Collection of texts

(1961-2020)

concerning

European Economic and Monetary Union

compiled and edited by

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Introduction

The **European Economic and Monetary Union (EEMU)** has so far been the greatest achievement of European economic integration. Though its history does not date back to the very beginnings of European integration, the first attempts for a *monetary integration* in Europe were formulated as early as in the 1960s. Eventually the *Delors plan* was implemented and the *common currency, the euro* was introduced in 11 member states of the EU in 1999. In 2020, the currency union accounts for 19 members. The *financial and economic crisis* of 2008-2013 has definitely been the largest stress test so far for the Eurozone, and for the EU as a whole too. The *monetary union* is still an unfinished construct but a lot of *institutional development* has been undertaken since the outburst of the crisis.

The current collection of texts relevant in relation to the EEMU follows the chronological order. The *selection of these texts* is that of the editor of this collection, and so is the within-text underlining. The aim of this collection and of the highlighting through underlining is to guarantee the learning outcomes and the apprehension of the knowledge, skills, attitude and autonomy as of below.

Learning Outcomes, Knowledge, Skills, Attitude and Autonomy

Learning outcomes of the European Economic and Monetary Union course are:

– to have a firm grasp on the *concepts, theories, processes and characteristics* of economics and the economy in general on a micro and macro level in the European economic space;
– to be up to date with the defining *economic facts of the European Economic and Monetary Union (EEMU)* and the *common currency, the euro*;
– to understand the *structure, operating process and relationships* (domestic and international) of *economic organisations* with a special emphasis on the *European institutional environment*;
– to become familiar with and to have a strong understanding of the *essential knowledge necessary to identify international processes in the European space* and the *methods of professionally relevant information gathering, analysing and problem-solving techniques* along with their field of use and limitations.

In completing the **European Economic and Monetary Union** course, students shall gain the following competences in terms of knowledge, skills, attitude and autonomy:

(1) **Knowledge**:
- history and major steps of European integration, with special regard to monetary integration;
- basics of monetary policy and the common monetary policy in the Eurozone;

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- economic policy coordination and economic governance in the EEMU;
- the Eurozone crisis;
- plans to improve the EEMU.

(2) **Skills**:

- comprehensive reading of high-level official and professional texts in relation to the European integration, monetary integration and monetary union, monetary policy and economic policy;
- analysing texts in relation to the EEMU and monetary policy;
- understanding the functioning of the central bank and monetary policy;
- understanding the functioning of a currency zone.

(3) **Attitude**:

- responsible thinking of a currency and its management;
- appreciating stabilisation-oriented economic and monetary policies and the knowledge behind their making.

(4) **Autonomy**:

- appreciating the independence of central banks and of monetary policy;
- ability to exhibit objectivity in relation to monetary and economic policies.

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The theory of Optimum Currency Areas; the beginnings of European monetary integration

The **European Economic Community (EEC)**, predecessor of the European Union (EU) was formed by the **Treaty of Rome** on **25 March 1957** by the following six member states: (West) Germany, France, Italy, Belgium, the Netherlands and Luxembourg. However, **the Treaty did not contain any provisions on monetary cooperation or integration**.

At that time, the **Bretton Woods System** was operating.

The Bretton Woods Agreement and System

The Bretton Woods Agreement was negotiated in July 1944 by delegates from 44 countries at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire. Thus, the name "Bretton Woods Agreement. Under the Bretton Woods System, gold was the basis for the US dollar and other currencies were pegged to the US dollar's value.

The primary designers of the Bretton Woods System were the famous British economist John Maynard Keynes and American Chief International Economist of the US Treasury Department Harry Dexter White. Keynes' hope was to establish a powerful global central bank to be called the Clearing Union and issue a new international reserve currency called the bancor. White's plan envisioned a more modest lending fund and a greater role for the US dollar, rather than the creation of a new currency. In the end, the adopted plan took ideas from both, leaning more toward White's plan.

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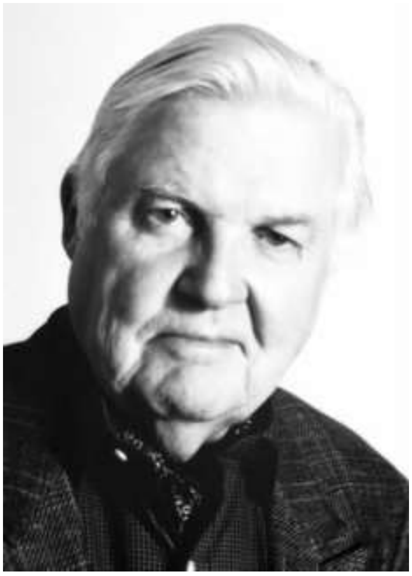
It wasn't until 1958 that the Bretton Woods System became fully functional. Once implemented, its provisions called for the US dollar to be pegged to the value of gold. Moreover, all other currencies in the system were then pegged to the US dollar's value. The exchange rate applied at the time set the price of gold at $35 an ounce.

In 1971, concerned that the U.S. gold supply was no longer adequate to cover the number of dollars in circulation, President Richard M. Nixon devalued the US dollar relative to gold. After a run on gold reserve, he declared a temporary suspension of the dollar's convertibility into gold. By 1973 the Bretton Woods System had collapsed. Countries were then free to choose any exchange arrangement for their currency, except pegging its value to the price of gold. They could, for example, link its value to another country's currency, or a basket of currencies, or simply let it float freely and allow market forces to determine its value relative to other countries' currencies.

The Bretton Woods Agreement remains a significant event in world financial history. The two Bretton Woods Institutions it created in the International Monetary Fund and the World Bank played an important part in helping to rebuild Europe in the aftermath of World War II. Subsequently, both institutions have continued to maintain their founding goals while also transitioning to serve global government interests in the modern-day.

Source: https://www.investopedia.com/terms/b/brettonwoodsagreement.asp

The Eurozone within the European Union forms a monetary union. As such, it can be compared to the theoretical implications of **Optimum Currency Areas** (OCAs) described by **Robert A. Mundell**, Nobel Memorial Prize-winning Canadian economist in a **1961** scientific journal article.



Robert A. Mundell (born October 24, 1932, in Kingston, Ontario, Canada) is a Nobel-prize winner economist. He earned his BA in Economics at the University of British Columbia in Vancouver, Canada, and his MA at the University of Washington in Seattle. After studying at the University of British Columbia and at The London School of Economics in 1956, he attended the Massachusetts Institute of Technology (MIT), where he obtained his PhD in Economics in 1956. In 2006 Mundell earned an honorary Doctor of Laws degree from the University of Waterloo in Canada. He was Professor of Economics and Editor of the Journal of Political Economy at the University of Chicago from 1965 to 1972, Chairman of the Department of Economics at the University of Waterloo 1972 to 1974 and since 1974 he has been Professor of Economics at Columbia University. He also held the post of Repap Professor of Economics at McGill University.

The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 1999 was awarded to Robert A. Mundell "for his analysis of monetary and fiscal policy under different exchange rate regimes and his analysis of optimum currency areas."

Robert Mundell has established the foundation for the theory which dominates practical policy considerations of monetary and fiscal policy in open economies. His work on monetary dynamics and optimum currency areas has inspired generations of researchers. Although dating back several decades, Mundell's contributions remain outstanding and constitute the core of teaching in international macroeconomics.

Mundell's research has had such a far-reaching and lasting impact because it combines formal – but still accessible – analysis, intuitive interpretation and results with immediate policy applications. Above all, Mundell chose his problems with uncommon – almost prophetic – accuracy in terms of predicting the future development of international monetary arrangements and capital markets. Mundell's contributions serve as a superb reminder of the significance of basic research. At a given point in time academic achievements might appear rather esoteric; not long afterwards, however, they may take on great practical importance.

Optimum Currency Areas

As already indicated, fixed exchange rates predominated in the early 1960s. A few researchers did in fact discuss the advantages and disadvantages of a floating exchange rate. But a national currency was considered a must. The question Mundell posed in his article on "optimum currency areas" (1961) therefore seemed radical: when is it advantageous for a number of regions to relinquish their monetary sovereignty in favour of a common currency?

Mundell's article briefly mentions the advantages of a common currency, such as lower transaction costs in trade and less uncertainty about relative prices. The disadvantages are described in greater detail. The major drawback is the difficulty of maintaining employment when changes in demand or other "asymmetric shocks" require a reduction in real wages in a particular region. Mundell emphasised the importance of high labour mobility in order to offset such disturbances. He characterised an optimum currency area as a set of regions among which the propensity to migrate is high enough to ensure full employment when one of the regions faces an asymmetric shock. Other researchers extended the theory and identified additional criteria, such as capital mobility, regional specialization and a common tax and transfer system. The way Mundell originally formulated the problem has nevertheless continued to influence generations of economists.

Mundell's considerations, several decades ago, seem highly relevant today. Due to increasingly higher capital mobility in the world economy, regimes with a temporarily fixed, but adjustable, exchange rate have become more fragile; such regimes are also being called into question. Many observers view a currency union or a floating exchange rate – the two cases Mundell's article dealt with – as the most relevant alternatives. Needless to say, Mundell's analysis has also attracted attention in connection with the common European currency. Researchers who have examined the economic advantages and disadvantages of EMU have adopted the idea of an optimum currency area as an obvious starting point.

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Indeed, one of the key issues in this context is labour mobility in response to asymmetric shocks.

Source: https://en.wikipedia.org/wiki/Robert_Mundell ; https://www.nobelprize.org/prizes/economic-sciences/1999/press-release/

Mundell, R.A. (1961): A Theory of Optimum Currency Areas (excerpts)

American Economic Review, November, pp. 657-665.

It is patently obvious that periodic balance-of-payments crises will remain an integral feature of the international economic system as long as fixed exchange rates and rigid wage and price levels prevent the terms of trade from fulfilling a natural role in the adjustment process. It is, however, far easier to pose the problem and to criticize the alternatives than it is to offer constructive and feasible suggestions for the elimination of what has become an international disequilibrium system. The present paper, unfortunately, illustrates that proposition by cautioning against the practicability, in certain cases, of the most plausible alternative: a system of national currencies connected by flexible exchange rates.

A system of flexible exchange rates is usually presented, by its proponents, as a device whereby depreciation can take the place of unemployment when the external balance is in deficit, and appreciation can replace inflation when it is in surplus. But the question then arises whether all existing national currencies should be flexible. Should the Ghanian pound be freed to fluctuate against all currencies or ought the present sterling-area currencies remain pegged to the pound sterling? Or, supposing that the Common Market countries proceed with their plans for economic union, should these countries allow each national currency to fluctuate, or would a single currency area be preferable?

The problem can be posed in a general and more revealing way by defining a currency area as a domain within which exchange rates are fixed and asking: What is the appropriate domain of a currency area? It might seem at first that the question is purely academic since it hardly appears within the realm of political feasibility that national currencies would ever be abandoned in favor of any other arrangement. To this, three answers can be given: (1) Certain parts of the world are undergoing processes of economic integration and disintegration, new experiments are being made, and a conception of what constitutes an optimum currency area can clarify the meaning of these experiments. (2) Those countries, like Canada, which have experimented with flexible exchange rates are likely to face particular problems which the theory of optimum currency areas can elucidate if the national currency area does not coincide with the optimum currency area. (3) The idea can be used to illustrate certain functions of currencies which have been inadequately treated in the economic literature and which are sometimes neglected in the consideration of problems of economic policy.

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I. *Currency Areas and Common Currencies*

A single currency implies a single central bank (with note-issuing powers) and therefore a potentially elastic supply of interregional means of payments. But in a currency area comprising more than one currency the supply of international means of payment is conditional upon the cooperation of many central banks; no central bank can expand its own liabilities much faster than other central banks without losing reserves and impairing convertibility. This means that there will be a major difference between adjustment within a currency area which has a single currency and a currency area involving more than one currency; in other words there will be a difference between interregional adjustment and international adjustment even though exchange rates, in the latter case, are fixed.

(…)

IV. *A Practical Application*

The theory of international trade was developed on the Ricardian assumption that factors of production are mobile internally but immobile internationally. Williams, Ohlin, Iversen and others, however, protested that this assumption was invalid and showed how its relaxation would affect the real theory of trade. I have tried to show that its relaxation has important consequences also for the monetary theory of trade and especially the theory of flexible exchange rates. The argument for flexible exchange rates based on national currencies is only as valid as the Ricardian assumption about factor mobility. If factor mobility is high internally and low internationally a system of flexible exchange rates based on national currencies might work effectively enough. But if regions cut across national boundaries or if countries are multiregional then the argument for flexible exchange rates is only valid if currencies are reorganized on a regional basis.

In the real world, of course, currencies are mainly an expression of national sovereignty, so that actual currency reorganization would be feasible only if it were accompanied by profound political changes. The concept of an optimum currency area therefore has direct practical applicability only in areas where political organization is in a state of flux, such as in ex-colonial areas and in Western Europe.

In Western Europe the creation of the Common Market is regarded by many as an important step toward eventual political union, and the subject of a common currency for the six countries has been much discussed. One can cite the well-known position of J. E. Meade [4, pp. 385-86], who argues that the conditions for a common currency in Western Europe do not exist, and that, especially because of the lack of labor mobility, a system of flexible exchange rates would be more effective in promoting balance-of-payments equilibrium and internal stability; and the apparently opposite view of Tibor Scitovsky [9, Ch. 2] who favors a common currency because he believes that it would induce a greater degree of capital mobility, but further adds that steps must be taken to make labor more mobile and to facilitate supranational employment policies. In terms of the language of this paper Meade favors national currency areas while Scitovsky gives qualified approval to the idea of a single

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currency area in Western Europe.

In spite of the apparent contradiction between these two views, the concept of optimum currency areas helps us to see that the conflict reduces to an empirical rather than a theoretical question. In both cases it is implied that an essential ingredient of a common currency, or a single currency area, is a high degree of factor mobility; but Meade believes that the necessary factor mobility does not exist, while Scitovsky argues that labor mobility must be improved and that the creation of a common currency would itself stimulate capital mobility.

VI. *Concluding Argument*

The subject of flexible exchange rates can logically be separated into two distinct questions. The first is whether a system of flexible exchange rates can work effectively and efficiently in the modern world economy. For this to be possible it must be demonstrated that: (1) an international price system based on flexible exchange rates is dynamically stable after taking speculative demands into account; (2) the exchange rate changes necessary to eliminate normal disturbances to dynamic equilibrium are not so large as to cause violent and reversible shifts between export and import-competing industries (this is not ruled out by stability); (3) the risks created by variable exchange rates can be covered at reasonable costs in the forward markets; (4) central banks will refrain from monopolistic speculation; (5) monetary discipline will be maintained by the unfavorable political consequences of continuing depreciation, as it is to some extent maintained today by threats to the levels of foreign exchange reserves; (6) reasonable protection of debtors and creditors can be assured to maintain an increasing flow of long-term capital movements; and (7) wages and profits are not tied to a price index in which import goods are heavily weighted. I have not explicitly discussed these issues in my paper.

The second question concerns how the world should be divided into currency areas. I have argued that the stabilization argument for flexible exchange rates is valid only if it is based on regional currency areas. If the world can be divided into regions within each of which there is factor mobility and between which there is factor immobility, then each of these regions should have a separate currency which fluctuates relative to all other currencies. This carries the argument for flexible exchange rates to its logical conclusion.

But a region is an economic unit while a currency domain is partly an expression of national sovereignty. Except in areas where national sovereignty is being given up it is not feasible to suggest that currencies should be reorganized; the validity of the argument for flexible exchange rates therefore hinges on the closeness with which nations correspond to regions. The argument works best if each nation (and currency) has internal factor mobility and external factor immobility. But if labor and capital are insufficiently mobile within a country then flexibility of the external price of the national currency cannot be expected to perform the stabilization function attributed to it, and one could expect varying rates of unemployment or inflation in the different regions. Similarly, if factors are mobile across national boundaries then a flexible exchange system becomes unnecessary, and may even be positively harmful, as I have suggested elsewhere.

Canada provides the only modern example where an advanced country has experimented with flexible exchange rates. According to my argument the experiment should be largely unsuccessful as far as stabilization is concerned. Because of the factor immobility between regions an increase in foreign demand for the products of one of the regions would cause an appreciation of the exchange rate and therefore increased unemployment in the remaining regions, a process which could be corrected by a monetary policy which aggravated inflationary pressures in the first region; every change in demand for the products in one region is likely to induce opposite changes in other regions which can not be entirely modified by national stabilization policies. Similarly the high degree of external capital mobility is likely to interfere with stabilization policy for completely different reasons: to achieve internal stability the central bank can alter credit conditions but it is the change in the exchange rate rather than the alteration in the interest rate which produces the stabilizing effect; this indirectness conduces to a cyclical approach to equilibrium. Although an explicit empirical study would be necessary to verify that the Canadian experiment has not fulfilled the claims made for flexible exchange rates, the prima facie evidence indicates that it has not. It must be emphasized, though, that a failure of the Canadian experiment would cast doubt only on the effectiveness of a flexible exchange system in a multiregional country, not on a flexible exchange system in a unitary country.

Mundell, R.A. (1994): The European Monetary System 50 Years after Bretton Woods: A Comparison Between Two Systems (excerpts)

Paper presented at Project Europe 1985-95, the tenth edition of the "Incontri di Rocca Salimbeni" meetings, in Siena, 25 November 1994

This paper evaluates key features of the international monetary system that emerged in the post-war period and contrasts it with the European Monetary System that originated in the late 1990s and which came to be regarded as the prelude to European Monetary Union.

1. Fifty Years Ago

A half century ago, when the conference at Bretton Woods was held, the international situation was very different from today. The world war was still raging but its initiative had passed to the Allies. Allied troops had landed in Normandy and were advancing across France; German forces were being pushed up the Italian spine; and the Japanese Empire was in full retreat. Thoughts had already turned to the task of reconstructing the post-war international economic system.

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Haunting the deliberations were the four horsemen of the 1930s: economic isolationism, depression, nationalism and instability. The specific challenge was the need to set up institutional machinery to temper the business cycle, avoid currency chaos, protectionism, trade restrictions, exchange control, dried-up lending and discrimination. It was generally agreed that management of interdependence would require some surrender of national sovereignty in exchange for a voice in supranational power.

The challenges came to be divided into two categories. One was the financial problem concerning the balance of payments, exchange rates, and international lending; the other was the commercial problem involving protectionism, discrimination and the growth of trade and employment.

The main initiatives came from the United States and Great Britain. In the United States, the financial problems came to be centered in the Treasury, under Henry Moregenthau Jr., Harry Dexter White and others; and the commercial problem at State, under Will Clayton and others. A companion division of labor developed across the Atlantic with Lord Keynes, involved in his Clearing Union Plan, James Meade with his plan for a Commercial Union, and Lionel Robbins as head of the Economic Section of the War Cabinet Secretariat.

The financial negotiations gave birth to the Bretton Woods twins. The IMF was given responsibility over exchange rates, liquidity, and short-term balance-of-payments finance; and the IBRD (World Bank) over long-term lending and development policy. Both institutions were handicapped in the early years by resources inadequate in relation to their task. More important, however, was that their functions in the early years were preempted by Marshall Plan aid; the recipients of that bilateral aid could not double-dip by drawing on the Fund. The first decade served as a formative period that prepared the two institutions for more important work in the 1960s.

The other half of the grand design, however, was less lucky in its institutional promise. It fell afoul of complicated negotiations, bad compromises, and finally, the United States Congress. The ITO Charter, signed in Havana in March 1948, came under attack in both countries: In Britain, which wanted commercial rules to be contingent on full employment, and in the United States, because of its escape clauses, lack of provision for investor protection and failure to rule out discrimination and exchange control; it was charged that only the United States and Switzerland would adhere to its provisions.(1) Fortunately, the less controversial commercial provisions of the Havana Charter (which was rejected by the U.S. Congress in 1950) had earlier been incorporated into the GATT.

The failure of the Havana Charter meant that the post-war airplane had to limp along on three engines, the IMF, the IBRD and the GATT. There was no explicit arrangements for ensuring price stability or full employment at the international level. Global macroeconomic stability had to rest on the stability of the international monetary system.

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2. Order vs System

Twenty five years ago, at an earlier Bretton Woods retrospect, I made a distinction between a monetary system and a monetary order: A system is an aggregation of diverse entities united by regular interaction according to some form of control. When we speak of the international monetary system we are concerned with the mechanisms governing the interaction between trading nations, and in particular between the money and credit instruments of national communities in foreign exchange, capital, and commodity markets. The control is exerted through policies at the national level interacting with one another in that loose form of supervision that we call co-operation.

An order, as distinct from a system, represent the framework and setting in which the system operates. It is a framework of laws, conventions, regulations, and mores that establish the setting of the system and the understanding of the environment by the participants in it. A monetary order is to a monetary system somewhat like a constitution is to a political or electoral system. We can think of the monetary system as the modus operandi of the monetary order.

We are accustomed to thinking in terms of a given monetary system. In what follows I shall have to treat as variables what are usually, in economic analysis, regarded as constants. But the system may be undergoing change without our noticing it. The "monetary order" may be rigid and unable to cope with the problems of the new system. If we fail to distinguish between system problems and order problems we may wrongly discard ideas about the system that no longer appear to work, or blame the order because it was created to house a system that had grown beyond it. In the latter case we have to ask whether it would be better to strengthen the order and suppress changes in the system, or modify the order to accommodate change in the system.

3. The Post-War System

The IMF Articles of Agreement signed at Bretton Woods, New Hampshire did not create a new international monetary system. On the contrary, it almost made it impossible for the existing international monetary system to function. According to the agreement, countries were required to maintain exchange rates within one percent of the par value. This clause would have forced a revolutionary change in operating procedures in the United States which did not, as a rule, intervene in the foreign exchange market. As the system had operated since the devaluation of the franc in 1936 and the Tripartite Agreement in the same year, the United States bought and sold gold within narrow margins of its fixed parity. Most of the other countries fixed their currencies to the dollar, directly or indirectly through the pound sterling or one of the other reserve currencies. The exchange rate rule would have required the United States to support all the foreign currencies in the New York market or else close it.

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To negate this obligation--almost as an afterthought--the United States had a crucial sub-clause, Article IV-4(b) inserted into the articles. This sub-clause enabled a member to fix the price of gold in lieu of adhering to its exchange rate obligations. When the United States notified the Fund that it was buying and selling gold freely (to foreign monetary authorities for official monetary purposes) it was relieved of its exchange rate obligations.

This sub-clause established the legal basis for the asymmetrical post-war international monetary system, a system that been in existence since the late 1930s. It was a dollar standard, anchored to gold.

Was the anchored dollar standard a “system”? A system is an aggregation of diverse entities united by regular interaction according to a form of control. The anchored dollar standard can be identified as a system if we can perceive the order in the interaction of its components and outline the form of control.

In a presentation before the Subcommittee on International Exchange and Payments of the U.S. Congress, I presented, in a paper entitled “Rules of the Gold Exchange Standard”, the first complete analysis of the gold exchange standard as coherent system.

The rules of the game of the system constitute a combination of laws, commitments, conventions and gentlemen's agreements by which the inner country (the United States) pegs its currency (the dollar) to gold and the outer countries (Let us call them Europe) peg their currencies to the dollar, either directly or indirectly through another currency (such as the pound sterling or the franc). This means that the United States acts as the residual buyer or seller of gold, whereas Europe acts as the residual buyer or seller of dollars. The U.S. has to buy up any excess supply of gold on world markets and satisfy any excess demand out of its own reserves; failure to do so would result in the dollar price of gold moving away from the dollar parity. Europe, on its part, has to take up any excess of dollars offered to it or supply any excess of dollars demanded; failure to do so would result in the exchange rate moving away from its dollar parity.

The boundary conditions are given by the U.S. stock of gold and Europe's stock of dollars; the United States cannot supply gold, nor Europe dollars, they lack. But there is an asymmetry in these conditions because, as long as gold and dollars can be supplied at the U.S. Treasury, Europe has access to additional dollars in exchange for gold. The total reserves (dollars and gold) of Europe therefore constitutes Europe's boundary condition, whereas the gold reserve of the United States represents the U.S. constraint.

Control of the system rests on U.S. monetary policy, on the one hand, and Europe's gold-dollar portfolio on the other. When the United States expands the dollar supply it puts upward pressure on world incomes and prices--directly, because of interest rate effects and spending changes in the United States, and indirectly because of increases in European reserves. Similarly, when the United States contracts the dollar supply, it puts downward pressure on world prices.

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Europe's gold-dollar portfolio is the other control variable. When Europe converts dollars into gold it weakens the U.S. reserve position and stimulates or compels a monetary contraction and when it converts gold into dollars it strengthens the reserve position and permits or compels a monetary expansion. Europe's gold-purchase policy thus influences U.S. monetary policy, while the latter "determines" world prices and incomes. When U.S. monetary policy is forcing inflation on the rest of the world, Europe can stimulate or compel a contraction by gold purchases; and when U.S. monetary policy is deflationary, Europe can entice an expansion by gold sales.

We may thus express the control mechanism of the system as follows: The United States expands or contracts its monetary policy according to whether its gold position is excessive or deficient, and Europe buys or sells gold from the United States according to whether U.S. policy is causing inflation or deflation. The gold exchange standard therefore constitutes a "system" and it is with its implications that we must now be concerned.

(…)

5. The Mounting Crisis

At the end of 1950 the United States had 652.0 million ounces of gold and seven European countries had 95 million. By 1971, the United States stock had dropped to 291.6 million ounces, while Europe's seven countries held 481.7 million ounces. The seven countries were the original six countries that signed the Treaty of Rome and Switzerland. The bulk of this enormous shift of gold from the United States to Europe occurred in the late 1950s and early 1960s.

It is clear from the analysis of the system that the anchored dollar standard had crisis-laden potential if it is run in such a way that the United States policy is governed by its reserve ratio while Europe tries to control the world rate of inflation by pressure exerted on the composition of the US balance of payments. In the 1960s the United States and Europe were on a collision course with respect to the international monetary system--what Prime Minister Harold Wilson of the U.K. called a "monetary war."

The risk lies that the variables would hit the boundary conditions determined by the stock and price of gold, bringing on a convertibility crisis. A higher price of gold--to make up for World War II and post-war inflation--would have provided more room for adjustment within the parameters of the system. But, in the 1960s, an increase in the price of gold was ruled out--mainly for political reasons.

(…)

In June, the system was disbanded and the period of flexible exchange rates began.

7. Formation of the ERM

It will be recalled that Germany had proposed a joint float of the European currencies against the dollar both before and after the crisis that followed August 15, 1971, proposals that were rejected by the other countries. In the Spring of 1973, before the breakup of the unanchored dollar standard set up at the Smithsonian Institution, Germany again proposed a joint float of the European currencies, again rejected. One reason is not far to seek: A joint float would by no means have been a symmetrical outcome. Whenever the dollar weakened, a joint float would have had to rally around the mark. Neither France nor Britain were ready yet to acknowledge the mark as the natural center of the system.

Nevertheless, the European countries had earlier indicated an interest in, if not consensus on, European monetary integration. Proposals for monetary integration go back to the late 1950s. The Treaty of Rome had called for individual policies for achieving equilibrium in overall balance of payments, maintaining confidence in currencies, and coordinating policies through collaborations of governments and central banks.

Four years later, in October 1962, the European Commission submitted to the Council of Ministers a set of proposals for coordination of monetary and economic policies within the Community, leading to the eventual establishment of a monetary and economic union. In 1964, the Committee of governors of the Central Banks of the Member States was set up, along with budgetary and economic policy committees. In February 1968, the commission proposed that members commit themselves to adjust their exchange rate parities only by common agreement and to consider the elimination of margins on each others' currencies around the established parities. The next year, on February 12, 1969, the "Barre Report" called for concerted economic policies to ensure the attainment of agreed medium-term objectives. The Council agreed with many features on the Barre Report and committed members to prior consultation before a member altered its economic policies in such a way as to have an important impact on other members.

The Community Summit conference at the Hague, on December 1 and 2, 1969, requested the Council to draw up a plan, based on the Barre Report, to establish by stages an economic and monetary union in the Community. On March 6, 1970, the Council authorized the creation of a committee, headed by Pierre Werner of Luxembourg, to draw up a plan for economic and monetary union. Along the lines of the Barre Report, central banks established a fund for balance of payments support by which members could draw up to $1 billion for a period of three, extendable to six months. The Werner Report of October 8, 1970 recommended a program for the establishment by stages of an economic and monetary union by 1980.

In its final form, the union was to have the following features: (1) a single Community currency (or else rigid and irrevocable fixing of exchange rates with zero margins and total interconvertibility); (2) complete liberalization of capital movements; (3) a common central banking system, organized along the lines of the Federal Reserve System; and (4) centralized responsibility in a Community "center of decision for economic policy" politically responsible to a European Parliament. These provisions were later watered down at French insistence, leaving undecided the exact division of powers between the Community and member states. The substance of the amended Werner Report was adopted by the Council of Ministers of February 9, 1971. Subsequent progress, however, was overtaken by the turmoil in the exchange markets in the spring and summer of 1971.

The impulse for European monetary integration fluctuates with the dollar cycle: it is strongest when the dollar is weak, as in the early and late 1960s and the early and late 1970s. After the implementation of the Snake under the Werner Plan, the next great thrust forward came in the wake of the weak dollar depreciation in the late 1970s. Following the Bremen summit in 1978, President Giscard d'Estaing and Chancellor Helmut Schmidt made the agreement to create the European Monetary System, which came into existence in March 1979.

8. Crisis of the ERM

The EMS was viewed as a prelude to monetary unification:

"The purpose of the European Monetary System is to establish a greater measure of monetary stability in the Community. It should be seen as a fundamental component of a more comprehensive strategy aimed at lasting growth with stability, a progressive return to full employment, the harmonization of living standards and the lessening of regional disparities within the Community. The Monetary System will facilitate the convergence of economic development and give fresh impetus to the process of European Union." (De Cecco – Giovannini 1978)

The EMS went beyond the Snake in that it created an institution, the European Monetary Cooperation Fund, and introduced a kind of pre-money, the ECU, defined as a basket of the currencies of the EC countries, weighted by a formula that took account of both trade and GDP. The ECU was to serve as numeraire for the EMS exchange rate mechanism; as a basis for indicating divergence; as the numeraire for central bank operations; and as a means of settlement between monetary authorities of the European Community. The Fund was to provide a source of ECUs for settlement of central bank transactions against a deposit of 20% of gold and 20% of foreign exchange reserves.

The exchange rate mechanism (ERM) within the EMS in theory was symmetrical with respect to its member countries, but in practice the DM became the "inflation anchor" of the system. The Bundesbank has been able to pursue monetary policies dictated by the requirements of internal balance (as its constitution requires). When a conflict exists--such as an appreciating mark (or a payments surplus) combined with inflationary pressure-- Germany has opted for tight money to prevent inflation rather than easy money to relieve the external

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pressure on itself or its partners in the EMS. By contrast, the other countries in the ERM have had to give priority to external balance, tightening or easing monetary policy according to whether their currencies are at their upper or lower limit. In short, the ERM has all the hallmarks of a currency areas anchored to the mark and German monetary policy.

The analogy with the dollar standard is apparent. But it should not be carried too far. The dollar standard was global, the mark standard, regional. As already noted, the size of a country's transactions domain plays a large role in determining its ability to cushion shocks in the system as a whole; the burden of international adjustment is distributed inversely in proportion to the size of country. With a country one-third the size of the US economy, Germany, qua anchor, is only one-third as stable. The turnaround in German fiscal policy due to unification brought about a reduction in the German current account from a surplus of $46 billion in 1990 to a deficit of $20.7 billion, a turnaround of $66.7 billion. This corresponded to an adjustment of 4.4% of German GDP, but the same absolute disturbance would have involved a turnaround of only 1.1% of US GDP.

The effect of the enormous inward transfer to (or reverse outward transfer from) Germany put pressure on the German price level, forcing the Bundesbank to react with higher interest rates--and the highest interest differentials (relative to the United States) favoring the mark--in years. Left alone with a neutral monetary policy (say a fixed rate of monetary expansion) the mark would temporarily have appreciated strongly in the spot market against all currencies, but going to a substantial discount in the forward market to reflect both the interest differential and a future weakness of the mark. Equilibrium would have been served by a substantial realignment involving a temporary appreciation of the mark or a downward realignment of the currencies of Germany's partners in the ERM. It should be emphasized, however, that had Germany been a larger country, the needed scale of real exchange rate adjustment would have been proportionately smaller.

