REFLECTION PAPER

DEEPENING OF THE ECONOMIC AND MONETARY UNION

Contribution to the European Commission reflection paper in the context of its White paper on the Future of Europe

Out of the crisis - a better economic model for Europe

Economic Union that works for you

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INTRODUCTION

The European Commission's reflection papers aim at taking a long-term view. We understand that not everything can be resolved in the short term, and that such a process of reflection can be helpful in preparing the ground for major reforms.

However, Europeans need to see a stronger economic and monetary union emerging right now - both more resilient and more effective in being an engine for sustainable and fairly shared prosperity. Already, past years have been marked by intense reflection on this matter. Clear proposals for reform have been set out, not least in the consecutive Four and Five Presidents' reports, in the European Commission's own communication on steps towards completing EMU, and in several important European Parliament resolutions, the latest of which on the need for a budgetary capacity and a strong European Pillar of Social Rights.[1]

Therefore, we urge the European Commission to take responsibility and to present as soon as possible - and in any case in good time during this parliamentary term - legislative, institutional and financial proposals most of which can already be accomplished within the current limits of the Treaties, in order to complete EMU with necessary social, fiscal and budgetary policy capabilities.

There is no room for complacency or for reform fatigue at time of a rising tide of populism on both sides of the Atlantic. Europe cannot afford to procrastinate but needs to deliver. The existing governance system is not yet strong enough to tackle potential future crises and shocks as it should, nor is it yet sufficiently good at reaching the goal of full quality employment, generating sustainable growth and social cohesion. Action must be taken in order to mitigate negative spillover effects and to bridge the widening economic and social divides within the EU and the Eurozone. The challenge of clarifying the specific relations between the member states of the Euro area also needs to be addressed without waiting for the final result of the Brexit negotiations. Last, but not least, the mutual obligations between euro and non-euro member states should be taken into account, while the EU as well as the non-euro area Members should do their utmost to create the conditions for joining the euro area as soon as possible.

[1] The S&D Group has presented detailed and still relevant proposals for the deepening of EMU in its position paper of April 2015. The Party of European Socialists has formulated detailed proposals in its Presidency declaration of June 2016 and in the conclusions of its high-level working group on EMU.

Without a well-equipped and well-functioning euro area, the EU will not be able to address successfully the many complex challenges of our time. At the heart of these lies the imperative to transform our model of development in line with the COP 21 agreement and the 2030 United Nations Sustainable Development Goals, to which all our Member States did sign up to in 2015.

During the crisis, the Economic and Monetary Union had to confront existential threats due to a combination of inadequate policy decisions, growing divergences within and among the economies of the Member States inside the euro area, ill-designed rules and a lack of critical policy instruments and institutions. This has been widely recognized, and some changes have occurred - such as progress towards a proper banking union, and a somewhat more flexible use of fiscal rules.

However, despite the ambitious plans outlined in the consecutive Four and Five Presidents' reports, and the repeated calls and multiple proposals emanating from the European Parliament, further essential changes have still not even been initiated. Precious time has already been lost. This is particularly alarming in the context of today's unstable and unpredictable global economic and political environment, and at a time of record-low interest rates, of persistent inequalities and high unemployment in a number of Member States, in particular among younger people and among women. The next crisis may be closer than we think, and the EU should speed up the completion of EMU before it could be too late.

The deepening of the economic and monetary union should include:

- **A new policy framework, comprising a revised set of rules governing macro-economic, as well as macro-social, imbalances and budgetary surveillance to meet the multiple challenges of achieving full quality employment, economic and social cohesion, efficient and fair taxation, fiscal soundness, as well as environmental sustainability**
- **A Convergence Code, to be adopted under the ordinary legislative procedure for a five-year period to guide the euro area towards new economic, social and environmental convergence, ensuring a more sustainable and cohesive Europe**

