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Completing the Economic and monetary Union during the net European legislature

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A lot has been done since the EA debt crisis, mainly:

1. **Emergency assistance**
   - European Stability Mechanism (ESM)
2. **Self-fulfilling crises**
   - "Whatever it takes" (July 2012), Outright Monetary Transactions (OMTs)
3. **Unconventional monetary policy**
   - Quantitative easing, negative interest rates
4. **Banking union**
   - Single supervision
   - Single resolution (bail-in, unfinished)
   - Under discussion: European deposit insurance scheme

What still does not work

1. The sovereign-bank loop is still alive

- Governments are no longer supposed to bail out the banks (BRRD)
- But banks fund their sovereigns
- Which is stabilizing in the short term but makes them vulnerable (cf. Italy today)
- No €Z safe asset, redenomination risk, low profitability

2. Macro stabilization tools are weak

- Monetary policy not yet normalized
- Fiscal policies constrained by debt levels (except maybe for public investment, cf. debate on r-g)
- Capital markets and banks still fragmented: firms have different access depending on where they are located

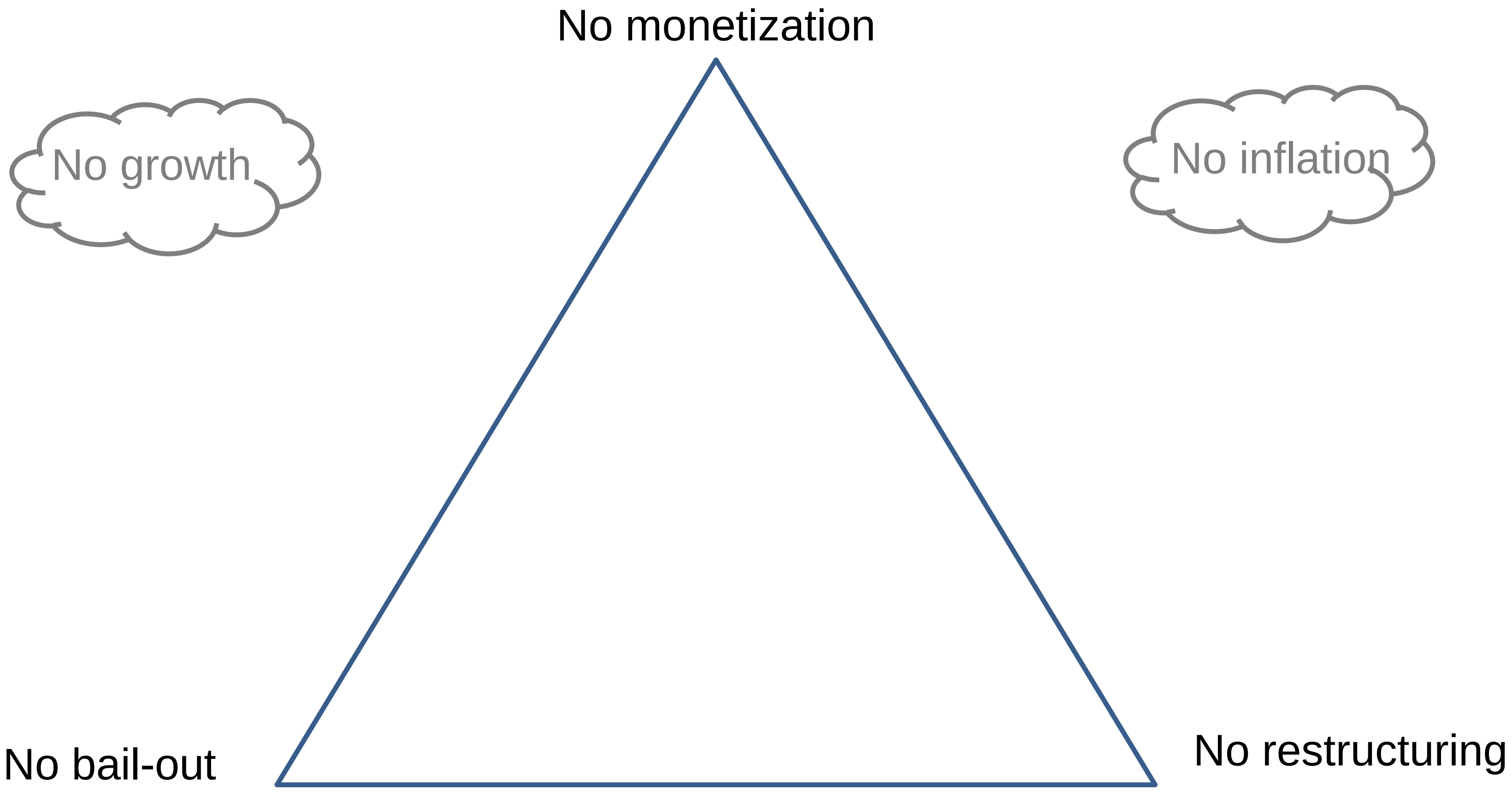
3. Still some holes in the European safety net

- ESM programs not popular
- No fiscal stabilization tool at euro level
- ESM precautionary lines to be defined
- Single resolution fund under-calibrated

4. Macro re-convergence is difficult

- Inflation is too low for relative price adjustments and deleveraging to take place safely
  - Asymmetric adjustment → deflationary bias
- European semester is weak, country-by-country approach still dominates
  - Productivity is a positive-sum game
  - Labor cost is a negative-sum game

The fundamental flaw is still there



Solution so far: a little bit of the 3 (Ireland, Greece)
Long-term solution: debt restructuring within the euro area. The big problem is how to get there without triggering a crisis. Proposals like blue/red bonds will have to be reconsidered

The crisis has destroyed simple ideas

1. **Policy assignment**
   - ECB → aggregate (demand) shocks
   - National governments → idiosyncratic shocks
2. **Allocation and stabilization policies are distinct**
   - Long-term productivity growth and short-term stability may be complements rather than substitutes:
     - Long-term growth is a key determinant of fiscal space
     - Scarring rather than cleansing effect of financial crises: Aghion, Hémous and Kharroubi, 2014; Duval, Hong and Timmer, 2017; Kalemli-Ozcan, Laeven and Moreno, 2018.
3. **External imbalances are benign**
   - Sudden stops cushioned by Target system
   - But current-account imbalances (both deficits and surpluses) reveal unsustainable macro imbalances, with spillovers on other countries

To do list

1. Fiscal policy

- Expenditure rules at country level
- A €Z fund for exceptional times
- Easy access to ESM precautionary lines

2. Banking and capital market union

- Banking union: finish the job (breaking the doom loop), incl. safe asset
- Capital market union: accelerate

3. Macroeconomic policies: clarify the European semester

- Long-term growth: structural reforms, multi-annual monitoring
- Short term and medium term: policies “at the margin”
  - Minimum wage, taxation, macro-prudential policy
  - Role of national productivity councils

MIP: clarification needed

Identification of imbalances

1. Flagship indicator: current account
2. Judgement (in-depth reviews)

Tools available "at the margin"

1. Minimum wage, public remunerations, social security contributions
2. Taxation, energy policy
3. Housing policy
4. Macro-prudential policies

Governance

1. MIP
2. National productivity boards
3. Macro-prudential authorities

Agreed rules of thumb

1. Real wage growth = labour productivity growth
2. Current account within a symmetric range
3. Credit growth = GDP growth