Strengthening the EMU: economic priorities for the EU and member states

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Harald Waiglein

Thank you very much for joining us. This panel is trying to take a longer-term view of the challenges of EMU and how we should address them in the next legislative cycle. Let me set the scene against which we discuss what should happen over the next five years. The situation is very different from what it was just before the last legislature, because now we have a more pressing concern about the competitiveness gap with the US and other major global powers. It is widening. Europe is falling behind. We have concerns in some countries that old business models based on cheap Russian gas are probably no longer viable, or maybe they are. I do not know. It is up for debate, but it is certainly an issue. We have the high debt and structural problems in other parts of Europe that we are trying to address with new rules. We now have the challenge of making those new rules work and implementing them in a way that actually tackles the problem.

We have the very pressing problem of the incomplete single market, particularly in financial services. That is what we are trying to address with a Capital Markets Union (CMU) and a Banking Union. We are having a fairly new discussion because 15 years ago the consensus was that we would not interfere with market mechanisms, but now we are talking again about state intervention, subsidies and industrial policy. Can that be the solution? Should we discuss this or should we go back to where we were 15 years ago? We have the geopolitical situation, with the ongoing war in Ukraine, which is unlikely to end before the beginning of next year.

Marketta Henriksson

I think your diagnosis is correct. Europe is indeed experiencing slower GDP growth than That's my first point. I'll make three, as is our custom in Finland. The slowdown in growth is not the only problem facing the EU (my second point), and so far the EU's response has not been ideal (my third one).

Going back to the first point, there is a lack of investment in Europe, particularly in high tech and R&D. The Draghi report picked up on the fact that the EU's innovation activities are mainly concentrated in sectors with low R&D intensity, such as automobiles, whereas in the US there has already been a shift to software and hardware sectors and further to the digital sector, where the US is clearly more advanced than the EU.

Turning to other challenges, in addition to growth and productivity, there is the long-term challenge of ageing. At the same time, we need to digitise and decarbonise the economy. We are still grappling with the problems that started with Chechnya, Russia's war of aggression and the other global conflicts. These have also required significant responses from the EU. Then there is the internal issue of the EU, where we are not always very fast in taking decisions and making progress, even on important issues like the CMU. Another issue where we are perhaps too good is the development of new regulation. I have noticed that the future President of the Commission has made this one of her main points, where she wants to reduce regulation and simplify things. On the other hand, I have noticed that in her first 100 days she is more or less adding regulation. This will be a priority for the next Commission.

The EU's response to all this has perhaps not been ideal. We have new instruments, relaxation of state aid rules, new tariffs and then the call for industrial policy. Starting with the new instruments, the main ones are the Next Generation EU (NGEU) and the Recovery and Resilience Plans (RRP). It is perhaps a bit early to say whether the RRPs have been a great success or just a small one. It is often said that there is not a lot of money going from the EU to the member states, and this has been taken as a sign that things are not progressing, but from the member state side, we have spent all the money. We are just waiting to get it back from the EU, so the measures are ongoing. We are now in a phase where - coming from Finland, which is one of the countries that wanted this - we have all these checks and very tight control over the money that it is well spent. I wonder a little bit if we have gone too far on that front and maybe we could have done it with less bureaucracy. We need to do a post-mortem on the RRP and how it worked before we start another one or anything like it. There is probably something we can learn and something we do not want to repeat.

Then, in terms of the solution and what needs to be done, we need to address the challenge of the productivity gap. That is quite clear, but it has to be done in the most efficient way. We need the most effective technological solutions for digitalisation and decarbonisation. Here I wonder how much public intervention is optimal. The public sector is not always very good at picking winners, because politics tends to get in the way, both at national and EU level, so we need to be careful here, especially when we choose things like disruptive innovation, which was mentioned in the Draghi report. We still need a level playing field to encourage competition, so we need to allow growth-oriented small and medium-sized enterprises to compete with the big ones.

We need to keep CMU on track. I think Mindaugas will talk a lot about this, so I will more or less leave it at that, but this is a key answer. Rather than focusing on financing investment through common EU debt instruments, which my government is not in favour of but which has been suggested again this week in the Draghi report, the priority should be to ensure that our capital markets function as efficiently as possible.

