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OPENNESS, STRENGTH AND RESILIENCE

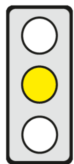
cep**PolicyBrief** No. 2021-08

KEY ISSUES

Background: Brexit, the unilateral actions of the Trump-administration against free trade and the COVID-19-pandemic have induced calls for more European autonomy.

Objective of the Communication: The Commission sets out how it wants to strengthen the EU's "open strategic autonomy" in the macro-economic and financial field.

Affected parties: Companies, especially in the financial industry.



Pro: (1) "Open strategic autonomy" must not lead to protectionist policies as the gains of an open economy are enormous. Hence, the Commission's assurance that the EU remains committed to open trade is of high importance.
(2) For reasons of financial stability, the EU's reliance upon third-country central counterparties should be reduced.

Contra: (1) Contrary to the Commission's opinion, the international strength of the Euro is a market-led consequence of – not a prerequisite for – the economic and political power of the EU.
(2) The objective of harmonised, deep and liquid capital markets should not serve as a blanket justification for a common deposit guarantee scheme (EDIS), that may only be useful and efficient if a number of – ambitious – preconditions are met.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Communication COM(2021) 32 of 19 January 2021: The European economic and financial system: fostering openness, strength and resilience.

Brief Summary

► **Background and Objectives**
- Reinforced by the COVID-19 pandemic, the Commission wants to strengthen the EU's "open strategic autonomy". This means that the EU should remain committed to open and fair trade but should be more resilient to future shocks by reducing dependency and strengthening the security of supply in certain areas. [see: Europe's moment: Repair and Prepare for the Next Generation, COM(2020) 456, p. 12]
- The Commission now sets out how it wants to strengthen the EU's "open strategic autonomy" in the macro-economic and financial fields by strengthening:
  - the single market,
  - the international role of the Euro,
  - the EU's financial market infrastructures,
  - the implementation and enforcement of EU sanctions.

► **Safeguard and deepen the single market**
- As a foundation for a resilient EU, the Commission wants to safeguard and deepen the single market. This will promote economic growth, ensure fiscal stability and strengthen the EU's geostrategic and economic influence. (p. 3)
- In order to safeguard and deepen the single market, the Commission intends to (p.3-4)
  - strengthen the capital market union through
    - easier access to equity markets for small and medium enterprises by reduce their administrative burdens and compliance costs and
    - convergence of the insolvency frameworks across the EU.
  - complete the banking union through the creation of a European Deposit Insurance Scheme and the implementation of the common ESM backstop to the Single Resolution Fund,
  - strengthen the EU's industrial and technological presence in strategic areas like artificial intelligence, supercomputing and cloud,

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- **Strengthening the international role of the Euro**
  – According to the Commission, a stronger international role of the Euro would help (p. 5-8)
    - the European economy in dealing with foreign exchange shocks as well as ensure lower transaction, financing and risk management costs. These benefits outweigh the disadvantages associated with an appreciation of a stronger Euro in times of stress,
    - to protect "global public goods" such as the responsiveness of international trade to exchange rate adjustments and the alleviation of asymmetric shocks linked to US-monetary policy decisions.
  – In order to strengthen the international role of the Euro, the Commission will (p. 8-11)
    - issue 30% of total bonds under the Next Generation EU in the form of green bonds,
    - support Euro-denominated commodity derivates, benchmarks and trading venues when reviewing the Benchmark Regulation [(EU) 2016/1011] and MiFID-II-Directive [2014/65/EU],
    - use nascent energy markets and sustainable finance as international leverage for use of the Euro,
    - attempt to expand the EU emission trading scheme (ETS) to emissions
      - from maritime transport,
      - potentially from buildings and from road transport, and
      - potentially from all other emissions from fossil fuels combustion,
    - through dialogue, seek a better understanding of obstacles for investment by major non-European investors in Euro-denominated bonds and for Euro-denominated invoicing in international trade.