- **A new agenda of future-oriented reforms, in which the economic, environmental, and social dimensions of sustainable development are treated as indivisible and equal**
- **A comprehensive and ambitious sustainable investment strategy combining existing and new instruments and resources**
- **A fiscal capacity to support upward convergence and counter asymmetric and symmetric economic shocks.**
- **The completion of the banking union, including support to an accelerated clean-up of bank balance sheets to improve growth prospects, a credible European deposit insurance scheme and a common fiscal backstop for the Single Resolution Fund**
- **Reinforced democratic ownership, legitimacy, accountability and control based on the Community method, with both a significantly reinforced role for the European Parliament at European level and of national parliaments at Member States' level**
- **An improved European Semester process, including the formalization of the euro area aggregate fiscal stance as a key tool for policy formulation and implementation across EMU.**
- **A Common Corporate Consolidated Tax Base, to ensure that profits are taxed where the economic value is created, and set up a fairer corporate tax system in Europe**

1 A NEW POLICY FRAMEWORK

Economic policy across the euro area must be re-framed in such a way as to effectively deliver multiple and interrelated results in terms of full quality employment, economic and social cohesion, and environmental sustainability. Such results require responsible budget policies and a sustainable growth-supportive fiscal stance. However, such policies are not an end in itself, from which broader policy objectives will simply derive. The euro area must depart from a bad policy equilibrium characterised solely by fiscal austerity, persistently high levels of unemployment, inequality, poverty, economic and social divergences, and insufficient levels of public and private investment. This bad policy equilibrium is politically unacceptable, has a destructive economic and social effect and undermines the public support for the European project.

Instead, we require a policy equilibrium that achieves fiscal sustainability via sustainable growth, social balance and upward convergence within our common currency. Furthermore, as the aggregate fiscal stance communication by the Commission has shown, the overall economic situation of the Eurozone requires countries that run a trade surplus to pursue an active and meaningful investment agenda, especially in the current low interest rate environment. This would contribute to the goal of quality full employment in the euro area.

The new framework must include a revision of the existing set of rules governing budgetary surveillance and macro-economic imbalances. The Commission communication issued in 2015 on making the best use of flexibility in the existing rules of the Stability and Growth Pact already pointed in the right direction in this respect. This must now be taken further. In this regard, the Economic and Monetary Union requires a new set of rules to integrate the budgetary and wider macro-economic, as well as macro-social, dimensions of economic policy-making and coordination. Its aim must be to ensure fiscal responsibility while clearly supporting anti-cyclical fiscal policy stances when justified in specific Member States or at an aggregate level for the euro area as a whole, and stimulating productive sustainable public investment within the COP21 and wider sustainable development framework. This should include the integration of the euro area's social and environmental dimensions into policy-making by giving economic, social and environmental indicators and targets equal importance in the surveillance process and in the related policy recommendations, also with a view to ensuring an adequate level of social investment throughout economic cycles.

The necessary re-convergence of euro area economies should also be taken on board in the policy-making framework. A Convergence Code, adopted under the ordinary legislative procedure for a five-year period, should define a clear path towards economic, social and environmental convergence objectives, including sustainable investment, taxation, employment and de- carbonisation criteria, laid down as being binding for the euro area and between its members, which should be reflected in country-specific recommendations and in the availability of means.

The Convergence Code should promote upward economic, social and environmental convergence towards a sustainable model of. It should reflect the objectives set out in Article 3 TFEU, such as full employment, social progress and a high level of protection and improvement of the quality of the environment, which should also guide the formulation of an optimal aggregate fiscal stance and a desirable current account position of the euro area.

Furthermore, and to ensure this convergence, the establishment of a fairer European tax system, that taxes profits where the economic value is generated and averts tax avoidance and tax evasion practices, is needed.

Adequate support for Member States implementing reforms under the Convergence Code should be established.

Last, but not least, this new framework must be combined with a new agenda of sustainability- focussed reforms, in which the economic, environmental, and social dimensions of sustainable development are treated as indivisible and equal.

2 ESTABLISH A FISCAL CAPACITY WITHIN THE EURO AREA

It is by now widely recognised, and the current crisis has amply made this point, that the euro area lacks a common policy instrument that would enable it to confront significant economic shocks in such a way as to prevent them from becoming entrenched and excessively damaging, not least in terms of unemployment. As a complement to a renewed economic policy framework, it needs an additional dyke against such shocks, as there will in future inevitably be situations in which shocks cannot be addressed rapidly and effectively enough in the absence of such an instrument.

