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**A blueprint for a deep and genuine economic and monetary union
Launching a European Debate**

A BLUEPRINT FOR A DEEP AND GENUINE EMU

Launching a European debate

1. Rationale, aspirations, and benefits of EMU

According to the Treaties, the aim of the European Union is to promote peace, its values and the well-being of its people. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote economic, social and territorial cohesion, and solidarity among Member States. The European Union shall establish an Economic and Monetary Union (EMU) whose currency is the Euro (cf. Art 3 TEU).

The creation of the EMU and the introduction of the euro were milestones of European integration. They stand out among the EU's most far-reaching achievements and the euro is one of Europe's defining symbols at home and across the globe. The founders of the EMU pursued great aspirations with the single currency, both economic and political. Some of these aspirations have already been realised, while others remain to be achieved.

As the world's second largest reserve currency, the euro is an integral feature of the global economy. It is entrenched in balance sheets around the world. Its existence has helped to open up the internal market to more than 330 million citizens living in the euro area, by enabling immediate price comparisons for goods and services across countries. By eliminating exchange rate risk and foreign transaction costs, the euro also facilitates a more efficient distribution of resources, and makes prices for goods and services fully transparent across countries. In our interconnected electronic world, this levelling of the playing field of the single market is a powerful tool for growth. The euro has demonstrably facilitated trade between euro area countries and has equally promoted physical and financial investment between Member States. The stability of the currency has made the euro area an attractive investment destination. These trade and investment gains have boosted growth and jobs. Ample liquidity provision by the Eurosystem has helped to deal with problems in the interbank market during a period of financial disruption and uncertainty. The euro area is a dynamic and open construction. Despite the crisis, membership of the euro area, which is constituted by 17 Member States and is set to increase in the future, has remained an attractive prospect: Slovakia joined the single currency in January 2009 and Estonia joined in January 2011.

Weaknesses in the initial design of EMU and adherence to rules

By the time of the eruption of the financial crisis in 2008 some euro area Member States had accumulated large private and public debts, losses in competitiveness, and macroeconomic

imbalances. This rendered them particularly vulnerable when the crisis struck, with considerable contagion effects across the euro area once it turned into a sovereign debt crisis. The build-up of these vulnerabilities was partly due to an insufficient observance of and respect for the agreed rules underpinning EMU as laid down in the Stability and Growth Pact (SGP). In good part these vulnerabilities stemmed from features of the original institutional setup of EMU, in particular the lack of a tool to address systematically macroeconomic imbalances.

EMU is unique among modern monetary unions in that it combines a centralised monetary policy with decentralised responsibility for most economic policies, albeit subject to constraints as regards national budgetary policies. Unlike other monetary unions, there is no centralised fiscal policy function and no centralised fiscal capacity (federal budget)¹. It has been clear since the inception of the euro that the increased interdependence of its Member States meant that sound budgetary and economic policies were of particular importance. The SGP² set down the rules governing the coordination of budgetary policies. It also foresaw action to be taken against Member States that did not comply with the rules. It was thought that this coordination would be sufficient to ensure sound policies at national level. Already in 2008, the Commission's EMU@10 report³ presented a range of possible changes to this setup. The crisis accelerated the need for change.

The following issues have been at the heart of the challenges faced by the euro area since 2008:

(a) The SGP was insufficiently observed by the Member States and lacked robust mechanisms to ensure sustainable public finances. The enforcement of the preventive arm of the SGP, which requires that Member States maintain a strong underlying budgetary position, was too weak and Member States did not use periods of steady growth to pursue ambitious fiscal policies. At the same time, the debt criterion of the Treaty was not rendered operational in practice in the corrective arm of the SGP. The result was budgetary slippages during good times, and an inability to bring down the debt levels of highly indebted countries.

(b) The coordination of national economic policies beyond the budgetary area relied on soft instruments – peer pressure and recommendations – and had a limited impact on the action of individual euro area Member States. The instrument was therefore too weak to counter the progressive opening of competitiveness gaps and growth divergences between Member

¹ The adjective “fiscal” in this text is used in the sense of “budgetary”.

² The EMU policy framework comprises a set of detailed Treaty provisions, which (a) establish the European Central Bank (ECB) as an independent monetary authority for the euro area; (b) elaborate a set of rules governing the conduct of national budgetary policies (such as the excessive deficit procedure, the prohibition of monetary financing and privileged access and the so-called “no bail-out clause”); and (c) govern the surveillance of economic policies more generally in the Member States.

³ http://ec.europa.eu/economy_finance/publications/publication_summary12680_en.htm

States. Little consideration was given to the euro area-wide spillover effects of national measures. National economic policy-making paid insufficient attention to the European context within which the economies operate. The generalised absence of risks stemming from a global economic liquidity glut contributed to this.

(c) Financial markets play an important role in creating incentives for countries to run sustainable public finances, by pricing the risk of default into the rate at which sovereigns can borrow money. With the global easing of inflationary pressure in the late 1990s, there was a rapid and sustained expansion in the money supply by central banks. Along with new approaches to risk transfer in the financial system this resulted in globalised excess liquidity, a pervasive search for yield and ultimately a severe mispricing of risk of both private and public assets. In parallel, with the introduction of the euro the European Central Bank (ECB) relied on national bonds for its open market operations, thereby conferring upon them the top-quality status required for central bank collateral. The result was strong yield convergence, considerably limiting market discipline, despite differences in national budgetary performances. This contributed, inter alia, to the significant investments on sovereign bonds made by banks. Euro area economies in a cyclical expansion and with relatively higher inflation rates tended to enjoy low or even negative real interest rates. This led in some countries to strong credit expansion fuelling significant housing bubbles.

(d) The inception of EMU saw a sharp acceleration in the pace of financial integration. While this opened opportunities for portfolio diversifications, it also accelerated the transmission of shocks across national borders. Despite the increased market integration, the responsibility for prudential supervision and crisis management remained predominantly at the national level. This asymmetry between integrated financial markets on the one hand, and a financial stability architecture still nationally segmented on the other, resulted in inadequate coordination among the relevant authorities at all stages of the current crisis. The absence of common rules and euro area-wide supervisory and resolution institutions for the financial sector was a major problem in responding to the crisis. The lack of an integrated EU-level framework and of a mechanism to mutualise the response to risks coming from the banking sector affecting several or all Member States, resulted in powerful and damaging negative loops emerging between the banking system and the sovereigns in the vulnerable countries. These loops fuelled the debt crisis further and led to a reversal in the direction of capital flows. As a result, some Member States have been excluded from market financing and there has been a risk of contagion effects affecting the euro area as a whole. In this context, the absence of an effective mechanism to provide liquidity to Member States in distress and thus to manage contagion risk and to safeguard euro area financial stability emerged as a clear inadequacy in the crisis management arrangements.

While the EU has taken decisive action to address those major challenges, EMU needs to be deepened further. This Blueprint for a Deep and Genuine EMU describes the necessary elements and the steps towards a full banking, economic, fiscal and political union.

2. The measures taken so far: a crisis response

In tackling the crisis, the Commission has taken a leading role in preserving the single market against emerging protectionist tendencies and fragmentation according to national borders, especially in the banking sector; in overhauling EMU's economic governance to address the weaknesses of economic surveillance and in putting forward important legislative proposals to initiate the reform of financial sector supervision, in ensuring EU-level coordination and oversight of bank rescue and in spear-heading support to the real economy under the European Economic Recovery Programme.

The strong support of the European Parliament has been instrumental in enabling quick progress on these initiatives, and in bringing the legislative proposals quickly into force. In 2010, the Task Force set up by the President of the European Council for strengthening economic governance enabled a swift emergence of consensus among member states in support of the proposals by the Commission. Frequent meetings of the European Council have resulted in important commitments and significant steps by the member states to respond to Europe's crisis.

All euro area Member States and most others have committed themselves to incorporating the EU rules and principles of budgetary surveillance into their national legal frameworks under the Treaty on Stability, Coordination and Governance in Economic and Monetary Union (TSCG) signed by all EU countries except the Czech Republic and the UK in March 2012. The creation of a financial firewall for the euro area and successive decisions to increase its size and flexibility of operations and to make it permanent have significantly strengthened the crisis management capacity.

2.1 Budgetary surveillance

The Commission presented a strategy for strengthening economic governance in Europe in its two Communications of 12 May 2010 and 30 June 2010⁴. These Communications were followed up by a package of legislative proposals adopted by the Commission on 29 September 2010.

As a result of efficient inter-institutional cooperation, the legislative process proceeded quickly and the European framework of economic and budgetary surveillance was overhauled in December 2011 with the adoption of a package of six legislative proposals (known as the six-pack) designed to address the weaknesses revealed by the economic and financial crisis. It comprised three Regulations strengthening the European budgetary surveillance framework (the SGP), two Regulations introducing a new surveillance procedure

⁴ See the Commission's communications of 12 May 2010 (COM (2010) 250 final) and 30 June 2010 (COM(2010) 367 final), and its "six pack" legislative proposals of 29 September 2010 (COM (2010) 522 through 527 final).

for macroeconomic imbalances and a Directive imposing minimum standards for Member States' national budgetary frameworks.

The legislative package drastically reinforced the preventive arm of the SGP by introducing an expenditure rule anchoring expenditure growth to the medium-term growth rate of potential GDP. The legislation also introduced the possibility of sanctions early in the process. Countries will now face lodging an interest-bearing deposit of 0.2% of GDP if their underlying budgetary position is not strong enough. The new legislation also provides for stronger action to correct gross policy errors within the corrective arm of the SGP and a new quantified rule requiring those Member States that exceed the debt threshold of the Maastricht Treaty to reduce the excess rapidly. The launch of an Excessive Deficit Procedure (EDP) can now result from unfavourable government debt developments as well as from high government deficits. The introduction of the reverse qualified majority rule significantly strengthens the Commission's hand in decisions relating to sanctions on euro area Member States. Whereas in the past, such decisions required the support of a qualified majority in the Council, in future, a qualified majority would be required to halt the sanction proposed by the Commission.

The six-pack also included the adoption of a Directive defining minimum requirements for national budgetary frameworks to ensure that Member States' fiscal frameworks are fit to respect the EU rules. This concept, of ensuring that the national decision-making processes are set up to deliver policy in line with the European requirements is also at the heart of the intergovernmental Treaty on Stability, Coordination and Governance in Economic and Monetary Union (TSCG). Euro area signatory Member States have committed to integrating the core principles of the SGP straight into their national legal framework through provisions of binding force and permanent character which will include a national correction mechanism supervised by an independent monitoring body to ensure compliance with the budgetary targets in the preventive arm of the Pact. Although it is intergovernmental, the TSCG foresees incorporating its provisions into Union law within 5 years. The Commission is already working with the European Parliament and the Council to integrate some of the TSCG elements into EU law applicable to euro area Member States through the legislative proposals known as the two-pack, which are currently in the EU decision-making process.

The two-pack – which consists of two Regulations – was proposed by the Commission in November 2011 and aims to further reinforce both budgetary coordination and budgetary surveillance, for more targeted prevention and more effective corrective action in case of deviations from the budgetary policy requirements deriving from the SGP. All Member States of the euro area will present ahead of parliamentary adoption their draft budgetary plans for the forthcoming year to the Commission and to their euro area partners, according to a common timetable. The two-pack also strengthens the monitoring and surveillance procedures for Member States experiencing severe difficulties with regard to their financial stability or for those in receipt of financial assistance.

2.2 Economic policy surveillance

A major weakness of the pre-crisis surveillance arrangements was the lack of systematic surveillance of macroeconomic imbalances and competitiveness developments. While such developments were analysed in the context of the Commission's reports on Member States, including the opinions on the Stability and Convergence Programmes, and in the euro area's informal competitiveness reviews every two years, there was no formal instrument for their systematic analysis and follow-up through concrete policy recommendations. The six-pack introduced a new Macroeconomic Imbalances Procedure (MIP) to close this gap: a new surveillance mechanism aiming to prevent macroeconomic imbalances and to identify and allow the timely correction of any emerging competitiveness divergences. It is based on an alert system that uses a scoreboard of indicators and in-depth country studies to identify imbalances and launch a new Excessive Imbalance Procedure (EIP) where necessary. The new procedure is backed up by enforcement provisions in the form of financial sanctions for euro area Member States which do not comply with the EIP.

The various components of economic, budgetary and structural surveillance were also fully integrated as a result of changes introduced since the onset of the crisis which set up the European Semester. While these components were previously assessed separately, their surveillance is now undertaken in parallel over the first six months of each calendar year, allowing Member States to take country-specific guidance into account in their national budgetary processes over the next six months. Policy advice is given to Member States before they finalise their draft budgets for the following year.

