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Session 1: A European path to growth: re-launching investment and reducing inequalities

SMEs are at the heart of Europe's growth and competitiveness. Until now, the EU has been good in terms of efficiency driven growth, we now need to tap into what is beyond the horizon and shift to innovation based growth.

SMEs must face global competition. Unfortunately the internal market does not push them, they still remain parochial, this a wrong perception of the situation. SMEs are in effect competing locally with global companies and need to be able to respond to new consumer tastes. And these tastes are shaped globally, particularly due to the Internet.

We have to review the small business act. Competitiveness can come from innovation.

Unfortunately pro-growth policies suffer of shortcomings. Finance ministers often disagree about their role in bringing about growth. We see it clearly in the debate ignited by Mario Draghi's call for a monetary-fiscal policy mix to kick-start the eurozone's economy. We have seen strong reluctance from the member states also when Draghi specifically asked for government guarantees for riskier tranches of the asset backed securities which the ECB intends to start buying later this year. As time goes on, we are becoming increasingly aware of the limits of monetary policy. The fiscal side will need to kick-in sooner rather than later.

Growth can also come from liberalized trade of course. Here the TTIP currently in the making brings along one of the biggest growth promises to date.

- Europe's growth performance over the past few decades has been impressive. Its use of trade, finance, enterprise, innovation, labour and government transformed the continent into a powerful convergence machine. The crisis revealed some of the model's shortcomings and economic prosperity entered a downward path starting with 2008. Albeit less impressive, Asia and the Americas also recorded strong economic growth in the run-up to the crisis.

- The sustained increase in real disposable income for OECD households however occurred in the background of rising inequalities. The richest 10% experienced much faster income growth than the poorest 10%, leading to a 9 to 1 income ratio between rich and poor.

- At the heart of rising inequalities lies the rapid onset of globalization. With increased mobility of capital, developed countries outsourced production to the developing world. This in turn led to improvements in employment prospects and living standards for poor individuals in Asia, in particular in China and India. At the same time, the new developments harmed domestic workers, resulting in layoffs and lower wages.

- Globalisation however is not the only culprit and some empirical studies have even found that not only high-wage, but also low-wage countries have seen inequality rise as a result of trade integration. Furthermore inequality can also be traced back to other factors. One element is the improvement in information and communication technology, a highly skill-biased sector. Additionally, regulation and institutions are also key players in inequality trends. In mainland Europe and Japan, inequality has been less of an issue than in the Anglo-Saxon world due to the corporate governance, tax laws and unionization in place. More specifically, product market deregulation, social transfer changes, wage-setting mechanisms all played a significant part.

- The economic advantages stemming from growth and globalization were evident. Increased competition improved efficiency and innovation, leading to economic prosperity at the national level. The economic fundamentals were and remain hard to argue with, even though social inequity has been on the rise. Since they do not want to hinder growth, national governments are left with a challenging task, namely with ensuring that inequality does not pervade the social system, leaving the most vulnerable citizens exposed. The task is difficult, yet not impossible and there are tools at the disposal of economic policy makers.

- Of course taken together the economic governance package of the EU (comprising the fiscal compact, six-pack, two-pack) together with the financial sector reforms (in particular the banking union) pursued in the EU should in the long-run provide a boost to growth

- However also more targeted policies can be pursued, especially if we also intend to tackle the issue of rising inequalities in the post-crisis world.

- One policy option for reducing EU inequalities is an EU-wide unemployment benefit scheme. One idea would be to extend the duration of unemployment insurance beyond the current national limits, following a path similar to that taken by the US system (*the federal extended Unemployment Insurance benefits in the United States: when unemployment reaches a threshold level, US states are required by federal law to extend benefits*). The EU scheme could also attempt to harmonise conditions such as those regarding voluntary entry into unemployment, availability for work, and refusal of job offers. A more ambitious plan would involve the EU playing the part of the state itself and providing an autonomous social security system. The system could be opened on a voluntary basis to all EU citizens.

