

The UK Balance of Competences Review on Economic and Monetary Policy

Event Summary - Chatham House Roundtable workshop

Wednesday 25th June

The following main points were made in the discussions. The event was held under the Chatham House rule.

- There is a high level case for economic co-ordination among countries based on the potential for serious spill-overs. The Treaty already states that Member States must treat their economic policies as a “matter of common concern”. But, the key question is, which areas have the greatest spill-overs?
- The system of economic governance in the EU was insufficient pre-crisis, with macroeconomic imbalances not being picked up early. In response to this, Herman Van Rompuy created a taskforce on economic governance out of which the “six-pack” and “two-pack” legislation arose.
- Participants agreed that greater co-ordination among euro area Member States is needed going forward. This however raises further questions:
 1. What are the institutional challenges for the UK?
 2. How can we make the EU work for the euro area while ensuring parity for non-euro area countries? and
 3. How can the single currency and single market work together/alongside each other?
- One participant raised three further and interrelated questions:
 1. What is the balance between national and supra-national decisions?
 - i) There is a political question regarding sovereignty and subsidiarity.
 - ii) There is also an economic question about how far policy co-ordination is worth doing.
 2. What is the relationship between euro area ‘ins’ and ‘outs’?
 3. How do particular instruments work and do they achieve their desired objectives?
- In response to the first question, this participant argued that there is a case for supra-national co-ordination. This is because:
 1. The costs of not co-operating are potentially high, for example if trust breaks down and countries enter into a trade war (although the panellist argues that structures in Europe have meant that you almost certainly wouldn’t and couldn’t get into an egregious case of breaching the Single Market);
 2. In extreme circumstances (for example a credit crunch) spillovers increase enormously, and the costs of not co-operating are massively increased. This explains the pressure to reform the governance system.
 3. Co-operation requires a basic agreement on the size of spill-overs. All Member States need to agree that failure to co-operate can have negative effects. In the EU, this debate took a long time to happen. The MIP is an example of a meeting of minds. Spillovers are greater in

the euro area than elsewhere. Therefore, there is a need for further integration. Further integration is needed to ensure financial stability, fiscal integration, and the creation of a lender of last resort to act as a backstop.

- On the second question, this participant argued that the health of the EU/euro area has an impact on the UK. Therefore, it is important that the UK continues to support further integration among euro area Member States. But, this also is likely to cause political and economic problems for the UK, especially in terms of the risk of euro area caucusing. One of the main challenges for the UK is the increasing the role of the Eurogroup and the effect of changes to the Qualified Majority Voting Rules which come into effect in November. Therefore, it is important that the UK continues to secure important safeguards to protect its interests in the future.
- One participant argued that the co-existence of euro area and UK would need a change in mind-set, suggesting that the EU could comprise one banking union for the Single Market and one for the euro area.
- There was wide agreement by those present that the UK should not join the banking union. One participant argued that the European Central Bank (ECB) is likely to supervise EU banks in favour of euro area interests. The ECB will have an interest in capping banks' exposure to their sovereign to avoid the "doom loop" between banks and their sovereigns that characterised the euro area sovereign debt crisis. The UK, on the other hand, does not have this problem given its independent monetary policy. Therefore, it is unlikely that the banking union will negatively impact the City.
- Some participants suggested that further integration in the euro area would take the form of a confederation, with further intergovernmental agreements. They consider these tensions to be manageable. But, they argue, that there could be a case for the UK to join the banking union to maintain the City's pre-eminent position in financial services.
- Some participants questioned whether euro area integration was as big an issue as some had made out. They did not consider the euro area to be a caucus outside of financial stability issues, while the UK had actually gone further than the EU on prudential regulation. Moreover, it was unlikely that the UK would be alone as a euro 'out' in the near future.
- The effectiveness of the new policy mechanisms was also discussed. Post crisis, the EU has adopted certain measures to strengthen its governance framework and certain rules had been enacted to avoid a future crisis. One participant was of the view that the new mechanisms had made things worse, as effective monetary policy is not a solution to all problems. Another participant commented that without appropriate transfer mechanisms/burden sharing the only means of adjustment were painful internal devaluations.
- There was also a brief discussion between participants on the issue of the role of fiscal policy in responding to the crisis. It was considered difficult to resolve arguments between the Keynesian view (use fiscal stimulus to get growth and reduce deficits) and traditional view (need austerity to get growth).