VIABILITY AND FUTURE OF THE EUROZONE

1. The European Journey

The Chair welcomed participants to the discussion. Remembering when the euro started and the excitement surrounding it, the Chair asked Pierre Gramegna what can be done now about the structural weaknesses in the eurozone.

1.1. Europe has come a long way since the crisis

Pierre Gramegna stated that the euro was greeted with scepticism by some who said it would never work. It went well for 10 years before the world financial crisis and the subsequent euro-area crisis. With many not fulfilling the criteria of Stability and Growth Pact (SGP), there were those who thought the euro would sink. Instead, Europe has come out of this 'teenage crisis' stronger, with the Banking Union (BU) and the Capital Markets Union (CMU).

The BU was agreed upon at ECOFIN meeting in December 2012, followed the next day by newspaper headlines claiming it would never be implemented. ECOFIN has now implemented 75% of the BU. Banking supervision for the European Central Bank is working fine and the euro-area has been strengthened. Additionally, the activity surrounding Brexit has given more popularity to Europe and the euro now has the support of 75% of people across Europe. It is the second most important international currency, although much remains to be done.

The Chair asked Pierre Gramegna how Luxembourg perceives certain structural weaknesses. Luxembourg has seen immense success and is still growing well. It has no issue with debt, but there is some concern that certain of these weaknesses still persist and have now persisted for a long time.

1.2. Europe must continue with structural reforms and sound fiscal policies to make its economies more resilient and competitive

Pierre Gramegna believes that in the past 20 years no country apart from Luxembourg has been able to fulfil and comply with the rules of the Stability and Growth Pact (SGP) all the time. A number of goals must be achieved. First is that most or all countries must fulfil the fiscal criteria for their own good. The Maastricht criterion is there because it means the appropriate management of public finances. Analysis is needed on how to improve that alongside more economic and social convergence in Europe. In the last six months there has been agreement on strengthening the European Stability Mechanism (ESM) which, by June, will play a larger role in preventing crises and will have more tools for when a crisis occurs.

Second is the new budgetary instrument of the euro-area. Much progress is being made, and convergence is growing on there being two main goals: ensuring that countries that are weakening can still invest to become more productive; and determining how a new budget instrument can make countries that are lagging behind, and cannot fulfil the SGP criteria, undertake the necessary structural reform.

A third goal relates to governance. It is important not to duplicate or complicate mechanisms. At present it is difficult to explain to people that the EU has the right ideas on how to strengthen the euro-area but they will take three or four years to implement. The EU must become faster and more efficient.

The Chair believed that the structural current account deficit and surplus countries look locked in and unchanging. Some countries' public sector debt is actually increasing post-crisis with economic growth in Europe, whereas others' debts are decreasing. Such structural disequilibria are urgent to address, but this is a very difficult issue to solve.

1.3. Reaching greater economic consistency and ensuring the sustainability of our economies

Pierre Gramegna agreed that there are discrepancies in current accounts in Europe, although a retrospective look shows countries becoming more efficient and productive compared to each other. The EU is the export world champion. Part of that is the intra-EU commerce, but Europe is also extremely efficient: productivity, for example, has increased on a regular basis in most countries. Every country should specialise, following leaders such as Germany in cars and machinery, France in aircraft and power, and Luxembourg in finance. With every country specialising, there will be a critical mass and knowledge.

Pierre Gramegna noted that digitalisation is a game changer in the world of tomorrow that will disrupt the business models of today. Europe is a pioneer in the fight against climate change and is far ahead in clean and renewable energy. This is a European success story, but the road was very long.

The Chair asked whether Pierre Gramegna agrees that unless Europe can grow its economy by above 1% over a sustained period these structural problems will remain, or it will be very politically difficult to solve them. It is important to identify key areas for the next political cycle where the EU can ramp up economic growth and get to grips with these structural issues. Pierre Gramegna responded that 1 2% growth is necessary, and will require focus on sustainable growth, as Europe already treats the environmental and social aspects.

2. Europe is in the middle of the road

Bruno Le Maire stressed that, looking at the past, many things have already been achieved to enforce eurozone architecture, including financial assistance mechanisms, the first two pillars of the BU (the Single Supervisory Mechanism and the Single Resolution Mechanism) and the procedure to monitor macroeconomic imbalances. Europe is currently in the middle of the road: after the European elections it can either reinforce the eurozone by taking tough decisions to position all 19 member states to be able to face any kind of financial crisis or face the risk of a total weakening of the eurozone.