Finally, my third point on the solution side is the limited role of government. For the single market to work, the role of the state must be limited, and market forces must be allowed to drive economic activity. We should limit government intervention to correcting obvious market failures. That is all from my side. I think I have avoided mentioning the word "fiscal" once, so I can congratulate myself on that.

Harald Waiglein

This is going to trigger a question for me because I noticed this. We both come from frugal countries. I am not going to go into the details of all the reports we have received. There are very good things in them. There are things in them that probably need to be discussed more, but what I found very lacking was a lot of focus on the potential risks of having very high debt in the current interest rate environment. It is not there at all. Are we wrong now? Is it no longer an issue? What are your thoughts? I will ask Paula the same question afterwards.

Marketta Henriksson

Coming from a frugal country and chairing a committee that wants to keep debt levels low, and on a personal basis as well, I would see it as a problem. I do not know why it is not in the reports, but I noticed in the Draghi report that there were a couple of things where fiscal rules were mentioned. One was having a common debt and then, in contrast to that, having tighter rules for member states, the rules that we have just reformed very painfully and probably do not want to reopen anytime soon. That was one place where that came up, but I also noticed that the European Semester in the future should only be about fiscal policy.

Harald Waiglein

Paula, what do you think about the challenges? You heard my question on fiscal and debt issues. We have seen the agreement on the revision of the Stability and Growth Pact under the Spanish Presidency, with contributions from you, so I was wondering what you think of the progress made so far. You can answer the general question first.

Paula Conthe Calvo

We have been fortunate to have a very good diagnosis in all the reports. I agree with some of the points made by Marketta, but perhaps not so much with those relating to the Recovery Plan, which I think has been a very good experience and has had a very positive impact on many countries. The main priority that could sum it all up, looking forward to the next five years, is really to look at everything from a European perspective. In particular, when we look at the investment gap, it is very much related to fiscal policy. Obviously, national fiscal space is limited, but we have a huge investment gap that we have to finance.

Many of the investments that need to be made to improve competitiveness in Europe are things that are really European public goods. This is true for defence, innovation, research, energy and many of the things that have been mentioned. Investment at national level would not be the most efficient solution. It would be much better to have a common action that would be efficient and take advantage of the economies of scale of a market of 450 million people.

For that to happen, there has to be funding, and a lot of that is private funding. When Mindaugas goes to the CMU, I am sure we will very much agree on the need to make strong progress there with very concrete proposals. There is also a very strong case for joint public investment. We may agree or disagree with some aspects of the various reports, but as we enter this new legislative cycle, we have the opportunity to have an open discussion about this common public investment and how to finance it. Perhaps one of the options, especially given the limited fiscal space and the high debt of certain countries, if we want the most efficient solution, would be a common debt. We now have the opportunity to actually discuss this in our groups. I look

forward to doing that in the next few months, hopefully not too many.

Harald Waiglein

I mentioned the fiscal rules earlier, and you rightly mentioned the huge needs for investment and other spending. At the same time, if you look at recent developments in at least two very large countries, it looks like we are going to have a default under the new rules very soon. Are you not worried that we will lose all credibility when we talk about the big investment needs if at the same time, we cannot get fiscal policy on track, or do you think that the new rules will bite and we will actually see good results?

Paula Conthe Calvo

I have every confidence that the new rules will indeed create a framework that will allow fiscal responsibility to go hand in hand with the growth and investment that Europe needs to regain its competitiveness and become a global player that can compete with other players right now. Right now we are in a situation where there is a significant competitiveness gap - I think we all agree on that - and that needs to be addressed. The fiscal rules provide the space to combine fiscal responsibility with this investment. At the same time, I hope that if we approach joint public investment in those elements that we absolutely need in terms of innovation, energy, high technology and many other aspects, we can have a very constructive dynamic for Europe in the coming years.

Harald Waiglein

I will move to Mindaugas. We are also in a very similar situation. Sometimes, when you look at European challenges, you have a different view if you come from a small open economy than if you are a big country. I know that we agree on many things with Lithuania when we discuss issues. I was wondering what your view is on these big challenges that we rarely discuss as broadly as we have the opportunity to do here.

