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WORKING PAPER

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MEETING DOCUMENT

From:	Presidency
To:	Financial Counsellors - ECOFIN preparation
Subject:	Presidency Issues Note on 'Reflections on the future of the Economic and Monetary Union (EMU)'

Delegations will find attached a Presidency Issues Note on 'Reflections on the future of the Economic and Monetary Union (EMU)' for the working lunch on Friday 7 April 2017 at the Informal EU Finance Ministers' Meeting in Valletta.

Please note that the lunch will be held in English only and there will be no interpretation.

Reflections on the future of the Economic and Monetary Union (EMU)

Informal EU Finance Ministers' Meeting, 7-8 April 2017, Valletta

Presidency Issues Note

Background

Launched in 1992, the Economic and Monetary Union (EMU) has contributed to the integration of European economies through a common currency, a common monetary policy and the coordination of economic and fiscal policies. Gradually, the euro became the second most important global currency after the US dollar.

The situation today is that two-thirds of Europeans consider the euro to be a good thing for the EU (Eurobarometer). At the same time when one looks at the individual Member States and the perceptions of people on the ground, there are stark contrasts in the degree to which the single currency is considered to have contributed to national prosperity. Whilst it is clear that the euro has delivered tangible benefits for citizens and businesses through the elimination of currency risks, removal of exchange costs, lower interest rates and trade facilitation, it has also exacerbated some vulnerabilities by promoting large capital flows that fuelled imbalances in the Euro Area. The situation came to a head during the last financial crisis.

The Euro Summit of 2014 highlighted the need for closer coordination of economic policies for the smooth functioning of the EMU. This process culminated in the Five Presidents' Report, published in June 2015, which outlined ambitious plans on how to deepen and complete the EMU in three stages by 2025, with the aim of creating a better and more prosperous life for all citizens.

Towards a Complete EMU

The Five Presidents' Report set out the stages for developing a robust and complete EMU:

- Stage 1 "Deepening by Doing" (1 July 2015 – 30 June 2017) – EU institutions and euro area Member States are to build on existing instruments and Treaties;
- Stage 2 "Completing EMU" - Work on concrete measures of a more far-reaching nature to complete EMU's economic and institutional architecture;
- Final Stage (by 2025) – Completed EMU, which would provide a stable and prosperous place for all citizens of the euro area.

Reflecting on the Progress so far

Following the financial and sovereign debt crisis, a number of bold steps were taken to strengthen the EMU. This included the strengthening of the economic and fiscal governance frameworks, the establishment of the European Stability Mechanism, and the creation of Banking Union with single supervision and a common bank recovery and resolution. In parallel, the ECB's monetary policy played a crucial role in overcoming the crisis and supporting the ongoing economic recovery.

In September 2015, the European Commission launched the Capital Markets Union with the aim of establishing a true single market for capital across the EU and thus to support investment in the long term. Subsequently in October 2015, the Commission adopted a package of proposals that included a revised approach to the European Semester; a more unified representation of the euro area in international financial institutions (in particular, IMF). It also proposed specific steps towards completing the Banking Union with a European Deposit Insurance Scheme, which were, in November 2016, complemented by proposals to reduce risk in the banking sector. Technical work on these Banking Union dossiers, including on the credible backstop to the Single Resolution Fund, is ongoing.

The debate on the Future of Europe

The debate on deepening the EMU is taking place against the background of the broader discussion on the future of Europe as outlined in the White Paper published on 1 March 2017. As announced in the White Paper, during the coming months, the European Commission is expected to publish a series of reflection notes including one on deepening the EMU.

In a context where Europe's challenges do not show signs of abating, the White Paper raises questions on the future role of the EU. Indeed, whilst the economy is still recovering from the global financial crisis, the UK vote to leave the EU, the migration crisis, terrorism and a changing geopolitical landscape are significant challenges that the EU must deal with. Against a background of rising scepticism amongst European citizens, the White Paper presents five scenarios – ranging from focusing on the single market to further integration on all fronts – with a view to generate debate and reflection on future integration in several policy domains, including the EMU.

