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Financial fragmentation in the EMU: what has been done and what remains to be done

We live in challenging times - Brexit, trade wars, weakening global demand. Sometimes it is easy to get caught in the news of the hour, in largely exogenous issues and miss the bigger picture - that there are endogenous structural challenges that are more relevant than ever.

The global financial crisis revealed several structural weaknesses in the Economic and Monetary Union (EMU). Most of them can be boiled down to a lack of financial unity in the EMU, in other words, the financial system is too fragmented. At the time of global financial crisis the member states were often cut off from the single market and had to face challenges in the banking sector singlehandedly, which made the burden very heavy to carry. The capital market, which was supposed to “step in” and fill in the void created by the banking sector, thus alleviating the credit crunch, failed to do so as it was also fragmented and, to a large extent, confined to the single member states.

Much has been done since then. We raised the confidence in our banking system by introducing and implementing the Single Supervisory Mechanism, which reduced fragmentation in terms of rules and regulations. Then the Single Resolution Mechanism followed; a member state no longer had to carry the burden of its banking sector issues on its own, which greatly increased the banking sector stability and issue resolution predictability in the whole EMU. The fragmentation in capital markets has not been forgotten as well. A significant amount of work has been done with substantial progress that we can be proud of. The agreement has been made on legislative initiatives ranging from harmonisation of rules and supervision to offering better options for retirement savings and improving SME’s access to capital. These milestones brought much needed unity in capital markets by reducing the fragmentation further and further. At the end of the day, can we say that the EMU financial system has significantly improved? Yes. However, have we done enough? No.

With the global financial crisis behind us, it is tempting to relax and gloat over the success achieved. However, as I have already mentioned, there is an ample amount of other issues, which despite their exogenous nature can be a substantial challenge to the EMU financial system and this time we need to be not mostly, but fully ready to face it. That is why I have always supported and called for a full completion of the Banking Union (BU) and Capital Markets Union (CMU).

The European Deposit Insurance Scheme (EDIS) is a still missing element of the Banking Union, which, I believe, will be setup one day. This would be a final nail in the coffin of instability and fragmentation of the banking sector. I understand political difficulties in risk sharing when the risks are not evenly distributed. However, I believe that a mutually agreeable balance could be found. On the other hand, the progress on risk reduction is evident. As a result, there is some reason to be optimistic regarding the eventual adoption and implementation of EDIS.

I firmly believe that in the long term every member of the EMU will benefit from stability, resilience and confidence a fully-fledged BU will bring. We should not forget that the EMU is not a zero-sum game. One member’s gain is not offset by another’s loss, despite the fact that it may sometimes seem so in the short-term - the EMU is a positive- sum game.

With regard to the CMU, the progress on remaining policies should be sped up. Nevertheless, I am glad that in addition to more traditional capital market aspects important sustainable finance issues are also being tackled. The initiatives on low carbon benchmarks and disclosure are agreed upon and only some taxonomy issues remain, which I believe will be tackled in the near future with full support from the Lithuanian side.

In addition to the aforementioned structural weaknesses of the EMU, I feel the need to touch upon one more issue which is crucial for the sustainability of the euro area - sustainability of public finances. It is vital that the Stability and Growth Pact rules are respected.

I understand the political and economic hardship this brings. However, the only way to address the sustainability of public finances is to focus on structural reforms inside the country, as, unfortunately, these reforms cannot be done from the outside. I wholeheartedly wish that these issues, wherever they may occur, are successfully resolved all across the EMU, as this will benefit us all.