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TOWARDS A GENUINE ECONOMIC AND MONETARY UNION
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I. CONSOLIDATING THE ECONOMIC AND MONETARY UNION

The economic and monetary union (EMU) was established to bring prosperity and stability across Europe. It is a cornerstone of the European Union. Today the EMU is facing a fundamental challenge. It needs to be strengthened to ensure economic and social welfare.

This report, prepared by the President of the European Council in collaboration with the President of the Commission, the President of the Eurogroup and the President of the European Central Bank, aims at developing a vision for the EMU to ensure stability and sustained prosperity. It does so by proposing a strong and stable architecture in the financial, fiscal, economic and political domains, underpinning the jobs and growth strategy.

Challenges

An effective vision has to confront the long-term challenges that the EMU faces. The euro area is diverse and policy-making at the national level is the most effective method for many economic decisions. Yet, national policies cannot be decided in isolation if their effects quickly propagate to the euro area as a whole. Therefore, such national policies must reflect fully the realities of being in a monetary union. Maintaining an appropriate level of competitiveness, coordination and convergence to ensure sustainable growth without large imbalances is essential. This should allow for the appropriate policy mix with the single monetary policy in pursuit of price stability.

But to ensure stability and growth in the euro area, Member States have to act and coordinate according to common rules. There have to be ways on ensuring compliance when there are negative effects on other EMU members. This is necessary to guarantee the minimum level of convergence required for the EMU to function effectively.

Overall, closer EMU integration will require a stronger democratic basis and broad support from citizens. For this reason, it is essential that already the process towards realising this vision is based on wide consultation and participation. Integration and legitimacy have to advance in parallel.

The vision for the future of EMU governance laid out in this report focuses on the euro area Member States as they are qualitatively distinct by virtue of sharing a currency. Nevertheless, the process towards deeper economic and monetary union should be characterised by openness and transparency and be in full compatibility with the single market in all aspects.

Vision

The report proposes a vision for a stable and prosperous EMU based on four essential building blocks:

- *An integrated financial framework* to ensure financial stability in particular in the euro area and minimise the cost of bank failures to European citizens. Such a framework elevates responsibility for supervision to the European level, and provides for common mechanisms to resolve banks and guarantee customer deposits.
- *An integrated budgetary framework* to ensure sound fiscal policy making at the national and European levels, encompassing coordination, joint decision-making, greater enforcement and commensurate steps towards common debt issuance. This framework could include also different forms of fiscal solidarity.

- *An integrated economic policy framework* which has sufficient mechanisms to ensure that national and European policies are in place that promote sustainable growth, employment and competitiveness, and are compatible with the smooth functioning of EMU.
- Ensuring the necessary *democratic legitimacy and accountability* of decision-making within the EMU, based on the joint exercise of sovereignty for common policies and solidarity.

These four building blocks offer a coherent and complete architecture that will have to be put in place over the next decade. All four elements are necessary for long-term stability and prosperity in the EMU and will require a lot of further work, including possible changes to the EU treaties at some point in time.

II. KEY BUILDING BLOCKS

1. An integrated financial framework

The financial crisis has revealed structural shortcomings in the institutional framework for financial stability. Addressing these shortcomings is particularly important for the euro area given the deep interdependences resulting from the single currency. However, this needs to be done whilst preserving the unity and integrity of the single market in the field of financial services. Therefore, an integrated financial framework should cover all EU Member States, whilst allowing for specific differentiations between euro and non-euro area Member States on certain parts of the new framework that are preponderantly linked to the functioning of the monetary union and the stability of the euro area rather than to the single market.

Building on the single rulebook, an integrated financial framework should have two central elements: single European banking supervision and a common deposit insurance and resolution framework.

Integrated supervision is essential to ensure the effective application of prudential rules, risk control and crisis prevention throughout the EU. The current architecture should evolve as soon as possible towards a single European banking supervision system with a European and a national level. The European level would have ultimate responsibility. Such a system would ensure that the supervision of banks in all EU Member States is equally effective in reducing the probability of bank failures and preventing the need for intervention by joint deposit guarantees or resolution funds. To this end, the European level would be given supervisory authority and pre-emptive intervention powers applicable to all banks. Its direct involvement would vary depending on the size and nature of banks. The possibilities foreseen under Article 127(6) TFEU regarding the conferral upon the European Central Bank of powers of supervision over banks in the euro area would be fully explored.