2.3 Financial regulation and supervision

Over the past four years, the European Union has taken decisive steps in the area of financial regulation and supervision and an ambitious and substantial financial reform agenda is being implemented. The aim is to make financial institutions and markets, which have been at the heart of the crisis, more stable, more competitive and more resilient. The Commission President asked Jacques de Larosière, the former IMF Managing Director and Governor of the Banque de France, to present a comprehensive report on the appropriate measures. Drawing on the de Larosière Report, the Commission proposed a comprehensive programme of financial regulatory reform.

Stronger prudential requirements for banks have been proposed under the fourth Capital Requirements Directive and the Capital Requirements Regulation (CRD4/CRR) currently under discussion. For the first time, the capital adequacy requirements will be enshrined in a Regulation and not a Directive. The adoption of the Capital Requirement Regulation will be a significant step forward in the completion of the single rulebook for financial institutions in the European Union. The EU has also taken action in the field of governance by introducing binding rules on remuneration practices to avoid excessive risk-taking by the banks.

The EU tightened supervision of the financial markets by establishing a European System of Financial Supervisors (ESFS) composed of three European Supervisory Authorities (ESAs) – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – and of a macro-prudential watchdog, the European Systemic Risk Board (ESRB). The three ESAs work together with Member States' national supervisory authorities to ensure harmonised rules and a strict and coherent implementation of the new requirements. The ESRB monitors threats to the stability of the whole financial system, allowing any weaknesses to be addressed in due time.

Credit Rating Agencies, which played an important role in triggering the crisis, are now closely supervised by ESMA. Legislation adopted in 2012 will ensure that all standardised over-the-counter derivatives are cleared by central counterparty clearinghouses, reducing the risk of default of counterparties. In addition, all standardised and sufficiently liquid derivatives will be traded on regulated platforms once the legislation proposed by the Commission is adopted. The issue of short selling has already been addressed, through the adoption of legislation increasing transparency.

2.4 Crisis resolution mechanisms

A key part of the crisis resolution approach was the development of a crisis resolution mechanism that would address financial market fragility and mitigate the risk of contagion across Member States. On the Commission's initiative, in May 2010 two temporary crisis resolution mechanisms were established: the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF). The EFSM is a financial support instrument backed by the resources of the EU budget, available to all 27 Member States of the European Union, and based on the existing Treaty framework. The EFSF is a company owned by the euro area Member States, incorporated in Luxembourg, whose functioning is regulated in an intergovernmental agreement. The EFSF's lending capacity is backed solely by the guarantees of participating Member States, and is accessible only to the euro area Member States.

Faced with the further entrenchment of the crisis, euro area Member States made the existing support mechanisms more robust and more flexible; and eventually decided on the creation of a permanent crisis resolution mechanism to better protect the financial stability of the euro area and of its Member States. As a result, the euro area's permanent financial backstop, the European Stability Mechanism (ESM) was finally inaugurated on 8 October 2012, and is now fully operational following completion of ratification of the ESM Treaty by all euro area Member States. The ESM is the world's most capitalised international financial institution and the world's biggest regional firewall (€500 bn). Its creation is a key step for ensuring that the euro area has the capacity needed for rescuing Member States experiencing financial

difficulties from default. On 27 November 2012, the European Court of Justice confirmed that the ESM Treaty is in line with EU law as it stands.⁵

The ECB has played a crucial role in the euro area response to the economic and financial crisis. First, the official refinancing rate has been lowered almost to zero, as the economy has slowed. In addition, the ECB has taken a range of measures to address the effects of the crisis on the functioning of financial markets when interbank market activity nearly stalled. One of the earliest of these effects was the drying-up of wholesale funding for banks, amid concerns about the quality of assets on their balance sheets. The ECB responded to this by expanding banks' access to monetary policy operations via a relaxation of collateral rules for both standard refinancing operations and for emergency liquidity assistance. In May 2010, the Eurosystem started the Securities Market Programme (SMP), purchasing government bonds in limited and sterilised interventions. As funding pressures intensified in the second half of 2011, threatening financial stability across the euro area, the ECB provided banks with access to exceptionally long-term refinancing operations (LTROs) with maturities of up to three years (compared to a maximum maturity of three months under normal procedures). The three LTRO allotments have had a powerful impact on investor sentiment and have substantially eased the pressure building in funding markets. While access to wholesale funding remains problematic for many banks, there has been recent evidence of a gradual thawing in these markets especially for larger banks.

The spread of the crisis to sovereign debt markets and the development of negative feedback loops between banks and sovereigns has resulted in a broader fragmentation of the euro area financial system and the emergence of so-called "redenomination risk" linked to fears about the reversibility of the euro. The ECB has adopted a decision as a basis to undertake Outright Monetary Transactions (OMT) in the secondary sovereign bond markets subject to strict and effective conditionality⁶. The objective is to safeguard proper transmission of the ECB's policy stance to the real economy throughout the euro area and to ensure the singleness of monetary policy. The transactions would be undertaken strictly within the ECB's mandate to maintain price stability over the medium term. A necessary condition for Outright Monetary Transactions is strict and effective conditionality attached to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) programme. As long as programme conditionality is fully respected, the ECB Governing Council will consider Outright Monetary Transactions to the extent that they are warranted from a monetary policy perspective. They will be terminated once their objectives are achieved or when there is non-compliance with the macroeconomic adjustment or precautionary programme. The liquidity

⁵ Judgment of 27 November 2012 in case C-370/12 Pringle. The Court also confirmed the validity of European Council Decision 2011/199/EU amending Article 136 TFEU and that the Member States were free to conclude and ratify the ESM Treaty before the entry into force of that Decision.

⁶ ECB Press Release of 6 September 2012 on Technical features of Outright Monetary Transactions: http://www.ecb.int/press/pr/date/2012/html/pr120906_1.en.html

created through Outright Monetary Transactions will be fully sterilised. The announcement of the OMT programme, which replaces the more limited Securities Market Programme, has again had a powerful impact on investor sentiment, resulting in a significant decline in sovereign yields in the vulnerable Member States.

EMU has been overhauled, but the work is not yet complete

The totality of measures taken so far amounts to a strong response to the crisis, particularly when compared with what was considered politically feasible only a few years ago. It has taken time to put in place many of these measures, such as the overhauled instruments of economic and budgetary policy coordination or the permanent financial firewall. Also, for some of these measures to have a positive impact on confidence, they will need to be seen working well for some time. That is one reason why – despite a strong response – it has not been possible to prevent the sovereign debt crises from turning into a crisis of confidence that threatens to put into question the integrity of the euro area itself.

Another factor behind this has been the gap between the sharp acceleration of financial integration under EMU on the one hand, and the comparatively slow progress in the integration of EU-level financial regulation and supervision on the other.

The lack of strong supra-national EU-level institutions for bank supervision made the management of the crisis much more difficult and costly for the taxpayer than it otherwise would have been. More importantly, in the absence of such institutions, the crisis of confidence combined with the lack of appropriate governance of the financial sector (architecture for regulation, supervision and resolution) and the consequent public authorities' response based on national interest, resulted in a re-fragmentation of financial markets, as risk pricing based on national benchmark bonds led to distinctly different financing conditions for businesses and households in different euro area Member States, thereby wiping out many benefits of European financial integration.

This has worked as an additional drag on growth in some Member States, as credit conditions tightened in particular where activity was already slow, further exacerbating the existing feedback interactions between banks and sovereigns in the Member States concerned and further constraining their capacity to grow out of the crisis, ultimately with implications for their capacity to refinance themselves in the markets and the potential need for financial assistance. Conversely, credit conditions eased further in Member States where activity was already relatively strong.

The lack of strong integrated EU-level institutions thus effectively resulted in the reversal of integration and caused damage to the level playing field for businesses and households simply on account of their location on one or the other side of a border between two Member States of the euro area. Quasi-identical businesses within only a few kilometres on two different sides of such a border may no longer be able to finance investments on comparable terms. On one side of the border investment may stall and unemployment rise, as credits are not granted on feasible terms. On the other side, investment costs and unemployment may fall

to new lows at the very same time. The same applies to the financing conditions accorded to private households. Such diverging developments that are detached from economic fundamentals and the needs of citizens and businesses can hamper the whole project of European integration.

Ultimately, the negative feedback loop between sovereigns and banks and the associated re-fragmentation of the EU's financial markets led to the emergence of a re-denomination risk, the bet by financial market participants that this development would eventually threaten the existence of the single currency.

Anachronistically, more than 50 years after the foundation of the European Union the crisis of confidence appears to be reinstating the constraining power of national borders, questioning the Single Market and threatening the achievements and as yet unfulfilled aspirations of Economic and Monetary Union. This is also a threat to the European Union's model of a social market economy.

The lessons learned in the context of the economic, financial, and sovereign debt crises since 2008 have been drivers of a major overhaul of the economic governance of Economic and Monetary Union, which has already led to unprecedented steps. This overhaul has made EMU much more robust than it was at the onset of the crisis. The crisis has clearly demonstrated how much the interdependence of our economies has increased since the foundation of EMU. It has also shown beyond any doubt that success or failure of EMU will be a success or a failure for all involved.

The threat entailed in the crisis of confidence is however much more fundamental. It therefore requires a much more fundamental response. That response must be able to restore confidence that the achievements of the Single Market and the single currency will not be undone and that their as yet unfulfilled achievements will be realised and maintained for citizens and businesses for the future.

To be effective and credible, that response must first of all deal with the pressing practical difficulties citizens, businesses, and Member States face today. A banking union would be able to end the disintegration of the EU's financial market and ensure reasonably equal financing conditions for households and business across the EU; it would help sever the negative feedback loops between Member States and banks; and it would help ensure that divergences between the business cycles across the euro area are not artificially amplified. Second, the response must set out the vision for a more deeply integrated EMU to be achieved in the future. And third, it must chart a clear and realistic path towards that ultimate ambition based on the firm commitment of the EU's institutions and its Member States.

3. The way forward: combining substantial ambition with appropriate sequencing

EMU is facing a fundamental challenge, in particular as regards the euro area, and needs to be strengthened to ensure economic and social welfare for the future. The European Council in June 2012 invited the President of the European Council, in close collaboration with the President of the Commission, the President of the Euro Group and the President of the ECB, to present a specific and time-bound roadmap for the achievement of a genuine EMU. An interim report was presented to the October European Council, and a final report is due in December 2012. The European Parliament adopted on 20 November its report "Towards a genuine Economic and Monetary Union", which outlines the Parliament's preferences for a more deeply integrated EMU. The Commission's proposal on the way forward is outlined in this blueprint.

A comprehensive vision for a deep and genuine EMU conducive to a strong and stable architecture in the financial, fiscal, economic and political domains, underpinning stability and prosperity is necessary. In such a deep and genuine EMU all major economic and fiscal policy choices of its Member States should be subject to deeper coordination, endorsement and surveillance at the European level. These policies should cover also taxation and employment, as well as other policy areas crucial for the functioning of EMU. Such an EMU should also be underpinned by an autonomous and sufficient fiscal capacity that allows the policy choices resulting from the coordination process to be effectively supported. A commensurate share of decisions with regard to revenue, expenditure and debt issuance should be subject to joint decision-making and implementation at the level of EMU.

It is clear that the current EMU cannot be completed overnight by a transformation into a deep and fully integrated version, in particular considering the significant additional transfer of political powers from the national to the European level. In order to arrive at an EMU that can ensure its citizens stability, sustainability and welfare on a permanent basis, decisive steps towards the goal need to be launched already in the short term (within the next 6-12 months). Such steps need then to be followed by further steps in the medium and long term. The steps to be taken in the short, medium and long term must build on each other and follow from each other.

The way forward needs to be carefully balanced. Steps towards more responsibility and economic discipline should be combined with more solidarity and financial support. This balance has to be struck in parallel and in each phase of the development of EMU. The deeper integration of financial regulation, fiscal and economic policy and corresponding instruments must be accompanied by commensurate political integration, ensuring democratic legitimacy and accountability.

This chapter identifies the steps and actions required in the short, medium and long term to arrive at a deep and genuine EMU on a permanent basis, from stronger policy coordination to fiscal capacity to greater pooling of decisions on public revenue, expenditure and debt issuance.

Some of the instruments can be adopted within the limits of the current Treaties. Others will require modifications of the current Treaties and new competences for the Union. The former can therefore progress in the short term and should be completed at the latest in the medium term. The latter can only be initiated in the medium term and completed in the long term. It should however be clear throughout that the concept is a holistic one in which each stage builds on the previous one.

In the short term (within the next 6-18 months), while immediate priority should be given to the full deployment of the new economic governance tools brought by the six-pack as well as rapid adoption of current Commission proposals such as the two-pack and the Single Supervisory Mechanism, more can still be done through secondary law, in particular in the area of economic policy coordination and support to structural reforms necessary to overcome imbalances and to improve competitiveness. Once a decision on the next Multi-annual Financial Framework for the EU has been taken, the establishment of a financial instrument within the EU budget to support re-balancing, adjustment and thereby growth of the economies of the EMU would serve as the initial phase towards the establishment of a stronger fiscal capacity alongside more deeply integrated policy coordination mechanisms. Together, the next step in fiscal and economic policy coordination and the corresponding initial phase of the build-up of a fiscal capacity could take the form of a "convergence and competitiveness instrument". Following the adoption of the Single Supervisory Mechanism, a Single Resolution Mechanism for banks will be proposed.