Most economic events are spread across countries. The German unification disturbance was unique, a shock unparalleled since the oil price increases of the 1970s, but concentrated in a single country. One approach to the shock would have been for Germany to appreciate its currency against the dollar and against its partners in the Community. But this would have undermined its usefulness as an anchor and would have overvalued German labor (especially in the Eastern provinces) in the long run. In any case, France at this time would have resisted such a general appreciation of the mark and insisted on a proportional appreciation of the franc.

The best policy--given the ERM--might have been for the Bundesbank to follow a monetary policy that would be neutral for Europe as a whole. Abstracting from ordinary economic growth, there are two candidates for a "neutral" monetary policy. One is that the growth of the money supply in Europe is kept unchanged. Under these circumstances, an increase in German government spending, financed by an increase in debt, would lead to somewhat higher interest rates in Europe and a somewhat higher ECU. The price of domestic goods would rise somewhat in Germany, and fall somewhat in the rest of Europe with international goods prices remaining constant. A Europe-wide monetary policy would have cushioned the impact of the German unification shock over the EMS part of the continent. It would have

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led to more inflation than the Bundesbank wanted, and more deflation than her partners wanted, but a more balanced equilibrium for the fixed exchange rate mechanism. It would have been the equilibrium imposed by an independent Board of Directors of the European Central Bank with power distributed among the Board in proportion to the economic sizes of its member countries.

The ERM crisis of September 1992 illustrates a basic defect of the EMS system. The mark anchor works as long as disturbances are not too large and arise from outside Germany. But disturbances in Germany would be neutralized only if Germany adopted a policy appropriate for Europe as a whole, not Germany alone. The role of leader implies responsibility to the group not the individual. Self-centered behavior on the part of the leader undermines the whole system. European Monetary Union would eliminate much of that defect of the EMS.

(…)

10. Conclusion

My task in this paper was to contrast two systems: (1) the International Monetary System that came into being after the signing of the Bretton Woods Agreements fifty year ago, and which broke down in steps in the late 1960s and early 1970s; and (2) the European Monetary System which came into being after an agreement signed in Bremen between France and Germany in 1978 and which threatened to break down in various steps during 1992 and 1993.

Despite superficial similarities, there was a fundamental difference between the two systems. Consider first the earlier system. This was an anchored reserve-currency system. Under the Bretton Woods arrangements, most of the other currencies were pegged to the dollar, whereas the US dollar was pegged to gold. US monetary policy was disciplined by its internal gold reserve ratio and by its commitment to external convertibility of the dollar (for foreign monetary authorities). European countries were constrained by the discipline of balance of payments equilibrium, but had an additional weapon--conversion of dollar balances--with which they could put pressure on the United States to contract or encourage it to expand. Although the system was asymmetrical in the sense that the dollar had a special role, there was an exchange of commitments that distributed control between the United States and the outer countries.

The ERM system was basically different. Under the ERM system as it came to operate after the Plaza Accord, the outer countries were disciplined by the balance of payments under fixed exchange rates while the center country, Germany, could pursue an independent monetary policy geared to its version of price stability. Germany could pursue its own inflation preferences without any accountability mechanism; the other countries had no instruments to alter German monetary policy. It was a dominated system, a mark standard, the Roman solution.

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The correct analogy to the ERM is not the gold standard or the post-war system; it is the regime set up at the Smithsonian Institution in December 1971 and that lasted (albeit with a second devaluation of the dollar) until June 1973. This system was an unanchored dollar standard in which the United States could pursue its own inflation preferences, without any accountability mechanism; the other countries had no instruments to alter US monetary policy. It was a dominated system, a dollar standard, the Roman solution.

Both the dollar and mark standards threatened to break down when the center country pursued monetary policies that were at variance with the needs of the outer countries. The dollar standard broke down in 1973 because US monetary policy, taken in conjunction with the explosion of the Eurodollar market, flooded surplus countries with reserves. Rather than accept the inflationary consequences of expansion, or revalue the currencies in fundamental disequilibrium, the system was allowed to break up.

Similarly, the mark standard threatened to break down when German monetary policy, over-reacting to the unification shock, followed a money policy that was too tight for the rest of the ERM. Rather than import deflation (or less disinflation than was politically acceptable), several countries devalued or left the ERM. The mark standard broke up--or, more correctly, was transformed, because Germany monetary policy in the wake of the unification shock was too contractionary for the rest of the ERM. When, in the summer of 1992, the mark was soaring against the dollar--reaching a dollar low of DM1.385--the Bundesbank should have reacted to the error signal and moderated its policies.

The defect of both the dollar and mark standards was that the monetary policies of the anchor countries were out of line with the interests of their partners. In the case of the United States, monetary policy was too inflationary. In the case of Germany, monetary policy was too deflationary. There is an inherent defect in any unanchored currency standard that lacks a mechanism by which the partner countries can have some influence over the monetary policy of the leader and therefore the currency area as a whole.

Source: http://www.columbia.edu/~ram15/ABrettwds.htm

The first forum for discussing monetary matters in Europe was the informal meetings of the central bank governors of the EEC member states. Thus the **Committee of the Governors (CoG) was formed in 1964**, at that time as an **informal body**.

The Committee of Governors of the Central Banks of the Member States of the European Economic Community (1964-93)

The Committee of Governors ("CoG", or "Committee"), was established in 1964 to promote cooperation between the central banks of the Member States, by holding consultations and exchanging information on monetary policies and relevant measures, with a particular focus on the credit, and money and exchange markets.

In 1990, the Committee's role was reinforced as part of Stage One of Economic and Monetary Union. Its remit was extended to include helping to coordinate monetary and exchange rate policies, which were considered essential for achieving price stability and ensuring the proper functioning of the European Monetary System.

The Committee usually met in Basel at the Bank for International Settlements (BIS), which provided logistical and secretarial support. Several working groups and task forces were assigned to provide analytical expertise until 1990, when the Economic Unit joined the Secretariat, and the Monetary Policy Sub-Committee (MPSC), the Foreign Exchange Policy Sub-Committee (FXPSC) and the Banking Supervision Sub-Committee (BSSC) were established as formal substructures.

In January 1994, the Committee of Governors was replaced by the European Monetary Institute (EMI) and soon after, the official seat moved to Frankfurt am Main.

The Committee records are paper based and consist of 581 boxes. They mainly cover meetings, working papers and reports of the Committee of Governors and the Committee of Alternates, as well as of sub-committees and expert groups on monetary policy, foreign exchange and capital movement, banking supervision and other issues falling within the central banks' competences. Finally, they also include documents connected to relations with European and international institutions and fora. Documents predominantly cover the period from 1964 to 1993 (with some copies of documents from the 1950s) and they are written mostly in English, French and German.

Source and more information (on status, organisation, activities and relations):
https://www.ecb.europa.eu/ecb/access_to_documents/archives/cog/html/index.en.html

Upon The Hague Summit held in 1969, Luxembourgian Prime Minister, **Pierre Werner** was assigned the task to set up a **Committee** and draw up the **plans of monetary integration** in the EEC.

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Pierre Werner (1913-2002) is widely remembered for his major role in building a united Europe, particularly for his ideas on the need for strong monetary integration. He served as Prime Minister and Finance Minister of Luxembourg for over 30 years. After having completed a PhD in Law at the University of Luxembourg, he started a career in banking in 1938. When World War II ended he was elected to the Luxembourg parliament, joining the Ministry of Finance as Commissioner for Banking Control from 1945 to 1949 and as government counsellor until 1953, when he was appointed Minister of Finance and Minister of Defence. In 1959 he became Prime Minister, a position he held until 1974 alongside responsibilities on the Finance portfolio.

In this capacity, in March 1970 he was asked by the Council of the European Economic Community to chair a high level group for studying the prospects for a progressive achievement of an economic and monetary union in the Community. The final report of the high level group came to be known as "Werner Plan", foreshadowing the later economic and monetary union as it would have been defined in the Treaty of Maastricht in 1992.

In 1979 he was appointed Prime Minister for one final term before leaving politics in 1984. Werner had been aware of the importance of European issues since his university days. His experience of working in the international arena, particularly his awareness of the weakness and the divided state of Europe, made it almost an intellectual obligation.

By becoming more and more closely involved, through his posts in the Luxembourg Government, in the great issues of European integration, Pierre Werner, who was drawn to act as both a Luxembourger and a European, was to leave his imprint on the key events in that process. The 'battle of the seats' in 1965, the choice of Luxembourg as one of the three permanent capitals for the Community institutions, the 1966 'Luxembourg Compromise' and the 1970 Werner Report that sketched the outlines of Economic and Monetary Union are just some of the achievements to which he made a vital contribution.

Pierre Werner belongs to the group of European leaders who promoted policies firmly rooted in a coherent vision of Europe, bringing together economic, historical and political arguments, as of why peace and prosperity in Europe need economic and monetary integration.

At the end of the 1960s, the Werner Report defined monetary unification as a European long-term goal, proposing a blueprint on how to achieve monetary integration which dominated the debate on this issue in the following decades.

The international economic and financial turmoil of the 1970s brought this early impulse to a swift halt. The monetary arrangement known as 'the Snake' kept the policy initiative in monetary matters symbolically alive, but it was not until 1978 that the launch of the European Monetary System (EMS) marked the beginning of the path to the monetary union envisioned by Pierre Werner.

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The initial phase of the EMS was met with general scepticism and had little influence on domestic policies until 1983. Then, policy support of a new view of European monetary integration emerged, based on a fixed exchange rate that could 'borrow' anti-inflationary credibility and fiscal discipline from the country with the most successful inflation record, Germany, to the other European countries. This asymmetric view of European monetary arrangement was absent in early analyses, including the Werner Report, which instead influenced clearly the Delors report, and therefore the Treaty of Maastricht, in terms of ensuring the conditions for effective policy co-ordination.

Source: www.cvce.eu ;
https://www.eui.eu/Projects/PierreWernerChair/Pierre-Werner

Danescu, E.R. (2012): The Werner Report

In: *A rereading of the Werner Report of 8 October 1970 in the light of the Pierre Werner family archives*. CVCE (Centre Virtuel de la Connaissance sur l'Europe), Luxemburg

The speeches, discussions and exchanges which took place at the preliminary meeting in Luxembourg on 11 May 1970 and the first two working meetings (on 20 March in Luxembourg and 7 April in Brussels) helped the 'Werner Group' define the main points of its future common position and set up the framework for the report in its successive forms and stages.

At the first meeting, Pierre Werner, in the chair, presented a first comparative overview of the discussions that had been held on the subject of monetary integration and the proposals put forward by various governments (Germany, Belgium and Luxembourg) and the Commission. While emphasising what he believed to be the priorities for the work of setting up an economic and monetary union by stages, the chairman urged his colleagues to give thought to what practical measures and methods might be adopted for the attainment of the ultimate objective and to put them forward for discussion. The idea of drawing up a 'plan by stages' took shape and the members of the group reached agreement on the underlying principles and the issues to be addressed in such a document.

The Werner Group agreed, in fact, to take a pragmatic view, since 'abstract reasoning is not a reliable guide when it comes to seeking to identify in an accurate and detailed manner the configuration to be given to a construction of which one of the main characteristics will be its complexity.'

The various monetary integration plans put forward by some of the countries in the Six and the Commission were merely rough outlines, drafts, statements of intent, while the measures suggested for the period covered by the stages were set out in the form of extremely general indications — although there was no ambiguity about them. Taking these factors into account, and out of a desire to hammer out some practical solutions, as they had been

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instructed to, the members of the group decided to make as coherent a summary as they could of the various features of these plans and then try to make them specific or fill in the detail.

The concepts underlying the Werner Report

To give them a clearer view of the outlines of economic and monetary union in the plan by stages, the members of the Werner Group agreed that they should define a number of basic objectives and then try to identify and clarify the conditions to be met so that they could be achieved.

The basic objective of the plan by stages was to 'bring into being an area within which goods, services, people and capital would move freely while monetary transactions carried out by businesses would not be hindered in any way or exposed to exchange-rate risks'. Joint action in the field of economic policies — simple coordination, more sustained harmonisation, common policies — stands out as another very fundamental objective, designed to help hold the whole construction together more tightly and enable it to achieved sustained growth against a background of stability. The concept of common policies entailed the idea of shared risks and therefore the need for common solidarity.

Economic and monetary union implied a common currency, 'though it would hold together just as well, to begin with, if there were a system guaranteeing that the exchange rates between the Member States' currencies were fixed irrevocably. It also involved setting up a capital market at the European level and a sufficient degree of tax harmonisation.' If the exchange rates between Community currencies were irrevocably fixed, it would be impossible to devalue or revalue any one of the currencies on its own; but their exchange rate as a bloc could always be changed. Irrevocably fixed exchange rates and solidarity between Community currencies would be backed up by the Community's foreign exchange reserves, which would have to be available to meet all settlement requirements involving external parties, according to practical arrangements to be decided on jointly. The easiest way of achieving this aim would be through a European reserve fund.

It was also agreed that in international monetary relations the Community would speak and act as an entity in its own right.

Another common conclusion from the Werner Group was that there needed to be some transfer of decision-making powers on economic policy from the national to the Community level, particularly as regards budgetary matters, and centralisation in the field of monetary policy.

An aspect which was only lightly touched on in these early discussions, but which was to be dealt with in detail as the Werner Group pressed ahead with its work, was the question of the part the two sides of industry were to play in establishing economic and monetary union. It was stipulated that 'a Community body consisting of representatives of both sides of industry and of those responsible for economic policy in the Community' would be set up. This body, whose purpose would be to closely involve the two sides of industry in the shaping of the Community's economic policy, would be especially vital when it came to ensuring that

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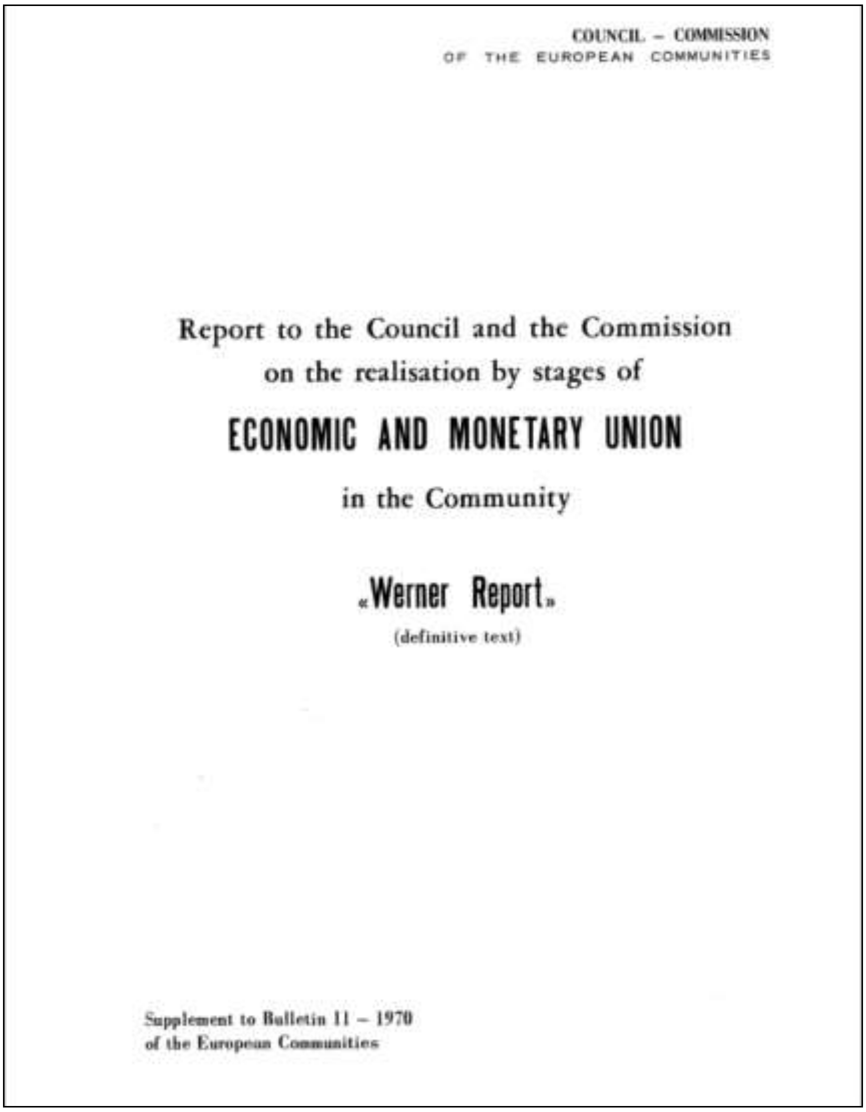
incomes and assets developed satisfactorily, which was necessary both from the social point of view and from the point of view of compatibility with the Community's economic objectives.

Source: www.cvce.eu



COUNCIL – COMMISSION
OF THE EUROPEAN COMMUNITIES

Report to the Council and the Commission
on the realisation by stages of

ECONOMIC AND MONETARY UNION

in the Community

«Werner Report»

(definitive text)

Supplement to Bulletin 11 – 1970
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Excerpts from the Werner Report

FOREWORD

The present report completes the work of the group set up under Mr Pierre Werner, the Prime Minister and Minister of Finance of the Luxembourg Government, to look into the various aspects of the realization by stages of economic and monetary union in the Community.

(…)

1. INTRODUCTION

In accordance with the directives issued by the Conference of Heads of State or Government held at The Hague on 1 and 1 December 1969 and in accordance with the mandate given to it by a decision of the Council of Ministers of 6 March 1970, the Group, presided over by Mr Pierre Werner the Prime Minister and Minister of Finance of the Luxembourg Government presented to the Council of Ministers on 20 May 1970 an interim report on the realization by stages of economic and monetary union in the Community. In response to the invitation of the Council issued during its session of 8 and 9 June 1970 the Group has the honour to present its final report which completes and amplifies the interim report, in the light in particular of the directives that emerged from the exchange of views that took place in the course of the same session. (…) The formulation of the plan by stages presupposes that an examination will first be made of the present situation, facilitating a precise definition of the starting point and the development of a common concept of the state of economic and monetary union upon the completion of the plan by stages. Thus, having clarified the extreme limits of the development, the report sets out certain fundamental principles and specific proposals for starting and developing the process which should lead the Member States to economic and monetary union. (…)

II. STARTING POINT

Since the signature of the Treaty of Rome, the European Economic Community has taken several steps of prime importance towards economic integration. The completion of the customs union and the definition of a common agricultural policy are the most significant landmarks.

However, the advances towards integration will have the result that general economic disequilibrium in the member countries will have direct and rapid repercussions on the global evolution of the Community. The experience of recent years has clearly shown that such disequilibrium is likely to compromise seriously the integration realized in the liberation of the movement goods, services and capital. (…)

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The increasing interpenetration of the economies has entailed a weakening of autonomy for national economic policies. The control of economic policy has become all the more difficult because the loss of autonomy at the national level has not been compensated by the inauguration of Community policies. The inadequacies and disequilibrium that have occurred in the process realization of the Common Market are thus thrown into relief. (…)

In foreign relations, and more particularly in international monetary relations, the Community has not succeeded in making its personality felt by the adoption of common positions, by reason as the case may be divergencies of policy or of concept. (…)

III. THE FINAL OBJECTIVE

The Group has not sought to construct an ideal system in the abstract. It has set out rather to determine the elements that are indispensable to the existence of a complete economic and monetary union. The union as it is described here represents the minimum that must be done, and is a stage in a dynamic evolution which the pressure of events and political will can model in a different way.

Economic and monetary union will make it possible to realize an area within which goods and services, people and capital will circulate freely and without competitive distortions, without thereby giving rise to structural or regional disequilibrium.

The implementation of such a union will effect a lasting improvement in welfare in the Community and will reinforce the contribution of the Community to economic and monetary equilibrium in the world. (…)

A monetary union implies inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates and the complete liberation of movements of capital. (…)

To ensure the cohesion of economic and monetary union, transfers responsibility from the national to the Community plane will be essential. These transfers will be kept within the limits necessary for the effective operation of the Community and will concern essentially the whole body of policies determining the realization of general equilibrium. In addition, it will be necessary for the instruments of economic policy to be harmonized in the various sectors. (…)

It is indispensable that the principal decisions in the matter of monetary policy should be centralized, whether it is a question of liquidity, rates of interest, intervention in the foreign exchange market, the management of the reserves or the fixing of foreign exchange parities vis-a-vis the outside world. The Community must have at its disposal a complete range of necessary instruments the utilization of which, however, may be different from country to country within certain limits. In addition, it will be necessary to ensure a Community policy and Community representation in monetary and financial relations with third countries and international organizations of an economic, financial and monetary nature. (…)

To make possible the abolition of fiscal frontiers while safeguarding the elasticity necessary for fiscal policy to be able to exercise its functions at the various levels a sufficient degree of fiscal harmonization will be effected, notably as regards the value-added tax, taxes likely to have an influence on the movement of capital and certain excise duties.

The suppression of the obstacles of various kinds should make it possible to arrive at a true common market for capital free from distortions. The financial policy of the Member States must be sufficiently unified to ensure the balanced operation of this market. (…)

To resume, economic and monetary union implies the following principal consequences:

– the Community currencies will be assured of total and irreversible mutual convertibility free from fluctuations in rates and with immutable parity rates, or preferably they will be replaced by a sole Community currency;

– the creation of liquidity throughout the area and monetary and credit policy will be centralized;

– monetary policy in relation to the outside world will be within the jurisdiction of the Community;

– the policies of the Member States as regards the capital market will be unified;

– the essential features of the whole of the public budgets, and in particular variations in their volume, the size of balances and the methods of financing or utilizing them, will be decided at the Community level;

– regional and structural policies will no longer be exclusively within the jurisdiction of the member countries;

– a systematic and continuous consultation between the social partners will be ensured at the Community level.

A result of this is that on the plane of institutional reforms the realization of economic and monetary union demands the creation or the transformation of a certain number of Community organs to which powers until then exercised by the national authorities will have to be transferred. These transfers of responsibility represent a process of fundamental political significance which implies the progressive development of political cooperation. Economic and monetary union thus appears as a leaven for the development of political union, which in the long run it cannot do without. (…)

The implementation of economic and monetary union demands institutional reforms which presuppose a modification of the Treaties of Rome. Certainly, the present provisions already allow substantial progress to be made towards economic and monetary union, but a modification of the treaties will be necessary eventually to make possible a more advanced development transfers of responsibility and the progressive establishment of the final institutions.

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The Group considers that economic and monetary union is an objective realizable in the course of the present decade, provided the political will of the Member States to realize this objective, solemnly declared at the Conference at The Hague, is present.

IV. THE PRINCIPLES OF REALIZATION OF THE PLAN BY STAGES

The Group in no way wishes to suggest that economic and monetary union are realizable without transition. The union must, on the contrary, be developed progressively by the prolongation of the measures already taken for the reinforcement of the coordination of economic policies and monetary cooperation. (…)

While pursuing its economic and monetary unification the Community will have to declare, vis-a.-vis the outside world, its own objectives of international political economy. It is important ' that in adapting its internal structures it should continue to participate through the member countries or by itself in the measures for the liberation of trade, economic and monetary cooperation, and aid to developing countries that are decided on at the world level. Under these conditions, economic and monetary union will have served to reinforce the international division of labour and not to establish a new autarkic bloc within the world economy.

V. THE FIRST STAGE

The reinforcement of the coordination of economic policies during the first stage seems one of the principal measures to be taken. One of the essential objectives to be attained will be to develop a rapid reciprocal exchange of information and to make possible the determination in common of the fundamental guidelines of economic and monetary policy. (…)

The coordination of the economic policies must be based on at least three annual surveys in depth of the economic situation in the Community that will make it possible to decide on guidelines in common. (…)

The coordination of economic policies during the first stage will depend on increased activity by the Community organs, in particular the Council and the Commission as well as the Committee of Governors of the central banks. (…)

VI. THE TRANSITION TOWARDS THE FINAL OBJECTIVE

In the course of this final phase, action will have to be taken on a number of fronts. The action will entail, first further coordination of national policies, then their harmonization by the adoption of directives or common decisions, and finally the transfer of responsibility from the national authorities to Community authorities. As progress is made Community instruments will be created to carryon or complete the action of the national instruments.

The coordination of economic and monetary policies will already have advanced to a point at which its fundamental elements are in place; subsequently it will have to be strengthened by ever closer regard for the common interest. (…)

The programmes of economic policy at medium term will have to be more and more closely geared to Community objectives, the realization of which will be ensured by policies conducted on the one hand at the national level and on the other hand at the Community level, the emphasis shifting gradually from the former to the latter. (…)

In the framework of an economic and monetary union it is not enough to pay attention to policies of global economic equilibrium alone. It will also be necessary to envisage measures bearing on structural problems the essence of which will be profoundly modified by the realization of this process. In this context the Community measures should primarily concern regional policy and employment policy. Their realization would be facilitated by an increase in financial intervention effected at Community level. In addition, it will be necessary to arrive progressively at Community guidance for policies on industry, transport, power, housing, and the environment. (…)

Progress in the convergence of economic and monetary policies should be such in the course of the second stage that the Member States no longer have to resort on an autonomous basis to the instrument of parity adjustment. In any case, it will be necessary further to reinforce the consultation procedures laid down for the first stage. Only at the moment of transition to the final stage will autonomous parity adjustments be totally excluded.

In order to prepare the final stage in good time, it will be necessary to set up as soon as possible a "European Fund for monetary cooperation" under the control of the Governors of the central banks. (…)

VII. CONCLUSIONS

The Group, recalling that the Council adopted on 8 and 9 June 1970

the conclusions presented by the Group in its interim report, suggests to the

Council that it should accept the contents of the present report and approve the following conclusions:

A. Economic and monetary union is an objective realizable in the course of the present decade provided only that the political will of the Member States to realize this objective, as solemnly declared at the Conference at The Hague is present. The union will make it possible to ensure growth and stability within the Community and reinforce the contribution it can make to economic and monetary equilibrium in the world and make it a pillar of stability.

B. Economic and monetary union means that the principal decisions of economic policy will be taken at Community level and therefore that the necessary powers will be transferred from the national plane to the Community plane. These transfers of responsibility and the creation of the corresponding Community institutions represent a process of fundamental political significance which entails the progressive development of political cooperation. The

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economic and monetary union thus appears as a leaven for the development of political union which in the long run it will be unable to do without.

C. A monetary union implies, internally, the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in rates of exchange, the irrevocable fixing of parity ratios and the total liberation of movements of capital. It may be accompanied by the maintenance of national monetary symbols, but considerations of a psychological and political order militate in favour of the adoption of a single currency which would guarantee the irreversibility of the undertaking.

D. On the institutional plane, in the final stage, two Community organs are indispensable: a centre of decision for economic policy and a Community system for the central banks. These institutions, while safeguarding their own responsibilities, must be furnished with effective powers of decision and must work together for the realization of the same objectives. The centre of economic decision will be politically responsible to a European Parliament.

E. Throughout the process, as progress is achieved Community instruments will be created to carry out or complete the action of the national instruments. In all fields the steps to be taken will be interdependent and will reinforce one another; in particular the development of monetary unification will have to be combined with parallel progress towards the harmonization and finally the unification of economic policies.

F. At this stage the laying down of a precise and rigid timetable for the whole of the plan by stages does not seem feasible. It is necessary in fact to maintain a measure of flexibility to permit any adaptations that the experience acquired during the first stage may suggest. Particular emphasis should therefore be placed on the first stage, for which a package of concrete measures is presented. The decisions on the details of the- final stages and the future timetable will have to be taken at the end of the first stage.

G. The first stage will commence on 1 January 1971 and will cover a period of three years. (…)

H. The second stage will be characterized by the promotion on a number of fronts and on ever more restrictive lines of the action undertaken during the first stage: the laying down of global economic guidelines, the coordination of short-term economic policies by monetary and credit measures, and budget and fiscal measures, the adoption of Community policies in the matter of structures, the integration of financial markets and the progressive elimination of exchange rate fluctuations between Community currencies.

The reinforcement of the intra-Community links in monetary matters must be effected as soon as possible by the establishment of a European Fund for monetary cooperation as a forerunner of the Community system central banks for the final stage. In accordance with the experience acquired in the matter of the reduction of margins and the convergence of economic policies it may well be possible to establish the Fund during the first stage and in any event in the course of the second stage. The preparatory work for this purpose must be put in hand as soon as possible.

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The Group expresses the wish that the Council should approve the suggestions contained in the present report and should make, on the proposal of the Commission, all the arrangements needed for the realization of the plan by stages, and in particular before the end of the year any that may be necessary to put the first stage into operation on 1 January 1971.

Source: Werner Report (available at the Archive of European Integration at the University of Pittsburgh, http://aei.pitt.edu/)

Even though the Werner Plan was not implemented, monetary integration was started in the EEC in the 1970s. Its most important elements initiated at that time are: the so-called **"Snake"** (i.e. the gradual narrowing of exchange rates), the **European Monetary Cooperation Fund**, the **European Currency Unit** and then, in 1979, the signature of the agreement establishing the **European Monetary System**.

The "Snake"

The European currency snake was created by the Basle Agreement signed on 10 April 1972. Under that Agreement, the governors of the central banks reduced the margin within which the exchange rates of EEC currencies could fluctuate. While under the snake-in-the-tunnel system a currency could fluctuate 2.25% on either side of the fixed parity, the snake system allowed a maximum drift of 2.25% around the fixed parity. As a result, the margin was reduced by half what was agreed at the Smithsonian Institution in Washington on 18 December 1971. Intervention by the EEC's central banks was automatically triggered when the outer fluctuation limits were reached. The unit of account (UA), whose value was defined in relation to gold, replaced the dollar as the currency of account in the European Economic Community.

Thus was created the European currency snake, which was allowed to move in its tunnel by a maximum variation of 4.5%. In the absence of genuine monetary union, the snake acted as a brace to provide a zone of relative stability against a backdrop of international monetary chaos.

The three future members of the EEC – the United Kingdom, Ireland and Denmark – were already in the tunnel and joined the snake system on 1 May 1972. However, they did not stay long, because their currencies came under speculative attack and they were unable to keep to the narrow margins imposed by the system. The pound sterling, the Irish punt and the Danish crown were then allowed to float. The pound sterling was even forced to leave the tunnel in June 1972.

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Tensions between France and Germany resurfaced when Karl Schiller demanded that France continue to support the dollar. Already under heavy fire for his earlier proposal that all European currencies should float, the German Minister for Finance and Economic Affairs was criticised on this occasion to such an extent that he was forced to resign in July 1972.

Source: https://www.cvce.eu

In October **1972**, the Heads of States and Governments of the member states of the EEC gathered in **Paris**. It was a **Summit of crucial importance in several aspects**. In terms of the **EMU**, the following are relevant on behalf of the member states: **commitment to set up a EMCF**; commitment to promote the process of EMU into the **second stage of the Werner Plan in 1974**; commitment to **establish the EMU by the end of the decade (1970s)**; commitment to **convert the EEC into European Union, also by the end of the decade (1970s)**.

The Paris Summit Declaration, 19-21 October 1972 (excerpts)

The Heads of State and Government of the Member States of the enlarged Community meeting for the first time on 19 and 20 October in Paris at the invitation of the President of the French Republic solemnly declare that:

At the time when the enlargement, decided under the Rules fixed by the Treaties and respecting the work already accomplished by the six original Member States, is about to become reality and give the European Community another dimension;

At time when world events are radically changing the international situation;

At a time when hopes for détente and cooperation are emerging, which satisfy the interest and deeply-felt desire of all nations;

At a time when disquieting monetary or trade problems are obliging us to seek lasting solutions for promoting expansion with stability;

At a time when many developing countries seeing the gap widening between them and the industrialized nations, are legitimately claiming increased aid and a more equitable utilization of wealth;

At a time when the Community's tasks are magnifying and new responsibilities are being assigned to it;

The time has come for Europe to realize the unity behind her interests, the scope of her capabilities and the importance of her obligations;

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Europe must be capable of making her voice heard in world affairs and making a creative contribution in proportion to her human, intellectual and material resources and affirming her own concepts in international relations, in line with her role in initiating progress, peace and cooperation.

