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A New Fair Deal for the Eurozone and the EU

Conclusions of the PES High Level Working Group on the EMU

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Introduction

The re-balancing of Europe's economic governance system and the completion of the Economic and Monetary Union (EMU) are crucially important for strengthening the foundations of the whole European Union and for achieving core European objectives of high employment and sustainable well-being. The need to deepen the EMU was highlighted already in late 2012 with the publication of the Commission's Blueprint and the Four Presidents' report '**Towards a Genuine Economic and Monetary Union**'¹ and a new momentum has arisen from the June 2015 Five Presidents' report '**Completing Europe's Economic and Monetary Union**'.²

The EMU's **macroeconomic policy mix has somewhat improved** in recent years, largely thanks to our political family's efforts. The clarification of the flexibility of the Stability and Growth Pact, the setting up of Banking Union aiming to protect citizens and public finances from financial shocks and the creation of the European Fund for Strategic Investments (EFSI) are examples of how progressives are influencing Europe in pursuit of sustainable and widely-shared prosperity. We are also re-defining the concept of 'structural reforms', moving it away from deregulation and privatization towards a strong **progressive agenda of reforms and investments** which strengthen productivity and economic growth potential through quality jobs and innovation, ensure sustainable and effective welfare systems with reduced inequalities, and foster a transition towards resource-efficient, low-carbon economic future.³

Reminder: [PES Programme of Progressive reforms](#)

The PES progressive reform agenda, elaborated in 2015, follows three main objectives:

- To boost Europe's growth capacity, quality job creation and an inclusive labour market
- To improve economic, environmental and social sustainability of Europe's development
- To reduce social inequalities and increase solidarity

We define structural reforms broadly as organisational or institutional changes, which contribute to better economic and social outcomes. Reforms cannot replace investment; indeed they are usually intertwined with it. Progressive reforms have a positive impact on the long-term sustainability of public finances and improved economic performance. They raise productivity, tackle new forms of inequalities and exclusion, and reinvent a sustainable growth model for our societies.

The three main priorities of our progressive reform agenda are:

- A sustainable European social model guaranteeing social rights
- Innovating for a new growth model, quality jobs and skills
- Re-gaining the capacity to invest with a fair and efficient fiscal system

Examples of progressive reforms include improvements in the functioning of public administration, tax collection, innovation and education systems, active labour market policies, as well as measures for greater resource and energy efficiency.

However, **a lot more needs to be done** for Europe to achieve satisfactory economic growth, social progress, territorial cohesion, upward social convergence, and people's wellbeing. The European Central Bank has recently, and perhaps belatedly, engaged in bold actions to counteract deflationary dynamics in the European economy. Yet monetary policy at the zero lower bound is an increasingly poor substitute for fiscal policy and growth enhancing reforms. What we need is a new architecture of the euro area in order to assure a better macro-economic management in the future. An important

¹ <http://bit.ly/SVFbWA>.

² <http://bit.ly/1TQYqvU>.

³ [PES Presidency declaration 'For a programme of Progressive reforms'](#) (<http://bit.ly/1rE8hvY>), 19 November 2015, building on the [Conclusions of the PES working group on 'Progressive reforms'](#) (<http://bit.ly/1UNeilJ>).

part of the economic divergences and ensuing social hardship can be attributed directly to the dysfunctional institutional framework of the euro area.

The long economic crisis, aggravated by the EMU's fragile set-up and harsh fiscal consolidation, has undermined investment in future growth, caused severe and unnecessary social hardship and deepened inequalities both within and between countries. Several major political projects initiated by European Socialists are still on-going and require **renewed efforts** to bear fruit, such as work on the introduction of a Financial Transaction Tax based on enhanced cooperation, fight against corporate tax avoidance, and structural reform of the banking sector to end the 'too-big-to-fail' problem.

In pursuit of sustainable economic growth and high employment, the euro area and the EU need to step up the efforts to close their major investment gaps with the establishment of an ambitious '**Investment Union**'. The rate of gross fixed capital formation has been below 20% GDP for a number of years due to the Eurozone financial crisis, thus substantially lagging behind the pre-crisis decade. Investment would need to grow by at least 2% GDP in order for Europe to return to healthy investment levels, obviously avoiding speculative investments in real estate and the like. The challenges of energy transition, climate change, rising social inequalities and digital revolution all call for substantial increase in public and private investments enabling to build a new sustainable economic model in Europe for years and decades to come. A European investment strategy should therefore aim at high resource efficiency and productivity, leadership in technological innovation as well as robust social investments in education, healthcare, childcare and inclusion programmes, enabling everyone to participate in the economy and achieving renewed cohesion and upward convergence between countries.

Existing European instruments need to be maintained and strengthened in pursuit of an 'investment union'. These include, in particular:

- **European Structural and Investment Funds**, supporting the goals of the Europe 2020 Strategy with over €325 billion for the whole EU in 2014-20;
- The **European Fund for Strategic Investments**, with a €16 billion guarantee from the EU budget, aiming to leverage additional investments from the EIB Group and private investors;
- The **flexibility of the Stability and Growth Pact**, allowing countries certain temporary deviations from their path towards nearly balanced budgets and/or extra time for reducing excessive deficits in return for growth-enhancing structural reforms and investments.

Moreover, Europe is facing a number of **new challenges**: helping large numbers of asylum-seekers, renewed geopolitical instability, increased security threats, and growing nationalist sentiment in several Member States. The political context for the effort to complete the EMU is also marked by the UK referendum process. All these new challenges also demonstrate the importance and urgency of strengthening social, economic and political cohesion in Europe and reducing in-built vulnerabilities, including in the current architecture of the EMU.

Growing populism and anti-Europeanism is mainly a consequence of widespread economic insecurity produced by conservative policies during the crisis. Fears of immigrants and various breakaway sentiments arise from pre-existing socio-economic anxieties. **A progressive, pro-European response to these challenges must therefore tackle the key weaknesses of our economic model, including the incomplete design of the Economic and Monetary Union.** We have to demonstrate to citizens that Europe can effectively uphold human rights and deliver widely-shared economic growth, with real equality of opportunity. Europe does have the resources necessary to overcome these challenges. It is one of the richest, most economically developed, most socially fair regions of the world, with the largest internal market. Yet it is clear that we need to revise certain key mechanisms of how our economy functions in order to make the most of those enormous resources for the good of our societies. **European Socialists have a historic responsibility and**

are uniquely placed to push through the necessary changes so that the EMU reduces divergences and achieves a robust recovery.

Strengthened European unity and ability to effectively tackle European challenges require re-balancing and deepening the Economic and Monetary Union particularly in the following ways:

1. Re-launching economic growth, rebuilding social cohesion and cracking down on tax avoidance, thereby renewing the EU's promise of prosperity for all in all Member States;
2. Strengthening political union whereby any transfer of sovereignty must go hand with democratic accountability and legitimacy;
3. Developing risk-sharing and solidarity mechanisms protecting the stability of the common currency, supporting convergence and ensuring swift recovery from economic shocks;
4. Completing the banking union, ensuring depositor's protection and restoring confidence in the financial sector.

The Five Presidents' report suggested a **two stage process**: in the first stage, the banking union would be completed and existing governance instruments used to implement reforms aiming at greater economic convergence, while the second stage would complete the EMU with a fiscal stabilization mechanism as an expression of increased solidarity and risk-sharing.

It is very important to focus our debate on both stages so that the right balance is found between national efforts and European instruments. We need to build a **common position on all we want to achieve in stages one and two**, ensuring that our political family's progressive values can be fully applied. Special attention must also be given at the proposed timetable: it is our duty to make sure that serious preparation of stage two starts without delay and that the EMU is completed in a timely and ambitious manner. **The two stages need not be seen in strict sequence**: steps in relevant areas of stage 2 (e.g. on political and fiscal union) can and should be taken even if some aspects of stage 1 remain to be finalized (e.g. banking union). In particular, it is urgent to step up our fight against tax avoidance and work towards greater tax convergence, even if this issue is related more to stage 2.

