of interesting ideas are advanced by both policymakers and independent analysts and academics.[45]

6. Concluding remarks

A central message of this paper is that a new approach to EMU governance and integration is needed, as serious weaknesses in the euro area economy persist and political support for further integration is weak. This approach consists of the following elements.

An optimal use of the institutional framework for economic, fiscal and financial policies is necessary and possible at each level of EMU integration which is politically feasible. Such reorientation of strategy is necessary as hard but indispensable work on the best use of the existing institutional framework is often neglected by both policymakers and analysts who prefer the more exciting job of designing new institutional architectures. Such a strategy is also possible as a wide margin for improvement exists within the new framework for economic governance.

Important elements of such an approach are enhanced synergies between stability and growth policies and a better policy-mix, initiatives to complete the Single Market and support public and private investment also by an intensive and intelligent use of EU funds and policy instruments, a more symmetric adjustment of current account deficits and surpluses and fiscal policies pursuing the twin objective of economic growth and fiscal sustainability.

[45] See Slaughter (2016).

Priority should be given to the implementation of banking union and capital markets union in the broader objective of completing financial integration which would facilitate the smooth transmission of monetary policy across all member countries of the monetary union, enhance financial stability and economic growth and contribute to macroeconomic stabilization through private risk sharing.

Initiatives towards deeper EMU integration should be pursued where there is strong evidence, within the EU and beyond, of their usefulness and for which widespread political support exists. This is the case for the financial union project and less so for a fully-fledged fiscal union except for fiscal backstops within banking union which are the least controversial elements of a fiscal union.

The strategy proposed in this paper, although consistent with the approach adopted in the Five Presidents' Report on "Completing Europe's Economic and Monetary Union", which foresees parallel progress in stages towards economic, financial, fiscal and political union, goes one step further by being more explicit about the priorities for advancing EMU integration, stating clearly the criteria, and their justification, on which such a choice has been made.

Finally it emerges from the analysis of economic and non-economic developments in recent years that institutional strengthening and democratic accountability and transparency are indispensable elements of a successful economic and monetary union.

Annex

Report on “Completing Europe’s Economic and Monetary Union”: main elements

Background

The Euro Summit of October 2014 underlined the fact that closer coordination of economic policies is essential to ensure the smooth functioning of EMU and called for work to continue to develop concrete mechanisms for stronger economic policy coordination, convergence and solidarity and to prepare the next steps on better economic governance in the euro area. In response to this invitation a report on “Completing Europe’s Economic and Monetary Union” (known also as the Five Presidents’ Report) has been prepared by the President of the European Commission, in close cooperation with the Presidents of the Euro Summit, the Eurogroup, the European Central Bank and the European Parliament, and was published on 22 June 2015. It has benefited from intense discussions with Member States and civil society and reflects the personal deliberations and discussions of the five Presidents. It focuses on the euro area, as countries that share a currency face specific common challenges, interests and responsibilities.

Objective

It is stated in the report that a complete EMU is not an end in itself but a means to create a better and fairer life for all citizens, to prepare the Union for future global challenges and to enable each of its members to prosper. The challenges of recent years forced national governments and EU institutions to take quick and extraordinary steps in order to stabilize their economies through the gradual and at times painstaking process of European integration and to protect all that has been achieved. However it is clear that the quick fixes of recent years need to be turned into a lasting, fair and democratically legitimate basis for the future.

Proposals

According to the report progress must happen on four fronts: first, towards a genuine Economic Union that ensures each economy has the structural features to prosper within the Monetary Union. Second, towards a Financial Union that guarantees the integrity of our currency across the Monetary Union and increases risk sharing with the private sector. This means completing the Banking Union and accelerating the Capital Markets Union. Third, towards a Fiscal Union that delivers both fiscal sustainability and fiscal stabilization. And, finally, a Political Union that provides the foundation for all of the above through genuine democratic accountability, legitimacy and institutional strengthening.

All four Unions depend on each other. Therefore, they must develop in parallel and all euro area member states must participate in all Unions. In each case progress will have to follow a sequence of short- and longer-term steps, but it is vital to establish and agree the full sequence today. The measure in the short-term will only increase confidence now if they are the start of a larger process, a bridge towards a complete and genuine EMU. The process would be organized in stages:

Stage 1: (1 July 2015-30 June 2017). In this first stage ("deepening by doing"), the EU institutions and euro area Member States would build on existing instruments and make the best possible use of the existing Treaties.

Stage 2: In the second stage (completing EMU), concrete measures of a more far-reaching nature would be agreed to complete EMU's economic and institutional architecture. Specifically, during this second stage, the convergence process would be made more binding through a set of commonly agreed benchmarks for convergence that could be given a legal nature. Significant progress towards these standards – and continued adherence to them once they are reached – would be among the conditions for each euro area Member State to participate in the shock absorption mechanism for the euro area during the second stage.

Final Stage: (at the latest by 2025): At the end of Stage 2, and once all the steps are fully in place, a deep and genuine EMU would provide a stable and prosperous place for all citizens of the EU Member States that share the single currency, attractive for other Member States to join if they are ready to do so.