Mindaugas Liutvinskas

Let me start where you started. Five years ago, the buzzword was Green Deal. Now I think the buzzword is competitiveness in the new cycle. As with the Green Deal, over time we have understood the complexity of the issue and the different policy tracks. I expect that in the next five years we will have a lot of debates on competitiveness. We will see where it goes.

The diagnosis you put on the table when we started is pretty much right. It is also well reflected in the Draghi report that we have all read. It is big, but it is good. It is a good basis for future policy steps. We are behind, yes, and there are challenges, but we are not in a desperate situation that we cannot get out of. We just need political action, political will, and coordination at the European level.

I will not go into the data on where we are compared to the United States because of the time constraints, but I will focus on what could be done and offer a few ideas from my side, although this is a very broad subject.

The first is the economic governance framework. We have focused on getting the reform done, so now we have the new fiscal rules. It has built-in incentives, as we know, for structural reforms and countries are now preparing their medium term fiscal structural plans (FSPs). What we have to do together, in the Council and the Commission, is to make sure that the plans are of high quality and that if there are reform commitments followed by extended fiscal adjustment paths, they are implemented. We have to have ownership and enforcement. We have to make fiscal rules work.

As far as private funding is concerned, CMU is obviously a major item on the agenda. I see it as a core element whenever we talk about competitiveness. We must not shy away from this issue, and we must actually have some momentum. What we did in the Eurogroup with the declaration is a good basis and a good starting point. I hope that in the near future we will be able to move on to concrete legislative issues, because progress in this area is closely linked to total factor productivity growth in economic terms. We need more funding for innovative, high-growth companies, which is not fully available at the moment. That is why many promising companies seek funding in other jurisdictions, such as the United States. We need to reduce this fragmentation.

Private funding is a big part of the puzzle we are trying to solve, but I agree that it is probably not enough, and we need to talk about what we can do with public funding. We have to be pragmatic and realistic. We have to recognise where we are at the political table and what kind of different views and positions we have in different capitals. There is one thing we should and could pragmatically focus on. The one real fiscal instrument that we have at the European level is the common budget, the multiannual financial framework (MFF). At some point, I think in the second half of next year, the Commission will propose the draft MFF for 2028-2034. This will be a big thing. It will be the blueprint of how the new Commission plans to financially implement its strategic objectives, so we need to focus on that.

From the Lithuanian perspective, we would be open to discussing ways to give the common budget more capacity and more financial muscle. This may involve some reordering of priorities, but we would also be open to discussing the possibility of having a bigger budget to deal with the new challenges that we are putting on the table as politicians, from competitiveness to defence policy and other issues, including the same Green Deal that is still on the table. I think there will be a debate on public finance, but I would urge that it should not just be reduced to 'single borrowing, common borrowing, yes or no'. Then we will probably get nowhere. Let us try to be pragmatic and see where we can go.

Of course, I must also mention the geopolitical environment and defence policy. Coming from the Baltics, this is a very big issue for us. We have been very focused on increasing our security and defence spending. We feel that with the change in the security environment, this needs to become a real European issue. It is indeed welcome that the President of the Commission has announced that there will be a Commissioner for Defence, so we are moving in the right direction. I think that the priority of defence policy and increased coordination needs to be reflected in the next

EU budget in a more thoughtful way than it is now. We need to focus on increased coordination of the defence industry, how we can make it more competitive at the European level and how we can improve its access to funding. There is a lot of work to be done in this respect and I think it is existential at this point.

My very last element that I wanted to mention - you also referred to it at the beginning, Harald, and it appears in the Draghi report - is the debate on industrial trade policy. I think we are moving into a period, internationally or geopolitically, where foreign policy and trade are more closely linked, or the security and geopolitical dilemmas are linked to economic policies and issues. We would be open to considering targeted industrial policies at the European level, especially in those segments of the economy where it is critical, such as critical raw materials and defence industries, things where we have the common European public good, and it is not just about fragmenting the single market, but rather creating some kind of added value at the Union level.

Finally, on foreign economic policy - it is a bit of a new term - in the political sense, it is on the table again. We need to recognise it, discuss it and think about what it needs, from foreign direct investment to supply chains to trade agreements with other blocs. Geopolitics is here at the ECOFIN table, at the EFC table, and it is here to stay.

