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The EU Economy: A Construction Site

Low growth, high unemployment in Southern European member states, TTIP negotiations and EU economic integration stalling, this is how headlines about the EU economy often look like these days.

This issue of the Future of Europe Observer analyses the implementation of current EU measures put in place to counter economic stagnation, shedding light on planned policies the EU has announced in this field.

Contents

Future of Europe Observer

accompanies the debate on governance and regulation in the European Union. Authors are ZEI Scholars, Master of European Studies Fellows and Alumni.

An Investment Plan for Europe

The European Union is suffering from low growth and high unemployment levels. Since 2007, investment rates have dropped 15 percent and credits are more difficult to obtain due to risk averse financial institutions.[1] From a macroeconomic perspective, low investment levels are bad for two reasons: (I) in the short run, low investment levels slow down the process of recovery, and (II) in the long run, productivity, innovation and employment suffer.[2] This macroeconomic reasoning is the backbone of the European Commission's Investment Plan and Juncker's agenda to boost jobs, growth and investment.

The Investment Plan aims at reducing difficulties to invest and allocate existing financial resources more efficiently, especially in the areas of infrastructure, education, research and innovation. Concrete measures include improved access to finance for Small and Medium Enterprises (SMEs), improved cooperation between national banks and EU initiatives, removal of non-financial barriers, provision of technical assistance, and allowance for flexibility in the Stability and Growth Pact for member states contributing to the budget.[3]

The Investment Plan materialised with the creation of the European Fund for Strategic Investment (EFSI), the institution in charge of operational aspects.[4] A steering board is in charge of the overarching direction, an investment committee for the actual project selection, and a special task force for identifying barriers to investments and screening potential projects.[5] With an initial budget of €21 billion, the Commission estimates yields of €315 billion in additional finances to investments until July 2018, and the creation of at least one million new jobs. The multiplier effect of times 15 is calculated by accounting for EFSI's risk profile and can be derived as followed: every initial euro protected by the EFSI is expected to create two additional euros in subordinate public debt.[6] In turn, every euro of subordinate debt is expected to create four additional euros in senior debt[7] through private investment.[8] Member states are encouraged to contribute to the budget, which so far nine have done.[9]

Until April 2016, the EFSI approved €11.2 billion in finances. Total investments related to EFSI approvals were calculated to an amount of 82.1€ billion, reaching over 220 investment projects in 25 member states. This corresponds to a multiplier effect just above times seven. While this is far from target, it is likely that the relationship between increased access to finance and investments will be exponential. So far, the EFSI board appears confident of reaching an average leverage ratio of 1:15 for the whole period. The allocation of finances to different sectors can be seen in the chart below.[10]