Building on existing and forthcoming Commission proposals, work should be taken forward on deposit insurance and resolution:

A European deposit insurance scheme could introduce a European dimension to national deposit guarantee schemes for banks overseen by the European supervision. It would strengthen the credibility of the existing arrangements and serve as an important assurance that eligible deposits of all credit institutions are sufficiently insured.

A European resolution scheme to be primarily funded by contributions of banks could provide assistance in the application of resolution measures to banks overseen by the European supervision with the aim of orderly winding-down non-viable institutions and thereby protect tax payer funds.

The deposit insurance scheme and the resolution fund could be set up under the control of a common resolution authority. Such a framework would greatly reduce the need to make actual use of the guarantee scheme. Nevertheless, the credibility of any deposit guarantee scheme requires access to a solid financial backstop. Therefore, as regards the euro area, the European Stability Mechanism could act as the fiscal backstop to the resolution and deposit guarantee authority.

2. Towards an integrated budgetary framework

The financial and debt crisis has underlined high levels of interdependence particularly within the euro area. The smooth functioning of the EMU requires not only the swift and vigorous implementation of the measures already agreed under the reinforced economic governance framework (notably the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance), but also a qualitative move towards a fiscal union.

In the context, within the euro area, of greater pooling of decision making on budgets commensurate with the pooling of risks, effective mechanisms to prevent and correct unsustainable fiscal policies in each Member State are essential. Towards this end, upper limits on the annual budget balance and on government debt levels of individual Member States could be agreed in common. Under these rules, the issuance of government debt beyond the level agreed in common would have to be justified and receive prior approval. Subsequently, the euro area level would be in a position to require changes to budgetary envelopes if they are in violation of fiscal rules, keeping in mind the need to ensure social fairness.

In a medium term perspective, the issuance of common debt could be explored as an element of such a fiscal union and subject to progress on fiscal integration. Steps towards the introduction of joint and several sovereign liabilities could be considered as long as a robust framework for budgetary discipline and competitiveness is in place to avoid moral hazard and foster responsibility and compliance. The process towards the issuance of common debt should be criteria-based and phased, whereby progress in the pooling of decisions on budgets would be accompanied with commensurate steps towards the pooling of risks. Several options for partial common debt issuance have been proposed, such as the pooling of some short-term funding instruments on a limited and conditional basis, or the gradual roll-over into a redemption fund. Different forms of fiscal solidarity could also be envisaged.

A fully-fledged fiscal union would imply the development of a stronger capacity at the European level, capable to manage economic interdependences, and ultimately the development at the euro area level of a fiscal body, such as a treasury office. In addition, the appropriate role and functions of a central budget, including its articulation with national budgets, will have to be defined.

3. Towards an integrated economic policy framework

In an economic union, national policies should be orientated towards strong and sustainable economic growth and employment while promoting social cohesion. Stronger economic integration is also needed to foster coordination and convergence in different domains of policy between euro area countries, address imbalances, and ensure the capacity to adjust to shocks and compete in a globalised world economy. This is essential for the smooth functioning of the EMU and is an essential counterpart to the financial and fiscal frameworks.

It is important, building on the principles spelled out in the European semester and the Euro Plus Pact, to make the framework for policy coordination more enforceable to ensure that unsustainable policies do not put stability in EMU at risk. Such a framework would be particularly important to guide policies in areas such as labour mobility or tax coordination.

Measures to strengthen the political and administrative capacity of national institutions and foster national ownership of reforms could be taken where necessary, as this is a vital condition for the efficient implementation of growth enhancing reforms.

4. Strengthening democratic legitimacy and accountability

Decisions on national budgets are at the heart of Europe's parliamentary democracies. Moving towards more integrated fiscal and economic decision-making between countries will therefore require strong mechanisms for legitimate and accountable joint decision-making. Building public support for European-wide decisions with a far-reaching impact on the everyday lives of citizens is essential.

Close involvement of the European parliament and national parliaments will be central, in the respect of the community method. Protocol 1 TFEU on the role of national parliaments in the EU offers an appropriate framework for inter-parliamentary cooperation.

III. NEXT STEPS--PROPOSAL FOR A WORKING METHOD

Further work is necessary to develop a specific and time-bound road map for the achievement of the genuine Economic and Monetary Union.

A report could be submitted to the December European Council by the President of the European Council in close collaboration with the President of the Commission, the President of the Eurogroup and the President of the European Central Bank. There will be regular and informal consultations with the Member States and the EU institutions. An interim report could be presented in October 2012.