SESSION SUMMARY - BERLIN SEPTEMBER 2020

Is the EU response to the Covid 19 economic crisis fit for purpose?

1. Europe's response to the pandemic is a significant step forward Europe responded quickly and appropriately to the pandemic with several measures designed to help the most affected countries

1.1 A major achievement

With the Coronavirus Response Investment Initiative (CRII) the European Commission aimed to mobilise around €50 billion for crisis repair. Ventilators and medical equipment were supplied in Spain, innovative syringes in Belgium, telemedicine in northern Italy, small and medium enterprises in Greece, tele schooling in Poland, and masks, ventilators and small and medium enterprise jobs everywhere.

An official considered that a common response from the European Union to the crisis has been achieved, which started with the immediate measures of activating the general escape clause, the exceptional framework concerning state aid, CRII and the extension of the solidarity funds taken in March and the April decisions by the Eurogroup for the €540 billion programme. A temporary solidarity Instrument (SURE) has been established to support protecting workers and jobs in the current crisis. The EIB will create a pan-European guarantee fund of €25 billion to support up to €200 billion of EU businesses, in particular SMEs, throughout the crisis. The ESM has also provided pandemic crisis support, in the form of precautionary credit lines. The only requirement to access the credit line being that euro area member states requesting support commit to use this credit line to support domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID-19 crisis.

In July, the European Council agreed on a Recovery and Resilience instrument and a new Multiannual Financial Framework (MFF) for the period 2021-2027, with an overall package worth €1.8 trillion. Trilateral discussions started as quickly as possible.

A policymaker commented that common borrowing to scale up the common budget to an unprecedented dimension to finance a green, digital and balanced recovery has never occurred before in the history of the EU. The Recovery and Resilience Facility (RRF) comprises €312.5 billion in grants and up to €360 billion in loans to support public investments and reforms. The Commission has established a new Directorate General, DG Reform that will support member states to implement such structural reforms.

1.2 Europe reacted swiftly and appropriately to the pandemic

A public representative emphasized that the European Parliament was very pleased to see the responsiveness of European institutions. All the draft reports related to the Next Generation EU Plan have been prepared by the ECON Committee. Amendments are being tabled, which will soon move to compromises. The plan is to vote everything in the Committee by October. The biggest one, the RRF, should go to the plenary in early November. It is vital that the ratification process of member states should start as soon as possible.

An official stated that all institutions have learned the lessons of what occurred in the Global Financial Crisis (2008). The rapidity of the reaction is extremely important. There is confidence that the EU agreement will be finalised with the European Parliament and the Council of the EU by the end of the year so that everything can start in January. Support for the economy is needed, both in the very short term and in the long term. There will be new challenges on how to use this money effectively and to ensure that it is well spent. Each country in Europe is in dialogue with the Commission to ensure that it is well used. The green dimension is fundamental.

An International Financial Institution (IFI) representative commented that they are impressed by the size and the speed of the package, especially compared to what the EU tried to achieve in 2008 to 2010. The sense of emergency responsibility has been there, and the employment and investment priorities are clear.

An industry representative pointed out that the handling of the first wave was a quick and appropriate answer to something extraordinary. European and national public authorities and central banks deserve credit for providing answers, which have dramatically limited the damage, particularly in the financial sector. A second phase will be a massive shock. More long-term structural growth needs to be rebuilt, which this package will contribute to. In itself, it will probably not be enough, but at least it is a significant and very structural element.

1.3 A common answer viewed positively by the markets

Another industry representative is of the view that the package is larger than the market expected. The EU has been much more coordinated in its response to the pandemic, having learned in the aftermath of the Global Financial Crisis (GFC) that much coordination is vital. The package is large enough that it makes a difference economically. Europe is leading the way globally, whether it is on digital or green, which are the right priorities to focus on.

1.4 Implementing the EU recovery agreement quickly is essential

An IFI representative commented that what has been very striking is the speediness in decision making. The speediness of delivery is very important, as well as the instruments being workable by the private sector and smartly linked to reforms.