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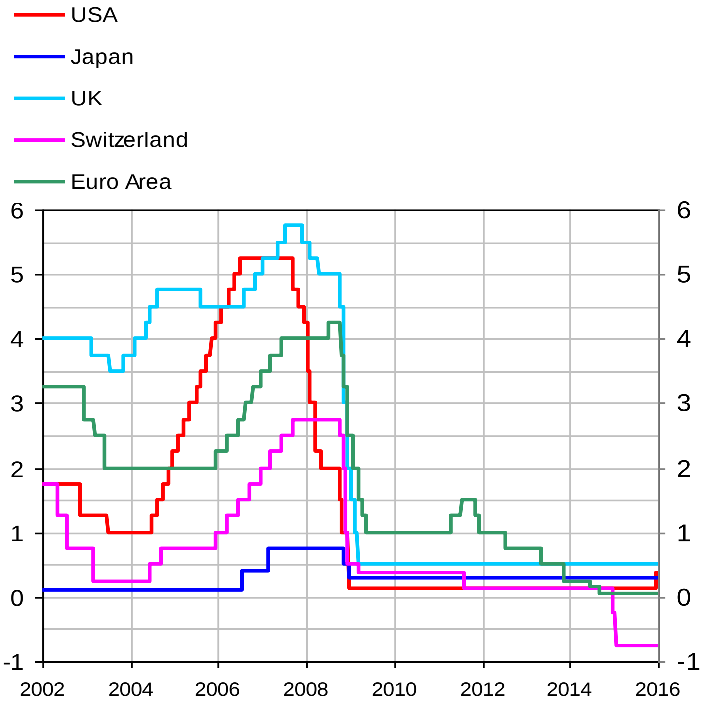
Chart 1 Central Banks's Key Interest Rates (January 2002 - November 2016)

(*annual percentage, daily data)*



Soures: Euro area: ECB. USA: Federal Reserve. Japan: Bank of Japan. United Kingdom: Bank of England. Switzerland: Swiss National Bank

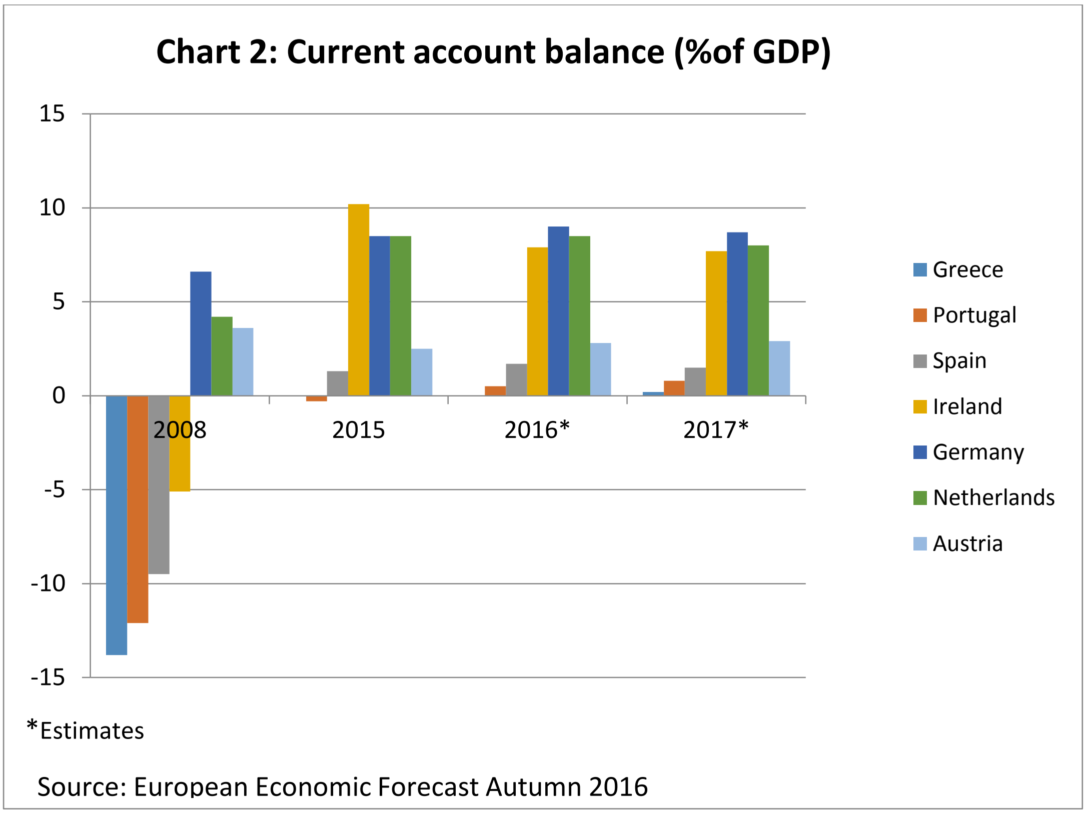


Chart 2: Current account balance (%of GDP)
15
10
5
0
-5
-10
-15
2008
2015
2016*
2017*
Greece
Portugal
Spain
Ireland
Germany
Netherlands
Austria
*Estimates
Source: European Economic Forecast Autumn 2016

