



Completing Europe's Economic and Monetary Union

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Outline

1. *Overall rationale*
2. *Sequencing*
3. *The four unions: economic, financial, fiscal and political*

1. The rationale

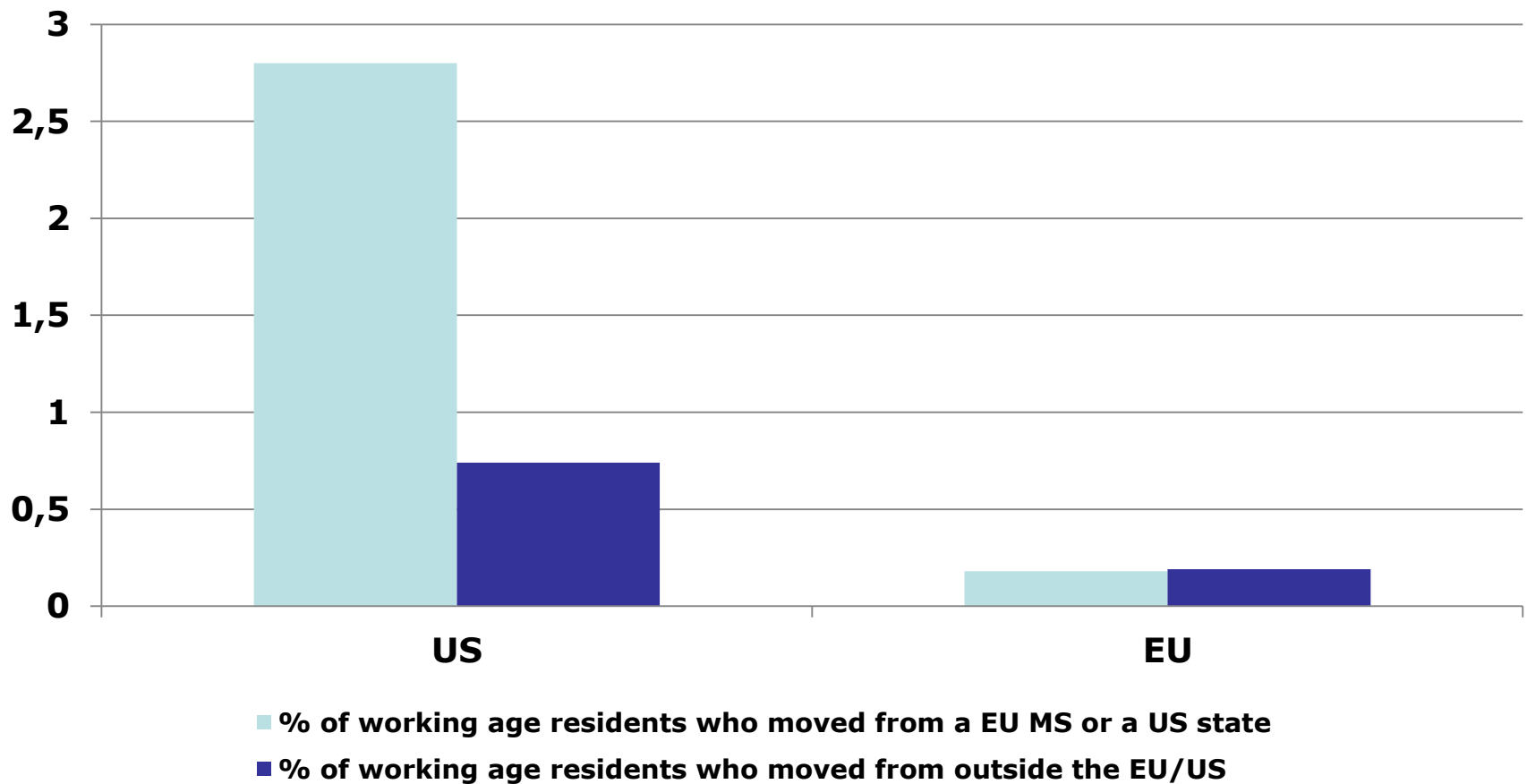
Despite the progress made over the recent years, EMU remains incomplete. Two implications:

