Deepening EMU: why, how, when?

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European Commission, DG Economic and Financial Affairs

To what extent are we moving towards a two-speed Europe?
Seminar Ministry of Finance Sweden / Bruegel
Stockholm, 12 November 2015
A multi-speed Europe is reality

<table>
<thead>
<tr>
<th>European Union</th>
<th>Members</th>
<th>Non-members</th>
<th>Non-members who are obliged to join</th>
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A highly differentiated European reality
An evolving multi-speed Europe

1999

2015

EU Member States
- Euro area
- Opt out
- No euro

Non-EU
- Monetary agreement
- No euro
Factors contributing to differentiated integration

- Crisis-induced strengthening of EMU governance
- Tendency towards intergovernmentalism
- Increased heterogeneity of EU
Initial design flaws of the Maastricht assignment

• No credible structural reforms at the national level
• Lack of tools to prevent macroeconomic imbalances
• Fiscal framework was weakly enforced, focused too little on debt, did not prevent pro-cyclical fiscal policies
• Lack of a crisis management mechanism
• No tools to address financial fragmentation of the banking system
• High bank dependency/little diversified sources of finance
Main reforms introduced in 2011-2014 strengthened a multi-speed Europe

<table>
<thead>
<tr>
<th>Field</th>
<th>Enacted Reforms</th>
<th>Applies to:</th>
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<tr>
<td></td>
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<td>EACs</td>
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<tr>
<td>Surveillance</td>
<td>• Reinforced treaty-based commitment to fiscal discipline (<em>TSCG</em>)</td>
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<td>• Strengthened preventive monitoring of fiscal developments (<em>6-P, 2-P</em>)</td>
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<td></td>
<td>• Closer surveillance of countries in financial difficulty (<em>2-P</em>)</td>
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<td>• New voting rules for excessive deficit procedure (<em>TSCG</em>)</td>
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<td>• Debt criterion for correction of excessive deficit (<em>6-P</em>)</td>
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<td></td>
<td>• Prevention and correction of macroeconomic imbalances (<em>6-P</em>)</td>
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<td></td>
<td>• Integration of sectoral procedures within the European semester (<em>6-P</em>)</td>
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<td></td>
<td>• Macro-prudential oversight (<em>specific legislation</em>)</td>
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<tr>
<td>Crisis management and resolution</td>
<td>• Creation of ESM (<em>specific treaty</em>)</td>
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<td>• OMT programme (<em>ECB</em>)</td>
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<tr>
<td>Systemic Integration</td>
<td>• Banking Union (<em>specific legislation</em>)</td>
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Notes:  
1) For NEACs (excl. UK, SE and HR) the TSCG is only binding after euro adoption; 2) 2-P provisions are only binding for EACs; 3) The Macroeconomic Imbalance Procedure (MIP) foresees different thresholds in the scoreboard for EACs/NEACs, possible sanctions in case of 'excessive' imbalances can only be imposed on EACs; 4) NEACs can opt in.
5 Presidents' Report: 3 stages, 4 unions

- **Stage 1**
  - "Deepening by doing"
  - by 30 June 2017

- **Stage 2**
  - "Completing EMU"

- **Stage 3**
  - "Final stage"
  - At the latest by 2025

**Unions**
- Economic Union
- Financial Union
- Fiscal Union
- Political Union
Rationale for EMU deepening

- New boost to jobs, growth and convergence
- Prevent macroeconomic imbalances
- Stronger coordination of economic policies
- Assure fiscal discipline and fiscal sustainability
- Provide fiscal stabilisation and run pro-growth fiscal policies
- Increase transparency and reduce complexity of the rules
- Remove negative feedback loop between sovereign and bank risks
- Restore credit flows to the real economy
- Strengthen financial integration
- Enhance democratic accountability
- Strengthen the EA's role in global governance
Policy response: Economic Union

- Creation of a EA system of Competitiveness Authorities
- Stronger and more encompassing Macroeconomic Imbalance Procedure (MIP)
- Greater focus on employment and social performance
- Stronger coordination of economic policies within a revamped European Semester

