Contributions from the Sherpas of the Member States to the Five Presidents' Report

ITALY

Second Contribution
I. State of play

The depth of the economic and financial crisis and its long-lasting impact highlight fundamental unresolved issues related to the incompleteness of the Economic and Monetary Union, despite important steps forward made in response to the crisis – the European Stability Mechanism, the Banking Union, strengthened fiscal surveillance, as well as the launch of unconventional monetary policies by the ECB. The overall economic performance of the area is disappointing, pointing to persisting very low levels of growth. The impact of the crisis on growth potential, also due to the dramatic fall in investment and to the deterioration of unemployed human capital, is expected to last for a long time, even evoking the risk of secular stagnation.

In addition, disaffection in the European project is widespread among citizens and it is leading to the rise of populist political forces. The current upswing in growth rates, albeit modest, is likely to trigger complacency in national governments and European institutions with the risk of deepening the divide with citizens still heavily affected by the legacy of the crisis in terms of unemployment, poverty and rising inequalities.

Against this background, the Union is at a crossroad between muddling through and facing with determination the new challenges: restore growth potential, foster a job-rich sustained growth in a stable macroeconomic environment and rebuild the relationship between European institutions and European citizens. For too long in the public discourse “Europe” has resonated with austerity. This perception must be replaced by the prospect of the range of opportunities offered by being part of the Union.

The launch by the Commission of a multiannual European investment plan and the definition of adequate incentives for investment and reforms are positive important steps in this direction, especially in the framework of a growth-friendly fiscal policy. However, the urgency and complexity of the issues at stake call for a more ambitious policy mix involving fiscal, structural, social and monetary policies. It requires measures to deal with the social emergency left by the crisis and to restore a common European identity. It requires more effective economic governance and a coherent institutional architecture. It requires continuing and possibly improving the road map “Towards a genuine economic and monetary union” released in 2012 for the full implementation of the Banking Union, the Economic Union, the Fiscal Union and the Political Union.

European leaders should show a high level of ambition and of political will for the European project. The new report on the Future of the EMU must be ambitious and give the right signal of the commitment by all Institutions to move towards a strengthened institutional framework endowed with adequate resources and democratic legitimacy. We need to preserve the irreversibility of the Euro, to avoid any internal fragmentation in the Eurozone, to promote its resilience in responding to shocks, to improve its performance. The peak of social discontent towards Europe could still be ahead and bring devastating consequences. Europe needs to adapt and keep up the
rhythm of change as governance instruments are concerned. Changing our governance means making it more effective, democratic, fair.

A first set of measures may be implemented within the existing Treaty configuration. More far reaching measures may require Treaty changes.

2. **Overarching key attributes of EMU reform**

This non paper ultimately calls for a more political approach. Making EMU sustainable entails ambitious policies, closer political integration and reinforced social cohesion. Several key attributes need to be developed if we want to bolster the EMU and achieve the final goals of sustainable growth, job creation, cohesion and stability:

(a) **Irreversibility.** The EMU is a key element of the European construction and its integrity and potential to deliver shared benefits should be further safeguarded. In this respect, within the debate on “deepening the EMU” the irreversibility of the single currency should be unambiguously made clear.

(b) **Resilience.** In the ongoing debate on the new framework for better economic governance, the need to improving the euro area capacity to adjust to crisis and respond to shocks must be adequately taken into account.

(c) **Performance.** Correctly the Analytical Note circulated in February 2015 (*Preparing for Next Steps on Better Economic Governance in the Euro Area*, 12 February 2015) points at the fact that the United States responds more rapidly and better to crises. This can be pinned on the limits of the EU institutional setup and to lack of a genuine common policy stance.

(d) **Solidarity.** Together with responsibility, it is a constitutive element of a well-functioning EMU. Its nexus with the overall performance of the Eurozone should be made clear and addressed with effective instruments.