In the medium term (18 months to 5 years), further budgetary coordination (including a possibility to require a revision of a national budget in line with European commitments), the extension of deeper policy coordination in the field of taxation and employment, and the creation of a proper fiscal capacity for the EMU to support the implementation of the policy choices resulting from the deeper coordination should be established. Some of these elements will require amending the Treaties.

The reduction of public debt significantly exceeding the Treaty criterion could be addressed through the setting-up of a redemption fund. A possible driver for fostering the integration of euro area financial markets and in particular to stabilise volatile government debt markets is common issuance by euro area Member States of short-term government debt with a maturity of up to 1 to 2 years. Both of these possibilities would require amending the Treaties.

Finally, in the long term (beyond 5 years), based on the progressive pooling of sovereignty and thus responsibility as well as solidarity competencies to the European level, the establishment of an autonomous euro area budget providing for a fiscal capacity for the EMU to support Member States in the absorption of shocks should become possible. Also, a deeply integrated economic and fiscal governance framework could allow a common issuance of public debt, which would enhance the functioning of the markets and the conduct of monetary policy. As set out in the Commission's Green Paper of 23 November 2011 on the

feasibility of introducing Stability Bonds⁷, the common issuance of bonds could create new means through which governments finance their debt and offer safe and liquid investment opportunities for savers and financial institutions, as well as a euro area-wide integrated bond market that matches its US dollar counterpart in terms of size and liquidity.

This progressive further integration of the euro area towards a full banking, fiscal and economic union will require parallel steps towards a political union with a reinforced democratic legitimacy and accountability.

The progress in terms of integration will also have to be reflected externally, notably through steps towards united external economic representation of the euro area.

Box 1: The basic legal principles

In order to secure the sustainability of the common currency, the EMU must have the possibility to deepen more quickly and more thoroughly than the EU as a whole, whilst preserving the integrity of the EU at large.

This can be achieved through the observance of the following principles:

First, the deepening of the EMU should build on the institutional and legal framework of the Treaties, for the sake of legitimacy, equity between Member States and efficiency. The euro area is a product of the Treaties. Its deepening should be done within the Treaties, so as to avoid any fragmentation of the legal framework, which would weaken the Union and question the paramount importance of EU law for the dynamics of integration. Only EU decision-making rules provide full efficiency, resting on qualified majority instead of burdensome unanimity requirements and on a robust democratic framework.

Intergovernmental solutions should therefore only be considered on an exceptional and transitional basis where an EU solution would necessitate a Treaty change, and until that Treaty change is in place. They must also be carefully designed so as to respect EU law and governance, and not raise new accountability problems.

Second, the deepening of EMU should primarily and fully exploit the potential of the EU-wide instruments, without prejudice to the adoption of measures specific to the euro area. The European Semester, the internal market *acquis* and the support to competitiveness and cohesion through the EU budget provide a good basis for developing a comprehensive legal and financial framework for economic coordination, integration and real convergence. On-going efforts to make these policies more effective through e.g. macroeconomic

⁷ COM(2011)818.

conditionality of the structural funds or the new governance approach of the single market will also contribute to the strengthening of EMU.

At the same time, additional financial, fiscal and structural coordination or support instruments specific to the euro area should be established whenever needed and should be designed as a complement to the EU's foundations. The Lisbon Treaty has provided a useful legal basis (Article 136 TFEU) for deepening the integration of the euro area. This legal basis has been already widely used with the successive six-pack and two-pack.

Wherever legally possible the euro area measures should be open for participation of other Member States. Indeed, while the Treaties foresee that a number of rules apply only to euro area Member States, the present configuration of the euro area is only of a temporary nature, since all Member States but two (Denmark and the UK) are destined to become full members of EMU under the Treaties.

Third, moves towards a genuine EMU should primarily be constructed using all the possibilities offered by the Treaties as they stand, via the adoption of secondary legislation. Amendments to the Treaties should be contemplated only where an action indispensable for improving the functioning of the EMU cannot be constructed within the current framework. Possible changes should be carefully prepared, so as to ensure the political and democratic ownership needed for a smooth ratification process.

3.1 In the short term (within the next 6-18 months): measures possible under secondary EU law to move towards the banking union, improve policy coordination as well as taking a decision on the next MFF and creating a "convergence and competitiveness instrument"

The deepening of EMU must address the consequences of excessive public and private debt accumulation, and thereby reduce the associated imbalances that were generated in the European economy. But adjustment is proving a long and difficult task, involving constraints in the credit supply, stretching public finances, and weak growth in the private sector as firms and households clean their balance sheets.

Commitment to budgetary discipline is an essential safeguard of the stability of the euro area, and a necessary step towards a fully-fledged integrated budgetary framework. This will ensure sound budgetary policies at the national and European levels and thereby contribute to sustainable growth and macroeconomic stability. Full deployment of the new tools for budgetary and economic surveillance and quick adoption of the current proposals should be the first priority. In parallel, the progress towards a banking union needs to start through the adoption and implementation of the proposals made on financial regulation and supervision, notably the proposal for a Single Supervisory Mechanism (SSM) for the euro area and for non-euro area Member States wishing to join.

To ensure a smooth functioning of the EMU, more should be done in the area of coordination of economic policies. The weight of the growth and adjustment challenge in the euro area contrasts with the absence of strong forms of policy coordination in the area of structural reforms. The evidence of large cross-country externalities calls for a reinforcement of the way in which economic policy must be run in the euro area. The proper functioning of the EMU requires that euro area Member States work jointly towards an economic policy where, whilst building upon the existing mechanisms of economic policy coordination, they take the necessary actions and measures in all areas which are essential to the proper functioning of the euro area. In particular, the setting-up of a procedure for the ex-ante discussion of all major economic policy reforms is necessary. This should be underpinned with the corresponding initial phase of the build-up of a fiscal capacity for the EMU, providing targeted financial support for the Member States facing adjustment difficulties.

Recalling the importance of sound public finances, structural reform and targeted investment for sustainable growth, the Heads of State or Government signed a Compact for Growth and Jobs on 28-29 June 2012, demonstrating their determination to stimulate job-creating growth in parallel to their commitment to sound public finances. The Commission is also monitoring the impact of tight budget constraints on growth-enhancing public expenditure and on public investment. In this context, the euro area should ensure that investment is kept at an adequate level in order to ensure the framework conditions for competitiveness developments and to contribute to growth and jobs.

All the initiatives presented in this section can be adopted in the short-term and within the limits of the current Treaties.

3.1.1 Full implementation of European Semester and six-pack and quick agreement and implementation of the two-pack

The completion of the current economic governance framework and its full implementation must be the first order of the day.

The introduction of the European Semester as well as the six-pack legislation has addressed central lessons learned in the context of the crisis. They included a reform of the SGP, the creation of the Macroeconomic Imbalances Procedure, and the introduction of minimum standards for national fiscal frameworks. They represent a leap forward in terms of economic policy coordination. This promises stronger policy implementation at national level, in particular for euro area Member States, and a better functioning of EMU as a consequence, thereby contributing to a return of confidence. That promise must now be delivered through the full use and strict implementation of the new tools that are already in place.

For any further steps towards a deep and genuine EMU to become possible the proposed two-pack legislation ought to be agreed by co-legislators without any further delay. The two-pack contains important instruments to sharpen budgetary surveillance and to deal more efficiently with situations of financial instability in Member States. Its swift adoption and

implementation thereafter should bolster confidence in the commitment of EU institutions to complete the overhaul of economic governance.

3.1.2 Financial regulation and supervision: single rulebook and proposals for a Single Supervisory Mechanism

The euro area summit held on 29 June 2012 marked a turning point in the approach to the crisis. It recognised the "imperative" need to "break the vicious circle between banks and sovereigns" that is weakening the finances of euro area countries, to the point of threatening the very existence of the EMU. In particular, the agreement to set up a Single Supervisory Mechanism (SSM) was based on the conviction that financial fragmentation must be overcome and that the centralisation of banking supervision is necessary to ensure that all euro area countries can have full confidence in the quality and impartiality of banking supervision.

A true Economic and Monetary Union must indeed include shared responsibility for policing the banking sector and intervening in case of crises. This is the only way to effectively break the vicious circle linking Member States' public finances and the health of their banks, and to limit negative cross-border spillover effects.

An integrated financial framework, evolving over time into a full banking union, would help decisively by providing an integrated set of tools better to monitor and contain the risk in the financial system. That would lessen financial fragmentation, considerably reduce the necessity for public intervention, aid rebalancing and in so doing improve the prospects for growth. The tools are integrated because their impact will be lessened if any individual components are weak. Although some necessary parts of the system will take time to develop, that must not delay the swift implementation of those elements that can bring immediate benefits.

The Commission set out a vision of a gradually unfolding banking union in its Communication of 12 September 2012.⁸ The Presidents of the European Council, the Commission, the Euro Group and the ECB have endorsed that vision in principle.⁹ The European Council of 18 October 2012 confirmed the "*need to move towards an integrated financial framework, open to the extent possible to all Member States wishing to participate.*"¹⁰ In its report "Towards a genuine Economic and Monetary Union" of

⁸ See Commission Communication titled "A Roadmap towards a Banking Union" outlining the Commission's overall vision for rolling out the banking union, covering the single rulebook, common deposit protection and a single bank resolution mechanism", COM(2012)510, http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-510_en.pdf

⁹ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/132809.pdf

¹⁰ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/132986.pdf

November 2011, the European Parliament calls for the adoption of the proposals of the Commission in this respect as soon as possible.

The first, crucial step on this path will be the Single Supervisory Mechanism, which must subsequently be complemented by a Single Resolution Mechanism (see 3.2.1).

A Single Supervisory Mechanism must ensure full sharing of information between supervisors about banks, common prevention tools and common action to address problems at the earliest possible stage. In order to restore confidence among banks, investors and national public authorities, it must also allow for supervision to be carried out in a strict and objective manner, with no room left for regulatory forbearance.

On 12 September 2012, the Commission made legislative proposals to create a Single Supervisory Mechanism composed of the ECB and national supervisors,¹¹ and to amend the 2010 regulation establishing the European Banking Authority in order to adapt it to the creation of the Single Supervisory Mechanism and ensure a balance in its decision-making structures between euro area and non-euro area Member States¹².

The Single Supervisory Mechanism as proposed by the Commission is based on the transfer to the European level of specific, key supervisory tasks for banks established in the euro area Member States and for banks established in non-euro area Member States which decide to join the banking union. Under this new framework, the ECB will be responsible for supervising all banks within the banking union, to which it will apply the single rulebook applicable across the single market. The framework proposed by the Commission ensures effective and consistent supervision in all participating Member States, while relying on the specific know-how of national supervisors. It is of crucial importance that the negotiations on the SSM are completed before the end of the year, and that its implementation starts early on in 2013. As a complement, the European Banking Authority (EBA) will be adjusted to the new framework for banking supervision in order to ensure the integrity of the Single Market.

This will pave the way towards the use of the ESM as a public backstop in order, where appropriate, and once an agreement has been reached on this instrument, to directly recapitalise banks in accordance with the conclusions of the European Council of 19 October 2012. This will further reinforce the euro area, by helping to break the negative feedback loop between banks and their sovereigns.

Depositor and market participants' confidence is paramount in resolving banks. To achieve a level of public trust that is comparable to the best resolution authorities around the world, there will need to be a credible single resolution system and a powerful financial backstop in

¹¹ http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-511_en.pdf

¹² http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-512_en.pdf

place. That responsibility remains national in the near term. But once the SSM is in place, and subject to the relevant guidelines, the ESM should be allowed to offer mutualised support to directly recapitalise banks that fail to raise funds in the market and that cannot be rescued by their home Member State without endangering its fiscal sustainability.

An integrated financial framework including a single supervision and subsequently a single resolution mechanism must be based on a single rulebook. Therefore, it is essential to conclude as a matter of urgency the negotiations on the Commission proposals establishing new regulatory frameworks in the areas of banking prudential rules, deposit guarantees, and bank recovery and resolution.

3.1.3 A Single Resolution Mechanism

An effective banking union requires not only a Single Supervisory Mechanism ensuring high quality supervision across Member States, but also a Single Resolution Mechanism to deal with banks in difficulties. This was recognised by the European Council on 19 October 2012, which stated that it *"notes the Commission's intention to propose a single resolution mechanism for Member States participating in the SSM once the proposals for a Recovery and Resolution Directive and for a Deposit Guarantee Scheme Directive have been adopted."*

Following the adoption of the Single Supervisory Mechanism, the Commission will therefore make a proposal for a Single Resolution Mechanism, which will be in charge of the restructuring and resolution of banks within the Member States participating in the Banking Union. This mechanism will be articulated around a separate European Resolution Authority, which will govern the resolution of banks and coordinate in particular the application of resolution tools. This mechanism will be more efficient than a network of national resolution authorities, in particular as regards cross-border banking groups for which, in times of crisis, speed and coordination are crucial to minimise costs and restore confidence. It would also entail significant economies of scale, and avoid the negative externalities that may derive from purely national decisions.

