Shaping the Economic Union

The euro-zone crisis as an opportunity

Draft2011.11.17

Maria Joao RODRIGUES
Professor of European Economic Policies, Institute of European Studies, Université Libre de Bruxelles. Policy Advisor in the EU Institutions

Maria Joao RODRIGUES

Draft 2011.11.15

Contents

The current debate and reform of the EU economic governance can open a new chapter in the history of the Economic and Monetary Union. After an assessment of the current euro-zone crisis, this paper develops a comprehensive view on how can we use the ongoing reforms of the EU economic governance to shape the EMU. Its purpose should be not only to overcome the current euro-zone crisis, but also to pave the way to foster a new growth model in the EU and all its Member States.

1. Crisis in the euro-zone or of the euro-zone?

There are two different ways to look to the current euro-zone crisis: a crisis in the euro-zone or a crisis of the euro-zone.

According to the first version, the main problem has to do with the lack of fiscal discipline in some peripheral countries which led to unsustainable public debts damaging the credibility of the euro. Hence, the logic solution should be to strengthen fiscal discipline and to impose austerity even at the cost of recession in these countries, which should learn a lesson. Ultimately, if they default, their negative effect can be contained because they are peripheral economies.

According to the second version, the need to strengthen fiscal responsibility is also accepted, but a more comprehensive diagnosis is proposed. Some fiscal and macro-imbalances were already at work before the financial crisis, but they were deeply worsened by its impact leading to a recession, rising unemployment and banks rescues requiring stimulus packages with strong implications for public deficits. This shock has hit the euro-zone as a whole, but the recovery process was easier for the Member states with more fiscal space and/or more reliance on exports to outside Europe.

This differentiation in the recovery was then turned into an increasing differentiation in the financing conditions (spreads) within the euro-zone, which were magnified by some financial operators learning how to extract extra-profits from the euro-zone flaws. First, when exploiting some countries'fears to default by offering them loans at higher price; second, when finally the euro zone could create its defence mechanism, by exploiting some countries's fears regarding its tough conditions leading to a forced recession.

In this second version about what is happening, there are two reasons why we are in face of a **systemic crisis of the euro-zone**:

- first, while some differences in the spreads across Member States can be accepted as normal, these increasing divergences are worrying because they will also turn into divergences of their investment conditions, their growth and employment rates as well as their public deficits and debts;
- These cumulative divergences will be magnified by the strong interconnections among banks across the euro-zone, creating a domino effect which will be very difficult to control and can turn fragmentation into collapse.

2. What is at stake: the euro-zone and globalization

Ultimately, what is at stake is **to strengthen the euro-zone in order to reposition Europe for the new emerging global competition**. In its fundamentals, Europe is well placed to take the lead in building the competitive advantages of the future focusing on a new growth model, a greener, smarter and inclusive one. What is missing is a stronger launch of this strategy overcoming the major flaws in the euro-zone management.

The financial and economic crisis has exposed extensively these **flaws**:

- they are not only the **weak coordination** fiscal policies to ensure the necessary discipline in a common monetary zone; they are the need to have more European coordination of tax policy, notably if new tax sources (such as green or financial taxation) need to be introduced to re-balancing the budgets,
- they are also the **lack of instruments to ensure macro-economic stability**, since Member States lost their traditional instruments but these were not replaced by others at European level. When the manipulation of the exchange rate to foster growth is no longer possible by definition, it is crucial to ensure a **reasonable interest rate** to enable recovery. This depends on

controlling inflation- the main task of the European Central Bank – but also on improving the public debt management –something which seems to be beyond its normal remit.

As long as new instruments are not available, **macroeconomic stabilisation in face of strong shocks will no longer be possible** at least for some euro-zone countries, meaning they can only adjust by lowering wages or destroying employment. Needless to say that investing into a new growth model will become for them an almost impossible task. One can reply these countries need to make structural reforms to foster their structural competitiveness; they certainly need to make more than they are doing but, in the meantime, they will go to a recession and further risks of insolvency and default. This will increase the systemic risks which were referred above for the euro-zone as a whole. **In such conditions, the euro-zone will certainly not be a strong platform for Europe to compete at global level**. It would become instead an interesting area for other global competitors to buy some strategic assets cheaper.