- 1) raises doubts about the viability of EMU in the long run;
- 2) makes it more difficult to achieve a more rapid, even and sustainable recovery in the short run

With no large-scale, permanent fiscal transfers and limited labour mobility, a well-functioning EMU requires:

1. Each MS must be able to better **prevent** crisis through good fiscal and structural policies;
2. When shocks occur each MS must be able to **absorb the shocks internally** by having resilient labour markets, flexible product markets and sufficient fiscal buffers to allow automatic stabilisers to play fully.

Comparatively limited intra-EU labour mobility



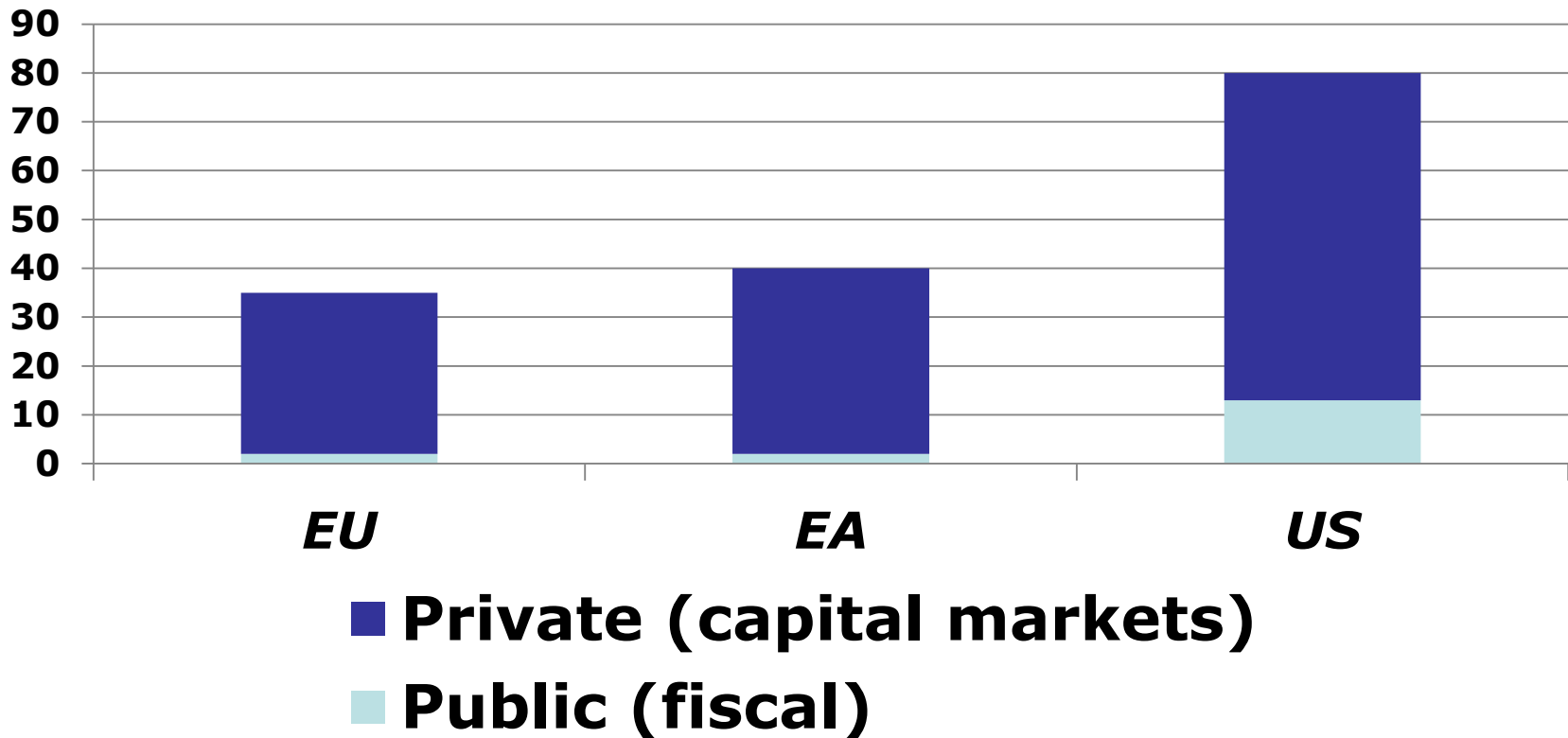
However:

- relative price adjustments will never occur as quickly as exchange rate adjustments;
- market pressures can deprive countries of their fiscal stabilisers in a slump.

Therefore:

- some shocks cannot be absorbed nationally only; they need to be shared within EMU.

Percentage of shock smoothing via type of risk sharing: EU, EA and US



2. Sequencing

Underlying *rationale* of the staged approach:

- frontload private sector-risk sharing (*through banking union; capital markets union*)
- link higher public sector risk-sharing to progress on further pooling of sovereignty on fiscal and structural policies (*through fiscal stabilisation/shock absorption function*)
- need to *move from rules to institutions (i.e. joint decision-making on national budgets and structural polices)*

Stage 1 (1 July 2015-30 June 2017):

- build on existing instruments and make best use of existing Treaties;
- boost competitiveness and structural convergence;
- complete the Financial Union (BU and CMU);
- achieve and maintain responsible fiscal policies;
- enhance democratic accountability and legitimacy.

Stage 2:

- most measures will require treaty change
- convergence process would be made more binding
- significant progress in convergence is a pre-condition to participate in a mechanism of shock absorption for the EA

White Paper (Spring 2017) will prepare transition from Stage 1 to Stage 2; will draw on input from expert consultation group

3. Economic union

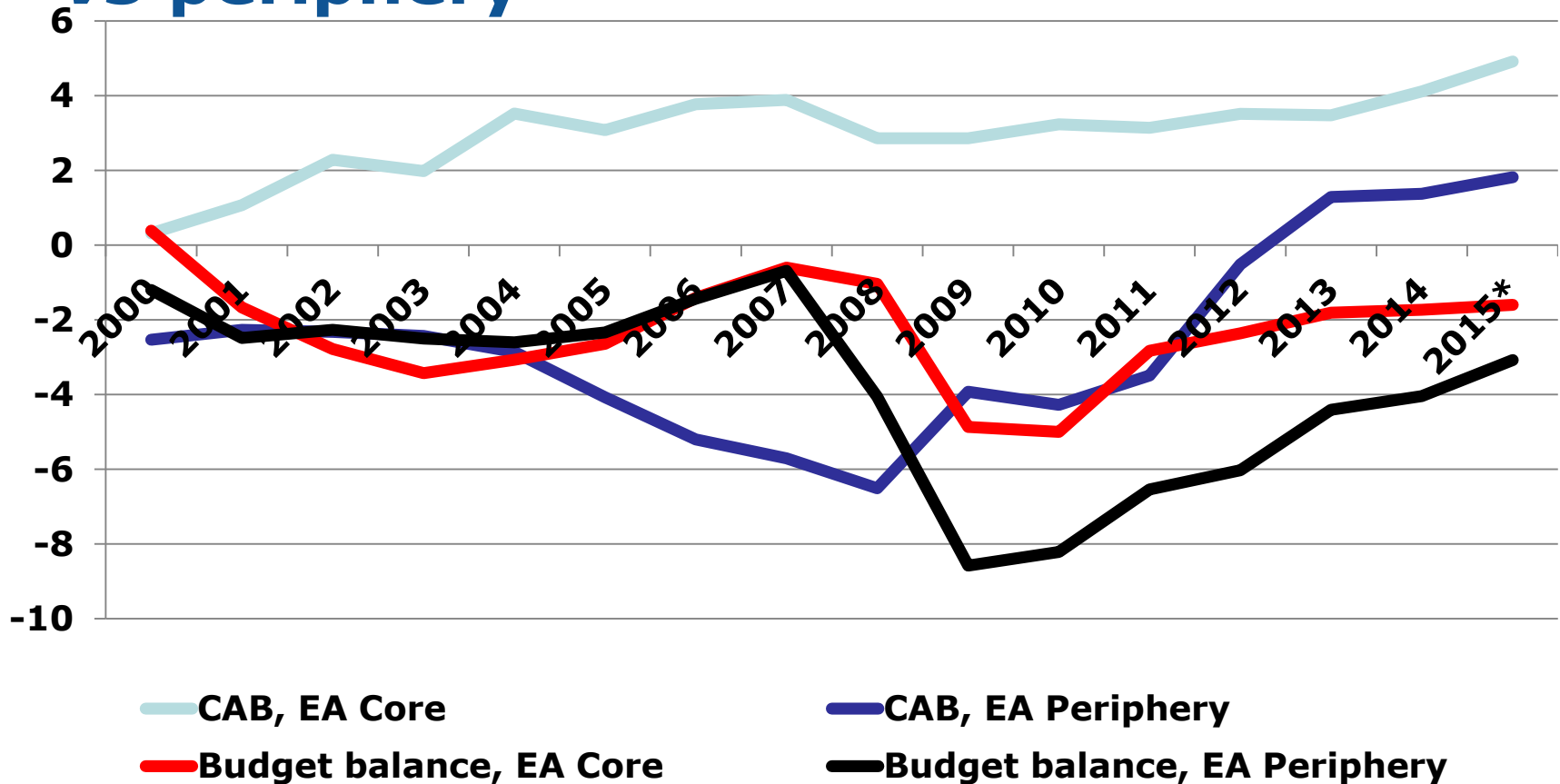
Stage 1: *Renewed effort for all to converge towards best performance and practices in EU*

