Background Note

Widening and deepening of EMU Governance: What next?

Completing the Economic and Monetary Union (EMU) remains a clear objective in the new Commission policy agenda: President von der Leyen political guidelines outline a number of areas where progress should be made, namely on:

- Delivering a Budgetary Instrument for Convergence and Competitiveness (BICC) for the euro area;
- Putting forward a European Unemployment Benefit Reinsurance Scheme;
- Making full use of the flexibility allowed within the Stability and Growth Pact (SGP);
- Completing the Banking Union through a common backstop to the Single Resolution Fund, an European Deposit Insurance Scheme and a robust bank resolution and insolvency framework;
- Strengthening the international role of the euro;
- Refocusing the European Semester into an instrument that integrates the United Nations Sustainable Development Goals;
- Granting the European Parliament a louder voice on economic governance.

It could be also note that the Euro, after completing its twentieth anniversary, remains a project that some “non-euro Member States” wish to join. As the President of the Eurogroup underlined in July, “Croatia’s intention to join ERM II shows that the eurozone is a solid anchor of stability and growth in Europe that continues to attract new members. I am convinced the eurozone will continue to grow in coming years”. EMU widening complements EMU deepening.

New EU budgetary Instruments for reforms

On 31 May 2018 as part of the package for the new multiannual Financial Framework (MFF), the Commission proposed a Reform Support Programme (RSP) with the objective of supporting implementation of structural reforms across EU Member States via three instruments:

- Reform Delivery Tool: EUR 22 bn (financial support – for all MS)
- Technical Support: EUR 840 mio (continuation of SRSP – for all MS)
- Convergence Facility: EUR 2.16 bn (additional financial and technical support - for non-euro area MS committed to adopt the euro)

Following the Commission proposals to establish a Reform Support Programme (RSP) and a European Investment Stabilisation Function (EISF), a Budgetary Instrument for Convergence and Competitiveness (BICC) has been developed on the basis of Member State’s input and Eurogroup discussions. The BICC would aim at financing structural reforms and public investments in euro area Member States, strengthening the
potential growth of their economies and the resilience of the single currency against economic or financial shocks. Progression BICC (for euro area Member States) and a Convergence and Reform Instrument (CRI) for non-euro Member States is expected under the Croatian Presidency, as outlined in its priorities for the Ecofin, on the basis of the Commission proposal on the Reform Support Programme and the proposal on the governance framework for BICC.

A proposal for a European Unemployment Benefit Reinsurance Scheme

The European Social Pillar also features in President von der Leyen political guidelines. There she pledges to introduce an European Unemployment Benefit Reinsurance Scheme, aimed to protect citizens in case of unemployment and reduce the pressure on public finances following external shocks. Various models have been flagged to provide such form of stabilisation, namely based on loans, or on direct support to national budgets granted by a fund to which Member States would contribute during good times. The Commission foresees coming up with proposals in the last quarter of 2020, in accordance with its 2020 Work Programme.

The review of the European Semester framework

The current EU economic governance framework is based on EU legislation, namely directives and regulations. It was revised after the crisis via the so-called “Six-pack” and “Two-pack” and integrated into the European Semester for economic policy coordination. Each of these legislative acts includes a review clause, requiring the Commission to publish a report and possibly proposals for amendments by end 2019. On 5 February 2020, the Commission published its review of the effectiveness of the current economic surveillance framework and launched a public debate until end of June 2020. The Commission will consider all views and on that basis complete by the end of 2020 its internal reflections on the scope for any possible future steps.

The Commission has, in addition, put forward in its Annual Sustainable Growth Strategy relevant issues to be addressed in the fiscal rules and the European Semester: that “Europe needs well-targeted investments to support the move to a climate-neutral and fully digital economy deployed. The flexibility allowed within the Stability and Growth Pact should be fully used to enable the necessary investment while safeguarding fiscal sustainability,” and also that “Differentiated, yet closely coordinated, policies in Member States are therefore necessary. (...) the European Semester (...) can help drive these policies towards the achievement of the SDGs by monitoring progress and ensuring closer coordination of national efforts in the area of economic and employment policies, keeping its focus on issues that have economy-wide implications.”

Some other suggestions to refocus the Stability and Growth Pact have been put forward, namely by the European Fiscal Board (EFB). The EFB proposes to overcome the complexity of the current EU fiscal framework by simplifying the EU fiscal rules and advocates for a reformed SGP, which would be based on (a) one single target (sustainable public debt), (b) one single instrument (controlling net expenditure growth, to be linked to potential growth); (c) one general escape clause, triggered based on independent economic judgement. The EFB proposes the introduction of a limited “golden rule” to protect public investment.

The Banking Union

Completing the Banking Union has been a continuous endeavour during the years. In the Annual Sustainable Growth Strategy, the Commission reiterates the need to make progress following the last outcome of the Euro Leaders in December 2019.

During 2019, the Eurogroup (in inclusive format) mostly discussed the outcome of deliberations of the so called “High Level Working Group on EDIS”, set up by Eurogroup following its 3 December 2018 meeting. After an initial report in June 2019, the Chair of HLWG on EDIS reported back to Eurogroup in December 2019 through a letter. Such letter sets out a programme for action in the various dimensions necessary for a fully-fledged Banking Union (i.e. full implementation of EDIS with loss coverage; diversification of banks’ portfolios of sovereign exposures; significant reduction of banks NPLs and its appropriate monitoring; well integrated banking sector operating efficiently and safely across borders; appropriate crisis management
framework). On the basis of previous discussions, the work plan foresees a preparatory and negotiating phase and an implementation phase. The first two phases could span from 2019 to 2024, the with implementation phase going further. During the preparatory and negotiating phase, the work will continue on the set-up and clarification of the features of EDIS; on bank’s sovereign exposures; on the current crisis management framework and on financial integration.