3. The priorities to strengthen the long-term sustainability of the euro-zone

To overcome this outlook, we need to have a more comprehensive view on the priorities to strengthen the long-term sustainability of the euro-zone. They seem to be:

a/ **Fiscal responsibility** coupled with a last resort **solidarity** regarding sovereign debt

b/ A **reformed financial system** to ensure financial stability and foster growth

c/ A stronger coordination of economic policies combined with structural reforms to promote a new kind of **growth**

d/ The reduction of the internal divergences. On the long term it is difficult to ensure the nominal **convergence** between the euro-zone members without increasing their real convergence.

This last issue has been overlooked in the management of the euro-zone. Its internal divergences do not have only to do with different commitments with fiscal discipline or with structural reforms, but also with different stages of competitive development and with different patterns of industrial specialisation. These differences involve different risks of asymmetric shocks, requiring adapted solutions to be supported at European level.

Moreover, the reduction of macro-economic imbalances depend not only on the effort of each Member State, but also on providing the appropriate European general conditions: a reasonable interest rate for all Member

States, a higher European growth rate, a European bank framework to ensure responsible lending and borrowing, a European financial support for catching-up regions.

The new Euro-zone Pact should consider these four priorities and not only the first two ones, as the initial German proposal was doing. The Euro-plus Pact adopted in March 2011 has introduced some improvements, but still remains imbalanced and uncomplete.

4. Shaping the euro-zone reforms in the good direction

The current reforms of the EU economic governance should be shaped to progress in these priorities.

In fact, major reforms of the EU economic governance are already underway, covering the following building blocks:

- The Europe 2020 strategy for growth and jobs
- The European semester and the new coordination process of fiscal, economic and social policies at European level
- The reform of the Stability and Growth Pact
- The new procedure of macro-economic surveillance
- The new single market agenda
- The Community budget
- The new instruments for financial stability
- The reform of the financial system and the new supervision system
- The Euro-Plus Pact as a new general and political agreement for deepening the coordination between the euro-zone members and the others wanting to join

We need to have a **comprehensive view** of all these building blocks to shape the overall direction of these reforms and set a new compromise to strengthen the euro-zone. There are **two major strands in these reforms**:

- The **coordination of national policies**, not only budgetary and macro-economic policies, but also economic and social policies in general
- **Stronger European instruments**: not only the European financial supervision bodies, the next Community budget and its programmes, but also the need to create a permanent European Financial Mechanism, able to assist in sovereign debt crisis, to improve debt management and to support key investments.

These reforms should pave the way for a very much needed qualitative leap: building an Economic Union, to be coupled with the current Monetary Union.

<u>**Central Question**</u>**: How should these reforms be conducted in order to advance the above mentioned priorities to strengthen the euro-zone sustainability** (see Table 1)?

a/ The European semester should improve the consistency between the European and national decisions and the coherence between the Stability and Convergence Programmes and the National and Reform Programmes, creating more positive synergies between growth, structural reforms and fiscal consolidation

b/ **The single market agenda** should open new market opportunities, while actively promoting tax convergence and the upward convergence in social and environmental standards

c/ **The macro-economic surveillance** should reduce the macro-economic imbalances with a balanced approach, focusing on sustainable growth as its main objective; should also improve the cross national coordination of deficit and surplus countries, in order to increase the positive spill-over effects and to counter the negative ones

d/**The Community budget** should fund stronger Community programmes to support to the EU20202 Strategy and provide structural funds for catching-up countries, with stronger conditionality regarding the EU2020 objectives

e/ The revised Stability and Growth Pact should ensure stronger fiscal discipline, reward the quality of public finances, improve the coordination of tax sources and social contributions and ensure public space for the EU2020 investments and for catching-up investments

f/ The European Stability Mechanism should reduce speculative pressures over the euro-zone, ensure reasonable spreads among Member States, work as a last resort solidarity against sovereign default and enable key national public investments which do not find other financing alternatives g/ **The European supervision and regulation of the financial system** should ensure stronger financial stability, reduce speculative pressure on sovereign debt and more focus of the financial system on supporting growth and investment according to the EU2020 objectives

h/ The **Euro-Plus Pact** should deepen the coordination between the euro-zone members regarding not only budgetary, tax and financial policies, but also economic, social and environmental policies for sustainable development