To this end:

1. The Member States reaffirm their resolve to base their Community development on democracy, freedom of opinion, free movement of men and ideas and participation by the people through their freely elected representatives;

2. The Member States have resolved to strengthen the Community by forming an Economic and Monetary Union, as a token of stability and growth, as the indispensable basis of their social progress and as a remedy for regional disparities;

3. Economic expansion which is not an end in itself must as a priority help to attenuate the disparities in living conditions. It must develop with the participation of both sides of industry. It must emerge in an improved quality as well as an improved standard of life. In the European spirit special attention will be paid to non-material values and wealth and to protection of the environment so that progress shall serve mankind;

4. Aware of the problems arising from the persistent underdevelopment in the world, the Community affirms its resolve, within overall policy, towards the developing countries, to raise its efforts in aid for and cooperation with the poorest nations and with special consideration for the countries towards whom historically, geographically and through signed commitments the Community has specific obligations;

5. The Community reaffirms its resolve to promote the development of international trade. This resolve is extended to all countries without exception. The Community is prepared, open-mindedly as it has already proved and in line with the IMF and GATT procedures, to enter as soon possible into negotiations based on the principle of reciprocity, which will allow stable and balanced economic relations to be achieved in monetary affairs and trade and where the interests of the developing countries must receive full consideration;

6. In the interests of the good neighbourly relations which must exist between all the European nations whatever their regime, the Member States are resolved, especially through the Conference on European Security and Cooperation, to promote their policy of détente and peace with Eastern European countries, establishing on a permanent basis broader human and economic cooperation;

7. In line with its political aims, the construction of Europe will allow the continent to assert its personality in the loyalty of its traditional friendships and in the alliances of its Member States and to make its mark in world affairs as a distinct entity determined to promote a better international balance, which respects the United Nations Charter. The Member States of the Community, the driving wheels of European construction declare their intention of converting their entire relationship into a European Union before the end of this decade.

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Economic and Monetary Policy

1. The Heads of State and Government reaffirm the resolve of the Member States of the enlarged Community to move irrevocably the Economic and Monetary Union, by confirming all the details of the Acts passed by the Council and by the Member States representatives on 22 March 1971 and 21 March 1972.

The required decisions will have to be taken during 1973 to allow transition to the second stage of the Economic and Monetary Union on 1 January 1974 and in view of its complete realization by 31 December 1980 at the latest.

The Heads of State and Government reaffirmed the principle of parallel progress in the various fields of the Economic and Monetary Union.

2. The declared that fixed but adjustable parities between their currencies are an essential basis for achieving the Union and expressed their resolve to set up mutual defence and support mechanisms within the Community, which will allow the Member States to ensure that they are honoured.

They decided to set up officially a European Monetary Cooperation Fund before 1 April 1973. Based on the EEC Treaty, the Fund will be run by the Governors Committee of the Central Banks within the overall guidelines of economic policy adopted by the Council of Ministers. In its early stage the Fund will function on the following basis:

(i) Concertation between the Central Banks over the required shrinkage of fluctuation margins between their currencies;

(ii) Multilateralizing of positions arising from interventions in Community currencies and multilateralizing inter-Community rules.

(iii) Utilization for the above of a European monetary unit of account.

(iv) Administration of short-term monetary support between the Central Banks.

(v) The very short-term financing of the Agreement on shrinking the margins and short-term monetary support, will be regrouped within the Fund through an updated mechanism. For this, the short-term monetary support will be adjusted technically without changing its basic character or the consultation procedures involved.

The competent Community agencies will have to submit reports:

(i) On short-term aid dealings by 30 September latest;

(ii) On terms for progressive pooling of reserves by 31 December 1973.

3. The Heads of State and Government insisted on the need for closer coordination of Community economic policies and adopting more effective procedures for same.

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In the present economic situation, they consider that the anti-inflation campaign and stabilization of prices must get priority. They officially briefed their authorized Ministers when the enlarged Council meets on 30 and 31 October 1972, to take specific measures in the various areas ripe for effective and realistic short-term moves to attain these objectives allowing for the different conditions in the countries of the enlarged Community.

4. The Heads of State and Government express their resolve that the Member States of the enlarged Community will contribute through a joint outlook in guiding the reform of the international monetary system towards the adoption of a lasting equitable order.

They consider that the system should be based on the following principles:

(i) Fixed but adjustable parities.

(ii) An overall convertibility of currencies.

(iii) An effective international regulation of world liquidity supply.

(iv) Curtailing the role of national currencies as reserve resources.

(v) An equitable and effective adjustment process.

(vi) Equality of rights and obligations for all under the system.

(vii) The need to reduce the unbalancing effects of short-term capital movements.

(viii) Consideration of the developing countries' interest.

Such a system would be completely suitable for achieving Economic and Monetary Union.

(…)

European Union

16. The Heads of States and Government have assigned themselves the key objective of converting, before the end of this decade and in absolute conformity with the signed Treaties, all the relationships between Member States into a European Union. They are therefore asking the Community Institutions to prepare before the end of 1975 a report to be submitted to a further Summit Conference.

Source: The Paris Communiqué (available at the Archive of European Integration at the University of Pittsburgh, http://aei.pitt.edu/)

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The European Monetary Cooperation Fund (1973-93)

The European Monetary Cooperation Fund ("EMCF", or "Fund"), was established in 1973 to increase cooperation between Member States working towards Economic and Monetary Union. It operated from Basel, with the Bank for International Settlements (BIS) providing the necessary administrative and technical support.

The Fund's primary aim was to ensure the proper functioning of the progressive narrowing of the fluctuation margins between the Community currencies (the so called "Currency Snake"). It also monitored interventions on the exchange markets in Community currencies. Finally, it was responsible for the administration of short-term financing and for settlements between central banks, leading to a concerted policy on reserves.

From 1976, the Fund was also put in charge of carrying out the administration of Community loans to support the balance of payments of certain Member States. From 1979, with the introduction of the European Monetary System and the European Currency Unit (ECU), it carried out all tasks related to the creation, use and remuneration of ECUs.

The Fund's Board of Governors consisted of the central bank governors who were part of the Committee of Governors, with the addition of a member and potentially even an alternate member from the European Commission. Following its first meeting, on 14 May 1973, the Board assigned the Bank for International Settlements as the agent to carry out the Fund's operations in accordance with the relevant directives.

The Fund was dissolved on 1 January 1994, when its roles were taken over by the European Monetary Institute (EMI), while the Bank for International Settlements continued to operate as an agent for a transitional period until 15 May 1995.

Source: https://www.ecb.europa.eu/ecb/access_to_documents/archives/emcf/html/index.en.html

Regulation (EEC) No 907/73 of the Council of 3 April 1973 establishing a European Monetary Cooperation Fund

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 235 thereof;

Having regard to the proposal from the Commission;

Having regard to the Opinion of the European Parliament;

Having regard to the Opinion of the Economic and Social Committee;

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Whereas the Council Resolution (1) and the Representatives of the Governments of the Member States of 22 March 1971 on the progressive establishment of economic and monetary union in the Community provided for the establishment of a European Monetary Cooperation Fund to be integrated at a later stage into a Community organization of central banks;

Whereas the Heads of State or of Government meeting in Paris on 19 and 20 October 1972 envisaged that the Fund should be established before 1 April 1973;

Whereas the Council has been informed of the Opinions requested on this subject in the Council Resolution (2) and the Representatives of the Member States, of 21 March 1972, from the Monetary Committee and from the Committee of Governors of the Central Banks;

Whereas the purpose of the Fund must be to contribute to the progressive establishment of an Economic and Monetary Union between the Member States of the European Economic Community, which, in its final stage as regards its monetary aspects will have the following characteristics:

- either the total and irreversible convertibility, at irrevocable parities, of Community currencies against each other,

- or the introduction of a common currency;

Whereas it is necessary to confer immediately on the Fund the responsibility for facilitating both the concertation necessary for the smooth operation of the exchange arrangements introduced in the Community and for the settlement of the positions resulting from interventions in Community currencies, for assuring thereby the multilateralization of intra-Community settlements, and for administering a financing mechanism which combines the mechanism for short-term monetary support contained in the Agreement of 9 February 1970 between the Central Banks of the Community with the mechanism for very short-term financing which was contained in the Agreement of 10 April 1972 between those same Central Banks;

Whereas the conferment of these responsibilities constitutes merely a first stage in the progressive development of the Fund; whereas it is therefore important that the Statutes of the Fund should be drawn up in such a way as to permit the scope of its activities to be gradually extended;

Whereas it is necessary to establish the Fund if Community objectives are to be attained, in particular as regards the progressive harmonization of the Member States' economic policies, the proper functioning of the common market and the establishment of economic and monetary union; whereas the Treaty made no provision for the powers essential to the establishment of the Fund;

Whereas it is appropriate to specify that the general provisions of the Treaties concerning the European Communities as regards privileges and immunities, non-contractual liability and the obligation of professional secrecy are applicable to the Fund;

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HAS ADOPTED THIS REGULATION:

Article 1

A European Monetary Cooperation Fund, hereinafter referred to as 'the Fund', is hereby established; it shall have legal personality.

Article 2

Within the limits of its powers the Fund shall promote:

- the proper functioning of the progressive narrowing of the margins of fluctuation of the Community currencies against each other;

- interventions in Community currencies on the exchange markets;

- settlements between Central Banks leading to a concerted policy on reserves.

Article 3

In the first stage of its functions the Fund shall be responsible for:

- the concerted action necessary for the proper functioning of the Community exchange system;

- the multilateralization of positions resulting from interventions by Central Banks in Community currencies and the multilateralization of intra-Community settlements;

- the administration of the very short-term financing provided for by the Agreement between the Central Banks of the enlarged Community of 10 April 1972 and of the short-term monetary support provided for in the Agreement between the Central Banks of the Community of 9 February 1970, to which the Central Banks of Denmark, Ireland and the United Kingdom acceded with effect from 8 January 1973, and the regroupment of these mechanisms in a renewed mechanism.

Article 4

The provisions contained in the Agreements referred to in the third indent of Article 3 shall become the administrative rules of the Fund. The necessary technical adaptations to those provisions shall be made by the Board of Governors of the Fund without however changing the basic nature of those provisions and in particular the consultation procedures contained therein.

Article 5

The Statutes of the Fund are set out in the Annex to this Regulation and form an integral part thereof.

Article 6

This Regulation shall enter into force on 6 April 1973.

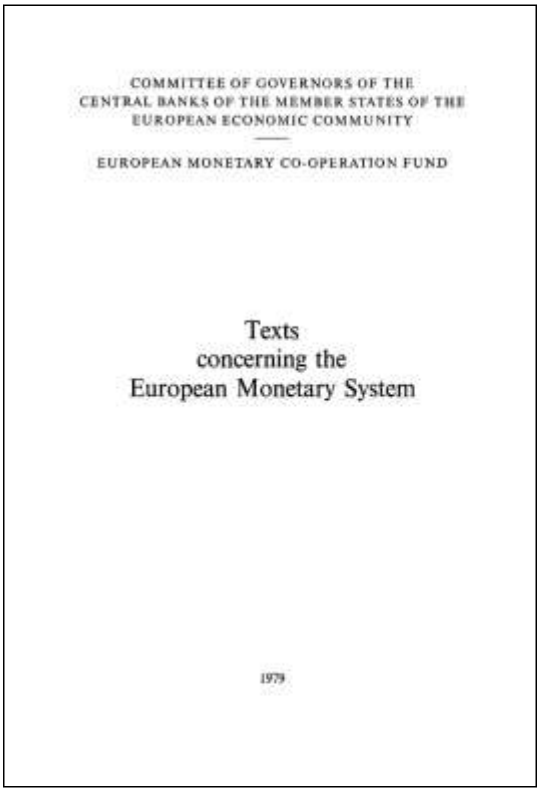
This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Luxembourg, 3 April 1973.

Source: EMS Regulation (available at the Archive of European Integration at the University of Pittsburgh, http://aei.pitt.edu/)

The agreement establishing the **European Monetary System (EMS)** was signed at the BIS in Basel, on 13 March **1979**.

The EMS was eventually an **exchange rate regime** set up in 1979 (and ended in 1999) to foster **closer monetary policy co-operation** between the central banks of the member states of the European Economic Community (EEC). The **objective** of the EMS was to **promote monetary stability in Europe**.

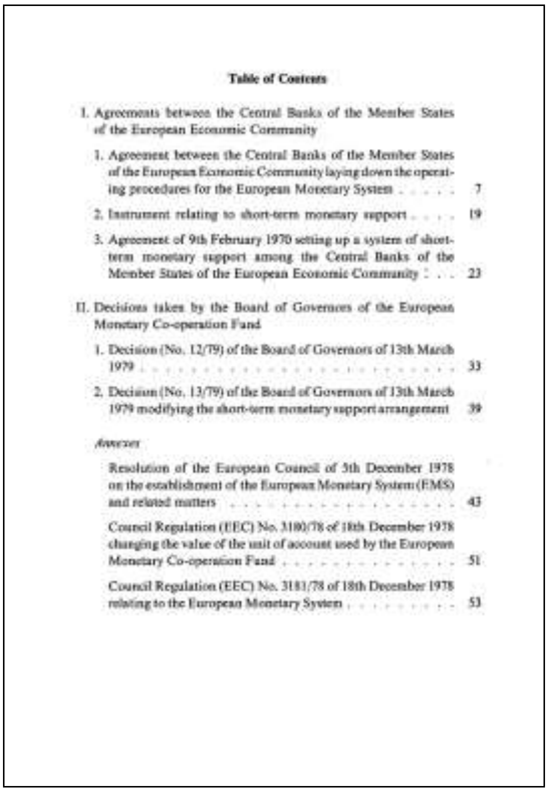


COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS OF THE MEMBER STATES OF THE EUROPEAN ECONOMIC COMMUNITY

EUROPEAN MONETARY CO-OPERATION FUND

Texts concerning the European Monetary System

1979



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Agreement between the Central Banks of the Member States of the European Economic Community laying down the operating procedures for the European Monetary System (excerpts)

<u>THE CENTRAL BANKS OF THE MEMBER STATES OF THE EUROPEAN ECONOMIC COMMUNITY</u>,

(…)

Whereas <u>the European Council has agreed to set up a scheme for the creation of closer monetary co-operation leading to a zone of monetary stability in Europe</u>;

Whereas the said Resolution provides that <u>a European currency unit, the ECU, shall be at the centre of the European Monetary System</u> and that the value and composition of the ECU shall, initially, be identical with the value and composition of the European unit of account (EUA);

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Whereas under the terms of the said Resolution

- each currency will have an ECU-related central rate and the central rates will be used to establish a grid of bilateral parities or central rates,

- fluctuation margins of 2.25 per cent will be fixed around these bilateral central rates, although Member States not at present participating in the narrower margins mechanism may in the initial stage of the European Monetary System opt for wider margins of up to 6 per cent., which must be progressively reduced as soon as economic conditions permit;

Whereas the said Resolution further provides that a formula for an ECU-based basket shall be used as an indicator to detect divergences between Community currencies, and sets out the principles governing the operation of this indicator, which will be re-examined at the end of a period of six months;

(…)

Whereas a Member State that does not initially participate in the exchange rate mechanism can do so at a later date and whereas it is therefore advisable to ensure co-operation between the central bank of such a State and the central banks of the participating States;

(…)

HAVE AGREED AS FOLLOWS:

I. Exchange rate mechanism

Article 1 - Central rates in terms of the ECU

Each participating central bank shall notify the Secretariat of the Committee of Governors of the Central Banks of the Member States of the European Economic Community of a central rate in terms of the ECU for its currency. The Secretariat shall pass on this information to the other central banks and the Commission of the European Communities.

(…)

II. Very short-term financing

Article 6 - Basic principles

6.1 To enable interventions to be made in Community currencies, the participating central banks shall open for each other very short-term credit facilities, unlimited in amount, in accordance with the conditions set out in Articles 7 to 16 of the present Agreement.

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6.2 The financing operations concluded in this connection shall take the form of spot sales and purchases of Community currencies against the crediting or debiting of accounts denominated in ECUs with the European Monetary Co-operation Fund (hereinafter referred to as "EMCF").

(…)

Article 15 - Working balances

The central banks may hold working balances in Community currencies within the limits laid down by the Committee of Governors. These limits may be exceeded only with the consent of the central bank concerned.

(…)

Article 18- Utilisation of ECUs

18.1 ECU assets shall be used in intra-Community settlements within the limits and on the terms set out in Article 16 of the present Agreement.

18.2 The central banks may transfer ECUs to one another against dollars, EEC currencies, Special Drawing Rights or gold.

18.3 For the purposes of meeting a decline in its dollar reserves a central bank may acquire dollars against ECUs from the EMCF between two periodic adjustments, initially by unwinding a swap transaction.

18.4 The operations referred to in Articles 18.2 and 18.3 of the present Agreement shall not be carried out for the sole purpose of altering the composition of a central bank's reserves.

(…)

Article 21 -Institutional provisions

The Committee of Governors shall periodically review the operation of the present Agreement in the light of experience gained.

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(…)

The present Agreement shall be drawn up in duly signed versions in English, French and German. A certified copy of the original in each language shall be sent to each central bank by the Secretariat of the Committee of Governors, which is required to retain the originals.

Done at Basle, 13th March 1979.

Banque Nationale de Belgique C. de Strycker	Central Bank of Ireland C. H. Murray
Danmarks Nationalbank Erik Hoffmeyer	Banca d'Italia Paolo Baffi
Deutsche Bundesbank Otmar Emminger Karl Otto Pohl	Nederlandsche Bank J. Zijlstra
Banque de France B. Clappier	Bank of England Gordon Richardson

Source: EMS Agreement (available at the Archive of European Integration at the University of Pittsburgh, http://aei.pitt.edu/)

The road to EEMU

The EMS operated smoothly in the course of the 1980s therefore **the heads of the EEC member states decided to revitalise the European monetary union project**. It occurred in parallel with the single market agenda, also launched in the 1980s. Both projects were nurtured by **at-that-time President of the European Commission, Jacques Delors**.

Jacques Delors (born 20 July 1925) is a French politician who served as the 8th President of the European Commission from 1985 to 1995. He served as Minister of Finance of France from 1981 to 1984. He was a Member of the European Parliament from 1979 to 1981. As President Delors was the most visible and influential leader in European affairs. He implemented the policies that closely linked the member nations together and tirelessly promoted the need for unity. He had critics but on the whole was well respected for his imagination and commitment to the cause of European unity. His two main achievements were creating a single market and the proposal for the monetary union to create the euro, a new currency to replace individual national currencies.

Delors became the President of the European Commission in January 1985. During his presidency, he oversaw important budgetary reforms and laid the groundwork for the introduction of a single market within the European Community. It came into effect on 1 January 1993 and allowed the free movement of persons, capital, goods, and services within the Community.

Delors also headed the committee that in early 1989 proposed the monetary union to create a new currency, the euro, to replace individual national currencies. This was done in the 1992 Maastricht Treaty.

In opposition to the strident neoliberalism of American President Ronald Reagan (1981-1989) which dominated the American political agenda, Delors promoted an alternative interpretation of capitalism that embedded it in the European social structure. He synthesized three themes. From the left came favouring the redistribution of wealth, and the protection of the weakest. Second a neo-mercantilist approach wanted to maximize European industrial output. A third was reliance on the marketplace. His emphasis on the social nature of Europe is been central to an important exceptionalism narrative that became central to the self-identification of the European Union.

The Delors presidency has been considered as the apex of the European Commission's influence on European integration.

Source: https://en.wikipedia.org/wiki/Jacques_Delors

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In parallel with the launch of the Single European Market, the **preparation for the common currency started**: **Jacques Delors** chaired a committee that elaborated the **plans for the economic and monetary union**.

The Delors Committee (1988-1989)

The Committee for the Study of Economic and Monetary Union, better known as the Delors Committee, was set up in June 1988. Its establishment followed a European Council mandate to examine and propose concrete stages leading to European Economic and Monetary Union. The Committee was chaired by Jacques Delors, the President of the European Commission at the time. It consisted of the Governors of the European Economic Community Member States' central banks and some other members. Among them was Alexandre Lamfalussy, then General Manager of the Bank for International Settlements in Basel and later the first President of the European Monetary Institute.

The Delors Committee fulfilled its mandate by launching a report in April 1989 on "Economic and Monetary Union in the European Community". Among other proposals, the report suggested three stages for achieving Economic and Monetary Union and helped the monetary and economic unification process to develop.

Source: https://www.ecb.europa.eu/ecb/access_to_documents/archives/delors/html/index.en.html

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COMMITTEE FOR THE STUDY OF ECONOMIC AND MONETARY UNION

Jacques Delors
Chairman

Report on economic and monetary union in the European Community

Presented April, 17, 1989

This report has been prepared in response to the mandate of the European Council 'to study and propose concrete stages leading towards economic and monetary union'.

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Report on economic and monetary union in the European Community (Delors Report)

(excerpts)

Chapter I

Past and present developments in economic and monetary integration in the Community

Section 1

The objective of economic and monetary union

1. In 1969 the Heads of State or Government, meeting in The Hague, agreed that a plan should be drawn up with a view to the creation, in stages, of an economic and monetary union within the Community. This initiative was taken against the background of major achievements by the Community in the 1960s: the early completion of the transition period leading to a full customs union, the establishment of the common agricultural policy and the creation of a system of own resources.

At the same time the Bretton Woods system was showing signs of decline. The Werner Report prepared in 1970, presented a plan for the attainment of economic and monetary union. In March 1971, following the Werner Report, Member States expressed 'their political will to establish an economic and monetary union

2. Several important moves followed: in 1972 the 'snake' was created; in 1973 the European Monetary Cooperation Fund (EMCF) was set up; and in 1974 the Council Decision on the attainment of a high degree of convergence in the Community and the Directive on stability, growth' and full employment were adopted. Yet, by the mid-1970s the process of integration had lost momentum under the pressure of divergent policy responses to the economic shocks of the period.

3. In 1979 the process of monetary integration was relaunched with the creation of the European Monetary System (EMS) and the European Currency Unit (ECU). The success of the EMS in promoting its objectives of internal and external monetary stability has contributed in recent years to further progress, as reflected in the adoption, in 1985, of the internal market programme and the signing of the Single European Act.

Section 2

The European Monetary System and the ECU

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4. The European Monetary System was created by a Resolution of the European Council followed by a Decision of the Council of Ministers and an Agreement between the participating central banks.

5. Within the framework of the EMS the participants in the exchange rate mechanism have succeeded in creating a zone of increasing monetary stability at the same time as gradually relaxing capital controls. The exchange rate constraint has greatly helped those participating countries with relatively high rates of inflation in gearing their policies, notably monetary policy, to the objective of price stability, thereby laying the foundations for both a downward convergence of inflation rates and the attainment of a high degree of exchange rate stability. This, in turn, has helped moderate cost increases in many countries, and has led to an improvement in overall economic performance. Moreover, reduced uncertainty regarding exchange rate developments and the fact that the parities of the participating currencies have not been allowed to depart significantly from what is appropriate in the light of economic fundamentals have protected intra-European trade from excessive exchange rate volatility.

The EMS has served as the focal point for improved monetary policy coordination and has provided a basis for multilateral surveillance within the Community. In part, its success can be attributed to the participants' willingness to opt for a strong currency stance. Also important has been the flexible and pragmatic way in which the System has been managed, with increasingly close cooperation among central banks. Moreover, the System has benefited from the role played by the Deutschmark as an 'anchor' for participants ' monetary and intervention policies. The EMS has evolved in response to changes in the economic and financial environment, and on two occasions (Palermo 1985 and Basle/Nyborg 1987) its mechanisms have been extended and strengthened.

At the same time, the EMS has not fulfilled its full potential. Firstly, a number of Community countries have not yet joined the exchange rate mechanism and one country participates with wider fluctuation margins. Secondly, the lack of sufficient convergence of fiscal policies as reflected in large and persistent budget deficits certain countries has remained a source of tensions and has put a disproportionate burden on monetary policy. Thirdly, the transition to the second stage of the EMS and the establishment of the European Monetary Fund, as foreseen by the Resolution of the European Council adopted in 1978, have not been accomplished.

6. In launching the EMS, the European Council declared in 1978 that a European Currency Unit (ECU) will be at the centre of the EMS. Apart from being used as the numeraire of the exchange rate mechanism and to denominate operations in both the intervention and credit mechanisms, the ECU serves primarily as a reserve asset and a means of settlement for EMS central banks. Although it is an integral part of the EMS, the ECU has for a number of reasons played only a limited role in the operating mechanisms of the EMS. One reason is that central banks have preferred to intervene intra-marginally; therefore, compulsory interventions and the build-up of intervention balances to be settled in ECUs have remained rather limited.

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By contrast, the ECU has gained considerable popularity in the market place, where its use as a denominator for financial transactions has spread significantly. It ranks fifth in international bond issues, with a 6% market share. The expansion of financial market activity in ECUs reflects in part a growing issuance of ECU-denominated debt instruments by Community institutions and public-sector authorities of some member countries, and in part the ECU's attractiveness as a means of portfolio diversification and as a hedge against currency risks.

International banking business in ECUs grew vigorously in the first half of this decade, but has moderated since then, although the creation of an ECU clearing system has contributed to the development and liquidity of the market, as has the issue of short-term bills by the UK Treasury. The lion's share of banking business represents interbank transactions, whereas direct business with non-banks has remained relatively limited and appears to have been driven primarily by officially encouraged borrowing demand in a few countries. ECU-denominated deposits by the non-bank sector have stagnated since 1985, suggesting that the ECU's appeal as a near money substitute and store of liquidity is modest. In addition, in the nonfinancial sphere the use of the ECU for the invoicing and settlement of commercial transactions has remained limited, covering at present only about 1% of the Community countries' external trade.

Section 3

The Single European Act and the internal market programme

7. In January 1985 the Commission proposed realizing the objective of a market without internal frontiers by the end of 1992. The detailed measures for the removal of physical, technical and fiscal barriers were set out in a White Paper, which specified the precise programme, timetable and methods for creating a unified economic area in which persons, goods, services and capital would be able to move freely. This objective was embodied in December 1985 in the Single European Act.

8. The Single European Act marked the first significant revision of the Treaty of Rome. It introduced four important changes in the Community s strategy for advancing the integration process. Firstly, it greatly simplified the requirements of harmonizing national law by limiting harmonization to the essential standards and by systematic adoption of mutual recognition of national norms and regulations.

Secondly, it established a faster and more efficient decision-making process by extending the scope of qualified majority voting. Thirdly, it gave the European Parliament a greater role in the legislative process. Fourthly, it reaffirmed the need to strengthen the Community s economic and social cohesion, to enhance the Community's monetary capacity with a view to economic and monetary union, to reinforce the Community s scientific and technological base, to harmonize working conditions with respect to health and safety standards, to promote the dialogue between management and labour and to initiate action to protect the environment.

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9. Over the last three years considerable progress has been made in implementing the internal market programme. In particular, it has been decided that eight member countries will have fully liberalized capital movements by 1 July 1990 and that the other member countries will follow suit after a period of transition.

In December 1988 the European Council, meeting in Rhodes, noted that, at the halfway stage towards the deadline of December 1992, half of the legislative programme necessary for the establishment of the large market is already nearly complete, and underlined the irreversible nature of the movement towards a Europe without internal frontiers. There is, indeed, widespread evidence that the objective of a single market enjoys the broad support of consumers and producers and that their economic decisions are increasingly influenced by the prospects of 1992. The anticipation of a market without internal frontiers has generated a new dynamism and has contributed to the recent acceleration of economic growth in the Community.

Section 4

Problems and perspectives

10. The completion of the single market will link national economies much more closely together and significantly increase the degree of economic integration within the Community. It will also entail profound structural changes in the economies of the member countries. These changes offer considerable opportunities for economic advancement, but many of the potential gains can only materialize if economic policy at both national and Community levels responds adequately to the structural changes.

By greatly strengthening economic interdependence between member countries, the single market will reduce the room for independent policy manoeuvre and amplify the cross-border effects of developments originating in each member country. It will therefore, necessitate a more effective coordination of policy between separate national authorities. Furthermore Community policies in support of a broadly balanced development are an indispensable complement to a single market. Indeed the need to back up the removal of market barriers with a strengthening of common regional and structural policies was clearly recognized in the Brussels package of measures agreed in February 1988.

11. Although substantial progress has been made, the process of integration has been uneven. Greater convergence of economic performance is needed. Despite a marked downward trend in the average rate of price and wage inflation, considerable national differences remain. There are also still notable divergences in budgetary positions and external imbalances have become markedly greater in the recent past. The existence of these disequilibria indicates that there are areas where economic performances will have to be made more convergent.

12. With full freedom of capital movements and integrated financial markets incompatible national policies would quickly translate into exchange rate tensions and put an increasing and undue burden on monetary policy. The integration process thus requires more intensive and effective policy coordination even within the framework of the present exchange rate arrangements, not only in the monetary field but also in areas of national economic management affecting aggregate demand prices and costs of production.

A tighter coordination of economic policy-making is required. In the monetary field the problems of the EMS referred to above continue to exist. In the economic field, policy coordination remains insufficient. Especially in the area of fiscal policy, the 1974 Decision on economic convergence has not succeeded in establishing an effective foundation for policy coordination. The pressure for mutually consistent macroeconomic policies has stemmed from the growing reluctance to change exchange rate parities. Such pressure has hitherto been lessened to some extent by the existence of capital controls in some countries and by the segmentation of markets through various types of non-tariff barriers, but as capital movements are liberalized and as the internal market programme is implemented, each country will be less and less shielded from developments elsewhere in the Community. The attainment of national economic objectives will become more dependent on a cooperative approach to policy-making.

13. Decision-making authorities are subject to many pressures and institutional constraints and even best efforts to take into account the international repercussions of their policies are likely to fail at certain times. While voluntary cooperation should be relied upon as much as possible to arrive at increasingly consistent national policies, thus taking account of divergent constitutional situations in member countries, there is also likely to be a need for more binding procedures.

14. The success of the internal market programme hinges to a decisive extent on a much closer coordination of national economic policies, as well as on more effective Community policies. This implies that in essence, a number of the steps towards economic and monetary union will already have to be taken in the course of establishing a single market in Europe.

Although in many respects a natural consequence of the commitment to create market without internal frontiers, the move towards economic and monetary union represents a quantum jump which could secure a significant increase in economic welfare in the Community. Indeed, economic and monetary union implies far more than the single market programme and, as is discussed in the following two chapters of this Report, will require further major steps in all areas of economic policymaking. A particular role would have to be assigned to common policies aimed at developing a more balanced economic structure throughout the Community. This would help to prevent the emergence or aggravation of regional and sectoral imbalances which could threaten the viability of an economic and monetary union. This is especially important because the adoption of permanently fixed exchange rates would eliminate an important indicator of policy inconsistencies among Community countries and remove the exchange rate as an instrument of adjustment from the member countries' set of economic tools. Economic imbalances among member countries would have to be corrected by policies affecting the structure of their economies and costs of

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production if major regional disparities in output and employment were to be avoided.

15. At its meeting on 27 and 28 June 1988 the European Council confirmed the objective of economic and monetary union for the Community. In accordance with its mandate, the Committee has focused its attention on the task of studying and proposing concrete stages leading towards the progressive realization of economic and monetary union. In investigating how to achieve economic and monetary union the Committee has examined the conditions under which such a union could be viable and successful. The Committee feels that concrete proposals towards attaining this objective can only be made if there is a clear understanding of the implications and requirements of economic and monetary union and if due account is taken of past experience with and developments in economic and monetary integration in the Community. Hence, Chapter II of this Report examines the principal features and implications of an economic and monetary union. Chapter III then presents a pragmatic step-by-step approach which could lead in three stages to the final objective. The question of when these stages should be implemented is a matter for political decision.

Chapter II

The final stage of economic and monetary union

Section 1

General considerations

16. Economic and monetary union in Europe would imply complete freedom of movement for persons, goods, services and capital, as well as irrevocably fixed exchange rates between national currencies and, finally, a single currency. This, in turn, would imply a common monetary policy and require a high degree of compatibility of economic policies and consistency in a number of other policy areas, particularly in the fiscal field. These policies should be geared to price stability, balanced growth, converging standards of living, high employment and external equilibrium. Economic and monetary union would represent the final result of the process of progressive economic integration in Europe.

(…)

Section 2

The principal features of monetary union

22. A monetary union constitutes a currency area in which policies are managed jointly with a view to attaining common macroeconomic objectives. As already stated in the 1970 Werner Report, there are three necessary conditions for a monetary Union:

- the assurance of total and irreversible convertibility of currencies;

- the complete liberalization of capital transactions and full integration of banking and other financial markets; and

- the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities.

The first two of these requirements have already been met, or will be with the completion of the internal market programme. The single most important condition for a monetary union would, however, be fulfilled only when the decisive step was taken to lock exchange rates irrevocably.

As a result of this step, national currencies would become increasingly close substitutes and their interest rates would tend to converge. The pace with which these developments took place would depend critically on the extent to which firms, households, labour unions and other economic agents were convinced that the decision to lock exchange rates would not be reversed. Both coherent monetary management and convincing evidence of an effective coordination of non-monetary policies would be crucial.