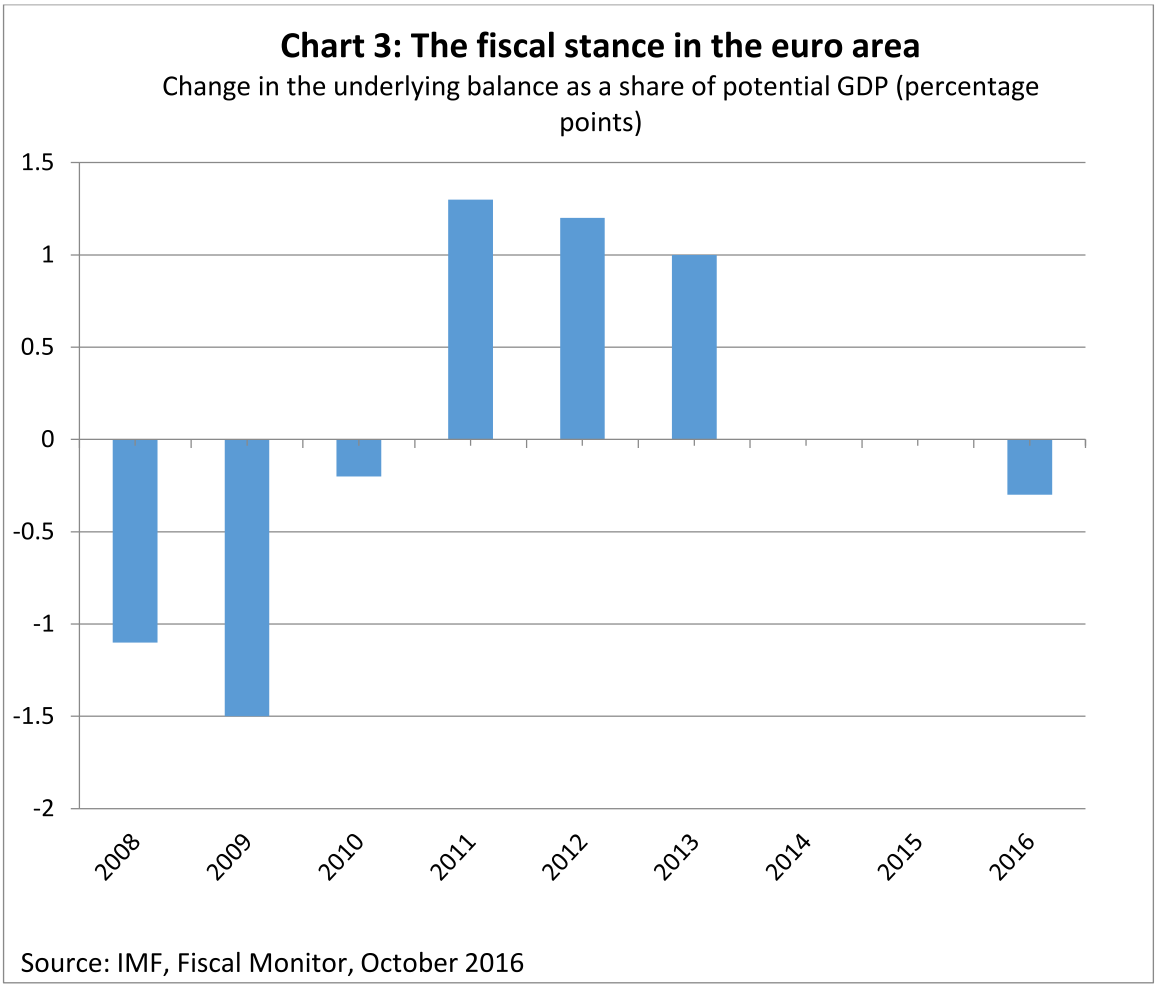


Chart 3: The fiscal stance in the euro area
Change in the underlying balance as a share of potential GDP (percentage points)
1.5
1
0.5
0
-0.5
-1
-1.5
-2
2008
2009
2010
2011
2012
2013
2014
2015
2016
Source: IMF, Fiscal Monitor, October 2016

Table 1: Cross-border risk sharing through different channels

(In % of total asymmetric shock to output)

	Euro area (1)	**USA (2)**
Risk sharing through:		
Capital markets	5.6	44.8
Cross-border fiscal transfers	0.0	8.3
Credit markets	18.2	26.7
Unsmoothed	75.7	17.6

(1): All euro area Member states except CY, MT, LU, LT, AT, GR. (2) 50 states

Source: "Cross-border risk sharing after asymmetric shocks: evidence from the euro area and the United States", European Commission, DG ECFIN, Quarterly Report on the euro area, Vol. 15 No 2, 2016.

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