3. **Lines of action**

Persisting instability and current weak economic performance are related to structural features of the monetary union, notably the absence of a genuine common policy stance and the uncertainty on the irreversibility of the common currency. Next immediate steps should address those weaknesses; some of them are needed at EU level while others are specific to the euro area.

Significant advancements cannot be achieved if mutual trust and therefore willingness to share risks for the common good is not restored. Trust and confidence among Member states have been heavily affected by the crisis, with the rise of a defensive attitude aimed at building firewalls against negative spillovers and possibly contagion. This attitude was further fuelled by the perception of an uneven distribution of the costs of the crisis. To defeat the view that the participation to the common currency can be an obstacle to the development of national economies, it is necessary to prove the benefits for all in terms of more growth, opportunities and jobs creation of being part of an economic integrated union.

Political resistance to more coordination and risk pooling brings instability and limits the possibility of implementing more effective and far-sighted policy choices, including the most appropriate design of economic reforms. This attitude must change if the Eurozone /Europe is to secure prospects of sustained growth, prosperity and stability.
for the well-being of its citizens. To this end, the following lines of action can be envisaged:

1. **Economic governance** must imply a much more cooperative rebalancing where the added value of being part of an economic union is maximized and the implementation of structural reforms is supported.

2. Measures to **address the social cost of the crisis** and enhance citizens’ trust in the EU are needed. Adjustments, notably in the labour market, could greatly benefit from a **common cyclical unemployment support** that would amplify positive spillovers, impact and effectiveness of reforms. In addition, a positive signal on the **irreversibility** of the common currency would contribute to macroeconomic stability and anchor positive expectations.

3. **The Banking Union must be completed** with the implementation of a **common backstop and a Single Deposit Insurance scheme**, while a deeper financial integration is needed to address markets’ fragmentation and to promote all lending channels within **a Capital Markets Union**.

4. **Single market must be a driver of growth and innovation** in support of structural reforms.

5. An effective use of the **resources of the EU budget and of the Juncker Plan** must address market failures in the financing of European public goods bringing the highest growth potential, possibly with direct support from Member states.

### 3.1. Economic governance

The assessment of the current economic governance framework should consider to what extent it has been successful in **achieving deeper integration, policy coordination and convergence of economic performances**. The existing set of rules has proved to be rigid and not adequate to deal with prolonged recession and weak growth, resulting in pro-cyclical policies. The focus of the adjustment on internal devaluations in “vulnerable” countries mainly resulted in a reallocation of demand within the currency union with no aggregate boost to the benefit of the overall area. Nominal income growth further weakened, thus making more difficult the reduction of the debt burden. Coordination has been insufficient and the overall outcome inefficient, as comparison with the US clearly points out.

Persisting wide imbalances are incompatible with an economic union. The **governance structure should facilitate a cooperative rebalancing within the economic area, lacking which adjustment will remain highly asymmetric**. Demonstrating the win-win character of integration is of capital importance to build and keep consensus on the necessary reforms at national level and on the EU project. It improves decision making, enhances ownership and rebuilds mutual trust. The framework of the European semester can play a key role to achieve these objectives along the following principles:

- **Priorities** - The definition of the policy mix should be based on a **clear identification of medium term euro - wide priorities to define a genuine common policy stance**, in the Broad economic policy guidelines, in the Annual Growth Survey and in the Euro area country specific recommendation.

- **Consistency** - A much **clearer link** should be established between the analysis and policy recommendation at aggregate level and their country
specification. This will help in tackling current asymmetries in adjustments and clarify that reforms and cooperative policy action are needed by all Member states to maximize common welfare.

✓ Systemic approach - The examination of country specific structural reforms should be completed by an overview of the overall coherence of the reform measures taken by each country and of the impact of the overall reform effort on the functioning of the Union/euro area, to understand spillovers and budgetary implications. Reforms entail costs and benefits at domestic level but also systemic positive returns that should be acknowledged. Spillovers can be economic and political, as it is evident in the case of implementation of coordinated and simultaneous reform efforts.

