BRIEFING

European Parliament

An evolutionary approach to a genuine Economic and Monetary Union

Following the publication of the Five Presidents' [report](#) on 22 June 2015, the European Commission released in spring 2017 a white paper on the future of the European Union, which includes some measures to complete the EMU, and in September 2017 the Commission President [proposed](#) some further short and long-term policy initiatives to strengthen the governance of EMU. On 21 September, the President of the European Council [announced](#) that he will call a Euro Summit in December 2017 in an inclusive format and that concrete decisions on these issues should be taken at the European Council by June next year at the latest.

This document provides a short overview of the on-going debate aimed at enhancing resilience and improving the governance in the euro area. It proposes a simple reading grid for analysing the various proposals/options to enhance the economic governance in EMU. The annexes include an overview of Eurozone scrutiny activities of the European Parliament, as well as of state-of-play of the short-term measures included in the Five Presidents' report.

This document is an update of a previous version published on 25 January 2017.

The current economic governance system in a nut-shell

According to EU Treaty provisions, Member States shall consider their domestic economic policies as a "common concern", because policies (or the absence of some policies) of one Member State may have externalities (or spill over effects) in the short or long-term on other Member States' policies. Today, the prevention of unsustainable economic and budgetary policies can take many forms. At the Union level, a legal framework for the surveillance of the economic, employment and budgetary policies of the Member States has been introduced since the introduction of the euro, based on the EU Treaties.

The EU surveillance tools are integrated in the so-called *European Semester for economic policy coordination*, which mainly results in multilateral and bilateral surveillance of Member States fiscal policies based on the Stability and Growth Pact (SGP), economic and social policies based on the so-called Macroeconomic Imbalance Procedure (MIP), and employment policies based on the so-called Employment Guidelines. For structural reforms, also in view of preventing and correcting macro-economic imbalances, the so-called country specific recommendations (partly based on the

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PE 587.389 - September 2017

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preventive arms of the SGP and the MIP) are adopted annually by the Council to steer the policies of the Member States. Tools aiming at prevention are, in particular, important in times of economic booms. In one or more Member States, there might be the risk of a nominal economic growth not supported by its economics fundamentals, which may even be fuelled by diverging real interest rates among participating Member States and possible resulting assets bubbles However, the effectiveness of these surveillance tools depend on the will, by all involved parties, to fully apply and implement them.

In addition, *intergovernmental arrangements* have been agreed, such as the agreement to introduce balanced budget rules (the so-called "Fiscal Compact") into national law. The correction of unsustainable policies may today take the form of macro-economic adjustment programmes, where external financial assistance is requested by Member States (from the European Stability Mechanism (ESM) and/or the International Monetary Fund (IMF)) based on strict macro-economic conditionality, while respecting the no-bail out clause of the EU Treaty. Both the ESM and the IMF can grant financial assistance only if the public finances are assessed to be sustainable, while the Member State has temporarily lost market access.

Furthermore, some commonly agreed rules and instruments, while not being economic governance tools as such, may also have a direct or indirect effect on how Member States conduct their policies. This is the case, for instance, with the so-called "no-bail out" and the "no monetary financing" clauses of the EU Treaty, the objective of which is to avoid any *moral hazard*.

In addition, a capacity to adjust to changing economic developments is even more important in a monetary union. Resilient economic structures may help to adjust to economic shocks without having permanent effects on employment levels and/or potential output. In a monetary union (in the absence of nominal exchange rate policies), the economic structures of the various countries may need to absorb large economic shocks via internal adjustment processes.

Furthermore, well-regulated and supervised financial markets (e.g. Banking Union and Capital Markets Union) may increase the capacity to adjust in a monetary union. The various on-going work-streams aiming at completing the Banking Union have, as one objective, the aim to make the credit rating of banks and sovereign debt of participating Member States less interdependent.