This paper is the result of an in-depth process of debates and exchanges between high-level representatives of PES parties⁴. It reflects the dynamics of the discussions and proposes a **progressive approach** on how the Economic and Monetary Union can be deepened and completed. It takes note of the proposals included in the Five Presidents' report and brings forward additional proposals and recommendations. It highlights the need to treat social, financial, fiscal and economic policy on an equal footing and points out ways for strengthening democratic legitimacy. It proposes several solidarity, risk-sharing and convergence mechanisms, which would make the EMU more resilient. It aims at promoting core progressive objectives of welfare state sustainability, high employment with quality jobs, and social fairness of real equality of opportunity.

Throughout the process of deepening the EMU, we advocate an **inclusive approach**, whereby non-Euro area Member States can be actively involved in the debate. All Member States have an interest in ensuring that the EMU functions well and delivers balanced growth, high employment and social progress while maintaining fiscal responsibility. Member States with a commitment to adopt the euro in the future rightly seek to be part of discussions on the Euro area's future shape. At the same time, when new steps need to be taken in deepening the EMU, for example the creation of a European Deposit Insurance Scheme, advances in policy coordination or creation of new insurance mechanisms against shocks, it is understandable if these are based on decisions taken at the level of the Euro area, in close consultation with non-euro area Member States. In all these steps, strong

⁴ The first High Level Working Group took place on the 3rd of December 2015: <http://bit.ly/1UeWsTd>
The second on the 28th of January 2016 : <http://bit.ly/1Sfm2w4>
The third and final meeting took place on the 28th of April 2016 : <http://bit.ly/1TTMh9q>

democratic legitimacy and accountability must of course be ensured, through greater involvement of the European Parliament and national Parliaments.

Finally, we underline that a number of important challenges facing Europe are by no means specific to the Eurozone but should be addressed at the level of the European Union as a whole. These include the need to stabilise Europe's neighbourhood, improve external border management, ensure adequate humanitarian assistance to refugees as well as the need to step up future-oriented investments in the European economy. A common European approach and common EU tools such as the EU budget need to be developed and used in this respect.

1. Towards a real Social Economic and Monetary Union⁵

Harsh economic adjustment policies undertaken in response to the Eurozone crisis since 2010 have resulted in mass unemployment and serious social hardship in many Member States. In the absence of a framework for coordinating a 'symmetric adjustment', many countries had to undergo more painful asymmetric internal devaluations, which has also contributed to deflationary pressures and weak aggregate demand. As a result, the whole Eurozone and EU have suffered in terms of growth and employment over the past years, while cuts in investment and social services have undermined Europe's longer-term growth potential.

It is time to adapt the EU's economic governance to avoid repeating such mistakes during future economic shocks, while better safeguarding fiscal responsibility and ensuring the sustainability of welfare systems. Especially at the zero lower bound, an actively set aggregate fiscal stance for the Eurozone is needed, implying coordination of fiscal policies. Moreover, employment and social challenges need to be equally and systematically considered at the EMU level. A proper social dimension of the EMU has to be established, guided by progressive objectives of welfare state sustainability, high employment with quality jobs, and social fairness with real equality of opportunity.

Most of the actions set out in this section concern and would benefit all EU Member States, notably improvements in Europe's socio-economic governance, a strong investment-led growth policy, and further measures against tax avoidance. Institutional developments such as EPSCO Eurogroup meetings or the establishment of national competitiveness authorities concern primarily Euro area Member States, but should be open to all countries committed to adopt the euro in the future.

1.1 More space for employment and social policies within the European Semester

Our objectives:

Social and economic policy are indispensable and interlinked, therefore their development should go hand in hand. Sustainable growth, healthy public finances and social inclusion can only be achieved if more efforts are made to create new, decent jobs and to improve social protection and social inclusion and better skills. These objectives must be reflected more strongly in the structure of the European Semester and in the future EMU, by ensuring a balance of financial and economic objectives on the one hand with social and employment objectives on the other hand.

- ➔ Social targets must be strengthened at every step of the European Semester in order to best reflect social challenges.
- ➔ The creation of a binding set of social and labour standards should be thoroughly discussed, with close involvement of social partners, aiming at achieving upward social convergence and reducing inequalities, including through minimum income schemes and minimum wages defined by law or collective bargaining.

Our proposals:

⁵ "[Making Europe's economy work for its citizens](http://bit.ly/1TQYqvU)", article by five PES GAC Ministers, June 2015 (<http://bit.ly/1TQYqvU>).

1.1.1. *Improving social standards*

- To prevent that social and employment policies are used as the variable for adjustment in case of economic shocks, **binding minimum social standards** for the EMU should be adopted. The progressive family should prepare an ambitious response to the recently launched consultation on the European Pillar of Social Rights, advocating concrete and binding standards aiming at achieving upward convergence, with a non-regression clause. The creation of a **Social Protocol for the whole EU** within the Treaties,⁶ laying out a common set of social and labour standards and clarifying the equal footing between economic freedom and social rights, should be promoted in this context.
- We should seek, especially in the context of posting of workers, to codify that workers should receive **equal rights** and equal pay for the same work at the same place. The establishment of **decent minimum wages** (by law or social dialogue) is also important as protection against downward social competition within the EMU. Member States should no longer compete against each other by lowering wages and salaries but by increasing productivity. Minimum wages would also limit inequalities and the phenomenon of the working poor. Minimum frameworks for **employment protection** and build-up of **social security entitlements** should also be established in order to curtail the growing phenomenon of precarious work. **Minimum income schemes** should be promoted as a tool to enable dignified life and reduce inequalities.⁷

1.1.2. *Creating a true social dimension in the European Semester*

- We need **stronger surveillance of the employment and social situation** in Europe and constant and appropriate follow-up at every step of the European Semester: the Annual Growth Survey, macroeconomic surveillance, the National Reform Programmes, the Country Specific Recommendations. We cannot let austerity or internal devaluation policies prevail over return to growth, employment and social protection. Achieving smart, sustainable and inclusive growth requires better coherence between the policies put forward in the European Semester, notably between recommendations following from the Stability and Growth Pact, the Macroeconomic Imbalances Procedure and the **Europe 2020 Strategy's** targets. This also requires in depth assessment of social and employment effect of policies recommended to the Member States.
- The existing **scoreboard of key employment and social indicators** in the Joint Employment Report needs to be strengthened. In particular, social indicators such as household incomes, real wages, poverty and child poverty, inequalities, homelessness and access to health care and education should be better reflected in the European Semester. In case of clear social imbalance they should trigger policy action based on country-specific recommendations in order to restore social justice and social progress, in line with the horizontal social clause of Article 9 of the Lisbon Treaty. Consideration should also be given to strengthening the monitoring of social indicators during the European Semester by creating a real **Social Imbalances Procedure** along the above lines, ensuring that the social impact of economic policies is properly assessed and that policy mistakes are prevented and/or corrected. In particular, it should be ensured that fiscal policies do not undermine growth potential or weaken the sustainability of welfare systems.
- Increased **monitoring of employment-related indicators under the Macroeconomic Imbalances Procedure** (participation rate, youth unemployment rate, long-term unemployment rate) should serve to reflect better the social situation and ensure the implementation of the correct policy mix based on investment and strong active labour market policies. However, these indicators should not be used as a pretext for internal devaluation

⁶ [“Towards a Social Union”](http://bit.ly/1TzQ7nU), Declaration of PES Ministers for Social Affairs and Employment, February 2013 (<http://bit.ly/1TzQ7nU>).

⁷ Countries which achieve a high level of social progress based on social dialogue rather than legislation should be able to maintain this model.

measures and excessive flexibilisation of the labour market.

- **Reforms in employment and social fields** should focus on promoting creation of decent jobs in fair labour markets, boosting knowledge and skills in order to quickly embrace the digital economy, improve school-to-work transitions, reduce inequalities, eliminate poverty and ensure sustainable and effective social protection, all based on strong social dialogue. A healthy level of **social investments** such as in education, childcare and healthcare needs to be ensured.
- Both the **National Reforms Programmes** and the **Stability and Convergence Programmes** need to fully reflect social and employment coordination, while the **Country Specific Recommendations** need to address key employment and social challenges, with concrete recommendations to reach the Europe 2020 targets.
- **Social dialogue** has a key role to play in the making of economic and social policies. The views of social partners should be better integrated in all steps, levels and relevant institutions during the Semester, from the Annual Growth Survey to the Country Specific Recommendations. The **sustainability of our welfare systems** is one of our core priorities. To achieve this requires sound management of public resources and of these systems themselves. But, crucially, it also requires the political will to support and prioritize them, instead of allowing them to be the main victims of conservative austerity policies.