✓ Complementarity - National reforms need to be complemented by far-reaching EU level initiatives. It will help fully implementing the single market agenda. Specific road maps could be established for the completion of priority reform processes both at national and EU level.

✓ Ownership - National ownership of reforms should be maximized, as the most effective tool to increase the likelihood of thorough implementation. National governments and parliaments should take the lead on the reform effort and be fully accountable for their implementation.

✓ Time dimension - A well-defined multi-year time dimension is needed for a more effective implementation of far-reaching reform processes both at domestic and at EU level that, in most cases, goes beyond the yearly horizon of the recommendations. This, in turn, would improve the credibility of EU multilateral surveillance and help in keeping reforms’ momentum over time.

3.2 Enhance adjustment mechanisms in labour market/modernize the European social model

The crisis has increased unemployment, poverty and widened inequalities, especially across generations. Far reaching common initiatives are needed to address the European social emergency and modernize our social model to promote and facilitate adjustments that are taking place in European labour markets. Effective investment in welfare systems, supporting basic and higher education, long-life learning and vocational training as well as essential services to citizens is key for long-term economic productivity.

✓ Proposing social rights as “rights of European citizenship”, could strengthen the European identity and give to the youngest generations reasons to believe that the EU can be a source of opportunities instead of a threat to social protection as it is often perceived.

✓ The development of an unemployment insurance scheme to smooth the fluctuations of the economic cycle could stimulate convergence of different labour market institutions and add the European dimension which is necessary to achieve successful policy coordination and provide incentives to national initiatives, (as it is happening, for example, with the domestic reforms triggered by the Banking Union). It would therefore not be coherent to postpone risk-sharing at the conclusion of the convergence process. Far from being a way out for countries that are not ready for accelerating reforms, risk-sharing could be a
**Driving force behind reforms.** On the contrary, separate national initiatives could end up being mutually inconsistent. The mechanism could be financed with resources currently spent on a variety of national benefits, to be partly pooled in a common unemployment insurance fund as the adjustments in labor markets kick in and unemployment is reduced. The implementation of the mechanism would require significant progress towards harmonization of diverse national systems and therefore take time; but once launched it immediately triggers positive expectations on increased competitiveness and stability. Moreover, it could be a **powerful signal of the willingness to commit to a Citizens’ Union** addressing fragmentation among citizens.

- Progress in the **portability of social entitlements** is also a much needed step to foster mobility and integration.
- **Direct measures** aimed at **extreme poverty and deprivation** could also be considered. Common programs could be launched, in the spirit of the Youth guarantee, where resources are earmarked and capped from the EU budget to be managed at national level following common guidelines.

### 3.3 Complete the Banking Union and develop a Capital Markets Union

A further strengthening of the EMU should go hand in hand with the completion of (i) a fully-fledged Banking Union, in order to permanently break the perverse loop between fragile public finances, weak economic performance and deteriorating bank conditions, (ii) a genuine Capital Markets Union to deepen financial integration addressing markets’ fragmentation and promoting all lending channels, so as to enable access by EU economic agents to the best-suited possible financing options.

- The Single Supervisory Mechanism is now fully operational. Further steps are needed towards a **common fiscal backstop** and a **single deposit guarantee fund**. The current set-up, dimension, and burden sharing of the resolution mechanism might not be up to the task in case of major crises.
- The implementation of a **Capital Markets Union**, boosting efficient cross border allocation of capital throughout all Member states, is essential to **diversify sources of financing** especially for **small and medium enterprises** and would contribute much to deepening the Single market. Rebalancing financial intermediation towards capital markets and increasing cross-border integration requires short-term policy action, for example in the securitization market and towards the strengthening of the availability of credit information, while the creation of fully integrated capital markets in the long run ought to be based also on common principles to address the protection of property rights and taxation.
- A successful Capital Markets Union would **better distribute adjustments to shocks across the euro area, making the monetary union more robust**. Well-integrated and deep capital markets can spread region-specific risk, smoothing the impact of the negative cycle on consumption and investment.