A simplified reading grid of the possible evolutions

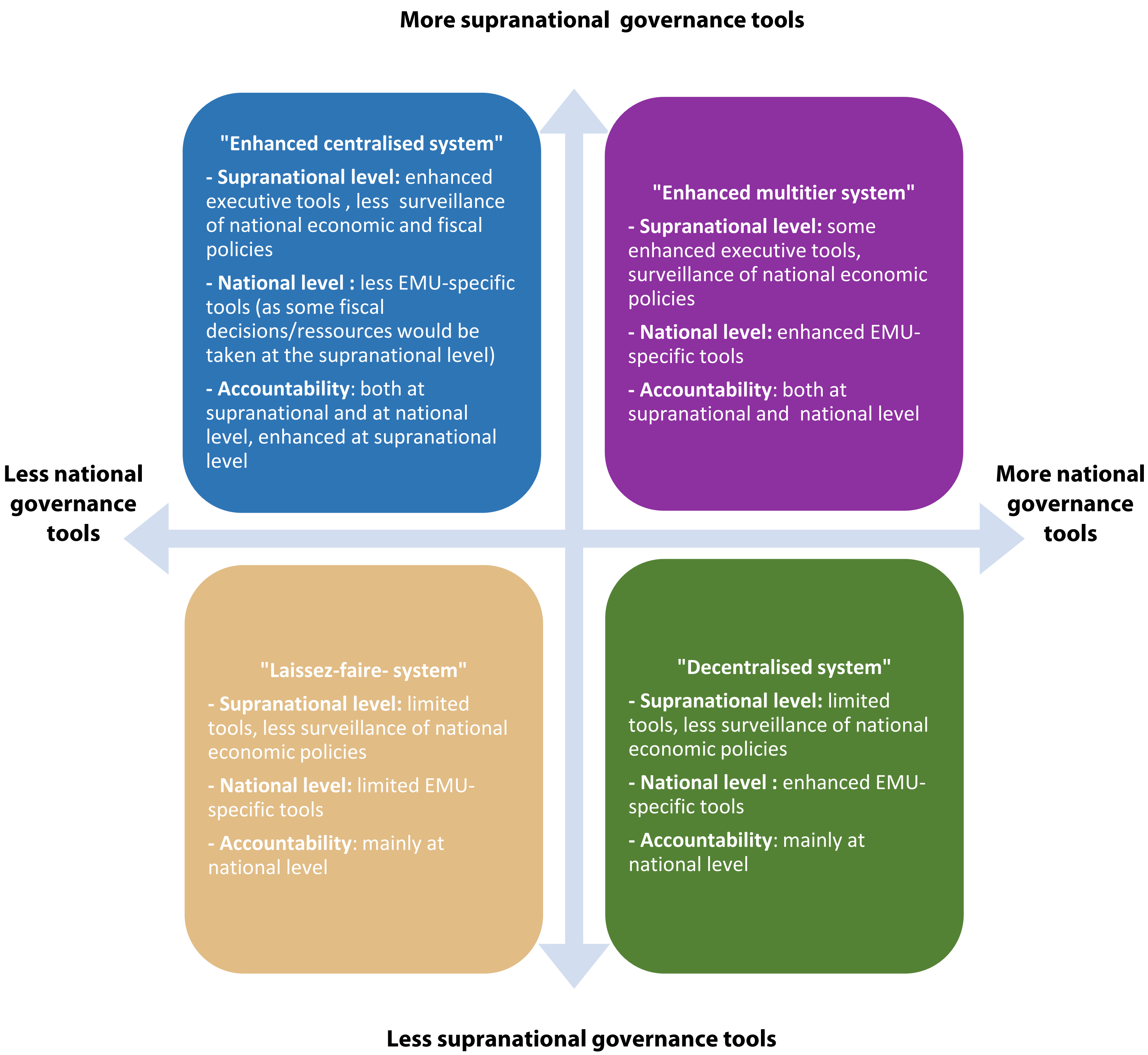
Based on the current institutional set-up of the EMU, any enhanced governance framework may rely on both enhanced national tools and enhanced tools at the Union level. The various governance tools should over time optimally form a *coherent governance framework* (optimally the policies conducted should be both time consistent and incentive compatible), as well as rely on a legitimate backing at the appropriate level.

Any economic governance structure (using available tools at the supranational and the national level) should be able to address one or more of the following objectives:

- prevent any unsustainable policies (*ex ante*);
- correct any unsustainable policies (*ex post*); and/or
- Anticipate (*ex ante*) and/or adjust (*ex post*) to economic and social developments.

The below analysis, based on a simplified two-dimensional "EMU governance matrix" (i.e. more/less supranational level vs more/less national level tools), describes four stylised scenarios for the possible evolution of the EMU governance framework that is currently debated. It tries to identify various “EMU related policy tools” that may be established at national or supranational level (i.e. EU-level or Euro area level), depending on the secenario in question.