Against this framework, the **EU 2020** would have better conditions to be implemented, involving all Member States, increasing the international attractiveness of Europe for new investments and strengthening Europe's global competitiveness.

5. Striking new compromises

The fine-tuning of all these instruments will face many divergences requiring **specific compromises** which are interconnected in a more **general compromise**.

New compromises regarding the **Single Market**:

- opening or protecting the national markets? Opening, combined with support to capacity building and protection of better standards
- standards harmonization or flexibility? More convergence, combined with support to capacity building

New compromises regarding **macro-economic surveillance**:

- reducing the imbalances of the deficit or of the surplus countries? Both
- reducing the current account and competitiveness deficits or the unemployment rates? Both
- Changing countries' behaviours with sanctions or with incentives? With both
- Overcoming imbalances by national efforts, but also by better European coordination

New compromises regarding the **Community Budget**:

- less or more resources? The same, but a new kind of resources
- less or more structural funds? The same, with stronger conditionality
- Focus on excellence or easier access to the Community Programmes? Focus on excellence and support to capacity building to be provided by structural funds

New compromises regarding the **Stability and Growth Pact**:

- straight fiscal tightening blocking all public investments or keeping fiscal space for investments? Selective spending cuts and fiscal space specially for key EU 2020 investments

- spending cuts or new revenues? Selective spending cuts and new sources of revenue (financial and green)

- Tax harmonization or tax flexibility? Tax convergence

- Social contributions and retirement age harmonization or social flexibility? Social convergence promoting active ageing and discouraging early retirement

- automatic or discretionary rules for fiscal discipline? Semi-automatic and smarter rules

Finally, new compromises regarding the **European Stability Mechanism**:

- providing loans or buying national bonds? Both
- higher or lower interest rate? Lower, I assuming that public creditors are considered senior
- more or less resources? More to minimize use
- sovereign default or not? To be avoided by a stronger preventive action
- strong conditionality or not? Strong but balanced, considering fiscal consolidation and growth
- larger euro-bonds issuance or not? Yes, with a cap and an access price in line with the national risk

Two of these issues deserve a more detailed development in the next sections because they are **interconnected at the heart of a new Euro-zone Pact**:

- the transition from the current EFSF, European Financial Stability Facility to the new ESM, European Stability Mechanism
- the coordination and convergence of national economic policies in the framework of the so-called European semester

6. The transition to the European Stability Mechanism

The transition from the current EFSF, European Financial Stability Facility to the new ESM, European Stability Mechanism should be stepped up in order to deactivate the epicentre of the financial pressure hitting the euro-zone and to restore financial stability for all Member States. This transition can proceed by taking the following steps, in a gradual metamorphosis:

- regarding its **roles**: control and prevent sovereign debt crisis; support key investments which cannot find other funding solutions; improving debt management of the euro-zone members
- regarding its **instruments**: providing conditional credit lines and loans, buying in the primary and secondary markets, issuing euro-bonds to provide loans; issuing euro-bonds to buy national bonds; special issuance of euro-bonds to fund key investments; to turn a capped tranche of national bonds into euro-bonds
- regarding the **financial base** to ensure AAA rating: national guarantees with senior status; a provisional credit line by the ECB; joint guarantee; own reserves and capitalisation (by buying and selling bonds)
- regarding **conditionality**: fiscal re-balancing and banks restructuring; fiscal consolidation, sustainable growth and structural reforms
- regarding the **interest rate**: higher than German bund, but reasonable enough to enable fiscal consolidation and recovery
- regarding the **amount** of resources: large enough to deter financial speculation