Any intervention by the single resolution mechanism will have to be based on the following principles:

- The need for resolution should be reduced to the minimum, thanks to strict common prudential rules, and improved coordination of supervision within the Single Supervisory Mechanism.
- Where intervention by the Single Resolution Mechanism is necessary, shareholders and creditors should bear the costs of resolution before any external funding is granted, in accordance with the Commission proposal on Bank Recovery and Resolution.
- Any additional resources needed to finance the restructuring process should be provided by mechanisms funded by the banking sector, instead of using taxpayers' money.

Future Commission proposals for a single resolution mechanism will be based on these principles.

The Commission considers that, just as the establishment of an effective Single Supervisory Mechanism, the creation of a Single Resolution Mechanism can be realised by secondary law without require any amendment of the current Treaties.

3.1.4 A quick decision on the next Multi-annual Financial Framework (MFF)

The Commission proposal for the 2014-2020 Multi-annual Financial Framework represents the decisive driver for investment, growth and employment at the EU level. It also foresees to tie the funding from cohesion policy, rural development and the European maritime and fisheries policy more systematically to the different economic governance procedures. The Common Strategic Framework (covering the following 'CSF Funds': the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund) establishes a strong link between these funds and the national reform programmes, the stability and convergence programmes drawn up by the Member States, as well as the country-specific recommendations adopted by the Council for each Member State.

This will be implemented via partnership contracts/agreements between Member States and the Commission and the application of rigorous macroeconomic conditionality. In the Commission proposal macroeconomic conditionality is applied in two ways:

1. Reprogramming: this concerns amendments to the partnership contracts and relevant programmes in support of Council recommendations, or to address an excessive deficit, macroeconomic imbalances or other economic and social difficulties or to maximise the growth and competitiveness impact of the CSF Funds for Member States receiving financial assistance from the EU. Where a Member State fails to respond satisfactorily to such a request, the Commission may suspend part or all of the payments for the programmes concerned.
2. Suspension: when a Member State fails to take corrective action in the context of the economic governance procedures. In such a case, the Commission shall suspend part or all of the payments and commitments for the programmes concerned.

The partnership contracts and operational programmes will ensure that the planned investments co-financed by the CSF funds will effectively contribute to addressing the structural challenges facing Member States. In the case of Council recommendations in the context of Articles 121 and 148 of the Treaty and the corrective arm of the MIP, a reprogramming will be triggered for those recommendations that are relevant for the CSF funds and related to structural challenges that can be addressed through multi-annual investment strategies. Such recommendations cover, among other things:

- Labour market reforms that will improve the functioning of the labour market such as addressing the skills mismatches
- Measures to foster competitiveness such as the improvement of education systems or the promotion of R&D, innovation and infrastructure
- Measures to improve the quality of government such as the improvement of the administrative capacity and statistics

Through a swift adoption of the MFF and the relevant sector legislation, in particular the "Common Provisions Regulation" for the CSF Funds, incentives and support for structural reforms in Member States will be rapidly strengthened.

3.1.5 Ex-ante coordination of major reforms and the creation of a "Convergence and Competitiveness Instrument"

The fact that Member States' economic policies are a matter of common concern has been brought into sharp relief through the experience of the crisis, especially in the euro area. Slow or absent implementation of important structural reforms over long periods of time aggravated competitiveness problems and hampered Member States' adjustment capacity, in some cases significantly. This contributed to increasing these Member States' vulnerability. Short-term costs, be they political or economic in nature, often act as a deterrent to reform implementation even when the medium- to long-term benefits are sizeable. The potentially significant spillover effects associated with structural reforms in the euro area justify the use of specific instruments, as has already been done through the enforcement mechanisms introduced under the six-pack legislation. In view of these considerations, the existing framework for economic governance of the euro area should be strengthened further through ensuring greater ex-ante coordination of major reform projects and, following the decision on the next MFF, through the creation of a "Convergence and Competitiveness Instrument" to provide support for the timely implementation of structural reforms (see Annex 1 for a more detailed description of the intended setup). This instrument would combine deepening integration of economic policy with financial support, and thereby respect the principle according to which steps towards more responsibility and economic discipline are combined with more solidarity. The Commission will, in a forthcoming proposal, set out the precise terms for this instrument.

Ex-ante coordination of major reforms

The current EU economic surveillance framework already provides a basis for economic policy coordination. This framework, however, does not provide for systematic ex ante coordination among the Member States of national plans for major economic policy reforms. Ex ante discussion and coordination of major reform plans, as envisaged in Article 11 of the TSCG, would allow the Commission and Member States to assess the potential spillover

effects of national action and comment on the plans before final decisions are taken at national level. In a forthcoming proposal, the Commission will propose a framework for the ex-ante coordination of major structural reforms in the context of the European Semester.

A Convergence and Competitiveness Instrument: contractual arrangements and financial support

The proposed Convergence and Competitiveness Instrument (CCI) would encompass contractual arrangements underpinned by financial support.

The implementation of structural reforms in the euro area Member States would be facilitated by the set-up of contractual arrangements to be agreed between them and the Commission. This new system would build on the existing EU surveillance framework, namely the procedure for the prevention and correction of macroeconomic imbalances (the Macroeconomic Imbalances Procedure or MIP)¹³. Such arrangements would be negotiated between individual Member States and the Commission, discussed in the Euro Group and concluded by the Commission with the Member State. They would be compulsory for euro area Member States subject to an Excessive Imbalance Procedure and the corrective action plan (CAP) they have to submit under this procedure would constitute the basis of the arrangement to be negotiated with the Commission. For the euro area Member States subject to a preventive action as regards their macroeconomic imbalances, the participation would be voluntary and would involve the presentation of an action plan similar to that required under the Excessive Imbalance Procedure.

The arrangements would therefore be always based on the country-specific recommendations emanating from the MIP, which typically focus on enhancing adjustment capacity and competitiveness and promote financial stability, i.e. factors critical to the good functioning of the EMU. The MIP therefore establishes a sensible filter for major reforms eligible to be accompanied by financial support in view of the associated externalities present in a currency union.

The action plan presented by the Member State would then be assessed by the Commission and a final set of reforms and measures and the timeline for their implementation would be adopted as an arrangement. This arrangement would thus set out the more detailed measures which the Member State commits to implement after having obtained the endorsement of its national parliament where appropriate under national procedures. This system of negotiated arrangements would enhance the quality of the dialogue between Commission and Member States as well as the Member States' commitment to and ownership of their reforms.

The reforms taken up in the contractual arrangements would be financially supported, as a complement to the discipline requirements already introduced by the six-pack. The aim of

¹³ Regulation (EU) N° 1176/2011

such support would be to lead to timely reform adoption and implementation by overcoming or at least lessen political and economic deterrents to reform. By promoting structural reforms that enhance the adjustment capacity of a Member State the CCI would improve the economy's capacity to absorb asymmetric shocks through enhancing market functioning.

Financial support would only be granted for reform packages that are agreed and important both for the Member State in question and for the good functioning of EMU. The financial support would be supporting the efforts of a Member State and in particular provide support in cases where the emergence of imbalances happened in spite of full compliance with previous country-specific recommendations addressed to the Member State concerned..

The financial support will have a clear signalling effect recognising both the cost of reform for the Member State in question as well as the benefit of national reforms accruing to the rest of the euro area given positive cross-border externalities (which may not be sufficient though to lead to reform impetus by Member States). Where the Commission finds ex post that a Member State has not fully complied with the contract, the financial support can be withheld.

The financial support should be designed as an overall allocation to be used to contribute to financing measures flanking difficult reforms. For example, the short-term impact of reforms raising the flexibility in the labour market could be accompanied by training programmes financed in part through support provided under the CCI. The use of financial support would be defined as part of the contractual arrangement concluded between the Member State concerned and the Commission.

To support this mechanism of financial support a special financial instrument could be set up in principle as part of the EU budget.

The instrument would be established by secondary legislation. It could be construed as part and parcel of the MIP reinforced by the contractual arrangements and financial support as outlined above and thus be based on Article 136 TFEU. Alternatively one could envisage having recourse on Article 352 TFEU, if necessary by enhanced cooperation (coupled with a decision pursuant to Article 332 TFEU on expenditure being included in the EU budget).

The financial contributions necessary to the instrument could be based on a commitment of the euro area Member States or a legal obligation to that effect enshrined in the EU's own resources legislation. Contributions should be included in the EU budget as assigned revenues. Being financed through assigned revenue, the instrument would not be placed under the ceilings set in the MFF Regulation. Only contributing Member States would be in a position to enter into a contractual arrangement with the Commission and benefit from the financial support. Support through the CCI would be coherent and consistent with the support from the Structural Funds, in particular the European Social Fund. The volume of the instrument could remain limited in the initial phase but could become larger over the medium

term provided that the support mechanism proves to be effective in promoting rebalancing, adjustment and thereby sustainable growth in the euro area.

The Commission will in forthcoming proposals set out the precise terms for this "convergence and competitiveness instrument" based on contractual arrangements and financial support.

3.1.6 Promoting investment in the euro area

Structural reforms supported, first, by the MFF and, second, the Convergence and Competitiveness instrument will be essential to improve the medium-term growth potential of euro area members and their adjustment to shocks. Credible and growth-friendly consolidation that improves the efficiency of the tax structure as well as the quality of public spending will contribute to stimulating growth. As recommended in the Annual Growth Surveys 2012 and 2013, the Member States should strive in particular to maintain an adequate fiscal consolidation pace while preserving investments aimed at achieving the Europe 2020 goals for growth and jobs.

The EU fiscal framework offers scope to balance the acknowledgment of productive public investment needs with fiscal discipline objectives.

Public investment is one of the relevant factors to be taken into account when the fiscal position of a Member State is being assessed in the report foreseen under Article 126(3) TFEU that precedes the launch of an EDP.¹⁴ The importance of relevant factors, such as public investment, for the assessment has considerably increased with the recent reform of the SGP. Under certain conditions, consideration of relevant factors may lead to not placing a Member State in EDP¹⁵; and relevant factors should be taken into account in formulating recommendations for correcting the excessive deficit, including the deficit reduction path.

In the preventive arm of the SGP, public investment is taken into consideration in the new expenditure benchmark, which is used alongside the structural balance to assess the progress towards the medium-term budgetary objective. Specifically, general government gross fixed

¹⁴ Specifically, according to Article 126(3) TFEU: "The report of the Commission shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors (...)".

¹⁵ First, consideration of relevant factors may lead to not placing a Member State in EDP despite a breach of the deficit criterion when the debt ratio is below the reference value. Second, a breach of the debt reduction benchmark should result in the opening of an EDP only after the assessment of the relevant factors.

capital formation is averaged over a number of years, in order to avoid that Member States penalised because of annual peaks in investment¹⁶.

The Commission will explore further ways within the preventive arm to accommodate investment programmes in the assessment of Stability and Convergence Programmes. Specifically, under certain conditions, non-recurrent, public investment programmes with a proven impact on sustainability of public finances could qualify for a temporary deviation from the medium-term budgetary objective or the adjustment path towards it.¹⁷ This could apply, for example, for government investment projects co-financed with the EU, consistently with the framework of macro-conditionality.

While a fully-fledged framework would have to be worked out to render operational such conditions (notably in terms of information/definitional requirements), a specific treatment of public investment could only lead to a temporary deviation from the medium term budgetary objective (MTO) or the adjustment path towards it. The Commission will issue a Communication on the appropriate path towards the MTO in Spring 2013.

Specific provisions for investment projects should not be confused with a 'golden rule', which would allow a permanent exception to all public investment. Such an indiscriminate approach could easily put in danger the prime objective of the SGP by undermining the sustainability of government debt.

3.1.7 External representation of the euro area

Building on progress achieved in the economic governance of the euro area, a strengthening and consolidation of its external representation should be pursued. This can be fully achieved on the basis of the current Treaties (Article 17 TEU and Article 138 TFEU).

¹⁶ Also, expenditure on EU programmes, and thus also investment expenditure, to the extent that it is fully matched by EU funds revenue, is also excluded from the expenditure considered for assessing the compliance with the expenditure benchmark.

¹⁷ The SGP embeds specific provisions that allow for such a possibility. Regulation 1466/97 - Article 5(1): "...When defining the adjustment path to the medium-term objective for Member States that have not yet reached this objective, and in allowing temporary deviation from this objective for Member States that have already reached it, provided that an appropriate safety margin with respect to the deficit reference value is preserved and that the budgetary position is expected to return to the medium-term budgetary objective with the programme period, the Council and the Commission shall take into account the implementation of major structural reforms which have direct long-term positive budgetary effects, including by raising potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances..."

