A BLUEPRINT FOR A DEEP AND GENUINE EMU (28.11.2012)

Launching a European debate

Executive summary

1. Rationale, aspirations, and benefits of EMU

The creation of Economic and Monetary Union (EMU) and the introduction of the euro as the currency of the European Union were milestones of European integration and are crucial for the economic, social and environmental well-being of the citizens. They stand out among the EU's most far-reaching achievements and the euro is one of Europe's defining symbols at home and across the globe.

EMU is unique among modern monetary unions in that it originally combined a centralised monetary policy with decentralised responsibility for most economic policies, albeit subject to constraints as regards national budgetary policies. It has been clear since the inception of the euro that the increased interdependence of its Member States meant that sound budgetary and economic policies were of particular importance. The Stability and Growth Pact set down the rules governing the coordination of budgetary policies.

By the time of the eruption of the financial crisis in 2008 some euro area Member States had accumulated large private and public debts, losses in competitiveness, and macroeconomic imbalances. This was partly due to an insufficient observance of and respect for the agreed rules underpinning EMU as laid down in the Stability and Growth Pact (SGP). In good part these vulnerabilities stemmed from features of the original institutional setup of EMU, in particular the lack of a tool to address systematically macroeconomic imbalances.

2. The measures taken so far: a crisis response

In tackling the crisis, the Commission has taken a leading role in preserving the single market, in overhauling EMU's economic governance, in the reform of financial sector regulation and supervision, and in spearheading support to the real economy.

The totality of measures taken so far amounts to a strong response to the crisis. Yet for some of these measures to have a positive impact, they will need to be seen working well for some time. That is one reason why – despite a strong response – it has not been possible to prevent the sovereign debt crises from turning into a crisis of confidence.

In the meantime, the level playing field for businesses and households has been damaged. Diverging developments that are detached from economic fundamentals can hamper the whole project of European integration.

A fundamental response to the crisis must be able to restore confidence that the achievements of the Single Market and the Single Currency will not be undone.

3. The way forward: combining substantial ambition with appropriate sequencing

A comprehensive vision for a deep and genuine EMU conducive to a strong and stable architecture in the financial, fiscal, economic and political domains, underpinning stability and prosperity is required.

This blueprint sets out the actions the Commission believes are necessary in the short, medium and long term. The transformation cannot be completed overnight. The way forward needs to be carefully balanced. Steps towards more responsibility and economic discipline should be combined with more solidarity and financial support. This balance has to be struck in parallel and in each phase of the development of EMU. The deeper integration of financial regulation, fiscal and economic policy and corresponding instruments must be accompanied by commensurate political integration, ensuring democratic legitimacy and accountability.

Some of the required steps can be adopted within the limits of the current Treaties. Others will require modifications of the current Treaties and new competences for the Union. This must be built on the following basic principles. First, the deepening of EMU should build on the institutional and legal framework of the Treaties. Second, the Euro Area must be able to integrate quicker and deeper than the EU at large, whilst preserving convergence with future members of the Euro Area as well as the integrity of the policies conducted at 27, notably the single market. This means that, wherever appropriate, the euro area measures should be open for participation of other Member States. Indeed, while the Treaties foresee that a number of rules apply only to euro area Member States. The present configuration of the euro area is only of a temporary nature, since all Member States but two (Denmark and the UK) are destined to become full members of EMU under the Treaties.

In the short term (within the next 6-18 months), while the immediate priority should be given to the full deployment of the new economic governance tools brought by the six-pack as well as rapid adoption of current Commission proposals such as the two-pack and the Single Supervisory Mechanism, more can still be done through secondary law, in particular in the area of banking union, economic policy coordination and support to structural reforms necessary to overcome imbalances and to improve competitiveness.

Once a decision on the next Multi-annual Financial Framework for the EU has been taken, the establishment of an instrument within the EU economic governance framework and the EU budget, separate from the MFF, to support rebalancing, adjustment and thereby growth of the economies of the euro area would serve as the initial phase towards the establishment of a stronger fiscal capacity alongside more deeply integrated policy coordination mechanisms.

The existing framework for economic governance of the euro area should be strengthened further through ensuring greater ex-ante coordination of major reform projects and through the creation of a "Convergence and Competitiveness Instrument" (CCI) to provide a framework for commitments to and support for the timely implementation of structural reforms.

Financial support would be granted for reform packages that are agreed and important both for the Member State in question and for the good functioning of EMU. The use of financial support would be defined as part of the contractual arrangement concluded between the Member State concerned and the Commission.

The financial support mechanism would be part of the EU's budget but outside the ceilings set in the Multi-annual Financial Framework Regulation.

The "Convergence and Competitiveness Instrument" would combine deepening integration of economic policy with financial support, and thereby respect the principle according to which steps towards more responsibility and economic discipline are combined with more solidarity.