1.2 Ensuring upward social and economic convergence

The current crisis has exposed the shortcomings of having a monetary union without an economic union. Stronger and better economic policy coordination is needed in order to promote sustainable economic growth and social progress in the EU as a whole. Our aim is to develop policies that ensure sound management of our public finances, ensure a healthy level of investments, increase the well-being of our citizens and preserve the sustainability of our welfare systems. Our fight against tax avoidance and for fairer tax systems is also very important in order to build a stable and prosperous EMU.

Our objectives:

We want to develop an economic policy framework that recognised the complementarities between monetary, fiscal and structural policies, reduces imbalances and protects against macroeconomic and social divergences, notably by stimulating productive investment and domestic demand while preserving social standards. Upward convergence should be driven by the Europe 2020 Strategy and the economic policy framework should be geared towards supporting all Member States in their effort to achieve its targets

- ➔ An ambitious investment policy aiming at low-carbon, smart and inclusive growth must be pursued without delay. Private investment alone is not sufficient. Both private and public investment should be stimulated in order to bridge Europe's investment and demand gap and promote the creation of new and quality jobs. Greater investment is also crucial to address the EU's migration and security challenges.
- ➔ Wage, price and productivity policies should be coordinated, building on social dialogue as much as possible, in order to protect the EU's labour standards, overcome current imbalances and foster upward convergence in a growth-friendly way.
- ➔ Fiscal responsibility needs to be strengthened across the business cycle while providing for an adequate degree of flexibility in order to support the implementation of structural reforms and stimulate economic growth during cyclical downturns.
- ➔ The Stability and Growth Pact should be reformed to better factor in the longer term outlook and to promote sustainable economic growth, to help reduce economic inequalities and provide fiscal stabilisation.
- ➔ Countries under the corrective arm should have greater room for reforms and investments which enhance growth potential and improve fiscal sustainability

- ➔ The Eurozone should be considered as one macroeconomic entity, for which an optimal aggregate fiscal stance and its approximate country-by-country breakdown should be defined at or close to the zero lower bound, in order to avoid that the sum of national fiscal policies is excessively expansionary or contractionary.⁸ While the Eurozone's actual growth is below potential and monetary policy is reaching its limits, countries with greater fiscal space should use this space to stimulate domestic demand.
- ➔ Creating fair taxation frameworks is essential for putting end to the existing fiscal race to the bottom and aggressive tax planning which weakens public budgets. In particular, the Commission's proposed actions against tax avoidance should be implemented without delay and further progressive adjustments in our tax systems should be promoted
- ➔ A more balanced governance framework should be established in the euro area, particularly by creating a Eurozone EPSCO meeting and establishing greater cooperation with the Eurogroup.

1.2.1 Pursuing a strong investment-led growth agenda

- The mid-term review of the **Europe 2020 strategy** should aim at shifting the focus to promoting progressive structural reforms and investments. Factors such as innovation, resource efficiency, sustainable re-industrialisation, a well-functioning Single Market, high employment and social cohesion should be at the core of the Strategy's re-launch.
- The creation of the **European Fund for Strategic Investment** is a major political success for our family. Its establishment is a step forward for changing the conservative doctrine of painful austerity and a step towards establishing a real Investment Union. Economic growth and investment are directly linked and must remain a central part of the EMU's economic strategy.
- Although the creation of the EFSI is a step towards the right direction its investment capacity cannot bridge Europe's short-term investment gap, estimated at approximately 2% GDP per year.⁹ The need to pursue a **combined public and private investment strategy** therefore becomes apparent, especially to unlock investments that are at the edge of financial viability but play an important economic role from a longer-term perspective. The aim should be to stimulate growth-inducing sectors, but also to finance sustainable social investments and projects enabling transition towards a resource-efficient, low-carbon economy.
- European industry has to be modernised in the framework of an **active industrial policy** focused on the digital revolution and ecological transition. Special attention should be given to the development of social economy by supporting social enterprises. Europe's investment strategy must aim at meeting both short-term and long-term goals. In the short term it should be linked to serve the goals of the Europe 2020 strategy and in the long term of building a viable and sustainable economic environment with strong social and territorial cohesion that takes into account future social and economic needs.
- New challenges, such as large-scale **arrivals and integration of asylum-seekers**, building a safe and humane external European border, stabilising migrants' countries of origin and transit as well as increased security threats require European solutions, new progressive policies and new financing resources. Financing of new necessary investments should be organised through the EU budget, but not at the detriment of already planned investments. **The ceilings of the 2014-20 Multiannual Financial Framework should therefore be raised** and the use of its flexibility rules extended under a clear and consistent methodology

⁸ While looser coordination of national fiscal policies can be envisaged for 'normal times' when monetary policy can fully play its usual role in counteracting economic shocks, closer coordination of fiscal policies becomes necessary when monetary policy reaches its limits and fiscal policy gains relatively greater influence on economic output.

⁹ S&D Group strategy concerning the implementation of the 5 Presidents' report – Completing and re-balancing Economic and Monetary Union, October 2015 (<http://bit.ly/1Kyfdki>). See also e.g. "Investment in Europe: Making the best out of the Juncker Plan", Notre Europe - Jacques Delors Institute, March 2016 (<http://bit.ly/1SaXkYM>), or the Strategic Note No. 11 of the European Political Strategy Centre "EFSI – Maximising its Potential", (<http://bit.ly/1Vqf1cl>).

in order to address new urgent needs which were not foreseen when the MFF was being agreed in 2013.

1.2.2 **Reducing macroeconomic and macro-social imbalances while supporting growth and jobs**

- The **Macroeconomic Imbalances Procedure** should aim at bridging current economic and social inequalities in a way supportive of economic growth and conducive to full employment. The EU's and especially the Eurozone's aggregate economic performance should be taken into account and country-specific recommendations should be fully coherent with the needs of the EMU as a whole.
- The EU and the Eurozone should promote upward **wage convergence** (through law or collective bargaining) in line with productivity and the objective of a stable currency with an inflation rate of below but close to two percent. Competitiveness should be approached from the angle of productivity and non-cost competitiveness, rather than price or wage competition.¹⁰ More attention should be paid to relative intra-EMU differences in wages, productivity and prices, and the objective of **symmetric adjustment** in order to minimize economic and social adjustment costs.

1.2.3 **Reconciling budget consolidation with growth**

- The pursuit of **responsible fiscal policies**, in combination with the clarification of the use of flexibility in the SGP in early 2015, has been a move in the right direction, enabling to strengthen Europe's recovery. Member States now have greater possibilities to invest in European projects, notably through the EFSI, while growth-enhancing investments, structural reforms and cyclical conditions will be better taken into consideration, especially for countries in the preventive arm of the SGP, allowing for temporary deviations from the fiscal consolidation path.
- Nonetheless, the **Stability and Growth Pact should be further reformed** in order to provide Member States with adequate room for progressive structural reforms and investments, while strengthening the sustainability of public finances across the business cycle. A progressive framework for fiscal responsibility should take into account the need for long-term sustainability of public finances as well as the role of public budgets in (i) strengthening economic growth potential, (ii) providing counter-cyclical stabilisation and (iii) ensuring necessary pre-distribution through quality public services and re-distribution mitigating economic inequalities. The reduction of structural deficits should never lead to undermining growth potential.
- In particular, **national co-financing of EU structural and investment funds programmes**, which represents growth-enhancing investment with thorough conditionality, should be exempted from deficit calculations in the context of the SGP.¹¹ The accounting treatment of public investment within the SGP should also properly take into account the amortization schedules of investments, their risk factor and the guarantee assets of public authorities.
- Moreover, the **calculation of potential growth**, and thus also of the output gap and structural deficit, should be based on a longer time horizon than the 2 years currently used

¹⁰ Cf. the conclusions Cf. the [conclusions](#) of the PES working group on progressive reform for a detailed agenda for strengthening economic growth potential through innovation, improvements in productivity and quality jobs (<http://bit.ly/1UNeilJ>).

