The Euro: Past, Present and Future
Presentation by Professor Dr. René Smits
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Twenty Years Treaty on European Union: Reflections from Maastricht
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1. Introduction

I would like to thank the organisers of this Conference for inviting me. It is a pleasure to be in Maastricht almost twenty years after the famous Treaty entered into force. Maastricht has become <u>in</u>famous for many citizens due to its connection with the Maastricht criteria: the eligibility criteria for the single currency. Member States need to pass the convergence test. This test includes the 3% and 60% budget deficits and public debt norms. These norms also apply in the permanent budgetary framework of what is now the Treaty on the Functioning of the European Union (TFEU). For many, 'Maastricht' is synonymous with budget tightening and economic change.

Before looking to the past and discussing, with the benefit of hindsight, some weaknesses or failures in the set-up of EMU, and before looking to the current restoration of these fault lines and into the future, I would like to emphasise that the single currency is part of a political project to bring, and maintain, peace, prosperity, and freedom to Europe. The Euro is supposed to unite but, currently, the single currency seems to divide. Between North and South, between haves and have-nots, between Germany and the 'periphery'.

Even though this talk is by a lawyer, I would like to recall here the plight of the unemployed, the pensioners and all others who suffer under the combined effect of structural measures and budget tightening (austerity) in the wake of the euro area debt crisis. And I would like to give central place to the cultural aspect of the Euro.

2. Past: weaknesses / failures

1. Imbalance between the economic and monetary pillars of EMU

Economic and Monetary Union shows a remarkable imbalance between a well-developed monetary pillar and an underdeveloped economic pillar. The single currency, monetary policy, an independent central banks with adequate powers were all provided for but a strong economic governance or economic government were conspicuous by their absence.

When the Maastricht Treaty was negotiated, its authors were steeped into the market thinking of the 1980s, epitomised by British Prime Minister Margaret Thatcher and US President Ronald Reagan. These were the years of deregulation, liberalisation, privatisation (although not in France, where banks were first nationalised in the 1980s) and reliance on open markets. 'Maastricht' marked the introduction into the Treaty of the 'principle of an open market economy with free competition, favouring an efficient allocation of resources'. This principle can now be found in Articles 119, 120 and 127 (1) TFEU. Those were the days when citizens started to become economic actors only. The days of the start of the 'market economy' that later became a 'market society'. In the area of EMU, the provisions adopted in Maastricht relied on free markets that would correct spendthrift governments. Admittedly, there are provisions on avoiding excessive budget deficits, and there was the subsequent tightening of the rules in the Stability and Growth Pact, which prescribes budgetary balance over the medium term, but this framework largely relied on voluntary cooperation. This, too, was a conscious choice: there was a big deal of reluctance to relinquish 'sovereignty', a concept of the past. With monetary sovereignty passing to the European level of government, Member States were loath to give away too much on the economic front.

This shows the attachment of the authors of 'Maastricht', for all their far-sightedness when it came to the single currency, to the past. It makes clear the level to which these authors were still living inside concepts of the past century. This, of course, has cost us dearly: both the overreliance on markets as correcting factors and on intergovernmental cooperation as a guiding principle in the 'E' of EMU.

2. Banking supervision remained national

Another fault line that is easy to see from the vantage point of the present, is that banking supervision remained national. Member States remained the primary actors in prudential supervision of banks until well after the 2008 crisis. Even when the Lamfalussy reforms of the early 2000s were replaced by the post-crisis Larosière reforms with the introduction of the European Supervisory Authorities (EBA, ESMA and EIOPA) and of the European Systemic Risk Board, Member State sovereignty and budgetary autonomy were upheld. The authors of the Maastricht Treaty did not acknowledge one of the 'trilemmas': things one cannot all have, such as national banking supervision, an integrated financial market and a stable financial system. This went relatively well until the Great Recession, or rather the crisis in the Autumn of 2008 preceding it. National supervisory authorities thought of themselves and forgot their neighbours in the crisis: even mandatory mutual information exchange dried up.