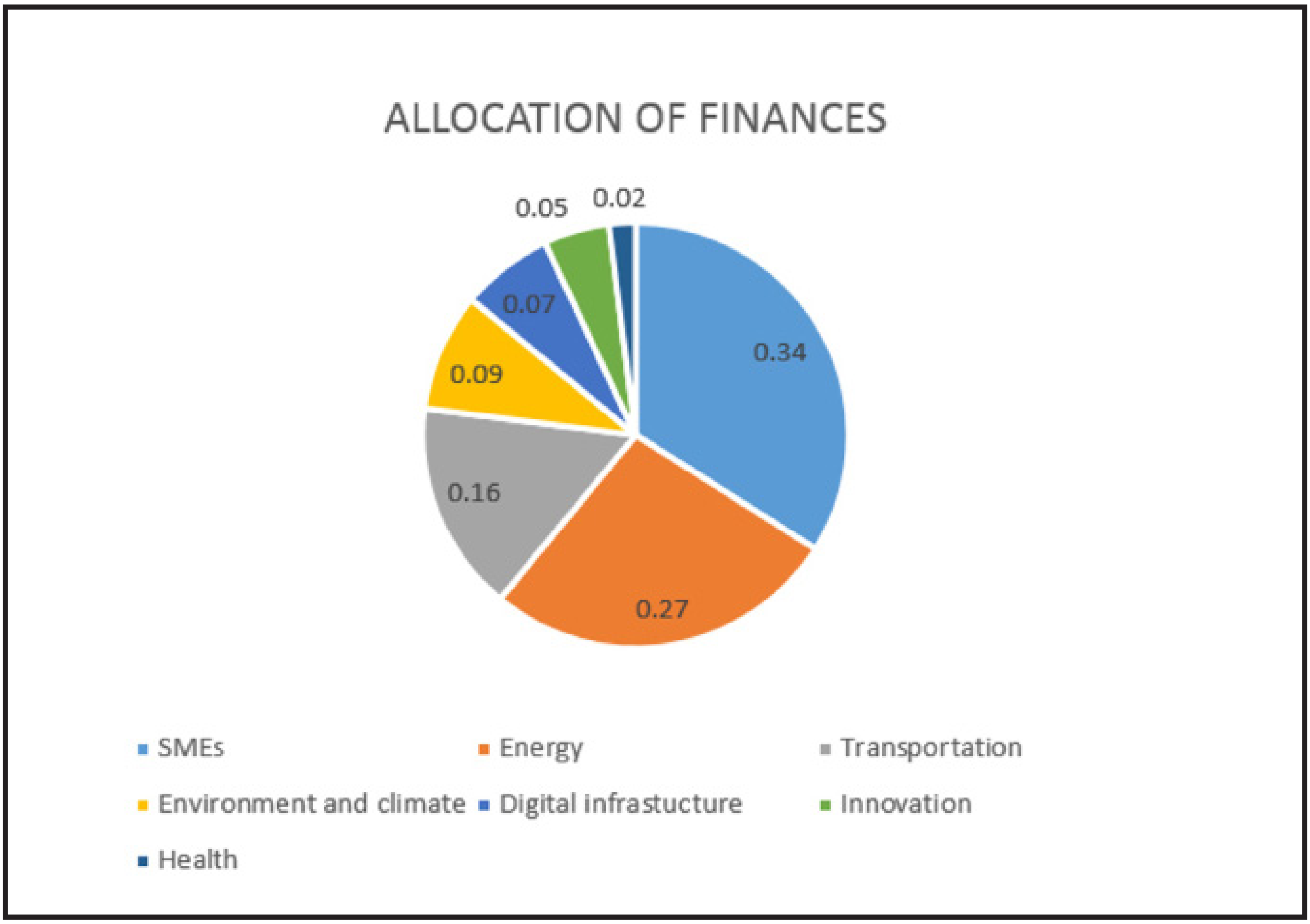

Chart 1: Allocation of finances (percent) (European Commission, 2016)

The large allocation to SMEs is in line with the Commission's overall strategy to support SMEs, as they have large potential to grow and increase both demand for labour and GDP.[11]

While the general view is that the Investment Plan and the EFSI are positive initiatives, some reservations have been expressed. The most controversial aspect is the leverage ratio, argued to be overly ambitious or even unrealistic due to the heavy reliance on private investment. Then there is the question of additionality: How much of the EFSI finances are de facto additional contributions to EU investments, as the budget of €21 billion is reallocated from the EIB budget and other EU projects?[12] The same line of reasoning can be applied to national contributions. It is hard to determine whether these contributions are additional or solely represent a reallocation of financial funding already dedicated to projects that would benefit similar developments. An impact assessment of the Investment Plan must therefore be measured against the return the money would have generated in the initial EU framework, from normal EIB lending practices, and from the initial intention of member state contributions.[13]

Furthermore, the Commission is treating all the member states as a single entity, where there in reality are large differences in both investment rates and interest rates.[14] The Investment Plan is therefore likely to disproportionately benefit politically and economically stable countries. To illustrate this, imagine an investor choosing between a project in Greece and Denmark. For investments in Greece, higher risk premia must be incorporated due to the country's recent political and economic instability, whereas the same investments in Denmark require much lower risk premia because of its stable institutions and proven resilience during the economic crisis.[15] Additionally, countries with a highly educated population are, in the EFSI framework, able to apply for credits with less effort than countries with lower human capital levels, making concerns of economic divergence a real threat. The Commission should consider geographical guidelines and increased support for countries with lower human capital levels to prevent an investment bias.[16]

