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“Strengthening the economic governance of the euro: short-term priorities and the long-term view”

High Level Seminar. Banco de España

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Ladies and Gentlemen,

Let me first extend a warm welcome to you all to the Banco de España. Thank you for joining us today in this seminar that addresses the pressing and very important topic of the ***Economic Governance of the Euro: Short-term Priorities and the Long-term View***.

I would like to thank the panelists who have been so kind to accept our invitation; we are very pleased to have among us a long list of distinguished participants that would certainly throw much welcomed light on the discussion.

The timing of this conference is particularly relevant. After years of low growth, Europe is now experiencing a robust recovery which opens up a window of opportunity to make progress in the governance reform agenda before the next economic downturn unfolds. Supported by expansionary monetary policy, real GDP in the Euro Area has expanded for 19 quarters in a row. Stronger price dynamics are yet to materialize, but we are confident that if we are prudent, patient and persistent, our monetary policy measures will be effective in achieving the medium-term goals.

Price stability is a necessary but not a sufficient condition for achieving sustained and balanced growth. In fact, one important lesson we can draw from the first twenty years of the EMU is the need to improve the area's resilience to large macroeconomic shocks and to increase its stabilization capacity.

In this context, we currently find ourselves at a crossroads in what refers to the pace of the governance reform agenda.

Despite evident progress since the peak of the crisis, the building of a more cohesive monetary union, as proposed in the Van Rompuy's Report of June 2012 (the so-called Four Presidents' Report) and in the Juncker's Report of June 2015 (the so-called Five Presidents' Report), is, we all know that, a very difficult task. As a matter of fact, there has been no significant step forward since the establishment of the Single Resolution Fund in June 2014.

Recently, several initiatives have attempted to re-launch the debate on the future of euro area's governance, including, in December 2017, the European Commission's report on "Further steps towards completing Europe's Economic and Monetary Union: A roadmap", or, in January of the present year, the Center for Economic Policy Research's report on "Reconciling risk sharing with market discipline: A constructive approach to euro area reform", which, as many of you probably know, we discussed in a recent seminar here at the Banco de España.

The package of reform measures put forward by the EC cover a broad set of issues, from the completion of the Banking Union and the design of mechanisms that reconcile market discipline and risk sharing to the establishment of a European Union Finance Minister. The panelists today will share their views and analysis on these central issues. Let me briefly reflect upon them.

The Euro-Summit on 15th December 2017 resulted in a renewed political commitment to foster further progress on EMU's architecture during the first semester of the present year. The aim was to trigger the necessary discussions and achieve material progress in the

months preceding the closure, in spring 2019, of the current legislature of the European Parliament.

Our political leaders assigned priority to the completion of the Banking Union, with the establishment of a common fiscal backstop for the Single Resolution Fund, and the introduction of a common European Deposit Insurance Scheme (EDIS) with eventual full risk mutualisation. Both are essential elements to sever the links between banks and sovereigns and to bolster the ability of the area to deal with large macroeconomic shocks. The development of the Capital Markets Union is surely another key project that deserves to be mentioned at the top of the political agenda.

Leaders also agree on the need to reduce risks in banks' balance sheets, including –but not only- the stock of non-performing loans, which is still too large in some jurisdictions. Current proposals to create Sovereign Bond-Backed Securities (SBBS) could contribute to reduce current home-bias in bank's sovereign holdings if accompanied by regulatory reforms that ensure acceptance by investors. But these reforms should be carefully calibrated to avoid hindering liquidity and price formation in sovereign bond markets.

But there are other issues that will require more time to agree and to put in motion. As most of the empirical evidence points out, risk sharing channels are substantially weaker in the euro area than in other monetary unions, but also when compared with large countries inside the euro area, so that a larger share of idiosyncratic or national shocks to income **cannot** be smoothed out. Upgrading the efficiency of risk-sharing channels, both private and public, and better exploiting the synergies among them would provide the euro area with the shock-absorption capacity and the improved access to cross-border equity finance that is currently lacking.

On the fiscal front, the euro area needs to achieve eventually a more complete fiscal union. Some form of semi-automatic cyclical insurance mechanism against asymmetric shocks could be designed to make it possible more risk-sharing without entailing permanent transfers between countries. Depending on modalities, such an instrument could also contribute to smooth aggregate shocks, achieve a more balanced policy mix and increasing sharing responsibilities with monetary policy.

In addition, the EU rule-based fiscal framework needs to gain in simplicity and transparency. Recent proposals, which seek to give greater weight to public debt as a medium-term anchor and to the expenditure rule as an operational tool, deserve consideration. At the same time, increased national ownership should be fostered by enhancing the oversight role of independent fiscal authorities. The aim being to generate enough room for maneuver during good times, so that the stabilising capacity of fiscal policy may be larger at crisis times.

In sum, a lot of work remains to be done both in the near- and in the medium-term. These perspectives underpins the agenda of today's Seminar, which we have organized around two panels.

A first panel, on ***Short-term Challenges towards a Complete EMU***, will discuss the reform agenda that is feasible to pursue in the current European parliamentary cycle (until 2019).

In a second panel, on ***Long-term Prospects for a Cohesive EMU***, we would like to address the medium- to long-run steps necessary to increase the euro area's capacity to prevent crisis and to manage them.

Finally, Economy Minister Ramón Escolano will close the Seminar explaining the strategic vision underlining the recent proposals on EMU architecture articulated by the Spanish government. The proposals constitute, in my view, a politically realistic program to advance the process of governance reform in the short-term without losing sight of the longer-term needs. The final goal being providing the EMU with a more solid institutional framework that help ensure the prosperity and well-being of euro area citizens and improve the public perception of the integration project.

Now, according to the agenda, I give the floor to the moderator of the first panel, Paloma Marín.