3. The customers forgotten: SEPA, dual pricing

Another mistake I see concerns the neglect of the customer. The persons for whom the whole exercise had been started, the ordinary citizens, were left waiting for the benefits of the single currency in bank payments. Not fast forwarding to the customers' advantage in bank payments was, as I see it, an error: cash payments were 'Europeanised' in 2002, bank payments are only made truly 'domestic' with the introduction of the Single Euro Payments Area, over ten years later. A project, moreover, that has been spearheaded by the banks, a feature that has not brought consumer welfare as the prime motivator of the SEPA process.

In the same vein, the customer's interests were not sufficiently heeded when it came to the transition to the Euro. Dual pricing for a period ahead of the transition to the cash euro and afterwards might have minimised the perceived inflationary effect of the introduction of the single currency. It might have helped avoid the 'consumer-perceived inflation' of the *Teuro*.

These two deficiencies in EMU's set-up but did not play a role in the Euro Area crisis but merit to be mentioned nevertheless. Different approaches might have endeared the single currency to its citizens instead of alienating them before the really hard times began.

4. <u>Neglect of the cultural aspect of the single currency</u>

This brings me to another neglected aspect: the cultural element of the single currency. As the author of a recent booklet on the Euro wrote:

« La monnaie a une dimension sociale: elle constitue une abstraction et un signe (…) la monnaie n'est pas, en premier lieu, une innovation économique mais l'expression d'un vivre ensemble » (Michel Dévoluy, *L'euro est-il un échec ?*, Paris, 2012).

The single currency's social value concerns both the economic structure (a single labour market does not function effectively without a common second language) and the social embedment of the single currency (we lack a European media space in which to discuss policy together or, as I would like to say here: *ensemble*).

3. Present: Restoring these deficiencies now

The European Union and the Member States have, hesitantly and agonisingly slowly, started to remedy the 'fault lines of Maastricht'. This concerns repairing what Giorgio Maganza called earlier during this Conference: "The work that remained to be done", as he and colleagues identified it on 11 December 1991, the day after the political compromises on the Maastricht Treaty had been struck. Here, looking back, it amazes how much has been achieved over the past five years. Both in terms of strengthening of financial sector regulation and supervisory architecture and in strengthening the economic pillar of EMU. Let me list the achievements:

- Banking union, which consists of the following three or four elements:
    - A Single Supervisory Mechanism (SSM) with the European Central Bank (ECB) at the apex and the National Competent Authorities (NCAs) cooperating with the ECB. The relevant regulations have just been adopted. They do not provide for the measure of central supervision originally envisaged and give the ECB only direct control over the systemically important credit institutions but it is a long way from where we were or, actually, still are. The SSM is considered to become operational by November 2014. There is still a major hurdle: the stress testing of banks against agreed capital and contingency norms, plus the provision of extra capital on the basis of the resulting shortfalls established, with a common fiscal backstop to inject capital if private sources cannot be found. The June 2013 agreement on the European Stability Mechanism (ESM) injecting capital directly into banks has to be translated still into law and Germany is already backtracking. But the contours of joint banking supervision are there and the ECB is preparing for the actual prudential supervision of Europe's banks.
    - A Single Resolution Mechanism (SRM), an authority to steer banks through a Recovery & Resolution process that may end with their winding up. The legal and institutional issues are rife, here, with Germany again pitted against the Commission and others. The legislative process of a Directive on national R&R regimes is still on-going. A long road ahead, even though the ECB,

rightly, insists that this element of banking union should be ready before it can assume direct prudential tasks.

- A <u>Single Deposit Guarantee System</u> (DGS), the contours of which are still vague as there is no formal proposal yet. Amendments to the DGS of the individual Member States are still on the table and have not yet been accepted.

All of this is based on a

- A <u>Single Rule Book</u>, which has more or less been adopted with the translation of the Basle-III accords into Union law with CRD IV and CRR.

