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Towards a Genuine Economic and Monetary Union

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Towards a Genuine Economic and Monetary Union

identified in the report “Towards a genuine Economic and Monetary Union” presented at the June European Council. It incorporates valuable input provided by the Commission in its communication "A Blueprint for a deep and genuine EMU – Launching a European Debate" of 28 November 2012. The European Parliament has also made a valuable

Member States as they face specific challenges by virtue of sharing a currency. The process towards a deeper EMU should be characterised by openness and transparency and be fully compatible with the Single Market in all aspects.

political commitment to implement the proposed roadmap. The urgency to act stems from the magnitude of the internal and external challenges currently faced by the euro area and its individual members.

ensure trust in the effectiveness of European and national policies, to fulfil vital public functions, such as stabilisation of economies and banking systems, to protect citizens from the effects of unsound economic and fiscal policies, and to ensure high level of growth and social welfare.

A more resilient and integrated EMU would buffer euro area countries against external economic shocks, preserve the European model of social cohesion and maintain Europe’s influence at the global level.

a roadmap towards a genuine EMU. They underscore that ‘More Europe’ is not an end in itself, but rather a means for serving the citizens of Europe and increasing their prosperity.

mutually reinforcing comprehensive package. The creation of an integrated financial framework has important fiscal and economic implications and therefore cannot be envisaged separately. Similarly, the proposals put forward in the fiscal and economic policy sphere are closely intertwined. And, as all the proposals imply deeper integration,

Overview of sequencing

The process could rest on the following three stages (see also diagram in annex):

Stage 1 (End 2012-2013)

Ensuring fiscal sustainability and breaking the link between banks and sovereigns

of public finances and break the link between banks and sovereigns, which has been one of the root causes of the sovereign debt crisis. This stage would include five essential elements:

implementation of a stronger framework for fiscal governance ('Six-Pack'; Treaty on Stability, Coordination and Governance; 'Two-Pack').

systematic ex ante coordination of major economic policy reforms, as envisaged in Article 11 of the Treaty on Stability Convergence and Governance (TSCG).

Single Supervisory Mechanism (SSM) for the banking sector and the entry into force of the Capital Requirements Regulation and Directive (CRR/CRDIV).

national resolution and deposit guarantee frameworks, ensuring appropriate funding from the financial industry.

framework for direct bank recapitalisation through the European Stability Mechanism (ESM).

Stage 2 (2013-2014)

Completing the integrated financial framework and promoting sound structural policies

This stage would consist of two essential elements:

setting up of a common resolution authority and an appropriate backstop to ensure that bank resolution decisions are taken swiftly, impartially and in the best interest of all.

on the policies countries commit to undertake and on their implementation. On a case-by-case basis, they could be supported with temporary, targeted and flexible financial support. As this financial support would be temporary in nature, it should be treated separately from the multiannual financial framework.

Stage 3 (post 2014)

Improving the resilience of EMU through the creation of a shock-absorption function at the central level

This stage would mark the culmination of the process. Stage 3 would consist in:

incentives-based system would encourage euro area Member States eligible for participation in the shock absorption function to continue to pursue sound fiscal and structural policies in accordance with their contractual obligations. Thereby the two objectives of asymmetric shock absorption and the promotion of sound economic policies would remain intrinsically and employment, building on the Member States' National Job Plans. More generally, as the EMU evolves towards deeper integration, a number of other important issues will need to be further examined. In this respect, this report and the Commission's "Blueprint" offer a basis for debate.

I. Integrated financial framework

between the fragilities of sovereigns and the vulnerabilities of the banking sector. The set-up of the Single Supervisory Mechanism (SSM) will be a guarantor of strict and impartial supervisory oversight, thus contributing to breaking the link between sovereigns and banks and diminishing the probability of future systemic banking crisis.

2013. It called for the rapid conclusion of the single rule book, including agreement on the proposals on bank capital requirements by the end of the year. It also called for the rapid adoption of the provisions relating to the harmonisation of national resolution and deposit guarantee frameworks.

responsibility for banking supervision is coupled with adequate control powers. In this regard, establishing an appropriate framework for macro-prudential policy that takes due account of both national and Europe-wide dimension will be important. The ECB has confirmed that it will establish organisational arrangements guaranteeing a clear

directly. The legal and operational framework for ESM direct bank recapitalisation should be finalised by end-March 2013. In order to move towards an integrated financial framework, the SSM will need to be complemented by a single resolution mechanism, as well as more harmonised deposit guarantee mechanisms.

