Senate Standing Committee on Economic Planning, Budget

Rapporteur: GUERRIERI PALEOTTI

Rome,

<u>Resolution on documents:</u>

(86) Report from the Commission to the European Parliament and the Council on the Appropriateness of the Development of a European Creditworthiness Assessment

for sovereign debt (COM (2015) 515 final)

(87) Communication from the Commission to the European parliament, the Council and the European Central Bank on steps towards Completing Economic and Monetary Union (COM (2015) 600 final)

(88) Council Recommendation On the establishment of National Competitiveness Boards within the Euro Area (COM (2015) 601 final)

(89) Communication from the Commission to the European Parliament, the Council and the European Central Bank “A roadmap for moving towards a more consistent external representation of the euro area in international fora” (COM (2015) 602 final)

(90) Proposal for a Council Decision laying down measures in view of progressively establishing unified representation of the euro area in the International Monetary Fund (COM (2015) 603 final)

(91) Commission Decision establishing an independent advisory European Fiscal Board (C (2015) 8000 final)

(92) Commission Decision withdrawing Commission proposal for Council decision on the Representation and Position Taking of the Community at International Level in the context of Economic and Monetary Union (C(2015) 8001 final)

The Budget Committee,

following consideration of the documents above,

whereas:

On 21 October 2015 the European Commission adopted measures to implement the first phase of the process leading to the completion of the Economic and Monetary Union as set out in the Five Presidents' Report: Completing Europe's Economic and Monetary Union of 22 June 2015, and illustrated in detail in the Communication on Steps towards Completing Economic and Monetary Union (COM (2015) 600);

With a view to the Budget Union, the European Commission has approved a Decision – immediately operational – establishing an independent advisory European Fiscal Board (COM (2015) 8000 final) (Commission Decision (EU) 2015/1937;

With a view to the Economic Union, the European Commission has presented a Council Recommendation on the Establishment of National Competitiveness Boards within the Euro Area (COM (2015) 601 final);

With a view to the Political Union by gradually strengthening democratic control and the legitimacy of the institutions, the European Commission has adopted a Roadmap for Moving towards a more Consistent External Representation of the Euro Area in International Fora

(COM (2015) 602), and the proposal for a decision laying down Measures for Progressively Establishing Unified Representation of the Euro Area in the International Monetary Fund (COM (2015) 603 final);

For the first phase of deepening the Economic and Monetary Union, the European Commission has also adopted a package on the Capital Markets Union which is of relevance to the Financial Union, including a Communication ("Action Plan on Building a Capital Markets Union" COM (2015) 468), two proposals for a Regulation on Securitisation (COM (2015) 472) and on Prudential Requirements for Credit Institutions and Investment Firms (COM (2015) 473), and a proposal for a Regulation to establish a European Deposit Insurance Scheme (COM (2015) 586);

The measures provided by the Community documents referred to above are not yet operational, because neither the National Competitiveness Boards nor the advisory European Fiscal Board have been established;

Also whereas:

The outcome of the United Kingdom referendum to leave the European Union will lead to long and complex negotiations to define the content of the divorce, thus opening up a whole new phase for Europe, fraught with risks and uncertainties. In order to respond adequately to the present challenges, EU countries must show their determination to proceed further with the integration process by reviving and renewing its motives and content;

Dissatisfaction and malaise regarding the present difficult economic conditions of the EU have certainly played a role, together with more contingent domestic factors, in determining the outcome of the British referendum. In particular, after many years of stagnation, the present economic recovery of the euro area is still too modest both to appropriately respond to the economic and social costs brought about by so many years of crisis, and to address the high unemployment rates that still characterise the euro area, particularly South European countries;

The present phase remains critical and there are risks of a prolonged low growth of the Monetary Union in the medium term, which is likely to give a boost to the various anti-European and nationalist political movements, to varying degrees of extremism, like those proposing the return to national currencies;