Such strengthening is necessary to ensure that the euro area is represented in a manner commensurate with its economic weight, mirroring the changes taking place in the internal economic governance. The euro area must be able to play a more active role both in multilateral institutions and fora as well as in bilateral dialogues with strategic partners. This should result in delivering a single message on issues such as euro area economic and fiscal policy matters, macroeconomic surveillance, exchange rate policies and financial stability.

To achieve these objectives will require agreement on a roadmap aimed at streamlining and, where possible, unifying the external representation of the euro area in international economic and financial organisations and fora.

The focus should be on the IMF, which through its lending instruments and surveillance is a key institutional pillar in global economic governance. As the crisis has shown, it is of utmost importance for the euro area to speak with a single voice in particular on programmes, financing arrangements and the crisis resolution policy of the IMF. This will require a strengthening of coordination arrangements of the euro area in Brussels and Washington on EMU-related matters, to mirror changes in EMU internal governance and to ensure consistency and effectiveness of the messages provided.

Enhancing the euro area representation in the IMF should be done through a two-stage process. In a first stage, the country constituencies should be rearranged so as to re-group countries into euro area constituencies which could also include future euro area Member States. In parallel, observer status in the IMF executive board should be sought for the euro area¹⁸.

These measures should prepare the ground for the euro area seeking, at a second stage, a single seat in the IMF bodies (the executive board and the IMFC). The Commission will in due course make formal proposals under Article 138 (2) TFEU to establish a unified position to achieve an observer status of the euro area in the IMF executive board, and subsequently for a single seat. The appropriate institution to represent the euro area in the IMF, in accordance with Article 138 TFEU, would be the Commission, with the ECB being associated in the area of monetary policy. More details on this aspect of deepening EMU are found in Annex 2.

3.2 The medium term: Enhanced economic and budgetary policy integration and steps towards a proper fiscal capacity

The medium term should see the establishment of further budgetary coordination (including the possibility to require amendments to national budgets or to veto them), the extension of

¹⁸ I.E., the EU representing the euro area Member States in accordance with the Treaties.

deeper policy coordination to the fields of taxation and employment and the creation of an autonomous, proper fiscal capacity for the EMU to support the implementation of the policy choices resulting from the deeper coordination. Some of these elements will require amending the Treaties.

The reduction of public debt significantly exceeding the SGP criteria could be addressed through the setting-up of a redemption fund. A possible driver for fostering the integration of euro area financial markets and in particular to stabilise volatile government debt markets is common issuance by euro area Member States of short-term government debt with a maturity of up to 1 to 2 years. Both of these possibilities would require amending the Treaties.¹⁹

3.2.1 Reinforcement of budgetary and economic integration necessitating Treaty changes

The overhaul of the budgetary and economic governance that the euro area would have undergone with the adoption of the two-pack and the availability of the Convergence and Competitiveness Instrument would represent major steps forward in ensuring budgetary discipline but also economic competitiveness.

However, moving towards more mutualisation of financial risk would require bringing the coordination of budgetary policy one step further by ensuring that there is collective control over national budgetary policy in defined situations.

In particular, the innovations brought by the two-pack and especially the possibility of a Commission opinion on draft budgetary plans, and in extreme cases, the possibility to request a new draft budgetary plan in case of serious violation of the Member State's obligations under the SGP, are reaching the limit of what is possible under the current Treaties in terms of coordination and intervention from the EU level in the national budgetary process. With the two-pack, once adopted, the EU will largely have exhausted the limits of its legislative competence in these respects.

Moving further in terms of national budgetary policy control, for example by setting up a European right to require a revision of national budgets in line with European commitments, would require a Treaty change.

The following (non-exclusive) avenues could be considered:

- First, an obligation for a Member State to revise its (draft) national budget if the EU level so requires in case of deviation from obligations of budgetary discipline previously set at EU level. This would involve changing the nature of the opinion on national budgets foreseen in the two-pack from a non-binding to a binding character.

¹⁹ See Judgment of 27 November 2012 in case C-370/12 Pringle, points 137 and 138.

- Second, building upon the tighter monitoring and coordination process set up by the two-pack, in certain particularly serious situations to be defined, a right to require a revision of individual decisions of budget execution in line with European commitments which would result in a serious deviation from the path of budgetary consolidation set at EU level.
- Third, a clear competence for the EU level to harmonise national budgetary laws (along the lines of the Treaty on Stability, Coordination and Governance in Economic and Monetary Union²⁰) and to have recourse to the Court of Justice in case of non-compliance.

As regards economic policy, tax policy can support economic policy coordination and contribute to fiscal consolidation and growth. Based on the experience to be gained with the structured discussions of tax policy issues which focus on areas where more ambitious activities can be envisaged, one might in future consider in the context of a Treaty change providing scope for legislation on deeper coordination in this field in the euro area. Another area of similar importance where such progress could be considered is labour markets, given the importance of well-functioning labour markets and in particular labour mobility for adjustment capacity and growth within the euro area.

Coordination and surveillance of employment and social policies should be reinforced within the EMU governance, and convergence promoted in these areas. The current Broad Economic Policy Guidelines and Employment Guidelines could be reinforced by merging them into one single instrument.

These changes would provide the basis for developing a proper fiscal capacity for the euro area to support structural reform on a large scale as well as for enabling forms of debt mutualisation to facilitate the solution of the problems of high debt and financial segmentation that are among the legacies of the crisis.

3.2.2 A proper fiscal capacity for the euro area

Building on the experience of systematic ex-ante coordination of major structural reforms and the CCI, a dedicated fiscal capacity for the euro area should be established. It should be autonomous in the sense that its revenues would rely solely on own resources, and it could eventually resort to borrowing. It should be effective and provide sufficient resources to support important structural reforms in a large economy under distress.

²⁰ In any event, the substance of that Treaty should be integrated into Union law as foreseen in its Article 16.

This proper fiscal capacity for the euro area could initially be developed under secondary law, as explained in section 3.1.3. Its enhancement would however benefit from new, specific Treaty bases which would be necessary if the capacity had to be able to resort to borrowing.

3.2.3 A redemption fund

A clearly reinforced economic and fiscal governance framework could allow addressing the reduction of public debt significantly exceeding the SGP criteria through the setting-up of a redemption fund subject to strict conditionality.

The initial proposal of a European Redemption Fund (ERF) as an immediate crisis tool was developed by the German Council of Economic Experts (GCEE) as part of a euro area-wide debt reduction strategy.

In order to limit moral hazard, and to ensure the stability of the structure as well as the redemption of payments, the GCEE proposed several supervisory and stabilising instruments, such as: (1) strict conditionality, similar to the rules agreed within EFSF/ESM programmes; (2) immediate penalty payments in case of non-compliance with the rules; (3) strict monitoring by a special institution (e.g. Court of Justice of the EU); (4) an immediate stop of debt transfer to the fund during the roll-in phase in case of non-compliance with the rules; (5) pledging of Member States' international reserves (foreign exchange or gold reserves) as a security against their liabilities and/or assignment of (possibly newly introduced) taxes to cover the debt service (e.g. VAT revenues) to limit the liability risk.

The Commission agrees that a strong economic and budgetary framework is a pre-requisite for a workable redemption fund. Increased surveillance and power of intervention in the design and implementation of national fiscal policies would be warranted as discussed in the previous section. The credibility of the adjustment plans would require appropriate fiscal conditions to be set when a Member State enters the system. Strict observance of the adjustment path towards the medium-term objective as proposed by the Commission would represent a minimum in this respect.

A European Redemption Fund under such strict conditionality (see also Annex 3) could thus provide an anchor for a credible reduction in public debt, bringing the level of government indebtedness back below the 60% ceiling as foreseen in the Maastricht Treaty.

The introduction of such a framework could give another signal that euro area Member States are willing, able and committed to reduce their debt levels. This could in turn lower the overall financing costs of over-indebted Member States. By assuring the funding of the reduction of the "excess debt" at sustainable cost, in combination with both incentives and continuous monitoring of its reduction, it could provide euro area Member States with the possibility to gear debt reduction in a manner that could facilitate investment in growth-supporting measures. Furthermore, such a framework could contribute to debt reduction

being done on a transparent and coordinated basis across the euro area, thereby complementing the coordination of budgetary policies.

The setting up of such a debt redemption fund could only be envisaged in the context of a revision of the current Treaties. For accountability reasons, the act creating such a fund would need to be framed with great legal precision, as regards the maximum transferrable debt, the maximum time of operation and all other features of the fund, to guarantee the legal certainty required under national constitutional laws.

A possible model ensuring appropriate accountability for a debt redemption fund thus designed would be as follows: a new Treaty legal base would allow the setting up of the fund through a decision of the Council, adopted by unanimity of the euro area members with the consent of the European Parliament, and subject to ratification by Member States under their constitutional requirements. That decision would set up the maximum volume, length and conditions of participation in the fund. A European debt management entity within the Commission, accountable to the European Parliament, would then manage the fund in accordance with the rules set up by the Council decision.

3.2.4 Eurobills

An important effect of the crisis has been the reassessment of sovereign-credit risk within the euro area. After more than a decade during which Member States could borrow at almost identical conditions, markets started again to differentiate risk premia across countries. Government securities issued by the weaker euro area Member States have been traded at considerably higher yields, with adverse consequences for the sustainability of public finances for the sovereigns concerned as well as for the solvency of the financial institutions holding those government securities as assets. This segmentation of credit risk together with the "home bias" that characterises financial institutions has proved to be a powerful engine of financial fragmentation in the euro area. Banks overexposed to weaker sovereigns find it increasingly difficult to refinance and credit conditions for the private sector have become significantly diverse according to the location of the borrower. At the same time, segmentation of the financial market hinders the transmission of monetary policy and easing at central level does not translate into an appropriate improvement of lending conditions where it would be more warranted.

In light of this situation, there is a strong argument for the creation of a new euro area sovereign instrument. A possible driver for fostering the integration of euro area financial markets and in particular to stabilise volatile government debt markets is so-called eurobills. This common issuance by euro area Member States of short-term government debt with a maturity of up to 1 to 2 years would constitute a powerful tool against the present fragmentation, reducing the negative feedback loop between sovereign and banks, while limiting the moral hazard. Additionally, it would also help restoring the proper transmission

of monetary policy. Eurobills could progressively replace existing short-term debts, and not expand the overall amount of national euro area short-term debt.

These so-called eurobills could contribute to completing European financial markets by creating a large integrated short-term securities market in the euro area. Given the important role of short-term papers for cash management and the short-term nature of bills, these securities typically enjoy a particularly high credit quality. At the same time, the revolving, short-term nature of such bills makes it possible to adjust the funding schemes quickly to national fiscal behaviour, thereby setting incentives for fiscal discipline.

The common issuance would strengthen financial stability insofar as it would ensure a ready supply of short-term liquidity for all euro area Member States. It would also create a pool of safe assets across the euro area, which would greatly facilitate the liquidity management of financial institutions and thereby reduce their often strong home bias, which proved very detrimental in crisis situations. The eurobills would also help greatly for the conduct of monetary policy in the euro area, as the transmission channels would be strengthened and harmonised. Eurobills would thereby be fully compatible and complementary to the concept of a redemption fund.

Due to their character as financial instruments requiring joint and several guarantees by the participating Member States, changes to the Treaties would be required to allow these instruments to be developed. Eurobills are not a substitute for improved economic governance and fiscal discipline. The implementation of such a common debt instrument would require a closer coordination and supervision of Member States' debt management in order to ensure sustainable and efficient national budgetary policies. This monitoring and managing function could be provided by an EMU Treasury within the Commission.

3.3 A longer-term vision for EMU

In the longer term, the European Union should move towards a full banking union, a full fiscal union, a full economic union, which all require, as a fourth element, appropriate democratic legitimacy and accountability of decision-making. Major Treaty reform will be required on this path.

3.3.1 Full banking union

Over the longer term, the logic of aiming for a full banking union for all banks is compelling. The direct supervision by the ECB applying the single Rulebook and the standards developed by EBA ensure a consistently high quality of supervision across the euro area. In combination with euro area level macro-prudential policy tools, there will be an effective system to monitor and contain both micro- and macro-prudential risks in the financial system.

That system and a common system for banking resolution, combined with effective and solid deposit guarantee schemes in all Member States, will lastingly place the banking sector back

on a solid footing and contribute to keeping up confidence in the sustainable stability of the euro area. To maximise public trust, there will also need to be a credible and powerful financial backstop. That could ultimately be facilitated by the development of a euro area safe asset.