Session 2: EU economic and financial governance tools

- The idea of issuing debt jointly is part of a broader attempt to gradually complement the monetary union with a fiscal layer. Joint issuance is ultimately one of the latter's defining elements, alongside a eurozone ministry of finance, with a taxation capacity and a strong euro area budget.
- While monetary policy is indeed centralised in the EMU, fiscal policies are merely under a rules-based European surveillance, while remaining national in nature. Asymmetric shocks are thus dealt with through national fiscal stabilizers.
- The crisis episode put an emphasis on the imperfections of the common currency area on a number of fronts. It quickly emerged that the EMU was lacking mechanisms to ensure sustainable public finances, that one size fits all monetary policy could easily coexist with wide disparities in competitiveness between North and South (lacking other well-functioning adjustment tools) and that in spite of sharing one currency, market risk was perceived differently across the different member states, leading to a wide disparity in borrowing costs both for sovereigns as well as for private sector actors.
- At the same time, a missing integrated EU-level framework to deal with financial sector regulation also led to the emergence of a strong connection between banks and their sovereigns, which implied that once one of the two links faced difficulties, the other could also come under pressure.
- The crisis gave policymakers the needed push to take action. Broad ranging economic governance and financial sector reforms were put in place. The six-pack and two-pack of economic governance as well as the fiscal compact are pushing for fiscal discipline and a better check and tackling of macroeconomic imbalances. The European banking union, currently in the making, together with the bank recovery and resolution directive (the BRRD) have made headway in severing the banking-sovereign loop and increasing EU financial integration.
- Unfortunately, the problems of accumulated debt and market access for debt burdened sovereigns, remain as of yet unresolved. A number of euro area member states are still dealing with a severe debt overhang, accumulated in the years prior the crisis and amplified by the crisis episode. Moreover, member states are also suffering from a growth crisis, with only a modest recovery in sight, which does not promise impressive growth in the short run. This disappointing growth performance has further burdened debt to GDP ratios. Finally, wide cross-country differences in borrowing costs exist, making it nearly impossible for some debt burdened member states to access markets at a competitive rate. Debt mutualisation promises to provide the cure for these ailments.
- Any form of debt mutualisation or redemption comes with afferent risks, with moral hazard standing out in particular
- The hazard is directly related to guarantee structure, the volume of joint issuance in relation to debt left at national level, the duration of the scheme, the maturities of the instruments chosen and political constraints set on governments.
- To address moral hazard, various mechanisms can be considered: prior conditions for entrance into the debt mutualisation scheme (a period of probation and restricting eligibility for participation), reinforced competences of

the European level over member states' fiscal and economic policies in cases of non-compliance, financial incentives and sanctions

- Such instruments face not only moral hazard worries but also legal constraints. Within current Treaties, nu guarantees for joint and several liabilities are possible. Pro-rata commitments on the other hand could, under certain conditions, be envisaged, according to the expert group (modelled to some extent after the ESM)
- One could however set up a temporary eurobills scheme through a combination of a regulation based on Article 352 involving enhanced cooperation and an intergovernmental agreement
- Finally, the question of whether the two debt mutualisation instruments would be accessible to all euro member states or only to those who are not under a programme (although arguably the latter are most in need of assistance) also remains open.

Session 3: Completing the banking union and financing the real economy

The banking union project is composed of **three pillars**:
-a single supervisory mechanism (**SSM**): adopted by the European Parliament in September 2013; the body will become operational in November 2014 (the SSM will oversee both euro as well as non-euro zone banks depending on the decision of non-euro member states to opt-in)

-a single resolution mechanism (**SRM):** the European Parliament adopted the SRM in April 2014, the SRM will become operational as of January 2015, bail-in provisions under the SRM are applicable as of January 2016 (the SRM will take decisions and provide funding in resolution cases for banks covered by the SSM)

-a single deposit guarantee scheme (**SDGS**): there are no concrete plans to bring forward a proposal on this from the side of the Commission for the time being

-completing the three pillars comes also the **level 2 work**, currently on-going, on contributions to the funds established under the SRM and the bank recovery and resolution directive (BRRD, adopted by Parliament in December 2013, due to become operational as of January 2015, bail-in provisions are applicable as of January 2016):

- a **delegated act for the BRRD** covering the risk adjustment of individual contributions in proportion to the risk profile of institutions (to that end, the precise amount that individual credit institutions will have to pay each year to their respective resolution funds needs to be determined. This amount will depend on the bank's size and risk profile)
- **an implementing act for the SRM** specifying the methodology for the calculation of contributions on the basis of the same risk factors identified in the delegated act applying to national resolution funds

