

Leibniz Institute for Financial Research SAFE
Sustainable Architecture for Finance in Europe (https://safe-frankfurt.de/)

# **SAFE Finance Blog**

## What effectively helps Europe achieve greater unity

07/02/2020

Jan Krahnen: Germany's 2020 EU Council Presidency is an opportunity for sustainable development towards a political union regarding capital market, banks and the budget



When Angela Merkel's economic policy credo is to be followed, the German EU Council Presidency for a period of six months from 1 July 2020 onwards is going to make Europe stronger again. The focus on a few policy areas, as declared by the Chancellor, in order to revive the European economic area in the foreseeable future after the effects of the corona pandemic can point in the right direction if short, medium, and long-term goals are set correctly and filled with ambition.

In our view at SAFE, **three areas are of paramount importance**: intensive treatment of the capital market union, completion of the banking union, and courageous planning of a fiscal union — so that Europe can be helped to become more resilient and thus ultimately more united.

#### Intensive treatment for the capital market union: reform of market supervision

Europe's further developments towards a European capital market union worthy of the name finally requires a uniform European market for debt and equity capital in which the same rules of the game apply to all companies listed on the market. For this reason, **the current regulatory and supervisory patchwork should be substituted** by a lean uniform market supervision modeled on the US Securities and Exchange Commission SEC, which is the global style-setter. The centralization and new supervisory authority with strong powers of intervention — let's call it the "European Single Market Supervisor" (ESMS) — can then effectively replace London's previous leading role and thus mitigate the consequences of Brexit for the capital markets of continental Europe. The limits of national stock exchange supervisory authorities can currently be observed very well using the example of the payment service provider Wirecard in Germany.

It is difficult for a national stock exchange supervisory authority, which is closely linked to banking supervision and is therefore not independent, to create confidence in a market architecture that is primarily designed to protect investors, shares, and bondholders. If both international and national investors, such as pension companies, are to strengthen the domestic economy, market supervision with strong enforcement powers that can enforce uniform standards is needed.

## Completing the Banking Union: More power for banking SSM and SRM

The Banking Union is an area that has made great progress since the major financial crisis of 2008 (https://safe-frankfurt.de/news-latest/all-news/news-view/europes-banking-union-is-alive.html). With the current state of regulation, the Bank Recovery and Resolution Directive (BRRD) provides a viable legal framework based on the principle of private liability. Much remains to be done, however. For example, there is still a lack of consistent supervision of all credit institutions in the eurozone regardless of their size. Moreover, there is a lack of functioning coordination between the Single Supervisory Mechanism SSM and the Single Resolution Mechanism SRM. As a result, in recent years not a single credit institution has been "passed on" from SSM to SRM. For this reason, the so-called bail-in regulation, the participation of private creditors in bank losses, of which we are so proud of in Europe, has not been used to date. In this respect, every effort must be made to enforce private liability and to prevent hasty rescue attempts by banking associations.

There is also a lack of a uniform and credible deposit insurance scheme across Europe. Linked to this is the shift in the focus of banking supervision away from controlling bank management (micro-management of the assets side) towards a more stringent control of the liability requirements for equity and debt capital in the bank balance sheet (micro-management of the liabilities side). Europe's banking regulation therefore must set the regulatory framework in such a way that banking risks can be controlled by the markets themselves in order to complete the banking union as a whole as quickly and comprehensively as possible.

### Planning a fiscal union: a European budget?

As the German Chancellor said in her statement on Germany's EU Presidency 2020, the Corona crisis has once again highlighted the imbalance in the fiscal room for maneuver among the European member states. **Europe's development into a partial fiscal union** can ultimately help in the long run to curb the centrifugal forces within the eurozone that result from the existence of a monetary union in the absence of overall fiscal responsibility at EU level. A partial fiscal union does not mean a complete handover of national sovereignty over taxes and the budget to Brussels, but rather the supranationalization of certain tasks where added value is possible and sensible.

For example, defense policy, foreign policy, border controls, and possibly economic policy could be spent from a European budget while other items such as education, social security, and pensions would remain a national responsibility. What is important above all is that the European structured budget is controlled as

democratically as it is at the national level, by a strong, directly, and equally elected parliament that holds the government(s) responsible. This development naturally requires a revision of the Lisbon Treaty, which is a task that most politicians currently shy away from. Germany could lead the way here and take the risk. Otherwise, Europe is threatened with an ongoing crisis of legitimacy.

The triad of capital market, banking, and fiscal union provides policymakers with the necessary tools to repair old lines of conflict and new vulnerabilities to crises. Whether these tools will be used in the near future is now in Germany's hands and a rare opportunity of a historic footprint for the Berlin government.

## **Further reading**

SAFE White Paper No. 63 (https://safe-

frankfurt.de/fileadmin/user\_upload/editor\_common/Policy\_Center/SAFE\_White\_Paper\_63.pdf): Completing Banking Union (https://safe-

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SAFE White Paper No. 66: Reform der Einlagensicherung (https://safe-

frankfurt.de/fileadmin/user\_upload/editor\_common/Policy\_Center/SAFE\_White\_Paper\_66\_final\_pdf.pdf) (in German only)

SAFE Policy Letter No. 85: Priorities for the CMU agenda

SAFE Policy Letter No. 88: The Wirecard lessons: A reform proposal for the supervision of securities markets in Europe

(https://safe-frankfurt.de/fileadmin/user upload/editor common/Policy Center/SAFE Policy Letter 88.pdf)

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Keywords: Macro Finance (https://safe-frankfurt.de/news-latest/safe-finance-blog/search-result-blog.html? tx\_news\_pi1%5BoverwriteDemand%5D%5Bcategories%5D=206&cHash=c24373ed7eda58252edb7a48be7be7Banking Regulation (https://safe-frankfurt.de/news-latest/safe-finance-blog/tag/banking-regulation.html), Banking Supervision (https://safe-frankfurt.de/news-latest/safe-finance-blog/tag/banking-supervision.html), Banking Union (https://safe-frankfurt.de/news-latest/safe-finance-blog/tag/banking-union.html), Capital Markets Union (https://safe-frankfurt.de/news-latest/safe-finance-blog/tag/capital-markets-union.html), Fiscal Policy (https://safe-frankfurt.de/news-latest/safe-finance-blog/tag/fiscal-policy.html)









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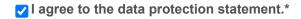
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Bank capital and the European recovery from the COVID-19 crisis (https://safe-frankfurt.de/policy-center/policy-publications/policy-publ-detailsview/publicationname/bank-capital-and-the-european-recovery-from-the-covid-19-crisis.html)

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