# PES Financial and Economic Network
# Discussion Paper: Strengthening and deepening of the Economic and Monetary Union (EMU)

## Contents




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## 1. Introduction

The time has come to secure a strong economic and political future for the Eurozone and the EU through a significant deepening and reform of the Economic and Monetary Union. We must enter into a phase of **valuable reforms that focus on the most fundamental and long-term problems and possibilities** for the Eurozone and its architecture. The reform discussions that will take place this year, following from the European Commission's package for deepening the EMU, and the 2021-2027 Multiannual Financial Framework should not be wasted.

The aim of this process should be to enhance the Eurozone's capacity to work as a system that **provides for sustainable growth, bridges inequalities, and brings job creation, upward convergence, common action and democracy.** A new economic growth model needs to be built focusing transitioning towards a low carbon economy, accommodating the changes of the digital era and setting the means for sustainable financing.

In recent years we have seen **progress** in this direction, and significant policy **successes** for our political family. The **investment plan** for Europe and the European Fund for Strategic Investments (EFSI) are providing a significant contribution for the crucial task of **closing Europe's investment gap**. The clarification of the **flexibility rules** of the Stability and Growth Pact in 2016, allowing member states more room for manoeuvre to pursue investments, was an important achievement that should also contribute to this goal. We have helped to rebalance the European agenda, giving more weight to social rights rather than economic freedoms through the **European Pillar of Social Rights.** Representatives of our family in the European Commission, European Parliament and member states have been combining a **progressive policy mix** and reform agenda, bringing **more investment** and **aiming at stronger domestic demand.**

However, there is much more that needs to be done. **New action is needed to provide European common public goods such as social welfare, common migration and asylum policy, common defence and security policy.** The Eurozone's political and economic architecture needs to be deepened to enable **more investment**, to maintain and promote **more economic demand**, to allow a **proper response to future crises**, to bring greater **upward social and economic convergence**, social and territorial cohesion, and to achieve **greater democratic legitimacy**. Ultimately, this is a process that must be guided by the need for our economy to transition to a new growth model, guided by the **Sustainable Development Goals (SDGs)** that is sustainable, innovative, egalitarian and inclusive.

Europe's economic policy needs to change. The EMU will be instrumental in preventing and safeguarding Europe from a new financial and economic crisis. It will be catalytic in keeping investment at sustainable levels. Especially today, when Europe's future growth prospects are worryingly low and the continent is marked by a long period of underinvestment. Europe's current economic governance is steadily paving the way for a multispeed Europe and is hampering young people's opportunities for a brighter future. The EMU's reform must put these issues at the centre of its strategy. The overall aim is to offer prosperity to all. To assist all Member States to move forward and grow exponentially in an equal manner.

Current political and economic circumstances provide a window of opportunity for reform that should not be missed. In the past year, promising new initiatives have been taken from various sides that have begun a process aimed at towards the significant reform of the Economic and Monetary Union. The Rome declaration by European leaders in March 2017 outlined a vision for Europe as a political, social and cultural entity, not just a single market or a monetary union. The European Commission's proposals for the EMU have followed this trend by providing a concrete agenda for reform for the next years, with a potential for measures that could consist of very significant moves towards a more balanced and integrated Eurozone. This was followed by the first Eurozone Summit in more than two years in December 2017, and the scheduling of two more in the first half of 2018.

Last but not least, the European Central Bank has been continuing to purposefully pursue the unconventional policy of quantitative easing. In an effort, to help economic recovery accelerate, by lowering borrowing costs and increasing the potential for public investment. But Europe's growth prospects cannot simply rely on the monetary policy pursued by the ECB. Quantitative easing can, in the future, cease to apply. Mario Draghi's commitment to impose 'no limits' to how far monetary policy might fade out with the end of his mandate. It is therefore crucial for Europe to create the fiscal incentives and policies to safeguard itself from future shocks.