In regards to the current challenges facing the EU, most urgently the migrant crisis and the upcoming Brexit vote, it is important to evaluate the Investment Plan to ensure stable economic movements to counter disruptive trends. Structural change is at this point not only desired but required to improve economic conditions.[17] Inefficient and uncompetitive tax regimes, unbalanced accounts, and rigid labour markets are no longer sustainable, despite public and political resistance. This need to reform, complemented by a restructuring of oligopolistic markets and enablement of cross-border investments in electricity and gas, for example, has the potential of generating sufficient investment returns and significantly improve the investment climate in Europe.[18] Still, the success is dependent on whether the Commission can address the issues mentioned in this article.

Although this article is merely one tangent to a much more complex field, it may be reflected upon in order to enable for a wider discussion on the bigger issue of boosting jobs, growth, and investment across the EU. The Investment Plan is bound to have some positive effects and should be seen as an important component of growth promotion. Not however as the only policy response! As a final point, a stronger willingness of member states to devote long term commitment to EU affairs is a precondition for any large scale undertaking. Without such a shared strategic direction, the Investment Plan is bound to have a quite limited impact.

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4. ibid.
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Banking Union: European Bank Deposit Insurance Scheme

In June 2012, the European Council announced the historical decision for the creation of a European Banking Union as a response to the Eurozone crisis and with the declared goal to "ensure that the supervision of banks in all EU member states is equally effective in reducing the probability of bank failures".[1] The foundation of the Banking Union is the Single Rulebook, which is based on three pillars: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the European Deposit Insurance Scheme (EDIS).

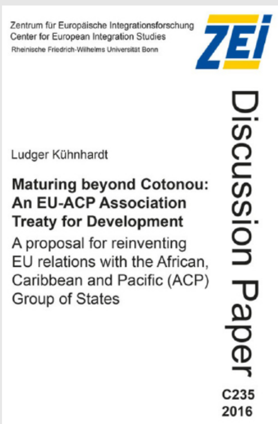
While the Single Supervisory Mechanism and the Single Resolution Mechanism are already implemented and in operation since November 2014 and January 2016 respectively, the third pillar is still missing.

According to the proposal by the European Commission on the 24th of November 2015, the EDIS would be the third pillar of the Banking Union and include every deposit-taking bank in the Banking Union, with the aim of preventing capital flight and deposit outflows. The proposal would amend the existing regulation (EU) 806/2014 establishing the Single Resolution Mechanism and the Single Resolution Fund.

New ZEI Discussion Paper C 235/2016

Maturing beyond Cotonou: An EU-ACP Association Treaty for Development. A proposal for reinventing EU relations with the African, Caribbean and Pacific (ACP) Group of States

by Ludger Kühnhardt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2016

In this Discussion Paper, ZEI Director Prof. Dr. Ludger Kühnhardt takes stock with the EU-ACP partnership and makes bold proposals for its future: He calls for a strategic maturation and the negotiation of an "EU-ACP Association Treaty for Development".

The idea behind the EDIS is a common deposit insurance mechanism that should be introduced gradually, in three separate phases between 2017 and 2024, complementing national deposit guarantee schemes.[2] Phase I of the EDIS, the re-insurance phase, would last until 2020 and would provide a specified amount of liquidity to assist the national deposit guarantee scheme in a bank resolution procedure or in the event of a pay-out. Phase II, the co-insurance phase, would last for four years until 2024. The EDIS would increasingly take on higher shares of the losses incurred by the national deposit guarantee schemes over this period. In practice, the costs for covering deposits would progressively be shared between the national deposit guarantee schemes and the EDIS. Finally, the full insurance scheme would start from 2024 with the EDIS becoming a fully functioning deposit insurance scheme across the euro area and covering all liquidity needs related to bank resolution schemes or pay-outs.[3] Funding of the EDIS would be ensured through ex-ante contributions from financial institutions in the euro area, while each bank's contribution would be calculated on the basis of that bank's risk profile and amount of deposits. The fund's absolute size would be equivalent to 0.8% of the covered deposits of all banks in the Banking Union and cover losses up to EUR 100.000 per depositor and bank.