The issue of 'bail-in' (letting creditors bleed instead of taxpayers) is topical and appealing to the general public. Yet, warnings have been sounded about the wisdom of this approach[1].

- <u>Economic union strengthening</u>

Here, an array of measures and procedures can be mentioned of which I can only mention the resulting changes in passing, not doing justice to their complexity and innovations:

- The introduction of the <u>European semester</u>:
  - joint timing of economic and budgetary policy decision making
- <u>'Six-pack'</u>

  The name for six legal acts that together reinforce economic governance. It consists of:
  - A strengthening of the EDP and the SGP, notably by renewed emphasis on debt reduction, by setting quantitative targets for budgetary balance over time and tightening of procedures, by introducing the possibility of earlier sanctions, and through requiring Member States' budgetary planning to be based on realistic and independent economic forecasts;
  - The introduction of an <u>Excessive Imbalances Procedure</u> plus, for the Euro Area Member States, effective sanctions ('outs' can only see a recommendation adopted);
  - A strengthening of <u>national statistical frameworks</u> and strong Commission powers to sanction statistical misreporting;
  - The introduction of an <u>Economic dialogue</u> between the (Ecofin) Council, the Commission, the European Parliament and a representative from the Member State concerned.

[1] Avinash Persaud, *Bank bail-ins are no better than fool's gold*, Financial Times, 22 October 2013. See, also, *Brussels stands ground against Mario Draghi about bailout curbs*, Financial Times, 20 October 2013.

- A strengthened role for the Commissioner for Economic and Monetary Affairs, Olli Rehn, and the appointment of a Chief Economic Advisor at his DG.
- 'Duo-pack'

  The name for an additional legislative package that further reduces national budgetary autonomy, bringing:
  - Ex ante assessment of draft budgets, and
  - Enhanced surveillance of Member States in difficulties
- Fiscal Compact

The adoption, at German insistence, of sound budgetary rules already enshrined in the 'six-pack' legislation, in a separate Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed by 25 Member States:

  - Strict budgetary rules for all Member States but two
  - A strengthening of Euro Area governance, including an Inter-Parliamentary Conference which just met in Vilnius (LT)
- European Stability Mechanism, replacing the previous 'bail-out funds', the EFSF and the EFSM, providing a common funding for Member States in financial difficulties that cannot access the markets on their own (or only at excessive costs) when the stability of the Euro Area is at stake. In its *Pringle* judgment, the European Court of Justice made clear that the ESM is to be counted among the economic policy provisions. Its operation does not run against the so-called 'no bail-out' clause. Even though, in the psychology of the markets, this clause (Article 125 TFEU) meant that Member States will not grant credits to each other in order to repay their debts, the ECJ has made clear that the provision is to be read more narrowly. When new debts are created, by the lending to Member States from the ESM, Article 125 does not apply. It does require such lending to be undertaken in a manner that seeks compliance with the TFEU's budgetary rules by the borrowing States. This is the issue of the much-discredited conditionality 'imposed' by the troika (ECB, Commission and IMF).

- On the monetary side of EMU, the ECB has been engaging in extraordinary measures:
  - Long-Term Refinancing Operations (LTROs), through which the central bank has infused liquidity to the banking system on a hitherto unknown massive scale, just like its counterparts in the US and the UK[2]
  - The introduction of a Securities Market Programme (SMP) which has now been ended in favour of the announcement of:
  - Outright Monetary Transactions (OMTs), transactions through which the ECB will seek to rekindle the transmission of its monetary policy instruments as the single money market had become balkanised with banks retreating to home turf and credit conditions diverging widely between borrowers in ‘core’ and ‘peripheral’ States of the Euro Area. The mere announcement of the OMTS in September 2012 served to bring the speculation on the demise of the euro to an end[3].
  - A steady widening of the eligibility criteria for collateral that permitted the ECB to continue lending to banks whose available marketable instruments had been downgraded by credit rating agencies or otherwise become less attractive.

