THE NEW ARCHITECTURE OF ECONOMIC GOVERNANCE IN THE EUROPEAN UNION

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Abstract: The economic crisis that began in 2007-2008 has highlighted the need for a stronger economic coordination at EU level, to ensure financial stability. The new architecture of economic governance in the European Union is based on Fiscal Pact, on Macroeconomic Imbalances Identification Mechanism, on European Stability Mechanism and on Banking Union. Since the banking system is the most significant component of the financial system, we will give more importance to the analysis of Banking Union, which is based on three pillars: The Single Supervisory Mechanism, The Single Resolution Mechanism and The Deposit Guarantee Schemes.

Keywords: Fiscal Pact, Macroeconomic Imbalances Identification Mechanism, European Stability Mechanism, Banking Union, European Union.

JEL Codes: O23, P43, L51.

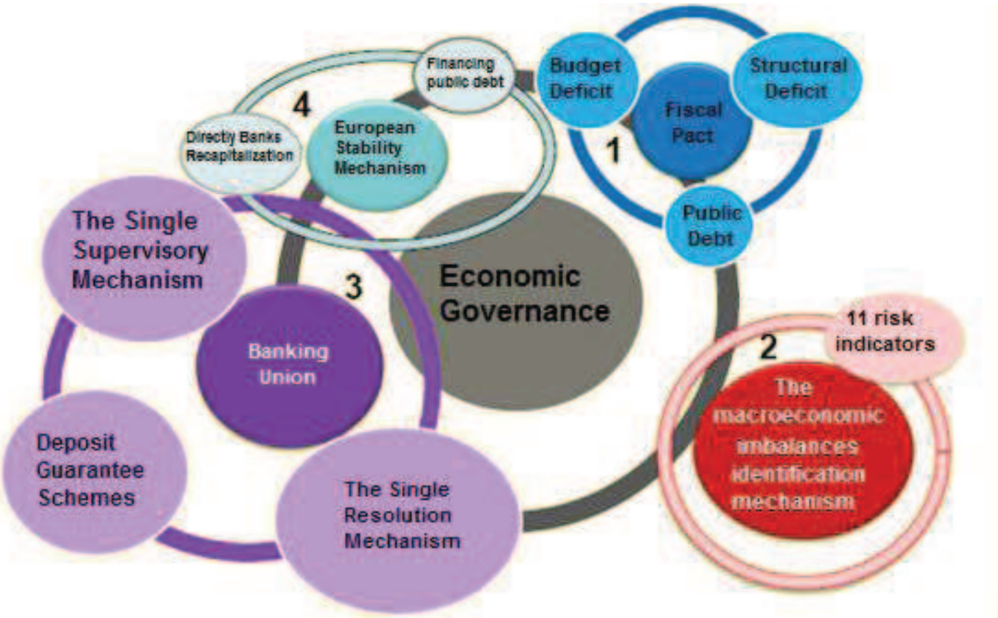
1.Introduction

To restore confidence and to ensure stability in the euro area is necessary to strengthen the institutional framework of Economic and Monetary Union. At European Union level, the new architecture of economic governance is based on Fiscal Pact, on Macroeconomic Imbalances Identification Mechanism, on Banking Union and on European Stability Mechanism.

These mechanisms focus on the following aspects (see figure 1):

- Fiscal Pact: budget deficit, structural deficit, public debt;
- Macroeconomic Imbalances Identification Mechanism : 11 risk indicators;
- European stability mechanism: directly banks recapitalization, financing public debt;
- Baking Union: the Single Supervisory Mechanism, Deposit Guarantee Schemes, the Single Resolution Mechanism.

Figure 1: The new architecture of economic governance in the European Union



Source: Georgescu, 2014

2. Fiscal Pact

Fiscal Pact objective is to strengthen fiscal discipline within the euro area through the "budget balance rule" and an automatic correction mechanism. Fiscal Pact was signed on March 2, 2012 for 25 EU countries, except the Czech Republic and the UK.

According to Fiscal Pact, countries that joined it must have a balanced or a surplus national budget or must have a speed of adjustment of the structural deficit > 0.5% of GDP / year by MTO; MTO is the medium-term objective for the budgetary position and differs for each EU Member State. In the case of Romania, the structural deficit must be 1% of GDP.