An industry representative considered the capacity to implement this EU recovery plan quickly crucial. Banks have worked very efficiently with national authorities and governments. It is important to contribute to finding more structural solutions to help, as well as limiting the

destruction of production capacities. Money is needed, with a different split between equity and debt. Europe needs to have a financial system, which would be able to accompany structural growth and fund productive investments.

2. Much remains to be done

2.1 Avoiding a self-congratulatory feeling

An industry representative warned against the emerging self-congratulatory feeling about having managed the first wave of the crisis. The virus is going to be with the world for a long period of time, and Europe needs to look at whether it will have the resilience and the dynamics to manage this long-lasting crisis. Europe has managed the first wave of the crisis despite its complexity rather than because of it. Meanwhile, some projects have been put on the backburner for a few months or quarters, such as the Banking Union (BU) and the Capital Markets Union (CMU) with appropriate involvement of international players. Other issues like structural domestic reforms have been on the backburner for years or decades.

Europe needs to refocus on reforms and more agile and dynamic structures are needed in decision making within the EU. Some EU countries that had many buffers in their systems coped well early on with the crisis but it is important to re-establish more sustainable structures in almost every dimension of the EU; first and foremost this would involve the BU and the CMU. This crisis is a great opportunity because the Recovery and Resilience Facility is a sizeable fund. However, Europe has reacted in an instinct to finance projects through debt, rather than admitting that if there are European tasks and expenditure then Europe needs to design revenues (own resources) for the European level in order not to rely on the debt only, as it has always done in the past.

2.2 Fiscal risk in the monetary union has not been addressed in/by the EU fiscal agreement

An official considered Austria as one of the countries that has been more critical and difficult in the process but agrees that the response taken is the correct one. Austria is still sceptical because there are some problems in the medium term that the markets have not yet priced in. Pouring lots of liquidity into the market by mutualising debt but not strengthening fiscal rules cannot be repeated.

The main economic weakness of the euro area stems from unsustainable public and private debt in a number of member states. Before the 2009 crisis, diverging debt developments were not a major concern for investors. Some member states are now in a particularly weak position to address the economic fallout, and differentiation according to country risk has re-emerged. There will be huge political problems if the EU member states do not do their homework.

An IFI representative stated that the lessons of 2010 need to be drawn on, to use the market condition and the action of the ECB to avoid excessively quick fiscal tightening at this stage. At some point this will require the Stability and Growth Pact (SGP) to be back in the equation, otherwise the very disruptive opposition between frugals and spenders will come back in the coming months and years.

An official noted that for a number of countries the EU recovery plan is a huge amount of money. It needs to be used as leverage for reform. Discussion is needed on the fiscal strategy and fiscal consolidation. State aid is a short-term challenge. The Commission reacted very quickly, adjusting its state aid framework to facilitate liquidity support for companies through banks and balance sheets. That needs to be phased out and to move into 2021, because there is a temporary state aid framework until the end of 2020. Traditional issues such as the CMU and the BU need to be brought back into the discussion, as the impact of the crisis on the financial sector will be very important and there will be some scars.

2.3 Finding agreement on increasing the EU's own resources will be challenging

2.3.1 New own resources to repay EU Borrowing

An official hoped the informal Ecofin taking place in Berlin would be used to start the debate on the conclusion of the July EU summit on own resources and to strengthen the own resources of the European Union. A dedicated session would take place at the informal Ecofin that would cover the question of the specific own resources that were named, such as the European Emissions Trading System (ETS), the Carbon Border Adjustment (CBA), new plastic levy, digital tax, and the Financial Transaction Tax (FTT).

An expert asked a public representative how they see the own resources discussion in the European Parliament, and whether it would be supportive of those ideas. The public representative stated that the European Parliament has been supporting this for a very long time. Another concern was that the significant effort currently being put into the recovery fund might have a negative effect in the long term on the budget and MFF. That is, if additional, genuinely new own resources are not found to ensure that in the future there is the room to pay for both debt and to support the European programmes that the EU would like to continue to support.