The deepening of the EMU must be an **open, transparent and democratic process**, one which includes all members of the European Union and abides to the community process. Democracy, rule of law and a corruption-free environment are the preconditions of the deepening of the EMU. A leading aim of EMU reform should be for more Member States to adopt the euro currency. The deepening and widening of the Eurozone are mutually reinforcing goals which need to be embraced simultaneously. A strong euro creates positive spillovers across the EU, and an EMU which works better for its members will attract others to join it.

The aim of Europe's member states and institutions should be to agree on measures on the deepening of the EMU during this legislature, without leaving topics open for after 2019. A new economic model for Europe is the answer against populism and nationalism. Europe has to strengthen its foundation and address the challenges that it faces, be those social, economic, political, digital, and humanitarian. The time to act is now.

This paper seek to build on the work that our political family carried in recent months, and in particular the PES High Level Working Group on the EMU which agreed on a set of conclusions on creating 'a new fair deal for the EU and the Eurozone'[1] and the PES Presidency declaration on establishing an EMU 'of sustainable economic growth and employment'[2].

[1] http://bit.ly/2D6bY3u

[2] http://bit.ly/2jaY21D

## 2. Strengthening economic governance

The EU's and Eurozone's economic recovery and sustainability depends on Europe's ability to fulfil its potential in growth and investment, to tackle social and economic imbalances, and to address its vulnerabilities to new economic shocks. The EU needs to play a more substantial role in the provision of European public goods, in tackling negative externalities, and in enabling upward social and economic convergence. The rules of the EU and of the EMU need to be strengthened so that they facilitate and promote, rather than undermine, growth-friendly fiscal policies, investment, and full employment. To achieve this:

- The European Budget must be equipped to finance European public goods.
- Priority should be given to bridging economic, social and territorial inequalities by promoting upward convergence and strengthening Europe's social dimension.
- Implementation of expansionary fiscal policies is necessary for raising domestic demand. The implementation of an aggregate fiscal stance is also much needed to ensure the internal balance of the EMU.
- Public investment must be strengthened, especially with the introduction of a 'golden rule' in the Stability and Growth Pact.
- Tax policy needs to be coordinated. Tax evasion and fraud must be addressed with ambitious policies. Taxation of digital companies must be implemented.

2.1 Strengthening the EU Budget to ensure provision of European public goods

*O*ne of the EU's greatest assets is its ability and strength to respond to challenges that cannot be as effectively dealt with on a national level. Much more could be done on an EU level to **improve the management and provision of European public goods**. Cross-border mobility, public welfare, common migration policy, and common defence and security policy are all areas that need more common European action to be dealt with more effectively. **The EU budget should therefore be strengthened to answer the common challenges in these areas.** The Multiannual Financial Framework for 2021-2027 should be revised upwards. Its financing should focus on delivering the tools for sustaining the European public goods but also promoting European cohesion policy to support upward convergence and enhance the economic potential of Europe as a whole. Successful programmes such as Erasmus and Horizon 2020 should continue and new policy areas must be identified. To achieve this the EU Budget needs to become more flexible in dealing with unforeseen challenges. On the spending side, the flexibility provision can be reinforced to allow extended use of margins across headings and years. The creation of new instruments or reserves to be mobilised in times of crisis can be an additional option. While on the revenue side, new own resources need to be defined and implemented. Creating European green and digital taxation must be considered.

The 2021-2027 Multiannual Financial Framework needs to be ambitious and reflect a clear long-term vision of the Union´s future. Despite of the increasing resources to support the new challenges identified (security, defense, migration, ERASMUS and innovation) and a positive first step on the proposal on own resources, there are significant shortcomings. Increase of resources in the new priorities come at the extent of significant cuts on cohesion, agriculture policy and the European Social Fund. Own resources can be increased if digital taxation is considerd. The general proposal lacks a global strategy and it does not reflect the commitments set at the Paris agreement on climate change and does not increase climate-related spending. The MFF should also reflect more on achieving gender equality commitments and promoting inclusiveness.[3]