Combining all these elements, a full banking union is a key part of a long-term vision for economic and fiscal integration.²¹

3.3.2 Full fiscal and economic union

Arriving at a full fiscal and economic union would be the final stage in EMU. As a final destination, it would involve a political union with adequate pooling of sovereignty with a central budget as its own fiscal capacity and a means of imposing budgetary and economic decisions on its members, under specific and well-defined circumstances. How large this central budget would be will depend on the depth of integration desired and on the willingness to enact accompanying political changes. Such a deep degree of integration would have created the conditions for a common issuance of debt through Stability Bonds as set out in the Commission's 2011 Green Paper.

The absence of a central budget with a stabilisation function has long been identified as a potential weakness of the euro area in comparison with other successful monetary unions.

Central Budget providing for a fiscal capacity with a stabilisation function

The current EMU architecture relies on decentralised national fiscal policies under a rules-based framework. The stabilisation function of fiscal policy in this setting is expected to be already exerted at national level, within the limits of the rules of the Treaty and the SGP. Indeed, a traditional view of EMU arrangements assigns to national fiscal policies the task of responding to country-specific shocks, and to monetary policy the task of ensuring price stability and in so doing stabilise EMU-wide macroeconomic conditions. Moreover, national automatic stabilisers carry a significant potential for stabilisation in EMU countries, given the relatively large size of welfare states.

Building on the fiscal capacity, an EMU-level stabilisation tool to support adjustment to asymmetric shocks, facilitating stronger economic integration and convergence and avoiding the setting up of long-term transfer flows, could become a component for a genuine EMU. Such a mechanism would need to be strictly targeted to address short-term asymmetries and

²¹ See Commission Communication titled "A Roadmap towards a Banking Union" outlining the Commission's overall vision for rolling out the banking union, covering the single rulebook, common deposit protection and a single bank resolution mechanism", COM(2012)510, http://ec.europa.eu/internal_market/finances/docs/committees/reform/20120912-com-2012-510_en.pdf

cyclical developments in order to avoid permanent transfers over the cycle. It must be supportive of structural reforms and be subject to strict political conditionality to avoid moral hazard.

A common instrument dedicated to macroeconomic stabilisation could provide an insurance system whereby risks of economic shocks are pooled across member states, thereby reducing the fluctuations in national incomes. Second, it may help improve the conduct of national fiscal policies throughout the cycle. In particular, it may encourage fiscal retrenchment during economic booms, while providing additional room for manoeuvre for a supportive fiscal stance in downturns. Overall, a shared instrument could deliver net gains in stabilising power, as compared with current arrangements.

Depending on the design, the mechanism could focus on asymmetric shocks or also comprise shocks that are common to the euro area. However, this second approach, while more encompassing, would require strong safeguards to maintain fiscal credibility, as increased stabilisation power against common unfavourable shocks could only be obtained by effectively increasing the total borrowing flow of the euro area in these periods, and thus would have to be financed by higher surpluses in good times. Under this approach, the central budget should probably be given the capacity to borrow and issue bonds. Moreover, monetary policy would still remain the primary instrument to address common shocks.

In its simplest formulation, a stabilisation scheme to stabilise asymmetric shocks could require monetary net payments that are negative in good times and positive in bad times. For example, a simple scheme would determine net contributions/payments of countries as a function of their output gap (relative to the average). No further requirements would be made on the use of the payments received from the fund.

Alternatively, schemes may require that the payments from the fund be earmarked for a defined purpose, with counter-cyclical effects (as e.g. in the US unemployment benefit system where a federal fund reimburses 50% of the unemployment benefits exceeding standard duration up to a given maximum, conditional on unemployment being at a certain level and rising). While earmarking transfers might enhance stabilisation properties, the risk that governments offset the impact of the transfers via fiscal measures with opposite effects cannot be fully prevented.

Schemes should operate in such a way to avoid “permanent transfers” across countries. In other words, they should be designed in such a way to avoid that, over a too long period of time, any country is a net loser or gainer from the scheme. A necessary condition is that cross-country differences in net transfers to the scheme do not depend on absolute income differences but rather on differences in cyclical positions. Income level differences may persist over decades, while relative cyclical positions are likely to change sign in the course of a decade. There is a trade-off between the extent to which transfers are obliged to be

temporary and the degree to which asymmetric long-lasting demand shocks (e.g. capital outflows cum deleveraging) could be addressed.²²

Institutional considerations

Treaty amendments providing the legal bases for such a fiscal capacity with a stabilisation function could, inter alia:

- create a new explicit legal basis allowing to set up a fund serving objectives more broadly defined than is currently possible under Article 136 TFEU, including for macroeconomic stabilisation purposes;
- create a corresponding, dedicated budgetary and own resources procedure;
- create a new taxation power at the EU level, or a power to raise revenue by indebting itself on the markets (presently barred by Articles 310 and 311 TFEU);
- provide for an EMU Treasury within the Commission;
- and finally if wished, allow other Member States to freely opt in to such a fiscal capacity, as a step in preparing their joining the euro area.

Attaining a deep and genuine EMU involves incremental measures, building on what would have been achieved over the short and the medium-term and introducing further integration on a step-by-step, policy-by-policy basis. In this way deeper economic and budgetary policy coordination accompanied by financial support instruments for implementing jointly agreed policy priorities could eventually be followed by the emergence of a central budget with common stabilisation mechanisms, by the integration of the ESM into the EU Treaty framework and by steps towards the mutualisation of issuance of sovereign debt between the Member States.

The progress towards a deep and genuine EMU would over the medium term necessitate a structure akin to an EMU Treasury within the Commission to organise the shared policies undertaken with the common fiscal capacity to the extent that they imply common resources and/or common borrowing. Such a Treasury would embody the new budgetary authority and manage the joint resources. It would need to be headed by a senior member of the Commission such as the Vice President responsible for Economic and Monetary Affairs and the euro, in appropriate coordination with the Budget Commissioner, and supported by appropriate collegiate structures.

²² Some existing analyses assess econometrically the contribution of existing transfer schemes available in federal states on the absorption of asymmetric shocks. For example, estimates on the stabilisation capacity of transfers across US States vary from 10% to 30% of the shock offset by the transfer for the US.

While it would not be excluded to integrate the ESM into the EU framework under the current Treaties, via a decision pursuant to Article 352 TFEU and an amendment to the EU's own resources decision, it appears that, given the political and financial importance of such a step and the legal adaptations required, that avenue would not necessarily be less cumbersome than operating an integration of the ESM through a change to the EU Treaties. The latter would also allow the establishment of tailor-made decision-making procedures.

All the different steps mentioned above imply a higher degree of transfers of sovereignty, hence responsibility at the European level. This process should be accompanied by steps towards political integration, to ensure strengthened democratic legitimacy, accountability and scrutiny.

4. Political Union: Democratic legitimacy and accountability as well as enhanced governance in a deep and genuine EMU

4.1. General principles

Any work on democratic legitimacy as a cornerstone of a genuine EMU needs to be based on two basic principles. First, in multilevel governance systems, accountability should be ensured at that level where the respective executive decision is taken, whilst taking due account of the level where the decision has an impact. Second, in developing EMU as in European integration generally, the level of democratic legitimacy always needs to remain commensurate with the degree of transfer of sovereignty from Member States to the European level. This holds true for new powers on budgetary surveillance and economic policy as much as for new EU rules on solidarity between Member States. Briefly put: Further financial mutualisation requires commensurate political integration. This section sets out preliminary and non-exhaustive avenues for further work.

It follows from the first principle that it is the European Parliament that primarily needs to ensure democratic accountability for any decisions taken at EU level, in particular by the Commission. A further strengthened role of EU institutions will therefore have to be accompanied with a commensurate involvement of the European Parliament in the EU procedures. At the same time, whatever the final design of EMU, the role of national parliaments will always remain crucial in ensuring legitimacy of Member States' action in the European Council and the Council but especially of the conduct of national budgetary and economic policies even if more closely coordinated by the EU. Cooperation between the European Parliament and national parliaments is also valuable: it builds up mutual understanding and common ownership for EMU as a multilevel governance system; concrete steps to further improve it, in accordance with Protocol N° 1 of the EU Treaties and Article 13 of the TSCG, are thus welcome. Interparliamentary cooperation as such does not, however, ensure democratic legitimacy for EU decisions. That requires a parliamentary assembly representatively composed in which votes can be taken. The European Parliament, and only it, is that assembly for the EU and hence for the euro.

The maxim of ensuring a legitimacy level commensurate to sovereignty transfers and solidarity within a political Union leads to two general considerations.

First, the issue of accountability arises in fundamentally different ways as regards short-term action, which can be undertaken through EU secondary law, and the further stages which involve Treaty change. The Lisbon Treaty has perfected the EU's unique model of supranational democracy, and in principle set an appropriate level of democratic legitimacy in regard of today's EU competences. Hence, as long as EMU can be further developed on this Treaty basis, it would be inaccurate to suggest that insurmountable accountability problems exist. Conversely, discussions on medium and long-term Treaty amendments as

envisaged in sections 3.2 and 3.3 will need to include reflections on adaptations to the EU's model of democratic legitimacy.

Second, serious accountability and governance issues would however arise if intergovernmental action of the euro area were significantly expanded beyond the current state of play. This would in particular be the case if such action were used to influence the conduct of Member States' economic policies. Such an avenue would first raise problems of compatibility with the EU's primary law in this area. As confirmed by the Court of Justice, the Treaty attributes the task of coordination of the Member States' economic policies to the Union; the ESM is in line with the Treaties precisely because its object is not to achieve such coordination but to provide a financing mechanism and because it contains express provisions by virtue of which the conditionality foreseen by the ESM Treaty - which is not an instrument of economic policy coordination - ensure that the ESM's activities are compatible with EU law and the EU's coordination measures. Moreover, intergovernmental action could entrust only limited tasks to the Union's institutions, such as the Commission and the ECB, which may be tasks of coordination of a collective action or management of financial assistance, to be exercised on behalf of the Member States and which must not denature the functions attributed to those institutions under the Treaties.²³ In any event, one fails to see how parliamentary accountability could be organised for an intergovernmental European level seeking to influence economic policies of individual euro area Member States.

To the extent that a need arises for reinforced governance structures in a deepened EMU, these should therefore be devised, with efficiency and legitimacy, as part of the Union's institutional framework and in line with the Community method.

4.2 Optimising accountability and governance in the short term

Bearing in mind the above principles, the discussion on how to ensure optimal democratic accountability and governance without Treaty change should focus on practical measures, in particular those designed to foster parliamentary debate in the European Semester.

The starting point in this respect should be the Economic Dialogue which has been recently set up by the six-pack and which provides for discussions between the European Parliament, on the one hand, and the Council, the Commission, the European Council and the Eurogroup on the other hand. Thus, one could foresee the involvement of the Parliament in the discussions on the Commission's Annual Growth Survey and that, in particular, that two debates in Parliament be held at key moments of the European Semester, namely before the European Council discusses the Commission's Annual Growth Survey and before the adoption by the Council of the country-specific recommendations (CSRs). This could be achieved through an inter-institutional agreement between the European Parliament, the Council and the Commission. The Commission and the Council could also be present at

²³ See the judgment in Case C-370/12, Pringle, at points 109 – 111 and 158 - 162.

inter-parliamentary meetings to be held between representatives of the European Parliament and of national parliaments during the European Semester. Moreover, to facilitate the task of national parliaments, members of the Commission could attend debates within such parliaments, on their request, on the EU's CSRs.

The application of the comply-or-explain principle, according to which the Council is publicly accountable (in practice mainly to the European Parliament) for any changes it introduces to the Commission's economic surveillance proposals, such as the CSRs, should be reinforced in practice.

In a deepened EMU, the Parliament should also be more directly involved in the choice of the multiannual priorities of the Union as expressed by the Integrated Guidelines of the Council (Broad Economic Policy Guidelines and Employment Guidelines).

The European Parliament should be regularly informed of the preparation and implementation of the adjustment programmes concerning Member States receiving financial assistance, as foreseen in the two-pack. It should be underlined that this economic policy conditionality vis-à-vis the Member States concerned is framed by the economic policy coordination pursued within the EU framework.

Furthermore, the European Parliament has the possibility of adapting its internal organisation to a stronger EMU. For instance, it could set up a special committee on euro matters in charge of any scrutiny and decision-making pertaining especially to the euro area.

Similarly, some further practical measures can still be taken without Treaty change to improve the functioning of the Euro Group and its preparatory instance, in line with the euro area summit statement of 26 October 2011.

Finally, and without this being a point specific to EMU, a number of steps of significant importance can be taken to foster the emergence of a genuine European political sphere. This includes, in the context of the European elections of 2014, most importantly the nomination of candidates for the office of Commission President by political parties, as well as a number of pragmatic steps that are possible under current EU electoral law. Moreover, the proposal recently tabled by the Commission for a revised statute for European political parties should be rapidly adopted.