23. The three abovementioned requirements define a single currency area, but their fulfilment would not necessarily mark the end of the process of monetary unification in the Community. The adoption of a single currency, while not strictly necessary for the creation of a monetary union, might be seen for economic as well as psychological and political reasons as a natural and desirable further development of the monetary union. A single currency would clearly demonstrate the irreversibility of the move to monetary union, considerably facilitate the monetary management of the Community and avoid the transactions costs of converting currencies. A single currency, provided that its stability is ensured, would also have a much greater weight relative to other major currencies than any individual Community currency. The replacement of national currencies by a single currency should therefore take place as soon as possible after the locking of parities.

24. The establishment of a monetary union would have far-reaching implications for the formulation and execution of monetary policy in the Community. Once permanently fixed exchange rates had been adopted, there would be a need for a common monetary policy, which would be carried out through new operating procedures. The coordination of as many national monetary policies as there were currencies participating in the union would not be sufficient. The responsibility for the single monetary policy would have to be vested in a new institution, in which centralized and collective decisions would be taken on the supply of money and credit as well as on other instruments of monetary policy, including interest rates. This shift from national monetary policies to a single monetary policy is an inescapable consequence of monetary union and constitutes one of the principal institutional changes. Although a progressively intensified coordination of national monetary policies would in many respects have prepared the way for the move to a single monetary policy, the implications of such a move would be far-reaching. The permanent fixing of exchange rates would deprive individual countries of an important instrument for the correction of economic imbalances and for independent action in the pursuit of national objectives, especially price

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stability.

Well before the decision to fix exchange rates permanently, the full liberalization of capital movements and financial market integration would have created a situation in which the coordination of monetary policy would have to be strengthened progressively. Once every banking institution in the Community is free to accept deposits from, and to grant loans to, any customer in the Community and in any of the national currencies, the large degree of territorial coincidence between a national central bank's area of jurisdiction, the area in which its currency is used and the area in which its banking system operates will be lost. In these circumstances the effectiveness of national monetary policies will become increasingly dependent on cooperation among central banks. Indeed, the growing coordination of monetary policies will make a positive contribution to financial market integration and will help central banks gain the experience that would be necessary to move to a single monetary policy.

Section 3

The principal features of economic union

25. Economic union in conjunction with a monetary union combines the characteristics of an unrestricted common market with a set of rules which are indispensable to its proper working. In this sense economic union can be described in terms of four basic elements:

- the single market within which persons, goods, services and capital can move freely;

- competition policy and other measures aimed at strengthening market mechanisms;

- common policies aimed at structural change and regional development; and

- macroeconomic policy coordination, including binding rules for budgetary policies.

(…)

26. The creation of a single currency area would add to the potential benefits of an enlarged economic area because it would remove intra-Community exchange rate uncertainties and reduce transactions costs, eliminate exchange rate variability and reduce the susceptibility of the Community to external shocks.

At the same time, however, exchange rate adjustments would no longer be available as an instrument to correct economic imbalances within the Community. Such imbalances might arise because the process of adjustment and restructuring set in motion by the removal of physical, technical and fiscal barriers is unlikely to have an even impact on different regions or always produce satisfactory results within reasonable periods of time. Imbalances might also emanate from labour and other cost developments, external shocks with differing repercussions on individual economies, or divergent economic policies pursued at national level.

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With parities irrevocably fixed, foreign exchange markets would cease to be a source of pressure for national policy corrections when national economic disequilibria developed and persisted. Moreover, the statistical measurement and the interpretation of economic imbalances might become more difficult because in a fully integrated market balance-of-payments figures, which are currently a highly visible and sensitive indicator of economic disequilibria, would no longer play such a significant role as a guidepost for policy-making. None the less, such imbalances, if left uncorrected, would manifest themselves as regional disequilibria. Measures designed to strengthen the mobility of factors of production and the flexibility of prices would help to deal with such imbalances.

27. In order to create an economic and monetary union the single market would have to be complemented with action in three interrelated areas: competition policy and other measures aimed at strengthening market mechanisms; common policies to enhance the process of resource allocation in those economic sectors and geographical areas where the working of market forces needed to be reinforced or complemented; macroeconomic coordination, including binding rules in the budgetary field; and other arrangements both to limit the scope for divergences between member countries and to design an overall economic policy framework for the Community as a whole.

28. Competition policy conducted at the Community level would have to operate in such a way that access to markets would not be impeded and market functioning not be distorted by the behaviour of private or public economic agents. Such policies would not only have to address conventional forms of restrictive practices and the abuse of dominant market positions, but would also have to deal with new aspects of antitrust laws, especially in the field of merger and takeover activities. The use of government subsidies to assist particular industries should be strictly circumscribed because they distort competition and cause an inefficient use and allocation of scarce economic resources.

29. Community policies in the regional and structural field would be necessary in order to promote an optimum allocation of resources and to spread welfare gains throughout the Community. If sufficient consideration were not given to regional imbalances, the economic union would be faced with grave economic and political risks. For this reason particular attention would have to be paid to an effective Community policy aimed at narrowing regional and structural disparities and promoting a balanced development throughout the Community. In this context the regional dimension of other Community policies would have to be taken into account.

Economic and monetary integration may have beneficial effects on the less developed regions of the Community. For example, regions with lower wage levels would have an opportunity to attract modern and rapidly growing service and manufacturing industries for which the choice of location would not necessarily be determined by transport costs, labour skills and market proximity. Historical experience suggests however, that in the absence of countervailing policies, the overall impact on peripheral regions could be negative. Transport costs and economies of scale would tend to favour a shift in economic activity away from less developed regions, especially if they were at the periphery of the Community, to the highly developed areas at its centre. The economic and monetary union would have to encourage and guide structural adjustment which would help poorer regions to catch up with the wealthier ones.

(…)

30. Macroeconomic policy is the third area in which action would be necessary for a viable economic and monetary union. This would require an appropriate definition of the role of the Community in promoting price stability and economic growth through the coordination of economic policies.

(…)

However, an economic and monetary union could only operate on the basis of mutually consistent and sound behaviour by governments and other economic agents in all member countries. In particular, uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community. Moreover, the fact that the centrally managed Community budget is likely to remain a very small part of total pub1ic sector spending and that much of this budget will not be available for cyclical adjustments will mean that the task of setting a Community-wide fiscal policy stance will have to be performed through the coordination of national budgetary policies. Without such coordination it would be impossible for the Community as a whole to establish a fiscal/monetary policy mix appropriate for the preservation of internal balance, or for the Community to play its part in the international adjustment process. Monetary policy alone cannot be expected to perform these functions. Moreover, strong divergences in wage levels and developments, not justified by different trends in productivity, would produce economic tensions and pressures for monetary expansion.

(…)

Section 4

Institutional arrangements

31. Management of the economic and monetary union would call for an institutional framework which would allow policy to be decided and executed at the Community level in those economic areas that were of direct relevance for the functioning of the union. This framework would have to promote efficient economic management, properly embedded in the democratic process. Economic and monetary union would require the creation of a new monetary institution, placed in the constellation of Community institutions (European Parliament, European Council Council of Ministers Commission and Court of Justice). The

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formulation and implementation of common policies in non-monetary fields and the coordination of policies remaining within the competence of national authorities would not necessarily require a new institution; but a revision and, possibly, some restructuring of the existing Community bodies, including an appropriate delegation of authority, could be necessary.

32. A new monetary institution would be needed because a single monetary policy cannot result from independent decisions and actions by different central banks. Moreover, day-to-day monetary policy operations cannot respond quickly to changing market conditions unless they are decided centrally. Considering the political structure of the Community and the advantages of making existing central banks part of a new system, the domestic and international monetary policy-making of the Community should be organized in a federal form, in what might be called a European System of Central Banks (ESCB). This new System would have to be given the full status of an autonomous Community institution. It would operate in accordance with the provisions of the Treaty, and could consist of a central institution (with its own balance sheet) and the national central banks. At the final stage the ESCB acting through its Council would be responsible for formulating and implementing monetary policy as well as managing the Community's exchange rate policy vis-a-vis third currencies. The national central banks would be entrusted with the implementation of policies in conformity with guidelines established by the Council of the ESCB and in accordance with instructions from the central institution.

(…)

Section 5

Economic and monetary union in the context of the world economy

35. The establishment of an economic and monetary union would give the Community a greater say in international negotiations and enhance its capacity to influence economic relations between industrial and developing countries.

36. The responsibility for external trade policy has been assigned to the Community in the Treaty of Rome, and the Commission, acting as the Community s spokesman, represents all the member countries in multilateral trade negotiations. This role will be strengthened with the completion of the single market, which has the potential to stimulate multilateral trade and economic growth at the global level. However this potential can only be exploited to the full in an open trading system, which guarantees foreign suppliers free access to the Community market and, conversely, guarantees exporters from the Community free access to foreign markets. The removal of internal trade barriers within the Community should constitute a step towards a more liberal trading system on a worldwide scale.

(…)

38. The institutional arrangements which would enable the Community to fulfil the new responsibilities implied by its increased weight in the world economy are partly in place or would be implemented in the process of creating an economic and monetary union. In the area of external trade policies and, to some extent, in the field of cooperation with developing countries, the responsibilities have already been attributed to the Community. With the establishment of the European System of Central Banks the Community would also have created an institution through which it could participate in all aspects of international monetary management. As far as macroeconomic policy coordination at the international level is concerned, the Community as such is currently represented only at the summit meetings of the major industrial countries. In order to make full use of its position in the world economy and to exert influence on the functioning of the international economic system, the Community would have to be able to speak with one voice. This emphasizes the need for an effective mechanism for macroeconomic policy coordination within the economic and monetary union.

Chapter III

Steps towards economic and monetary union

39. After defining the main features of an economic and monetary union, the Committee has undertaken the task of studying and proposing concrete stages leading towards this union. The Committee agreed that the creation of an economic and monetary union must be viewed as a single process. Although this process is set out in stages which guide the progressive movement to the final objective, the decision to enter upon the first stage should be a decision to embark on the entire process.

(…)

Section 3

The principal steps in stage one

50. Stage one represents the initiation of the process of creating an economic and monetary union. It would aim at a greater convergence of economic performance through the strengthening of economic and monetary policy coordination within the existing institutional framework. In the institutional field, by the time of the transition to stage two, it would be necessary to have prepared and ratified the Treaty change.

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(…)

52. In the monetary field the focus would be on removing all obstacles to financial integration and on intensifying cooperation and the coordination of monetary policies. In this connection consideration should be given to extending the scope of central banks' autonomy. Realignments of exchange rates would still be possible but an effort would be made by every country to make the functioning of other adjustment mechanisms more effective. Action would be taken along several lines.

Firstly, through the approval and enforcement of the necessary Community Directives, the objective of a single financial area in which all monetary and financial instruments circulate freely and banking, securities and insurance services are offered uniformly throughout the area would be fully implemented.

Secondly, it would be important to include all Community currencies in the EMS exchange rate mechanism. The same rules would apply to all the participants in the exchange rate mechanism.

(…)

Section 4

The principal steps in stage two

55. The second stage could begin only when the new Treaty had come into force. In this stage the basic organs and structure of the economic and monetary union would be set up, involving both the revision of existing institutions and the establishment of new ones. The institutional framework would gradually take over operational functions, serve as the centre for monitoring and analysing macroeconomic developments and promote a process of common decision-making, with certain operational decisions taken by majority vote. Stage two must be seen as a period of transition to the final stage and would thus primarily constitute a training process leading to collective decision-making, while the ultimate responsibility for policy decisions would remain at this stage with national authorities. The precise operating procedures to be applied in stage two would be developed in the light of the prevailing economic conditions and the experience gained in the previous stage.

(…)

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56. In the economic field, the European Parliament, the Council of Ministers, the Monetary Committee and the Commission would reinforce their action along three lines.

Firstly, in the area of the single market and competition policy the results achieved through the implementation of the single market programme would be reviewed and, wherever necessary, consolidated.

Secondly, the performance of structural and regional policies would be evaluated and, if necessary, be adapted in the light of experience. The resources for supporting the structural policies of the Member States might have to be enlarged. Community programmes for investment in research and infrastructure would be strengthened.

Thirdly, in the area of macroeconomic policy, the procedures set up in the first stage through the revision of the 1974 Decision on convergence would be further strengthened and extended on the basis of the new Treaty. Policy guidelines would be adopted by majority decision. On this basis the Community would:

- set a medium-term framework for key economic objectives aimed at achieving stable growth, with a follow-up procedure for monitoring performances and intervening when significant deviations occurred;

- set precise, although not yet binding, rules relating to the size of annual budget deficits and their financing; the Commission should be responsible for bringing any instance of non-compliance by Member States to the Council's attention and should propose action as necessary;

- assume a more active role as a single entity in the discussion of questions arising in the economic and exchange rate field, on the basis of its present representation (through the Member States or the Commission) in the various forums for international policy coordination.

57. In the monetary field the most important feature of this stage would be that the European System of Central Banks would be set up and would absorb the previously existing institutional monetary arrangements (the EMCF, the Committee of Central Bank Governors, the sub-committees for monetary policy analysis, foreign exchange policy and banking supervision, and the permanent secretariat). The functions of the ESCB in the formulation and operation of a common monetary policy would gradually evolve as experience was gained. Some possible schemes for coordinating monetary policies in the course of this stage are discussed in the Collection of papers submitted to the Committee. Exchange rate realignments would not be excluded as an instrument of adjustment, but there would be an understanding that they would be made only in exceptional circumstances.

The key task for the European System of Central Banks during this stage would be to begin the transition from the coordination of independent national monetary policies by the Committee of Central Bank Governors in stage one to the formulation and implementation of a common monetary policy by the ESCB itself scheduled to take place in the final stage.

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(…)

Section 5

The principal steps in stage three

58. The final stage would commence with the move to irrevocably locked exchange rates and the attribution to Community institutions of the full monetary and economic competences described in Chapter II of this Report. In the course of the final stage the national currencies would eventually be replaced by a single Community currency.

(…)

60. In the monetary field, the irrevocable locking of exchange rates would come into effect and the transition to a single monetary policy would be made, with the ESCB assuming all its responsibilities as foreseen in the Treaty and described in Chapter II of this Report.

(…)

The change-over to the single currency would take place during this stage.

Section 7

Suggested follow-up procedure

64. If the European Council can accept this Report as a basis for further development towards economic and monetary union, the following procedure is suggested.

65. The Council and the Committee of Governors should be invited to take the decisions necessary to implement the first stage.

66. Preparatory work for the negotiations on the new Treaty would start immediately. The competent Community bodies should be invited to make concrete proposals on the basis of this Report concerning the second and the final stages, to be embodied in a revised Treaty. These proposals should contain a further elaboration and concretization, where necessary, of the present Report. They should serve as the basis for future negotiations on a revised Treaty at an inter-governmental conference to be called by the European Council.

Source: Delors Report (available at the Archive of European Integration at the University of Pittsburgh, http://aei.pitt.edu/)

The text of the **Treaty on European Union** (TEU) was adopted in Maastricht, in December 1991, that is why we often refer to it as **the Maastricht Treaty**. It was of fundamental importance for European integration. **It created the European Union that is based on the European Economic and Monetary Union**.

The Maastricht Treaty was signed on 7 February 1992, and entered into force on 1 November 1993. **The purpose of the Treaty was to prepare for the EEMU and introduce elements of a political union** (citizenship, common foreign and internal affairs policy).

Excerpts from the introduction of Maastricht Treaty relevant in light of the EEMU

[The signatories]

RESOLVED to mark a new stage in the process of European integration undertaken with the establishment of the European Communities,

RECALLING the historic importance of the ending of the division of the European continent and the need to create firm bases for the construction of the future Europe,

CONFIRMING their attachment to the principles of liberty, democracy and respect for human rights and fundamental freedoms and of the rule of law,

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CONFIRMING their attachment to fundamental social rights as defined in the European Social Charter signed at Turin on 18 October 1961 and in the 1989 Community Charter of the Fundamental Social Rights of Workers,

DESIRING to deepen the solidarity between their peoples while respecting their history, their culture and their traditions,

DESIRING to enhance further the democratic and efficient functioning of the institutions so as to enable them better to carry out, within a single institutional framework, the tasks entrusted to them,

RESOLVED to achieve the strengthening and the convergence of their economies and to establish an economic and monetary union including, in accordance with the provisions of this Treaty, a single and stable currency,

DETERMINED to promote economic and social progress for their peoples, taking into account the principle of sustainable development and within the context of the accomplishment of the internal market and of reinforced cohesion and environmental protection, and to implement policies ensuring that advances in economic integration are accompanied by parallel progress in other fields,

RESOLVED to establish a citizenship common to nationals of their countries,

RESOLVED to implement a common foreign and security policy including the progressive framing of a common defence policy, which might lead to a common defence in accordance with the provisions of Article 17, thereby reinforcing the European identity and its independence in order to promote peace, security and progress in Europe and in the world,

RESOLVED to facilitate the free movement of persons, while ensuring the safety and security of their peoples, by establishing an area of freedom, security and justice, in accordance with the provisions of this Treaty,

RESOLVED to continue the process of creating an ever closer union among the peoples of Europe, in which decisions are taken as closely as possible to the citizen in accordance with the principle of subsidiarity,

IN VIEW of further steps to be taken in order to advance European integration,

HAVE DECIDED to establish a European Union.

(…)

TITLE I

COMMON PROVISIONS

Article 1

By this Treaty, the HIGH CONTRACTING PARTIES establish among themselves a EUROPEAN UNION, hereinafter called 'the Union'.

This Treaty marks a new stage in the process of creating an ever closer union among the peoples of Europe, in which decisions are taken as openly as possible and as closely as possible to the citizen.

(…)

Article 2

The Union shall set itself the following objectives:

— to promote economic and social progress and a high level of employment and to achieve balanced and sustainable development, in particular through the creation of an area without internal frontiers, through the strengthening of economic and social cohesion and through the establishment of economic and monetary union, ultimately including a single currency in accordance with the provisions of this Treaty.

(…)

Source: CONSOLIDATED VERSION OF THE TREATY ON EUROPEAN UNION, Official Journal of the European Communities, C 325/5. 24 December 2012.

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Protocol (No 4) of the Maastricht Treaty on the Statute of the European System of Central Banks and of the European Central Bank (excerpts)

THE HIGH CONTRACTING PARTIES,

DESIRING to lay down the Statute of the European System of Central Banks and of the European Central Bank provided for in the second paragraph of Article 129 of the Treaty on the Functioning of the European Union,

HAVE AGREED upon the following provisions, which shall be annexed to the Treaty on European Union and to the Treaty on the Functioning of the European Union:

CHAPTER I

THE EUROPEAN SYSTEM OF CENTRAL BANKS

Article 1

The European System of Central Banks

In accordance with Article 282(1) of the Treaty on the Functioning of the European Union, the European Central Bank (ECB) and the national central banks shall constitute the European System of Central Banks (ESCB). The ECB and the national central banks of those Member States whose currency is the euro shall constitute the Eurosystem.

The ESCB and the ECB shall perform their tasks and carry on their activities in accordance with the provisions of the Treaties and of this Statute.

CHAPTER II

OBJECTIVES AND TASKS OF THE ESCB

Article 2

Objectives

In accordance with Article 127(1) and Article 282(2) of the Treaty on the Functioning of the European Union, the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in

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accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119 of the Treaty on the Functioning of the European Union.

Article 3

Tasks

3.1. In accordance with Article 127(2) of the Treaty on the Functioning of the European Union, the basic tasks to be carried out through the ESCB shall be:

— to define and implement the monetary policy of the Union;

— to conduct foreign-exchange operations consistent with the provisions of Article 219 of that Treaty;

— to hold and manage the official foreign reserves of the Member States;

— to promote the smooth operation of payment systems.

3.2. In accordance with Article 127(3) of the Treaty on the Functioning of the European Union, the third indent of Article 3.1 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances.

3.3. In accordance with Article 127(5) of the Treaty on the Functioning of the European Union, the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system.

(…)

CHAPTER III

ORGANISATION OF THE ESCB

Article 7

Independence

In accordance with Article 130 of the Treaty on the Functioning of the European Union, when exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and this Statute, neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the ECB or of the national central banks in the performance of their tasks.

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Article 8

General principle

The ESCB shall be governed by the decision-making bodies of the ECB.

Article 9

The European Central Bank

9.1. The ECB which, in accordance with Article 282(3) of the Treaty on the Functioning of the European Union, shall have legal personality, shall enjoy in each of the Member States the most extensive legal capacity accorded to legal persons under its law; it may, in particular, acquire or dispose of movable and immovable property and may be a party to legal proceedings.

9.2. The ECB shall ensure that the tasks conferred upon the ESCB under Article 127(2), (3) and (5) of the Treaty on the Functioning of the European Union are implemented either by its own activities pursuant to this Statute or through the national central banks pursuant to Articles 12.1 and 14.

9.3. In accordance with Article 129(1) of the Treaty on the Functioning of the European Union, the decision making bodies of the ECB shall be the Governing Council and the Executive Board.

(…)

Article 14

National central banks

14.1. In accordance with Article 131 of the Treaty on the Functioning of the European Union, each Member State shall ensure that its national legislation, including the statutes of its national central bank, is compatible with these Treaties and this Statute.

14.2. The statutes of the national central banks shall, in particular, provide that the term of office of a Governor of a national central bank shall be no less than five years.

A Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct. A decision to this effect may be referred to the Court of Justice by the Governor concerned or the Governing Council on grounds of infringement of these Treaties or of any rule of law relating to their application. Such proceedings shall be instituted within two months of the publication of the decision or of its notification to the plaintiff or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be.

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14.3. The national central banks are an integral part of the ESCB and shall act in accordance with the guidelines and instructions of the ECB. The Governing Council shall take the necessary steps to ensure compliance with the guidelines and instructions of the ECB, and shall require that any necessary information be given to it.

14.4. National central banks may perform functions other than those specified in this Statute unless the Governing Council finds, by a majority of two thirds of the votes cast, that these interfere with the objectives and tasks of the ESCB. Such functions shall be performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB.

(…)

CHAPTER IV

MONETARY FUNCTIONS AND OPERATIONS OF THE ESCB

Article 17

Accounts with the ECB and the national central banks

In order to conduct their operations, the ECB and the national central banks may open accounts for credit institutions, public entities and other market participants and accept assets, including book entry securities, as collateral.

Article 18

Open market and credit operations

18.1. In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may:

— operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in euro or other currencies, as well as precious metals;

— conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral.

18.2. The ECB shall establish general principles for open market and credit operations carried out by itself or the national central banks, including for the announcement of conditions under which they stand ready to enter into such transactions.

Article 19

Minimum reserves

19.1. Subject to Article 2, the ECB may require credit institutions established in Member States to hold minimum reserve on accounts with the ECB and national central banks in pursuance of monetary policy objectives. Regulations concerning the calculation and determination of the required minimum reserves may be established by the Governing Council. In cases of non-compliance the ECB shall be entitled to levy penalty interest and to impose other sanctions with comparable effect.

19.2. For the application of this Article, the Council shall, in accordance with the procedure laid down in Article 41, define the basis for minimum reserves and the maximum permissible ratios between those reserves and their basis, as well as the appropriate sanctions in cases of non-compliance.

Article 20

Other instruments of monetary control

The Governing Council may, by a majority of two thirds of the votes cast, decide upon the use of such other operational methods of monetary control as it sees fit, respecting Article 2.

The Council shall, in accordance with the procedure laid down in Article 41, define the scope of such methods if they impose obligations on third parties.

Article 21

Operations with public entities

21.1. In accordance with Article 123 of the Treaty on the Functioning of the European Union, overdrafts or any other type of credit facility with the ECB or with the national central banks in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments.

21.2. The ECB and national central banks may act as fiscal agents for the entities referred to in Article 21.1.

21.3. The provisions of this Article shall not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, shall be given the same treatment by national central banks and the ECB as private credit institutions.

Article 22

Clearing and payment systems

The ECB and national central banks may provide facilities, and the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Union and with other countries.

Article 23

External operations

The ECB and national central banks may:

—establish relations with central banks and financial institutions in other countries and, where appropriate, with international organisations;

—acquire and sell spot and forward all types of foreign exchange assets and precious metals; the term "foreign exchange asset" shall include securities and all other assets in the currency of any country or units of account and in whatever form held;

—hold and manage the assets referred to in this Article;

—conduct all types of banking transactions in relations with third countries and international organisations, including borrowing and lending operations.

Article 24

Other operations

In addition to operations arising from their tasks, the ECB and national central banks may enter into operations for their administrative purposes or for their staff.

CHAPTER V

PRUDENTIAL SUPERVISION

Article 25

Prudential supervision

25.1. The ECB may offer advice to and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Union legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.

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25.2. In accordance with any regulation of the Council under Article 127(6) of the Treaty on the Functioning of the European Union, the ECB may perform specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

(…)

Article 28

Capital of the ECB

28.1. The capital of the ECB shall be euro 5 000 million. The capital may be increased by such amounts as may be decided by the Governing Council acting by the qualified majority provided for in Article 10.3, within the limits and under the conditions set by the Council under the procedure laid down in Article 41.

28.2. The national central banks shall be the sole subscribers to and holders of the capital of the ECB. The subscription of capital shall be according to the key established in accordance with Article 29.

28.3. The Governing Council, acting by the qualified majority provided for in Article 10.3, shall determine the extent to which and the form in which the capital shall be paid up.

28.4. Subject to Article 28.5, the shares of the national central banks in the subscribed capital of the ECB may not be transferred, pledged or attached.

28.5. If the key referred to in Article 29 is adjusted, the national central banks shall transfer among themselves capital shares to the extent necessary to ensure that the distribution of capital shares corresponds to the adjusted key. The Governing Council shall determine the terms and conditions of such transfers.

Article 29

Key for capital subscription

29.1. The key for subscription of the ECB's capital, fixed for the first time in 1998 when the ESCB was established, shall be determined by assigning to each national central bank a weighting in this key equal to the sum of:

— 50 % of the share of its respective Member State in the population of the Union in the penultimate year preceding the establishment of the ESCB;

—50 % of the share of its respective Member State in the gross domestic product at market prices of the Union as recorded in the last five years preceding the penultimate year before the establishment of the ESCB.

The percentages shall be rounded up or down to the nearest multiple of 0,0001 percentage points.

29.2. The statistical data to be used for the application of this Article shall be provided by the Commission in accordance with the rules adopted by the Council under the procedure provided for in Article 41.

29.3. The weightings assigned to the national central banks shall be adjusted every five years after the establishment of the ESCB by analogy with the provisions laid down in Article 29.1. The adjusted key shall apply with effect from the first day of the following year.

29.4. The Governing Council shall take all other measures necessary for the application of this Article.

(…)

Article 44

The General Council of the ECB

44.1. Without prejudice to Article 129(1) of the Treaty on the Functioning of the European Union, the General Council shall be constituted as a third decision-making body of the ECB.

44.2. The General Council shall comprise the President and Vice-President of the ECB and the Governors of the national central banks. The other members of the Executive Board may participate, without having the right to vote, in meetings of the General Council.

44.3. The responsibilities of the General Council are listed in full in Article 46 of this Statute.

(…)

Article 49

Exchange of banknotes in the currencies of the Member States

Following the irrevocable fixing of exchange rates in accordance with Article 140 of the Treaty on the Functioning of the European Union, the Governing Council shall take the necessary measures to ensure that banknotes denominated in currencies with irrevocably fixed exchange rates are exchanged by the national central banks at their respective par values.

Source: Official Journal of the European Communities, C 202, 7 June 2016, pp.230–250.

ECB: Five things you need to know about the Maastricht Treaty

1. It established the European Union

The Maastricht Treaty, officially known as the **Treaty on European Union**, marked the beginning of “a new stage in the process of creating an ever closer union among the peoples of Europe”. It laid the foundations for a single currency, the euro, and significantly expanded cooperation between European countries in a number of new areas:

- European citizenship was created, allowing citizens to reside in and move freely between Member States;
- a common foreign and security policy was established;
- closer cooperation between police and the judiciary in criminal matters was agreed.

The Treaty was signed in the Dutch city of Maastricht, which lies close to the borders with Belgium and Germany. It was the result of several years of discussions between governments on deepening European integration.

2. It was signed by 12 countries

Representatives from 12 countries signed the Treaty on 7 February 1992 – Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain and the United Kingdom.

The parliaments in each country then ratified the Treaty, in some cases holding referendums. The Maastricht Treaty officially came into force on 1 November 1993 and the European Union was officially established.

Since then, a further 16 countries have joined the EU and adopted the rules set out in the Maastricht Treaty or in the treaties that followed later.

3. It laid the foundations for the euro

The Maastricht Treaty paved the way for the creation of a single European currency – the euro. It was the culmination of several decades of debate on increasing economic cooperation in Europe. The Treaty also established the **European Central Bank (ECB)** and the European System of Central Banks and describes their objectives. The main objective for the ECB is to maintain price stability, i.e. to safeguard the value of the euro.

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The idea of a single currency for Europe was first proposed in the early 1960s by the European Commission. However, an unstable economic landscape in the 1970s meant that the project was brought to a halt.

European leaders revived the idea of a single currency in 1986 and committed to a three-stage transition process in 1989. The Maastricht Treaty formally established these stages:

- **Stage 1** (from 1 July 1990 to 31 December 1993): introduction of free movement of capital between Member States
- **Stage 2** (from 1 January 1994 to 31 December 1998): increased cooperation between national central banks and the increased alignment of Member States' economic policies
- **Stage 3** (from 1 January 1999 to today): gradual introduction of the euro together with the implementation of a single monetary policy, for which the ECB is responsible

4. It introduced the criteria that countries must meet to join the euro

Along with setting out the timeline for the introduction of the single currency, the Treaty also established rules on how the euro would work in practice. This included how to determine if countries were ready to join the euro.

The purpose of these particular rules, sometimes referred to as the Maastricht criteria or the convergence criteria, is to ensure price stability is maintained in the euro area even when new countries join the currency. The rules work to ensure that countries joining are stable in the following areas:

- inflation
- levels of public debt
- interest rates
- exchange rate

5. It was a giant leap forward for European integration

Since the signing of the Maastricht Treaty, European countries have grown closer together while some policy areas such as economic and fiscal policies remain at national level. European leaders have agreed on additional steps to promote further integration between European states:

- the **Stability and Growth Pact** was agreed in 1997 to ensure that countries followed sound budgetary policies;

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- the European Stability Mechanism was established to provide financial assistance to euro area countries experiencing or threatened by severe financing problems;
- the Single Supervisory Mechanism and the Single Resolution Board were created after the financial crisis to make the European banking system safer, as well as to increase financial integration and stability

25 years after the roadmap towards the euro was agreed, the euro has become the world's second most traded currency and is part of the daily life of 340 million citizens in 19 countries.

Source: https://www.ecb.europa.eu/explainers/tell-me-more/html/25_years_maastricht.en.html

The **convergence phase of the Delors Plan was managed by** a transitionary institution, **the European Monetary Institute (EMI)**.

The European Monetary Institute (1994-98)

In 1992, the Treaty on European Union, better known as the Maastricht Treaty, laid out a road map to a common currency and central bank for the European Union. As part of this, the European Monetary Institute (EMI) was established in January 1994 and was an intermediate, but crucial step towards establishing the ECB. Unlike the Committee of Governors before, the EMI got its own legal personality and quickly grew as an organisation and in terms of staff numbers. The EMI had two Presidents: first Alexandre Lamfalussy and then Willem Frederik Duisenberg from July 1997. Duisenberg also became the first President of the ECB in 1998. The President of the EMI chaired the Council, which also included the Vice-President and the Governors of the EU central banks.

Over the next four and a half years, the EMI quickly established its organisational structure. Major work was done in parallel by sub-committees, working groups and underlying task forces of the central banks and the EMI; a cooperative structure that was established during the period of the Committee of Governors.

The EMI's main focus was on establishing the European System of Central Banks, including the ECB and the new currency. It also dealt with some operational tasks, such as replacing the European Monetary Cooperation Fund, which had come before. The EMI aimed to:

- better coordinate monetary policy in the EU
- enforce financial stability
- improve (cross-border) payment systems in the EU

- develop a regulatory, organisational and logistical framework
- develop a common monetary policy strategy for the euro
- prepare a single money market.