Stage 1

Stage 2

- Binding targets for structural convergence of EA economies
- Challenging task to be dealt with by the expert group
- Main issues:
  - Which standards?
  - Convergence to which frontier?
  - How to define benchmarks?
  - Key role for the Single Market?
Policy response: Fiscal Union

- Increase transparency and reduce complexity of the rules
- Create a new advisory European Fiscal Board (EFB) with three functions:
  - Provide an evaluation of the implementation of the EU fiscal framework
  - Advise the Commission on the appropriate fiscal stance
  - Cooperate with the national fiscal councils

- Set up a EA-wide macroeconomic stabilisation mechanism for the euro area (e.g.: EA unemployment insurance; emergency fund; investment fund)
- Create EA Treasury
- Other possible elements (to be developed by experts group)
  - Introduce a sovereign debt restructuring procedure
  - Credible pan-European backstop for banking sector
  - Some form of common borrowing (backed by common revenue)
Policy response: Financial Union

• **Complete the Banking Union:**
  - Single bank supervision
  - Single bank resolution (SRF)
    - Setting up bridge financing for the SRF
    - Implementing concrete steps towards the common backstop to the SRF
  - Single deposit insurance: could be conceived as re-insurance system at the EU level for the national deposit guarantee schemes

• **Launch the Capital Markets Union**
  - Ensure more diversified sources of finance
  - Strengthen cross-border risk-sharing through deepening integration of bond and equity markets
Policy response: Political Union

- Enhanced role of national and European Parliaments (e.g. more systematic appearances of Commissioners in national Parliaments; plenary debate on the Annual Growth Survey)
- Consolidate external representation of the Euro Area
- Integrate inter-governmental arrangements into EU law framework (ESM; TSCG; EuroPlus Pact; Single Resolution Fund)
- Strengthening of Eurogroup

Stage 1

Stage 2

- Full-time presidency of Eurogroup
- Integrate ESM into EU law framework
- Set up a Euro Area treasury accountable at European level
### Alternative models for the future of the Euro area

<table>
<thead>
<tr>
<th>Model</th>
<th>Discipline</th>
<th>Solidarity</th>
<th>Governance</th>
<th>Legitimacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fully decentralised model</td>
<td>Strict no bail out, maximum exposure ceilings for banks</td>
<td>No Euro area-specific solidarity</td>
<td>Insolvency procedures for sovereigns</td>
<td>No specific accountability</td>
</tr>
<tr>
<td>Federal model</td>
<td>Rules and procedures for fiscal and macroeconomic surveillance</td>
<td>Countercyclical transfers and conditional assistance financed by common budget</td>
<td>Federal institution (presumably COM) as Euro area executive</td>
<td>Accountability to European Parliament</td>
</tr>
<tr>
<td>Hybrid model</td>
<td>National rules consistent with common principles, network of national institutions</td>
<td>Graduated mutual support system</td>
<td>Euro area coordination executive</td>
<td>Parliamentary body built from national parliaments and the EP</td>
</tr>
</tbody>
</table>

*Source: Pisani-Ferry (2015): Rebalancing the governance of the euro area, p. 20.*
Conclusion

• More than thirty shades of differentiation epitomises a complex reality and contributes to conceptual confusion

• Various factors will continue to drive increased differentiation

• Alternative scenarios for future euro area, but:
  o In short-run, functionalism likely to prevail, implying at least temporarily further differentiation
  o In medium term and beyond, in particular in case of political convergence process, providing fully legitimate institutions and involving Treaty changes, the process might lead to the emergence of a more permanent two-speed Europe

• Five Presidents' report puts short-term further integration along four dimensions in the context of a long-term agenda
Background slides
Euro area potential growth remains weak

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<th>Euro Area</th>
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<th>US</th>
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<td></td>
<td>Potential Growth</td>
<td>GDP per capita (Potential)</td>
<td>Potential Growth</td>
<td>GDP per capita (Potential)</td>
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<td>1998-2007</td>
<td>2.0</td>
<td>1.6</td>
<td>2.8</td>
<td>1.7</td>
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<tr>
<td>2008-2013</td>
<td>0.7</td>
<td>0.4</td>
<td>1.5</td>
<td>0.7</td>
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<tr>
<td>2014-2023</td>
<td>1.1</td>
<td>0.9</td>
<td>2.5</td>
<td>1.8</td>
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Economic performance: EA vs. non-EA