- *Set up of a euro area system of competitiveness authorities*
- *A stronger Macroeconomic Imbalance Procedure: forceful and symmetric*
- *Stronger focus on employment and social performance*
- *A more integrated European semester: better take into account the EA dimension*

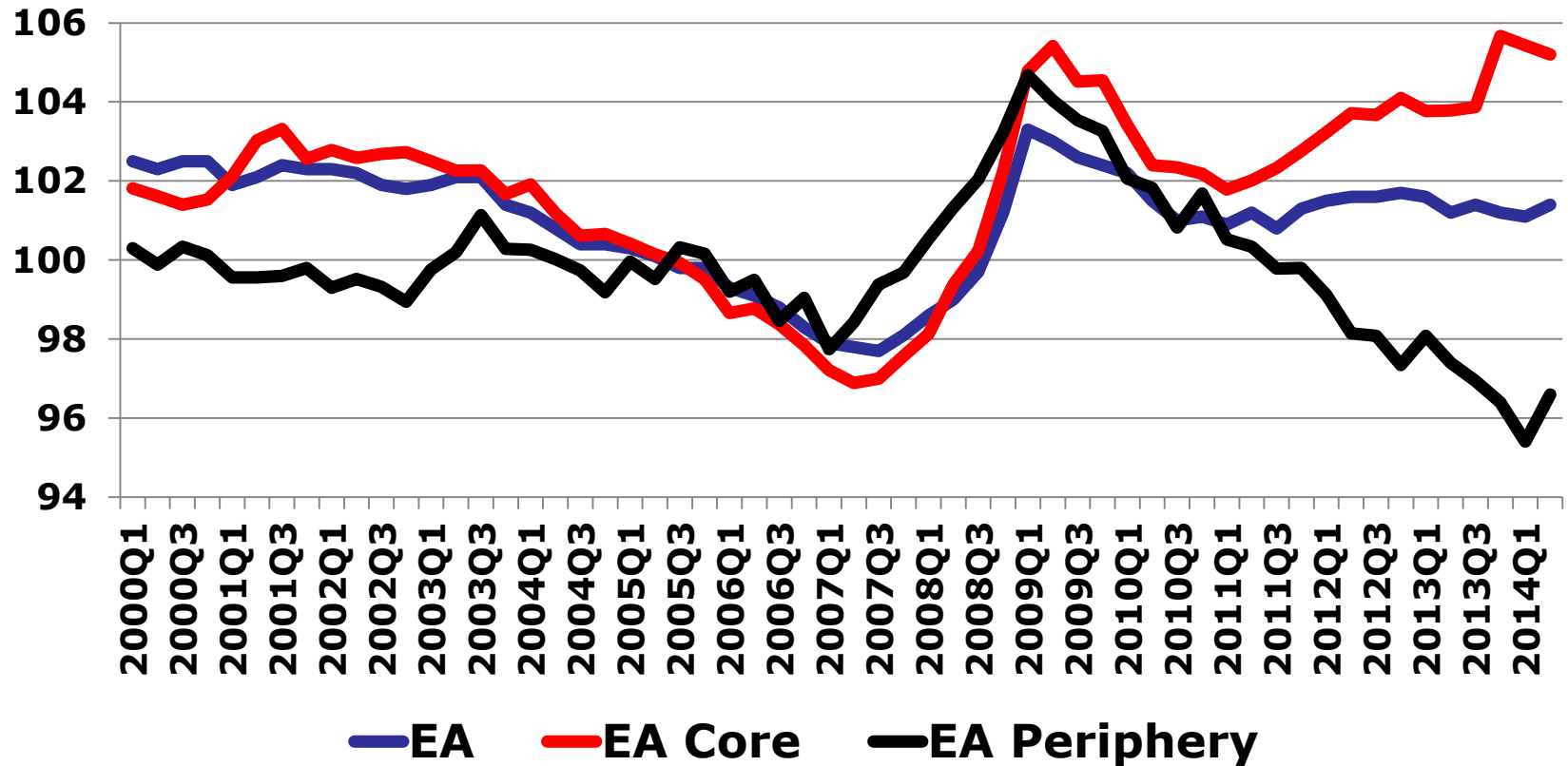
Stage 2: *Formalising the convergence process*

- *Agree on common high-level standards defined in legislation (e.g. on labour markets, competitiveness, taxation)*