### 3.4 Single Market and structural reforms
The Single market has always been the core of European integration which is the ultimate driver of EU growth, but domestic resistance, defense of national interests, institutional barriers and bottlenecks at national and EU level still prevent it from fully deploying its benefits in terms of competitiveness and growth. Further progress is not easy as differences in country specific procedures, especially as regards secondary legislation, are large. However they must be faced with renewed determination if Europe is to make a quantum leap in economic performance and job creation.

✓ Reforms are still needed in product markets, energy, transport, services, public services including public administration and civil justice, labour markets, intellectual property, the digital economy.

✓ National reforms, which are necessary in all countries, need to be complemented by far-reaching EU level policy action as the announced initiatives on an Energy Union and regarding the Digital Single Market.

✓ EU needs to progress quickly in addressing unfair tax competition, base erosion and profit shifting and in achieving more transparency in the tax area, reforms that can greatly benefit cross border business activity and improve consumers’ welfare.

✓ The forthcoming mid-term review of the Europe 2020 Strategy should contribute to refocusing structural reforms and related investment towards competitiveness and innovation, resource efficiency, sustainable re-industrialization, social cohesion and a well-functioning Single Market.

3.5 Investment and EU budget

An effective use of the resources of the EU budget and of the Juncker Plan could be a very powerful tool to address market failures in the financing of European public goods, notably in connection with achievement of the EU 2020 objectives and of the completion of the Single market. Moreover, to boost potential growth, Europe should capitalize on its innovative capacity and human capital as the ultimate source of productivity growth in mature economies as correctly identified in the context of the Lisbon strategy.

✓ The maximization of the leverage of private resources by the Juncker Plan requires additionality of its operation and attractive financing and operational conditions. The European Investment Bank should play its role effectively, especially in those areas where investment has been most severely hit by the crisis.

✓ Supportive state-aid environment and rules by the EU Commission that truly establish a level playing field for enterprises in different national markets is needed to reduce the competitive gap and support business activity and growth also vis-à-vis the rest of the world. Quick, transparent and predictable procedures are warranted as well as greater coherence with EU level objectives of growth and production of European common goods.

✓ The Juncker investment Plan should aim at financing knowledge-intensive initiatives, focusing on more investment in research, innovation and high-level education, as investments with the highest growth potential. Moreover, it should support the completion of the Single market with investment in interconnecting infrastructures. If supported by a strong political will the Plan
could be a catalyzer for the provision of those goods. In turn, the focus on European public goods could attract direct contribution to the Fund from Member states. The development of a borrowing capacity aimed at financing investments should also be considered.

✓ The forthcoming midterm review of the EU budget could be the chance also to reconsider the financing of the budget on the basis of the proposals of the Monti group on own resources with a view to the definition of a genuine Budget for Europe focused on European public goods.

✓ In perspective a specific budget financed by own resources could evolve in a euro area anti-cyclical buffer with stabilization functions.

4. Longer term perspective

4.1 Progress towards a Fiscal Union

In the longer term the development of a proper stabilization function to cope with asymmetric shock implies increasing degrees of fiscal integration and cross-country transfers financed by a common fiscal capacity. Such mechanisms, that are part and parcel of currency unions worldwide, would give individual countries the means to smooth demand in presence of negative shocks, avoid a too restrictive overall fiscal stance and minimize negative spillovers.

The development of such a function requires further transfers of sovereignty, drawing nearer a true Political union as envisaged in the 2012 Four Presidents’ Report. Since then, fiscal surveillance for euro area member countries has significantly shifted towards a more centralized approach: a stronger control on national budgets of the Euro area is now in place with the possibility of requesting changes in draft budgetary plans. In addition, credibility and trustworthiness of national fiscal policies has been strengthened with the approval in all national legislations of provisions of the Fiscal compact, including automatic corrective mechanisms and the establishment of independent fiscal councils.