As far as the EMU is concerned, the scenarios included in the White Paper range from the current practice of incremental progress (scenario 1), over limited changes (scenario 2) or enhanced cooperation (scenario 3), to consolidating the EMU by doing less more efficiently (scenario 4) or moving towards a genuine EMU (scenario 5).

To facilitate the debate and provide guidance to the Commission in its preparation of the reflection note, the Maltese Presidency outlines in Annex 1 its interpretation of what each of these integration models might imply for the EMU.

QUESTIONS FOR MINISTERS:

1. In the wider context of the Commission's White Paper on the Future of Europe, do Ministers consider that the scenario where 'some do more' is the more realistic way forward? How could this be implemented and what are the risks associated with the adoption of such an approach?
2. To what extent do Ministers consider the present state of the EMU 'fit for purpose' following recent reforms to the economic, fiscal, financial and macro-prudential frameworks? Is doing less an option for Ministers?
3. How can the current EMU governance framework be improved, in particular made leaner and more efficient?
4. In light of the ongoing challenges faced by the Union, which initiatives would Ministers prioritise for further economic integration, and how would they envisage gaining public support?

Annex: Possible implications for the EMU of the White Paper's scenarios, as perceived by the Presidency

Scenario 1

Scenario 1 ('carrying on') is one of incremental progress that builds on the current rules-based surveillance framework and the existing proposals to improve governance in the context of the European Semester and, importantly, to complete the Banking Union and establish building blocks for the Capital Markets Union, which notably allows for enhanced private risk sharing to smooth asymmetric shocks.

Scenario 2

The White Paper does not offer much insight on what Scenario 2 ('nothing but the single market') implies for the EMU other than that 'cooperation in the Euro Area is limited' as the functioning of EMU becomes the raison d'être of the EU. This could in turn put at the risk the integrity of the euro and the capacity to respond to a new financial crisis.

Scenario 3

Scenario 3 ('some do more') describes a situation where a group of countries deepen cooperation in areas such as taxation and social standards. This can be interpreted in a broad manner, but it presumably implies a move from rules to institutions-based policy coordination. From the perspective of the smooth functioning of the currency union, it seems likely that this would at least cover a convergence to minimum standards for certain budgetary aspects and for the functioning of the labour market. This scenario would presumer greater harmonisation of tax rules and rates tax alongside agreed social standards that provide certainty for business and contribute to improved working conditions. In this context, Scenario 3 would offer a link with the European Pillar of Social Rights that is currently being discussed.

Scenario 4

As far as Scenario 4 is concerned, the White Paper points to consolidating the Euro Area and ensuring its stability, although it is less clear what 'doing less more efficiently' could mean in practice even if it is stated that the EU would lower its ambition in some parts of employment and social policy. It is not obvious that there is much scope for downsizing the Euro Area's policy toolkit, which has been revised and expanded in recent years precisely to safeguard financial stability and improve the functioning of the EMU. Nevertheless, one could look for ways to reduce the complexity of rules-based surveillance and make the related decision-making processes more efficient. One could also seek to strengthen market-based incentives or instruments to foster sound national policies. Examples may include a market-based European Safe Asset (based on risk pooling and/or tranching of national sovereign debt) or a Sovereign Debt Restructuring Mechanism.

Scenario 5

In Scenario 5 ('doing much more together'), Euro Area Member States would establish a genuine and deep EMU along the lines of the Five Presidents' Report that is marked by greater coordination on fiscal, social and taxation matters, as well as European supervision of financial services. As is the case in mature currency unions, they would engage in some degree of public risk sharing through the provision of EU financial support which would boost economic development and respond to shocks at regional, sectoral and national level. Public risk sharing would complement the private risk sharing provided by a completed Banking Union and a Capital Markets Union. Public risk sharing could fund many purposes, such as investing in projects of common concern or contributing to macroeconomic stabilization through a European unemployment insurance scheme, for example. The sharing of public risk would have to be accompanied by a degree of sharing of decision-making power in budgetary matters as well as convergence to minimum standards in certain economic policy areas to address concerns about moral hazard or permanent fiscal transfers. Democratic legitimacy and accountability would have to be strengthened at the European level commensurate with the degree of public risk sharing.