¹¹ European Structural and Investment Funds operate with comprehensive *ex-ante conditionality*, i.e. sets of horizontal and policy-specific conditions which need to be fulfilled in the first years of the multiannual programming period in order to ensure that investments in each of the 11 thematic objectives of the ESI funds fall on a fertile ground and can achieve the intended effects. The 7-year programming process (allocation of ESI funding within each country to specific priorities, through Partnership Agreements and Operational Programmes) is also closely linked to the relevant country-specific recommendations issued in the context of the European Semester. Finally, the so-called macroeconomic conditionality (based on Article 23 of the Common Provisions Regulation) enables the Commission to request and effectively enforce re-programming (and ultimately a suspension) of ESI Funds within a Member State in light of evolving country-specific recommendations and their implementation by the Member State.

in the Commission's forecasts. This methodological change would help to avoid e.g. underestimations of potential growth in a cyclical downturn or overestimations of potential growth in a cyclical upturn due to short-term developments.

- **Equal treatment between Member States within the framework of the Stability and Growth Pact** needs to be ensured in line with fiscal sustainability. Greater attention should be paid notably to investment gaps, to the social and fiscal effects of proposed reforms and their impact on the sustainability of welfare states as well as to the need for an appropriately financed European asylum and migration policy. Assessments of the economic and fiscal performance of Member States (especially those under the Excessive Deficit Procedure) should also take into account real growth and inflation, in order to reflect better the economic situation.
- **Stimulatory supply-side structural policies** that work toward achieving full employment should be pursued. Their application should not put further pressure on public balances and should aim at increasing public expenditure and the growth potential while in the longer term improving public debt to GDP ratios. **Good-quality public investments** need to contribute to the transition towards a new sustainable growth model. EU cohesion policy instruments have a crucial role to play in supporting structural convergence. Well-targeted tax incentives to companies or stimulatory tax credits for households can also play a role but should not fuel competition between Member States.
- We need to develop proactive counter-cyclical policies that follow the trends of the economic cycle and allow for the effective **activation of automatic stabilisers** to uphold domestic demand. To this end, existing flexibility should be used as needed, while sustaining healthy public finances over the longer term. Furthermore, concrete proposals for the design of an EMU fiscal stabilisation function, envisaged in stage two of the Five Presidents' Report, should be prepared during 2016, building on the expert work undertaken over the past years and the on-going work of the EP's ECON and BUDG committees on a Eurozone budgetary capacity (see further in section 3).¹²
- Deeper coordination of the **Eurozone's aggregate fiscal stance** should be undertaken, based on more explicit proposals from the Commission. In such situations, the overall fiscal position of the Eurozone should be more than a coincidental sum of national fiscal positions: it should be jointly decided at the European level, based on a democratic debate, and should take into account requirements of fiscal sustainability, the economic cycle as well as investment gaps.¹³ At a time when the Eurozone's further economic recovery is held back by weak domestic demand, countries with fiscal space should be asked to use this fiscal space for their own and general benefit, just as countries with reform space need to pursue productivity and growth enhancing reforms.

1.2.4 Ensuring fairer taxation for additional resources and less inequalities¹⁴

- **Progressive tax policy** should be pursued to ensure fairness in tax systems and a socially and economically beneficial allocation of resources in the economy, for which a certain degree of redistribution and robust public investments are essential. In particular, the implementation of the Financial Transaction Tax on the basis of enhanced cooperation, the development of ambitious green and corporate taxation, implementation of progressive taxes on high income and wealth and a reinforced fight against tax avoidance and aggressive tax planning are needed to ensure a fair taxation system that responds to the alarming recent

¹² See two [working documents](http://bit.ly/1NF3hRd) published by EP rapporteurs P. Berès and R. Böge in February-March 2016 (<http://bit.ly/1NF3hRd>) and their [draft report](http://bit.ly/1sXc8F8) from 4 May 2016 (<http://bit.ly/1sXc8F8>) as well as the S&D Group Discussion Paper, 'EMU-level fiscal capacity: What functions? What instruments?' prepared for a Progressive Economy Workshop, 16 November 2015, Brussels

¹³ See the EP report on the European Semester for economic policy coordination: Annual Growth Survey 2016 ([2015/2285\(INI\)](http://bit.ly/1pNAHSr), rapporteur M.J. Rodrigues), especially paras 24-32 (<http://bit.ly/1pNAHSr>).

¹⁴ This sub-section builds, inter alia, on the [conclusions](http://bit.ly/1SOAAQQ) of the second interparliamentary conference for a Progressive Europe, held at the Assemblée Nationale in Paris on 7-8 April 2016 (<http://bit.ly/1SOAAQQ>).

rise in inequalities, provides a solid basis for social cohesion in the future and discourages harmful tax competition.

- More **convergence in tax policy** is also important in relation to building an EMU fiscal capacity, which needs to count on fair contributions from all participating Member States. The stronger is the ability of central fiscal instruments to protect against shocks and support structural convergence, the less need there is for national fiscal systems remaining as different as they are today. Full harmonisation is not on the cards (differentiated tax rates, for example, do play a role in promoting economic convergence), but a number of steps can and should be taken in order to reduce the space for a fiscal race to the bottom.
- In particular, a **Common Consolidated Corporate Tax Base (CCCTB)** should be put in place rapidly in order to prevent profit shifting by regulating transfer pricing. If no sufficient progress is achieved at Union level in this direction, enhanced cooperation could be used. Interested Member States should therefore start working together on a blueprint outlining how partial harmonisation of corporate profit taxation on the basis of enhanced cooperation could be achieved.
- Restoring social and fiscal justice¹⁵ also requires **automatic exchange of tax-related information** among tax authorities to the greatest possible extent. Countering illicit tax flows such as cross-border tax rulings, patent box schemes and transfer pricing arrangements should be pursued without delay. The thresholds for enterprises and banks applicable in this respect should be harmonised.
- A **clear framework to discourage aggressive tax planning and close down tax havens** also needs to be formalised, based on a common European definition and a public blacklist of tax havens.
- It must be ensured that public **country-by-country reporting** by multinational enterprises delivers real transparency and discourages aggressive tax planning, notably by requiring that companies publish the requested data for all countries and not only for EU Member States.
- In the context of revising the **VAT directive**, steps leading to renewed divergence between national VAT systems should be avoided, as this would risk weakening the tax base.
- **Trust funds** must be adequately regulated in order to avoid that they lead to a form of fiscal evasion through credits or loans;
- A central public registry of all legal entities, trusts and foundations, and their ultimate beneficial ownership should be created. Bold steps should be taken in order to **reduce indirect ownership of securities** (through various intermediaries), which is often used to hide the identity of the real owner.
- Developing **stronger sanctions** for banks and legal entities that assist in tax fraud, money laundering and terrorist financing should be considered. These could include the temporary suspension or lifting of operating licences as well as the freezing of assets.

1.2.5 Developing a more balanced policy-making framework for the Eurozone

- The Eurozone's economic policy coordination is mainly organised through an informal body - the Eurogroup. The Eurogroup focuses its discussion mainly on economic and fiscal policies, but does not assess the effects of economic policy on the social situation. This approach should be revisited as it has led to the promotion of an unbalanced policy mix which has contributed to a lack of investment in Europe and hit the weakest members of our societies hardest.
- It is essential to establish a stronger cooperation between the EPSCO and ECOFIN Council formations to ensure that social and employment concerns are given equal attention to economic and financial ones. Within the EMU, the role of the EPSCO should be clearly reinforced, notably with an EPSCO Eurogroup meeting, which would remain open to the

¹⁵ PES Presidency Declaration adopted 22/04/2016: '[Panama papers – it is high time to close all loopholes](http://bit.ly/1r6K8h2)' (<http://bit.ly/1r6K8h2>).

participation of all EU Member States and would focus on policy coordination, to ensure that more attention is paid to social and employment policies in the European Semester and to prevent harmful cost-cutting and austerity measures.¹⁶

- The European Commission should be more involved in coordinating these informal Council bodies, alongside the respective Presidents. Greater accountability should be granted to the European Parliament.