Reform of the European Stability Mechanism
In June 2019, the Eurogroup reached a broad agreement on revising the text of the ESM treaty, covering issues such as the common backstop for bank resolution, the precautionary instruments and debt sustainability, as well as institutional aspects, including the cooperation between the ESM and the European Commission (within and outside financial assistance programmes). Later, in their December meeting, Ministers reached an agreement in principle, subject to national procedures, on the packaging of draft documents related to the ESM reform: those relating to the common backstop to the Single Resolution Fund, those relating to the amendments to the ESM precautionary financing instruments, and those on the terms of reference and explanatory note of single limb Collective Action Clauses (CACs) to be introduced by the 1st of January 2022. Ministers greeted the agreement reached between the Commission and ESM on their future cooperation arrangements and the finalisation of a working document on a common methodology on debt sustainability analysis.

The international role of the euro
Following an earlier Commission Communication, President von der Leyen political guidelines reiterate the intention to continue reinforcing and strengthening the international role of the euro. She stated “I want to strengthen the international role of the euro, including its external representation. A strong, integrated and resilient capital market is the best starting point for the single currency to become more widely used internationally.”. Similar messages are included in the Commission Annual Sustainable Growth Strategy which links a reinforced international role of the euro to progress on the other work strands referred to above: “All the above will be essential to reinforce the international role of the euro, a key enabler to increase European clout on global markets. It will help European firms, consumers and governments to withstand unfavourable external developments and assert the role of euro area economy on the world stage. The urgency to act has become even stronger in the current context (…) which risk undermining many of the benefits of globalization.”.

ECB launches review of its monetary policy strategy
On 23 January 2002, the ECB launched a review of its monetary policy strategy. The monetary policy strategy was adopted in 1998 and some of its elements were clarified in 2003. The Governing Council will take stock of how the monetary policy strategy has supported the fulfilment of the ECB’s mandate under the Treaty over the years and consider whether any elements of the strategy need to be adjusted. The quantitative formulation of price stability, together with the approaches and instruments by which price stability is achieved, will figure prominently in this exercise. The review will also take into account how other considerations, such as financial stability, employment and environmental sustainability, can be relevant in pursuing the ECB’s mandate. The Governing Council will review the effectiveness and the potential side effects of the monetary policy toolkit developed over the past decade. It will examine how the economic and monetary analyses through which the ECB assesses the risks to price stability should be updated, also in view of ongoing and new trends. Finally, it will review its communication practices. The process is

1 Ministers agreed on a Backstop Guideline and three Board of Governors resolutions: one determining the nominal cap and setting out the provisions on the permanence of the legal framework; a resolution granting the backstop facility and determining the key financial terms and conditions thereof and for the termination of the backstop facility; a third resolution confirming that the Direct Recapitalisation Instrument (DRI) of the ESM will be cancelled at the time the common backstop is introduced. One additional guideline on pricing policy is also available.

2 The PEG letter notes, nevertheless, that the legal status of such terms of reference are to be clarified ahead of signing the ESM treaty amendment.
expected to be concluded by the end of the year. The Governing Council will be guided by two principles: thorough analysis and open minds. Accordingly, the Eurosystem will engage with all stakeholders. The process is expected to be concluded by the end of the year. The Governing Council will be guided by two principles: thorough analysis and open minds. Accordingly, the Eurosystem will engage with all stakeholders.

Reinforcing democratic accountability at the EU-level

In her political guidelines, President von der Leyen pledged to “give a stronger role to the voice of the people, the European Parliament, in initiating legislation. I support a right of initiative for the European Parliament.” and “I want the European Parliament to have a louder voice when it comes to the economic governance of our Union.”. Reinforcing democratic accountability could contribute to strengthening Europe’s real economy and society. In their Annual Growth Strategy Report, the Commission further develops such commitments by proposing to engage in a dialogue with the European Parliament on how to operationalise such stronger voice and commitments. Members of the Commission have voiced economic matters. In the European Parliament before each key stage in the European Semester cycle. The Commission also proposes continuing the dialogue with Member States, and invites the Member States to involve national parliaments, social partners and all other relevant stakeholders in the Semester.

Widening the Economic and Monetary Union

Croatia and Bulgaria are in line to enter the Exchange Rate Mechanism (ERM II) and, later on, to become euro area members. Their intentions have been made clear and the accession procedures are ongoing. Commitment of both countries to access ERM II seems strong. In particular, Croatia has presented in April 2018 a comprehensive strategy for joining the euro. For more than two decades, Croatia has maintained low inflation and a stable exchange rate, and has recently significantly improved its budget balance and reduced its public debt. Croatia remains committed to ensuring the continuation of the positive trends to enable the fulfillment of all conditions for introducing the euro in the near future.

The euro remains a cornerstone of integration. Measures such as integrating non-euro area Member States in relevant discussions work as aggregators and facilitate integration through knowledge and experience sharing, as it happens in the work of the “inclusive Eurogroup meetings” on EMU deepening.

Some framing questions for the debate

1. What should be the short term priorities (by June 2020) in EMU governance, including banking union, reform?
2. What should be the long term objective for the EMU governance structure?
3. What role for the new budgetary instruments (BICC and CRI) in the governance framework?
4. What lessons can be drawn from the European Semester for economic policy coordination and surveillance? What lessons can one draw from its design and what lessons from its application and implementation?
5. How can/should parliaments reinforce accountability and democratic ownership of EMU governance?

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3 This is somewhat aligned with one of the 5 Presidents Report proposals ("These dialogues may be enhanced by agreeing on dedicated time-slots during the main steps of the Semester cycle.").