Let me end this enumeration of measures by giving a few general observations:

- We see a peculiar interplay between intergovernmental progress and EU law-based efforts, with some new instruments squarely outside the Treaty framework but with a promise of future integration.
- We see further dividing lines between <ins> and <outs>, with the original distinction between States that are inside monetary union and those that are out blurred, with monetary <outs> possibly joining the banking union and all <outs> but the United Kingdom and the Czech republic signing the Fiscal Compact.

[2] Even though these central banks also apply ‘quantitative easing’ (QE), i.e. measures to buy long-term securities thereby bringing down interest rates in order to stimulate their economies, something the ECB has not done. Its covered bonds programme, not discussed here, came closest to this instrument.
[3] Together with ECB President Mario Draghi’s remarks, in London earlier in the summer of 2012 that, within its mandate, the ECB stands ready to do what it takes to preserve the euro, announcing that this would be enough.

- We see the role of Member States strengthened in discussions:
  - in banking union, the ECB's role is shared with national competent authorities in the Single Supervisory Mechanism, whilst national parliaments are involved in the accountability on banking supervision;
  - in the Economic Dialogue, a representative of the Member State whose action is discussed is included in the European debate;
  - the governance provision of the Fiscal Compact provides for a new interparliamentary assembly with MEPs and national MPs;
- We see a notable strengthening of the role of the Commission, even in areas where the instruments adopted are in intergovernmental form. The Commission has a role to play in the ESM's functioning, as well as in the Fiscal Compact. Traditionally, in EMU law, the Commission's role was limited but now it is assuming an ever more important function.
- Even the role of the European Parliament has been strengthened even though 'Lisbon' weakened it in respect of 127 (6) TFEU: mere consultation was required for the adoption of the SSM Regulation whilst assent had been required beforehand.

Allow me to also mention the following:

- Monetary policy in the first ten years of EMU was intended as 'one size fits all' but may be characterised as 'one size fits none', as the Notre Europe think tank analysis of the Spring of 2012 calls it: for some States it was too restrictive, for others too accommodating[4]. This shows that Europe is not 'an

[4] Completing the Euro - A road map towards fiscal union in Europe, Report of the "Tommaso Padoa-Schioppa Group", under the patronage of Jacques Delors and Helmut Schmidt, June 2012, available at: http://www.notre-europe.eu/media/completingtheeuroreportpadoa-schioppagroupnejune2012.pdf?pdf=ok.

optimal currency area'. But neither is the US. It also shows that the EU is not as economically integrated as we thought it would be by now.

- The management of the single currency's problems brought deep divisions to the surface between German politicians and central bankers and others. Together with the divisions among the electorates, and the rise in alienation and xenophobia, these are worrisome features of the crisis. We should acknowledge them openly to confront them.

4. Future

Please, permit me to have a look ahead into the future. Which is uncertain, of course. But our current thinking and our current actions shape the future.

I see the following options forward:

- Jointly beating the markets:
  - Eurobonds: joint issuing debt by Member States can be undertaken in a manner that reinforces (the credibility of) conditionality and budgetary rules. Proposals have been put forward to that effect, notably the Euro T Bills proposal with which I have been involved[5]. Currently, an expert group established by the Commission studies the possibilities[6]
  - Joint assessment of creditworthiness of sovereign risk (important for financial sector supervision), an issue which Bundesbank President Jens Weidman recently drew attention to[7], may lead towards a shared appreciation of risks that banks, insurance companies and pension funds are exposed to, thus moving from the current fiction that all sovereigns are equal to a more realistic approach.
  - Europe should consider introducing a sort of Sovereign Debt Restructuring Mechanism (SDRM)[8] for Member States that would allow them to reschedule their debt and reorganise their finances. Such a mechanism, if properly

[5] See The ELEC "Euro T-Bill Fund" - A proposal for a two-year refinancing for all € bills/optional refinancing of bond maturities until 2015, 27 January 2012, available at: http://www.elec-lece.eu/documents/doc/mon-12jan-EmuBondFund.pdf. See, also, legal considerations in my **Outline of the legal chapter on Eurobonds** at: http://renesmits.eu/calendar/.