7. More coordination and convergence of national economic policies

The coordination of the national economic policies at European level in the framework the European semester will by translated into the presentation by all Member State of:

- their Stability and Convergence Programmes, indicating their medium term objectives for fiscal consolidation and for macroeconomic re-balancing and their priorities to achieve them
- their National Reform Programmes, indicating their national targets to meet the EU2020 headline targets and their priorities to achieve them as well as to implement the EU2020 flagship initiatives

These two national programmes should be made **coherent in the framework of the integrated guidelines for growth and jobs**, encompassing the broad economic guidelines and the employment guidelines, aiming at a policy mix reaching three main objectives: promoting a greener, smarter and inclusive growth, re-balancing the national budgets and reducing the macro-economic imbalances.

In order to make consistent progress in these three objectives when national economies are strongly interconnected, this coordination should also involve a certain level of **convergence which should engage particularly the euro-zone member states and all the others wanting to join.** This joint convergence effort should notably focus on:

The following indicators:

a/total unit costs and unit labour costs (low competiveness countries should increase productivity, high competitiveness countries should increase internal demand)
b/ growth rates and well being indicators
c/ public debt rates (MTOs considering different investment needs)
d/reasonable interest rates for private and public investments
e/minimum investment rates in R&D, education and infrastructures
f/unemployment rate (general, women, young, elderly people)
g/ stress tests indicators

The following policy measures:

- Coordinated innovation and industrial policy, supported by structural funds with stronger conditionality
- Framework for public debt sustainability
- tax sources and levels (common consolidated tax base, minimum corporate taxes, new sources of taxation)

- promoting active ageing and the employment rate, closing the gap between effective and legal age, while considering professional specificities
- convergence of minimum social standards (precarious work, minimum income schemes)
- crisis management regime for banks at the national and European levels

The efforts to be deployed by Member States towards these convergences should be followed up at European level with peer pressure, recommendations, sanctions and incentives to be provided by:

- the Stability and Growth Pact (fines/ more time to consolidate budgets)
- the macro-economic surveillane
- the European Stability Mechanism (access and interest rate to be paid to use euro-bonds)
- the Community Budget (stronger conditionality related to the structural funds, project selection in the Community Programmes)

The Euro-Plus Pact defined in February 2011 was an attempt to deepen this coordination and convergence. Some progress was made, but it remained an imbalanced and uncompleted framework. For a detailed assessment see the Table 2 below.

8. Central dilemmas for the European economic policy

Beyond overcoming the sovereign debt crisis, the most daunting challenge in the short term will be ensuring fiscal consolidation whilst boosting recovery. Moreover, recovery cannot be seen as a return to the past, but rather as a transition toward a new low-carbon, knowledge-intensive and more inclusive growth model. Basically, the euro-zone faces two central choices:

- Either to prioritise fiscal consolidation and sacrifice recovery, or to prioritise recovery while paving the way for consolidation. Investment and job creation are essential for a more effective strategy of fiscal consolidation as they reduce the costs of social protection and increase tax revenues. Higher rates of growth and concomitantly higher public revenue, together with returns generated by public investments, can help to reduce public debt. The cuts to introduce in public spending should not damage this central process

- Either to impose a uniform pace for consolidation or leave some room of manoeuvre to foster real convergence, accommodating different investment needs, welfare system reforms, patterns of specialisation and their implications for the asymmetric shocks stemming from the financial and economic crisis.

Depending on which choices are made, the euro-zone can expect two different scenarios:

- If it chooses to move uniformly to attain fiscal consolidation quicker, it risks internal fragmentation, with many regions stagnating or trapped by recession
- In order to prevent such tensions, the alternative scenario should combine fiscal responsibility with stronger coordination of economic growth policies and with new European instruments to finance growth

In order to deal with this central dilemma over the next few years, economic policies should undergo some important changes:

a/ improving the **surveillance regarding fiscal consolidation** with ex-ante coordination and a stronger focus on the long term sustainability of the public debt

b/ coordinating the re-direction of **public expenditure to promote key investments** to foster a more low-carbon, knowledge-intensive and inclusive growth model and to prioritise jobs creation, making a clear distinction between “good” and “bad” spending cuts. Member States that are more able to undertake this shift should have more time to reduce their public deficit and debt. The improvement of the quality of public finances should be rewarded.