- **Increase the resilience of EU financial market infrastructures**
  – According to the Commission (p. 12),
    - it is in the self-interest of the EU to develop a financial market industry that is less reliant on critical services from third countries,
    - EU-based financial market infrastructures should be shielded from the "unlawful extra-territorial application" of unilateral sanctions by third countries,
    - the fact that a large share of Euro-denominated contracts is cleared and settled outside the EU is a risk to EU financial stability.
  – In order to increase the resilience of the EU financial market infrastructures, the Commission will (p. 13-15)
    - assess possible issues related to the transfer of financial contracts denominated in Euro to central counterparties located in the EU,
    - analyse the EU's vulnerabilities regarding third-country sanctions and consider issuing recommendations to prevent and counter the impact on EU-based providers,
    - explore options to ensure the uninterrupted and secure flow of essential financial services between the EU and its trading partners,
    - mandate the European Banking Authority in 2021 to do a study on the dependence
      - of the EU on non-EU financial operators and
      - of EU banks on funding in foreign currencies.

- **Strengthen the implementation and enforcement of EU sanctions**
  – According to the Commission (p. 15),
    - a more rapid and effective implementation and enforcement of EU sanctions and a stronger policy tackling the unlawful extra-territorial application of unilateral sanctions by third countries will benefit the EU's strategy for openness, strength and resilience,
    - EU sanctions are most effective when information about their impact is promptly available,
    - more coordination between Member States is necessary to avoid uncoordinated enforcement of EU sanctions.
  – In order to strengthen the implementation and enforcement of EU sanctions against third countries, the Commission will (p. 17-19)
    - consider countering the effects of the "unlawful extra-territorial application of third-country unilateral sanctions" on EU entities by changing the EU Blocking Statute [Regulation (EC) 2271/96] which exerts pressure on EU companies to not abide by third-country sanctions,
    - develop a database on the implementation and enforcement of EU sanctions, and
    - facilitate anonymous reporting to the Commission of behaviour by Member States that violate EU sanctions against third countries, thus allowing the Commission to proceed against those Member States.

Policy Context

In May 2018, the US Government withdrew from the Joint Comprehensive Plan of Action that had been negotiated between Iran on the one hand and the permanent UN Security Council Members and the EU on the other. The US issued a series of unilateral sanctions against Iran that have extraterritorial effects, i.e. they also have the purpose of keeping EU companies from trading with Iran. The EU – especially Germany, France and the UK – protested against these sanctions, but could do little to prevent EU companies from being directly affected by them.

Following Brexit, financial service providers in the UK do not longer have unlimited access to the EU. A market access system, based on unilateral decisions of equivalence, is still to be set up. Given the high relevance for EU financial markets of clearing and settlement in London, the EU-Commission and the European Securities and Markets Authority (ESMA) have recognised three major UK clearing houses (CCPS), allowing them to offer their services until 30 June 2022. The Commission has made clear that the EU financial "industry is strongly encouraged to work together in developing strategies that will reduce their reliance on UK CCPs" (see here).

Options for Influencing the Political Process

Directorates General:	DG Financial Stability, Financial Services and Capital Markets Union
Committees of the European Parliament:	Economic and Monetary Affairs (leading), Rapporteur: N.N.

ASSESSMENT

Economic Impact Assessment

The COVID-19-pandemic has illustrated that globalisation creates dependencies. Not every country has the available technical infrastructure to produce masks, vaccines or supplies therefor and those countries who have the infrastructure may not be willing to export to other countries. For efficiency reasons, production capacities for some of these goods may have been moved away from Europe to other regions of the world. What for a long time has been seen as an efficient division of labour, is now in part seen as a supply risk that Europe should no longer accept. There is no easy answer as to how much inefficiency – in the form of reserve stocks or excess production capacity – is in the EU's self-interest as the nature of the next pandemic or other negative external shock is unknown today.

From an economic point of view, the Commissions aim to achieve **"open strategic autonomy" must not lead to protectionist policies as the** net **gains of an open** and trade-based **economy are enormous. Hence, the Commission's assurance that the EU remains committed to open** and fair **trade is of high importance.**

Contrary to the Commission's opinion, the international reputation and **strength of the Euro is a market-led consequence of – not a prerequisite for – the economic and political power of the EU.**

The Commission rightly aims at strengthening the economic attractiveness of the Eurozone's capital markets by increasing its depth and liquidity. This is a precondition for the Euro to gain relevance vis-à-vis the US-Dollar. The Commission's intention to reduce administrative burdens and compliance costs for SMEs when accessing capital markets is thus to be welcomed. European SMEs are heavily reliant upon bank funding: According to the 2019 SAFE survey of the ECB, only 10.4% of European SMEs use markets to satisfy their financial needs, for an amount of 26% of their needs on average. In Europe, SMEs receive five times less funding from capital markets than SMEs in the USA. Given low bank lending capacities – at least in some EU Member States – easier capital market funding may increase economic growth.