Single resolution mechanism

resolution framework would contribute to limiting the cost of bank failures to taxpayers. The current legislative proposal on recovery and resolution will ensure that harmonised tools necessary for orderly bank resolutions are available in all EU Member States, including early interventions, bailing-in and the creation of bridge banks.

Scheme Directive have been adopted. This single resolution mechanism – built around a single resolution authority – should be established as the ECB assumes its supervisory responsibility in full. This mechanism covering all banks supervised by the SSM should be based on robust governance arrangements, including adequate provisions on independence and

The need for a single resolution mechanism

Establishing a single resolution mechanism is indispensable to complete an integrated financial framework:

many of the current obstacles to resolution, such as national bias and cross-border cooperation frictions. This would reduce resolution costs, as early and prompt actions contribute to maintaining the economic value of banks that need to be resolved.

legal and administrative capability as well as the necessary independence to carry out effective and least-cost resolution. By ensuring that the private sector bears the primary burden of bank resolution costs, the authority would increase market discipline, and minimise the residual costs for the taxpayers of bank failures.

are restructured or closed down swiftly. The SSM would provide a timely and unbiased assessment of the need for resolution, while the single resolution authority would ensure actual timely and efficient resolution.

resolution regime. It would be funded through *ex ante risk-based levies on all the banks directly participating in the SSM. The single resolution mechanism should include an appropriate and effective common backstop. This could possibly be organized by means of an ESM credit line to the single resolution authority. This backstop should be fiscally-neutral*

Deposit guarantee mechanisms

provisions to ensure that sufficiently robust national deposit insurance systems are set up in each Member State, thereby limiting the spill-over effects associated with deposit flight between institutions and across countries, and ensuring an appropriate degree of depositor protection in the European Union. A rapid adoption of this proposal is

II. Integrated budgetary framework

This would contribute to sustainable growth and macroeconomic stability. The October Interim Report stressed the need for stronger economic governance and suggested, as an additional step, the possibility to develop gradually a fiscal capacity for the EMU, which could facilitate adjustment to economic shocks. Following the conclusions of the

Sound national budgetary policies are the EMU's cornerstone

imbalances, on debt developments, on better enforcement mechanisms, and on national ownership of EU rules. The other elements related to strengthening fiscal governance in the euro area ('Two-Pack'), which are still in the legislative process, should be finalised urgently and be implemented thoroughly. This new governance framework will provide for ample *ex ante coordination of*

Towards a fiscal capacity for the EMU

against adverse shocks differ, all other currency unions are endowed with a central fiscal capacity. In this respect, the European Council in October 2012 asked to explore further mechanisms, including an appropriate fiscal capacity, for the euro area. It would support new functions which are not covered by the multiannual financial framework from which it is clearly

arrangements would be mandatory for euro area Member States and voluntary for the others (see section III below). The Commission intends to make a proposal on specific ways to put in place such contractual arrangements and on the means to support their implementation, building on EU procedures.

country-specific economic shocks. Such a function would ensure a form of fiscal solidarity exercised over economic cycles, improving the resilience of the euro area as a whole and reducing the financial and output costs associated with macroeconomic adjustments. By contributing to macroeconomic stability, it would usefully complement the crisis management policies of the Member States, the two objectives of supporting growth-enhancing structural reforms and cushioning country-specific economic shocks are complementary and mutually reinforcing.

Economic rationale for such a fiscal capacity

shocks are less than perfect. This is clearly the case in the euro area, where labour mobility is comparatively low, capital flows are susceptible to sudden swings that can undermine financial stability, and structural rigidities can delay or impede price adjustments and the reallocation of resources. In such cases, countries can easily find themselves pushed

would provide countries with an additional strong incentive to implement sound economic policies both before and once they join the shock absorption mechanism. In the transition towards establishing this automatic stabilisation function, and depending on their specific circumstances, limited, temporary and flexible financial incentives

Options for the shock absorption function of the euro area fiscal capacity

form of an insurance-type system between euro area countries. Contributions from, and disbursements to, national budgets would fluctuate according to each country's position over the economic cycle.