In line with the European Parliament's recent demand, the European Commission should submit a concrete proposal for a fiscal capacity as soon as possible. The fiscal capacity is to be achieved notably by:

- establishing an instrument inside the EU budget (but outside the MFF ceilings), working with assigned revenue and serving to strengthen structural re-convergence within the euro area,
- linking the participation in the fiscal capacity to the path towards the objectives defined in the above-mentioned Convergence Code,

- converting the European Stability Mechanism (ESM) into a Community institution, which is to function according to the Community method and possessing adequate lending and borrowing capacities;
- laying down a clearly defined mandate to absorb asymmetric and symmetric shocks,
- elements preparing European support for unemployment benefit schemes or a rainy day fund.

The euro area fiscal capacity should be complementary and additional to other existing instruments of the EU budget, such as the Structural and Investment Funds that promote convergence and cohesion in the whole single market. Neither the euro area, nor the single market, can function properly without the relevant mechanisms to address the current imbalances within the EU.

3 A COMPREHENSIVE AND AMBITIOUS SUSTAINABLE INVESTMENT STRATEGY

The euro area, as much as the EU as a whole, faces major immediate as well as longer term challenges. It needs to achieve a profound transformation into a carbon-free and environmentally sound economic system sustaining full quality employment, while strengthening its global competitiveness in this way. It needs to re-build its economic and social cohesion, eliminate poverty, generate full quality employment, reduce inequalities as a whole and support gender equality in particular. The strategy must also be supportive of the need to re-build economic and social convergence across the euro area, and the EU as a whole. This will take many years to achieve, even in the most optimistic of scenarios. In the meantime, citizens need to see positive change already in the short to medium term, in particular through more and better jobs being created, and purchasing powers being secured and improved.

Within the existing economic policy framework, and notwithstanding the contribution of the European Fund for Strategic Investment (EFSI), public and private investments continue to lag dramatically behind the financing needs these challenges require.

As part of the euro area’s deepening, the need for a comprehensive and ambitious sustainable investment strategy should be fully acknowledged and addressed by the

European Commission and the Council, building on the analysis of the annual aggregate fiscal stance. Without such a strategy, the EU and the euro area will fail to respect the COP21 agreement and to achieve the 2030 United Nations Sustainable Development Goals.

The necessary financing of this strategy will need to combine existing and yet-to-be-created instruments and resources. A reinforced and extended EFSI, as well as a new economic policy framework actively conducive to higher levels of productive public investment in national budgets must be among its key elements. The latter should be made possible by ensuring, in particular, that fiscal rules provide for a clearer differentiation in public spending with regard to the quality and importance of public investment spending, which in turn should be taken clear account of when assessing countries' debt and deficit situations. This should build on the existing investment clause foreseen in the Commission's flexibility communication, which should be extended and implemented without the additional constraints introduced by the ECOFIN Council.

However, considering the scale of needs representing around 1% of the EU's GDP in additional public investment alone, new resources need to be brought in, including a more effective European tax framework to end today's massive tax avoidance and evasion practices, to be achieved via corporate tax convergence and enhanced tax transparency, an improved collection of the value added tax through an EU definitive regime in order to fix the current 'VAT gap', new tax revenue sources including a Financial Transactions Tax, own resources based on part on a common consolidated corporate tax, a reinforced EU budget and a European Treasury. In this regard, the discussion of appropriate solutions for the mutualisation of debt and the joint issuance of bonds and their respective conditions have to be brought back to the fore. It should be recalled that the financing needed to achieve the COP21 targets alone is extremely important, having been estimated at some USD 90 trillion over the next 15 years on a global scale. Hence, public investment, though crucial, will not be sufficient. Therefore, private investment will also need to play a key role.

4 COMPLETING THE BANKING UNION

Together, with a fiscal capacity, the completion of the banking union must provide the euro area with a full arsenal of policy instruments in the case of economic turbulences or shocks. The banking union must be completed by a credible European deposit insurance scheme to counter the risk of bank runs and to reduce the sovereign bank link, as well as by a common fiscal backstop for the Single Resolution Fund, to be in place at the latest by 2024, avoiding the risks of contagion and bank-runs as a result of depleted means.

