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Common policies against common shocks

History tells us that crises happen. Some of them can be more easily anticipated. The Coronavirus outbreak, which is spreading around the globe, has little to do with economic fundamentals or the quality of economic governance. In addition to the huge stress it is placing on healthcare systems, it combines elements of supply and demand shocks which require measures to prevent the closure of firms and to support firms' and households' expenditure. It has also caused a confidence shock in financial markets, unleashing fire sales, a hurried search for liquidity and flows towards safe havens. This situation is likely to be transitory, but the speed and the scale of our response to the crisis and our ability as policymakers to work together will determine the strength of the recovery.

These events underline the need to strengthen EMU with a comprehensive package of common safety nets, robust joint policy tools, and a reinforced and effective coordination of national policies. Notable among common actions are those aimed at effectively materialising the capacity to share budgetary risks within EMU, and more broadly the EU. Joint fiscal actions in the face of this common shock would not only ensure maximum efficiency in our response, but also embody the solidarity values underpinning the European project. A common safe asset would be ideal, providing a neutral source of funding and simultaneously sending a strong signal of unity and goodwill. The world is watching. If not now, when?

We also need to conclude the Banking Union. The sizeable monetary policy and liquidity provisioning measures already taken will surely mitigate the risks in the banking sector. But we should not be complacent when it comes to raising a firewall against further deterioration of the crisis.

Regarding the current resolution framework, we need to accelerate the entry into force of its final stage. A fully centralised resolution mechanism will weaken the doom loop because it alleviates the burden of bank resolutions for national sovereigns. Given the observed progress in risk reduction, Member States should summon up the political resolve to bring forward the full mutualisation of the SRF, duly reinforced by the ESM as the common backstop. This is an essential step that would ensure that the SRM/SRF is fully operational.

A stable banking system also requires a credible safety net for depositors, especially during confidence crises. It is what prevents liquidity shocks such as the current one from morphing into banking crises and, eventually, bank runs. More generally, it allows for higher private risk-sharing, by increasing confidence in the European banking framework.

The current institutional arrangements of the Banking Union do not provide the required level of credibility. Banking activity transcends national frontiers, but the guarantee on deposits is still borne by Member States. The two pillars already in place have reduced moral hazard concerns by transferring supervisory and resolution power to common institutions. On the one hand, the Single Supervisory Mechanism provides a strong and neutral institutional framework for bank supervision across Member States. On the other, the Single Resolution Mechanism covers the uniform enforcement of resolution frameworks when a bank is failing or likely to fail. But, by retaining responsibility for deposit protection at the national level, an additional and important problem may arise, namely one of discredit of the banking framework. The alignment of power, responsibility and accountability is what provides the necessary legitimacy of any institutional arrangement.

Current circumstances are highlighting even more the need to strengthen our Union. Completion of the Banking Union and the deployment of mutualised fiscal instruments will contribute to the stability of the European Union, enhancing the necessary private risk-sharing channels and helping European citizens to overcome current and future crisis. ●