Harald Waiglein

There are very interesting debates ahead when I imagine discussing this in the EFC. I have one thought on what you said, because I agree with you completely on the budget. We recognise how much the situation has changed, and it has probably changed even more in the last, let us say, 20 or 30 years, but the priorities of the EU budget have remained largely the same, as if nothing had changed, and we do not have that discussion. We are discussing 'let's leave everything as it is and fill the gap with joint debt'. That is our particular problem in this debate, but I do not want to go into it too much. Our position is well known. It is something we really need to think about.

Now we have somebody who actually has the experience of having been a finance minister and now working in an international financial institution dealing with stability, so his advice is probably twice as good as ours. Pierre, how do you see this?

Pierre Gramegna

Thank you for the kind words and the introduction. I hope I will not disappoint you in five minutes on such a broad subject. Let me start with the three megatrends that are affecting Europe and perhaps the world. One is the geopolitical landscape, another is demographic trends and the third is increasing climate risks. Let us leave aside climate risks, not because they are not important and growing, but because they affect the whole planet.

With regard to the other two issues, the impact on Europe is greater than on other parts of the world. Why is that? The geopolitical landscape has reduced the prospect of continued growth in world trade. Europe is the world champion in world trade. We cannot expect world trade to be the engine of growth that it has been in the past, and that will affect Europe more. The second is the cost of energy. Also because of geopolitics, we have lost access to cheap resources. That will affect us more than others. On demographics, everyone knows that we are one of the regions of the world where this issue is becoming more critical.

We have a competitiveness problem and a lack of investment that is even worse than perhaps five years ago. In that sense, the Draghi report and the Letta report, which partly cover similar issues, are timely. There are a lot of common themes. My conclusion from both reports - and this will not surprise you, because I am who I am and I have spent my life trying to strengthen Europe - is that the answer is more Europe, not less Europe. Let us not forget what is happening in all the Member States. You have many parties that are - let us put it this way - nationalist. They do not believe that the solution lies in Europe. That has not been mentioned here, but we have to keep that in mind. The IFIs have to convince people, politicians and stakeholders that we can only solve these megatrends and the lack of competitiveness together.

A key point of both the Letta and Draghi reports is how we are going to finance this €800 billion of public and private investment per year, which is three times the size of the Marshall Plan. Obviously, most of it will have to come from the private sector. In the private sector, we are talking about Banking Union and Capital Markets Union. On Banking Union, we have unfinished business there, on the one hand the lack of a backstop for the single resolution fund, but on the other hand a common deposit insurance scheme. There is unfinished business.

In Capital Markets Union, we should really switch to the name that Letta suggests. It is an investment and savings union. That tells you why we need it. Talking about capital speaks only to enterprises and some public servants, but 'investment and savings' union talks to the people. The common ground here, also compared with the banking union, is that we have to move all the topics in this area in parallel. There cannot be winners and losers in this investment and savings union. This is key to understand.

Let me then turn to public risk-sharing and say a word about the new economic governance we have. The new Stability and Growth Pact provides the right framework for more investment. That is good news. The key now is to implement it in a credible way. That will not be easy, despite the room for manoeuvre in the new system. If we can have a credible implementation, I think it will encourage countries to go further in solidarity and perhaps have more public investment or more solidarity in public investment. We have to build trust.

Let me conclude by saying that I see a lot of good things happening. First, the NGEU. Who would have thought that we could agree on that? It is not finished yet, but I am convinced that the post-mortem will be positive, because it is not just a distribution of money. It comes with programmes. Let us look at the great work that the European Investment Bank (EIB) has done in the past. Its size has increased. Its leverage has increased. Let us look at the European Stability Mechanism (ESM). The

ESM is also a way of leveraging public money to help the private sector and our private economies.

I will end with the idea of Letta, who suggests that the ESM could eventually be made accountable by offering a precautionary line for defence spending. Again, you see that defence is something that is in everyone's interest. It is a public responsibility, but ultimately it is also a private investment. How can we leverage private investment? There is an idea that in the EIB and in the ESM there should be a kind of paid-in capital, as you can call it, or a part of the public money, but then the rest has to be done by the private sector.