c/ to **make the best of positive spill-over effects**, increasing European aggregated demand. The starting point should be to estimate the aggregate effect of Member state public investments projected for the coming years.

d/ coordinating the shift **of the tax burden to new sources**, notably pollution and financial transactions, so as to avoid overburdening labour costs, which would damage jobs creation and social fairness. If it is to work properly, this re-direction of tax policies also requires better European coordination.

e/Developing of a new European instrument to create better conditions for Member states to issue national debt, in order to support new long term investments needed to promote the transition to a more low-carbon, knowledge –intensive and inclusive growth model. The issuance of **euro-denominated bonds** is already happening successfully within the framework of the Community Mechanism to support non-euro-zone EU Member States with balance of payments problems and euro-zone Member States as well as with the recently created EFSF, European Financial Stability Facility.

f/ **Monitoring and reducing the macro-economic imbalances in the euro-zone.** Some macroeconomic imbalances were magnified by the crisis and are now more visible in the current accounts and the balance sheets of the households and companies. Their underlying causes might be explained by unsustainable public spending, wage developments or by lack of productivity improvements. Nevertheless, in the present conditions, they are also explained by lack of demand for investment and consumption at European level, inequalities in income distribution, increasing unemployment and poverty, deeper regional inequalities and lack of effective instruments to finance public budgets. Therefore, multilateral surveillance should follow-up these different dimensions in order to identify the appropriate and specific solutions. Beyond the national specific solutions, there are general principles which should be implemented. Macroeconomic imbalances can be reduced by better conditions for recovery in all Member States, and this requires more European coordination.

9. Moving to a new EMU architecture

This final section addresses the **central issue for the future of the eurozone and of the European integration**: how can we complete the architecture of the EMU by building on its current features and ongoing reforms? These reforms of the economic governance are now quite comprehensive and involve the coordination of the economic policies as well as the development of new European instruments.

A reference to the experience of federal systems will also be made, not because this is feasible in the EU but because it can give a sense of direction. There is a quite large variety of federal systems according to the way the **functions of allocation of resources, the redistribution of resources and of macro-economic stabilization** are performed at the different levels of governance: local, State or Federal level. There are two particular issues in the experience of federal systems which are relevant for the current European debate:

- Is the role of **macro-economic stabilization necessary** in a way or another? Yes it is, to ensure a smoother path of sustainable growth while the necessary adjustments take place in allocation and redistribution of resources to cope with new challenges

- What should be the **response when particular State(s) or region(s) are facing special** difficulties? The central problem is always to strike the right balance between the effort to make by this State and the one to be made by the Federal level, when it comes these three main functions.

We urgently need to deepen the European debate about these issues. In retrospective terms, we can remark that:

- Before the launch of the single currency, these three functions were mainly played by the national level, with a small complementary role of the Community budget when it comes allocation and redistribution. Macro-economic stabilization could be ensured by the exchange rate, monetary and budgetary policies at national level;

- With the creation of the eurozone, its Member States can no longer use exchange and monetary policies for macro-economic stabilization; they are only confined to the budgetary ones, and in a more constrained way according to the limits set by the Stability and Growth Pact.

This uncompleted construction is only sustainable as long as there are converging growth rates and interest rates across Member States, and as long as there are not major symmetric or asymmetric shocks disturbing this convergence.

If there is major shock- which is now the case since the financial crisis of 2008 – the EMU will be confronted with the two central issues above defined. An effort needs certainly to be made by the hit States themselves, **but this effort should be complemented by new developments at European level**, notably if the macro-stabilization role of the national budgetary policies is to be reduced in order to diminish the public debt burden, which is the case now. These new developments are particularly:

- A permanent mechanism to ensure **reasonable costs for public debt service** in all euro-zone members, even if some differences are kept among them;

- A function of **macro-economic stabilization to be introduced in the community budget** in order to support particular regions or groups under stress;

- More **convergence in tax policies**;

- A **European growth strategy** combining new investments with a coordinated agenda for structural reforms.