Source: https://www.ecb.europa.eu/ecb/access_to_documents/archives/emi/html/index.en.html

The Maastricht convergence criteria were put in place to measure progress in countries' preparedness to adopt the euro, and are defined as a set of **macroeconomic indicators**, which focus on:

- Price stability
- Sound public finances, to ensure they are sustainable
- Exchange-rate stability, to demonstrate that a Member State can manage its economy without recourse to excessive currency fluctuations
- Long-term interest rates, to assess the durability of the convergence

The Maastricht convergence criteria				
What is measured:	**Price stability**	**Sound and sustainable public finances**	**Durability of convergence**	**Exchange rate stability**
How it is measured:	Harmonised consumer price inflation (HICP)	Government deficit and debt	Long-term interest rate	Exchange rate developments in ERM(-II)
Convergence criteria:	A price performance that is sustainable and average inflation not more than 1.5 percentage points above the rate of the three best performing Member States	Not under excessive deficit procedure at the time of examination	Not more than 2 percentage points above the rate of the three best performing Member States in terms of price stability	Participation in ERM(-II) for at least 2 years without severe tensions, in particular without devaluing against the euro

Source: https://ec.europa.eu/info/business-economy-euro/euro-area/enlargement-euro-area/convergence-criteria-joining_en

At the **Madrid Summit in 1995**, the **name of the single currency** was decided and thus the term **"euro"** and the abbreviation **"EUR"** was born.

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Presidency Conclusions of the Madrid Summit of 15-16 December 1995 (excerpts)

INTRODUCTION

The European Council, meeting in Madrid on 15 and 16 December 1995, took decisions on employment, the single currency, the Intergovernmental Conference and enlargement to bring in countries of Central and Eastern Europe and the Mediterranean.

The European Council considers that job creation is the principal social, economic and political objective of the European Union and its Member States, and declares its firm resolve to continue to make every effort to reduce unemployment.

The European Council adopted the scenario for the changeover to the single currency, confirming unequivocally that this stage will commence on 1 January 1999.

The European Council decided to name the currency, to be used from 1 January 1999, the "Euro".

(…)

A. ECONOMIC AND MONETARY UNION

I. The scenario for the changeover to the single currency

1. The European Council confirms that 1 January 1999 will be the starting date for Stage 3 of Economic and Monetary Union, in accordance with the convergence criteria, timetable, protocols and procedures laid down in the Treaty.

The European Council confirms that a high degree of economic convergence is a precondition for the Treaty objective to create a stable single currency.

2. The name of the new currency is an important element in the preparation of the transition to the single currency, since it partly determines the public acceptability of Economic and Monetary Union. The European Council considers that the name of the single currency must be the same in all the official languages of the European Union, taking into account the existence of different alphabets; it must be simple and symbolize Europe.

The European Council therefore decides that, as of the start of Stage 3, the name given to the European currency shall be Euro. This name is meant as a full name, not as a prefix to be attached to the national currency names.

The specific name Euro will be used instead of the generic term "ECU" used by the Treaty to refer to the European currency unit.

The Governments of the fifteen Member States have achieved the common agreement that this decision is the agreed and definitive interpretation of the relevant Treaty provisions.

3. As a decisive step in the clarification of the process of introduction of the single currency, the European Council adopts the changeover scenario attached in Annex 1 which is based on the scenario elaborated at its request by the Council, in consultation with the Commission and the European Monetary Institute. It notes with satisfaction that the scenario is compatible with the EMI report on the changeover.

4. The scenario provides for transparency and acceptability, strengthens credibility and underlines the irreversibility of the process. It is technically feasible and aims to provide for the necessary legal certainty, to minimize adjustment costs and to avoid competitive distortions. Under the scenario, the Council, in the composition of Heads of State or Government, will confirm as early as possible in 1998 which Member States fulfil the necessary conditions for the adoption of the single currency. The European Central Bank (ECB) will have to be created early enough so as to allow preparations to be completed and full operation to start on 1 January 1999.

5. Stage 3 will begin on 1 January 1999 with the irrevocable fixing of conversion rates among the currencies of participating countries and against the Euro. From that date, monetary policy and the foreign exchange rate policy will be conducted in Euro, the use of the Euro will be encouraged in foreign exchange markets and new tradeable public debt will be issued in Euro by the participating Member States.

6. A Council Regulation, whose technical preparatory work shall be completed at the latest by the end of 1996, will enter into force on 1 January 1999 and provide the legal framework for the use of the Euro, which, from this date, will become a currency in its own right, and the official ECU basket will cease to exist. This regulation will establish, as long as different monetary units still exist, a legally enforceable equivalence between the Euro and the national units. The substitution of the Euro for national currencies should not of itself alter the continuity of contracts, unless otherwise provided in the contract. In the case of contracts denominated by reference to the official ECU basket of the European Community, in accordance with the Treaty, substitution by the Euro will be at the rate of one to one, unless otherwise provided in the contract.

7. By 1 January 2002 at the latest, Euro banknotes and coins will start to circulate alongside national notes and coins. At most 6 months later, the national currencies will have been completely replaced by the Euro in all participating Member States, and the changeover will be complete. Thereafter, national banknotes and coins may still be exchanged at the national Central Banks.

8. The European Council calls on the ECOFIN Council to speed up all the additional technical work necessary to implement the changeover scenario adopted today. The labelling of Euro banknotes and coins in the different alphabets of the Union will also be defined.

II. Further preparation of Stage 3 of EMU

Durable economic convergence

Budgetary discipline is of crucial significance both for the success of the Economic and Monetary Union and for the acceptance of the single currency by the public. It is therefore necessary to ensure that, after moving to Stage 3, public finances are kept on a sound track in line with Treaty obligations.

The European Council notes with interest the Commission's intention to present in 1996 its conclusions on ways to ensure budgetary discipline and coordination in the monetary union in accordance with the procedures and principles of the Treaty.

The relationship between Member States participating in the Euro area and non-participating Member States.

The future relationships between Member States participating in the Euro area and non-participating Member States will have to be defined prior to the move to Stage 3.

The European Council requests that the ECOFIN Council, together with, in their respective fields of competence, the Commission and the EMI, study the range of issues raised by the fact that some countries may not initially participate in the Euro area. In particular, the study should cover those issues related to monetary instability.

Work ahead

The European Council requests the ECOFIN Council to report on the two foregoing questions as soon as possible.

Work on both questions should respect the Treaty requirement that Member States entering the Euro area after 1999 should be able to do so on the same terms and conditions as those applied in 1998 to the initial participating Member States.

(…)

ANNEX 1: THE SCENARIO FOR THE CHANGEOVER TO THE SINGLE CURRENCY

1. At its meeting in Cannes on 27 June 1995, the European Council requested the ECOFIN Council to define, in consultation with the Commission and the European Monetary Institute (EMI), a reference scenario for the changeover to the single currency and to report back to the European Council at its meeting in December 1995 in Madrid with a view to its adoption.

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2. Since the entry into force of the Treaty on European Union ("Maastricht Treaty"), particularly since the start of Stage 2 of the process of moving to an Economic and Monetary Union, the Member States, the European bodies and representatives of many private organizations have been studying the different aspects of the changeover. Preparations have now reached a level which allows the presentation of a reference changeover scenario containing clearly defined measures to be implemented within pre-set dates or deadlines.
3. The preparations underway are guided by the overriding Treaty objective to create a stable single currency. One precondition for this is to achieve a high degree of convergence of economic performance before locking exchange rates irrevocably. A strict application of the convergence criteria in assessing which Member States fulfil the necessary conditions for the adoption of a single currency will establish confidence in the new currency and convince the public at large as well as markets that it will be strong and stable. After moving to Stage 3 of Economic and Monetary Union, convergence will have to be maintained. In particular public finances must be kept on a sound track in line with Treaty obligations. Therefore work has to be done on ways to secure budgetary discipline among participants in the Euro area in accordance with the procedures and the principles of the Treaty. In addition, the future relationship between the Member States participating in the Euro area and the others will need to be defined prior to the move to Stage 3 with a view, inter alia, to safeguarding monetary stability within the single market.
4. The removal of uncertainties requires careful technical preparation of the move to Stage 3. This preparation will also contribute to public acceptability of the new currency. The changeover scenario presented below has been defined in consultation with the Commission and the EMI and has benefitted from the Commission's Green Paper and the EMI report on the changeover to the single currency. It is in line with the timetable, procedures and criteria laid down in the Treaty. It provides for transparency, strengthens credibility and underlines the irreversibility of the process. It is technically feasible and aims to provide for the necessary legal certainty, to minimize adjustment costs and to avoid competitive distortions. The changeover scenario, by announcing concrete measures to be taken within a clear timetable, offers the users of money the information necessary for them to adapt to the introduction of the single currency. The scenario is compatible with the EMI report on the changeover.
5. This changeover scenario is based on 1 January 1999 as the starting date for the third stage. The steps to be taken during the different stages of the changeover process are presented below and summarized in the annexed tables which set out the timing and the various dates and deadlines for the participating Member States.
6. The Council in the composition of Heads of State and Government will confirm which Member States fulfil the necessary conditions for the adoption of the single currency. The date of this decision marks the beginning of an interim period prior to the entry into Stage 3, during which decisions are to be taken to complete the preparations. On the one hand, the magnitude of the workload would suggest that this interim period lasts for about one

year; but, on the other, the Heads of State and Government should base their decision on participating Member States on the most recent and reliable actual data for 1997. Thus, special efforts will be made so that the Heads of State and Government make their decision as soon as possible in 1998. Advance preparation will help to ensure that all the necessary measures will be in place for the start of Stage 3 of Economic and Monetary Union. Several of these measures fall within the competence of the European Central Bank (ECB).

7. The ECB will have to be created early enough so as to allow preparations to be completed and full operation to start on 1 January 1999. Therefore, as early as possible in this interim period, the Council and the participating Member States will have to adopt a number of legal provisions and to appoint the Executive Board of the European Central Bank (ECB). As soon as the Executive Board of the ECB is appointed, the ECB and the European System of Central Banks (ESCB) will be established. The decision-making bodies of the ECB will decide on, implement and test the framework needed for the ESCB/ECB to perform its task in Stage 3 of Economic and Monetary Union.

8. Stage 3 of Economic and Monetary Union will start on 1 January 1999, with the irrevocable fixing of conversion rates among currencies of participating countries and against the Euro and with the single monetary policy which will be defined and implemented by the ESCB in Euro. The ESCB will encourage the use of the Euro in the foreign exchange markets; its operations in these markets will be effected and settled in Euro. The payments system's infrastructure needs to be in place so as to ensure the smooth functioning of an area-wide money market based on the Euro. National central banks could provide conversion facilities for those financial institutions which have not been able to equip themselves with such facilities to translate amounts from Euro into national monetary units and vice-versa.

9. A Council regulation entering into force on 1 January 1999 will provide the legal framework for the use of the Euro. From that date, the Euro will be "a currency in its own right" and the official ECU basket will cease to exist. This Regulation will have the effect that the national currencies and the Euro will become different expressions of what is economically the same currency. As long as different national monetary units still exist, the Council Regulation will establish a legally enforceable equivalence between the Euro and the national currency units ("legally enforceable equivalence" means that each monetary amount is assigned, in a legally enforceable way, an unchangeable countervalue in terms of the Euro unit at the official conversion rate and vice versa). For the period before the deadline set for the completion of the changeover, the Regulation will ensure that private economic agents will be free to use the Euro; at the same time they should not be obliged to do so. As far as possible, they should be allowed to develop their own mechanisms of adjustment to the changeover; however, the implementation of these principles should take into account market practices in terms of standardization. The Regulation will also provide that national banknotes will continue to remain legal tender within the boundaries of the respective national territories until the completion of the changeover to the single currency. The technical preparatory work for this Regulation

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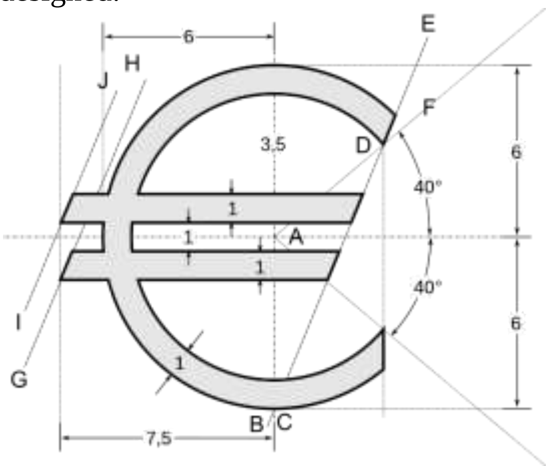
shall be completed at the latest by the end of 1996.

10. The substitution of the Euro for national currencies should not of itself alter the continuity of contracts; amounts expressed in national currency will be converted into Euro at the rate of conversion laid down by the Council. In the case of fixed interest rate securities and loans, this substitution will not of itself alter the nominal interest rate payable by the debtor unless otherwise provided in the contract. In the case of contracts denominated by reference to the official ECU basket of the European Community, in accordance with the Treaty, substitution by the Euro will be at the 1:1 rate, subject to the particular terms of individual contracts.
11. New tradeable public debt - particularly debt coming to maturity after 1 January 2002- will be issued in Euro by the participating Member States as from 1 January 1999. By 1 July 2002 at the latest, public debt denominated in the former national currencies will be redeemable only in the single currency.
12. The generalization of the use of the Euro for public sector operations will occur in all participating Member States at the latest when the Euro banknotes and coins are fully introduced. The time frame will be laid down in Community legislation and might leave some freedom to individual Member States.
13. The public authorities are invited to set in hand the arrangements for planning the adaptation of their administration to the Euro.
14. By 1 January 2002 at the latest, Euro banknotes and coins will start to circulate alongside national notes and coins. Euro notes and coins will have legal tender status. In line with the increasing circulation of Euro notes and coins, national notes and coins will be withdrawn. Member States should endeavour to keep this period of dual circulation of national and Euro notes and coins to the minimum. In any event, national notes and coins will cease to be legal tender at the latest 6 months after the introduction of Euro notes and coins. By that deadline, the changeover will be complete. Thereafter, national banknotes and coins may still be exchanged free of charge at the national central banks.

Source: https://www.europarl.europa.eu/summits/mad2_en.htm

Later, the **euro sign** was designed:



Source: www.europa.eu

The **design was presented** to the public by the European Commission on **12 December 1996**.

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The ECB and the common monetary policy

On **1 January 1999** the **third and final stage of EMU** commenced with the **irrevocable fixing of the exchange rates** of the currencies of the **11 member states** initially participating in monetary union and with the conduct of a **single monetary policy under the responsibility of the ECB**.

Thus the ECB is the **central bank of the Eurozone**.

ECB, ESCB and the Eurosystem

Since 1 January 1999 the European Central Bank (ECB) has been responsible for conducting monetary policy for the euro area - the world's largest economy after the United States.

The euro area came into being when responsibility for monetary policy was transferred from the national central banks of 11 EU Member States to the ECB in January 1999. Greece joined in 2001, Slovenia in 2007, Cyprus and Malta in 2008, Slovakia in 2009, Estonia in 2011, Latvia in 2014 and Lithuania in 2015. The creation of the euro area and of a new supranational institution, the ECB, was a milestone in the long and complex process of European integration.

To join the euro area, the 19 countries had to fulfil the convergence criteria, as will other EU Member States prior to adopting the euro. The criteria set out the economic and legal preconditions for countries to participate successfully in Economic and Monetary Union.

European Central Bank

The legal basis for the single monetary policy is the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks and of the European Central Bank. The Statute established both the ECB and the European System of Central Banks (ESCB) as from 1 June 1998. The ECB was established as the core of the Eurosystem and the ESCB. The ECB and the national central banks together perform the tasks they have been entrusted with. The ECB has legal personality under public international law.

European System of Central Banks

The ESCB comprises the ECB and the national central banks (NCBs) of all EU Member States whether they have adopted the euro or not.

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Eurosystem

The Eurosystem comprises the ECB and the NCBs of those countries that have adopted the euro. The Eurosystem and the ESCB will co-exist as long as there are EU Member States outside the euro area.

Euro area

The euro area consists of the EU countries that have adopted the euro.

Source: https://www.ecb.europa.eu/ecb/orga/escb/html/index.en.html

Eurosystem mission

The Eurosystem, which comprises the European Central Bank and the national central banks of the Member States whose currency is the euro, is the monetary authority of the euro area. We in the Eurosystem have as our primary objective the maintenance of price stability for the common good. Acting also as a leading financial authority, we aim to safeguard financial stability and promote European financial integration.

In pursuing our objectives, we attach utmost importance to credibility, trust, transparency and accountability. We aim for effective communication with the citizens of Europe. We are committed to conducting our relations with European and national authorities in full accordance with the Treaty provisions and with due regard to the principle of independence.

We jointly contribute, strategically and operationally, to attaining our common goals, with due respect to the principle of decentralisation. We are committed to good governance and to performing our tasks effectively and efficiently, in a spirit of cooperation and teamwork. Drawing on the breadth and depth of our experiences as well as on the exchange of know-how, we aim to strengthen our shared identity, speak with a single voice and exploit synergies, within a framework of clearly defined roles and responsibilities for all members of the Eurosystem.

Source: https://www.ecb.europa.eu/ecb/orga/escb/eurosystem-mission/html/index.en.html

ECB mission

The European Central Bank and the national central banks together constitute the Eurosystem, the central banking system of the euro area. The main objective of the Eurosystem is to maintain price stability: safeguarding the value of the euro.

The European Central Bank is responsible for the prudential supervision of credit institutions located in the euro area and participating non-euro area Member States, within the Single Supervisory Mechanism, which also comprises the national competent authorities. It thereby contributes to the safety and soundness of the banking system and the stability of the financial system within the EU and each participating Member State.

We at the European Central Bank are committed to performing all our tasks effectively. In so doing, we strive for the highest level of integrity, competence, efficiency and accountability. We respect the separation between our monetary policy and supervisory tasks. In performing our tasks we are transparent while fully observing the applicable confidentiality requirements.

Source: https://www.ecb.europa.eu/ecb/orga/escb/ecb-mission/html/index.en.html

The **decision-making bodies** of the ECB are:

- Governing Council
- Executive Board
- General Council
- Supervisory Board

The Governing Council

The Governing Council is the main decision-making body of the ECB. It consists of

- the six members of the Executive Board, plus
- the governors of the national central banks of the euro area countries.

Responsibilities

- to adopt the guidelines and take the decisions necessary to ensure the performance of the tasks entrusted to the ECB and the Eurosystem;
- to formulate monetary policy for the euro area. This includes decisions relating to monetary objectives, key interest rates, the supply of reserves in the Eurosystem, and the establishment of guidelines for the implementation of those decisions.

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- in the context of the ECB's new responsibilities related to banking supervision, to adopt decisions relating to the general framework under which supervisory decisions are taken, and to adopt the complete draft decisions proposed by the Supervisory Board under the non-objection procedure.

Meetings and decisions

The Governing Council usually meets twice a month at the ECB's premises in Frankfurt am Main, Germany.

The Governing Council assesses economic and monetary developments and takes its monetary policy decisions every six weeks. At the other meetings, the Council discusses mainly issues related to other tasks and responsibilities of the ECB and the Eurosystem. To ensure the separation of the ECB's monetary policy and other tasks from its supervisory responsibilities, separate meetings of the Governing Council are held.

The monetary policy decision is explained in detail at a press conference held every six weeks. The President, assisted by the Vice-President, chairs the press conference.

In addition, the ECB publishes regular accounts of the Governing Council's monetary policy meetings before the date of the next one.

Source: https://www.ecb.europa.eu/ecb/orga/decisions/govc/html/index.en.html

The Executive Board

The Executive Board consists of

- the President,
- the Vice-President and
- four other members.

All members are appointed by the European Council, acting by a qualified majority.

Responsibilities

- to prepare Governing Council meetings;
- to implement monetary policy for the euro area in accordance with the guidelines specified and decisions taken by the Governing Council. In so doing, it gives the necessary instructions to the euro area NCBs;
- to manage the day-to-day business of the ECB with the support of the Chief Services Officer;

- to exercise certain powers delegated to it by the Governing Council. These include some of a regulatory nature.

All Executive Board members are appointed for an eight-year term that cannot be renewed. As an exception, the members appointed to the first Board in 1998 received terms of varying lengths so that not all members would need to be replaced in the same year.

Source: https://www.ecb.europa.eu/ecb/orga/decisions/eb/html/index.en.html

The General Council

The General Council comprises
- the President of the ECB;
- the Vice-President of the ECB;
- the governors of the national central banks (NCBs) of all EU Member States.

In other words, the General Council includes representatives of the euro area countries and the non-euro area countries.

The other members of the ECB's Executive Board, the President of the EU Council and one member of the European Commission may attend the meetings of the General Council but do not have the right to vote.

Responsibilities

The General Council can be regarded as a transitional body. It carries out the tasks taken over from the European Monetary Institute which the ECB is required to perform in Stage Three of Economic and Monetary Union on account of the fact that not all EU Member States have adopted the euro yet.

The General Council also contributes to:
- the ECB's advisory functions;
- the collection of statistical information;
- the preparation of the ECB's annual report;
- the establishment of the necessary rules for standardising the accounting and reporting of operations undertaken by the NCBs;
- the taking of measures relating to the establishment of the key for the ECB's capital subscription other than those laid down in the Treaty;
- the laying-down of the conditions of employment of the members of staff of the ECB;
- the necessary preparations for irrevocably fixing the exchange rates of the currencies of the "EU Member States with a derogation" against the euro.

In accordance with the Statute of the European System of Central Banks and of the European Central Bank, the General Council will be dissolved once all EU Member States have introduced the single currency.

Source: https://www.ecb.europa.eu/ecb/orga/decisions/genc/html/index.en.html

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The Supervisory Board

The Supervisory Board meets every three weeks to discuss, plan and carry out the ECB's supervisory tasks. It proposes draft decisions to the Governing Council under the non-objection procedure.

Composition

- Chair (appointed for a non-renewable term of five years)
- Vice-Chair (chosen from among the members of the ECB's Executive Board)
- four ECB representatives
- representatives of national supervisors

If the national supervisory authority designated by a Member State is not a national central bank (NCB), the representative of the competent authority can be accompanied by a representative from their NCB. In such cases, the representatives are together considered as one member for the purposes of the voting procedure.

Steering Committee

The Steering Committee supports the activities of the Supervisory Board and prepares the Board's meetings.

Composition

- Chair of the Supervisory Board
- Vice-Chair of the Supervisory Board
- one ECB representative
- five representatives of national supervisors

The five representatives of national supervisors are appointed by the Supervisory Board for one year based on a rotation system that ensures a fair representation of countries.

Source: https://www.ecb.europa.eu/ecb/orga/decisions/ssm/html/index.en.html

Economic policy coordination

The main decision-making body of the European Union is the **Council**. The Council consists of the respective representatives of the member states. In case of economy and finance related decisions, it is constituted of the ministers of economy and/or finance, referred to as **ECOFIN**.

The ECOFIN

The Economic and Financial Affairs Council (ECOFIN) is responsible for EU policy in three main areas: economic policy, taxation issues and the regulation of financial services.

How does ECOFIN work?

The ECOFIN Council is made up of the economics and finance ministers from all member states. Relevant European Commissioners also participate in meetings.

There are also specific ECOFIN sessions, attended by national budget ministers and the European Commissioner for financial programming and budget, to prepare the EU's annual budget.

ECOFIN meetings generally take place once a month.

About economic and financial affairs policy

The Economic and Financial Affairs Council, commonly known as the ECOFIN Council, is responsible for economic policy, taxation matters, financial markets and capital movements, and economic relations with countries outside the EU.

It also prepares the EU's annual budget and takes care of the legal and practical aspects of the single currency, the euro.

The ECOFIN Council coordinates member states' economic policies, furthers the convergence of their economic performance and monitors their budgetary policies.

It also coordinates EU positions for international meetings, such as the G20, the International Monetary Fund and the World Bank. It is also responsible for the financial aspects of international negotiations on measures to tackle climate change.

Source: https://www.consilium.europa.eu/en/council-eu/configurations/ecofin/

A **sub-group of ECOFIN** is the **Eurogroup** that comprises the **respective ministers of Eurozone countries only**.

The Eurogroup

The Eurogroup is an informal body where the ministers of the euro area member states discuss matters relating to their shared responsibilities related to the euro.

Tasks

Its main task is to ensure close coordination of economic policies among the euro area member states. It also aims to promote conditions for stronger economic growth.

The Eurogroup is also responsible for preparing the Euro Summit meetings and for their follow-up.

Meetings

The Eurogroup usually meets once a month, on the eve of the Economic and Financial Affairs Council meeting. The commissioner for economic and financial affairs, taxation and customs and the president of the European Central Bank also participate in the Eurogroup meetings.

The first informal meeting of finance ministers of the euro area countries took place on 4 June 1998 at the Château de Senningen in Luxembourg.

President

The Eurogroup elects its president for a term of 2.5 years by a simple majority of votes.

Legal base

Treaty on the Functioning of the European Union (TFEU):

- Article 137 - rules specific to EU countries whose currency is the euro
- Protocol (No 14) on the Euro Group

Source: https://www.consilium.europa.eu/en/council-eu/eurogroup/

There is a **strategy-building formation in the Eurozone** called the **Euro Summit**.

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The Euro Summit

The Euro Summit brings together the heads of state or government of the euro area countries, the Euro Summit President and the President of the European Commission. Euro Summit meetings provide strategic guidelines on euro area economic policy.

Role of the Euro Summit

The Euro Summit provides policy guidance to ensure the smooth functioning of the Economic and Monetary Union. This helps to coordinate all the relevant policy areas between the euro area member states.

Regular high-level discussions on the specific responsibilities related to euro area membership also allow euro area countries to take greater account of the euro area dimension in their national policy-making.

As euro area issues have political and economic importance for all EU countries, they also are regularly discussed in European Council meetings.

Euro Summit meetings

According to the Treaty on Stability, Coordination and Governance (TSCG) in the Economic and Monetary Union, Euro Summit meetings should take place at least twice a year. If possible, they should be held after European Council meetings in Brussels.

Euro Summit meetings are organised according to specific rules of procedure, adopted on 14 March 2013.

Members

The members of the Euro Summit are the heads of state or government from the euro area countries, the Euro Summit President and the President of the European Commission. In addition:

- the President of the European Central Bank is invited to take part
- the President of the Eurogroup may be invited to take part, as the Eurogroup is responsible for the preparation and follow-up of Euro Summit meetings
- the President of the European Parliament may also be invited to speak

Where appropriate, and at least once a year, leaders of non-euro area member states that have ratified the Treaty on Stability, Coordination and Governance (TSCG) also take part in the Euro Summit meetings.

Euro Summit President

Euro area leaders elect the Euro Summit President by simple majority, at the same time as the European Council elects its President. The Euro Summit President's term of office is 2.5 years.

The President is responsible for convening, chairing and steering Euro Summit meetings. He also discusses euro area matters with the President of the Commission and the President of the Eurogroup.

The Euro Summit President reports to the European Parliament after each Euro Summit meeting. He also informs all the non-euro area member states about the preparation and outcome of Euro Summit meetings.

Source: https://www.consilium.europa.eu/en/european-council/euro-summit/

The Maastricht criteria included **two fiscal conditions**:

- budget deficit must not exceed 3% of the country's GDP
- gross national (government) debt must not exceed 60% of the country's GDP

The main idea behind the **Stability and Growth Pact (SGP)**, adopted in 1997 and entering into force in 1999, was that these two fiscal conditions must be met also after joining the Eurozone, in order to guarantee the stability of the currency and the currency area as a whole. **The ECOFIN was safeguarding the implementation of the SGP**.

However, with the global financial and economic crisis unfolding in 2008-2009, it turned out that **the original setup of European economic policy coordination was not sufficient**, refinement of the system was needed. This way the **economic policy coordination was developed into European economic governance**. The new system was launched 2011 (in fact, November 2010 with the first Annual Growth Survey).

The EU's economic governance explained by the European Commission

The recent economic and financial crisis revealed weaknesses in the EU's economic governance. The EU responded by taking a wide range of measures to strengthen its governance and to facilitate a return to sustainable economic growth, job creation, financial stability and sound public finances. Central pillars of these efforts are: the legislative packages to strengthen the Stability and Growth Pact known as the **"Six Pack"** and **"Two Pack"**, and the **Treaty on Stability, Coordination and Governance in the Economic and Monetary Union**. All EU Member States except the Czech Republic and Croatia have now signed this Treaty. The "Six Pack" strengthened the Stability and Growth Pact and also introduced a new macroeconomic surveillance tool: the macroeconomic imbalance procedure. The "Two Pack" requests that euro area Member States present Draft Budgetary Plans for the following year in mid-October. This ensures that fiscal policy is discussed early in the budgetary process and that Commission's guidance can be taken into account before national budgets are adopted.

The rules are applied in the context of the **European Semester**, an annual cycle of coordination and surveillance of the EU's economic policies. Compared to the previous set up this integrated system ensures that there are clearer rules, better follow-up and improved implementation by Member States of the commonly agreed policies throughout the year. It also allows for regular monitoring, and the possibility of swifter response ahead or in case of problems. This helps Member States deliver their reform and budgetary commitments, while making the Economic and Monetary Union more robust. By allowing more time for dialogue, the revamped European Semester, initiated in 2015 and applied subsequently, allows for greater involvement of the European Parliament and national legislatures, as well as social partners and stakeholders at all levels.

Coordination throughout the year: the European Semester

Before the crisis, economic and budgetary policy planning took place essentially at the national level, with only a limited coordinated overview at EU level of the national efforts. Member States hardly needed to discuss a collective strategy for the EU economy, or indeed the euro area, as a whole.

The European Semester, introduced in 2010, ensures that Member States discuss their economic and budgetary plans with their EU partners at specific times in the first part of the year, so that national action could be accordingly taken in the second part of the year, notably with the adoption of the budgets for the subsequent year. This early interaction allows them to comment on each other's plans and monitor progress collectively. It also allows them to take better account of common challenges. Each year in spring, the Commission analyses in detail the EU Member States' plans for macroeconomic, budgetary and structural reforms and issues recommendations for the next 12-18 months to be adopted by the Council. Since 2016, the recommendations to Member States reflect to a large extent the annual recommendations for the euro area which are adopted through a similar process at the beginning of the year. The Commission also monitors Member States' efforts in working towards "Europe 2020", the EU's targets for its long-term growth strategy in the fields of employment, education, innovation, climate and the fight against poverty.

The European Semester cycle starts in November with the publication of the Commission's **Annual Sustainable Growth Strategy (ASGS)**, the **Alert Mechanism Report (AMR)**, the draft Joint Employment Report and recommendations for the euro area, accompanied by a **Staff Working Document**. The Annual Sustainable Growth Strategy sets out general economic and social priorities for the EU and provides Member States with generic policy guidance for the following year. The Alert Mechanism Report is the starting point of the annual **macroeconomic imbalance procedure (MIP)**. The MIP aims to identify potential risks early on, prevent the emergence of harmful macroeconomic imbalances and correct the imbalances already in place in the economies of Member States, the EU, or the euro area. The recommendations for the euro area address key issues for the functioning of the euro area and provide orientation on concrete actions for their implementation, which are reflected in the country-specific specific recommendations where appropriate. The euro area recommendations are published alongside the ASGS to allow for better integration of the euro area and national dimensions of EU economic governance and therefore strengthen the surveillance process. The euro area recommendations are accompanied by a Staff Working Document, the Report on the Euro Area. The draft Joint Employment Report analyses the employment and social situation in Europe and the policy responses by Member States. Moreover, the Commission publishes its opinions on the Draft Budgetary Plans of euro area Member States. This year – for the first time – the Commission also presented a communication on the euro area fiscal stance.

Prepared by discussions at ministerial level, EU leaders consider in March the Annual Sustainable Growth Strategy, the Alert Mechanism Report, the euro area recommendations and the draft Joint Employment Report and provide guidance on a common direction for the EU and euro area as a whole. The euro area recommendations are adopted by the Council in February.

In February, the Commission publishes a country report for each Member State analysing its economic situation and progress with implementing the Member State's reform agenda. For those Member States selected in the Alert Mechanism Report, the country report includes the findings of the so-called **"in-depth review"** of possible imbalances the Member State faces.

In April, Member States present their national reform programmes and their **stability or convergence programmes** (three-year budget plans, the former for euro area countries, the latter for other EU Member States) to the Commission. In these programmes, countries report on the specific policies they are implementing and intend to adopt in order to boost jobs and growth, prevent or correct macroeconomic imbalances, and on their concrete plans to ensure compliance with the outstanding EU's country-specific – and where applicable euro area – recommendations and fiscal rules.