Harald Waiglein

That was quite pragmatic. Maybe just a word on the Marshall Plan, because the Marshall Plan has often been quoted and compared to the NGEU. It is interesting, if you look at the history of the Marshall Plan, that the success story was in the countries that had no choice in implementing it. That was Germany and Austria, whereas in other countries, some of the victors who had more say and more responsibility, such as Britain and France, it was much less successful. This is just food for thought for the ownership debate. Here is someone who has decades of experience of financial crises, debt, industrial policy and where it all went wrong. I will now hand over to Jacques de Larosière, who has also published his new book. Jacques, how do you see this in the grand scheme of things?

Jacques de Larosière

I feel a bit on the sidelines of this discussion, because when I look at my own country, France, I see that there is a lack of investment and that growth is lagging behind, and I look at the causes of this. In a very objective analysis that I have made, I come to a number of observations.

The first observation is that French companies have lost much of their competitiveness because of the excessive weight of taxation. This excessive tax burden is the result of a very zealous policy of increasing public spending in the budget. This has been to the detriment of the private sector and of companies, which have had to bear the consequences of this excessive taxation. I am sorry to say that nothing in the reports that you have mentioned in the discussion will help companies in France to regain their competitiveness unless there is a very strong action to reduce excessive spending. This is a very important point, and it shows that fiscal policy in a country like France is at the heart of regaining competitiveness.

A second thing I wanted to say is that if we want French companies to invest more, we must have a sufficient number of companies that are able to invest. What I see is that France's industrial capacity has been reduced by a good third over the last 20 years. We have fewer companies and groups able to invest. If, in France, we take a share of the 800 billion euros that are presented to us in these reports, but we have fewer and fewer companies that can digest this money - and I can promise you that this is the case in my country - because the money cannot just be used for investment and has to be digested by a company that invests, it will not help.

We need to go back to basics. Fiscal policy needs to be more normal in a case like ours, and the number of companies able to invest needs to increase. It is not so much a question of money. We have a lot of savings in France, but these savings are not directed towards long-term investments. They are channelled into very short-term investments that do not benefit the real productive economy. The reason why there has been this shift of private savings from longer-term investments to very short-term liquid placements is that monetary policy has not helped the investment climate. If you want to invest your money in a long-term project - let us say 20 years - in an industrial technology - let us say energy improvements and ecological research - if you ask 'what will I get out of it', the answer is that you will get nothing in real terms.

Then the liquidity trap that Keynes described so well comes into play. The liquidity trap is what we are suffering from. I have done some studies on this which are absolutely convincing. It is that, instead of long-term projects, people prefer to finance or buy apartments that already exist, which do not add any value to the economy, or to participate in financial placements that are very speculative and where you really make money, because the values increase on the market, but it is only the financial value that increases. It is not the real increase in the economy.

I am sorry to say this, but I do not think that grabbing a little bit of €800 billion is the problem. The problem is that we do not have enough projects, and we do not have enough companies able to invest, and the reason why we do not have them is twofold. The fiscal position is completely overstretched and is too much of a burden on the corporate sector. The second is that monetary policy has not been conducive to long-term investment. Very low interest rates have encouraged the flight of this money into the dollar area. I have calculated that, at European level, the problem of the liquidity trap, the fact that long-term investment has not earned money in real terms because of the zero-interest rate issue, which forces savings into very immediate liquid placements and does not favour longer-term investment, has cost 800 billion euros a year. It is an irony of history that we ourselves have contributed to the flight of €800 billion a year and now we say: 'Ah, we have to borrow another €800 billion to make up for this flight of which we are the authors'. Yes, use the reports. They are excellent but let us look at the basics. Fundamental things will force us to be a little more normal in terms of the fiscal policy that we pursue and a little more normal also in terms of offering returns to people who accept to put their money in long-term companies.

Harald Waiglein

I will definitely take that to heart. It is never a bad idea to focus on the simple, basic things. We should do that more often. My second takeaway is actually in line with the International Monetary Fund (IMF). The focus should be on the corporate sector, regardless of what we think about public debt, but the corporate sector is where the productivity problem is. Thank you for listening.