2.2 Rebalancing economic and social governance and ensuring upward convergence

A truly progressive and integrative European Union must be one that takes as much account of the **well-being of society and people's social conditions as it does to the economy and finance.** This means that strengthening economic governance must also include a rebalancing of social and economic governance. It means finding the right policy mix, put in place counter-cyclical fiscal policies and promote reforms that aim at raising domestic demand. It also needs a level of common social protection and coordination of social standards that matches its level of economic integration. This challenge is made more pressing by the need to overcome the EU's current social and economic imbalances. It is therefore essential that fiscal and monetary reforms be combined with measures for **upward social and economic convergence** and the implementation of the **European pillar of social rights.**

The Gothenburg **proclamation[4] on the Pillar of Social Rights** must pave the way for a social progress protocol for the EU. This should establish that economic freedoms must not override social rights and should place **assessment of social impact and targets for social progress at the heart of both EU and EMU policymaking**. In case of Treaty change, these principles should be enshrined into the EU treaties. In the meantime, the principles of European Pillar of Social Rights should be pursued through secondary legislation, adequate financial resources and the European Semester should better reflect the EU's social objectives. This is particularly relevant in legislation regarding minimum income schemes, access to life-long learning, care services and affordable housing as well as access to social protection to cover unemployment or pensions. We are committed to the close monitoring and follow-up of the promises made by Member States in Gothenburg. The Europe 2020 strategy should be succeeded by targets developed from the Sustainable Development Goals and the Social Scoreboard must be used to monitor the European Semester.

In order to improve both the democratic accountability and European-level coherence of Semester recommendations, the role of the European Parliament in the Semester process should be intensified, notably defining the European Semester priorities. Draft euro-area recommendations should be subject to plenary debate in the parliament with the Council, Commission and president of the Eurogroup. Democratic accountability must also be strengthened at national level. National, and where possible, regional parliaments must claim ownership of the reforms they implement.

Europe cannot claim to be a truly integrative project if it does not afford basic social rights and living standards to all of its citizens. **Wage, price and productivity policies should be coordinated around an objective of general wage growth and targets for the improved productivity which can help to enable it.** Stronger social standards must also be included in every step of the **European Semester**. A forward-looking Europe also needs to pay particular attention to the prospects of its future generations, investing in its

[3] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+MOTION+B8-2018-0239+0+DOC+PDF+V0//EN

[4] https://ec.europa.eu/commission/priorities/deeper-and-fairer-economic-and-monetary-union/european-pillar-social-rights/european-pillar-social-rights-20-principles_en

citizens as well as in capital and infrastructure. This is not possible when 25% of children in the EU live at risk of poverty or social exclusion. **A European Child Guarantee** should ensure that every child in Europe has the right to free healthcare, education, care, housing and adequate nutrition. The EU and European governments have a duty to secure these rights by providing the financial support and investments necessary to ensure that no child in Europe is left behind.

Minimum wages in the majority of EU countries are still very low, on top of this the lack of minimum wages is contributing to excessive wage disparities and to weak domestic demand. Continuing with policies that support cost competitiveness through the implementation of moderate wage developments and decentralised wage setting mechanisms is hampering Europe's growth potential and the speed of upward social convergence. Europe is in dire need of more dynamic wage development. **The European Semester** should include an objective for minimum wages above the poverty line (60% of median national wage). Collective bargaining systems need to be strengthened to support all workers demands and trade unions need to be strongly represented in order to ensure fair income distribution.

The Macroeconomic Imbalance Procedure (MIP), though established after the crisis to prevent the development of economic imbalances other than fiscal deficits, has not been able to fully fulfil this role, particularly when it comes to dealing with current account surpluses. **The MIP needs to be implemented more effectively and proactively, including to promote policy action to improve domestic demand, wages and overall employment addressing macro-social imbalances.**

<u>2.3 Adopting an aggregate fiscal stance and an expansionary fiscal policy</u>

Effective European fiscal policies need to include the adoption of an **aggregate fiscal stance.** The Eurozone **should be considered one macroeconomic entity.** This is necessary to prevent the excessively contractionary or expansionary effects that can arise from an overall fiscal position that is only the sum of national fiscal policies. Europe's current recovering post-crisis economy demands expansionary fiscal policies that are particularly undermined by the contractionary bias of a system of fragmented fiscal policies and controls focused on deficits. **Expansionary fiscal policies** will also need to be implemented to address future economic downturns. In other circumstances, it could also be essential for a counter-cyclical fiscal policy to be pursued during more positive times through the development of fiscal buffers, to offset adjustments during less positive times, as has been highlighted in the first annual review of the European Fiscal Board[5].