Chart: Simplified two-dimension EMU economic governance matrix



An "Enhanced centralised system" (Blue box)

Under this scenario, further governance tools (and resources) would be allocated to the supranational level. Such tools could, inter alia, include the following: establishment of own resources for the financing of EU-wide public goods, euro-area specfic resources for reforms/stabilisation/convergence, setting-up of minimum social standards, enhanced ESM, issuance of European "safe assets", direct supervision and resolution of banks, common deposit guarantee scheme, enhanced macro-prudential tools etc.

Such resources at the supranational level -if sufficiently large- would limit the need for commonly agreed rules and surveillance mechanisms applied to national economic policy-making. Member States could have full discretion (naturally the monitoring of the use of supranational loans/grants would take place) as regards their own budgetary policies, while some budgetary/fiscal policy decisions would be taken and implemented at the supranational level. Over time, these own resources at the supranational level could enable the issuance of supranational debt instruments (with limited risks linked to an individual Member State).[1]

A "Laisser-faire" approach (Yellow box)

This scenario may be categorized as a governance system with both very limited supranational and national "EMU specific tools". The participating Member States would have full economic discretion, In this case, it would be up to national policy makers to take into account, if they so wish, any possible (short or long-term) external implications of their policies (for example, in budget policies or banking supervision...)[2]. In this respect, this scenario would be a step back compared to the situation prevailing today (which relies notably on an enhanced surveillance at supranational level, a banking union, the ESM...).

A "Decentralised governance" approach (Green box)

In this scenario, supranational involvement would be limited (for example, fewer surveillance tools available at the EU-level than currently limited euro area budgetary resources, less EU powers to supervise and resolve banks) while national governance tools would be made stronger, based on commonly agreed principles or self-imposed tools, for example via independent fiscal councils, balanced budget rules, national competitiveness bodies, national supervision and resolution of banks, enhanced macro-prudential tools etc.... Enforcement of these rules would be mainly up to the national level, including via authorities independent from governments. Such schemes would *inter alia* aim to prevent the conduct of policies that may risk financial stability. In this case, the supranational level would have very limited tools (for example, supranational resources limited to the EU budget, limited powers in supervision and resolution of banks, no common deposit guarantee scheme etc...). The major difference with the "laisser-faire scenario" described above

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[1] Similarly to the situation in the US, which has a significant supranational fiscal capacity and a well integrated capital and banking markets, an (orderly) sovereign default may be seen as a credible option by the parties involved. For an comparison of the main differences between EU ans US fiscal governance, see separate [EGOV briefing](#).

[2] Until the eruption of the euro crisis, the conduct of economic policies were very much up to individual Member States with no major limits/tools agreed at EU level (the only tool being the surveillance of fiscal policies under the SGP/EDP). Nor were there commonly agreed rules to be enforced at national level, (e.g. few Member States had binding balanced budget rules or independent fiscal councils) and banking supervision and resolution were national competences (providing they were in line with EU competition rules). in this kind of governance framework, market forces could- at least in principle - play a role as a "disciplinary factor" for unsustainable policies (even if experience of the first decade of the euro shows that this was not the case).

would be that, in this case, some rules or principles framing national discretion in the conduct of economic policy could be agreed at the supranational level, while implementation and enforcement would be left more or less to the individual Member States.[3]

An "Enhanced multitier system" (Purple box)

This scenario may look from the outset very similar to the system we have today. The current economic governance framework includes both quite extensive supranational tools (for example, economic surveillance, banking supervision and resolution partly centralised, the ESM as a backstop to safeguard the financial stability of the euro, some macro-prudential tools etc...) and commonly agreed rules or principles to be applied at national level (for example balanced budget rules, establishment of independent fiscal councils, national competitiveness boards, macro-prudential tools etc...). This system would continue to rely on governance tools available on both levels, pending the policy area in question (in this respect it includes elements of cases in the blue and green boxes). In this scenario, the allocation of tools should be clearly defined i.e. the concrete tools would be allocated to the level where they can best achieve their objectives (i.e. best enforced and legitimate). This is also part of the current debate on the right balance to be found between risk reduction and risk sharing among the Member States in the area of the banking union.