1.3 The creation of two new bodies in the first stage of EMU completion

In October 2015, the Commission proposed the creation of two new bodies in order to strengthen EMU governance, namely **National Competitiveness Boards** and an advisory **European Fiscal Board**. In this proposal, they are meant, respectively, to stimulate the process of structural convergence in the first stage of EMU deepening, and to help coordinate and assess the euro area's aggregate fiscal stance. Although the proposal for the creation of these bodies is built on successful examples from some EU Member States, there are strong and legitimate concerns, also expressed by trade unions, regarding the possibility of their extension throughout the EMU.

Careful consideration must be given to using existing national structures in order not to unnecessarily create duplicated institutions. If created, the scope of their mandate, their proposed functioning as well as the added value of their establishment should be vigilantly assessed and recommendations drawn for improvement. Particularly in the case of the proposed competitiveness boards, strong concerns arise about possible interference with collective bargaining. Their reframing as 'committees for growth and employment', strongly based on social dialogue, would be appropriate. Their mandate must encompass strong social indicators, such as the employment and education targets of the Europe 2020 strategy, to provide for a balanced approach. The creation of these two new bodies should also be followed by the inclusion of qualitative indicators to provide a clearer assessment of the fiscal situation in Member States. Otherwise they risk contributing to a fiscal race to the bottom, more austerity, and social dumping.

Our objectives:

- ➔ The national competitiveness boards should be transformed into 'committees for growth and employment', existing national structures should not be challenged nor duplicated with the creation of these new bodies. If created their mandate should be broad and take that into consideration current economic trends and intra-EMU imbalances. They should base their assessment on productivity factors rather than promoting price or wage competition. Their work should be strictly advisory and conciliatory, i.e. they should be used as a tool to build and strengthen social dialogue, in full respect of the autonomy of collective bargaining. They should also help to exchange best practices across Europe.
- ➔ The advisory European Fiscal Board within the European Commission could also make proposals on how the composition of the Eurozone's aggregate fiscal stance could be improved and short- and long-term fiscal shocks dealt with. The process of setting up the board should enable strong democratic legitimacy.

Our proposals:

1.3.1 The development of National Competitiveness Boards into Committees for Growth and Employment

- The Committees should build on and reinforce existing structures of social dialogue. Pre-existing national structures should be used wherever possible in order to avoid duplications and unnecessary bureaucratic burdens. They should fully respect collective bargaining and

¹⁶ The EPSCO Eurogroup should not deal with Single Market legislation and other matters directly affecting non-euro area Member States.

promote the wellbeing of society, not short-term business interests. In order for the Committees to provide advice of added value they should cover a broad spectrum of qualitative and quantitative indicators and take into consideration economic as well as social targets impact when formulating their advice. Their functioning should be adapted to national circumstances and take into account the repartition of policy competencies within the country, involving local and regional authorities accordingly.

- The Committees establishment should not lead to wage competition that will fuel deflationary dynamics and economic slowdown. Their overarching aim should be to cross-examine the performance of Member States in relation to the **Europe 2020 targets**. Moreover, competitiveness should be assessed mainly from the viewpoint of increasing productivity rather than price or wage competition.
- The Committees should work in a coordinated way in order to identify ways to bring about **symmetrical adjustment** and strengthen intra-EMU convergence in terms of productivity, wages and prices. The existing Macroeconomic dialogue at political and technical level could also be reinvigorated and used in this respect.

1.3.2 The establishment of an advisory European Fiscal Board

- The Board should be established as an advisory body within the European Commission providing ex-ante fiscal policy evaluation, in order to strengthen the precision and objectiveness on fiscal decision making. It should deepen the understanding and foster greater discussion on the aggregate fiscal stance of the euro area, especially when monetary policy is at its limits. This approach is particularly necessary for assessing the impact of the EMU fiscal framework on the Eurozone's domestic demand and financial resources, for identifying investment gaps, for improved coordination of tax policies and for establishing the correct policy mix to bridge social and economic inequalities.
- The Board should be given a broad mandate to assess and signal for future shocks that could affect the Union's and Eurozone's aggregate fiscal stance or macroeconomic stability, and to propose ways to deal with them better. Global economic and financial performance should be taken into consideration in order to best prepare a collective policy response.

2. Political union: Strengthening democracy in European economic governance

European efforts to achieve social, fiscal and economic coordination can only be considered credible if such integration provides for full democratic accountability and legitimacy. To restore the confidence of our citizens in the European Union, democratic legitimacy and accountability must be ensured for European as well as national decisions with regard to economic, financial and social policies. More common decision-making will be necessary in a deepened EMU equipped with new instruments. To ensure adequate democratic legitimacy and oversight, three principles should be observed:

- No taxation without representation and no representation without taxation. Decision-making powers over joint resources in the euro area and financial responsibility need to go hand in hand.
- Euro area governance decisions and resources must be joint, not just shared. Real transfer of resources to the level of the euro area must go hand in hand with a real transfer of sovereignty based on proper democratic legitimacy.
- Responsibility and solidarity need to go irrevocably hand in hand. Euro area solidarity requires robust safeguards against bankrolling irresponsible behaviour at national or regional level.

Our objectives:

- ➔ Deepening of EMU and development of a Eurozone fiscal capacity must be done in a way ensuring democratic legitimacy and accountability.
- ➔ National Parliaments should thoroughly discuss the Commission's Country Reports and vote on National Reform Programmes.
- ➔ The European Parliament - as the only directly elected European institution – must co-decide the shaping of the European Semester in order to ensure greater democratic accountability and legitimacy in European policy making
- ➔ The process of appointing external representation of the euro area to international fora should focus on ensuring transparency and accountability.

Our proposals:

2.1 Strengthening national relevance and ownership – promoting discussion and decision at national level

- To reinforce Member States' ownership of the European Semester and to comply with the subsidiarity principle, European policies must respect national competences and the repartition of policy competencies within the country. In particular, the role of the national parliaments must be reinforced to ensure transparency. It is a basic democratic requirement that national governments are kept accountable, and it is the role of national parliaments to do so.
- National parliaments should therefore discuss in detail and adopt **National Reform Programmes** and **Stability and Convergence Programmes**. The Commission's Country Reports should also be thoroughly assessed, in partnership with local and regional authorities and social partners.
- Furthermore, the procedures for a better coordination of the European Parliament and the National Parliaments in the framework of the European Semester should be improved, building on the European interparliamentary week and Article 13 TSCG conferences.

2.2 Ensuring greater democratic legitimacy at the European level – the role of the European Parliament

- To achieve greater democratic accountability it is essential that the European institutions stand on an equal footing in the decision making process, notably with a strengthened role of the European Parliament as the only directly elected European body.
- The European Parliament needs to be directly involved, via the co-decision procedure, in the shaping of the policy recommendations of the Annual Growth Survey and of the recommendation on the economic policy of the euro area. The multiannual Broad Economic Policy Guidelines and Employment Guidelines should be strengthened through a 'convergence code', which can be more detailed for euro area Member States and which should likewise be co-decided by the Council and the Parliament (see further in section 3). The EP should also discuss the **Country-Specific Recommendations** prior to their approval and adoption by the Council.
- The European Parliament is also the **parliament of the euro** and represents the default option for ensuring democratic oversight at the European level of the future Eurozone fiscal capacity.
- To strengthen the European Parliament's role as suggested, a Treaty change is needed. This might not happen in the near future. For greater democratic legitimacy in European policy making to be achieved in the short term, an inter-institutional agreement should be therefore negotiated as a basis for the Parliament's strengthened mandate.

2.3 The external representation of the Euro area – opportunities and challenges

- The external representation of the Euro area in international fora such as the IMF deserves careful consideration.

- The Commission suggests that the future President of the Eurogroup should be representing the euro area to the IMF, the aim being to enhance the singular role and weight of the euro area in the global economy.
- Although the argument is sound and the euro area should start coordinating with the aim of reaching common positions on international subjects, the role and mandate of the representative should be carefully drafted to ensure proper democratic accountability. The influence that the European Commission and the European Parliament will enjoy should be clearly defined.
- Consideration should be given to proposals for creating a **Euro area Finance Minister**¹⁷ that would be simultaneously a member of the European Commission and the President of the Eurogroup. Accordingly, she/he would be appointed by the European Council on the proposal by the President of the European Commission and would be accountable to the European Parliament. His/her role would be to supervise the performance of the euro area and to help manage shocks that threaten to destabilise it.