2.1. Reducing economic discrepancies, addressing banking fragmentation and advancing the CMU are urgent priorities

Bruno Le Maire observed that the current situation sees a striking rise of economic and financial divergence among eurozone member states. There is no future while those differences continue to grow. The first purpose of common monetary union is to reduce this divergence. Divergence in the situations of member states of a shared monetary union only creates structural difficulty.

Strong decisions must be made. First is to reduce banking fragmentation within the eurozone. The BU must be completed in weeks, not years, otherwise it will not take all the benefits possible from a common monetary union. Second, a eurozone budget must be established as soon as possible, with governance that will be decided by the 19 eurozone member states. Third, is to have the CMU. Europe currently does not take growing benefits from the eurozone and EU financial market because there is no CMU. In 2018 equity levels across the world sat at €100 billion in the US, €80 billion in China and €20 billion in Europe. Europe is the first market and the strongest union from an economic perspective, but the level of equity is far from the US and China. Examining the equity figure and lack of a CMU in Europe indicates why there is no European Google. If Europe can take the decisions necessary for an EU 27 CMU, a 19 member state BU and the eurozone budget, it will be the biggest economic and financial power in the world. Tough decisions must be agreed if Europe wants prosperity, growth and more jobs.

The Chair questioned whether participants are confident there can be greater convergence on the structural problems at the heart of the eurozone and disequilibria on the current account side, and how Europe will get there if so.

Pierre Gramegna stated that the EU has achieved 75% of what it needed to do. The markets have recognised the need for deposit insurance at a fully European level, which will provide stability and credibility, and a common umbrella across Europe. Non-performing loans (NPL) must be reduced, and that is about to happen. Reducing NPL is easier in times of growth, and Europe has seen seven years of growth, with growth in all euro-area countries in the last two years.

Pierre Gramegna agrees with Bruno Le Maire that the CMU must be completed. While solutions have been found on 13 of the 16 directives being negotiated, it is unfortunately likely that the press will comment on those three that do not yet have solutions.

Bruno Le Maire emphasised the need for the completion of the last step. It is the most difficult and the most interesting. Europe must achieve BU to mitigate the loss of financial means and tools in the banking market that growing fragmentation causes in the eurozone.

The ECB reports that over €300 billion of liquid assets are locked due to ring-fencing, meaning more new rules are being implemented at the national level. If a European supervisor is sufficient and European rules are enough then Europe must eliminate the new national requirements and rules that lead directly to ring-fencing, which means a loss of financial resources for growth and economic development.

There are two points to tackle as soon as possible. First, the EU continues to add more national requirements, but there is a European supervisor which should lead to a removal of those national rules. Second, the rules differ inside and outside the BU; the requirements inside the BU are greater than they are outside, which is something nobody understands.

2.2. A euro-area budget with permanent resources and a euro-area governance should support the competitiveness and convergence of Euro-area economies

Bruno Le Maire outlined that it is up to member states to make the necessary decisions for more convergence within the eurozone. Taking the first step means two things: obeying the European requirements for their budgets and taking structural decisions to improve the competitiveness of their economies.

France leads in this respect, having taken the necessary decisions to obey European law and be under 3% of public deficit, despite the resulting Yellow Jacket movement. France has also taken strong structural decisions to improve competitiveness. The Ministry of Economy and Finance has introduced a full overhaul of the French taxation system, and a reform of the job market and pension system is underway. The European response must be more solidarity within the eurozone and more convergence through a eurozone budget. Explaining these changes to the French public does not make sense without anticipating eurozone solidarity and efficiency.

To achieve more convergence and solidarity in Europe and among member states, national governments and the eurozone budget each has a role to play. There is no time for those crying out for reform but unwilling to move towards more solidarity and convergence in the eurozone. There is no future for the eurozone if one asks for more effort from member states without giving more solidarity. The Chair summarised that Pierre Gramegna also feels that so called surplus countries must make efforts, and that solidarity includes efforts by surplus and deficit countries towards convergence.

2.3. Solidarity does not mean a transfer union

Bruno Le Maire stated that solidarity does not mean a transfer union. There should be no transfer union. If Europe faces a crisis, it needs solidarity among the member states. Without solidarity there is no future for the eurozone. Pierre Gramegna agrees. Luxembourg supports more solidarity. He warned that everyone must respect the rules of the SGP over time. There may be difficult years, but that is acceptable. A transfer union cannot be explained. The message to spread is that Europe is about solidarity, a sentiment that started in the 1950s when everybody wanted to make peace.