Post-crisis Challenges for the Economies of SEE

Economic governance in EMU

Recent reforms and their significance for existing and prospective members

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1. Causes of the sovereign debt crisis and implications for EMU

- The global crisis affected most economies
  - And exposed the fragilities of economies with serious imbalances and structural weaknesses.
- Sovereign crisis in GR, IR, P: differences and common factors
  - Greece and Portugal: Inadequate fiscal adjustment and high government debt (especially Greece), loss of competitiveness.
  - Ireland: overinvestment in real estate, fragile financial sector

2. Policy implications for EMU

- The sovereign debt crisis was transformed into a systemic problem for the euro area
  - Risk to financial stability for the EA as a whole
  - A test for institutions, mechanisms, instruments

- Current events in historical perspective
  - A flavour of the 1992 EMS crisis
  - Differences
    - Then: simple monetary arrangements
    - Now: a fully fledged monetary union
  - Common element
    - need for adaptations and reform

3. Response to the crisis in three directions:

- Immediate measures to contain the impact of the crisis
  - The paradox of the “missing mechanism”
  - Financial support and adjustment schemes

- Decision to set up a permanent crisis management framework
  - European Stability Mechanism

- Strengthening economic governance
  - New architecture for policy coordination
  - Stricter fiscal and macroeconomic surveillance
  - New instruments to ensure financial stability

4. Establishment and activation of financial support mechanisms

- Ad hoc EA-IMF financial support to Greece
  - € 110 billion 3-year loan (extended to 7.5 yrs)
  - Strict economic conditionality (EC,IMF,ECB)
- European Financial Stability Facility (EFSF)
  - € 440 billion (up from €250 billion initially)
  - Strict economic conditionality (EC,IMF,ECB)
- European Finan. Stabilisation Mechanism
  - €60 billion loans guaranteed by EU budget
  - Strict economic conditionality (EC,IMF,ECB)

5.Financial support to Ireland – Request for support by Portugal

- €80 billion EU/IMF loan to Ireland
  - From the EFSF, the EFSM, the IMF, bilateral loans (UK,DK,SWE) and Irish Fund
  - Strong conditionality (EC, IMF, ECB)
  - Special provisions for the financial sector

- Request for financial support by Portugal
  - Ongoing negotiations on loan conditions
  - €80 billion a first estimate of the loan
  - Strict economic conditionality

6. A permanent European Stability Mechanism (ESM) from June 2013

- To provide financial assistance to EA countries facing severe financing problems
  - Limited treaty modification (art. 136) to establish a mechanism “to safeguard the stability of the euro area as a whole”.

- €500 billion effective lending capacity.
  - Loans to be provided under strict conditionality. Exceptionally the ESM may intervene in the primary debt markets.

- Possibility for private sector involvement
  - depending on the outcome of debt sustainability analysis.

7. Strengthening Economic Governance I

- The "European Semester"
  - A new architecture for economic governance
  - Ex ante coordination to provide guidance
  - Unified coordination to create synergies

- Procedure
  - Annual Growth Survey by the EC (January)
  - Debate and orientations by the EU Council, EP, European Council (March-April)
  - Adoption of national SCPs and NRPs (May)
  - Policy Guidance by EU Council (June-July)
  - Decisions at national level (Autumn)

8.Strengthening economic governance II

- Improving fiscal surveillance
  - Strengthening the SGP
    - Tighter monitoring, quantified reduction of gov. debt, more automatic sanctions- reverse QMV
  - National fiscal frameworks
    - Fostering national ownership, strengthening national structures for budgetary discipline
- Preventing and correcting macroeconomic imbalances
  - Early detection of imbalances (also ESRB role)
  - Excessive Imbalance Position

9.Strengthening economic governance III

- The “Euro plus Pact”
  - To strengthen the economic pillar of EMU by enhancing competitiveness and convergence
  - Focus on areas of national competence
  - EU fiscal rules into national legislation

- EU Financial sector reform – a European System of Financial Supervision
  - European Systemic Risk Board
  - European Banking, Insurance and Securities authorities

10. "Europe 2020" Growth Strategy

- "Europe 2020" is the EU's growth strategy for the coming decade (replaced Lisbon Strategy).
- Five objectives to be reached by 2020:
  - Promoting employment (employment rate to 75%), innovation (R&D 3% of GDP) and social inclusion, improving education levels, meeting climate change and energy objectives.
  - Key role for the Single Market to promote competitiveness and deliver growth and employment
  - Implementation through National Reform Programmes prepared by Member States

11. Preliminary assessment of reforms

- Greater coherence in economic governance: macro, fiscal, financial
  - Macro surveillance: the main new element
  - Ownership of new fiscal rules by MS essential
  - Financial stability: central role for the ECB
  - Financial support avoiding moral hazard
    - implications of private sector involvement
- Ok for stability, what about Growth
  - Focus on stability fully justified
  - However, growth initiatives indispensable
  - "Europe 2020" more focused than "Lisbon"
    - Single Market initiative, Project Bond Initiative

12. Importance of economic governance reforms for prospective members I

- A well-functioning EMU beneficial for all
  - a factor of stability and prosperity for main economic partners
- Fiscal and macro rules apply in general to all EU members
  - Approved by Ecofin, negotiations with EP
  - ECB asked for stricter rules for EA countries
- Euro convergence criteria: no change
  - Sustainability more important than ever

13. Significance of EconGov reforms for prospective members II

- Euro plus Pact: important for prospective emu members
  - Joined the Pact: BU, DK, LA, LI, PO, RO
  - Substance: useful in preparing for emu
  - In form: message of commitment to emu
- Lessons from the global-sovereign crisis
  - Central and SEECs showed resilience to shocks
  - Low public debt helped
  - Caution: important to maintain the cap

14. EMU beyond the sovereign crisis I

- EMU remains an attractive project
  - Estonia fulfilled convergence criteria and joined the euro area on 1.1.2011
  - Most non-members wish to join "as soon as possible"
- Improved overall performance and both higher convergence <u>and</u> persistent imbalances in the EA until the global crisis
  - Plus: overall price stability, 16 million jobs created (more than in the US), convergence in real GDP per head, balanced external accounts.
  - Minus: competiveness losses, fiscal and CA imbalances, diverging inflation rates

15. EMU beyond the sovereign crisis II

- There is nothing irreversible in the present difficulties in several euro area economies
  - There is no “inherent tendency” to low growth in the economies concerned. Evidence shows the contrary.
  - Real interest rates and perceived protection provided by the euro led to “reform and adjustment inertia”.
  - New EU rules and instruments will encourage reforms, enhance productivity, competitiveness and balanced growth in a more stable framework.
  - With strong commitment to adjustment and reform and a more sustainable growth model these economies can be the winners of the growth game in the next decades.