Dr. Daniela Schwarzer
Stiftung Wissenschaft und Politik (SWP)

Economic governance in the Eurozone in and after the crisis

CRIS Hearing, March 18th, 2010

Shortcomings of the EMU governance I

Crisis management

- **Fiscal stimulous**: insufficient co-ordination
  - Shows lack of reflection on EMU-wide fiscal stance
  - Revealed weak role of Commission and very limited flexibility of EU budget
  - Past experience raises questions for managing exit strategies
- **Sovereign debt crisis:** Wrong incentive structures and insufficient tools to manage liquidity and solvency problems
  - Market discipline's effect is insufficient
  - No orderly sovereign default procedure
  - No lender of last resort

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Shortcomings of the EMU governance I

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Supervision & Surveillance

- Financial market supervision and regulation
- Fiscal policy surveillance and co-ordination
  - Loss of credibility of Stability and Growth Pact
  - Unsustainable fiscal positions, lack of commitment to mid-term consolidation
- Economic policy surveillance and co-ordination
  - Too little action against divergences in competitivenesse and current account balances, impact of crisis has been aggravated
  - Underlying structural problem remain resolved

Legitimacy

- Problems of acceptability
  - Of intereference with „domestic affairs“
  - Of policy outcome on EMU aggregate level

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Underlying causes

- Incomplete institutional and regulatory framework only moderately reformed since Maastricht (reforms include Stability and Growth Pact, creation Eurogroup incl. President, first Eurozone summit)
- Underdeveloped perception of EMU reality (as “sitting in one boat”)
- National policy makers naturally have other incentives than being “good EMU governors” (moral hazard problems) – even if a cooperative game would be a win-win situation for every EMU member
- Role of supranational actors in pushing EMU logic: potential not fully used or insufficient formal competencies

The political context for EMU governance reform I

EU level developments

- A window of opportunity: The crisis and 'Greece' correlate with the EU2020 and EU budget debate
- Focus on risk management/prevention, low ambition to improve joint economic policy making
- Increased interest of the European Council in economic/fiscal policy issues. But this may weaken attention paid to EMU-specific problems

Governments

- Reluctance to accept policy interference from EU level (cp. positions on EU2020/Financial Market Supervision). Little appetite for truly strengthened policy coordination even if EMU underperforms as a whole
- Risk that previous assumptions on necessary solidarity and cohesion in the E(M)U are revised to the bottom

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The political context for reform II

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Domestic contexts

- Competitive pressure / need for real devaluation may cause political backlash in some countries
- Political fragmentation / rising populism may weaken governments' appetite for long-term integration projects
- Constitutional limits to further integration (Germany)
- Concerns about public opinion
  - High unemployment/low growth rates historically correlate with a decline of support for European integration. With real economic effects further hitting in 2010, support is likely to fall.
  - Meanwhile data shows rising expectations of the citizens towards the EU's problem-solving capacity in economic and social policy → increased risk of frustration with the EU and national politics
  - Rising importance of active communication / opinion leadership on benefits of EU and Euro

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Priorities for EMU governance – immediate

- Strengthen policy surveillance and coordination
  - Improve SGP to ensure a return to sustainable public finances
  - Regular reviews with recommendations to cope with current account imbalances
  - Involve national stakeholders more strongly (e.g. nat. Parliaments)
- In parallel to emergency aid for Greece: create EMF, default procedure and EMU exit option for coming cases
- Develop EMU institutionally within EU (Eurozone summit, Eurogroup for other Council formations, ext. represent.)
- Treat EU2020 and the EU budget in a coherent approach
- Publicly address policy divergence between the larger EMU countries in particular France and Germany

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Priorities for EMU governance reform – long-term

- Beyond crisis management: Further improve macro-economic governance (e.g. €-macro-economic dialogue)
- Introduce tools for macro-economic stabilisation in order to support convergence
  - Income side of the EU budget: an EU corporate tax would react counter-cyclically
  - Expenditure side: Exclude pro-cyclical effects of EU programmes and in the long-term introduce a stabilising function
- Tackle legitimacy and accountability problems that arise in the EMU
  - Overcome the situation in which voters' preferences hardly influence the direction taken in economic policy-making
  - Give the EMU economic governance that is accountable for its (in-)actions

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