In addition, the deficit should be in line with the minimum long-term sustainability of the country, established by the Stability and Growth Pact. Temporary deviation from the 'golden rule' of budget balance is only allowed in exceptional economic circumstances, for example in the case of economic decline. If public debt exceeds the 60% of GDP, the deficit limit may be set at 1% of GDP.

If a member state deviates from the golden rule of budget balance will trigger an automatic correction mechanism. It will have to correct deviations in a clearly defined time period. On the other hand, automatic correction mechanism will have to respect the prerogatives of national parliaments. In case of deviations from the programe assumed, deviations considered significant by the European Council, it can make recommendations and substantial monetary sanctions.

3. The macroeconomic imbalances identification mechanism

To detect macroeconomic imbalances, there are built scoreboards and are used 11 indicators with specified limits. Deviations from limits are determined automatically applying corrective side; These signals are combined with a detailed analysis of the economy, including through technical evaluation missions. Economic plans for medium-term stability or convergence are approved in advance by the European Council (Georgescu, 2014).

The European Council may issue recommendations or warnings to imbalances identified; their failure and lack of a national plan of correction attract penalties (Georgescu, 2014).

4. Banking Union

Banking Union aims to build an integrated financial framework to safeguard financial stability and minimize the costs of bank failures. The necessity of the Banking Union is based on the following arguments:

- Stopping the current trends of fragmentation of financial markets in the European Union, which is incompatible with the existence of an Economic and Monetary Union;
- Breaking the vicious circle of distressed banks and debt of the states;
- Prevention of bankrun, strengthening financial stability and restoring market confidence in the euro;
- Unique surveillance is a prerequisite for applying the direct capitalization of euro area banks by the European Stability Mechanism

The three pillars of the Union Bank are:

- The Single Supervisory Mechanism (SSM) – The transfer of the main responsibility regarding banking supervision from national to European level;
- The Single Resolution Mechanism (SRM) - Introduction of common provisions to ensure legal support required to manage bank failures problem;
- The Deposit Guarantee Schemes (DGS) - Harmonization of deposit guarantee rules (Georgescu, 2014).

4.1. The Single Supervisory Mechanism (SSM)

European Central Bank will directly supervise only 'significant' banks, the rest remaining the attribute of the national authorities. In the euro area, there are approximately 130 'significant' banking groups, which are separated from the rest of the banks according to their size, their importance to the national economy or the EU and the importance of cross-border activities.

The European Central Bank will supervise direct the following, also:

- banks that have applied for or have received public financial assistance directly from the EFSF or from ESM;
- banks less significant, when it is necessary to ensure consistent application of high standards of supervision;
- three of the largest banks from each participating member state (Georgescu, 2014).

The ECB will directly supervise about 85% of banking assets in the eurozone.

However, the activity will be governed by a single monitoring manual and all data of supervisory will be sent to the ECB. The European Central Bank will be able to directly supervise any bank or group of banks that represent a potential source of systemic risk.

The regulation regarding the Single Supervisory Mechanism came into force in November 2013, and the ECB has provided 12 months for its operationalization. In April 2014 the ECB published the Framework Regulation which establishes SSM conduct business. ECB will assume full supervisory duties from November 4, 2014 (Isarescu, 2014).

Potential conflict of interest generated by assuming a dual role by the European Central Bank's role as monetary authority and supervision, was settled by:

- Implementing a decision flow that completely separates the two activities by establishing the Supervisory Board;
- Building institutional capacity of ECB for supervision activity – ensure the specialized staffing;

4.2. The Single Resolution Mechanism (SRM)

During the recent financial crisis, a number of European banks had to be supported by public funds (bail-out). Use of public funds for this purpose, although it was considered necessary, is not sustainable in the future. (Georgescu, 2014).

The transnational consequences of a banking crisis justify building a resolution mechanism at european level.

Its objective is impartial and effective management of banking crises so as to minimize negative impacts on the economy and call for public funds.