An effective banking union would not only require the setting up of a Single Supervisory Mechanism, but after its adoption also a Single Resolution Mechanism to deal with banks in difficulties. It would be in charge of the restructuring and resolution of banks within the Member States participating in the Banking Union. Where intervention by the Single Resolution Mechanism proved necessary, shareholders and creditors should bear the costs of resolution before any external funding were granted. Any additional resources needed to finance the restructuring process should be provided by mechanisms funded by the banking sector, instead of using taxpayers' money.

Building on progress achieved in the economic governance of the euro area, a strengthening and consolidation of its external representation should be pursued, aimed at streamlining and, where possible, unifying it in international economic and financial organisations.

In the medium term (18 months to 5 years), the overhaul of the budgetary and economic governance that the euro area would have undergone with the adoption of the two-pack and the availability of the Convergence and Competitiveness Instrument would represent major steps forward in ensuring budgetary discipline, financial solidarity and economic competitiveness.

As further steps, a strengthening of the collective conduct of budgetary policy and as regards economic policy, the euro area would benefit from deeper coordination in the field of tax policy issues as well labour markets, given the significance of labour mobility for adjustment capacity and growth within the euro area.

Building on the Convergence and Competitiveness Instrument, the fiscal capacity for the euro area should be further enhanced. It should be autonomous and rely solely on own resources. It should provide sufficient resources to support important structural reforms in a large economy under distress.

A clearly reinforced economic and fiscal governance framework could allow considering the reduction of public debt significantly exceeding the SGP criteria through the setting-up of a

redemption fund subject to strict conditionality. This would warrant increased surveillance and power of intervention in the design and implementation of national fiscal policies.

The common issuance by euro area Member States of so-called eurobills - short-term government debt with a maturity of up to 1 to 2 years - could constitute a tool against the present fragmentation, reducing the negative feedback loop between sovereigns and banks, while limiting moral hazard. The introduction of such a common debt instrument would require a closer coordination and supervision of Member States' debt management in order to ensure sustainable and efficient national budgetary policies.

The monitoring and managing function for the fiscal capacity and other instruments should be provided by an EMU Treasury within the Commission.

The further strengthening of policy coordination and enhancement of the fiscal capacity would initially start under secondary law, but would require Treaty changes at some point. The creation of a Debt Redemption Fund and the common issuance of short-term government debt would require Treaty changes.

Finally, in the long term (beyond 5 years), based on progressive pooling of sovereignty and thus responsibility as well as solidarity competencies to the European level, the establishment of an autonomous euro area budget providing for a fiscal capacity for the euro area to support Member States in the absorption of shocks should become possible. The central budget would provide for an EMU-level stabilisation tool to support adjustment to asymmetric shocks, facilitating stronger economic integration and convergence and avoiding the setting-up of long-term transfer flows. Overall, a shared instrument could deliver net gains in stabilising power, as compared with current arrangements. How large this fiscal capacity would ultimately turn out to be will depend on the depth of integration desired and on the willingness to enact accompanying political changes.

Also, a deeply integrated economic and fiscal governance framework could allow a common issuance of public debt, which would enhance the functioning of the markets and the conduct of monetary policy.

This would be the final stage in EMU.

Attaining a deep and genuine EMU involves incremental measures, building on what would have been achieved over the short and the medium-term and introducing further integration on a step-by-step, policy-by-policy basis.

The full EMU would therefore realize the four building blocks: a banking union, a fiscal union, an economic union, which all require, as a fourth element, appropriate democratic legitimacy and accountability of decision-making.

This final stage would require a fundamental overhaul of the Treaties.

4. Political union: democratic legitimacy and accountability

Any work on democratic legitimacy as a cornerstone of a genuine EMU needs to be based on two basic principles. In multilevel governance systems accountability should be ensured at the level where the respective executive decision is taken. This holds true for new powers on budgetary surveillance and economic policy as much as for new EU rules on solidarity between Member States. Briefly put: further financial and economic mutualisation requires commensurate political integration.

The European Parliament needs to primarily ensure democratic accountability for any decisions taken at EU level, in particular the Commission. A further strengthened role of EU institutions will therefore have to be accompanied with a commensurate involvement of the European Parliament in the EU procedures. The European Parliament, and only it, is that Parliament for the EU and hence for the euro, ensuring democratic legitimacy for EU institutions' decisions. At the same time, the role of national parliaments will always remain crucial in ensuring legitimacy of Member States' action in the European Council and the Council.

In the short term, ensuring optimal democratic accountability and governance without Treaty change should focus on practical measures, in particular those designed to foster parliamentary debate in the European Semester, such as foreseeing the involvement of the Parliament in the discussions on the Commission's Annual Growth Survey.

In the context of a Treaty reform conferring further supranational powers to the EU level, steps should be considered to ensure a commensurately stronger democratic accountability.

A further way of strengthening the EU's legitimacy would also be to extend the competences of the Court of Justice.

Finally, special challenges to ensure appropriate democratic accountability need to be addressed in case the Treaty is changed to permit the mutualisation of the issuance of sovereign debt underpinned by a joint and several guarantee of all euro area Member States.