-also complementing the start of the banking union are the **stress tests and asset quality review (AQR) of the ECB**:

- Stress test – to be performed in close cooperation with the European Banking Authority (EBA), will examine the resilience of banks' balance sheets to stress scenarios, timeline: discussions with banks started in April 2014 and results should be known by mid-October
- AQR– to enhance the transparency of bank exposures by reviewing the quality of banks' assets, including the adequacy of asset and collateral valuation and related provisions; timeline: November 2013-October 2014, results to be published in mid-October, in time for the SSM taking up its duties in November 2014

The treatment of non-euro member states in the banking union:

Non-euro member states benefit from a number of positive participation conditions, ensuring a more equal treatment between them and their euro area counterparts in the new structure.

They include:

In the SSM:
1. Fiscal Backstop:
The SSM regulation states that the Commission should, in its review of the regulation, look into the fiscal effects that supervisory decisions taken by the SSM have on participating member states and consider the impact of any developments in relation to resolution financing arrangements.
2. Decision-making within the Supervisory Board:
Given the legal basis chosen by the Commission, it was impossible to grant non-euro member states equal rights relative to their euro area counterparts in the governing council, it was however possible to have the supervisory board (comprising euro and non-euro member states alike) present draft decisions to the governing council. This provision is part of the final text, according to which the supervisory board will present draft final decisions to the governing council. These decisions will then be deemed to be adopted unless the governing council objects to them within at most 10 days of their submission.
3. Opt-ins leaving the SSM: the possibility of a non-euro area opt-in member state to leave the SSM (under the original Commission proposal only the ECB had the power to terminate the close cooperation) is now part of the final compromises.
The opt-in may request a termination of its close cooperation with the ECB under the following circumstances:

- if three years after the publication in the official Journal of the European Union of the decision to establish the close cooperation have elapsed and provided the decision to leave the SSM is driven by potential significant adverse consequences regarding the fiscal responsibilities of these member states;
- it the supervisory board makes a decision, the governing council objects to this decision and the opt-in disagrees with this objection;
- if the opt-in is presented with a draft decision by the supervisory board, which it disagrees with, then the opt-in can put forward its objection to the governing council within five days of receiving the draft decision. The governing council will then make a decision about the disagreement between the supervisory board and the opt-in, taking into account the reasons behind it, and notify the opt-in within five days of its decision. The opt-in can then choose to terminate

the close cooperation with an immediate effect and will not be bound by the decision.

4. No common position for SSM countries in the EBA: the clause, proposed originally by the Commission, whereby the ECB would coordinate and express a common position for SSM members within the EBA is not part of the final text.

In the SRM:

1. Voting issues:

-so-called opt-ins (non-euro member states which decide to opt-in to the banking union) are protected in the SRM in virtue of the fact that they have a say in the decision-making process when banks on their territory are concerned (whether their own institutions or subsidiaries of other home member states)

-more specifically, when cross-border resolution decisions are taken, the national resolution authority of the member state where the home authority is based, as well as the national resolution authorities of the hosts, which have a subsidiary or entity covered by consolidated supervision on their territory, will also participate in decision-making

-if the aforementioned members cannot reach a joint agreement by consensus, then the decision will be taken by simple majority by the executive director and the other four permanent members of the Board only. Thus homes and hosts are not allowed to vote anymore in the second round, making the process fair to the extent that the homes do not get to have a potentially biased vote in favour of the institutions based on their territory.

2. Backstop Issue:

-a serious worry throughout the negotiations, from the perspective of potential opt-ins, was also the fact that they do not have a backstop in case the money in the single fund runs out (their euro counterparts could have potentially resorted to the European Stability Mechanism, the ESM)

-the fact that the fund will be able to borrow addresses this worry to a certain extent and creates a level playing field between euro and non-euro member states.

3. Non-discrimination clause:

-finally, ember states which are not participating in the banking union are also protected. The SRM regulation contains a non-discrimination clause, which stresses that banks should not be discriminated on account of nationality or place of business. Moreover, the text also asks that due consideration be given to non-participating member states when cross-border resolutions are taking place.