Against this backdrop, many of the preconditions for the implementation of common stabilization mechanisms are already in place. What is currently needed is the design of an appropriate incentive structure to ensure that Member states continue to pursue sound fiscal policies in presence of a stabilization mechanism. These incentives must be built in such a way as to limit moral hazard and avoid permanent transfers from some countries to others; for example the likelihood of using the shared resources must be largely outside the control of national government.

Possible initiatives may differ in scope or ways of financing (pooling resources from Member states; issuances based on an implicit EU budget guarantee as it is the case of Balance of Payment and Macro financial assistances; a specific Euro budget line with distinct funds and functions to be financed with a new tax base like carbon tax, digital taxation, FTT etc..) but they must include the common element of the full commitment of Member states to a shared long term vision. This is important as it anchors economic expectations to perspectives of more prosperity and stability with an immediate impact on the economy even if the realization of the project is for the long run.

To overcome political obstacles and build broad consensus, any mechanism must be based on gradualism in the shared effort and on an adequate medium-to-long term
time horizon for implementation. Far-reaching political ambition is needed as well as a pragmatic approach to implement it.

While in the long run Treaty changes will be necessary, existing Treaty provision could already allow the establishment of a targeted insurance fund and also a euro area budget could be established as a separate line within the existing EU budget.

Finally, the debate about deepening the EMU cannot but consider the role of ESM in the governance framework. This institution played a crucial role in the management of the crisis. It is endowed with abundant resources which need to be efficiently exploited while safeguarding the firewall mission of the institution. Several options for the evolving role of ESM have been elaborated, the most ambitious one being the transformation in a European Monetary Fund. An ambitious goal we may want to realize in the medium term. In a shorter perspective there is scope for developing concrete proposals aimed to effectively exploit ESM capacity to provide a common backstop within the framework of the banking union and for exploring how ESM could support growth and investment initiatives at EU level.

4.2 The institutional architecture

The path towards further integration requires the strengthening of the common institutional architecture and of its democratic legitimacy.

Further consideration is needed to understand whether strengthening the bonds among euro area Member states through enhanced cooperation could be an appropriate frame for a gradual transfer of sovereignty to better managing economic coordination without requiring Treaty changes. Moreover, a better use of all the available instruments, including with reference to Art. 136 TFEU, could facilitate the adoption and implementation of new measures for the euro area, in particular, but not exclusively, on fiscal matters. The general bridging clause (48.7 TEU), Art. 333 and 352 TFEU could also help in this respect.

Secondly, the current legislature has indeed brought significant elements of innovation in the election of the President of the Commission that are already influencing the accountability of the Commission towards the European Parliament and are resulting in a clearer political stance of its decisions.

A thorough reflection on the respective roles of national and European parliaments, European Commission, Council of the EU and European Council is necessary to overcome the current perception of democratic deficit of EU level decision making. Effective parliamentary oversight is key. Besides existing provisions of Art. 13 of the Fiscal compact, involvement of the European Parliament and of national Parliaments could be strengthened in the European Semester and in the scrutiny of the macroeconomic adjustment programmes.

At the same, to strengthen voice and effectiveness of operation, the issue of ensuring a more coherent representation of the Euro area within International Organizations should also be addressed.

Finally, better ways must be found to increase national ownership of decisions and accountability of Governments towards their own Parliaments for decisions taken in Council formation. Too often the perception is that deliberations have been taken at EU level to comply with the mandate of the electorate of a different country, thus contributing to the view of an estranged Europe, not acting in the interest of all of its
citizens. At the same time, need to reach unanimity and veto power is often an obstacle to effective EU decision-making in the common interest of Member states and could be, at least partially, reconsidered.