22 May 2015

Note for discussion by Sherpas
Next Steps on Better Economic Governance in the Euro Area
Draft Outline

This note offers an overview of the possible structure and main elements that could be discussed and developed in the Report. It builds on the discussions held by Sherpas on 11 March and 27 April, as well as on the subsequent written contributions. It does not bind the Five Presidents nor does it prejudge the final content of the Report. It aims at framing the discussions by Sherpas on 26 May 2015.

The report could be structured along the following lines:

1. Introduction

This short introduction would recall the Euro Summit and the European Council mandate as well as the process. It would explain in particular that the Report will build on the 2012 Four Presidents Report and on the Commission Blueprint. It would stress that the process towards deeper EMU should be open and transparent and be fully compatible with the Single Market in all aspects. In fact, advancing the Single Market in digital, services, energy and capital markets would offer a strong push towards a real economic union. Finally, it would underscore that a deeper EMU is not an end in itself, but rather a means for serving the citizens of Europe by increasing prosperity and stability through sustainable and job-rich growth.

2. Overview and sequencing

This section would offer an executive summary. It would present in particular the suggested phasing and the main steps proposed in each of the two stages.

3. The nature of a deep, genuine and fair Economic and Monetary Union

This section would put forward the overall vision for a deep and genuine EMU. It should bring together all the elements in the Report in a comprehensive and coherent way. It should also recall the benefits of having a common currency. In particular, it should explain what still needs to be done to complete EMU through a phased approach; it should stress that the euro is irrevocable and underline that "the success of EMU anywhere depends on its success everywhere" because otherwise there cannot be a truly single money; it should also explain what needs to be done, both at national and euro area level, to ensure that each Member State is better off inside than they would be outside the EMU, especially in case of shocks.

4. Towards a stronger economic union – fostering convergence, prosperity and social cohesion

This section would make the case for further sharing of decision making on those policy areas that are essential for the smooth functioning of EMU because of their impact on internal and external *imbalances and competitiveness. Moving towards a deeper Economic Union, alongside the Monetary Union, means both (i) a greater adjustment capacity for each of the euro area economies and (ii) a better management of the interdependencies. The focus should be on structural reform policies governing labour and product markets as well as the business environment, while at the same time ensuring a high level of social cohesion, and addressing the need for greater coordination of tax policies, notably to decisively avoid aggressive tax practices, evasion, as well as base erosion and profit shifting. Progress in this direction would take place in two phases.First, in the short term, a new impetus to reforms would set in motion a convergence process towards best performance and practices, while taking into account the need for a high degree of social cohesion. At the same time, the European Semester should be streamlined and refocused while strengthening ownership and reform implementation. In a second phase, the convergence process for key structural policies would be formalised by agreeing on a set of common standards (or benchmarks) which could be embodied in legal rules to be agreed at European level in a democratic manner. Sufficient progress towards the latter would be regularly monitored and would be a condition to benefit from a future shock absorption mechanism to be set up at the euro area level.*

The social dimension

The social dimension of structural policies would be an integral part of the convergence process during each of the two phases. This is particularly the case with regard to labour market policies. Unemployment, especially long term unemployment, is one of the main drivers of inequality and social exclusion. Therefore, efficient labour markets that promote a high level of employment, avoid duality and are able to absorb shocks without generating excessive unemployment are doubly important: they contribute to the smooth functioning of EMU as well as to more inclusive and resilient societies. Beyond labour markets, it would be important to ensure that every citizen benefits from an adequate education and that an effective social protection system is in place to protect the vulnerable groups in society. Sustainable pension systems are particularly important in this context.

5. Towards fiscal union—a framework for sound and integrated fiscal policies

This section would stress that one of the main lessons of the financial and debt crisis is that fiscal policies are a matter of vital common interest. Sustainable and responsible national fiscal policies are therefore a pre-requisite for a well-functioning EMU. In the near term, strict adherence to the strengthened common fiscal rules is critical. Additional efforts could be made to improve the implementation, coordination and ownership of the governance framework. At the same time, greater attention should be given to the euro area as a whole and the achievement of an appropriate aggregate fiscal stance. Also, the forthcoming review of the "six- and two-packs" should offer an opportunity to streamline the rules to improve transparency, compliance and legitimacy while preserving its stability-oriented nature. In the medium- to longer run, some public goods could be provided commonly and a shock absorption function would be set up at the euro area level. Access to this would be made conditional on sufficient progress towards the commonly agreed benchmarks for key structural policies. At the same time, as the euro area evolves towards a genuine economic and fiscal union, there would be a need for moving from a system of rules and guidelines for economic and fiscal policies towards a system of commensurate sovereignty sharing within common institutions. This shift would need to be accompanied with stronger democratic participation and accountability both at national and European levels.

6. Towards financial union

In the short run, the priority should be on reinforcing the credibility of the Single Resolution Fund by putting in place the bridge financing, and by taking concrete steps towards a credible common backstop to the fund. At the same time, further progress would be necessary towards a level playing field for all financial institutions in Member States participating in the banking Union by addressing the still significant margin for national discretion. In addition, the effectiveness of the European Stability Mechanism's direct recapitalisation tool could be improved. This would be complemented by launching the Capital Markets Union. In the medium-term, a European Deposit Insurance Scheme—the third pillar of a fully-fledged banking union alongside bank supervision and resolution—would be launched.

7. Democratic accountability, legitimacy and institutional strengthening

This section would set out the guiding principles for greater political accountability and legitimacy. It would put forward a number of specific suggestions on how to better involve the European and national Parliaments, as well as social partners across the various blocks. It would also argue in favour of a consolidated external economic representation of the euro area. It would discuss options to improve the functioning of the Eurogroup. Furthermore, it would discuss how a further sharing of sovereignty should be accompanied by strengthened European institutions with increased democratic legitimacy and accountability. Finally, it would stress the need to bring intergovernmental structures within the framework of EU law (Treaty on Stability, Coordination and Governance; European Stability Mechanism; Intergovernmental Agreement on the Single Resolution Fund; and the Euro Plus Pact).

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