To increase the real and potential growth of the euro area as a whole, the ECB's non-conventional expansionary monetary policy (Quantitative easing or QE) is not enough and it must be backed up by other measures and policies. Among them there are the structural reforms, which many countries are already implementing. They can offer a very substantial contribution towards improving the economies' potential supply-side performance. Certainly, more could and should be done to speed up and intensity ongoing reforms;

In this regard, the involvement of independent experts through the National Competitiveness Boards could help to support the reforms being implemented by Member States. One should add, however, that these structural reforms can bring positive effects only in the medium and long-term; while in the short-term, their impact on demand and growth due to increasing real interest rates will be virtually nil, if not negative;

It follows that to enhance the positive effects of structural reforms, policies supporting aggregate demand should be put in place. This is not being done in the euro area – or if at all, only minimally – as shown by the high output gaps (i.e., the differences between potential and actual incomes) which are still very significant in many European countries;

Expansionary fiscal policies should be implemented for the euro area as a whole. That implies more symmetrical adjustments among Member States than was the case in the past and the use of the 'fiscal space' available in a few countries. In this perspective the establishment of an independent advisory European Fiscal Board might help to ensure that more effective fiscal policies could be implemented in the euro area as a whole

A significant deepening of economic integration process is needed as well, together with greater centralisation of decision-making process at the European level. In this perspective, the completion of the Banking Union is an absolute priority, with its three pillars (Single Supervisory Mechanism, Single Resolution Mechanism, European Deposit Insurance Scheme) since it has always been considered a crucial ingredient of the efficient functioning of the European monetary area;

By strengthening the external representative unitary role of the euro area could help to give it a more active and effective role in International financial institutions (Ifs), also for the purpose of drafting new rules and mechanisms to formulate cooperative solutions. One should consider that in the present global environment, the conditions to ensure stable growth are identified as a "public good" in other terms as a result of international coordination and cooperation of economic policies of main areas and countries.;

expresses a favourable opinion, with the following observations which our Committee is confident the Commission will take into consideration when drafting a White Paper setting out the second stage of the Five President Report in order to deepen the Economic and Monetary Union, and by the European Parliament's Budget Committee and Economic and Monetary Affairs Committee in their Proposal on a fiscal capacity for the euro zone:

National Competitiveness Boards should aim not only at monitoring the so-called "factor costs" (prices and wages) of competitiveness, but also "structural factor" trends which are summarized in countries' productivity trends. As well known a competitive economy could be defined as a system characterized by high and sustained productivity growth rates over time. Different trends of productivity of individual member States are even contributing to the imbalances and divergences in competitiveness within the euro area today;

To address effectively these "productivity gaps" structural reforms in individual countries are needed so to achieve a more educated workforce, more efficient material and immaterial infrastructures, business environments which are more favourable to innovation and renewable energy. The National Boards should become the "guardians of structural competitiveness" of each country, with the responsibility to suggest measures to ensure the growth of productivity and analysing the impact on structural competitiveness of various policies adopted;

An independent advisory European Fiscal Board should contribute to implementing fiscal policies for the euro area as a whole, ensuring results in terms of fiscal balances of the entire euro system – the so-called "*fiscal stance*" of Eurozone. In this regard an effective fiscal policy for the Eurozone – with an anti-cyclical function to revive aggregate demand – cannot be achieved merely by pooling or indirectly coordinating national policies that are independently formulated according to existing rules. This is confirmed by the fact that even though fiscal policies today are no longer restrictive - as they were in 2011-2013 - nevertheless they offer only a modest contribution – neutral or only marginally positive – to the growth of the euro area, given the still strongly national character of the fiscal policies pursued by individual EU Member States;

Furthermore as to fiscal policy, it is necessary in the medium long-term to reaffirm the need to move in the euro area from a system of national decision-makings to the construction of a new overall fiscal capacity of the Eurozone. It should be a gradual path to follow in stages, but its final goal and direction must be clearly spelt out from today. The reason is that fiscal policy cannot be managed by just more or less automatic rules that individual countries are bound to respect. This is confirmed by the increasing complexity and lack of transparency of the existing rule-based system and the mounting difficulties encountered in enforcing these rules. All in all, it is only by moving towards a fiscal union - where a European Government and Parliament can contribute to decision-making on taxes and spending - that the Eurozone will be able to survive into the future;