2.3.2 The introduction of new own resources will be a medium to long-term project

An expert noted that a number of proposals have been put forward for the own resource package, such as border adjustment tax, plastics tax, and even a financial transactions tax. It will be very difficult to agree. An official agreed. The concept of unanimity will make it difficult to achieve agreement, but the plastics duty was unanimously agreed. That was a first step, and there was agreement to discuss others. The Carbon Border Adjustment Tax could be a very important shift towards pricing in some of the negative externalities seen.

An official considered that this debate has been with the EU for a very long time. There is now a new incentive, which is that the debt will have to be repaid; it will be much better to find new resources to do that. The discussions in the informal Ecofin are eagerly awaited. It is unlikely the 27 would have an agreement on enhanced cooperation. ETS makes a great deal of sense because it is completely consistent with the green agenda.

An official had no illusions about the difficulty of that debate and expected that the issue of repaying the debt for the next generation EU will give the debate on own resources a new push. The biggest surprise at the leaders' conclusions was the inclusion of the words 'financial transaction tax'.

3. The crisis presents an opportunity for CMU, BU and the digital union projects to be moved forward

The crisis has caused significant market disruption, but the projects which could assist recovery are already underway.

A political agreement at the EU Council of Head of States is required for achieving a more genuine single market for financial services.

3.1 For more integrated banking and capital markets in Europe

An industry representative anticipated the world in which banks are going to operate and compete to be even more complicated than six months ago. There is intense competition, a world of tangents, a world of uncertainty, and a world of low rates, sometimes negative, for a very long time. The banking sector needs to absorb the shock but also to finance the economy and projects. Europe needs to be better integrated. Accessing a diverse pool of equity financing requires deep capital markets and consideration should also be given to the coordination of supervision, and the relative tax and regulatory treatment of debt and equity.

Another industry representative stated that the CMU needs to be a priority for the Commission in order to help banks to recover, consolidate, and develop securitisation markets. Investment in digital finance and the green deal needs to take place over the next 10, 20 and 30 years and cannot be done by bank finance alone.

An industry representative was encouraged to hear that there is a willingness to make further progress. The industry will see formidable challenges, such as digital transformation, and needs to be able to invest in order to transform. The industry needs to be able to generate the capital that is required for Europe. The gap has widened with the US, both in terms of profitability and market value. Securitisation sometimes has a negative connotation in people's minds due to the financial crisis, but at the same time it is an instrument which is at the heart of the development of capital markets. Such markets are not just equities or bonds. The industry needs to try to find out what is needed to further improve and deepen the securitisation market and make people more comfortable with this relatively simple and necessary tool.

3.2 Reaping the benefits of a single market for financial services

Unlocking the single market's full potential and the complete range of its benefits, especially in financial services, will provide the much-needed funding to support economic recovery and finance a sustainable transformation. One of the key challenges to overcome in the deepening of the single market for financial services has been regulatory fragmentation. While much progress has been made, hundreds of millions of EU consumers, businesses, and the bloc's overall economy are still not reaping the full benefits of the single market.

3.2.1 The single banking and financial market has not been achieved so far

An industry representative stated that overcoming regulatory banking fragmentation should be a first step. National options and discretions in the prudential framework should be further harmonised in order to avoid unwarranted ring-fencing practices and let banking groups allocate capital and liquidity across multiple legal entities as are needed and are economically sensible. There are still more than 30 provisions, which require further harmonization. Further steps to complete the BU are also needed, particularly a single EU crisis management framework for further risk reduction measures and a common deposit guarantee scheme. EU depositors should be able to move and use funds across and in different countries seamlessly and without additional charges.

An IFI representative stated that overcoming the fragmentation of capital markets and ring-fencing practices should be a priority. The most difficult response is completing the BU. Europe needs to look at softer ways of coordination between supervisors and the private sector. The Vienna Initiative has worked well. Regarding the CMU, the EBRD is trying to oversee the development of local capital markets in smaller markets and has created a pan-Baltic capital market.