While it is generally agreed, that a Banking Union is considered complete when three basic functions – supervision, resolution and deposit insurance – are carried out by a single or 'common' institution, there is disagreement about the third function in the EU.[4] Some authors argue that key conditions for this third pillar have not even been set up properly. [5] Basically, the purpose of a deposit insurance is to prevent a run on deposits. However, within the euro area, the probability of a generalised bank run in any member state is much greater than in countries with an own national currency, since depositors could simply transfer their accounts abroad and continue their banking activities in the same currency. Thus, it is of great importance to provide savers with confidence about the safety of their deposits, even if an entire member state is under stress. Daniel Gros, Director of the Centre of European Policy Studies (CEPS), suggests a two-tier approach as in Phase I of the three phases of EDIS, the re-insurance phase, in order to address the issue of the reaction to the failure of a small bank in comparison to a systemic crisis at national level. The re-insurer (EDIS) would therefore only intervene in the event that the national deposit guarantee scheme would be overrun. Second, distribution of bank failures tends to be concentrated rather than distributed evenly over member countries. This often suggests a national, macroeconomic root cause for widespread or systemic banking crises. In reality, such a scenario can be addressed more effectively through a re-insurance approach than in cases where resolution and deposit insurance are centralised at European level.[6] Third, there is the issue of banks holding large amounts of debt of their own government. Indeed, the strong ties between banks and sovereigns are an obstacle in order to mutualise the protection of depositors. Government bonds are considered risk-free and exempt from capital requirements. However, this is one of the main reasons banks are so dependent on their national economic situation. With no restrictions on sovereign debt holdings currently in place, insolvency of the state immediately results in insolvency of all the countries' banks. Not addressing this issue properly, would introduce Eurobonds through the back door as sovereign debt could be mutualised through the EDIS.[7]

Moreover, since its proposal in November 2015, the European Deposit Insurance Scheme (EDIS) has been little discussed at European Council level mainly because achieving consensus on its set-up amongst euro area governments has proved to be a real challenge. On top of that, the third pillar has been widely considered as a positive development, but far less urgent than the other two mechanisms; in fact, there is a wide perception of being well-equipped already. This noticeable loss of momentum is displayed through repeated postponements.[8] So far, the ordinary legislative procedure regarding the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 806/2014 in order to establish a European Deposit Insurance Scheme has not come much beyond obtaining national parliaments' opinions. Discussions in the ECON Committee are the next steps expected for this year, before a draft report will be submitted for Committee vote.[9] As of today, adoption is still far from realisation.