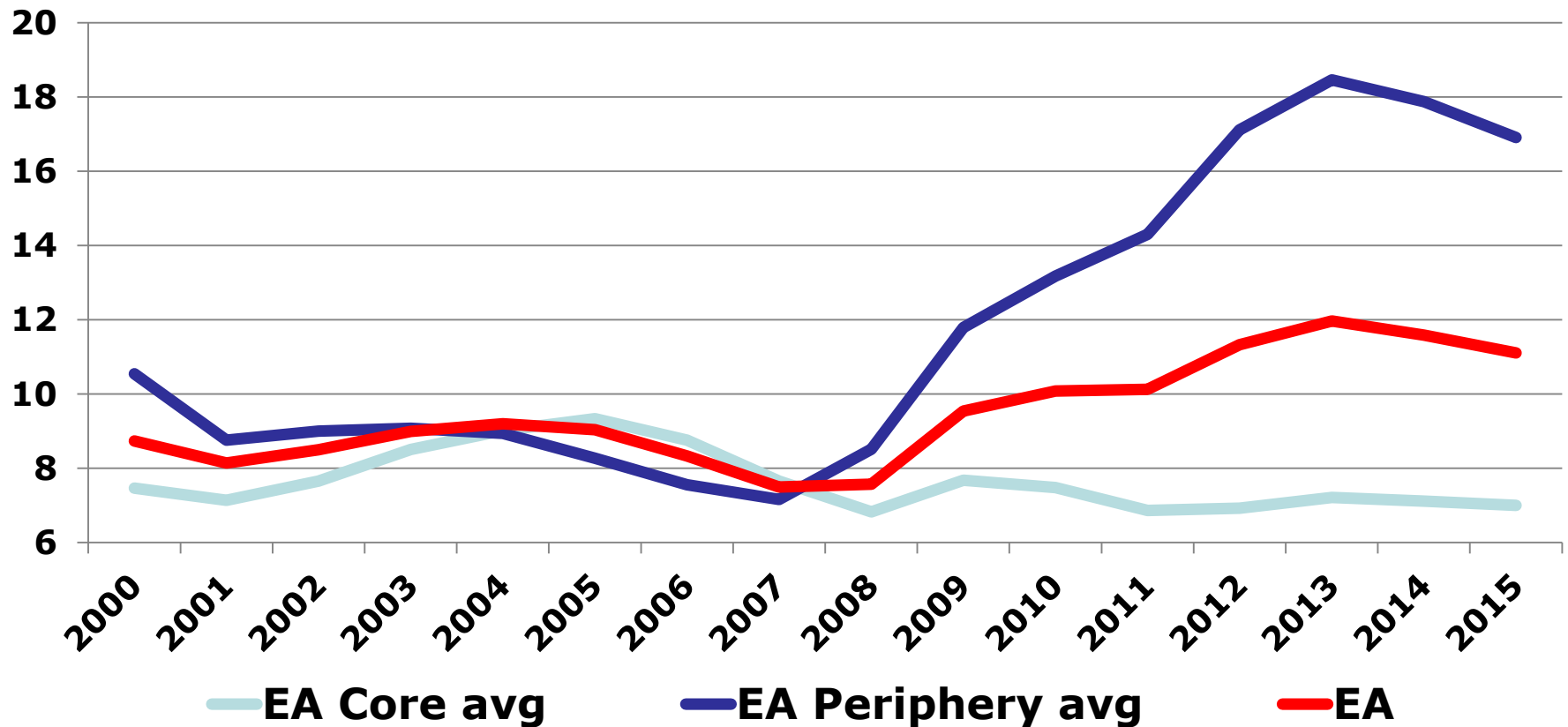
Fiscal and external imbalances, EA core vs periphery



RULC, EA core & periphery: divergence



Unemployment, EA core & periphery, %





Financial Union

In a monetary union, the financial system must be truly single or else the impulses from monetary policy decisions will not be transmitted uniformly across its MS. This requires:

Stage 1:

A Banking Union, composed of:

- Single bank supervision
- Single bank resolution
- Single deposit insurance: could be conceived as re-insurance system at the EU level for the NDGS

A Capital Markets Union

Fiscal union

Fiscal policy must perform 2 functions:

- guarantee public debt sustainability;
- ensure that fiscal automatic stabilisers can operate to cushion country-specific shocks

In addition:

- ensure appropriate aggregate fiscal stance to avoid pro-cyclicality;
- need for a EA-wide fiscal stabilisation function to absorb large shocks that cannot be smoothed through national fiscal stabilisers alone

Stage 1:

- Advisory European Fiscal Board: COM continues to be in charge of enforcing the SGP; EFB offers economic opinion on appropriate fiscal stance at national and EA levels; ex post evaluation on how governance framework was implemented

Stage 2:

- Set up a EA-wide fiscal stabilisation function/shock absorption mechanism

Democratic accountability

Stage 1:

- Enhanced role for national and European Parliaments (e.g. more systematic appearances of commissioners in national Parliaments; plenary debate on AGS);
- Consolidate external representation of the EA;
- Integrate inter-governmental arrangements into EU law framework (TSCG; EuroPlus Pact; SRF)
- Strengthening of Eurogroup

Stage 2:

- Full-time presidency of Eurogroup;
- Integrate ESM into EU law (e.g. transform it into a European Monetary Fund)
- Set up a Euro Area treasury

CONCLUSION

Conclusion of the European Council (25-26 June 2015):

"The European Council took note of the report on the Economic and Monetary Union requested by the December 2014 European Council and asked the Council to rapidly examine it."

Recent developments confirm the need to proceed rapidly with implementation of roadmap.