4.3 Issues for discussion in case of Treaty amendment

In the context of a Treaty reform conferring further supranational powers to the EU level, the following steps should be considered to ensure a commensurately stronger democratic accountability:

First, for the sake of visibility, transparency and legitimacy, the current Broad Economic Policy Guidelines and Employment Guidelines (currently presented together as "integrated guidelines" but based on two distinct legal bases) should be merged into one single instrument expressing the Union's multiannual priorities, and crucially, that instrument should be adopted through the ordinary legislative procedure providing for co-decision by the European Parliament and the Council.

Second, to be appropriately legitimised, a new power of requiring a revision of a national budget in line with European commitments, if considered necessary, could be taken as a legislative act by co-decision. This solution, ensuring maximum democratic legitimacy, is justified given that Member States' annual budgets are also adopted by their parliaments, usually with legislative character. To ensure speedy decision-making, a Treaty amendment should create a new special legislative procedure consisting of only one reading.

Integration of the ESM into the EU framework, as called for in this blueprint, would allow it to become subject to proper scrutiny by the European Parliament.

Institutional adaptations might also be considered:

A "euro committee" established within the European Parliament could also be granted certain special decision-making powers beyond those assigned to other committees, e.g. a greater weight in the preparatory parliamentary stages or even a possibility to perform certain functions or take certain acts in lieu of the plenary.

Within the Commission, any steps designed to reinforce even further than today²⁴ the position of the Vice President for Economic and Monetary Affairs and the euro, would require adaptations to the collegiality principle and, hence, treaty changes. They could be contemplated in the long run to allow for political direction and enhanced democratic accountability of a structure akin to an EMU Treasury within the Commission. In this context, a special relationship of confidence and scrutiny between the Vice President for Economic and Monetary Affairs and a "euro committee" of the European Parliament could be

²⁴ It should be recalled that, in October and November 2011, the position of the Commissioner for Economic and Monetary Affairs was already significantly strengthened by several acts adopted within the limits set by the current Treaty rules, in order to guarantee the independence, objectivity and efficiency in the exercise of the Commission's responsibilities of coordination, surveillance and enforcement in the area of the economic governance of the Union and of the euro area. In particular, following an amendment to the Commission's Rules of procedure, Commission decisions in this area are adopted upon a proposal from the Vice-President responsible for Economic and Monetary Affairs and the euro by a special written procedure allowing for a more objective and effective decision-making. The Vice-President is also empowered to adopt, acting in agreement with the President, decisions on behalf of the Commission in several areas relating to the 'six-pack' and in relation to economic adjustment programmes in the framework of the EFSM, EFSF and ESM. Finally, all Commission initiatives which have a potential impact on growth, competitiveness or economic stability require the prior consultation of the Vice-President's services.

created. Their design should however be carefully pondered. The collegiality principle applies to decisions across all policy areas for which the Commission has competence, from competition to cohesion policy. It stands for a system of collective internal checks and balances which contributes to improving the legitimacy of the Commission's action.

Sometimes a call is also made to strengthen the Euro Group further by making it responsible for decisions concerning the euro area and its Member States. This would require Treaty change, since the purely informal character of the Euro Group as set out in Protocol n° 14 implies a mere forum for discussions without decision-making powers. That said, the current Treaties, in Articles 136 and 138 TFEU, have already created the model of the Council adopting decisions with only its euro area members voting. In this blueprint, the Commission makes the case for creating further Treaty legal bases following this model. The main practical difference between it, and a Euro Group endowed with decision-making powers, would be that, in the second case, delegates from non-euro area Member States would be excluded not only from voting but also from deliberations and from preparatory work carried out at instances below the ministers' meetings. That would however be undesirable in the Commission's view, since it would in reality lead to building up a "euro area Council" as a separate institution without adequately taking into account the convergence between existing and future members of the euro area.

Furthermore, a specific point to be addressed by Treaty change would be to strengthen democratic accountability over the ECB insofar as it acts as a banking supervisor, in particular by allowing normal budgetary control by the European Parliament over that activity. At the same time, Article 127 paragraph 6 TFEU could be amended to make the ordinary legislative procedure applicable and to eliminate some of the legal constraints it currently places on the design of the SSM (e.g. enshrine a direct and irrevocable opt-in by non-euro area Member States to the SSM, beyond the model of "close cooperation", grant non-euro area Member States participating in the SSM fully equal rights in the ECB's decision-making, and go even further in the internal separation of decision-making on monetary policy and on supervision). A Treaty change creating a special status for Agencies in the field of financial regulation, strengthening the supranational character of these Agencies, and their democratic accountability could also be considered. Not only would this very significantly enhance the effectiveness of the ESAs, but it would significantly facilitate the establishment and working of the Single Resolution Mechanism to be created.

A further way of strengthening the EU's legitimacy would also be to extend the competences of the Court of Justice, i.e. by deleting Art. 126 paragraph 10 TFEU and thus admitting infringement proceedings for Member States or by creating new, special competences and procedures, although one should not forget that some of the issues do not lend themselves to full judicial review.

If a Treaty reform were to extend beyond EMU matters, it should include the objective of generalising the ordinary legislative procedure, i.e. making applicable co-decision by the

European Parliament and the Council, voting by qualified majority, instead of the currently remaining instances where special legislative procedures apply.

Finally, special challenges to ensure appropriate democratic accountability would arise in case the Treaty is changed to permit the mutualisation of the issuance of sovereign debt underpinned by a joint and several guarantee of all euro area Member States. The underlying accountability problem is that such a joint and several guarantee, if claimed by creditors, may result in considerable financial burden for one individual Member State's finances, for which that Member State's parliament is accountable, although the burden is the result of policy decisions that have been made over time by one or several other Member States under the responsibility of their parliaments. As long as the EU level is not granted very far-reaching powers to determine economic policy in the euro area and the European Parliament is not responsible for deciding on the resources of a substantial central budget either, this fundamental accountability problem cannot be overcome simply by entrusting the management of mutualised sovereign debt to an EU executive even if it is accountable to the European Parliament.

In contrast, that problem would no longer arise in a full fiscal and economic union which would itself dispose of a substantial central budget, the resources for which would be derived, in due part, from a targeted, autonomous power of taxation and from the possibility to issue the EU's own sovereign debt, concomitant with a large-scale pooling of sovereignty over the conduct of economic policy at EU level. The European Parliament would then have reinforced powers to co-legislate on such autonomous taxation and provide the necessary democratic scrutiny for all decisions taken by the EU's executive. Member States would not be jointly and severally liable for each other's sovereign debt but at most for that of the EU.

If the Treaty were changed so as to allow, as an intermediate step, the issuance of short-term eurobills, combined with reinforced powers of economic governance, an accountability model resting both on the EU and national levels would have to be devised. The European Parliament would provide the necessary accountability for decisions of management of the eurobills to be taken by an EMU Treasury within the Commission. However, there should also be Council decisions, adopted by unanimity of the euro area Member States with the consent of the European Parliament, on the first establishment and subsequent periodic renewal of the eurobills scheme. Member States could provide, within their national constitutional systems, the degree of accountability through their national parliaments that they deem necessary for consenting to these establishment and renewal decisions.

The proposal for a debt redemption fund raises accountability issues of a distinct nature. To design a model ensuring appropriate accountability for a DRF would presuppose that its legal basis can be framed with great legal precision, as regards the maximum transferrable debt, the maximum time of operation and all other features, to guarantee the legal certainty required under national constitutional laws. If this could be ensured, then a new Treaty legal base might be imagined that would allow the setting up of the fund through a decision of the Council, adopted by unanimity of the euro area Member States with the consent of the

European Parliament, and subject to ratification by Member States under their constitutional requirements. That decision would set up the maximum volume, duration and precise conditions of participation in the fund. The Commission, accountable to the European Parliament, would then manage the fund in accordance with the precise rules set up by the Council decision.

ANNEX 1: The Convergence and Competitiveness Instrument

Steps towards a genuine EMU in the area of economic policy coordination should build on the current system while further reinforcing the process. National ownership of the reforms in this setup would be key, as well as a gradual increase in the intrusiveness of euro area-level guidance when Member States fail to take appropriate action. Larger spillover effects within the currency union call for such a more stringent process of economic policy coordination for euro area Member States. On the basis of the current Treaties, the legislator could therefore set up an integrated framework for the surveillance of economic policies consisting of two elements: 1) a mechanism for systematic ex ante coordination of all major reform projects of Member States in the context of the European Semester, envisaged in Article 11 of the TSCG. 2) A Convergence and Competitiveness Instrument (CCI) in the framework of the Macroeconomic Imbalances Procedure (MIP) based on contractual arrangements between Commission and euro area Member States coupled with the possibility of financial support.

This framework would complement the MIP and the existing framework for the surveillance of the budgetary situation of the Member States (the SGP). Its objective would be twofold: first it would reinforce the existing procedures in particular by strengthening ex ante coordination of major economic reforms; second, it would strengthen the dialogue with the euro area Member States to enhance national ownership through the introduction of contractual arrangements to be concluded between the Commission and Member States. It would be coupled by a dedicated system of financial support, representing the initial phase of the build-up of a fiscal capacity for the EMU. The contractual arrangements together with the financial support would be bundled into a CCI for the EMU.

The Commission will in forthcoming proposals set out the precise terms both for the mechanism for ex ante reform coordination and the CCI, which is based on contractual arrangements with financial support. The Commission proposals will also aim to streamline the existing procedures that have been created over the time (European Semester, National Reform Programmes, MIP etc.).

The envisaged process would develop as follows:

The innovations to the European Semester would consist of the introduction of a systematic ex ante coordination of major economic reforms; stronger dialogue with the Member States; the introduction of contractual arrangements to be agreed by the Commission and euro area Member States; and financial support attached to the implementation of the contractual arrangements.

1. The Commission publishes the AGS and a proposal for integrated guidelines: Broad Economic Policy Guidelines (BEPGs) and Employment Guidelines (EGs). These would set out the priorities and objectives (quantified or not) for the coming year both for the policies of the Member States and for the EU level. The EU-level measures could include concrete proposals where the co-legislators would need to act once agreed and launched. The European Parliament would be consulted (this is currently obligatory only for the EGs; a political agreement would be concluded to consult the EP on the whole guidelines package). In parallel, the Commission presents the Alert Mechanism Report, which identifies Member States that are considered to be affected by imbalances and which will then be subject to an in-depth review (to assess whether those imbalances exist and if so, whether they are excessive).
2. On the basis of this guidance, each euro area Member State submits a National Reform Programme, a single document containing proposals for policy measures central to improving its growth and competitiveness, and a Stability Programme which presents its fiscal plans for the medium term.
3. The Commission assesses the programmes and presents its evaluation in a series of Staff Working Documents which also highlight remaining challenges. These documents would be published earlier than currently to enable a dialogue on the analysis. In parallel, the Commission writes a horizontal appraisal of the proposed major economic reforms in the euro area countries. This horizontal document and its conclusions are discussed in the Euro Group and the ECOFIN Council in view of systematically coordinating ex ante the major reform plans.
4. After this, the Commission comes forward with a proposal for country-specific recommendations (CSRs) setting out the specific policy measures agreed as well as the envisioned timeframe for implementation. In parallel, the Commission presents for the Member States with excessive imbalances a recommendation establishing the existence of such an excessive imbalance and recommending that the concerned Member States take corrective action. Thanks to the process of informal dialogue on the policy analysis, country-specific recommendations will be more detailed, policy-specific and time bound. The country-specific recommendations would focus on a small number of key elements related to growth and adjustment weaknesses in the Member State concerned. This increased focus and specificity could give a greater impetus to reform efforts in Member States.
5. After the adoption of the country-specific recommendations including the MIP recommendations by the Council, Member States under the preventive and corrective arm of the MIP submit (on a voluntary basis for the former and on a mandatory basis for the latter) a contractual arrangement proposal including specific policy action they

intend to implement and a timetable for those actions, based on the aforementioned recommendations. For Member States under the corrective arm of the MIP, the Corrective Action Plan would correspond to the contractual arrangements to be set up with the Commission. For Member States under the preventive arm of the MIP, the contractual arrangements would consist of an action plan similar to that required under the corrective arm.

For Member States under the corrective arm, the negotiation of the contractual arrangements corresponds to the approval of the Corrective Action Plan, so Articles 8 to 12 of Regulation 1176/2011 apply.

For Member States under the preventive arm, a similar procedure and deadlines should also apply, including on the monitoring and assessment of the implementation of the measures foreseen in the contractual arrangements. However, sanctions are not applicable.

Each year, the Member States would report on the progress in implementation of their contractual arrangements in their National Reform Programmes.

6. The contractual arrangements would be accompanied by financial support. They would be related to the CSRs emanating from the MIP, which focus on strengthening Member States' adjustment capacity and competitiveness, i.e. areas where reforms would lead to large positive spillover effects to other Member States and hence are necessary to ensure a smooth functioning of EMU.