The principles governing SRM are:

- A functioning market economy requires exit from the market in case of failure;
- Resolution cost to be support first by shareholders and creditors. "Resolution" involves restructuring a bank / financial institution by a resolution authority, using specific tools.
- The involvement of public funds should be only one last resort and accompanied by measures to ensure medium-term fiscal neutrality;
- Avoiding a potential conflict between the goals of structure decision by administration of of this mechanism by a single authority resolution different from the ECB, but with a similar broader institutional and geographical coverage (Ferran and Babis, 2013);

SRM will include all banks in the euro area and the Member States participating. It involves the distribution of responsibilities between the Single Board Resolution and the National Authorities Resolution.

Single Board resolution is directly responsible for cross-border banks and banks 'significant'. National Authorities Resolution are responsible for all other banks and for decisions of resolution for them, on condition of non-involvement in solving their fund resources.

Implementing the Single Resolution Mechanism will be done in two stages:

- January 1, 2015: partial entry into force, that will come into effect the provisions of the resolution planning preparation, collection of information and cooperation with national authorities;
- January 1, 2016: Full entry into force of the unique mechanism of resolution, that the entry into force of the provisions relating to the planning resolution, early intervention, actions and resolution tools, including bail-in, on condition entering into force of the Intergovernmental Agreement on the Single Fund resolution (http://www.europarl.europa.eu/news/ro/newsroom/content/20140410STO43248/html/Uniunea-bancar%C4%83-pe-scurt-ghid-despre-noile-reguli-UE).

4.3. The Deposit Guarantee Schemes (DGS)

This mechanism has the following objectives:

- EU harmonization of categories and level of guaranteed deposits;
- Reduction of payout;
- Harmonization of information provided to depositors;
- Establish monitoring requirements of deposit guarantee schemes.

Completing the Union Bank with a single deposit guarantee scheme seems difficult to achieve. There is major controversy between the member states on the need and on design it.

Obvious asymmetry between North and South in terms of its financing costs raises difficult policy issues.

Larosière report does not support the idea of mutualisation of resource of the deposit guarantee schemes in the Member States, considering that the harmonization the sets of related rules should be sufficient (High Level Group on Financial Supervision in the EU, Report February 25, 2009 - De Larosière Report).

The compromise that was reached at the European level provides for the harmonization of national guarantee schemes.
Steps in this direction have already been implemented:

- Coverage of national deposit guarantee schemes - harmonized level of 100 000 EUR / depositor / credit institution;
- Simplifying procedures for reimbursement of covered deposits: reduce payment periods and improved financing arrangements.

European directive adopted by the European Parliament in April 2014 imposed ex ante funding of all national guarantee schemes in the EU (Sibeltein, 2007).
Advantages of harmonization of deposit guarantee schemes:

- Ensuring the equal treatment of depositors in all EMU countries complementarity with single supervisory mechanism;
- Increasing confidence in the banking system; A larger volume of resources is likely to grow considerably the resistance of the system on shock.
- Limiting moral hazard and disposal of potent pro-cyclical effects; Contributions banking institutions are set according to their size and the risks involved (Ilie Mihai, 2003).

5. European Stability Mechanism

European Stability Mechanism is a permanent crisis resolution tool for eurozone countries. It can issue bonds to finance loans and other financial assistance to euro area Member States to strengthen the banking sector.
It was inaugurated in October 2012, and the shareholders are the member states of the euro area (Georgescu, 2014).
The main responsabilities of the European Stability Mechanism are:

- Guarantor of financial assistance;
- Establishing the terms and conditions of financial assistance;
- Lending capacity of the ESM;
- Creation of additional tools (Agnes, 2011).

At the release of this mechanism were available 500 billion euro to lend. Spain and Cyprus have received financial assistance programs, so now the remaining lending capacity is of about 450 billion euro.

6. Conclusions

The international financial crisis highlighted that the European project is incomplete, and further strengthen the institutional framework of EU economic governance reform efforts represents essential steps for achieving sustainable fundamental objectives of the European Union.
The EU wants to achieve a sustainable economic growth, generating employment. This must be supported by a deep reform of the european financial system regulation and supervision.
The new european conception doesn’t includes anymore exuberance or excessive conservatism on financial intermediation. Countering the regional contagion risk requires further integration of European banking. Union Banking is one of the fundamental pillars of the new economic governance framework at EU level.

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