3. Eurozone fiscal capacity: Preparing stage 2 of EMU completion

The EU budget plays a crucial role in promoting cohesion in the Single Market and upward structural convergence among the 28 Member States, as well as financing projects of common interest and delivering European public goods. By helping to reduce disparities in productivity and employment levels, instruments such as EU Structural and Investment Funds and the Youth Employment Initiative play an important role for the longer-term stability of the euro area and pave way for its further enlargement in the future. The European Fund for Strategic Investments (EFSI) aims to reduce the investment gap in the EU28 by leveraging financing from the EIB Group and private investors. Given Europe's present context of a serious shortage of investments, all these instruments **must be maintained and strengthened**.

Moreover, the EU is facing a multitude of **new challenges not foreseen when the Multiannual Financial Framework for 2014-20 was being agreed**, notably the need to develop a real European border, ensure adequate humanitarian assistance to asylum-seekers in Europe and its neighbourhood and strengthen external relations instruments. These European public goods are relevant and needed beyond the realms of the Euro area and the Schengen system and the policies and instruments in question must therefore be open to all EU Member States. To respond to these new challenges effectively, the EU budget should be strengthened in the context of the mid-term revision of the MFF 2014-20 through an **upward revision of the MFF ceilings** and extension of the flexibility provisions of the MFF. Simply put, effective European solutions require an adequate European budget. The additional contributions to and drawdowns from the EU budget implied by such reinforcement should also reflect the Member States' contribution to European solutions to the newly arisen challenges, e.g. in terms of border protection responsibilities or relocation of asylum-seekers.

However, as the Eurozone crisis has demonstrated, Member States sharing the euro face a number of **specific constraints on their economic and fiscal policies**, such as the absence of the exchange rate adjustment channel; lack of control over the single monetary policy (which creates endogenous pressures by impacting different countries differently); stricter and more enforceable fiscal rules; the risk of self-fulfilling dynamics regarding capital flows and the conditions for public and private investment; as well as stricter conditions for public and private debt management. Moreover, the present crisis has painfully revealed significant structural divergence within the Eurozone that was building up before the crisis and was aggravated by the crisis itself. It has also become apparent that economic adjustment within our incomplete EMU excessively relies on internal devaluation rather than symmetric adjustment, undermining political support to the European Union.

¹⁷ "[What would a European finance minister do? A proposal](http://bit.ly/1Z8a4DW)" by Henrik Enderlein and Jörg Haas, October 2015 (<http://bit.ly/1Z8a4DW>).

The EU budget as such is not the instrument to answer to these challenges, related specifically to the functioning of the Eurozone.

In order to ensure sustainability and good economic performance, all mature monetary unions count on instruments enabling to deal with symmetric and asymmetric shocks, as well as on an important level of structural convergence which can partly come about through the operation of market forces and factor mobility, but also requires targeted reforms and investments. The resilience of the EMU and its future economic performance would be greatly improved with the creation of a **Eurozone fiscal capacity** helping to tackle both symmetric and asymmetric shocks and supporting balanced growth, high employment and social progress based on renewed convergence, fiscal responsibility, and future-oriented investment.¹⁸

The EMU fiscal capacity could fulfil several functions: It could act as a permanent **counter-cyclical** fiscal instrument, activated when a Member State or the Eurozone as a whole enters a cyclical downturn to support national automatic stabilisers and reduce the impact of the economic shock. It would therefore provide for **stabilisation** of the whole EMU against symmetric shocks as well as **insuring** individual members for the event of particularly severe asymmetric downturns. As such, it would enable the EMU to adjust to future economic shocks in a more growth-friendly way than in recent years. Moreover, the Eurozone fiscal capacity could provide **support for reforms and investments necessary for restoring structural convergence** in the EMU. Finally, the long-envisaged backstop for the banking union's Single Resolution Fund (see section 4) can also be considered a form of fiscal capacity. The EMU fiscal capacity could consist of several instruments, as detailed below. Most of them could be implemented by **extending and adapting the mandate of the existing European Stability Mechanism (ESM)**.

The Eurozone fiscal capacity needs to be based on a democratically legitimate and effective governance structure at the euro area level that is able to decide swiftly in times of crisis while robustly addressing problems of moral hazard in order to assure its sustainability. Its development should also go hand in hand with strong measures against tax avoidance and steps towards greater tax convergence.

Participation in the Eurozone fiscal capacity would be obligatory for all Eurozone Member States and optional for other Member States with a commitment to adopt the euro in the future. A reinforcement of the EU budget in the context of the MFF 2014-20 mid-term review and revision would concern all Member States.

Our objectives:

- Creating a **Eurozone fiscal capacity** for immediate reaction to economic shocks, focused on reducing cyclical unemployment and strengthening real economic convergence by upholding domestic demand and maintaining healthy investment levels. The mandate of the ESM should be extended and adapted for this purpose and adequate democratic accountability ensured.
- **Increasing the ceilings and use of flexibility of the MFF 2014-20** in order for the EU to be able to deal effectively with new challenges in the field of migration, border control and security as well as reinforcing community instruments such as the Youth Employment Initiative, Horizon 2020 and the Connecting Europe Facility.

Some of the instruments constituting the Eurozone fiscal capacity would function as **rules-based insurance schemes** with little discretionary management, while others would require **common decision-making** to a greater extent. The fiscal capacity should be sufficiently strong not only to insure individual members against particularly severe downturns, but also to help the Eurozone as

¹⁸ The rationale and options for a Eurozone budgetary capacity are being intensively discussed in the European Parliament, notably in the context of the Berès-Böge report.

a whole to recover. The activation of the fiscal capacity would be subject to a set of regulated provisions, including requirements for national fiscal discipline.

At this stage, we are aiming to clarify and build consensus on the **purposes and functions** of the Eurozone fiscal capacity and on which instruments should be pursued as a matter of greatest priority. Questions of their size, precise legal forms and decision-making mechanisms will need to be addressed in the next step. The Commission and the expert group envisaged in the Five Presidents' Report are expected to develop detailed technical proposals in this regard. Our point of departure is that the **Community framework should be used to the maximum possible extent** (the ESM being integrated into the Community framework, new instruments decided through the ordinary legislative procedure, overseen by the European Commission, Parliament and Court of Auditors).

The Eurozone fiscal capacity should **rely as much as possible on own resources, which will enable to develop the role of the ESM**. Work is on-going on options for genuine own resources for the EU budget, some of which could potentially be used also for the Eurozone fiscal capacity. Should own resources be insufficient, national contributions would be drawn upon, as with the existing EU budget. Countries engaged in enhanced cooperation on own resources would then have their national contributions correspondingly reduced. Differences in geometry regarding own resources would therefore not necessarily undermine the fiscal capacity: countries not participating in certain own resources should transitionally provide larger national contributions.

Our proposals:

Three main types of instruments should be envisaged within the Eurozone fiscal capacity:

3.1. Structural convergence

- The first instrument should promote renewed structural convergence¹⁹ in the Eurozone after the long economic crisis. While economic policy coordination has been strengthened through the European Semester, its impact is reduced by the lack of financial instruments that could adequately support the **implementation of the Integrated Guidelines and relevant country-specific recommendations**.²⁰ Just like the EU Cohesion Fund was created in early 1990s, at the launch of EMU, as a tool supporting Member States (not regions) in stepping up real economic convergence prior to euro adoption, a new instrument supporting structural soundness within the Eurozone would help to reduce the vulnerability arising from the Eurozone's current core-periphery divide. While full convergence in productivity and income levels probably cannot be achieved, it is paramount for the Eurozone's longer-term stability to reverse the process of structural divergence in favour of a gradual process of renewed convergence.
- This 'convergence instrument' should support national debt issuance at good conditions and/or provide targeted grant support where necessary. As such, it should provide **incentives and support for progressive structural reforms based on a 5-year 'convergence code'**, enabling **better implementation of country-specific recommendations** that require structural reforms and investments.