public function sensitive to the economic cycle, such as unemployment insurance. In this case, the level of contributions/benefits from/to the fiscal capacity would depend directly on labour market developments. In this scenario, the fiscal capacity would then work as a complement or partial substitute to national unemployment

followed, establishing this function does not affect the overall level of public expenditure and tax pressure in the euro area. Equally, the exact conditions and thresholds for the activation of transfers would need to be studied carefully, as only country-specific shocks of a sufficient magnitude should be absorbed centrally. For example, in the case of the microeconomic

Financial resources of the fiscal capacity and ability to borrow

area fiscal capacity' could indeed offer an appropriate basis for common debt issuance without resorting to the mutualisation of sovereign debt. The question of applying a fiscal golden rule, such as the balanced budget rule enshrined in both the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance, to this fiscal capacity

III. Integrated economic policy framework

economies have negative repercussions for all members of the EMU. An integrated economic policy framework is necessary to guide at all times the policies of Member States towards strong and sustainable economic growth to produce higher levels of growth and employment.

and to facilitate price and cost adjustments that are key for competitiveness and growth. Urgent attention should be paid to promoting labour mobility across borders and addressing skills mismatch in the labour market. The Commission could undertake this assessment as a matter of priority. Finally, a framework for systematic ex-ante coordination of major

are a step in the right direction. But there is a need to go further and to put in place a stronger framework for coordination, convergence and enforcement of structural policies. In this context, the October European Council Conclusions called for further exploration of the idea of arrangements of a contractual nature between Member States and the EU

Arrangements of a contractual nature need to address vulnerabilities at an early stage

that these essential markets can adjust quickly to shocks and that national frameworks facilitate growth and employment. Contractual arrangements would thus need to focus on microeconomic, sectoral and institutional bottlenecks, and aim at enhancing the competitiveness and growth potential of the economy. The future contractual

Contractual arrangements need to focus on key weaknesses

This would take the form of an in-depth analysis by both parties, providing the basis for a tailor-made and detailed agreement on some specific reforms. Depending on the type of measures necessary, the length of these agreements would vary for each country, but would likely be of a multiannual nature. In order to maintain the focus on key weaknesses, such

Contractual arrangements need to be integrated into existing EU processes

country-specific recommendations. In accordance with the objective of early detection, the in-depth reviews would be generalised to all EMU countries. In-depth reviews would need to be based on a very thorough and on-the-ground dialogue and on analysis of Member States' economies. Based on the conclusions of the in-depth review, the Commission's country-

Contractual arrangements need to benefit from full domestic and European ownership and accountability

reporting to their respective parliaments (national and European) on progress achieved. Full accountability of both parties can only be ensured if the agreed reform agenda is specific, detailed and measurable. This requires *ex ante agreement on concrete timelines, on the specific modalities for monitoring and on access to information. The agreements and*

V. Democratic Legitimacy and Accountability

guiding principle is key to ensuring the effectiveness of the integrated financial, budgetary and economic policy frameworks. This implies the involvement of the European Parliament as regards accountability for decisions taken at the European level, while maintaining the pivotal role of national parliaments, as

national parliaments are not in the best position to take it into account fully. This implies that further integration of policy making and a greater pooling of competences at the European level should first and foremost be accompanied with a commensurate involvement of the European Parliament in the integrated frameworks for a genuine EMU

single resolution authority should take place at the European level, this should be complemented by strong mechanisms for information, reporting and transparency to national parliaments of the participating Member States.

Parliament and national parliaments on the recommendations adopted in the context of the European Semester. New mechanisms to increase the level of cooperation between national and European parliaments, for example building on Article 13 of the TSCG and Protocol 1 of the Treaty, could contribute to enhancing democratic legitimacy

legitimacy and accountability. The details of such arrangements would largely depend on its specific features, including its funding sources, its decision-making processes and the scope of its activities.

would ultimately need to be integrated into the legal framework of the European Union. This is already foreseen under the Treaty on Stability, Coordination and Governance, and could be envisaged also for other cases. Reinforcing the capacity of the European level to take executive economic policy decisions for the EMU is essential. Finally, as the

high degree of social cohesion, a strong participation of the European and national parliaments and a renewed dialogue with social partners. The openness and transparency of the process as well as the outcome are crucial to move towards a genuine Economic and Monetary Union.