The financial support would consist in a lump sum to be attributed per contractual arrangement, not earmarked to specific reforms. The definition and use of the amounts involved and of the disbursement (which can involve more than one tranche) will depend on the conditionality (measures/reforms to be implemented by the Member States) and should be also specified in the contractual arrangements.

In addition to the sanctions and underlying procedure applicable to Member States under the corrective arm (as envisaged by regulation 1174/2011), contractual arrangements could then be enforceable in that the Commission can issue warnings (by the use of 121.4 TFEU) if a Member State does not meet the contractual arrangements. These warnings, which the Commission can issue autonomously, could include a call for Member States to correct the deviation, including a timeline. When this is not met, the financial support can be withheld.

The financial support will be financed by a special fund/financial instrument, as mentioned in the main text. Euro area Member States will be required to contribute to that fund, based on a contribution key dependent on GNI.

When the Commission presents its proposal on reinforcing and streamlining the existing procedures, it will also address the risks of potential unintended consequences of introducing such financial support, such as moral hazard (e.g. rewarding relatively poor performers) and deadweight losses (reforms that would anyway have been implemented even without additional incentive).

ANNEX 2: External representation of the euro area

The progress that will be agreed on further integration will have to be reflected externally, notably through progress towards united external economic representation of the EU and of the euro area in particular. A strengthened voice of the Economic and Monetary Union is an integral part of the current efforts to improve the economic governance of the euro area.

One of the key lessons of the crisis is that, when faced with a global shock for which a collective response is needed, it is the size of the euro area that matters in influencing the type of policy responses that will be taken in international financial institutions and fora. Over the past few years, the Union, especially because of the euro, has become the natural counterpart of major economic powers when global growth, financial assistance or financial regulation are discussed. However, because of the current fragmentation of its representation in international financial institutions and fora, the euro area does not have an influence and leadership commensurate to its economic weight.

The efforts to strengthen the economic governance of the euro area need to be accompanied by a move towards a more unified and coherent external representation of the euro area in order to be fully effective. Such a step should mirror the significant strengthening taking place in the internal economic governance.

The external representation of the euro area²⁵ should be strengthened to allow it to play a more active role both in multilateral institutions and fora as well as in bilateral dialogues with strategic partners. This should result in delivering a single message on issues such as economic and fiscal policy, macroeconomic surveillance, exchange rate policies, and financial stability.

To achieve these objectives will require agreement on a roadmap aimed at streamlining and unifying the external representation of the euro area in international economic and financial organisations and fora.

The focus should be on the IMF, which through its lending instruments and surveillance is a key institutional pillar in global economic governance. At the moment, the 17 euro area Member States are spread across eight constituencies and chairs and have up to five Executive Directors. Currently, the presence of Union institutions in the IMF is very limited. The European Central Bank is an observer on the IMF Executive Board and the IMFC. The European Commission only has observer status at the IMFC.

Article 138 (2) TFEU foresees the adoption of appropriate measures to ensure unified representation within international financial institutions and conferences. The objective

²⁵ I.E., the EU representing the euro area Member States in accordance with the Treaties.

underlying this Treaty article was to achieve a stronger and unified representation of the Union for the euro area Member States in such institutions and conferences, given that the effectiveness of the current informal arrangements for representing the euro area was deemed unsatisfactory.²⁶

It is necessary to step up the euro area coordination infrastructure in Brussels and in Washington. The euro area coordination process should be improved, and Member States should follow common messages on a compulsory basis. Constituencies should be rearranged so as to re-group countries into euro area constituencies for the IMF which could also include future euro area Member States. In parallel, an observer status in the IMF Executive Board should be sought for the euro area. This requires negotiations with the IMF. Euro area members share a single currency, a single monetary and exchange rate policy, and the management of members' external reserves by the European System of Central Banks. The recent changes in euro area governance have fundamentally changed the way fiscal and economic policies are coordinated at European level. In euro area matters, the European Commission has become a natural interlocutor of the IMF. In addition, more recently, the Commission and the ECB have worked closely together with the IMF in negotiating the financial assistance packages for euro area and EU Members and by collaborating in general with the Fund on surveillance. Against this background, conferring observer status on the euro area, represented by the European Commission with the European Central Bank being associated in the area of monetary policy, is essential to increase the synergies of the cooperation between the IMF and the institutions that are at the core of the daily management of the euro area.

To reach the longer-term aim of a single seat of the euro area in the IMF, one should envisage a gradual approach that would allow all actors involved to make the necessary institutional arrangements to accommodate a single euro area seat.

In terms of concrete steps forward, the European Commission:

- will submit a roadmap with steps for consolidating the euro area representation in the IMF over time into a single seat.
- will in due course make formal proposals under Article 138 (2) TFEU to establish a unified position to achieve an observer status of the euro area in the IMF for an observer status in the IMF executive board, and subsequently for a single seat.
- will put forward a proposal for improving the coordination amongst Member States on IMF issues related to EMU.

²⁶ See also Final Report of the European Convention's Working Group VI on Economic Governance, WG VI 17, 21.10.2002, p. 8. Cf. equally Final Report of Working Group VII on External Action, WG VII 17, 16.12.2002, pt. 66.

- Will consider making use of the possibilities under Art. 138 (1) TFEU to propose common positions on matters of particular interest for economic and monetary union within the competent international financial institutions and conferences.
- will foster further the representation of the euro area in the context of bilateral relations with major economic partners. The setting of the discussions with China on macroeconomic and exchange rate issues (which are dealt with by a euro area delegation²⁷), could serve as a model.

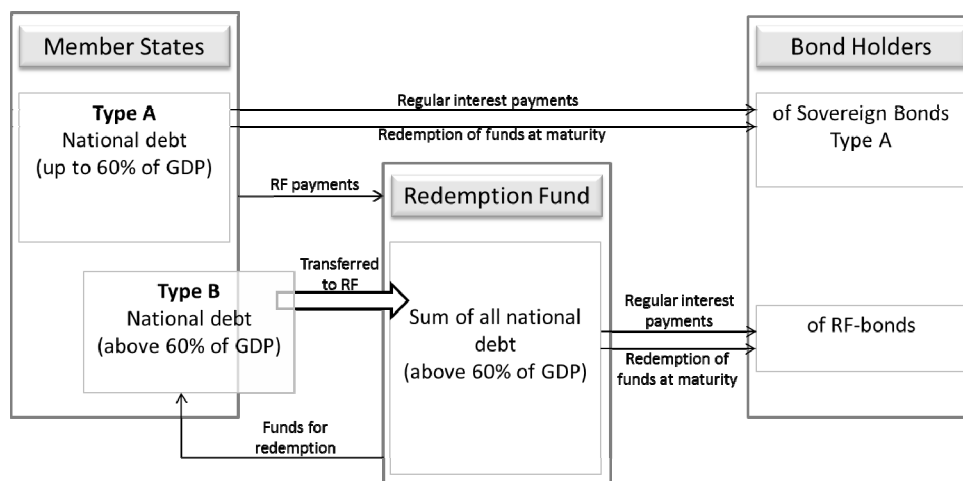
²⁷ This delegation is composed by the Commissioner for Economic and Monetary Affairs accompanied by the President of the Eurogroup and the president of the European Central Bank

ANNEX 3: A European Redemption Fund

The concept of the Redemption Fund (RF) was first presented in 2011 by the German Council of Economic Experts. The key idea of the RF is to provide a framework for bringing the euro area Member States' public debt to sustainable levels by lowering their overall financing costs in exchange for additional commitments to fiscal governance.

As a basic approach, the Member States' public debt would be divided into two parts: (1) one part is equivalent to 60% of GDP, which is the threshold stipulated by the Stability and Growth Pact; this part would remain each single Member State's responsibility; and (2) a part consisting of public debt above the 60% of GDP threshold, which would be transferred and pooled into a RF, and therefore be owned by the RF, though Member States would be obliged to autonomously redeem the transferred debt over a special period of time (e.g. 25 years). The RF would finance itself by issuing its own bonds, which would be serviced on a pooled basis by all participating Member States. In order to make these RF bonds attractive and marketable, investors would need sufficiently strong assurances about their credit quality. Therefore, the RF bonds would ideally be backed by a joint and several guarantee of all euro area Member States. The joint and several guarantees on RF bonds would result in a relatively low cost of financing for participating Member States thereby easing their overall debt-servicing burden. The repayment schedule for every Member State will have to be precisely specified and follow a transparent calculation key specifying the type of instalments (equal over time, or dependent on the economic situation, e.g. as a percentage of GDP, which would adapt the annual payments to the economic cycle). The scheme of this framework is depicted in Figure 1.

Figure 1: Scheme of the European Redemption Fund



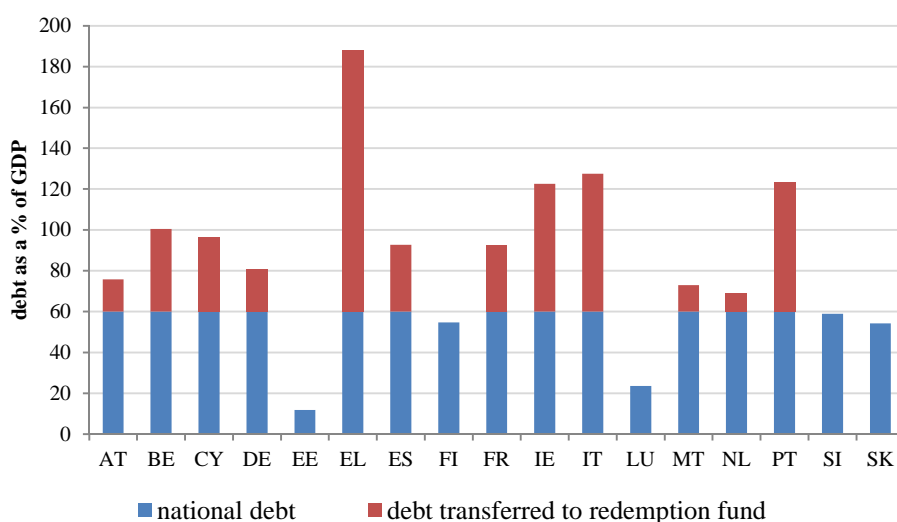
A problem of moral hazard is inherent to the RF approach, as the joint and several guarantee and ensuing lower financing costs for Member States could create unintended incentives for incurring further debt. This risk of moral hazard would need to be addressed by additional commitments by Member States in the area of economic governance. As a pre-condition for participating in the RF, a path for budgetary consolidation and structural reform would be laid down for each Member State, which would oblige the Member State to redeem autonomously the transferred debt over a certain period. Consolidation and reform agreements are a crucial condition of credibility and could include: (i) earmarking of tax revenue specifically for payment obligations to the redemption fund, (ii) depositing collateral,

(iii) mandatory commitment to previously agreed structural reforms and consolidation measures. In case of non-compliance, the transfer of national debt to the redemption fund could be immediately stopped.

From a practical point of view, the redemptions of maturing debt and new financing needs of participating Member States would be financed with the money received from the sale of RF bonds²⁸ until the transferred liabilities reach the agreed amounts. A clear and strict legal framework/contract governing this transfer of debt would be required, which would regulate in particular: (i) the maximum amounts to be transferred²⁹, (ii) the repayment scheme, as well as (iii) the seniority of bonds issued by the RF over national bonds.

As a result of the transfer to the RF, a country's total debt would be divided into two parts - national debt and bonds issued by the RF³⁰ (see Figure 2).

Figure 2: Member States' debt structure under a Redemption Fund scheme



Source: European Commission Autumn 2012 forecast, debt figures forecast for 2013

The establishment of a RF would pose several challenges. Firstly, although the entire euro area would benefit from a decline of sovereign and systemic risk due to reduction of overall debt levels and particularly debt levels in more vulnerable countries, high-credit quality Member States would seem to benefit relatively less from the Fund. Therefore, incentives for participation by these Member States would need to be created. Secondly, as excessive debt would be covered by joint and several guarantees it would be converted into a relatively low-risk asset. Hence, the market-disciplining effect would be substantially weakened. In fact, the disciplining task would be transferred entirely to the co-guarantors. Thirdly, the RF is intended as a way of bringing the debt levels down and Member States should not have incentives to prolong unnecessarily the participation in the RF only to benefit from lower financing costs. Finally, from a market perspective, a limited duration of the scheme would

²⁸ The management of the RF would be entrusted to a dedicated institution to be established under the Treaty, i.e. a European Debt Management entity within the Commission, accountable to the European Parliament.

²⁹ The contract should also specify clearly that the agreed amounts to be transferred are not expandable.

³⁰ The overall size of the RF could reach EUR 3 trillion. Calculation done on the basis of the European Commission Autumn 2012 forecast.

reduce market liquidity towards the end of the scheme. This would put in question the role and use of the commonly issued bonds as a benchmark and also the likelihood of establishing proper derivative markets. After the expiry of the common issuance, the euro area government bond market would be as little integrated as now and none of the potential benefits of common issuance would be achieved.