Franco-German ideas on strengthening the EU

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It has not been functioning properly, the Franco-German 'motor' of European integration but, last week, the sputtering engine has produced a paper. In a joint memorandum, the two leading nations set out their ideas on strengthening the European Union.

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In the Netherlands, attention focuses, parochially, on the suggestion to have a permanent chair of the Eurogroup. With Minister of Finance Jeroen Dijsselbloem just six months in office as chair, this idea is taken as an affront. Yet, the structural ideas on Europe in the joint text are far more important.

On ‘banking union’, the concept that was introduced to sever the pernicious link between banks’ health and the market standing of sovereigns, German reticence seems to have gained the upper hand from the need for reform. ‘Banking union’ consists of three elements: (1) the European Central Bank taking over prudential supervision of banks (2) a joint resolution system for banks and (3) joint depositor protection. These elements apply only in the euro area and in other EU Member States that have not yet adopted the euro but wish to join ‘banking union’.

Political agreement has been reached between the Ecofin Council and the European Parliament on the regulations that give the ECB the final say in supervision. The legal texts are far longer than the straightforward proposals that the Commission submitted in September of last year.

They are difficult to read, revealing a compromise under which the ECB will only supervise the entry and exit of the market of all banks and, for the remainder, only be fully responsible for supervision of the systemically important banks. Other banks remain subject to national supervision, although this is to be embedded in a framework which the ECB determines, giving the ECB strong oversight powers over national supervisors.

Hitherto, the joint resolution of banks has proven a stumbling block. The original idea, put forward by the Eurozone leaders themselves, was that, once subject to ECB supervision, banks could be recapitalised from the European Stability Mechanism (ESM). Twelve months later, that idea has been diluted to having a ‘single resolution board’ of national authorities that are competent to wind up banks, instead of a ‘Single Resolution Authority’ at EU level.

The Franco-German text now speaks of the possibility that the ESM “should play the role of an additional public backstop”, mentioning lending to Member

States “or direct recapitalisation based on the operational criteria still to be decided”. This reveals reticence and reluctance, instead of strong governance. And this reveals German fear that the present Treaty does not provide sufficient powers to make an EU resolution authority work.

This fear overlooks the fact that we have had an EU-wide ‘resolution authority’ for banks since the beginning of the crisis: the European Commission, applying state aid rules, effectively functions in that capacity. Just a week ago, ECB Board member Benoît Cœuré rightly insisted that joint resolution be in place before the ECB can assume its supervisory role.

Elements of the governance of the Economic and Monetary Union are given thought in the Franco-German paper, as well. So is the idea of a budget for the euro area. Unfortunately, a joint budget is implicitly rejected by advocating a euro area-specific fund to provide conditional financial incentives to Member States that have agreed to a contract on economic policy change. On such contractual arrangements, the Commission has been inviting replies to its two Communications of 20 March. A small budget for the euro area to enable automatic stabilisers to work across the currency union should, instead, be on the table.

To end on a positive note, the French and German political leaders insist that the € 120 billion promised last June as a “compact for growth and jobs” be (finally…) spent “without delay”. It is about time.