These new economic developments require stronger political coordination at European level and therefore, a new political legitimacy at European level - which should be strengthened in the European Council, the Council of Ministers as well as the European Council.
Against this background, we can now detail the **necessary developments of the EMU, Economic and Monetary Union** in the following terms:

a/ **National budgetary policies**:
- In the current EMU, play a role of macro-economic stabilization under the limits defined by the SGP;

- In a new EMU, if this role is more limited by national law and by a revised STABILITY AND GROWTH PACT, it needs to be developed at European level;

- We should bear in mind that, in federal systems, this role is more limited at State level because it was tranferred to the Federal level.

b/ **European budgetary and economic coordination:**
- In the current EMU, the surveillance of the MStates' budgetary policies proceeds according to the Stability and Growth Pact; the macro-economic imbalances are not under surveillance and correction;

- In a new EMU, there is a revised STABILITY AND GROWTH PACT with stronger prevention and correction procedures of MStates' public deficits and debts as well as a new macro-economic surveillance is put in place. Moreover, there is a coordination of budgetary and macro-economic policies to maximize sustainable growth at European level;

- We should bear in mind that, in federal systems, the limits of MStates' public deficits and debts are defined at Federal level and the overall budgetary and macro-economic policies are defined at Federal level.

c/ **Public debt management:**
- In the current EMU, public debt issuance and loans are managed by national agencies;

- In a new EMU, debt issuance is also partially managed by a European Public Financial authority (building on EFSF-ESM); the ECB should also play the role of lender of last resort;

- We should bear in mind that, in federal systems, a Federal Treasury can borrow and issue public debt.

d/ **The Community budget:**

- In the current EMU, is mainly funded by national contributions and can finance Community Programmes and structural funds to reduce regional divergences;

- In a new EMU, it can be more funded by own resources. Moreover, structural funds can also be used for macro-economic stabilization supporting specific regions and groups;

- We should bear in mind that in federal systems, the federal budget has a much bigger size, is funded by federal taxes and can finance Federal programmes supporting specific regions to reduce structural divergences and macro-economic imbalances.

e/ **The European growth strategy:**

- In the current EMU, is based on coordinating MStates structural reforms complemented by some quite small Community programmes;

- In a new EMU, the coordination of structural reforms at European level becomes deeper and these Community Programmes become larger;

- Whereas in federal systems, Federal Programmes and federal structural reforms complement the MStates' ones.

f/ **The executive power:**

- In the current EMU, is based on MStates Governments, the European Council, the EU Council of Ministers and the European Commission;

- In a new EMU, is also based on a Eurozone Government at PMs and ministerial level, with permanent Presidents. In the current conditions, this is an unavoidable complexity, in face of:

- Federal systems with permanent President and Ministers.

g/ **The legislative power**

- In the current EMU, is based on MStates parliaments and governments, the EU Council of Ministers and the European Parliament;

- In a new EMU, it is also based on a Eurogroup Council of Ministers; later on, a special committee for the eurozone in the European Parliament, creating a stronger European democratic legitimacy, beyond the national legitimacy provided by MStates' parliaments and governments. In the current conditions, this is an unavoidable complexity, in face of:

- Federal systems, where the central democratic legitimacy comes from a Federal Congress with a Senate and a House of Representatives.

In conclusion, the current reforms of the EU economic governance should be shaped bearing in mind a more comprehensive architecture for the EMU. A EMU more fitted for the future should be equipped with:

- A European strategy for a new growth model, smarter, greener and more inclusive, to be translated into national policies, budgets and stronger European instruments
- A Community budget, based on new own resources and able to provide leverage to a longer general re-allocation of resources focusing on the key strategic priorities of the Union; also able to reduce the regional divergences and the macro-economic imbalances
- A European public finance authority, monitoring the national budgets in their quantitative and qualitative objectives, ensuring coordinated discipline and providing the basis for:
- A European agency able to issue euro-bonds to finance long term investment needs and to improve debt management;
- A European stability mechanism, able to provide assistance in case of sovereign debt crisis
- A European framework for the financial system regulation and supervision
- A euro-zone pact deepening the coordination, convergence and the external representation of the euro-zone

This vision shows how the current crisis of the euro-zone and the ongoing reforms of the economic governance can provide an opportunity for a qualitative leap in the EMU, if a pro-European leadership is more influential.