Europe has experienced significant economic recovery in recent years. However, inflation continues to be well below the 2% target rate, wage growth is subdued, and the Eurozone remains solely dependent on the unorthodox monetary policies of the ECB to correct for these problems. Member States **with large current account surpluses need to further increase domestic demand and investment**, as highlighted at the 2018 Alert Mechanism report[6].

<u>2.4 Strengthening public investment</u>

Europe's economy also continues to be held back by worryingly low levels of investment, compared to both historical levels and international competitors, with an investment gap

[5] https://ec.europa.eu/info/sites/info/files/2017_efb_annual_report_en_0.pdf
[6] https://ec.europa.eu/info/publications/2018-european-semester-alert-mechanism-report_en

of close to 2% of GDP[7]. In order to ensure sustainable economic growth, we therefore need **to close this investment gap.** There needs to be a coherent and forward-looking European investment strategy directed towards both sustainable growth and the long-term transformation of our economy and society, including transition to the green and digital economy. A crucial part of this needs to come through **strengthening public investment,** as is also stressed by the 2018 Alert Mechanism Report.

The **European Fund for Strategic Investments (EFSI)** is an important contribution to this task and a major success for our political family. To ensure that strong EU-level support for public and private investment continues in the next decade, it **should be made permanent and should be distributed more equally across member-states and regions.** Moreover, the Union European Structural and Investment (ESI) Funds are the indispensable basis for key EU policies such as promoting social and territorial cohesion, and also play a specific and crucial role in supporting investment. **The budget of Funds for economic, social and territorial cohesion needs to be not only maintained, but increased,** in the Multiannual Financial Framework after 2020.

If Europe's investment gap is to be effectively closed, more ambitious and better funded investment programmes provided in the form of grants rather than loans, whether connected to EFSI, or other mechanisms, must be implemented after 2019.

However, EU-level funding alone cannot tackle the investment gap. In particular, the exemptions given to investment spending in the Stability and Growth Pact should be strengthened. **A 'golden rule' should be established whereby expenditure on public investment is not included in the calculation of public deficits.**

2.5 Coordination of tax policy

A fair and effective EMU must also involve EU rules and resources that meaningfully deal with the growing problems of **tax evasion, tax avoidance and aggressive tax planning**. Depending on estimates, tax evasion and tax avoidance could cost EU governments up to €1 trillion per year[8]. The vast majority of the beneficiaries of these practices are the very highest earning individuals and corporations in the world. This represents a glaring inequality, with devastating real-world consequences in lost resources at a time of continued social and economic stress and pressure on public finances. Increasing **coordination of tax policy, convergence of tax rates** and intensifying the fight against tax fraud and tax evasion is therefore essential, on the grounds of both basic principles of equality and the stability, coherence and long-term financial sustainability of the Union.

Significant progress in responding to this challenge has been made in recent years through the EU Anti-Tax Avoidance package. The remaining elements of the package need to be implemented, including strong legislation for **public country-by-country reporting of multinational profits**. The recommendations of the European Parliament's Committee of Inquiry into Money Laundering, Tax Avoidance and Tax Evasion (PANA) should be implemented, including a **permanent registry of the beneficial owners of companies**, **expanded whistleblower protection** and increased EU and national

[7] https://ec.europa.eu/epsc/sites/epsc/files/strategic_note_issue_11.pdf

[8] http://www.socialistsanddemocrats.eu/sites/default/files/3842_en_richard_murphy_eu_tax_gap_en_120229_1.pdf

resources to tackle tax evasion. **Stronger sanctions** must be put in place against the banks, law and accountancy firms, and other intermediaries who are often core components in the facilitation of tax evasion.

