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Restoring capital mobility in the euro area

During the decade from 2000 to 2010, there was a high level of capital mobility within the Eurozone but it mostly resulted from inter-bank funding which supported the financing of inefficient investments (e.g. in real state bubbles, sub-optimal business ventures and infrastructure projects notably in Spain, Italy, Portugal, Ireland and Greece) and which contributed to massive current account deficits. The 2011-2013 sovereign debt crisis halted the circulation of capital flows around Eurozone and EU countries.

Since then, financial flows between the Eurozone countries have declined; there has been a fall in cross-border loans in the euro area[1]. The share of the government bonds held by non-residents has dropped. Investors' and banks' portfolios have increasingly became national following the sovereign debt crisis.

Member States with excess savings (Germany and the Netherlands in particular) no longer finance investment projects in lower per-capita-capital countries (Spain, Italy, Portugal, Greece). Indeed the euro area exhibits from a savings surplus of more than €300 billion or 3,5% of GDP in 2017, which is no longer being lent to the other euro-area countries but to the rest of the world excluding the euro area.

Developing cross-border financial flows within the euro area is essential. The true objective of a currency area is that savings should flow to finance the most productive investments throughout the currency area. Indeed in a monetary union, the elimination of currency risk allows savings from the countries that have a high level of per capita capital (Germany, Netherlands, France) to finance investment in the countries with lower per capita capital and higher marginal productivity of capital (for example Spain, Italy, Portugal). Income convergence therefore normally stems from the transfer of savings from high per capita income countries to low per capita income countries. But, as mentioned above, these transfers disappeared in 2008-2010.

The fact that Germany's and the Netherlands' external surpluses are no longer lent to the other euro-zone countries reduces the capacity of peripheral countries to invest as well as their potential growth, and increases the per capita income heterogeneity in the euro area.

Symmetric economic adjustment in countries with large current account imbalances would significantly contribute to restore capital mobility in the euro area

Symmetric economic adjustment in countries with large current account imbalances is a prerequisite for restoring capital mobility in the euro area and achieving a durable rebalancing in the euro area. The pattern of euro area rebalancing that predominantly relies on "adjustment in weaker countries" is not sustainable either politically or economically. Lack of solidarity and an unjustified mistrust towards countries with lower productivity will indeed feed populism in Europe and undermine the cohesion of the euro area. In addition, lasting and excessive current account surpluses are not sustainable within a monetary union because they result in effect in creating currency advantages for the best performing countries. This is true also at the international level, as illustrated by the recent complaints of the US administration. Symmetric economic adjustment both in deficit and surplus countries is therefore a prerequisite for a durable rebalancing in the euro area.

We should not forget that countries with persistent current account surpluses are receiving a significant currency subsidy. It is estimated[2] that Germany's exchange rate is 20 % undervalued (in terms of real effective exchange rate towards the euro area); its correction would imply arithmetically a 2% annual inflation rate in Germany and a 0% inflation in the other countries for a decade, which would be unrealistic and probably misconceived.

This is not a matter of fiscal redistribution or a «union of transfers», but of correcting a «fundamental imbalance» which jeopardises the survival of the euro area[3] and threatens the functioning of the international financial system.

The proposal for a European savings-investment Fund

The proposal for a European savings- Investment Fund made to reinstate this capital mobility between countries in the Eurozone also needs to be taken up. This Fund would offer long maturity savings bonds to euro area households and life insurance companies with a guaranteed minimum rate of return over the holding period. Public domestic Development Banks would guarantee the minimum interest rate and the redemption of these savings bonds would provide that these savings are held for a sufficiently long period of time (e.g. until the retirement of the saver) and are invested in diversified portfolios mostly in euro equities[4].

The completion of financial integration

Encouraging an active banking and capital market in Europe whereby the North's surplus savings could find their way to invest in the South is essential. This push of capital mobility will of course not bear fruit unless the ecosystem is conducive, especially as regards the training and skills of young people and the development of innovation and new technologies in the South in particular.

By contrast in the US, it is the private market flows that take care of some 80% of the adjustment in case of asymmetrical shocks while fiscal federal transfers are very limited, less than 20%. This is why the Banking Union needs to be optimised and the so called "Capital Markets Union" should be concretely worked on.

It is of paramount importance for public decision-makers to strengthen the Banking Union by setting up a meaningful backstop to the Resolution Fund and addressing the concerns of host countries regarding the EU crisis management framework in order to eliminate the present ring fencing of capital, liquidity and bailinable

[1] Patrick Artus, The reasons why capital mobility between euro-zone countries should be restored, Flash Economics, Natixis Research, 4 April 2018.
[2] CEPII, "Some unpleasant Euro Arithmetic", Policy Brief No 21, January 2018.
[3] Didier Cahen and Jacques de Larosière, "Ensuring a viable EMU: are we on the right track?, September 2018.
[4] Thomas Mayer, Olivier Garnier, Edmond Alphandéry and Jacques de Larosière, "Proposal for a European Savings Investment Fund", Brussels, Euro 50 Group 2014.

liabilities which is hindering the operation of true transnational banking groups in the Union. Given the high degree of banking intermediation in Europe, compared to other jurisdictions around the world, striving for a smoother movement of capital and liquidity, across EU countries, is essential.

The Eurofi paper on "Optimizing the Banking Union" describes two conditions to allow capital, liquidity and bail in instruments to be defined only at the consolidated level (abandonment of the solo approach).

In order to reassure local supervisors, European transnational banking groups that wish to operate in an integrated way need to commit to providing credible guarantees to each subsidiary located in the euro area in case of difficulty and before a possible resolution situation ("outright group support"). This group support should be based on EU law and enforced by EU authorities.

In addition if the group was to go into liquidation (and not only local subsidiaries), a European approach to liquidation of these transnational banking groups is also required. Indeed despite the fact that these transnational banking groups are supervised at the EU level and that the impacts of this liquidation would impact the whole euro area, the liquidation is still managed at the national level (entity by entity) and this can require public money from the Member State.

A common liquidation regime for these banking groups should ensure an equal treatment of creditors of the same rank within the group and to address the possible costs at the EU level. In an interim stage however, a solution would be to extend to subsidiaries the liquidation approach currently used for branches, whereby resolution is managed under the regime of the parent company. This would allow all the subsidiaries of the Group to be treated under the same liquidation regime.