PRIORITIES FOR THE EUROZONE SUSTAINABILITY **EU POLICY INSTRUMENTS**	PROMOTING A NEW KIND A OF GROWTH	ENSURING FISCAL RESPONSIBILITY	ENSURING FINANCIAL STABILITY	INCREASING INTERNAL CONVERGENCE
EU2020 STRATEGY Community Programmes National Reform Programmes	Beyond GDP measuring growth 3 Strategic priorities 10 guidelines 7 flagships	Structural reforms for more effective and efficient public finances	Increasing the attractiveness for new investments	Generalising the implementation of the EU2020 Strategy
SINGLE MARKET	New market opportunities	New sources of taxation Tax coordination	Financial markets integration and reform	Tax and social convergence
MACRO-ECONOMIC	Create conditions to	Facilitate budget re-balancing	Strengthening National	Correcting the macro-economic

TABLE 1
THE REFORM OF EU ECONOMIC GOVERNANCE- COMPREHENSIVE OVERVIEW
Fine-tuning its policy instruments to strengthen the sustainability of the euro-zone

SURVEILLANCE AND CORRECTION	implement EU2020 Coordinate spill-over effects		attractiveness for new investments	imbalances with a balanced approach
EU BUDGET Community Programmes Structural Funds EIB	Providing additional financial support to the EU2020	Reducing national budgetary effort	Providing a guarantee to project bonds	EU support to catching-up
STABILITY AND GROWTH PACT	Ensure fiscal space for EU2020 investments	Stronger fiscal discipline Reward the quality of public finance New sources of public revenue	Credibility of the Medium-term objectives	Ensure fiscal space for catching up investments
EUROPEAN STABILITY MECHANISM	Enable key national public investments	Last resort solidarity against sovereign default Mutualisation of debt issuance	Reduce speculative pressures over the euro-zone	Ensure reasonable spreads among Member states
EUROPEAN SUPERVISION SYSTEM FINANCIAL SYSTEM REFORMS	Make financial system support Eu2020 objectives	Reducing speculative pressure on public debt	Stess tests, Regulations, reserves, bonus to ensure responsible financial investment	
EUROPEAN CENTRAL BANK	General conditions to promote growth	Ensuring stable conditions for low interest rates	Inflation control	Last resort to ensure access to credit(provisional)

TABLE 2 ASSESSING THE EURO-PLUS PACT

	POSITIVE	NEGATIVE
EMU DEVELOPMENT	Stronger Economic Union Permanent financial stability mechanism Stronger coordination of fiscal and economic policies Concern with internal convergence	No coordination for growth No stronger coordination of social policies Only focus on fiscal convergence The role of the Community budget is ignored in the overall architecture of the EMU
GENERAL PRIORITIES	Employment was added to fiscal sustainability and to competitiveness	Promoting growth and job creation is not a central priority Reforming the financial system neither
SPECIFIC PRIORITIES COMPETITIVENESS	Investment in education, R&D, innovation and infrastructures is mentioned	The relationship between wages and productivity remains central to increase competitiveness. Risk of making wage and social benefits cuts
SPECIFIC PRIORITIES EMPLOYMENT	Lifelong learning and not only flexicurity	No reference to upward convergence of social standards
SPECIFIC PRIORITIES SUSTAINABILITY OF PUBLIC FINANCES	Convergence on retirement age is more nuanced Financial transaction tax is referred Legal framework rather than constitutional debt break	Debt sustainability is not considering fiscal space to invest There is no real commitment regarding new tax sources to rebalance the budgets
SPECIFIC PRIORITIES FINANCIAL REFORM	More precise bank stress tests	No clear European framework to deal with bank restructuring No clear commitments to pursue the financial reform
GOVERNANCE	More references to community method More references to the role of social partners European Council and not Ecofin taking the lead	Many ambiguities regarding the community method Many ambiguities regarding the role of social partners Imbalance between Council formations. No reference to the European Parliament
FINANCIAL STABILITY MECHANISM	More resources New instruments(buying in the primary market) Possibility to reduce interest rate	No possibility to buy bonds in the secondary markets Interest rate still too high Imbalanced conditionality Role of the IMF No joint guarantee Issuance of Eurobonds for too limited purposes