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The Commission then assesses the plans of the Member States and presents a series of new **country-specific recommendations** to each of them in May. Due to a streamlining initiated in the 2015 European Semester cycle there are now less and more focused country-specific recommendations than before. These policy recommendations are discussed between Member States in the Council. EU leaders endorse them in June before Council adopts them in July. Governments then incorporate the recommendations into their reform plans and national budgets for the following year.

Budgetary monitoring intensifies in the autumn for euro area Member States: they must submit to the Commission **Draft Budgetary Plans** for the following year by 15 October. The Commission then assesses the Plans against the requirements of the Stability and Growth Pact and the relevant country-specific recommendations and issues an Opinion on each of them in November, so that this guidance is taken into account when national budgets are finalised. Euro area Finance and/or Economy Ministers then discuss the Commission's assessment of the Draft Budgetary Plans in the ECOFIN Council.

Throughout the year, the Commission is in dialogue with stakeholders and Member States' authorities to closely monitor policy implementation.

More responsible budgeting

The Stability and Growth Pact was established at the same time as the single currency in order to ensure sound public finances. However, as shown during the crisis, its enforcement did not prevent the emergence of serious fiscal imbalances in some Member States.

It was therefore reformed through the "Six Pack" (which became law in December 2011) and the "Two Pack" (which entered into force in May 2013), and reinforced by the Intergovernmental Treaty on Stability, Coordination and Governance (which entered into force in January 2013 in its 25 signatory countries). In January 2015, the Commission issued a Communication on making the best use of the flexibility within the existing rules of the Stability and Growth Pact, to strengthen the link between structural reforms, investment and fiscal responsibility in support of jobs and growth.

Better rules

- **Headline deficit and debt limits:** the Stability and Growth Pact sets limits of 3% of GDP for deficits and 60% of GDP for debt. They remain valid. A stronger focus on debt: the new rules make the existing 60% of GDP debt limit operational. This means that Member States can be placed in the Excessive Deficit Procedure if they have debt ratios above 60% of GDP that are not being sufficiently reduced (i.e. the excess over 60% is not being reduced by at least 5% a year on average over three years).

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- **A new expenditure benchmark:** under the new rules, public spending must not rise faster than medium-term potential GDP growth, unless it is matched by adequate revenue increases.
- **The importance of the underlying budgetary position:** the Stability and Growth Pact focuses more on improving public finances in structural terms (taking into account the effects of an economic downturn or one-off measures on the deficit). Member States set their own medium-term budgetary objectives. The Commission checks that the chosen medium-term budgetary objectives comply with the requirements set out in the Stability and Growth Pact. The goal is to improve the structural balance and converge towards the medium-term budgetary objective, by 0.5% of GDP a year as a benchmark. This provides a safety margin against breaching the 3% headline deficit target, with Member States, particularly those with debt levels over 60% of GDP, urged to do more in economically good times and less in bad times.
- **A fiscal pact for 25 Member States:** since January 2014, signatories to the TSCG must have legally binding, medium-term budgetary objectives enshrined in national law. They must also limit structural deficits to 0.5% of GDP (or to 1%, if their debt-to-GDP ratio is well below 60%). All Members States but the Czech Republic and Croatia have signed this Treaty.

The Treaty also says that automatic correction mechanisms should be triggered if the structural deficit limit (or the adjustment path towards it) is breached, which would require Member States to set out in national law how and when they would rectify the breach over the course of future budgets.

- **Flexibility during a crisis:** by focusing on the underlying budgetary position over the medium term, the Stability and Growth Pact can be flexible during a crisis. If growth deteriorates unexpectedly, Member States with budget deficits over 3% of GDP may receive extra time to correct those deficits, as long as the Member States have made the necessary structural effort.
- **Incentives for structural reforms and investment:** the guidance provided by the Commission in January 2015 sets out ways, within the existing rules of the Pact, to encourage effective implementation of structural reforms, promote investment, and take better account of the economic cycle in individual Member States.

Better enforcement of the rules

- **Better prevention:** The Commission and the Council assess whether Member States meet their medium-term budgetary objectives, as set out in their Stability or Convergence Programmes presented each April. The assessments feed into the Commission's Country-Specific Recommendations each spring. This comes on top of the opinions on the draft budgetary plans delivered annually to euro area Member States in autumn (see below).

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- **Early warning:** in addition to the Country-Specific Recommendations and dedicated fiscal recommendations, if there is a significant deviation from the medium-term objective or the adjustment path towards it, the Commission addresses a warning to the Member State, to be endorsed by the Council. This warning can be made public. The situation is then monitored throughout the year, and if it is not rectified, the Commission can propose an interest-bearing deposit of 0.2% of GDP (euro area only), which must be approved by the Council. This can be returned to the Member State if it corrects the deviation.
- **Excessive Deficit Procedure (EDP):** if Member States breach either the deficit or debt criteria, they are placed in an Excessive Deficit Procedure, where they are subject to additional monitoring (usually every three or six months) and are set a deadline for correcting their excessive deficit. The Commission monitors compliance throughout the year, based on regular economic forecasts and on Eurostat data. The Commission can request more information or recommend further action from those at risk of missing their deficit deadlines.
- **Swifter sanctions:** for euro area Member States in the Excessive Deficit Procedure, financial penalties kick in earlier and can be gradually stepped up. Failure to reduce the deficit adequately can result in fines of 0.2% of GDP. Fines can rise to a maximum of 0.5% if statistical fraud is detected. Penalties can include a suspension of EU regional funding, even for non-euro area countries. In parallel, the 25 Member States that signed the TSCG can be fined 0.1% of GDP for failing to properly integrate its provisions into national law.
- **Transparency and automaticity:** the adoption of the annual Country-Specific Recommendations follows a "comply-or-explain" principle, whereby Member States must justify changes to the original proposals from the Commission. Moreover, decisions on most sanctions under the Excessive Deficit Procedure are now taken by reverse qualified majority voting (RQMV), which means that fines are deemed to be approved by the Council unless a qualified majority of Member States overturns them. This was not possible before the "Six Pack" entered into force. In addition, the 25 Member States that have signed the Fiscal Compact have agreed to replicate the RQMV mechanism even earlier in the process, for example, when deciding whether to place a Member State in the Excessive Deficit Procedure.

Stepped-up surveillance in the euro area

The crisis has shown that difficulties in one euro area Member State can have contagion effects in others. Therefore, extra surveillance is warranted to contain problems before they spread.

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The "Two Pack" introduced an additional cycle of monitoring for the euro area, as well as tighter surveillance of those facing more serious difficulties.

- *Draft Budgetary Plans*: euro area Member States (except for those Member States under macroeconomic adjustment programmes) must present their Draft Budgetary Plans for the following year by 15 October. The Commission then issues an Opinion on these DBPs.
- *Economic Partnership Programmes*: euro area Member States must present such programmes when entering the EDP or receiving a new EDP deadline. These Economic Partnership Programmes contain detailed fiscal and structural reforms (for example, on pension systems, taxation or public healthcare) that will correct Member States' deficits in a lasting way.
- *Enhanced surveillance*: Member States experiencing financial difficulties or under precautionary assistance programmes from the European Stability Mechanism are put under "enhanced surveillance", which means they are subject to regular review missions by the Commission and must provide additional data, for example, on their financial sectors.
- Financial assistance programmes: Member States experiencing or threatened with serious difficulties in respect to their financial stability, which could have significant adverse effects on the rest of the euro area, can be asked to prepare full macroeconomic adjustment programmes. This decision is taken by the Council, acting by a qualified majority, on a proposal from the Commission. These programmes are subject to quarterly review missions and strict conditionality in exchange for any financial assistance.
- *Post-programme surveillance*: Member States will undergo post-programme surveillance as long as 75% of any financial assistance drawn remains outstanding.

Macroeconomic imbalance procedure

Drawing on the experience of the crisis, the "Six Pack" reforms introduced the Macroeconomic Imbalance Procedure (MIP) with the aim of monitoring and preventing economic developments that could jeopardise macroeconomic stability (linked, for instance, to current account imbalances, real estate bubbles, banking crises) and fostering adjustment by means of appropriate policies. The MIP is applied in the framework of the European Semester and developed through a number of main stages:

- **Alert Mechanism Report:** Member States are screened for potential imbalances on the basis of a scoreboard of main variables, as well as auxiliary indicators and other information, to measure economic developments over time. Each November, the Commission publishes its Alert Mechanism Report. The report identifies Member States that require further analysis (an in-depth review).

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- **In-depth reviews:** the Commission undertakes an in-depth review of those Member States identified in the AMR that are potentially at risk of imbalances. The in-depth review (IDR) verifies the existence of imbalances and their severity (the identification of excessive imbalances requiring enhanced surveillance). IDRs are published in the spring and are part of the European Semester Country Reports.
- **Recommendations:** For countries identified with imbalances, the Commission may propose recommendations to address these imbalances as part of the package of country-specific recommendations issued in May.
- **Monitoring:** The policies aimed at addressing by countries under MIP surveillance are monitored through a system of specific monitoring comprising missions and reports. The
- **Follow up to the identification of excessive imbalances:** Countries identified with excessive imbalances receive MIP-related recommendations commensurate with challenges, and close monitoring of action taken. If the Commission concludes that excessive imbalances exist in a Member State, it may also launch the Excessive Imbalance Procedure (EIP), implying the delivery and adoption of a corrective action plan within deadlines. The Commission monitors throughout the year whether the policies in the plan are being implemented. The repeated lack of compliance with the requirements of the EIP could lead to sanctions (amounting to 0.1% of GDP, applying to euro-area countries only).

Source: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/european-semester/framework/eus-economic-governance-explained_en

The banking union

The **need for a banking union in the EU** emerged from the financial crisis of 2008 and the subsequent sovereign debt crisis. It became clear that, **especially in a monetary union** such as the euro area, **problems caused by close links between public sector finances and the banking sector can easily spill over national borders and cause financial distress in other EU countries**.

A Roadmap towards a Banking Union (2012)

1. Introduction

Over the past four years, the EU has responded decisively to the economic and financial crisis. Significant improvements have been made to the Economic and Monetary Union (EMU), and a substantial financial reform agenda is being implemented, fulfilling commitments made in the G20 in response to the financial crisis, and to make financial institutions and markets more stable, more competitive and more resilient[1].

Completing this reform of the EU regulatory framework is essential but will not be sufficient to successfully address significant threats to financial stability across the Economic and Monetary Union. Further steps are needed to tackle the specific risks within the Euro Area, where pooled monetary responsibilities have spurred close economic and financial integration and increased the possibility of cross-border spill-over effects in the event of bank crises, and to break the link between sovereign debt and bank debt and the vicious circle which has led to over €4,5 trillion of taxpayers money being used to rescue banks in the EU. Coordination between supervisors is vital but the crisis has shown that mere coordination is not enough, in particular in the context of a single currency and that there is a need for common decision-making. It is also important to curtail the increasing risk of fragmentation of EU banking markets, which significantly undermines the single market for financial services and impairs the effective transmission of monetary policy to the real economy throughout the Euro Area.

The Commission has therefore called[2] for a banking union to place the banking sector on a more sound footing and restore confidence in the Euro as part of a longer term vision for economic and fiscal integration. Shifting the supervision of banks to the European level is a key part of this process, which must subsequently be combined with other steps such as a common system for deposit protection, and integrated bank crisis management. The report by the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank (ECB) of 26 June 2012[3] endorsed this vision. For its part, the European Parliament has recommended steps in the same direction, for example in its report from July 2010 on cross-border crisis management in the banking sector[4]. This was also confirmed by the Euro Area Summit of 29 June 2012[5].

Ensuring that bank supervision and resolution across the Euro Area meets high standards will reassure citizens and markets that a common, high level of prudential regulation is consistently applied to all banks. If banks get into difficulties in the future, the public should have the confidence that ailing banks will be restructured or closed while minimizing costs for the taxpayer. This future system will help build the necessary trust between Member States, which is a pre-condition for the introduction of any common financial arrangements to protect depositors and support orderly resolution of failing banks.

This communication accompanies two legislative proposals, respectively for the setting up of a single supervisory mechanism by conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions and for adaptations to the Regulation setting up the European Banking Authority (EBA)[6]. These legislative proposals mark a first important step which will make a qualitative improvement in financial stability and confidence in the Euro Area in particular. This communication sets the single supervisory mechanism in context and indicates further work towards a banking union beyond these first proposals.

2. The banking union and the single market

<u>The single market for financial services is based on common rules</u> which ensure that banks and other financial institutions which under the Treaty enjoy rights of free establishment and free provision of services are subject to equivalent rules and proper supervision across the EU.

<u>The creation of the banking union must not compromise the unity and integrity of the single market</u> which remains one of the greatest achievements of European integration. Indeed, the banking union rests on the completion of the programme of substantive regulatory reform underway for the single market (the "single rulebook").

<u>The single market and the banking union are thus mutually reinforcing processes</u>. Work to strengthen the single market must continue across all existing areas covered by Commission proposals.

Moreover, in three areas of specific relevance to the banking union, this work should be accelerated and agreement between the co-legislators on the relevant proposals reached before the end of 2012:

– <u>Stronger prudential requirements for banks have been proposed</u>. With its proposals on bank capital requirements ("CRD4")[7], the Commission launched the process of implementing the new global standards on bank capital and liquidity. The creation of the single supervisory mechanism should not require substantive changes to the proposed regulation and directive, although in a limited number of areas, some fine-tuning may be required to reflect the new situation. During the final stages of the CRD4 negotiations, the Commission will pay particular attention to ensure that the texts agreed are technically compatible with the proposed Regulation setting up the single supervisory mechanism, and will work with the European Parliament and the Council in this perspective. This will include in particular ensuring that all provisions of the proposed CRD4 Directive are operational for application

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both at national level and by the ECB.

– The coverage of national Deposit Guarantee Schemes (DGS) has already been raised to a harmonised level of €100,000 per depositor, per institution, effective as of 31 December 2010. In July 2010, the Commission proposed[8] going further, with the harmonisation and simplification of protected deposits, faster pay-outs and improved financing, notably through the ex-ante funding of deposit guarantee schemes paid for by contributions from banks and a mandatory borrowing facility between national schemes within certain fixed limits.

– The Commission's proposal on recovery and resolution tools for banks in crisis, adopted on 6 June 2012[9], is the last in a series of proposed measures to strengthen Europe's banking sector and to avoid the spill-over effects of any future financial crisis with negative effects on depositors and taxpayers. To ensure that financial stability is upheld while bank shareholders and creditors bear their full share of bank losses and recapitalisation costs, the Commission has proposed a common framework of rules and powers. This will help Member States prevent bank crises from emerging in the first place and, if such bank crises still emerge, to manage them in a more orderly and effective way. Member States would be required to establish an ex-ante resolution fund paid for by contributions from banks, and provision is made for a mandatory borrowing facility between national schemes, again subject to clear limits.

These rules will therefore constitute a common foundation across the single market on which the banking union proposals can build. This single rulebook is needed for the stability and integrity of the EU's internal market in financial services. It provides a common foundation which allows a move to the banking union without any risk of fragmenting the single market. Swift delivery of the outstanding reforms on capital requirements, deposit guarantee schemes, and bank resolution by the co-legislators by the end of the year, is therefore paramount.

These rules also have to be applied in the same way across the whole Union, through coherent and convergent supervision of credit institutions by national supervisors and the ECB. The European Banking Authority (EBA) has a crucial role in delivering this objective, in particular, by the set of instruments and powers provided by its founding regulation (addressing breaches of Union law, mediation, binding technical standards, guidelines, and recommendations). It is therefore critical that the EBA plays fully its role to build a common legal framework and supervisory culture across the whole Union.

Moreover, in order to avoid any divergence between the Euro Area and the rest of the EU, the single rulebook should be underpinned by uniform supervisory practices. Different supervisory handbooks and supervisory approaches between the Member States participating in the single supervisory mechanism and the other Member States pose a risk of fragmentation of the single market, as banks could exploit the differences to pursue regulatory arbitrage. The EBA should develop a single supervisory handbook to complement the single rulebook.

Any measures adopted by the ECB – for example to spell out further details on how prudential supervision is carried out in the context of the specific supervisory structure created by the single supervisory mechanism – must be in line with the single rulebook including the technical standards set out by delegated acts adopted by the European Commission. Finally, it should be noted that today's proposal maintains the current balance between home and host Member States, including as regards participation in supervisory colleges.

The effective impact and implications of the single supervisory mechanism on the operational functioning of the EBA will be further examined in the forthcoming review on the functioning of the European Supervisory Authorities to be presented by the Commission by 2 January 2014[10]. In that context, the Commission will in particular examine whether the role of the EBA with regard to stress testing exercises needs to be strengthened, to avoid making the authority too dependent on information and contributions by those authorities competent for assessing the effective resilience of the banking sector across the Union.

In parallel, the Commission will continue to strengthen financial stability and ensure a level playing field in the EU single market for banking through its control of state aid and conditionality for economic adjustment aid.

Key actions The Commission calls on the European Parliament and the Council to reach agreement by end-2012 on: (i) the CRD4 proposals, making them applicable both across the single market and within the context of the single supervisory mechanism; (ii) the proposal for a Directive on Deposit Guarantee Schemes as proposed by the Commission; (iii) the proposal for a Directive on bank recovery and resolution.

3. Completing the banking union

As set out by the Commission[11] before the June 2012 European Council and in the report of the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank of 26 June 2012[12], completing the banking union will require further work to deliver a single supervisory mechanism, a common system for deposit guarantees and an integrated crisis management framework. The establishment of the single supervisory mechanism is a crucial and significant first step.

*3.1. A **Single Supervisory Mechanism***

The single supervisory mechanism which the Commission is proposing today is based on the transfer to the European level of specific, key supervisory tasks for banks established in the Euro Area Member States. While retaining ultimate responsibility, the ECB would carry out its tasks within the single supervisory mechanism composed of the ECB and national supervisory authorities. This structure will provide strong and consistent supervision across the Euro Area, while making best use of the local and specific know-how of national supervisors. This will ensure that supervision remains highly aware of all national and local conditions relevant for financial stability. The Commission also proposes a mechanism

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which will allow Member States which have not adopted the Euro, but would like to participate in the single supervisory mechanism, to cooperate closely with the ECB.

Under the single supervisory mechanism, the ECB will become responsible for supervising all banks within the banking union, to which it will apply the single rulebook applicable across the single market. Recent experience has shown that difficulties, even in relatively small banks, can have significant negative impacts on the financial stability of Member States. Therefore, from the first day, the ECB will be empowered to take over the supervision of any bank in the Euro Area if it so decides, in particular if the bank is receiving public support. For all other banks, ECB supervision will be phased in automatically: on 1 July 2013 for the most significant European systemically important banks, and on 1 January 2014 for all other banks. Therefore, by 1 January 2014 all banks in the Euro Area will come under European supervision.

The ECB will be granted key specific supervisory tasks which are indispensable to ensure detection of risks threatening the viability of banks. It will be empowered to require banks to take the necessary remedial action. The ECB will, inter alia, be the competent authority for authorizing credit institutions, assessing qualifying holdings, ensuring compliance with the minimum capital requirements, ensuring the adequacy of internal capital in relation to the risk profile of a credit institution ("Pillar 2 measures"), conducting supervision on a consolidated basis and supervisory tasks in relation to financial conglomerates. The ECB will also ensure compliance with provisions on leverage and liquidity, apply capital buffers and carry out, in coordination with resolution authorities, early intervention measures when a bank is in breach of, or is about to breach, regulatory capital requirements.

The ECB will be vested with the necessary investigatory and supervisory powers to perform its tasks. Active involvement of national supervisors within the SSM is provided for to ensure the smooth and efficient preparation and implementation of supervisory decisions as well as the necessary coordination and information flow regarding issues of both local and European reach, in order to ensure financial stability across the Union and its Member States.

All tasks not explicitly conferred upon the ECB will remain with national supervisors. For example, national supervisors will remain in charge of consumer protection and the fight against money laundering, and of the supervision of third country credit institutions establishing branches or providing cross-border services within a Member State.

The ECB must be able to carry out its new supervisory functions in full independence whilst being fully accountable for its actions. The Commission proposal contains strong accountability safeguards, notably vis-à-vis the European Parliament and the Council, to ensure democratic legitimacy. In addition, the proposal lays down a number of organisational principles to ensure clear separation between monetary policy and supervision. This will mitigate potential conflicts between different policy objectives, while at the same time allowing full advantage to be taken of synergies. All preparatory activities and policy execution will therefore be carried out by bodies and administrative divisions separate from monetary policy functions through a supervisory board established within the ECB for this express purpose.

Finally, the proposed amendments of the EBA Regulation will ensure that the EBA can continue to fulfil its mission effectively as regards all Member States. In particular, EBA will exercise its powers and tasks also vis-à-vis the ECB. Voting arrangements within the EBA will be adapted to ensure EBA decision-making structures continue to be balanced and effective reflecting the positions of the competent authorities of Member States participating in the single supervisory mechanism and those which do not, and thereby preserving fully the integrity of the single market. Amendments of voting arrangements have been targeted to those areas where the EBA takes binding decisions on the application of the single rulebook when pursuing breaches of law and settling disagreements. In other areas, existing procedural safeguards are considered sufficient to ensure balanced and effective decisions making in those areas. For example, draft technical standards are submitted to the Commission for adoption, and the Commission can decide not to endorse or to modify them, in particular when they are not in full conformity with the fundamental principles of the internal market for financial services. Finally, a targeted review clause has been inserted in the draft Regulation amending Regulation 1093/2010 so as to take into account in particular any developments in the number of Member States whose currency is the Euro or whose competent authorities have entered into a close cooperation and examine whether in light of such developments any further adjustments of those provisions are necessary to ensure that EBA decisions are taken in the interest of maintaining and strengthening the internal market for financial services.

Key Actions The Commission calls: (i) on the Council to consider and adopt urgently the proposal for a Council Regulation conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions taking into account the opinion of the European Parliament; (ii) on the European Parliament and the Council to consider and adopt urgently the proposal amending Regulation 1093/2010 establishing the EBA. Agreement on these two proposals should be reached before the end of 2012.

3.2. Next Steps in the Management of Bank Crises

Global financial integration and the EU single market have enabled the banking sector in some Member States to outgrow national GDP many times over, resulting in institutions which are "too-big-to-fail" and "too-big-to-save" under existing national arrangements. On the other hand, experience shows that the failure of even relatively small banks may cause cross-border systemic damage. Furthermore, bank runs across borders can critically weaken national banking systems, further damaging the fiscal standing of the sovereign, and hastening funding problems for both.

Reinforced supervision within the banking union will help improve the robustness of banks. If a crisis nonetheless occurs it is necessary to ensure that institutions can be resolved in an orderly manner and that depositors are assured their savings are safe.

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Against this background, the Commission has underlined[13] that a banking union should include a more centralised management of banking crises. The European Parliament has also called for progress in this area. The need for "common mechanisms to resolve banks and guarantee customer deposits" was also referred to in the report by the Presidents of the European Council, the Commission, the Eurogroup and the European Central Bank of 26 June 2012[14].

Therefore, the Commission envisages notably making a proposal for a single resolution mechanism which would govern the resolution of banks and coordinate in particular the application of resolution tools to banks within the banking union. This mechanism would be more efficient than a network of national resolution authorities, in particular in the case of cross-border failures, given the need for speed and credibility in addressing banking crises. It would be a natural complement to the establishment of a single supervisory mechanism. It would also entail significant economies of scale, and avoid the negative externalities that may derive from purely national decisions. It would take its decisions in line with the principles of resolution set out in the single rulebook which are consistent with international best practice and in full compliance with Union state aid rules. In particular shareholders and creditors should bear the costs of resolution before any external funding is granted, and private sector solutions should be found instead of using taxpayers' money.

Moreover, and based on an assessment of its functioning, such a single resolution mechanism could also be entrusted with further tasks of coordination regarding the management of crisis situations and resolution tools in the banking sector, as set out in the report presented in June 2012 by the Presidents of the European Council, the Commission, the ECB and the Eurogroup.

Key actions Once agreement on the existing DGS and Bank Recovery and Resolution proposals is achieved, the Commission envisages to propose notably a single resolution mechanism to resolve banks and to coordinate the application of resolution tools to banks under the banking union.

4. Next steps

The European Union has the means to address its current weaknesses and set up the banking union as an essential step towards a genuine Economic and Monetary Union.

The Commission calls on the European Parliament and the Council to:

– give their full support to the banking union and endorse the orientations and roadmap described in this Communication;

– give the highest priority in the legislative process to the actions necessary for establishing the banking union;

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– finalise, as soon as possible and in any case before the end of the year, the proposals on the table on:

– Deposit Guarantee Schemes;

– access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD);

– prudential requirements for credit institutions and investment firms (CRR);

– a framework for the recovery and resolution of credit institutions and investment firms;

– conferring certain tasks on the ECB relating to the prudential supervision of credit institutions;

– amending certain provisions of the EBA Regulation.

With this communication and the accompanying legislative proposals, the Commission has acted swiftly and responsibly in response to the mandate given by the European Council and the Heads of State and Government of the Euro area at the end of June. Other institutions now need to do their part to ensure the single supervisory mechanism is established by 1 January 2013.

[1] http://ec.europa.eu/internal_market/finances/policy/map_reform_en.htm

[2] http://ec.europa.eu/commission_2010-2014/president/news/archives/2012/06/20120626_speeches_2_en.htm

[3] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

[4] European Parliament resolution of 7 July 2010 with recommendations to the Commission on Cross-Border Crisis Management in the Banking Sector (2010/2006(INI))

[5] "The Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution specific, sector-specific or economy-wide and would be formalised in a Memorandum of Understanding". http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf

[6] Regulation (EU) No 1093/2010

[7] http://ec.europa.eu/internal_market/bank/regcapital/new_proposals_en.htm

[8] http://ec.europa.eu/internal_market/bank/docs/guarantee/200914_en.pdf

[9] http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm

[10] Pursuant to Article 81 of the Regulations establishing the European Supervisory Authorities [Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010, and Regulation (EU) No 1095/2010]

[11] http://ec.europa.eu/europe2020/banking-union/index_en.htm

[12] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

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[13] http://ec.europa.eu/europe2020/banking-union/index_en.htm

[14] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

Source: COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL A Roadmap towards a Banking Union. COM/2012/0510 final

As part of the banking union setup, as of November 2014, **the Single Supervisory Mechanism (SSM) is the new system of banking supervision for Europe**. It comprises the **ECB** and the **national supervisory authorities** of the participating countries.

Single Supervisory Mechanism

The **Single Supervisory Mechanism (SSM)** refers to the system of banking supervision in Europe. It comprises the ECB and the national supervisory authorities of the participating countries.

Its main aims are to:

- ensure the safety and soundness of the European banking system
- increase financial integration and stability
- ensure consistent supervision

The SSM is one of the two pillars of the EU banking union, along with the Single Resolution Mechanism.

Why do we need European banking supervision?

The recent financial crisis has shown how quickly and forcefully problems in the financial sector can spread, especially in a monetary union, and how such problems directly affect people across the euro area.

The purpose of European banking supervision is to help rebuild trust in the European banking sector and increase the resilience of banks.

What is the ECB’s role?

As an independent EU institution, the ECB oversees banking supervision from a European perspective by:

- establishing a common approach to day-to-day supervision
- taking harmonised supervisory actions and corrective measures
- ensuring the consistent application of regulations and supervisory policies

The ECB, in cooperation with the national supervisors, is responsible for ensuring European banking supervision is effective and consistent.

What does banking supervision entail?

The ECB has the authority to:

- conduct supervisory reviews, on-site inspections and investigations
- grant or withdraw banking licences
- assess banks' acquisition and disposal of qualifying holdings
- ensure compliance with EU prudential rules
- set higher capital requirements ("buffers") in order to counter any financial risks

Who is supervised?

Directly supervised banks

The ECB directly supervises the 115 significant banks of the participating countries. These banks hold almost 82% of banking assets in the euro area.

The decision on whether a bank is deemed significant is based on a number of criteria.

Criteria for determining significance

The criteria for determining whether banks are considered significant - and therefore under the ECB's direct supervision - are set out in the SSM Regulation and the SSM Framework Regulation. To qualify as significant, banks must fulfil at least one of these criteria:

- *Size*: the total value of its assets exceeds €30 billion
- *Economic importance*: for the specific country or the EU economy as a whole
- *Cross-border activities*: the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%

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- *Direct public finance assistance*: it has requested or received funding from the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF)

Ongoing supervision of the significant banks is carried out by Joint Supervisory Teams (JSTs). Each significant bank has a dedicated JST, comprising staff of the ECB and the national supervisors.

Indirectly supervised banks

Banks that are not considered significant are known as "less significant" institutions. They continue to be supervised by their national supervisors, in close cooperation with the ECB.

At any time the ECB can decide to directly supervise any one of these banks to ensure that high supervisory standards are applied consistently.

Which countries participate?

All euro area countries participate automatically in the SSM.

Other EU countries that do not yet have the euro as their currency can choose to participate. To do so, their national supervisors enter into "close cooperation" with the ECB.

ECB Decision governing the procedures for close cooperation

Cooperation with non-participating countries

For those EU countries that are not participating in the SSM, the ECB and the relevant national supervisors may set out in a memorandum of understanding how they will cooperate on supervisory matters.

Source: https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html

The SSM is complemented by a resolution mechanism for cases when **bailout of any bank in the banking union becomes necessary**. This is called the **Single Resolution Mechanism (SRM)**.

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Single Resolution Mechanism

The Single Resolution Mechanism's (SRM) purpose is to ensure an orderly resolution of failing banks with minimal costs to taxpayers and to the real economy.

Scope

When the entirety of the Single Resolution Mechanism rules enter into force, they will apply to banks in the euro area member states and in those EU countries which choose to join the banking union.

Structure

A key element of Europe's banking union, the Single Resolution Mechanism consists of:

- An EU-level resolution authority - the Single Resolution Board
- A common resolution fund, financed by the banking sector
- Regulation on single resolution mechanism and single resolution fund

Key objectives

- to strengthen confidence in the banking sector
- to prevent bank runs and contagion
- to minimise the negative relationship between banks and sovereigns
- to eliminate fragmentation in the internal market for financial services

Source: https://www.consilium.europa.eu/en/policies/banking-union/single-resolution-mechanism/

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The EEMU after the Eurozone crisis

The **ESM** was set up in 2012 by the **euro area member states** as a **permanent international financial institution to help euro area countries in severe financial distress**.

European Stability Mechanism

The context

Euro zone debt crisis hits (2010)

Already struggling from financial turmoil that had washed up on its shores from the U.S. 2008-09 subprime mortgage collapse, a new home-grown crisis erupted in Europe in 2010. Markets began to mistrust a number of countries, requiring ever higher interest rates when they borrowed on the market. They judged them increasingly risky: their governments had let their deficits balloon, lost competitiveness, or allowed lax oversight of banks. Eventually, the unthinkable started to happen in 2010. Countries began to lose market access. They needed help; Greece was first to ask. The country received bilateral loans (Greek Loan facility) from the other euro zone countries on a bilateral basis.

A temporary backstop

The EFSF is established (June 2010)

<u>The European Financial Stability Facility (EFSF), which was set up as a temporary solution in June 2010. The EFSF still exists as a legal entity and a big issuer of bonds, but it can no longer make new loans</u>.

The ESM is established (October 2012)

<u>The European Stability Mechanism (ESM) was set up in October 2012 as a successor to the EFSF. It is a permanent solution for a problem that arose early in the sovereign debt crisis: the lack of a backstop for euro area countries no longer able to tap the markets</u>. The EFSF and ESM remain separate legal entities but share staff, facilities, and operations. Together, the EFSF and the ESM had €700 billion in firepower.

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The programmes

EFSF and ESM disburse total of €254.5 billion (2010 – 2016)

The EFSF and ESM have so far disbursed €254.5 billion to five countries. They helped keep the euro together. They proved that cash-for-reform programmes work, and that countries that do their financial and structural homework emerge fitter and better equipped to grow. These programmes have also eased the debt burden on countries receiving loans, passing on low interest rates, and pushing out the repayment period. They testify to the solidarity among euro area countries, and are a telling example of how the crisis has brought Europe closer together.

EFSF assists three countries: Ireland, Portugal, and Greece (2010 – 2012)

Three countries knocked at the EFSF door for help. First came Ireland (February 2011), then Portugal (June 2011). Greece came back in March 2012. Fears the euro area would be torn apart grew. As events tumbled ahead, European leaders realised they needed to do more.

Spain first to get ESM disbursement (December 2012), Cyprus follows (May 2013)

Spain (December 2012) was the first programme country to receive disbursements from the ESM to recapitalise its ailing banking system. Later in May 2013, Cyprus received the first tranche of financial assistance in what became the first fully fledged ESM programme.