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Due to the unique design of the EMU, it is most likely that its governance structures will continue to evolve based on a division of tools between supranational and national levels that best corresponds to the policy areas in question. This means that it is bound in practice to a multitier governance system, which is also in line with the EU subsidiarity principle. Furthermore, many policy tools may be complementary to each other and making progress on one may enable progress on another. For instance, any policy initiatives that tries to enhance the credibility of the "no-bail-out" clause, may benefit from progress in other policy areas, such as in completing the baking union and the capital markets union, and even in the longer term the introduction of a "safe asset" on the supranational level.

In this respect, it will remain important to have a clear vision on the future steps in order to build a coherent and consistent governance framework in the EMU over time. Also the allocation of EMU-specific governance tools should optimally provide the correct policy incentives to all involved and be backed with sufficient resources and enforcement mechanisms (and proper democratic controls mechansims) on the respective governance levels.

[3] Today, an example of such a decentralised governance framework can be found in the commonly agreed decisions to introduce at the national level the so-called balanced budget rules over the economic cycle as well as to establish independent fiscal councils.

Annex 1: Eurozone scrutiny in the European Parliament

As part of the discussion of future developments of the EMU governance framework, there have been calls to enhance the democratic control of the decisions taken. Today these decisions are taken at the European level, either under the traditional Community method (mostly decisions by the Council, de facto prepared and decided by the Euro group, based on recommendations by the Commission) or under an intergovernmental approach, in particular as regards the ESM financial assistance. In addition, the role of the European Central bank (ECB) has increased since the sovereign debt crises, as it has extended its monetary policy toolbox from standard to non-standard measures. The ECB has also become responsible for the direct supervision of euro area systemic banks.

Today the Economic and Monetary Committee (ECON) of the European Parliament is the main interlocutor for the scrutiny of these executive bodies at the EU-level (i.e. ECB fulfilling its monetary policy objectives, the Commission/Council/Euro group applying the EU economic governance framework, the enforcement of the recently set-up banking union legal framework by the Single Supervisory Mechanism (SSM) and the Single Resolution Board (SRB) - see overview chart).

In addition, specific working groups, such as the Banking Union Working Group and the Financial Assistance Working Group, have been established to closer monitor the implementation of the governance framework. Inter-parliamentary meetings with the members of the national parliaments are also organised on a regular basis, including under the framework of the so-called Article 13 Conference of the Treaty on Stability, Coordination and Governance in EMU, to discuss common issues relating to the functioning of the single currency area.

As part of this scrutiny work of the euro area by the competent committee(s) of the European Parliament, the services regularly provide expertise input as background material for the Members. For further information on:

- Expertise provided in advance of monetary dialogues
- Expertise provided in advance of economic dialogues
- Expertise provided in advance of banking union hearings

Annex 2: The Five President's Roadmap towards a Complete EMU: state of play in the implementation of the short term steps

STEPS	MILESTONES
• **A new boost to convergence, jobs and growth**	
1. Creation of a euro area system of Competitiveness Authorities;	The Council has adopted a decision giving guidance for national productivity boards. For further information, see this EGOV note.
2. Strengthened implementation of the Macroeconomic Imbalance Procedure;	The MIP has been used as the legal based for some of the Country Specific Recommendations and the Commission has launched specific monitoring for Member States assessed to have macroeconomic imbalances. The Commission has published a compendium on the implementation of the MIP. For further information, see this EGOV note.
3. Greater focus on employment and social performance;	The Commission has launched a public consultation on the social pillar to EMU, which closed on 31 December 2016. The Commission held a conference on 23 January 2017 and "*A consolidated version of the European Pillar of Social Rights*" was presented in summer 2017 by the Commission. The MIP scoreboard has been revised: it now includes three new socio-economic indicators.
4. Stronger coordination of economic policies within a revamped European Semester.	Substantial progress on the process: since the 2016 Cycle, euro area recommendations are published along the AGS at the start of the Semester to better integrate the euro and national dimensions, see this EGOV note. For an overview of the implementation of recommendations in practice, see EP resolution and this EGOV note.
• **Complete the Banking Union**	
1. Setting up a bridge financing mechanism for the Single Resolution Fund (SRF);	Member States have agreed to put in place individual loan facility agreements (i.e. credit lines to be drawn as a last resort) covering the entire targeted envelope of EUR 55 billion.
2. Implementing concrete steps towards the common backstop to the SRF;	On 8 November 2016 the ECOFIN has mandated the EFC to start technical work on the backstop. In September 2017, at the occasion of his state of the Union speech, President Juncker called for the creation of a dedicated Euro Area budget line providing notably for a backstop for the Banking Union (see Commission roadmap for a more united, stronger and more democratic European Union).
3. Agreeing on a common Deposit Insurance Scheme;	No agreement on EDIS yet. The Commission proposal is out since November 2015; further progress in Council and Parliament is linked to the progress made on the de-risking side For further information, see this EGOV note.
4. Improving the effectiveness of the instrument for direct bank recapitalization in the European Stability Mechanism (ESM).	The work on simplifying the direct recapitalization instrument (DRI) has not started yet; the current conditions to use DRI are quite restrictive; DRI has never been used so far. For further information, see this EGOV note.
• **Launch the Capital Markets Union**	The project has been launched and progress is monitored; In June 2017, the Commission published the mid-term review of the Capital Markets Union action plan. On 20 September 2017, the Commission proposed a revision of the European System of Financial Supervision (ESFS) framework to further strengthen and integrate EU financial market supervision, which includes a reinforced coordination role for the European Supervisory Authorities and new direct supervisory powers for the European Securities and Markets Authority.