In addition to fiscal policies, an important contribution to the growth of the euro area may come from the revival of investments. They have a peculiar role being able to increase both countries' aggregate demand and supply capacity. Private investments are today hampered by lack of demand and uncertainty dominating the international geo-economic environment. It follows that only a large volume of public investment could have a significant impact on economic growth in the euro area. As shown by many empirical studies, public investments could easily be funded in the present era of zero interest rates and could contribute – in the current wide margin of spare capacity – even to reduce the national debts of countries by generating additional income, production and employment;

As to the type of investments and how to implement them, it should be noted that the European Union has widespread weak points in several key areas, notably in research and development, innovation, information technology and communication (ICT), as well as developing new skills. To be competitive in an increasingly complex global economy, the European Union should encourage investments in these sectors as the core elements of the growth relaunching process. This should be done promptly, in order to better equip European industries to address global adjustment challenges. A further contribution could derive from the completion of the European internal market, by establishing a common research and innovation space;

To be effective at the euro area's macroeconomic level a new public investment plan – as shown by many studies – should make provision for investing an aggregate 600-800 billion euro. It is well beyond the size of the Juncker plan which, though positive, should only be seen as an important first step in the right direction. The huge resources needed can be found along several different paths: changing the present unfair fiscal regulations on medium and long-term investments, which today better reward financial short term speculation; implementing policies to recompose the public budget of individual countries through reductions of current expenditure and increase of capital spending; issuing bonds by the European Stability Mechanism (ESM) in order to make good use of the huge spare resources available; introducing the golden rule in national and European fiscal policies, including the *fiscal compact*;

As to the deepening of integration process, the Banking Union must be completed and associated with the Monetary Union. The EMU would not be able to survive – as has been amply demonstrated – by resting on the only leg of the currency and monetary policy. Completing the Banking Union, particularly strengthening the Single Resolution Mechanism and establishing a European Deposit Insurance Scheme, is essential in order to weather the effects of financial shocks. There is no doubt that with today's half-completed Banking Union, the euro area might be overwhelmed by the outbreak of a new serious financial crisis. In the current fragile situation for many European banks, banking integration in Europe cannot be further delayed and must completed as soon as possible;

The proposal submitted by the Commission on the completion of the Banking Union, and in particular the establishment of a European Deposit Insurance Scheme, is a compromise proposal, which so far has not been able to overcome the opposition of creditor countries. The concerns of these countries - particularly Germany - are actually in the opposite direction, as they propose to reduce banks' exposure to sovereign debt in individual countries before any further step can be taken towards completing the banking union. In other words, risk sharing must be preceded by risk reduction, not only as a technical, but also as a political prerequisite. However, it is just as obvious that without appropriate risk-sharing mechanisms – which can only be achieved by completing the Banking Union – it will be very difficult to cut the perverse linkage between sovereign risk and bank risk; the latter was the main driving force behind the euro crisis since its very explosion and threatens today to leave the Eurozone defenceless in case of any future financial storms;

Lastly, national parliaments must be encouraged to play a more active role in euro zone governance, as a means of enhancing the institutional and democratic legitimacy of the whole system. As is well known, the Lisbon Treaty provided for national parliaments to "actively participate" in the "good functioning of the Union"; later, the crisis legislation (Six pack, Two Pack, Fiscal compact, Banking Union) tightened the procedural and institutional links between the European Parliament and the national Parliaments, thus creating a composite parliamentary system within the European Union, with close and enhanced links among legislative Assemblies. This is a form of inter-parliamentary cooperation, which can become systemic and must be fostered and supported, for it could act as a counterweight to the inter-governmental role in Europe's economic governance that have simultaneously grown since the start of the crisis.