TABLE 3 ASSESSING THE 21 JULY 2011 PACKAGE

ISSUES	POSITIVE	NEGATIVE
General approach	Recognizes for the first	Falls short on a systemic

	time general nature of the eurozone crisis and , implicitly the risks for Europe as a whole	solution, on the quantum leap which is necessary for the EMU architecture. Patchwork approach remains
Greece	Recognizes for the first time the need for growth and a Marshall Plan Reduces interest rates and extends maturities	Marshall Plan not clear at all Ambiguities in the way to restructure the debt, involving the private sector but without default. The best solution would be a swap of Greek bonds against EFSF bonds (Eurobonds)
Stop Contagion	Ireland and Portugal will also benefit from lower interest rates and longer maturities Flexibilization of the EFSF, allowing preventive measures, loans without adjustment programmes and intervention in the secondary markets Recognizes for the first time the need to support growth. Decides better combination between structural funds and loans	The reform of EFSF is not strong enough regarding its scope, the absence of a joint guarantee and a larger use of Eurobonds in order to improve debt management. We need a European debt management agency Falls short on new financial means to support investment and growth (Eurobonds, FTT)
General deal on economic governance	Makes a connection between more solidarity, responsibility and coordination (in budgetary, fiscal and economic policies)	The general bias in the reform of the economic governance remains Stability and Growth Pact with no room for investment Macroeconomic surveillance imbalanced Euro Plus Pact without concern for growth , employment and the social dimension

TABLE 4
COMPLETING THE ARCHITECTURE OF THE EMU

Main features	Current EMU	New EMU	Federal systems
National budgetary policies	-National budgetary policies play the role of macro-economic stabilization under the limits defined by the SGP	-This role is more limited by national law and by a revised SGP	-This role is more limited at State level and it is tranferred to the Federal level
European budgetary and economic coordination	-Surveillance of the MS budgetary policies according to the Stability and Growth Pact -The macro-economic imbalances are not under surveillance and correction	-Revised SGP with stronger prevention and correction procedures of MS deficit and debt -New macro-economic surveillance -Coordination of budgetary and macro-economic policies to maximize sustainable growth	-The limits of MS public deficit and debt are defined at Federal level -The overall budgetary and macro-economic policies are defined at Federal level
Public debt management	-Public debt issuance and loans by national agencies	-Partial debt issuance by a European Public Financial authority (building on EFSF-ESM)	-Federal Treasury can borrow and issue public debt
Community budget	-Funded by national contributions -Financing Community Programmes and structural funds to reduce regional divergences	-More funded by own resources -Structural funds can also be used for macro-economic stabilization supporting specific regions and groups	-Much bigger size -Funded by federal taxes -Financing Federal programmes -Supporting specific regions to reduce structural divergences and macro-economic imbalances
European growth strategy	-Coordinating MS structural reforms plus some small Community programmes	-These Community Programmes become larger	-Federal Programmes and federal structural reforms complementing the MStates ones
Executive power	MS Governments European Council EU Council of Ministers European Commission	Idem plus Eurozone Government at PMs and Finance Ministers level with permanent Presidents	Federal Government with permanent President and Ministers
Legislative power	MS parliaments and governments EU Council of Ministers and European Parliament	-Eurogroup Council of Ministers; -Later on also European Parliament - special committee for the eurozone -MS parliaments and governments	Federal Congress with Senate and House of Representatives