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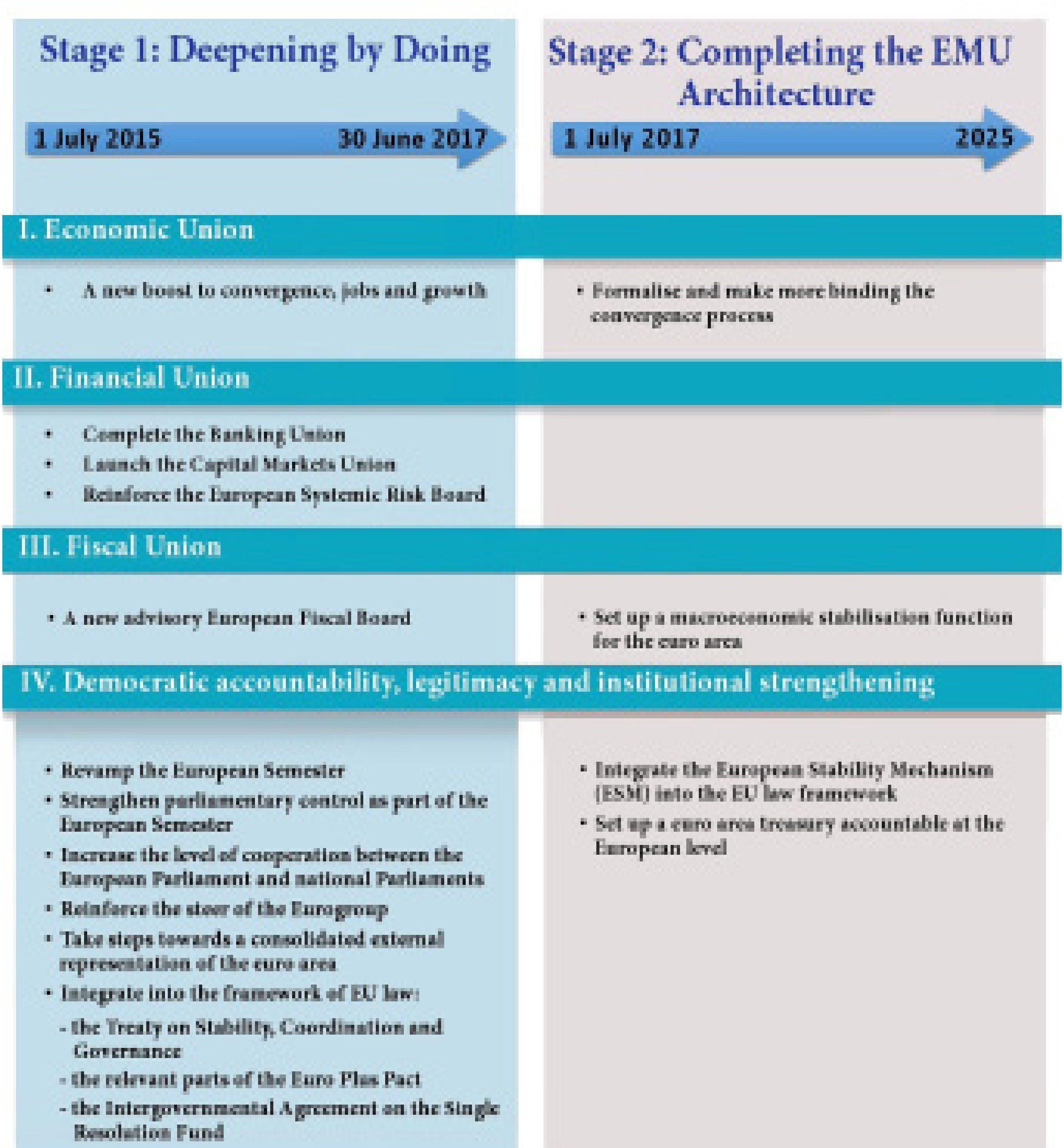
The Five Presidents' Report: Completing Europe's Economic and Monetary Union

On the 22nd of June 2015, the five Presidents – European Commission President **Jean-Claude Juncker**, the President of the Euro Summit **Donald Tusk**, the President of the Eurogroup **Jeroen Dijsselbloem**, the President of the European Central Bank **Mario Draghi** and the President of the European Parliament **Martin Schulz** – revealed ambitious plans on how to deepen the Economic and Monetary Union (EMU) as of the 1st of July 2015 and how to complete it by latest 2025.



EU-US Free Trade
TTIP Negotiations: Progress Update and Outlook

The world order has shifted as a result of the rise of emerging countries and the perceived declining influence of the West. The emerging powers are more likely to act as 'rule makers' rather than 'rule followers' as they have been promoting alternative initiatives and intergovernmental organisations to increase their international leverage. China for instance, has put forward the One Belt One Road (OBOR) initiative and the Asian Infrastructure Investment Bank (AIIB). Russia for its part has promoted the creation of the Eurasian Economic Union (EEU). Last but not least, the BRICS, composed of the biggest five emerging economies have reached consensus on new development strategies. Against such a backdrop, the United States and the European Union are seeking to maintain their leading role in global governance through various instruments. Amongst them, the most important one is the Transatlantic Trade and Investment Partnership (TTIP) that is still under negotiation. As Klaus Günter Deutsch argues, TTIP is 'being driven by the joint concern that standard-setting power could be increasingly lost to China, and transatlantic cooperation is the only way the two sides can continue to assert their market power and preserve their mutual economic interests worldwide[1].