[6] See: *President Barroso, in agreement with Vice-President Rehn, launches Expert Group on debt redemption fund and eurobills*, press release, 2 July 2013, available at: http://europa.eu/rapid/press-release_MEMO-13-635_en.htm.

[7] Jens Weidmann, *Stop encouraging banks to buy government debt*, Financial Times, 30 September 2013.

[8] Compare the failed attempt at the establishment of a global SDRM by the IMF. See: http://www.imf.org/external/NP/EXR/seminars/2003/sdrm/index.htm.

designed, might allow an orderly instead of a messy rescheduling of State debts, much like the system in the United States for municipalities.

- We should move towards a 'Genuine EMU'[9]
  - First and foremost, this means establishing "an economic government for Europe", with a limited budget that provides for automatic stabilisers through EU-funding of national unemployment benefits. This concept has been the subject of several proposals in the past. It has recently been advocated by:
    - the Glienicker Group, a number of German professionals who published their call in *Die Zeit* of 17 October 2013 but also made avialable French and English texts at their website[10]
    - the conclusions of the recent meeting, already mentioned, of the Interparliamentary Conference on Economic and Financial Governance of the EU, which was held in Vilnius (LT) on 16-17 October 2013. (This Assembly is based on Article 13 of the TSCG, better known as the "Fiscal Compact").[11]
  - Europe should finally move towards single external representation of the economic and monetary union in the IMF and in fora such as G8 and G20, something I have advocated for the past twenty years. The IMF's role in the troika of creditor institutions overseeing compliance with the conditionality of

[9] See the successive reports submitted under the title "Towards a genuine Economic and Monetary Union" by Herman Van Rompuy, in close collaboration with the Presidents of the European Commission, the Eurogroup and the ECB, to the European Council, available at: http://www.european-council.europa.eu/the-president/eurozone-governance?lang=en.
[10] *Towards A Euro Union*, available at: http://www.glienickergruppe.de/english.html.
[11] See its contribution at: http://renginiai.lrs.lt/renginiai/EventDocument/0f6147e3-6125-40b9-93d8-edc7c31e085f/EN%20Contribution%20-%20Vilnius%20IC-EFG.pdf.

loans to "programme States" (the European Commission, the ECB and the IMF) is all the more reason for this step forwards.[12]

- We should acknowledge our true democratic deficit: that markets (banks, credit rating agencies, hedge funds) and media determine more what happens in the Union than its (directly or indirectly elected) politicians, a situation that should be remedied. European citizens, by taking a longer-term and less materialistic approach to our shared society, should reclaim their political rights that markets and media have played with for too long.

I would like to end with two remarks.

Whilst fully acknowledging the plight of defenceless citizens who have seen their economic and social situation deteriorate by the crisis, we should put our misery in perspective. The relativity of the crisis is borne out by the remarks of Raghuram Rajan, currently Governor of the Reserve Bank of India who, in May 2013 when he was economic adviser to the President of India, was quoted in *Het Financieele Dagblad* as follows: "I would swap India's growth levels at any moment for the level of wealth in Europe." When we acknowledge that 40% of mankind is living on less than $2 per day, the crisis here is put into perspective.

And allow me to end on a positive note, a Euro bank note. I trust that, in the future, we will have images of inspiring Europeans on Euro bank notes instead of non-identifiable bridges and buildings. I envisage that, one day, Albert Einstein will appear

[12] An issue included in the ideas submitted by the European Commission in its Communication *A blueprint for a deep and genuine economic and monetary union - Launching a European Debate*, COM(2012) 777 final, 28 November 2012, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0777:FIN:EN:PDF.

on a new Euro banknote to signal that that the European dream has a universal vocation, with the following quote that may inspire us Europeans and humans across the globe:

- "***We are part of the whole which we call the universe, but it is an optical delusion of our mind that we think we are separate.***
- ***This separateness is like a prison for us.***
- ***Our job is to widen the circle of compassion so we feel connected to all people and all situations.***"