¹⁹ The process of divergence between Member States triggered by the recent Eurozone crisis threatens to remain a source of instability for the long term. This divergence is to some extent mitigated by existing tools of the EU budget (notably cohesion policy), which are however meant to serve the Single Market and whose allocations are determined predominantly on a regional basis.

²⁰ The link between the European Semester and European Structural and Investment Funds has been strengthened in the MFF 2014-20: the 7-year operational programmes must reflect relevant country-specific recommendations. However, the ESI Funds are designed to support economic, social and territorial cohesion by addressing also many other thematic objectives, not always covered in CSRs (e.g. business development, innovation, environmental infrastructure, social inclusion) and it would be counterproductive from the viewpoint of long-term convergence and investment planning to concentrate them only on areas highlighted in CSRs (which may also change from one year to another).

- The **convergence code**, adopted through co-decision, would build on and strengthen the existing Integrated Guidelines and set out key convergence targets, for example in terms of taxation and investment. It should respect national competences and be simple enough to enable strong national ownership. Meaningful **conditionality** would be ensured as the reforms and investments supported by the 'convergence instrument' would need to contribute directly to the fulfilment of the 'convergence code' and country-specific recommendations. Three areas of such conditionality could be sustainable growth, convergence in taxation and social standards. Conditionality attached to the convergence code would therefore be of a progressive nature, strengthening competitiveness through the high road of greater productivity, reduced inequalities, sustainable welfare systems and increased resource efficiency.

3.2 Addressing symmetric shocks

- The second instrument should enable the Eurozone to address large symmetric shocks, complementing monetary policy. Through this tool, the fiscal capacity would facilitate public investment, which should enjoy favourable treatment in the context of the Stability and Growth Pact. The instrument would provide countercyclical 'stabilisation across time' and help to accelerate economic recovery in the Eurozone as a whole.

3.3 Coping with asymmetric shocks through a European unemployment insurance scheme

- Cyclical shocks with asymmetric impact across the Eurozone could be mitigated through a European unemployment insurance scheme, acting as a **Eurozone-level automatic stabilizer**, providing temporary and conditional support for countries going through a cyclical economic downturn. As such, the scheme would help to avoid harmful pro-cyclical austerity by maintaining fiscal space needed for the implementation of longer-term reforms and investments.
- A common complementary unemployment insurance scheme would serve as a temporary fall-back mechanism helping Eurozone countries to ensure protection of short-term unemployed people and uphold aggregate demand in times of cyclical downturn. A **major increase in the short-term unemployment rate** would trigger the disbursement of finances for unemployment benefit expenditure, on the basis of harmonised relevant provisions, including conditionality and minimum standards of social protection, labour activation, and national schemes for maintaining employment.²¹ The applicable conditionality would be proportionate to the intensity of risk-sharing and could be reduced e.g. in case of a re-insurance scheme supporting national schemes only in cases of major shocks.
- In any case, the European unemployment insurance scheme would **complement and support, but not replace, existing national schemes**. Its design could also be adapted to cover schemes providing allowances where unemployment is prevented through temporarily reduced working hours, combined with training, such as 'Kurzarbeit' or 'chômage technique'. Such schemes should be developed through social dialogue and help to maintain quality employment even in times of downturn and lack of work.
- Additionally, an alternative option could be the creation of a **macro-insurance scheme** that would serve the purpose of stabilisation by facilitating national debt issuance and enabling Member State(s) in question to maintain a healthy rate of investment. This scheme would lead to reduced borrowing costs, providing a short term boost to public investment, including in social infrastructure and/or provision of essential public goods, such as education and health. This scheme would require collective decision making, but its activation should be rapid, based on clear macroeconomic criteria and pre-defined rules and conditions relating to the eligibility of expenditure.

²¹ For further details and references see e.g. "[Shared unemployment insurance: helping refocus the Eurozone on convergence and cohesion](http://bit.ly/20QIQ6K)" by László Andor, November 2015 (<http://bit.ly/20QIQ6K>).

3.4 The functioning of the Eurozone fiscal capacity

The ‘convergence instrument’ and the instrument for addressing symmetric shocks could be delivered by extending and adapting the mandate of the existing European Stability Mechanism. This intergovernmental organisation with over € 700 billion of authorised capital stock today primarily fulfils the role of providing emergency financial assistance to Eurozone Member States when necessary. Clearly, **the ESM needs to be integrated into the Community framework** and closer democratic scrutiny of its activities at the European level needs to be ensured – as proposed by the Five Presidents’ Report. With an enhanced governance in place, the institution could take on **additional functions** in the context of Eurozone’s fiscal capacity on the basis of proper revenues.

In this way, the ESM could evolve into a ‘European Monetary Fund’ or even a ‘Eurozone treasury’, helping to safeguard the stability of the common currency and ensure a healthy level of investment throughout the cycle. The ESM as an operator of part of the Eurozone fiscal capacity would **create an enabling environment for steady public investment**, and thus help to stabilise economic activity. The institution would strengthen the common currency and help to give Member States the necessary fiscal breathing space without involving lasting fiscal transfers.

The necessary legal changes could be implemented by **adapting the current ESM Treaty** and its operating rules (based already on the Community framework and the co-decision procedure).

A European unemployment insurance scheme probably should not be implemented through the ESM or a ‘Eurozone treasury’ but rather as a **specific instrument within the EU budget** (drawing on assigned revenue, outside MFF ceilings, serving participating countries only) **or as a self-standing insurance or re-insurance scheme**. Besides contributing to recovery from asymmetric shocks, it would also have the advantage of providing tangible support to people affected by cyclical downturns, creating a direct contact between Europe and citizens. Moreover, it could be implemented without Treaty changes.²²

3.5 Debt reduction strategy

- In 2017, the process should be launched to integrate the Treaty on Stability, Coordination and Governance in to the EU Treaties’ framework. In this context, we should bring back to the EU’s political agenda the question of feasibility of pursuing certain fiscal targets, in particular the **current benchmarks tied to debt reduction**. It should be stressed that a key requirement for debt sustainability is higher GDP growth, based on healthy investment and domestic demand and accompanied by inflation closer to the ECB target of price stability, which would help to accelerate the deleveraging process.
- In parallel, we should revisit options for partial pooling and **redemption or re-profiling of sovereign debt in the Eurozone**, which would help to strengthen incentives while bringing down overall re-financing costs, thus enabling to bring down governments’ debt/GDP ratios faster. The ESM could offer an institutional framework to that effect. These debt redemption operations would need to be based on a well-defined sovereign debt re-profiling procedure, whose existence would also help to strengthen market discipline of individual Member States. Such a procedure could have destabilising effects if introduced on its own, but it could strengthen the Eurozone if carefully designed and supported by sufficiently robust and growth-friendly European instruments.

²² For details, see the paper “[European unemployment insurance scheme](http://bit.ly/1X82H2n)” by the Ministry of Finance of Italy, October 2015 (<http://bit.ly/1X82H2n>). The legal solution proposed there involves Articles 136 and/or 175 TFEU as possible legal bases. The same legal bases could also be used to establish the ‘convergence instrument’ (with assigned revenue drawn only from participating Member States) should it be decided that this is a more feasible option in the short term than extending and adapting the ESM’s mandate.

4. Completing the Banking Union – towards effective financial risk reduction

The Banking Union is where most progress in strengthening the EMU has been achieved so far. It sets out a framework which aims at ensuring that the costs of banks' failure or restructuring are covered by the banking sector itself. This approach is of great political significance, and our political family has been condemning the use of public funds, i.e. taxpayers' contributions, for the rescue of banks.

Over recent years, banking regulation and supervision has been strengthened, which is an achievement we need to protect. Moreover, with the entry into force of the 'bail-in' mechanism, shareholders and creditors are much more responsible for covering the cost for saving banks. However, the banking market in Europe remains fragmented as banks in 'peripheral' countries are perceived to be more risky.