**Real GDP**
(yoy %, 5y avg.)
- 2004 - 2008: EA-19 3.7%, Non EA-9 4.2%
- 2010 - 2014: EA-19 1.0%, Non EA-9 1.3%

**Potential GDP**
(yoy %, 5y avg.)
- 2004 - 2008: EA-19 3.1%, Non EA-9 3.4%
- 2010 - 2014: EA-19 0.6%, Non EA-9 1.1%

**Real GDP per capita**
(in EUR 1000, 5y avg.)
- 2004 - 2008: EA-19 27.0, Non EA-9 18.8
- 2010 - 2014: EA-19 26.6, Non EA-9 18.9

**HICP inflation**
(yoy %, 5y avg.)
- 2004 - 2008: EA-19 4.9%, Non EA-9 3.9%
- 2010 - 2014: EA-19 1.8%, Non EA-9 2.5%

**Govt. deficit**
(in % of GDP, 5y avg.)
- 2004 - 2008: EA-19 2.4%, Non EA-9 2.5%
- 2010 - 2014: EA-19 3.2%, Non EA-9 2.7%

Note: Calculations are based on simple unweighted arithmetic means across EA-19/non EA-9 countries.
Source: Ameco.
Macroeconomic imbalances: EA- vs. non-EA

Note: The chart displays the percentage share of EA-19/non EA-9 countries violating a given MIP scoreboard indicator in 2008/2014. Calculations of EA-19/non EA-9 are based on simple unweighted arithmetic means across EA-19/non EA-9.
Initiative to reform: EA vs. non-EA

*Implementation record of COM country-specific recommendations (CSRs)*

Note: Implementation record is measured by a COM composite indicator ranging from 0 (no implementation) to 100 (full implementation). The country-specific recommendations (CSRs) list key reform needs of Member States as part of the European Semester.
Improving the toolbox of economic governance

- **Revamped European Semester**
  - Better integrate euro area and national dimensions
  - More attention to employment and social issues
  - Enhanced use of benchmarking
  - Support for reforms: EU Funds and technical assistance

- **Fiscal surveillance**
  - Increasing transparency
  - Reducing complexity
    - Consistency of methodology between the debt rule and the MTO
    - Streamlining assessment of compliance – a single indicator?
    - Updating of multi-annual EDPs

- **Macroeconomic Imbalances Procedure**
  - Increasing transparency
  - Ensuring appropriate follow-up to the identification of excessive imbalances
  - Stronger euro-area dimension
European Fiscal Board

• **Mission**
  • Contribute to multilateral surveillance in the euro area
  • Advisory role

• **Tasks**
  • Evaluate the implementation of the EU fiscal framework
  • Euro area fiscal stance: economic judgment within the rules
  • Cooperate with national fiscal councils

• **Set up**
  • High degree of independence
  • Five renowned economists, supported by small secretariat
  • Key stakeholders consulted on nominees (EWG, ECB, fiscal councils)
Competitiveness Authorities

• **Objective**
  - Monitor performance and policies in the field of competitiveness to foster convergence and increase reform ownership

• **Set up**
  - Can rely on existing institutions, conforming to common principles
  - Independent and unbiased

• **Tasks**
  - Monitor competitiveness
  - Conduct analysis
  - Publish annual reports

• **European dimension**
  - Commission coordination
  - Analysis feeding into Semester and MIP
External representation

• **A unified representation by 2025 at the latest**
  • One or several constituencies
  • Ministerial level: President of the Eurogroup
  • Executive Board: Executive Director of a euro area constituency

• **Transitional phase until the final stage can be reached:**
  • Start moving into constituencies composed of only EA member states
  • An observer status for the EA in the Executive Board

• **Need to maintain and further strengthen co-ordination with non-EA member states**