Greece gets third assistance programme (August 2015)

In the middle of 2015, Greece entered a new ESM programme of up to €86 billion. It was the third programme for the country, and followed months of tense negotiations. It is currently the only ESM or EFSF programme that is still active.

The results

The most visible example of the success of the two institutions is the improved performance of the countries that requested help. Cyprus (March 2016), Ireland (December 2013), Spain (December 2013) and Portugal (May 2014), successfully exited their EFSF/ESM programmes without a follow-up arrangement. After suffering severe financial distress just a few years ago, they emerged from European rescue loan programmes stronger and were able to return to normal market access (see figure below).

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Greece also made great progress but, dogged by more initial problems than the others, it entered a new programme in 2015. With four successful programmes so far, the approach by the ESM and the EFSF underlines that Europe has found the right approach to the crisis.

Source: https://www.esm.europa.eu/about-us/history

In June 2015, the "five presidents" of the EU published a report titled **Completing Europe's Economic and Monetary Union**.
The **five presidents** were:

- **Jean-Claude Juncker**, President of the European Commission (2014-2019)
- **Donald Tusk**, President of the European Council (2014-2019)
- **Jeroen Dijsselbloem**, President of the Eurogroup (2013-2018)
- **Mario Draghi**, President of the ECB (2011-2019)
- **Martin Schulz**, President of the European Parliament (2012-2017)

Five presidents' report (excerpts)

Completing Europe's Economic and Monetary Union

Introduction

The Euro Summit of October 2014 underlined the fact that 'closer coordination of economic policies is essential to ensure the smooth functioning of the Economic and Monetary Union' (EMU). It called for work to continue to 'develop concrete mechanisms for stronger economic policy coordination, convergence and solidarity' and 'to prepare next steps on better economic governance in the euro area'.

(…)

This report reflects the personal deliberations and discussions of the five Presidents. It focuses on the euro area, as countries that share a currency face specific common challenges, interests and responsibilities. The process towards a deeper EMU is nonetheless open to all EU Members. It should be transparent and preserve the integrity of the Single Market in all its aspects. In fact, completing and fully exploiting the Single Market in goods and services, digital, energy and capital markets should be part of a stronger boost towards economic union, as well as more jobs and higher growth.

A complete EMU is not an end in itself. It is a means to create a better and fairer life for all citizens, to prepare the Union for future global challenges and to enable each of its members to prosper.

1. The Nature of a Deep, Genuine and Fair Economic and Monetary Union

The euro is a successful and stable currency. It is shared by 19 EU Member States and more than 330 million citizens. It has provided its members with price stability and shielded them against external instability. Despite the recent crisis, it remains the second most important currency in the world, with a share of almost a quarter of global foreign exchange reserves, and with almost sixty countries and territories around the world either directly or indirectly pegging their currency to it.

(…)

Europe's Economic and Monetary Union (EMU) today is like a house that was built over decades but only partially finished. When the storm hit, its walls and roof had to be stabilised quickly. It is now high time to reinforce its foundations and turn it into what EMU was meant to be: a place of prosperity based on balanced economic growth and price stability, a competitive social market economy, aiming at full employment and social progress. To achieve this, we will need to take further steps to complete EMU.

The euro is more than just a currency. It is a political and economic project. All members of our Monetary Union have given up their previous national currencies once and for all, and permanently share monetary sovereignty with the other euro area countries. In return, countries gain the benefits of using a credible and stable currency within a large, competitive and powerful single market. This common destiny requires solidarity in times of crisis and respect for commonly agreed rules from all members.

(…)

Progress must happen on four fronts: first, towards a genuine Economic Union that ensures each economy has the structural features to prosper within the Monetary Union. Second, towards a Financial Union that guarantees the integrity of our currency across the Monetary Union and increases risk-sharing with the private sector. This means completing the Banking Union and accelerating the Capital Markets Union. Third, towards a Fiscal Union that delivers both fiscal sustainability and fiscal stabilisation. And finally, towards a Political Union that provides the foundation for all of the above through genuine democratic accountability, legitimacy and institutional strengthening.

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(…)

The aim of this report is two-fold: to lay out the first steps that will launch this process today, and to provide a clear orientation for the longer-term measures. The process would be organised in two consecutive stages:

Stage 1 (1 July 2015 - 30 June 2017): In this first stage ('deepening by doing'), the EU institutions and euro area Member States would build on existing instruments and make the best possible use of the existing Treaties. In a nutshell, this entails boosting competitiveness and structural convergence, completing the Financial Union, achieving and maintaining responsible fiscal policies at national and euro area level, and enhancing democratic accountability.

Stage 2: In this second stage ('completing EMU'), concrete measures of a more far-reaching nature would be agreed to complete EMU's economic and institutional architecture. Specifically, during this second stage, the convergence process would be made more binding through a set of commonly agreed benchmarks for convergence that could be given a legal nature. Significant progress towards these standards – and continued adherence to them once they are reached – would be among the conditions for each euro area Member State to participate in a shock absorption mechanism for the euro area during this second stage.

Final Stage (at the latest by 2025): At the end of Stage 2, and once all the steps are fully in place, a deep and genuine EMU would provide a stable and prosperous place for all citizens of the EU Member States that share the single currency, attractive for other EU Member States to join if they are ready to do so.

(…)

2. Towards Economic Union – Convergence, Prosperity and Social Cohesion

The notion of convergence is at the heart of our Economic Union: convergence between Member States towards the highest levels of prosperity; and convergence within European societies, to nurture our unique European model.

In EMU, monetary policy is centralised, but important parts of economic policy remain national. However, as the crisis made particularly visible, euro area members depend on each other for their growth. It is in each member's common and self-interest to be able to cushion economic shocks well, to modernise economic structures and welfare systems, and make sure that citizens and businesses can adapt to, and benefit from, new demands, trends and challenges. It is equally in each member's interest that all others do so at a similar speed. This is crucial in a Monetary Union like EMU where large scale fiscal transfers between members are not foreseen and where labour mobility is relatively limited.

(…)

Much can be achieved already through a deepening of the Single Market, which is important for all 28 EU Member States but in particular for the Member States which share the euro as their currency. In significant policy areas, such as goods and services, as well as in areas with untapped potential such as energy, digital and capital markets, the Single Market is still incomplete.

(…)

A stronger Macroeconomic Imbalance Procedure

The Macroeconomic Imbalance Procedure (MIP) was created at the height of the crisis. It is part of the European Semester, the annual cycle of reporting and surveillance of EU and national economic policies. It serves as a tool to prevent and correct imbalances before they get out of hand. It has become a vital device for European surveillance, for instance to prevent real estate bubbles, or to detect a loss of competitiveness, rising levels of private and public debt, and a lack of investment. It needs to be used to its full potential. This requires action on two fronts in particular:

– It should be used not just to detect imbalances but also to encourage structural reforms through the European Semester. Its corrective arm should be used forcefully. It should be triggered as soon as excessive imbalances are identified and be used to monitor reform implementation.

– The procedure should also better capture imbalances for the euro area as a whole, not just for each individual country. For this, it needs to continue to focus on correcting harmful external deficits, given the risk they pose to the smooth functioning of the euro area (for example, in the form of 'sudden stops' of capital flows). At the same time, the Macroeconomic Imbalance Procedure should also foster adequate reforms in countries accumulating large and sustained current account surpluses if these are driven by, for example, insufficient domestic demand and/or low growth potential, as this is also relevant for ensuring effective rebalancing within the Monetary Union.

A stronger focus on employment and social performance

The employment and social situations vary widely across the euro area, partly as a result of the crisis but also because of underlying trends and poor performance predating the crisis. Europe's ambition should be to earn a 'social triple A'.

This is also an economic necessity. For EMU to succeed, labour markets and welfare systems need to function well and in a fair manner in all euro area Member States. Hence, employment and social concerns must feature highly in the European Semester. Unemployment, especially long term unemployment, is one of the main reasons for inequality and social exclusion. Therefore, efficient labour markets that promote a high level of employment and are able to absorb shocks without generating excessive unemployment are essential: they contribute to the smooth functioning of EMU as well as to more inclusive societies.

There is no 'one-size-fits-all' template to follow, but the challenges are often similar across Member States: getting more people of all ages into work; striking the right balance between flexible and secure labour contracts; avoiding the divide between 'insiders' with high protection and wages and 'outsiders'; shifting taxes away from labour; delivering tailored support for the unemployed to re-enter the labour market, improving education and lifelong learning - to name but a few. Beyond labour markets, it is important to ensure that every citizen has access to an adequate education and that an effective social protection system is in place to protect the most vulnerable in society, including a 'social protection floor'. Our populations are ageing rapidly and we still need major reforms to ensure that pension and health systems can cope. This will include aligning the retirement age with life expectancy.

To secure EMU's long-term success, we should go a step further and push for a deeper integration of national labour markets, by facilitating geographic and professional mobility, including through better recognition of qualifications, easier access to public sector jobs for non-nationals and better coordination of social security systems.

A stronger coordination of economic policies

The European Semester has significantly strengthened the coordination of economic policies. However, the addition of numerous 'packs', 'pacts', 'procedures' and manifold reporting requirements has blurred its rationale and effectiveness. The European Semester must be about setting our priorities together and about acting on them, in a European perspective, with a clear sense of our common interest.

(…)

3. Towards Financial Union – Integrated Finance for an Integrated Economy

Progress towards a stronger Economic Union will go a long way to improving the functioning of EMU. At the same time, this must be accompanied by the completion of a Financial Union.

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(…)

In a Monetary Union, the financial system must be truly single or else the impulses from monetary policy decisions (e.g. changes in policy interest rates) will not be transmitted uniformly across its Member States. This is what happened during the crisis, which in turn aggravated economic divergence. Also, a single banking system is the mirror image of a single money. As the vast majority of money is bank deposits, money can only be truly single if confidence in the safety of bank deposits is the same irrespective of the Member State in which a bank operates. This requires single bank supervision, single bank resolution and single deposit insurance. This is also crucial to address the bank–sovereign negative feedback loops which were at the heart of the crisis.

At the same time, the financial system must be able to diversify risk across countries, so it can moderate the impact of country-specific shocks and lower the amount of risk that needs to be shared through fiscal means.

(…)

Completing the Banking Union

Completing the Banking Union requires first and foremost the full transposition into national law of the Bank Resolution and Recovery Directive by all Member States. This is crucial for sharing risk with the private sector. Indeed, the Banking Union is a way to better protect taxpayers from the cost of bank rescues.

Second, we also need a swift agreement on an adequate bridge financing mechanism – a way of ensuring there is enough money if a bank needs to be unwound even if the financing in the Single Resolution Fund is not enough at that time – for the Fund by the time it becomes operational on 1 January 2016.

Third, setting up a credible common backstop to the Single Resolution Fund and making progress towards a full level playing field for banks in all Member States should be a priority during the transition period to the creation of the Single Resolution Fund. A backstop should therefore be implemented swiftly. This could be done through a credit line from the European Stability Mechanism (ESM) to the Single Resolution Fund. This backstop should be fiscally neutral over the medium term by ensuring that public assistance is recouped by means of ex post levies on the financial industry.

Next, we propose the launching of a European Deposit Insurance Scheme (EDIS) – the third pillar of a fully-fledged Banking Union alongside bank supervision and resolution. As the current set-up with national deposit guarantee schemes remains vulnerable to large local shocks (in particular when the sovereign and the national banking sector are perceived to be in a fragile situation), common deposit insurance would increase the resilience against future crises. A common scheme is also more likely to be fiscally neutral over time than national deposit guarantee schemes because risks are spread more widely and because private contributions are raised over a much larger pool of financial institutions.

(…)

Launching the Capital Markets Union

Alongside Banking Union, launching the Capital Markets Union must be seen as a priority. This applies to all 28 EU Member States, but it is particularly relevant to the euro area. It will ensure more diversified sources of finance so that companies, including SMEs, can tap capital markets and access other sources of non-bank finance in addition to bank credit. At the same time, a well-functioning Capital Markets Union will strengthen cross-border risk-sharing through deepening integration of bond and equity markets, the latter of which is a key shock absorber. Truly integrated capital markets would also provide a buffer against systemic shocks in the financial sector and strengthen private sector risk-sharing across countries. This in turn reduces the amount of risk-sharing that needs to be achieved through financial means (public risk-sharing). However, as the closer integration of capital markets and gradual removal of remaining national barriers could create new risks to financial stability, there will be a need to expand and strengthen the available tools to manage financial players' systemic risks prudently (macro-prudential toolkit) and strengthen the supervisory framework to ensure the solidity of all financial actors. This should lead ultimately to a single European capital markets supervisor.

(…)

4. Towards Fiscal Union – an Integrated Framework for Sound and Integrated Fiscal Policies

One of the main lessons of the crisis has been that fiscal policies are a matter of vital common interest in a Monetary Union. Even a strong Economic and Financial Union and a price stability-oriented common monetary policy are no guarantee for EMU to always function properly. Unsustainable fiscal policies not only endanger price stability in the Union, they also harm financial stability insofar as they create contagion between Member States and financial fragmentation.

Responsible national fiscal policies are therefore essential. They must perform a double function: guaranteeing that public debt is sustainable and ensuring that fiscal automatic stabilisers can operate to cushion country-specific economic shocks. If this is not the case, downturns are likely to last longer in individual countries, which in turn affects the whole euro area. But this is not enough. It is important to ensure also that the sum of national budget balances leads to an appropriate fiscal stance at the level of the euro area as a whole. This is key to avoid pro-cyclical fiscal policies at all times.

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Finally, in case of a very severe crisis, national budgets can become overwhelmed, as was the case in some countries in recent years. In such situations, national fiscal stabilisers might not be enough to absorb the shock and provide the optimal level of economic stabilisation, which in turn can harm the whole euro area. For this reason, it would be important to create in the longer term a euro area-wide fiscal stabilisation function. Such a step should be the culmination of a process that requires, as a pre-condition, a significant degree of economic convergence, financial integration and further coordination and pooling of decision making on national budgets, with commensurate strengthening of democratic accountability. This is important to avoid moral hazard and ensure joint fiscal discipline.

In the meantime, we need to reinforce trust in the common EU fiscal governance framework. A continued thorough, consistent and transparent implementation of our current fiscal framework is therefore essential to prepare the ground for further steps ahead.

(…)

5. Democratic Accountability, Legitimacy and Institutional Strengthening

Greater responsibility and integration at EU and euro area level should go hand in hand with greater democratic accountability, legitimacy and institutional strengthening. This is both a condition for success and a natural consequence of the increasing interdependence within EMU. It also means better sharing of new powers and greater transparency about who decides what and when. Ultimately, this means and requires more dialogue, greater mutual trust and a stronger capacity to act collectively.

At the height of the crisis, far-reaching decisions had often to be taken in a rush, sometimes overnight. In several cases, intergovernmental solutions were chosen to speed up decisions or overcome opposition. Now is the time to review and consolidate our political construct – and to build the next stage of our Economic and Monetary Union.

A number of concrete steps towards more accountability and participation should be taken already in the short run:

– *A key role for the European Parliament and national Parliaments*
– *Consolidating the external representation of the euro*
– *Integrating intergovernmental solutions within the EU legal framework*
– *A central steer by the Eurogroup*

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– *A euro area treasury*

Conclusion

This report has put forward the principal steps necessary to complete EMU at the latest by 2025. It offers a roadmap that is ambitious yet pragmatic. Some of these steps can and should be implemented without delay. First initiatives to this end should be launched by the EU institutions as of 1 July 2015. Others will require more time. But above all, the report offers a clear sense of direction for Europe's EMU. This is essential for citizens and economic actors alike, and for their confidence in the single currency. Translating these proposals into action will require a shared sense of purpose among all Member States and EU institutions. The European Council is invited to endorse these proposals at the earliest occasion.

Source: Juncker, J-C., Tusk, D., Dijsselbloem, J., Draghi, M., Schulz, M. (2015): *Completing Europe's Economic and Monetary Union*. (Five presidents' report) European Commission, Brussels.

On 1 March 2017, the European Commission published its **White Paper on the Future of Europe** in which five scenarios are outlined for the post-Brexit EU27 by 2025. Each scenario has an element related specifically to the EMU.

White Paper on the Future of Europe (excerpts)

Five scenarios for Europe by 2025

Many of the profound transformations Europe is currently undergoing are inevitable and irreversible. Others are harder to predict and will come unexpectedly. Europe can either be carried by those events or it can seek to shape them. We must now decide.

The five scenarios presented in this White Paper will help steer a debate on the future of Europe. They offer a series of glimpses into the potential state of the Union by 2025 depending on the choices we will jointly make.

The starting point for each scenario is that the 27 Member States move forward together as a Union.

The five scenarios are illustrative in nature to provoke thinking. They are not detailed blueprints or policy prescriptions. Likewise, they deliberately make no mention of legal or institutional processes – the form will follow the function.

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Too often, the discussion on Europe's future has been boiled down to a binary choice between more or less Europe. That approach is misleading and simplistic. The possibilities covered here range from the status quo, to a change of scope and priorities, to a partial or collective leap forward. There are many overlaps between each scenario and they are therefore neither mutually exclusive, nor exhaustive.

The final outcome will undoubtedly look different to the way the scenarios are presented here. The EU27 will decide together which combination of features from the five scenarios they believe will best help advance our project in the interest of our citizens.

Scenario 1: Carrying on

In a scenario where the EU27 sticks to its course, it focuses on implementing and upgrading its current reform agenda. This is done in the spirit of the Commission's New Start for Europe in 2014 and of the Bratislava Declaration agreed by all 27 Member States in 2016. Priorities are regularly updated, problems are tackled as they arise and new legislation is rolled out accordingly.

As a result, the 27 Member States and the EU Institutions pursue a joint agenda for action. The speed of decision-making depends on overcoming differences of views in order to deliver on collective long-term priorities. EU legislation is checked regularly to see whether it is fit for purpose. Outdated legislation is withdrawn.

(…)

Scenario 2: Nothing but the single market

In a scenario where the EU27 cannot agree to do more in many policy areas, it increasingly focuses on deepening certain key aspects of the single market. There is no shared resolve to work more together in areas such as migration, security or defence.

As a result, the EU27 does not step up its work in most policy domains. Cooperation on new issues of common concern is often managed bilaterally. The EU27 also significantly reduces regulatory burden by withdrawing two existing pieces of legislation for every new initiative proposed.

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(…)

[In this scenario], the euro facilitates trade exchanges but growing divergence and limited cooperation are major sources of vulnerability. This puts at risk the integrity of the single currency and its capacity to respond to a new financial crisis.

(…)

Scenario 3: Those who want more do more

In a scenario where the EU27 proceeds as today but where certain Member States want to do more in common, one or several "coalitions of the willing" emerge to work together in specific policy areas. These may cover policies such as defence, internal security, taxation or social matters.

As a result, new groups of Member States agree on specific legal and budgetary arrangements to deepen their cooperation in chosen domains. As was done for the Schengen area or the euro, this can build on the shared EU27 framework and requires a clarification of rights and responsibilities. The status of other Member States is preserved, and they retain the possibility to join those doing more over time.

(…)

A group of countries, including the euro area and possibly a few others, chooses to work much closer notably on taxation and social matters. Greater harmonisation of tax rules and rates reduces compliance costs and limits tax evasion. Agreed social standards provide certainty for business and contribute to improved working conditions. Industrial cooperation is strengthened in a number of cutting edge technologies, products and services, and rules on their usage are developed collectively.

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Scenario 4: Doing less more efficiently

To better tackle certain priorities together, the EU27 decides to focus its attention and limited resources on a reduced number of areas.

As a result, the EU27 is able to act much quicker and more decisively in its chosen priority areas. For these policies, stronger tools are given to the EU27 to directly implement and enforce collective decisions, as it does today in competition policy or for banking supervision. Elsewhere, the EU27 stops acting or does less.

In choosing its new priorities, the EU27 seeks to better align promises, expectations and delivery. A typical example of recent mismatch is the car emissions scandal where the EU is widely expected to protect consumers from cheating manufacturers but has no powers or tools to do so in a direct and visible manner.

Scenario 5: Doing much more together

In a scenario where there is consensus that neither the EU27 as it is, nor European countries on their own, are well-equipped enough to face the challenges of the day, Member States decide to share more power, resources and decision-making across the board.

As a result, cooperation between all Member States goes further than ever before in all domains. Similarly, the euro area is strengthened with the clear understanding that whatever is beneficial for countries sharing the common currency is also beneficial for all. Decisions are agreed faster at European level and are rapidly enforced.

[In this scenario], within the euro area, but also for those Member States wishing to join, there is much greater coordination on fiscal, social and taxation matters, as well as European supervision of financial services. Additional EU financial support is made available to boost economic development and respond to shocks at regional, sectoral and national level.

Scenario	'Carrying On'	'Nothing but the Single Market'	'Those Who Want More Do More'	'Doing Less More Efficiently'	'Doing Much More Together'
Effect on the EMU	Gradual establishment in the operation of the eurozone	The cooperation within the eurozone is limited	Gradual improvement, further deepening among those strengthening the cooperation	Consolidation of the eurozone, less economic policy coordination on the EU-27 level	Economic, financial and fiscal union

Source: EC (2017): *White Paper on the Future of Europe: Reflections and scenarios for the EU27 by 2025*. COM(2017) 2025, 1 March, European Commission, Brussels.

In order to harmonise the French and German reform plans, **French President Emmanuel Macron** met **German Chancellor Angela Merkel** in June 2018, in the **Meseberg Palace** near Berlin. After their meeting, the two heads of state issued the so-called **Meseberg declaration** jointly, in which they made comments and recommendations concerning the EMU, among others.

The Meseberg Declaration

Renewing Europe's promises of security and prosperity

France and Germany share a common ambition for the European project: a democratic, sovereign and united Europe, a competitive Europe, a Europe that is a basis for prosperity and defends its economic and social model and cultural diversity, a Europe that promotes an open society, based on shared values of pluralism, solidarity and justice, upholding the rule of law everywhere in the EU and promoting it abroad, a Europe that is ready to assert its international role to promote peace, security and sustainable development and be a leader in the fight against climate change, a Europe that successfully addresses the migration challenge.

In reforming Europe we should listen to the voices of our citizens. France and Germany are therefore committed to pursue the citizens' consultations on Europe in order to keep the democratic debate alive ahead of the next European elections.

France and Germany are strongly committed to not only preserve the achievements of the European Union but also to further strengthen their cooperation within the European Union, with the constant preoccupation to ensure both the unity of its Member States and its efficiency. The European Union will live up to its values and be a strong voice for the protection of human rights and a force to defend, reform and strengthen multilateralism.

Today, the EU faces existential challenges. These include migration, a changing security environment, competitiveness and innovation, the digital revolution, the necessity to bring more resilience and stability to the Eurozone and to advocate climate protection. France and Germany share the belief that the only appropriate answer to these challenges lies in European cooperation. Merely national and un-coordinated actions pave the way for failure and division.

In order to anchor our European cooperation in a strong bilateral cooperation, France and Germany will finalise a new "Elysée Treaty" by the end of 2018, with the ambition to foster their economic, social and fiscal convergence, to develop new tools for their cross-border cooperation and to renew their commitment to support and facilitate the learning of the language of the partner.

In the light of the above, France and Germany agreed today in Meseberg:

Foreign policy, security and defence

- To look into new ways of increasing the speed and effectiveness of the EU's decision making in our Common Foreign and Security Policy. We need a European debate on new formats, such as an EU Security Council and means of closer coordination, within the EU and in external fora. We should also explore possibilities of using majority vote in the field of the Common Foreign and Security Policy in the framework of a broader debate on

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majority vote regarding EU policies.

- To seize the opportunity of their joint presence at the UN Security Council for joint initiatives, including in the field of conflict prevention, and increase EU coordination regarding UN matters.

- To stress the need to further develop the emergence of a shared strategic culture through the European Intervention Initiative, which will be linked as closely as possible with PESCO.

- To pursue their joint efforts in the field of capability development, in particular the Main Ground Combat System (MGCS) and the Future Combat Aerial System (FCAS).

- To reaffirm their strong call on the European Commission to propose swiftly legislative measures at EU level to combat illicit contents promoting terrorism online.

- To continue their efforts with Ukraine and Russia in the Normandy format to facilitate the implementation of the Minsk agreements in order to stabilise the situation in the East of Ukraine and to preserve Ukraine's territorial integrity.

- To progress towards a better integrated European defence, incorporating all civil and military aspects and means of crisis management and response of the EU.

Development, migration and asylum

- To promote the swift relaunch of a comprehensive Migration Agenda combining the three pillars of (i) externally, increased support and cooperation with origin and transit countries building on existing examples of cooperation and partnerships such as the EU-Turkey Statement, to avoid departures to Europe, fight illegal migration and speed up the process of return; (ii) at the EU borders, improved protection of European external borders through an ambitious strengthening in terms of staff and mandate of Frontex; (iii) internally, a Common European Asylum System which is resilient to crises and ensures a fair balance of responsibility and solidarity .

- To pursue European solutions, which are today more important than ever. Unilateral, uncoordinated action will split Europe, divide its peoples and put Schengen at risk. If Member States started to act unilaterally, this would end up in an overall increase of migration into Europe. Tackling the migration challenges effectively requires combined efforts of all Member States as well as the EU institutions.

- To jointly and resolutely tackle secondary movements inside the EU, especially by decreasing incentives for secondary movements in the new Dublin regulation but also by enhancing cooperation between Member States aiming at, inter alia, preventing registered asylum seekers from coming to other countries and ensuring swift transfers to and readmissions by the competent Member States.

- To propose two key reforms beyond the short run: (i) setting up a genuine European border police building on the existing Frontex and (ii) creating a European Asylum Office harmonizing asylum practices in Member States and being responsible of asylum procedures at external borders.

- To remain fully committed to close security and development partnership with Africa as a key priority.

- To set up swiftly a High level group of "wise persons" on the European Financial architecture for development (especially regarding the respective roles of EIB and EBRD), in order to make proposals for the December European Council.

Competitiveness, economic policy

- To develop the link between Structural Funds and economic policy coordination and strengthen economic, social and fiscal convergence.

- To develop a new medium to long-term strategic perspective for sustainable growth and employment at the European level, through innovation-enabling legislation, further deepening of the EU single market and promoting world class competitiveness of industry.

- To reaffirm their attachment to open markets, to multilateralism and to an ambitious EU trade policy.

- To support the European Commission in elaborating solutions to modernize the multilateral trade system, in particular with a view to strengthening the disciplines on market distortive practices and restoring the full operation of the dispute settlement function of the WTO.

Taxation

- To put in place actual tax convergence between France and Germany regarding corporate tax. Both countries have agreed on a common position on the Commission proposal for a directive establishing a Common Corporate Tax Base: we will promote it jointly in order to support and accelerate the European project to harmonise the corporate tax base in Europe.

- To reach an EU agreement on a fair digital taxation by the end of 2018.

EMU

- To ensure a strong economy, the European Union needs a strong currency union. This currency is the Euro, which is open to all Member States and which nearly all Member States intend to adopt in accordance with the EU treaties. Sharing the same currency entails specific needs in terms of economic coordination and integration.

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As a consequence, France and Germany have decided to propose key steps in the following roadmap to strengthen and deepen the Euro area further, and make it a genuine economic union.

European Stability Mechanism (ESM)

As a first step, we need to change the intergovernmental Treaty of the ESM in order to include a common backstop instrument, enhance the effectiveness of precautionary instruments for Member States and enhance its role in assessing and monitoring future programs. And in a second step, we can then ensure the incorporation of the ESM into EU law, preserving the key features of its governance.

Further work should be undertaken on an appropriate framework for liquidity support on resolution.

Conditionality remains an underlying principle of the ESM treaty and all ESM instruments but adapted to each instrument.

We recall that any decision to provide ESM stability support to a euro area Member State includes a debt sustainability analysis (DSA).

To improve the existing framework promoting debt sustainability and to improve their effectiveness, we should start working on the possible introduction of Euro CaCs with single-limb aggregation. When appropriate, the ESM may facilitate the dialogue between its Members and private investors, following IMF practice.

The ESM should have an enhanced role in designing and monitoring programmes in close cooperation with the Commission and in liaison with the ECB and based on a compromise to be found between the Commission and the ESM. It should have the capacity to assess the overall economic situation in the Member States, contributing to crisis prevention. This should be done without duplicating the Commission’s role and in full respect of the treaties.

Whenever a Member State requests ESM financial assistance, it may also request financial assistance from the IMF.

The ESM could be renamed.

ESM credit line

We should make existing precautionary instruments more effective to ensure stabilization. Such support would need to involve conditionality.

As a further development of the precautionary ESM credit line (PCCL), stability support could be used in case of risk of liquidity shortages where ESM Members are risk facing a gradual loss of market access, without the need for a full program.

We will set up a process to finalize a term-sheet by December.

Banking Union

As regards the Banking Union, the ECOFIN Council Roadmap of June 2016 recognized that further steps will have to be taken in terms of reducing and sharing risks in the financial sector, in the appropriate sequence, regarding NPLs, insolvency regimes, banking package and anti-money laundering.

Backstop

The ESM should be the backstop to the Single Resolution Fund. It should be provided in the form of a credit line. Based on sufficient risk reduction, its entry into force should be earlier than 2024.

The size of the backstop should be close to but not bigger than the size of the SRF. The backstop should replace the direct recapitalization instrument.

Fiscal neutrality over the medium term will be ensured especially through repayment of the common backstop via extraordinary ex-post contributions by the banking sector in three years with a potential extension of two years.

Provided that there is sufficient progress in all relevant fields of risk reduction, to be assessed by the relevant authorities (Commission, SSM and SRB), the entry into force of the backstop should be brought forward before 2024. In 2020, the relevant authorities will provide a report on the trend of NPLs and the building up of subordinated bail-in buffers. On that basis and if risk reduction is satisfactory, the final decision on an accelerated entry into force of the backstop should be taken by the Eurogroup /ECOFIN / European Council.

We will assess the size of the SRF in the context of the end 2018 review and the need to review the intergovernmental agreement to anticipate the backstop.

A term sheet with the precise features of the SRF backstop should be developed for political endorsement by December 2018, based on the work done in the relevant expert group so far.

EDIS

We reaffirm the importance of strengthening the Banking Union with a view to its completion. This means, on all elements of the ECOFIN Council Roadmap of June 2016, both risk reduction and risk sharing in the appropriate sequence. The work on a Roadmap for beginning political negotiations on EDIS could start after the European Council in June.

Capital Markets Union

We commit to making decisive progress towards a Capital Markets Union, on all the items agreed by our Finance Ministers.

Eurozone budget

We propose establishing a Eurozone budget within the framework of the European Union to promote competitiveness, convergence and stabilization in the euro area, starting in 2021.

Decisions on the funding should take into account the negotiations on the next Multiannual financial framework. Resources would come from both national contributions, allocation of tax revenues and European resources.

The Eurozone budget would be defined on a pluriannual basis.

The purpose of the Eurozone budget is competitiveness and convergence, which would be delivered through investment in innovation and human capital. It could finance new investments and come in substitution of national spending.

We will examine the issue of a European Unemployment Stabilization Fund, for the case of severe economic crises, without transfers. France and Germany will set up a working group with a view to making concrete proposals by the European Council of December 2018.

Strategic decisions on the Eurozone budget will be taken by the Euro zone countries. Decisions on expenditures should be executed by the European Commission.

Research, innovation, higher education, digital and space

- To jointly promote the swift launch of a pilot to fund breakthrough innovation within the remaining period of Horizon 2020 and also cooperate bilaterally.

- To set up a joint French-German centre for research on artificial intelligence.

- To work to quickly set up the first ‘European universities’, initially consisting in bottom-up networks of universities across the EU.

- To launch a working group to make proposals for the EU to find the right answers to address new challenges in space politics and economics (“NewSpace” in particular).

- In the field of launchers, to reaffirm their full support for the Ariane 6 programme of the European Space Agency.

Climate

- To commit to ambitiously implementing the Paris Agreement at all levels and to intensifying global efforts by multilateralism; to this end the Petersberg Climate Dialogue gave a strong signal.

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- To develop an EU strategy 2050 for the long-term transformation towards carbon neutrality, which is not only a necessity, but also an economic opportunity.

- To make sure that the EU take new commitments at COP24 to update its NDC by early 2020 taking into account possible sectoral emissions reductions enabled by current or coming agreements at the EU level.

- To set up a joint interministerial High Level Working Group on climate change to intensify cooperation in this cross-cutting field and build up common views on energy transition and tools for triggering sustainable finance and economic incentives, including carbon pricing issues.