Our objectives:

Cut the vicious link between banks and sovereigns, ensuring resilience of the financial sector and effective protection of taxpayers' money from future financial shocks, and making the financial sector serve the real economy by:

- ➔ **Implementing the outstanding legislative acts** related to banking union.
- ➔ Agreeing on the creation of a **common backstop to the Single Resolution Mechanism**, beyond national credit lines.
- ➔ Developing a common and coordinated **European Deposit Insurance Scheme** enabling to reduce financial fragmentation and protect deposits across Europe more effectively through risk-sharing accompanied by further risk-reduction.
- ➔ Creating a well-regulated **Capital Markets Union** to match better Europe's savings with its investment potential, notably by promoting innovative financing mechanisms such as crowdfunding, while avoiding repetition of mistakes in areas such as securitisation.
- ➔ Strengthening **financial regulation** to address the too-big-to-fail problem.

The responsibility for supervision and authority for resolution of larger banks has been shifted to the European level, but deposit protection remains dependent on national resources. Moreover, due to their slow post-crisis healing, banks do not fully transmit monetary policy impulses to companies and households. Overall, a lot more therefore remains to be done to ensure that the financial system starts serving the real economy, that citizens' insured deposits are effectively safeguarded from potential financial shocks in all euro area countries, and that the vicious link between public debt and bank failure is broken once and for all.

As with the Single Supervisory Mechanism and Single Resolution Mechanism, the remaining instruments of the banking union should also be obligatory for Euro area Member States, with a possibility for others to opt in. On the other hand, financial regulation covers all Member States in the context of the Single Market and the Capital Markets Union is likewise a project involving the whole EU.

Our proposals:

4.1 **Breaking the vicious link between states and banks – the creation of a fiscal backstop to the banking union**

- The implementation of the **Single Resolution Mechanism (SRM)** and the capitalisation of the **Single Resolution Fund (SRF)** must continue to assure the proper bail in of creditors of ailing banks and to stabilize the financial sector where this bail-in proves insufficient. However, judging from economic history, the foreseen financial capacity of the SRF could prove insufficient in future financial crises. Therefore, a **euro area fiscal backstop** is needed

for the resilience of the Banking Union and reliably to address the sovereign-bank nexus. Assigning the **European Stability Mechanism (ESM)** with the responsibility to serve as a backstop to the Single Resolution Fund would render the Banking Union more stable and resilient to financial shocks. This evolution of the ESM should go hand in hand with increasing its democratic accountability.

- Moreover, regulation **separating risky investment banking from retail banking activities**, drawing on the work done by the Liikanen group, must be achieved. Such a separation would strengthen the regulatory framework for protecting depositors and address the problem of too-big-to-fail.
- The implementation of the **Financial Transactions Tax**, initially based on enhanced cooperation, remains a key priority of our political family to restore fairness, promote financial stability, stimulate long-term investments and discourage financial speculation and excessive risk-taking. Revenue from the FTT could reinforce the relevant budgets and serve as an instrument of convergence and cohesion.

4.2 Safeguarding deposits

- The development and implementation of a **European Deposit Insurance Scheme** needs to be pursued based on the Commission's recent legislative proposal. The existing Deposit Guarantee Scheme is still vulnerable to financial shocks as it relies purely on a national fiscal backstop, thereby constituting another element of the sovereign-bank nexus that needs to be tackled. The safeguarding of citizens' deposits is pivotal for regaining stability and restoring a level playing field in the financial sector, for preventing bank runs and for re-cultivating trust in financial services.
- To meet this aim, a coordinated European framework that aims at delivering the highest degree of safeguards to depositors based on **shared responsibility for effectively tackling large financial shocks and minimizing both national and European financial risks** must be put in place. This framework should combine full implementation of national deposit guarantee schemes and the proposed European Deposit Insurance Scheme. The EDIS should be implemented in several stages and accompanied by appropriate further measures for risk reduction, carefully calibrated to control moral hazard and avoid possible further financial fragmentation.

4.3 Creating a Capital Markets Union for promoting useful investments²³

- The creation of a **Capital Markets Union** with adequate financial safeguards and **proper supervision** at the EU level should aim at **accelerating the ecological and digital transition** of the EU economy by building the appropriate framework to facilitate the flow of investment to the real economy, especially SMEs, in a way which is complementary to bank lending. However, greater private risk-sharing through a Capital Markets Union should not serve as an excuse not to complete the banking union or other pillars of the EMU. The use of capital flowing through Europe should also be carefully monitored and supervised: it is in the public interest to ensure that capital is used for economically, socially and environmentally useful investments to accelerate the ecological and digital transition as opposed to speculative and potentially destabilising activities.
- Attention should be paid to creating a Capital Markets Union that is **well regulated and abides to clear and transparent securitisation practices**, thus excluding tranching that renders securitised products complex and opaque. The development of innovative financing mechanisms such as crowdfunding and peer-to-peer lending should be supported with the Union, notably for private investments in line with Union objectives and policies. In order to build the necessary trust, a concrete framework should also be developed for efficient consumer and investor protection.

²³ "'A Progressive Capital Markets Union': Supporting Europe's real economy and SMEs", PES ECOFIN Ministers Declaration, September 2015 (<http://bit.ly/26zNBVK>).

Conclusion

The future of the Economic and Monetary Union depends on its successful integration, leading to sustainable and dynamic growth that stands to foster social and economic convergence. Ensuring financial stability, better responding to social imbalances, addressing Europe's investment needs, strengthening economic growth and fiscal responsibility, reducing financial risk and ensuring closer democratic oversight of Eurozone governance mechanisms are necessary elements that need to be achieved to successfully promote economic recovery and social inclusion. Fixing the Economic and Monetary Union is necessary for bringing the whole European Union back on a solid footing. Our political family can play a unique role in this respect.

Our overarching aim in the short term is to strengthen economic recovery, make sure that the EU and national governments can effectively deal with challenges facing them, break the vicious link between banks and sovereigns, reduce social inequalities, increase real economic convergence, address increased security risks and the arrival of asylum seekers, and strengthen democratic accountability. All this needs to be achieved in a fiscally responsible manner. For the medium term, Europe must urgently work towards creating fiscal stabilisation and solidarity mechanisms for tackling economic shocks and for promoting a steady investment flow. Developing these mechanisms will certainly take time but without them the EMU will still be vulnerable to crises and incapable to address and overcome them effectively.

As highlighted in the discussion of the working group, the following progressive policy goals should therefore be pursued as a matter of urgency:

- The **ceilings of the MFF 2014-20 should be revised upwards** in order to enable effective European responses to developments in the neighbourhood, create a safe and humane European border and implement a common European asylum policy;
- The European Investment Bank should be asked to implement the **EFSI** in full additionality to its pre-existing investment volumes and to make job creation, cohesion, and productivity growth the top priorities when selecting investment operations. On these conditions, the mandate of the EFSI should be further extended and additional public support provided to it;
- The **flexibility of the Stability and Growth Pact** should be extended, in particular by exempting national co-financing of EU Structural and Investment Funds programmes from deficit calculations. Estimation of potential growth should be based on a time horizon longer than two years;
- **Tax fairness**: Progressive changes to tax systems are needed, including implementation of the Financial Transaction Tax based on enhanced cooperation, as well as vigorous fight by the EU and all Member States against tax avoidance, so that profits generated by Europe's economy are re-invested for sustainable growth;
- Creation of a **Eurozone fiscal capacity**, building on the European Stability Mechanism where relevant, based on a workable and democratically legitimate governance structure and providing support to renewed structural convergence as well as ensuring macroeconomic stabilisation and preventing investment slumps in cases of symmetric and asymmetric shocks affecting the monetary union;
- Completing the **banking union** through a backstop to the Single Resolution Fund and a European Deposit Insurance Scheme;
- Establishment of a **well-regulated and supervised Capital Markets Union**, helping to diversify macro-economic risks away from banks and taxpayers while supporting Europe's ecological and digital transitions and long-term sustainable growth.

The Economic and Monetary Union is a magnificent project but it cannot be a Union that merely shares a common currency and the constraints that come with it. It has to become a true socio-economic monetary union that acts responsibly to the greatest aggregate benefit of the continent, also by undertaking necessary future-oriented investments. Such a union must go beyond national interests, fostering the growth potential throughout the union within the context of a Single Market

that preserves Europe's much-valued social model. Our family wants radical changes in the way economic and monetary policies are designed and implemented in Europe. We want to develop a Union in which people can prosper, where quality jobs are created, where the financial sector can be trusted and good-quality public services are provided to everyone.