Although the reason why TTIP should be reached seems clear for both the United States and the European Union, the path towards this goal seems rather steep. Indeed, TTIP negotiations have proven to be complex and are held in week-long cycles planned and conducted by 24 EU-US High Level Working Groups. The first round of negotiations took place on the 7th of July 2013 in Washington D.C. and a total of thirteen rounds have been completed so far. The negotiations began with the discussion on the harmonisation of regulations on energy and raw materials, including technical barriers to trade. Another area that the negotiations focused on was investment. There have been discussions concerning the alignment of the EU's and US' approaches to investment liberalisation.[2] It is anticipated that detailed texts will be drafted in the rounds to come. Both sides have in principal agreed on regulatory coherence and specific commitments in sectors such as medical devices, cosmetics. While the EU and the US have reached mutual agreement on chemical, pharmaceutical and automotive industries (whose potential mutual benefits are considerable), they still cannot agree on agricultural issues and investment rules where they persist having differences. Furthermore, TTIP negotiations have revealed different areas of controversy between the EU and US, including public education, copyright, data protection, and the Investor-State Dispute Settlement (ISDS).

First, concerning public education, EU member states hold different opinions on the export of education services, the movement of students, teachers and administrators. Because of lack of consensus on this issue, the EU has revised its proposal on services related to education.

Second, the copyright and data protection chapter has been closely linked with the Commission's initiative on building a Digital Single Market. The EU will amend current regulations on the digital market before making detailed commitments to TTIP. Additionally, the EU has started a data protection plan with the help of Germany that has the strictest data protection laws in the EU.[3] With these measures, the intention is to protect personal data from being used by foreign intelligence agencies and for commercial purposes. A new round of negotiation will be held before the summer break, most likely in July.

Third, with regard to the ISDS provisions, many critics claim that "the ISDS provisions are undermining the power of national governments instead of acting in the interests of their citizens", and that "TTIP could even undermine the democratic authority of local government"[4]. The public opposition in EU member states particularly that in Germany and in the UK has not shown any sign of weakening yet. In April 2016, during Barack Obama's visit in the UK, more than 130,000 people signed a petition urging Obama to stop negotiating TTIP.[5] Similarly, following his visit in Germany, thousands of demonstrators protested in Hannover against TTIP. One of the major concerns the protesters have is that detailed negotiation documents are only open to accredited member state representatives and legislators for internal consultation.

The ultimate goal of TTIP is to solidify the transatlantic partnership against the challenge from rising economies as a successful TTIP could boost economic growth, job creation and remove bilateral tariff and non-tariff barriers. It could also provide financial benefits to both sides of the Atlantic as a way to establish global trade governance. TTIP has also the potential to bring positive impact to the EU-US energy relations with guaranteed automatic licenses for all future US crude oil and gas exports to Europe, global trade system, third countries, and the overall state of the transatlantic relationship with the harmonisation of standards[6]. From the EU-US perspective, these new changes will lay a new economic foundation to the western transatlantic alliance comparable to that of the EU's single market, possibly leading to a transatlantic common market.

However, the outcome of elections in both the US and some EU member states such as Germany and France in 2017 is likely to stall negotiations. To cope with such a foreseeable challenge, the European Commission should build a better and more feasible political communication strategy to tackle diminishing public support. Finding achievable proposals may lead to a mutually advantageous TTIP agreement. Eventually, a successful TTIP will re-unite the EU and the US and create a new platform for joint cooperation. Eventually, it may evolve into a regulatory and political role model for future trans-continental trade agreements beyond the western hemisphere.

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