3.2.2 Drawing the lessons of the US experience?

An industry representative explained that, regarding the BU and the CMU, Europe is still awaiting what the US had in 1863 when it created the National Bank Act, which supports uniform U.S. banking policy. Europe still has international bank account number (IBAN) codes that are allocated at national level rather than a single EU IBAN allowing IBAN discrimination within payment systems. This needs to be overcome to establish a truly integrated single European payment platform, given the payments system is the backbone infrastructure of the financial system. In addition, the EU has a single supervisor but is still a conglomerate of 27 countries with 27 regulators and another regulator on top, which adds to the complexity. It is important to start at the European level and have European chartered banks that can work across jurisdictions. Europe needs to create a European league of banks if it wants to create European markets, rather than just national champions.

An official agreed with most of what has been said on the BU, but the US is slightly overrated in that respect and Europe is underrated. The ban on interstate banking in the US was a complete ban. One issue where Europe has an advantage is the supervisory system. It does not have the Office of the Comptroller of the Currency (OCC), established in 1863. The US also has state regulators, state chartered banks, national chartered banks, financial holding companies, and the system of functional supervision where every regulator just looks at function, leading to the fact that a financial institution in the US sometimes has to deal with 15 different supervisors. Europe is lucky not to have that. However fresh thinking is needed in Europe in some areas. The Single Resolution Fund and deposit insurance should be one fund in Europe as in the US and this could make the discussions on EDIS easier. Regarding the CMU, for a long time US banks were banned from holding equity in non financial companies, so there was no way a corporation could get equity from a bank. Naturally, that led to the fact that the US needed to develop capital markets out of sheer necessity. It was not by design; it was by default.

3.2.3 The benefits of a single market for financial services

An official agreed that many empirical studies have shown that when the US relaxed their restrictions on interstate and intrastate banking in the 1990s there was an increase in growth potential due to a better provision of lending and cross-state banking services. The European Union has a buffer that can still be accessed if it finally agrees to enact the Lisbon Treaty. The sister project is the CMU. If Europe wants its banks to scale, then it has to find an idea of how it can move away from the massive overweight of bank lending that it has in terms of the provision of financing to its real economy. That allows the corporates to also fund themselves through markets, which is the second big potential that Europe has in terms of catching up with the United States.

An expert noted that not all barriers inside the United States have been broken down, such as in insurance. The expert

asked whether panellists are convinced by the economic evidence of that, and whether the policies introduced in the 1980s and 1990s actually increased the growth potential of the United States.

An official stated that the empirics are there. It is impossible to imply direct causality, but it is a very reasonable assumption.

An industry representative considered that in the US the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (IBBEA) brought significant efficiency gains. Banks and holding companies were heavily regulated and had lost competitiveness to more innovative, less regulated entities. Lastly, Europe does not need a Glass–Steagall Act because European banks are not big players in investment banking.

3.3 Achieving a political agreement at the level of the Council of Head of States is essential for moving forward

A public representative noted that the European Parliament shows a bipartisan, horizontal desire for a real European capital market, and for seeing the Lisbon Treaty fully implemented. The problem is that every time Parliament tries to push these issues there are 19 or 27 national authorities that could be sceptical or unwilling to give up their own prerogatives and competences.

An expert considered that the High-level report on the CMU has put a great deal of emphasis on a new type of process. There has to be political agreement at the highest level.

An official noted that there is a lack of progress on the BU and the CMU. It is unclear whether the crisis would help, because on banking issues the previous crisis had more of an effect to entrench national positions and enhance barriers to avoid the risk of having a subsidiary left alone without liquidity. The key element is whether Europe wants to be dependent on external banks and US banks, or whether Europe wants to have its own capacity to think of itself as an independent power with its own infrastructure and financial capacities (intermediaries, investors, products...). ■