To fundamentally tackle the problems of aggressive tax planning and tax avoidance through transfer pricing, wider structural reforms are needed to harmonise tax rules and practices across the EU. The Commission's proposal for a **Common Consolidated Corporate Tax Base (CCCTB)** is a valuable and necessary step towards tackling these practices and improving the efficiency of the European Single Market. It should be strengthened through the introduction of a minimum effective corporate tax rate, and should be agreed upon and implemented as quickly as possible.

The nature of the digital economy, particularly its often intangible and mobile nature, also presents new dangers for the prevention of tax evasion and avoidance that will continue to escalate unless they are addressed. New measures to **prevent tax avoidance in the digital economy** are therefore a growing necessity. Solutions such as a GAFA (Google, Amazon, Facebook, Apple) **tax on the turnover of digital giants**, a '**web tax'** on intangible digital transactions similar to measures proposed in the last Italian budget, or taxation of companies based on measures of their **'digital presence'** in every country, should be pursued.

## 3. Developing a fiscal capacity in the Eurozone

Creating a fiscal capacity is essential for improving the euro area's ability to promote upward economic and social convergence and to deal and overcome symmetric and asymmetric shocks. We support the creation of a specific budget to:

- Ensure that public investment levels are not affected on the event of an economic shock or persistent deviation.
- Create a complementary unemployment insurance scheme to protect the short-term unemployed in case of a cyclical downturn.
- Create a convergence instrument to promote social and economic convergence.

But more ambition is needed to ensure that all EU Member States benefit from this scheme. Member States committed to join the euro should also have access to the convergence instrument to ensure smooth accession.

The fiscal capacity can be financed by a credit line from the European Stability Mechanism, European own resources and national contributions.

The lack of an exchange rate policy for the euro area as well as limited national stabilisation capacities have had a long lasting impact on growth potential. The Eurozone needs a **fiscal capacity that is equipped to tackle both symmetric and asymmetric shocks** and not adding additional stress to domestic stabilisers and investment programmes. This fiscal capacity should be developed in the EU framework. It should also be possible to trigger this fiscal capacity to provide **pre-accession support** for Member States committed to adopting the euro.

It should act as a Eurozone automatic stabiliser that encompasses the following instruments:

- **<u>Investment protection scheme</u>**: Investment is key for ensure sustainable economic growth. This scheme would act as a **macro-insurance scheme enabling Member States to keep up at healthy levels their public investment spending** in the event of economic downturn or persistent investment levels deviation. The measure would help address large shocks and help accelerate economic recovery.
- **<u>Unemployment insurance scheme</u>**: This measure would be triggered in the event of **cyclical downturn**. The scheme would be **complementary to national schemes, be financed by taxation, be underpinned by a convergence of general taxation rates** and ensure the **protection of the short-term unemployed and uphold domestic demand.** It would be mainly built to tackle shocks that would be evenly distributed among countries over the long term, restricting the possibility for permanent transfers**.**

The fiscal capacity should also support investment for upward convergence in the framework of a **convergence code.** The aim of the convergence code would be to **bridge social and economic imbalances** across the euroarea and reach the targets for having an aggregate fiscal stance. It would focus on **a five-year period of convergence criteria regarding taxation, labour market, investment, productivity, and social cohesion,** with indicators built from the Sustainable Development Goals and the European Pillar of Social Rights. It should be adopted under the ordinary legislative procedure and taking into account the country-specific recommendations.

The fiscal capacity can also be triggered to provide **pre-accession support for Member States committed to adopt the euro.** In this capacity Member States would be able to benefit from the **convergence instrument** on the condition that they stick to their timed accession roadmap. This instrument would be **additional to cohesion funds.** Any conditions attached to such measures must be clearly specified and directed only towards the achievement of the agreed strategic priorities of the instrument.