The objective of harmonised, deep and liquid capital markets should, however, **not serve as a blanket justification for** the installation of **a common deposit guarantee scheme** (EDIS) **that** would bear significant risks to the Eurozone's stability. EDIS **may only be useful and efficient if a number of – ambitious – preconditions are met** (see cep**Input**). EDIS must however be accompanied by further efforts to cut the nexus between banks and states and to allow for market cleansing by resolution also of nonprofitable smaller banks.

The massive issuance – under the Next Generation EU ("NextGen") and the common unemployment benefit ("SURE) programmes – of (green) Euro-denominated European sovereign bonds of different durations will put unprecedented one trillion Euros in EU debt instruments by 2026 in the markets. This will greatly contribute to the deepness and liquidity of the Euro-denominated capital market, but it may also be the nucleus of a European safe asset which through implicit common liability of Eurozone-States may lower fiscal discipline. The Commission's announcement to support Euro-denominated derivates, benchmarks and trading venues must not lead to protectionist and inefficient outcomes. There may be a variety of good reasons for market participants to use non-Euro instruments and venues. All regulatory intervention must be indispensable, e.g. for reasons of financial stability.

The Commission's intention to foster the denomination in Euro of nascent energy markets like hydrogen, is unlikely to have a significant impact, given the growing but still limited relevance of these energy sources. The use of sustainable finance as power leverage for the Euro responds to the same logic, but is also expected to have the same marginal impact in the use of Euro, even more if the US financial markets adopt different sustainability benchmarks for their bond and stock markets in the next years.

The expansion of the European Emission Trading System (ETS) to maritime transport should be decided at a global level under the auspices of the International Maritime Organisation (IMO, see cep**Input**).

The fact that the large majority of Euro-denominated financial contracts is cleared and settled in London may give rise to systemic risks. This goes all the more now that the UK is no longer a member of the EU. The EMIR 2.2-Regulation [(EU) No 648/2012] introduced a set of rules allowing the Commission to decide that a third country central counterparty (CCP) has such a high systemic relevance that no safeguards can be sufficient for recognition in the EU. In this case, the CCP can only offer its services with a seat in the EU [Art. 25 (2c) (EU) No 648/2012, see cep**Adhoc**]. **For reasons of financial stability, the EU's reliance upon third-country central counterparties should be reduced.** At the same

time and for the same reasons, hindering EU financial institutions from using UK-based CCPs will be practically possible only if efficient EU-based alternatives are available.
Strengthening sanctions and retaliation measures against EU companies that comply with third country, often US extra-territorial sanctions is difficult, since many EU companies are active in the US as well and non-compliance with US sanctions is not an option for them. For this reason, the economic, political and military power of the USA prevents the EU Blocking Statute from being effective. However, it may be useful to streamline the use of the rules allowing EU companies to comply with third-country sanctions [Art. 5(2) of Regulation (EC) 2271/96].

Legal Assessment

Legislative Competence of the EU

Dependent on the design of the individual legislative measures.

Subsidiarity

Dependent on the design of the individual legislative measures.

Proportionality with Respect to Member States

Dependent on the design of the individual legislative measures.

Compatibility with EU Law in Other Respects

Dependent on the design of the individual legislative measures.

Summary of the Assessment

"Open strategic autonomy" must not lead to protectionist policies as the gains of an open economy are enormous. Hence, the Commission's assurance that the EU remains committed to open trade is of high importance. Contrary to the Commission's opinion, the international strength of the Euro is a market-led consequence of – not a prerequisite for – the economic and political power of the EU. The objective of harmonised, deep and liquid capital markets should not serve as a blanket justification for a common deposit guarantee scheme (EDIS), that may only be useful and efficient if a number of – ambitious – preconditions are met. For reasons of financial stability, the EU's reliance upon third-country central counterparties should be reduced.