Furthermore, the banking sector remains in need of significant reform, and the remaining problems of very large financial institutions, of the overcapacity of the financial sector, and of curbing shadow banking must be addressed. The reform must ensure that banks actively support the European economy and that they are prevented from taking on excessive risks with depositors' money. A European framework to deal with non-performing loans allowing their transfer to dedicated asset management companies is also required, including by adapting the framework for the implementation of State aid, while ensuring the protection of the tax payer. This should go hand in hand with strengthened insolvency frameworks, and effective supervision that needs to fully integrate sustainable objectives.

5 A DEMOCRATIC INSTITUTIONAL FRAMEWORK

As the euro area's instruments and rules will be extended and strengthened, it is imperative to match this with a corresponding upgrade of democratic legitimacy and control. This primarily concerns the parliamentary dimension of economic governance, but it also means to safeguard the central role of the European Commission in managing the European Semester process, including in the field of budgetary surveillance and of economic policy coordination, while fully recognising the role of national parliaments in the budgetary process. It would be absurd to pursue stronger parliamentary legitimacy of economic governance while weakening the Commission's central responsibilities. This is also why the Community method should prevail in all aspects of a deepened euro area.

As has been called for in the recent EP resolution on the fiscal capacity, the European Parliament and national parliaments should exercise a strengthened role in an enhanced and completed economic governance framework, within their respective spheres of competence. This should include increased national ownership of the European Semester and convergence criteria implementation, and an enhanced Inter-parliamentary cooperation. For improving ownership, national parliaments should - within the framework of EU legislation - fully provide legislative, budgetary and political control functions at national level, just as the EP should do the same at EU and euro area level.

The positions of President of the Eurogroup and Commissioner for Economic and Financial Affairs should be merged, corresponding to a position of Vice-President of the Commission as finance minister. He/She should be fully democratically accountable and should be in charge of the euro area fiscal capacity while keeping the current responsibilities enforcing the economic governance framework and optimising the development of the euro area in cooperation with the Finance Ministers of the euro area Member States.

As far as a significant fiscal capacity shall be established, the European Parliament will need to review its rules and its organisation, to fully ensure its democratic role within this framework, taking into account the need to align euro area fiscal responsibility with decision making powers. The future stronger parliamentary dimension in the European Semester process should be laid down in an Inter-Institutional Agreement on Democratic European Economic Governance.

6 AN IMPROVED EUROPEAN SEMESTER PROCESS

Several additional reforms should complete the preceding changes in order to improve the functioning of the annual European semester process. The already initiated practice of specifying the euro area’s aggregate annual fiscal stance ahead of each year’s Spring European Council should be formalised and duly implemented by the Council.

The content and implementation of the country-specific recommendations at national and regional level, also taking into account the internal market dimension, must be improved, also addressing corporate tax issues, including harmful tax practices and their impact, and for relevant indicators, estimates of the tax gap arising from tax evasion and tax avoidance.

In order to frame the European semester clearly within the new sustainable development agenda, it should promote the inclusion of the circular economy principles and the potential for green employment, thereby taking in due consideration the potential the circular economy and resource efficiency have in terms of increased sustainable growth and job creation.

The common methodology on potential growth and output gap estimation and the current matrix specifying the required annual fiscal adjustment should be significantly improved in order to take fully into account the economic conditions stemming from a prolonged period of low inflation, low growth and high unemployment.

The provision of article 16 of the Fiscal Compact on the incorporation of the substance of the Treaty if implemented, amended in line with above-mentioned proposals, and on the basis of an assessment of the experience with its implementation, should be used to reform our fiscal framework.

Stronger macroeconomic and macro-social coordination should be established through joint ECOFIN/EPSCO, as well as Eurogroup/Social Eurogroup ministerial sessions. A strengthened role of the Environment Ministers in the European Semester is also required, to ensure progress towards the balanced integration of economic, social and environmental dimensions of sustainable development.