Despite of the large scope of reforms expected under the Reform Support Programme as proposed by the European Commission, it falls short to tackle the real challenges of the euro area and foster upward convergence. The allocation process should favour convergence and reforms should be the ones envisaged in the National Reform Programmes and be coupled with investment.. The European Investment Stabilisation Function is a step towards the right direction but a very small one. An increase of own resources and the role of the ESM should be further explored. Strict conditionality and a loan based approach do not provide a favourable framework.

Eligibility to access the support for these investments would be subject to specific **conditionalities**, but without additional conditionalities being attached to the moment of use. This would enable a fairer and more effective system of both crisis response and prevention than the current system, in which ability access to ESM funds does not require pre-qualification but comes with potentially contractionary and socially damaging conditions upon disbursement. **Activation of this fiscal capacity should be automatic** in order to ensure timely intervention and maximum effectiveness.

The capacity would consist of a combination of both grants and loans. **The fiscal capacity can be financed by predefined EU own resources and national contributions and leveraged by a credit line from the European Stability Mechanism,**

The development of a Eurozone fiscal capacity also comes with the opportunity to develop EU own resources, and it would be valuable for own resources to serve as a significant element in the funding for a fiscal capacity. This would be part of the development of more own resources for the EU budget as a whole. It would contribute to the integrity and completeness of a fiscal capacity, and to the deepening of economic and monetary union as a whole, by providing complementary European levels to both the revenue-raising and and expenditure sides of the budget. There are a wide range of possibilities for expanding own resources in the EU budget, including parts of the revenues from a Financial Transaction Tax, CCCTB or digital tax, proceeds from the EU Emissions Trading Scheme (ETS), a CO2 levy and other environmental taxes or seigniorage. A system for the inclusion of own resources in the funding for this fiscal capacity would need to restrict the revenues used to those that would otherwise accrue to euro members, and ensure that the revenue-raising rights of national parliaments in other pre-existing areas were protected.

## 4. The institutional dimension – democratising European governance

An overarching aim of the process of deepening the EMU must be to reinstate the trust of people in European politics. To achieve this, greater transparency and accountability of decision making needs to be achieved by:

- Enhancing European accountability by shifting from the intergovernmental to the interinstitutional approach.
- The European Parliament must be granted co-decision powers in policies regarding the future of the European economic and social policy and especially the European Semester.
- National Parliaments and were appropriate subnational authorities must ensure greater ownership of national reforms and thoroughly discuss Commission Country Reports and National reform programmes.
- Creating the role of a European Finance Minister, to be both President of the Eurogroup and Vice President of the European Commission, responsible for carrying out the EMU reform in its all dimensions and monitoring euro area's aggregate fiscal stance.

A vital element in this democratisation process must be a **shift from the current intergovernmental approach of governance to an institutional one**. The responsibility of agreeing on Europe's economic and social policy must be joined, not just shared. Strengthening **democratic legitimacy both in European and national level** is key for the well-functioning of the EU. The intergovernmental process lacks transparency and oversight. It is high time that all EU institutions actively participate in the ownership of European policy making.

In order to promote transparency both at national and EU level, the Eurozone's decision-making process must be subject to greater democratic accountability and responsibility. **The European Parliament should be able to influence Eurozone policy through the co-decision process.** The euro area recommendation should be given greater democratic legitimacy through the involvement of the European Parliament. Macroeconomic dialogue with social partners must be strengthened to increase the democratic involvement of all stakeholders.

**The establishment of the European Stability Mechanism (ESM) and Eurozone fiscal capacity should include their integration into the EU framework under the community framework.** The European Parliament should also be provided with oversight powers in both areas, including nomination powers over the ESM management.

Democratising European governance also means strengthening the role of national parliaments in the decision-making process. They should able to take **democratic ownership of national reform programme**, adapting them to the investment and reform needs of Member States.