• **Reinforce the European Systemic Risk Board**	A public consultation on the review of the macro-prudential policy framework, including the ESRB, was launched in August 2016 (closed in October 2016). On 20 September 2017, as part of the ESFS review (See above), the Commission proposed a number of changes to the ESRB functioning: i) The ECB president becomes its permanent chair; ii) the role of the head of the ESRB secretariat and its selection process is enhanced; iii) The Single Supervisory Mechanism and the Single Resolution Board become voting members in the ESRB general board. For further information on ESRB, see this EGOV note.
• **A new advisory European Fiscal Board**	
1. The board would provide a public and independent assessment, at European level, of how budgets – and their execution – perform against the economic objectives and recommendations set out in the EU fiscal framework. Its advice should feed into the decisions taken by the Commission in the context of the European Semester.	An advisory Fiscal Board has been established inside the European Commission. For more information, see this EGOV note.
• **Revamp the European Semester**	
1. Reorganise the Semester in two consecutive stages, with the first stage devoted to the euro area as a whole, before the discussion of country specific issues in the second stage.	Since the launch of the 2016 Semester Cycle this has been the case. For further information, see this EGOV note.
• **Strengthen parliamentary control as part of the European Semester**	
1. Plenary debate at the European Parliament on the Annual Growth Survey both before and after it is issued by the Commission; followed by a plenary debate on the Country-Specific Recommendations;	Since 2016, EP plenary debates on the AGS and the implementation of the Semester Cycles take place.
2. More systematic interactions between Commissioners and national Parliaments both on the Country-Specific Recommendations and on national budgets;	In its Communication on the 2017 AGS, the COM pledged to intensify the dialogue with the Member States on CSRs during spring 2017.
3. More systematic consultation and involvement by governments of national Parliaments and social partners before the annual submission of National Reform and Stability Programmes.	In its Communication on the 2017 AGS, the COM: (1) Pledged to intensify the dialogue with the Member States on the national programmes during spring 2017; (2) Called for a strong role of national Parliaments and a stronger involvement of social partners during the preparation of the national programmes.
• **Increase the level of cooperation between the European Parliament and National Parliaments**	Meetings between national parliaments and the European Parliaments has taken place on a regular bases both under the so-called Article 13 Conference of the Fiscal Compact, under the European Parliamentary

	Week and in Inter-parliamentary Committee meetings. For further information, see here.
• **Reinforce the steer of the Eurogroup**	Eurogroup has stepped up its work on benchmarking of structural reforms in Euro Area Member States. For further information, see this EGOV note.
• **Take steps towards a consolidated external representation of the euro area**	The Commission set out a roadmap towards an increasingly unified external representation of the EMU around which a consensus in the Council and in the European Parliament could be shaped, as explained in a Communication that was published on 21 October 2015. The Commission also made a proposal for a Council decision "laying down measures in view of progressively establishing unified representation of the euro area in the International Monetary Fund". The Council has not made progress on that proposal.
• **Integrate into the framework of EU law the Treaty on Stability, Coordination and Governance; the relevant parts of the Euro Plus Pact; and the Inter-governmental Agreement on the Single Resolution Fund**	No specific measures taken until today. In September 2017, the COM announced its intention to make a proposal in December 2017 to integrate the substance of the Treaty on Stability, Coordination and Governance in the EMU into EU law (see Commission roadmap for a more united, stronger and more democratic European Union).

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