Reforming the EU institutions

- To work for the European Commission to have less Commissioners than there are Member States – as foreseen in the Lisbon Treaty.

- To put in place transnational lists for European elections as of 2024.

Source: https://archiv.bundesregierung.de/archiv-de/meta/startseite/meseberg-declaration-1140806

The **euro** arrived at its **20th birthday** on **1 January 2019**. Mario Draghi, at-that-time President of the ECB gave a speech on the occasion in December 2019.

Europe and the euro 20 years on

Speech by Mario Draghi, President of the ECB, at Laurea Honoris Causa in Economics by University of Sant'Anna, Pisa, 15 December 2018

Next month, we will celebrate the 20th anniversary of the launch of the euro.

The two decades in which the euro has existed have perhaps been exceptional. The first was the culmination of a 30-year upswing in the global financial cycle, while the second saw the worst economic and financial crisis since the 1930s. But, exceptional as they were, these two periods can teach us some useful lessons about what still needs to be done.

Monetary Union has succeeded in many ways, but it has not delivered the gains that were expected in all countries. This is partly the result of domestic policy choices and partly the result of Monetary Union being incomplete, which led to insufficient stabilisation during the crisis.

The way ahead, therefore, is to identify the changes that are necessary to make our Monetary Union work for the benefit of all member countries.

We need to make these changes as soon as possible, but we also need to explain why they are important to the people of Europe.

The rationale for one market, one money

The Single Market is often seen simply as an expression of the globalisation process, which over time has even eliminated exchange rate flexibility. But the Single Market and globalisation are not the same thing.

Globalisation has led to higher overall welfare for all economies, and for emerging markets in particular. But it is now clear that the rules that accompanied this process were not sufficient to prevent it from causing severe distortions. Open markets have heightened economic insecurity for people exposed to intensified competition, and added to their sense of being “left behind” in a world where the great wealth created has been concentrated in a few hands.

From the outset, however, the Single Market was designed to reap the benefits of openness while also tempering its costs for the most vulnerable; to promote growth while protecting the people of Europe from the injustices of untrammelled free markets. This was undoubtedly also the vision of Jacques Delors, the architect of the Single Market.

The Single Market was conceived during a period of weakness in the European economy. Annual growth had averaged just 2.2% from 1973 until 1985 in the 12 countries that would go on to form the euro area[1], down from 5.3% between 1960 and 1973. Growth potential had also fallen from about 5% per year at the beginning of the 1970s to around 2% per year by the beginning of the following decade.

The typical response of governments to low growth was to increase fiscal deficits. From 1973 to 1985, public deficits in the euro area 12 averaged 3.5% of GDP, while in Italy the average was 9% of GDP. Unemployment rose from 2.6% in 1973 to 9.2% in 1985 for the euro area 12. In Italy, it climbed from 5.9% to 8.2% over the same period.

But the EU had a powerful tool at its disposal to raise growth: the common market.

One reason that growth potential had decelerated was that intra-EU trade growth had stalled in the early 1970s, because the common market covered mainly intermediate goods where growth was already saturated. Trade in sectors with high R&D and skill content was restricted by non-tariff barriers, preventing productivity spillovers.[2]

The Single Market offered a way to remove these barriers, reverse the decline in economic potential, and bring more people back into work.

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Yet the Single Market was never just about this. It also aimed to protect people from some of the costs of the changes that would inevitably arise. This, in turn, would create a more favourable political environment for advancing the process of European integration, following the setbacks of the 1970s.

Unlike the wider process of globalisation, the Single Market allowed Europe to impose its values on economic integration – to build a market that, to the extent possible, was *free* but *just*. Product rules could be used to protect consumers from lax standards in other countries, and protect producers from unfair competition. And production rules could be used to protect workers by putting a floor on "social dumping" and upholding labour standards.

This is why the launch of the Single Market agenda in the mid-1980s went hand in hand with a strengthening of common rule-making in the EU and of powers of judicial review. The opening of markets was accompanied by the creation of a strong European authority to safeguard fair competition; product standards became tighter, with the introduction of the geographical indication protections for specific foods, for example. And safeguards central to the European social model were progressively embedded in EU law, in areas where the EU had the power to act.

The Charter of Fundamental Rights has prevented a "race to the bottom" in terms of workers' rights. Legislation was adopted to curtail unfair labour practices, such as the revision of the Posted Workers Directive this year. EU legislation also protects those in less secure employment. One example is the Directive on part-time work in 1997, which sought equal treatment for part-time and fixed-term employees. Last year the EU institutions endorsed the European Pillar of Social Rights to support equal opportunities and access to the labour market, fair working conditions, social protection and inclusion.

EU legislation has not led to a complete harmonisation of labour protections across Europe. But it has meant that the gap in labour standards across countries has gradually narrowed, even as lower-income countries have joined the EU. Research finds a process of upward convergence in significant areas of social expenditure in the EU since 1980, although this has tailed off in recent years.[3] The same cannot be said at the international level.

But the Single Market required greater exchange rate stability than a free trade area, and this resulted in significant trade-offs for economic policy. These were well-articulated by Tommaso Padoa-Schioppa in his famous "inconsistent quartet".[4] If European countries wanted to have the benefits of managed open trade, they could not simultaneously have capital mobility, independent monetary policy and fixed exchange rates.

Governments initially responded to this conundrum by maintaining fixed exchange rates and introducing capital controls on short-term flows, which allowed a degree of monetary policy autonomy. But as financial integration deepened and capital controls were progressively eliminated during the 1980s, fixed exchange rates became unsustainable.

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Due to the international financial storms raging at the time, the countries that had pegged their currencies to the Deutsche Mark (DM) within the European Monetary System (EMS) had to periodically decide either to maintain an independent monetary policy and devalue, or to maintain parity with the DM and lose any sovereignty over their monetary policy.

Given the frequency with which policymakers had to make these decisions, some countries lost both the benefits of exchange-rate stability and their monetary policy independence. The social costs were high. This process came to an end with the ERM crisis in 1992-3, when it ceased to be credible for countries entering a recession to follow German interest rate rises.

At the same time, devaluing repeatedly was becoming incompatible with the deep Single Market that countries were trying to build.

Indeed, the prevailing view on devaluations was captured well by Nobel laureate Robert Mundell, who developed his theory of optimal currency areas in the belief that, *"I could not see why countries that were in the process of forming a common market should saddle themselves with a new barrier to trade in the form of uncertainty about exchange rates"*.[5] Exchange rate flexibility would have undermined the Single Market in two ways.

First, it would have weakened incentives for firms to raise productivity, because they could have lifted competitiveness – if only temporarily – by devaluing rather than increasing output per head.[6] Yet Europe had witnessed time and again that such actions did not lead to lasting welfare gains.

From the launch of the EMS in 1979 to the ERM crisis in 1992, the Italian lira was devalued seven times against the DM, losing around half of its value cumulatively vis-à-vis the German currency. Yet average annual productivity growth[7] in Italy was lower than in the euro area 12 over this period, Italy's GDP growth rate was roughly the same as that of its European peers, and its unemployment rate went up by 1.3 percentage points. At the same time, consumer prices in Italy grew cumulatively by 223%, compared with 103% in the euro area 12.[8]

Second, support for the Single Market would be undermined in the long run if firms that did invest in raising productivity could be deprived of some of the benefits by "beggar-thy-neighbour" behaviour through competitive devaluations in other countries. Open markets would not have lasted.

Europe had experienced the problems created by exchange rate flexibility in the 1960s with the common agricultural market. Absent a single currency, the common agricultural policy was based on prices quoted in units of account. But successive currency crises, in particular a revaluation of the DM and a devaluation of the French franc in 1969, jeopardised trust in the market, as the farmers affected demanded compensation for their losses.

The issue was smoothed over by introducing monetary compensatory amounts to mitigate sudden changes in farm prices caused by abrupt adjustments in exchange rates. But the system proved difficult to implement and sustain as it was virtually impossible to avoid distortions of production and trade, which poisoned intra-Community relations.[9]

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So, faced with an "inconsistent quartet" of policy choices, a single currency provided, at least in principle, a way to resolve them. It would allow countries to maintain stable exchange rates and therefore benefit from openness within the Single Market, while managing as far as possible its costs.

Not all countries that had joined the Single Market also joined the euro, of course. Some countries, such as Denmark, pegged their exchange rates to the euro. For other countries, the Single Market represented the gateway to the euro. Five additional countries[10] joined the euro in its first decade and three more in its second, but other smaller economies have stayed out so far.

Finally, there is the United Kingdom, the only large economy inside the Single Market that chose to stay out of the euro area. The United Kingdom is a particular case, not only for political reasons but also for structural reasons, such as the relatively low exchange rate pass-through it had in the past.[11]

The benefits of one market, one money today

We should consider what gains have been made as a result of having one market with one money.

With the euro protecting the Single Market, trade growth has increased, with intra-EU exports rising from 13% of EU GDP in 1992 to 20% today. Intra-euro area trade has risen both in absolute terms and as a share of total trade with advanced economies[12], even as emerging market economies have entered the global market. Foreign direct investment (FDI) flows within Europe have also grown[13], with inflows from the rest of the EU to Italy increasing by 36% from 1992 to 2010.[14]

Behind the growth of intra-EU trade lies perhaps an even more important development, which is the much closer intertwining of European economies through the deepening of value chains. Since the start of the 2000s, supply chain linkages between countries within the EU have intensified at a faster pace and were more resilient during the crisis, compared with their supply chain linkages with countries outside the Single Market.[15]

The removal of customs barriers as part of the Single Market agenda has facilitated multiple border crossings during the production process. Europe-wide standards have boosted intra-EU value chains by providing more certainty for firms about the quality of production in other countries and encouraging the fragmentation of the production process that is typical of value chains.[16] And the single currency has further enhanced the process by eliminating the costs of foreign exchange payments and settlements and of hedging exchange rate risk.

Participation in these value chains has brought gains for all countries, especially in terms of productivity spillovers. The imported inputs used in value chains generate a tangible boost to productivity.[17] And higher productivity in turn leads to higher wages. Integration within value chains is associated with an increase in hourly compensation for all skill groups.[18]

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Moreover, integrating into value chains has improved risk-sharing among European countries, since it has allowed the gains (and losses) of trade with the rest of the world to be more evenly spread. Within the EU, close to 20% of export-supported jobs are located in a country other than the one that exports the final product.[19]

Around half a million Italian workers are involved in the production processes of companies located in other EU countries that export to the rest of the world.[20] Italian firms themselves participate strongly in global value chains and this is positively associated with labour productivity.[21]

It is often this link to value chains that allows in particular the SMEs that are so typical of Italy's manufacturing sector to survive and grow. In a world that is increasingly dominated by scale, this permits Italy to retain one of its fundamental characteristics. Italy, through the Single Market and the single currency, is deeply integrated into the European production process.

The closer intertwining of European economies has had two significant effects on exchange rate relationships for euro area countries.

First, the cost of not being able to devalue within Monetary Union has fallen. ECB analysis finds that misalignments of real effective exchange rates are smaller – albeit more persistent – for euro area countries than those between advanced economies or countries linked by pegged exchange rates, and these misalignments have actually become smaller in the second decade of EMU relative to the first decade.[22]

At the same time, value chains have blunted the short-run benefits of competitive devaluations.[23] Since exports contain a greater share of imports, any boost to external demand associated with a hypothetical devaluation is now offset by higher input costs from imported intermediates. As a result, participation in value chains has been found to reduce the responsiveness of export volumes to movements in the exchange rate.[24]

So, any country hypothetically looking to devalue to regain competitiveness would have to do so to a much larger extent than was necessary in previous decades. And devaluations of such size would not only threaten the existence of the Single Market. They would also result in a substantial loss of welfare within the country carrying out the devaluation owing to the greater negative impact it would have via higher import prices. And studies on non-EU countries suggest that the welfare loss would be greatest for the poorest in society, since poorer households tend to spend a larger share of their income on tradeable goods than richer households.[25] This is also typically the case in euro area countries.

But does being outside the euro provide additional benefits in terms of monetary policy sovereignty? This is not so obvious.

First, the single currency has actually allowed countries to regain monetary sovereignty compared with the fixed exchange rate regimes of the past. Decision-making over monetary policy, which effectively belonged to Germany under the EMS, is now shared among all euro area countries. And the size of euro financial markets has made the euro area less vulnerable to US spillovers, even as global financial integration has accelerated.

Second, it is worth noting that the supposed advantages of monetary sovereignty – such as the ability to engage in monetary financing of government spending – do not appear to be valued highly by countries that are members of the Single Market but not the euro. Such countries have a weighted average public debt of 68% of GDP (44% of GDP if the United Kingdom is excluded), compared with 89% for countries that use the single currency.

In any case, as the history of Italy has shown, monetary financing of government debt did not lead to real long-term benefits.[26] In periods where debt monetisation was more common in Italy, such as in the 1970s, maintaining a growth rate similar to its European peers required repeated devaluations. Inflation reached unsustainable levels and hit the most vulnerable in society.

Convergence and divergence in the euro area

But if it is true that the supposed advantages associated with the freedom of being outside Monetary Union belong to a memory that has been obscured by time and the dramas of the recent crisis, it is also true that in some countries various benefits that were expected from EMU have not yet materialised.

It was not mistaken, and nor is it today, to expect higher growth and employment to emerge from the "culture of stability" that Monetary Union would bring about. But it was inconceivable that joining Monetary Union alone would be sufficient to achieve this. We needed and continue to need much more.

To the founders of EMU, it was clear that establishing a well-functioning monetary union would be a long and gradual process. Historical experience suggested that opening markets could lead to differentiated gains, with some regions profiting more than others. This had been the experience of both Italy and Germany after unification in the 19th century.[27]

Several euro area countries have achieved significant convergence, particularly the Baltic countries, Slovakia and, to a lesser extent, Malta and Slovenia. In these countries, the gap between real GDP per capita and the euro area mean has been reduced by around one-third since 1999.[28] Others that also started far from the euro area average – such as Portugal and Greece – have on balance been unable to close the gap considerably.

But such divergences are not exclusive to the euro area. GDP per capita in the richest state in the United States is around twice that of the poorest state, which is roughly the same gap as in the euro area.[29] And the dispersion of growth rates across euro area countries has fallen considerably over time and, since 2014, has been comparable to the dispersion across US states.

So what has driven the different convergence trajectory of countries, and how much is it related to membership of the euro? Convergence can be thought of in two ways.

The first is convergence of real GDP per capita *levels*. This is a long-term process which is driven by factors such as rates of FDI, productivity growth and institutional quality. Such factors can be fostered by sharing a single currency, but they are not determined by it. Domestic policies, structural and institutional reforms, and contributions from EU structural funds are what play a crucial role here.

The second concept of convergence relates to *growth rates*, i.e. how much business cycles across countries are synchronised, especially when major shocks hit. This is determined more by monetary union membership, since the design of a monetary union affects the capacity of countries to adjust and stabilise demand during recessions.

In the case of Italy, we see both long-term and cyclical factors at play. Between 1990 and 1999 – that is, before the introduction of the euro – Italy already had the lowest cumulative per capita GDP growth of the original euro area members. From 1999 to 2008, it again had the lowest per capita GDP growth of all euro area members. From 2008 to 2017, it recorded the second lowest cumulative growth, behind Greece. And, if we look further back, the growth we saw in the 1980s was borrowed from the future, having been based on debt that was left for future generations to bear.

So, low growth in Italy is a phenomenon that dates back a very long time before the euro. This is a supply-side problem, which is clear if one looks at regional performance. There is a correlation between GDP per capita in different Italian regions and some structural indicators, such as – just to take an example – the ease of doing business index compiled by the World Bank: the values for the poorer regions are generally lower than those of richer regions.

At the same time, the fact that Italy – and other countries – diverged further from the euro area average during the crisis highlights two important points. First, that structurally weaker countries are more vulnerable to economic slowdowns than others; and second, that our Monetary Union remains incomplete in some key respects.

There is a fair amount of evidence that countries that implemented decisive structural policies recovered faster from the crisis than others. In countries that made such changes, the labour market is now more responsive to growth,[30] and the improved economic conditions have led to gains in employment.[31] But alongside structural policies, different layers of protection are necessary to ensure that countries can stabilise their economies during crises.

Without appropriate backstops at the euro area level, individual countries in a monetary union can be exposed to self-fulfilling dynamics in sovereign debt markets. Such overshooting can aggravate adverse debt dynamics in downturns, inducing procyclicality in national fiscal policies, as we saw in 2011-12. Typically, sovereign borrowing costs should fall in a recession, but at that time economies representing one-third of euro area GDP saw their borrowing costs become positively correlated with risk aversion.[32] The result was a lack of stabilisation that harmed both growth and fiscal sustainability.

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So it is the structurally weaker countries that most need EMU to have instruments to diversify the risk of crises and counteract their effect on the economy. I have talked before about how countries like Italy, which had been weakened by decades of low growth and had no fiscal space when the crisis began, saw a crisis of confidence in government debt turn into a credit crisis with major repercussions for employment and growth.[33]

Deepening private risk-sharing through financial markets is one key element in preventing such events from recurring. In the United States, around 70% of shocks are mitigated and shared across the individual states through integrated financial markets, whereas in the euro area the share is only 25%.[34] It is therefore also in the interest of the weaker countries in the euro area to complete banking union and to proceed with the construction of a genuine capital market.

But national budgets will never lose their function as the main stabilisation tool during crises. In the euro area, around 50% of an unemployment shock is absorbed through the automatic stabilisers in national public budgets, significantly more than in the United States.[35] The use of automatic stabilisers, however, depends on countries not being constrained by their debt level. So the necessary fiscal space will have to be created again so that budget interventions can be made in the event of a crisis.

Yet national fiscal policies also need a complement at the European level. We need an institutional architecture that gives all countries the necessary support to ensure that their economies are not exposed to procyclical market behaviour during downturns. This will only be possible if the support is temporary and does not constitute a permanent transfer between countries, which would result in a failure to put in place the necessary fiscal consolidation, let alone the fundamental structural reforms needed for a return to growth.

Conclusion

It is not a technocratic desire to see convergence across countries and the smooth functioning of Monetary Union that has led me to frequently mention the importance of structural reforms in recent years. Each country has its own reform agenda, but such reforms are the only way to create the conditions for sustainable growth in wages, productivity and employment and to underpin our welfare state.

In large part these measures have to be undertaken at the national level, but they can be supported at the European level by the recent decisions to launch an instrument for convergence and competitiveness.

However, to tackle future cyclical crises, the two layers of protection against shocks – the diversification of risk through the private financial system on the one hand, and public countercyclical support through national budgets and the fiscal capacity of the EU budget on the other – need to interact in a complete and efficient manner.

The more progress we make in completing the banking union and capital markets union, the less urgent – although still necessary – it becomes to construct a fiscal capacity, which could at times serve to complement national stabilisers. Inaction on both fronts heightens the fragility of Monetary Union in times of great crisis and the divergence between countries increases.

It is clear that completing Monetary Union is the best way to prepare the transition to a form of union that is more complete. Monetary Union, a necessary consequence of the Single Market, has become an integral and defining aspect – with its symbols and its constraints – of the political project whose central aim is a Europe that is united in freedom, peace, democracy and prosperity.

It was an exceptional response – or to paraphrase Robert Kagan[36] an anti-historical response – to a century that had seen dictatorships, war and misery, and in that respect was not dissimilar to previous centuries. A unified Europe was part of that world order, itself the result of exceptional circumstances, which followed the Second World War.

The intervening years have confirmed the rationality of the choices made at the European and the global level. The challenges that have arisen have become ever more global in nature and need to be tackled together, not alone. And this is even more true for Europeans, both at the level of their individual nations and for the continent as a whole: rich but relatively small; strategically exposed, militarily weak.

Yet today, for many, the memories that inspired those choices seem distant and irrelevant, and the rationale behind them has been undermined by the misery created by the great financial crisis of the past decade. It does not matter that we are emerging from the crisis. Elsewhere in the world, the fascination with illiberal prescriptions and regimes is spreading; we are seeing little steps back in history.

And this is why our European project is even more important today. It is only by continuing to make progress, freeing up individual energies but also fostering social equity, that we will save it through our democracies, with a unity of purpose.

[1]Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.

[2]See Study Group appointed by the Commission and presided by Padoa-Schioppa, T. (1987), ”Efficiency, stability, and equity: a strategy for the evolution of the economic system of the European community: a report”.

[3]See Caminada, K., Goudswaard, K. and Van Vliet, O. (2010), “Patterns of Welfare State Indicators in the EU: Is there Convergence?”, *Journal of Common Market Studies*, 48(3), pp. 529-556; Paetzold, J. (2012), “The Convergence of Welfare State Indicators in Europe: Evidence from Panel Data”, Working Paper No 201204, University of Salzburg; Athanasenas, A., Chapsa, X. and Michailidis, A. (2015), “Investigating Social Protection Convergence in the EU-15: A Panel Data Analysis”, *European Research Studies Journal*, vol. 0(2), pp. 79-96.

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[5]Mundell, R., "Optimum Currency Areas", luncheon speech at Tel Aviv University, 5 December 1997.

[6]See Eichengreen, B. (2007), "The European Economy since 1945, Coordinated Capitalism and Beyond", Princeton University Press.

[7]Real GDP per hour worked.

[8]Reference period is 1979-1991, excluding Italy.

[9]European Commission (1980), "Reflections on the Common Agricultural Policy", *Bulletin of the European Communities*, Supplement 6/80.

[10]Greece was one of the original signatories of the Maastricht Treaty but only joined the euro area in 2001.

[11]See, for example, Campa, J.M and Goldberg, L.S. (2002), "Exchange Rate Pass-Through into Import Prices: A Macro or Micro Phenomenon?", *NBER Working Paper*, No. 8934.

[12]Euro area plus Australia, Canada, Denmark, Japan, Sweden, United Kingdom and United States.

[13]Carril-Caccia, F. and Pavlova, E. (2018), "Foreign direct investment and its drivers: a global and EU perspective", *Economic Bulletin*, Issue 4, ECB.

[14]Percentage increase of five-year centred average.

[15]Schmitz, M., Fidora, M. and Gunnella, V. (2017), "The impact of global value chains on the macroeconomicanalysis of the euro area", *Economic Bulletin*, Issue 8, ECB.

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[17]See, for example, Halpern, L., Koren, M. and Szeidl, A. (2015), "Imported Inputs and Productivity", *American Economic Review*, 105(12), pp. 3660-3703.

[18]Schmitz et al. (2017), op. cit.

[19]European Commission (2018), "Fact Sheet", 27 November.

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[24]See Amiti, M., Itskhoki, O. and Konings, J. (2014), "Importers, Exporters, and Exchange Rate Disconnect", *American Economic Review*, 104(7), pp. 1942-1978; Swarnali, A., Maximiliano, A. and Michele, R. (2017), "Global value chains and the exchange rate elasticity of exports", *The B.E. Journal of Macroeconomics*, 17(1), pp. 1-24; Rodnyansky, A. (2018), "(Un)Competitive Devaluations and Firm Dynamics", mimeo.

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[27]See Toniolo, G. (1990), “Economic Problems of the Unification” in *An Economic History of Liberal Italy*, Routledge; Study Group appointed by the Commission and presided by Padoa-Schioppa, T. (1987), op. cit.

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[29]Adjusted for purchasing power in euro area countries and excluding Luxembourg and Ireland.

[30]Based on a static relationship between changes in the employment rate and percentage changes in GDP for the period between the first quarter of 1999 and the second quarter of 2015. The period of recovery analysed is from the second quarter of 2013 to the second quarter of 2015. See the article entitled “What is behind the recent rebound in euro area employment?”, *Economic Bulletin*, Issue 8, ECB, 2015.

[31]See Banco de España (2015), “Competitive adjustment and recovery in the Spanish economy”, *Annual Report*, Box 2, pp. 39-63; Vansteenkiste, I. (2017), “Did the crisis permanently scar the Portuguese labour market? Evidence from a Markov-switching Beveridge curve analysis”, *Working Paper Series*, No. 2043, ECB, April; and Sestito, P. and Viviano, E. (2016), “Hiring incentives and/or firing cost reduction? Evaluating the impact of the 2015 policies on the Italian labour market”, *Questioni di economia e finanza (Occasional Papers)*, No. 325, Banca d’Italia, March.

[32]As measured by the VIX index (ECB calculations).

[33]See Draghi, M. (2018), “Risk-reducing and risk-sharing in our Monetary Union”, speech at the European University Institute, Florence, 11 May.

[34]European Commission estimates. See Nikolov, P. (2016), “Cross-border risk sharing after asymmetric shocks: evidence from the euro area and the United States”, *Quarterly Report on the Euro Area*, Vol. 15, No. 2.

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In 2020, the **EEMU has entered a next crisis induced by the COVID-19 pandemic**. Christine Lagarde, President of the ECB (as of November 2019) gave a speech on the occasion. We close our collection of texts concerning the EEMU with her speech.

The path out of uncertainty

Remarks by Christine Lagarde, President of the ECB, via videoconference at the inaugural session of the Italian National Consultation, 13 June 2020

There is no doubt that the economic situation we face today is characterised by profound uncertainty. Looking into the future has rarely been harder.

But, as Abraham Lincoln said, "the best way to predict your future is to create it". And this is the theme that I want to emphasise in my remarks today.

Obviously there are some major unknowns that we cannot do much about, such as possible second waves of the virus or when exactly vaccines will arrive. But there are steps we can take to help navigate out of the fog of uncertainty.

Most importantly, we need to elaborate and propose a reliable compass – that is, a positive vision of what our economy will look like after.

Our economies are entering an inevitable phase of transformation, but if policymakers can demonstrate that we will emerge together from the crisis stronger – with more agile, more modern and more equal economies than before – we can ensure a more resilient recovery today and more sustainable growth in the future.

Uncertainty in euro area economy

The crisis is weighing heavily on the euro area economy. Business investment looks to have collapsed in the first quarter, even more strongly than GDP. Measures of consumers' propensity to save have surged to historical levels, far above what we saw after the Lehman crash.

Some of this reflects "forced saving" because people have been unable to spend and will therefore reverse naturally. But we are also seeing significant precautionary saving, which is a sign that households are preparing for an uncertain future, and uncertainty is likewise a key factor in weak business investment.

There are two main sources of uncertainty today.

The first source is uncertainty about how the economy will recover from the coronavirus (COVID-19), which is evident in the Eurosystem's latest macroeconomic projections.

Our baseline projection sees GDP falling by 8.7% this year, but this is surrounded by a wide range of potential scenarios. In our mild scenario, the drop in GDP would be 5.9% this year, and in our severe scenario it would be 12.6%. In this latter case, output would still be well below its pre-crisis level at the end of 2022.

Faced with such an outlook, it is understandable that households are anxious about their future incomes and firms are hesitant about making irreversible decisions. In particular, many citizens fear that, in a slow recovery, some jobs will be lost once government support schemes are phased out.

This underlines why it is so important that the recovery is properly managed and that the economy is adequately stimulated. Confidence in government policies is critical to reducing uncertainty, which is itself a form of stimulus.

In fact, results of a survey conducted at the ECB show that households that assess government policies as adequate have lower uncertainty about their future income.

The second source is uncertainty about how the economy will change in response to COVID-19.

It is becoming increasingly clear that the crisis will restructure our economies in fundamental ways. In the manufacturing sector, we are likely to see a push to make supply chains more resilient, which will likely lead to a greater focus on "proximity", i.e. on-shoring of production and reinforcing of strategic value chains.

In the services sectors, by contrast, the pandemic is likely to shift the economy towards more "distancing" via more digitalisation.

We are already seeing this transition accelerate as retail trade gravitates towards e-commerce, services that we previously thought were "non-tradeable" start being traded online, and more remote working becomes possible.

As the workplace changes profoundly, it will take time for the new equilibrium in the economy to appear. Some sectors will grow and create more jobs as their reach increases – think of communication or education and training, for example.

But other sectors could undergo significant changes if, say, people no longer need to commute into work to the same extent, or to make as many business trips or attend as many conferences where they consume hospitality services.

This rebalancing should lead to higher investment in intangible capital, but part of the capital stock related to tangibles could be superseded. If such changes happen too rapidly, they can lead to temporary disruptions in the labour market.[1]

So it is natural for people to wonder what the economy will look like in the future and how we will ensure sustainable growth. Our task today – if we want to prevent a persistent increase in precautionary saving and instead to direct such saving towards needed investment – is to provide them with credible answers.

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Transitioning to the post-crisis economy

Dealing with uncertainty about the outlook is the task of stabilisation policies, and here the ECB will continue to take all necessary steps within our mandate of price stability – for all euro area citizens in all parts of the euro area.

Already our policies have dispelled tail risks in financial markets that could have led to self-reinforcing vicious circles. We are now orienting our measures to ensure that the right financial conditions are in place to support a recovery from the crisis.

This was the motivation behind our recent decision to expand our pandemic emergency purchase programme to €1.35 trillion, coupled with the up to €3 trillion we are making available to banks that lend to the real economy.

But monetary policy cannot address the more profound questions about how the economy will look in the future. Historical experience suggests that major economic shifts like the one we are going through today require government action to foster change and smooth the transition to the new normal.

In particular, governments need to foster innovation by providing the right framework to encourage experimentation and risk-taking in new and growing sectors, and to support the transition to new jobs for people working in "sunset" sectors.

In parallel, they need to ensure that the conditions are in place to direct investment towards the technologies and sectors of the future.

This requires sufficient financing. The European Commission estimates that the investment needs for delivering the digital transformation as well as the green transition will be at least €1.2 trillion over the next two years.[2]

But in a number of countries – Italy among them – mobilising investment requires above all a business-friendly economic environment, with efficient and agile public and private services, adequate physical and digital infrastructures, a well-functioning judicial system and a strong financial sector.

If such actions are taken, this crisis can engender a period of positive transformation. It offers an opportunity to policymakers to take a decisive step forward towards more inclusive, greener and more digital growth.

A renewed focus on the digital economy, for example, can help break the negative feedback loop we see in Europe between fragmented markets, low economies of scale and weak investment in digital capacities, which has at times resulted in the knowledge economy in the euro area contributing only about half as much to productivity growth as in the United States.[3]

Greater digitalisation would in turn help accelerate the shift in Europe towards what the economist Carlota Perez has termed "smart green growth", which is not only about renewables and sustainable goods, but also about innovation in the productivity of resources and the shift from tangibles to intangibles.[4]

Europe already hosts the largest eco-innovation and circular economy industry in the world[5] and the euro is the currency of choice for global green bond issuance.[6] In the twentieth century, Europe was also at the forefront of the creation of the welfare state. The crisis today offers a possibility to consolidate and expand our global leadership on the environmental front and to make it converge with more digital lifestyles – producing a new, more sustainable economic model.

Finally, the drive to build more resilient supply chains could be the catalyst we need to definitively complete the Single Market. If we are to "de-globalise" while also achieving allocative efficiency and strategic autonomy, we will have no choice but to make full use of the size and diversity of our continent-wide economy.

So the potential to frame a positive European vision should, I hope, be compelling. The Commission's recovery fund proposal is clearly a key building block in delivering on this goal. But the European level cannot be expected to do it alone.

Crucially, the recovery fund will only reach its full potential if it is firmly rooted in structural reforms conceived and implemented at the national level. We will get a "bigger bang" for each euro spent if countries conduct the structural reforms they need at the same time.

As an illustration, ECB research shows that in the event of a common shock hitting all euro area countries – of the type we have just seen – those with less efficient economic structures can on average suffer up to twice the output loss of a country that is at the frontier of institutional parameters.[7]

The Country Specific Recommendations identify further helpful reforms. In Italy's case, I understand that these recommendations call for, among other things, investing in digital infrastructure for education and training, promoting renewable energy production, developing e-business models and modernising public administration.

Such reforms – designed and owned by you – are indispensable to capitalise on this moment.

Conclusion

I therefore encourage you, as policymakers, not to let this crisis go to waste.

My institution, the ECB, will play its part within its mandate. But it is for you to prove to citizens that our societies will emerge from this transformation stronger and greener.

If we are collectively successful, uncertainty will start to turn into confidence, and then a real recovery can begin.

[1]See Anderton, R., Jarvis, V., Labhard, V., Morgan, J., Petroulakis, F. and Vivian, L. (2020), "Virtually everywhere? Digitalisation and the euro area and EU economies: Degree, effects, and key issues", *Occasional Paper Series*, ECB, forthcoming.

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[3]Anderton et al. (2020), op. cit.

[4]Perez, C. and Murray Leach, T. (2018), "A Smart Green 'European Way of Life': the Path for Growth, Jobs and Wellbeing", *Beyond the Technological Revolution Working Paper*, 2018-01.

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