**A Eurozone Minister, with an agenda to coordinate the Eurozone's policies, be the interface for the social dialogue and bring forward all the reforms needed in the evolution and deepening of the EMU. It should also define Europe's aggregate fiscal stance and ensure fiscal stabilisation**. This person in charge should be both President of the Eurogroup and Vice President of the European Commission and be subject to democratic and parliamentary control. He/ she would serve as a single point of contact inside Europe and outside Europe in international fora.

## 5. Developing the roles of the Economic Stability Mechanism (ESM) within the EU framework

It is high time that Europe starts using the European Stability Mechanism as an instrument to ensure both fiscal and financial stability. It is also extremely important that this instrument is included into the EU's legal framework and submitted to full democratic accountability.
The ESM should be strengthened and serve as:

- A backstop to the Single Resolution Fund and the European Deposit Insurance Scheme.
- A credit line to support the fiscal capacity
- Ultimately become the embryo of the European Monetary Fund

As an existing well-capitalised body that already has a lending capacity, credit-raising ability and institutional knowledge and resources, the European Stability Mechanism (ESM) has a particular valuable role to play in the deepening of the EMU and the development of new functions within it. Its existing architecture partly continues to reflect the demands arising from the immediate circumstances of the crisis, and therefore would also benefit from adaptation to a more long-term post-crisis context.

The ESM should be strengthened in both its size and functions. It should be given the role of a **common backstop to the Single Resolution Fund and the European Deposit Insurance Scheme**, key requirements for the completion of the banking union.

It could also provide **a credit line to back up a Eurozone fiscal capacity**. Such a fiscal capacity would, at least initially, be unlikely to be large enough to have the stabilising effect needed to address large symmetric or asymmetric shocks. The ESM could provide market financing needed to raise the funds necessary for the budget to have an effective stabilising function in that context.

The ESM's evolution must involve a move away from over-reliance on technocracy and informal structures, rather than a consolidation of those tendencies. It should be **integrated into the EU's legal framework**, rather than remaining the intergovernmental body which it is now. It should similarly become subject to full and clear structures of democratic accountability, including **being directly accountable to the European Parliament.** The requirement for unanimity in ESM financing can slow down the decision making process. The option of opting for faster decision making through qualified majority on decisions that do not have financial impact should be explored. The ESM could be managed by a Eurozone Treasury, and could be **chaired by the future European Finance Minister**. The size and functions of the ESM could be expanded in the future, with it acting as the embryo of a future European Monetary Fund (EMF). Any expansion of the ESM's surveillance powers should be treated with the greatest caution, however, and should not imply a subordination of the role of the Commission.

## 6. Completing the banking union

The completion of the banking union should be set at the top of the political agenda. The implementation of the European Deposit Insurance Scheme should be done without delay and offer full liquidity to cover all losses. The Capital Markets Union needs to be developed aiming at speeding up the ecological and digital transition. Moreover attention should be paid at:

- Proceeding in parallel with risk sharing and risk reduction
- Aiming at reducing non performing loans
- Ensuring that the link between banks and sovereigns is cut
- Adopting uniform International Financial Reporting Standards

Completing the Banking Union is crucial for ensuring financial stability, reducing financial fragmentation and strengthening risk diversification. It is the most developed pillar of the EMU having already established a supervisory and resolution mechanism and having reinforced prudential capital and solvency requirements for banks. These constitute great political achievement towards the reduction of risks. But more needs to be done to reach the agreement set out in the **roadmap for completing the banking union of June 2016**[9], and cutting the vicious link between banks and sovereigns. Risk sharing measures need to be swiftly implemented and complete the efforts done so far on reducing risk in the banking sector. This dual approach is necessary for strengthening Europe's safeguards against financial shocks. Attention also needs to be dedicated on reducing non-performing loans (NPLs) and timely adopting uniform International Reporting Financial Standards (IFRS). Greater steps need to be taken to end too-big-to-fail banks and make sure that public finances are no longer at risk of loss. To this end consideration should be given at separating the banks commercial and investment practices.

[9] http://www.consilium.europa.eu/en/press/press-releases/2016/06/17/conclusions-on-banking-union/

In order to complete the framework it is necessary to **implement the European Deposit Insurance Scheme and offer full protection to citizens' deposits**. The Scheme should have a **financial backstop** and provide full funding of liquidity needs and cover all related losses. Moreover, the **Capital Markets Union** also needs to be developed to open the window for other funding sources and strengthen investment, especially for SMEs and aim at accelerating the ecological and digital transition. It should be well regulated and abide to clear and transparent securitisation practices.

## 7. Stability of the euro

- To reinforce long term European integration and financial stability consideration should be given to issuing common safe asset. This instrument can take the shape of sovereign bond-backed securities with joint guarantees.
- The asset can also pave the way for the creation of a Eurozone treasury with the ability to finance investment through debt issuance.

The stability of the European economy, financial markets and public finances is undermined by the absence of **Europe-wide safe asset**. The existing situation of an integrated monetary system, in which sovereign bonds that can serve as safe assets are only issued by different members states, exposes the Eurozone to destabilising capital flows and fire sales on sovereign bonds, and reinforces the dangerous interconnection between the exposure of banks and sovereigns.

The Commission has released a proposal suggesting the pooling of sovereign bonds from all euro-area countries in proportion to the ECB's capitals keys. These sovereign bond-backed securities (SBBS) would be issued by private institutions divided into higher and lower risk securities. No mutualisation of risk or debt between the countries is foreseen. The Commission aims at creating the market conditions for greater portfolio diversification and financial stability by easing market access to Member States in times of crisis. Although the issuance of SBBS could serve as an approach to test the markets appetite for these type of securities, the aim of increasing financial stability by avoiding the flow of capital and by giving the impression that countries could rely on these instruments to sell their bonds to investors at all times is not the case. The lack of mutualisation is problematic. The premise countries could rely on these securities in case of crisis cannot be met as countries with low debt levels and no access to markets are disqualified of being part of the pool. Creating a variety of SBBS would result in a diversified bond market and offer lower liquidity and less transparency. Moreover interest for investors in junior SBBS, especially in times of economic crisis or political turmoil, would be very volatile.

The stability of the Eurozone therefore requires the creation of a true European safe asset. That can consist **of Eurozone-level sovereign bond-backed securities with joint guarantees**. This would mitigate the problems of the sovereign-bank nexus and destabilising capital flows between member states by providing a European level at which capital could be safely held. It would enable a system of stable fiscal risk-sharing and could facilitate risk reduction in the debts of member states. It could also significantly improve the coherence and integration of Europe's financial markets.

These safe assets could be issued by a **Eurozone Treasury** that would be created to manage and coordinate both the Eurozone budget line within the EU budget and the expanded ESM. They should be carefully designed, in coordination with other measures for the deepening of the EMU, to ensure that they do not produce disincentives for fiscal discipline on a national level, and concretely tackle the dangers of destabilising capital flows between bonds with different risk levels. They would be issued gradually and in a step-by-step process, starting with experimental issuances and becoming more extensive and systematic with time and learning, and in line with the rest of the EMU reform process.

Greater credit-raising on a European level may also be needed to fund the public investment spending required to close the investment gap. To this end, **the ESM should have the capacity to finance investment through debt issuance.**

## 8. Conclusions – the way forward

The Eurozone reform process that will take place this year should lead to concrete and substantive measures to deepen the Economic and Monetary Union. Its targeted intention should be to develop towards a true European fiscal, social and political union.

Reforms arising from this process should include the democratisation of the EMU's governance procedures, an aggregate fiscal stance and a Eurozone fiscal capacity, wider provision of European public goods, an equal balance between social and economic integration, mechanisms for upward convergence, the expansion of the European Stability Mechanism, and European securities to strengthen financial stability and to finance investment.

The changes that are needed in all of these areas should be agreed upon before the end of the current term of the European Commission and European Parliament in 2019. A slower timetable, or the postponement of political decisions in important areas, would risk the value of the outcomes that come from this process, would waste an important moment of opportunity, and would leave the Eurozone too exposed to future economic or political shocks.