



The Commission's "Saint Nicholas" EMU package – no real surprises

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No real surprises hidden in the "Saint Nicholas" reform package from Brussels, a detailed set of reform proposals and communications that the European Commission published on Wednesday as a "roadmap" for deepening EMU. The proposals build on Commission President Juncker's September State of the Union speech and, in essence, match closely with the French vision of more stabilization and risk-sharing in the EU, while they also try to meet German demands for better supervision of fiscal rules. The strong focus on anchoring any further integration of the Monetary Union - such as the reform of the ESM and the introduction of a Eurozone budget - in the institutional framework to a certain extent also illustrates the wariness in Brussels of being sidelined in its fiscal competencies and to allow the euro area to further develop on its own.

The Commission communication focuses on four areas of reform – (i) creation of a European Monetary Fund, (ii) integration of the Fiscal Compact into EU law, (iii) a Eurozone budget line in the EU budget and (iv) a European Minister of Economy and Finance. Measures that lead to the completion of banking/capital markets union, such as a fiscal backstop for the SRF, might be sensible but require substantial risk reduction in national banking sectors ex ante to be accepted by all member states. Transferring the Fiscal Compact into EU law is warranted under the aspect of legal consistency and avoidance of duplication while the arguments to integrate the ESM/future EMF into EU treaties is much weaker. Proposals regarding the creation of a European Finance Minister and a EU budget line to support reform efforts and finance a general stabilisation function are not convincing in terms of addressing the EMU's underlying shortcomings adequately.

The proposals are to be discussed by EU heads of state at next week's European Council meeting. But as the Eurogroup finance ministers did not have the chance to form an opinion beforehand and with the lack of a new German government, the discussion is unlikely to be full-hearted. It can be expected to become all the more heated next year though. The Commission's timeline for reforms is therefore very likely to be pushed back and it is questionable whether agreement on the bulk of reforms can be found, as planned, before the election campaign for the European Parliament starts and a new Commission is appointed in 2019.



"Saint Nicholas" package from Brussels

EU timeline (selected)

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2017-12	<p>Dec 14-15: European Council:</p> <ul style="list-style-type: none"> • Decision on progress in Brexit negotiations • Agreement on timeline for EMU reform decisions
2018-03	<p>Mar 22-23: European Council</p>
2018-05	<p>May 20: Italy, latest date for parliamentary elections</p> <p>EC proposal for post-2020 Multiannual Financial Framework</p>
2018-06	<p>Jun 28-29: European Council</p> <ul style="list-style-type: none"> • EMU - concrete decisions on reforms (e.g. agreement on common backstop for SFR)
2018-10	<p>Oct 18-19: European Council</p> <ul style="list-style-type: none"> • Brexit transition deal, "political declaration on future relationship" (best-case scenario, according to EU Brexit negotiator Michel Barnier)
2018-12	<p>Dec 13-14: European Council</p> <ul style="list-style-type: none"> • MFF (progress report) • Adaption of proposal on EDIS
2019-03	<p>Mar 21-22: European Council</p> <ul style="list-style-type: none"> • EMU (state of play and any further decisions) <p>Mar 29: Brexit date - UK to leave the EU</p>
2019-05	<p>European Parliament elections, followed by appointment of new Commission</p>
2019-06	<p>June: European Council</p> <ul style="list-style-type: none"> • Adoption of proposals for EMF, integration of Fiscal Compact in EU law; common understanding of role of European Minister of Economy and Finance; conclusion of discussion of new EA budgetary instruments

No real surprises hidden in the "Saint Nicholas" reform package from Brussels, a detailed set of reform proposals and communications that the European Commission¹ published on Wednesday as a "roadmap" for deepening EMU. The proposals build on Commission President Juncker's September² State of the Union speech and, in essence, match closely with the French vision of more stabilization and risk-sharing in the EU, while they also try to meet German demands for better supervision of fiscal rules. The strong focus on anchoring any further integration of the Monetary Union - such as the reform of the ESM and the introduction of a Eurozone budget - in the institutional framework also illustrates the Commission's wariness of being sidelined in their fiscal competencies and to allow the euro area to further develop on its own. The release of detailed reform proposals a week ahead of this year's last European Council meeting was announced already in September but now appears almost premature, with the Eurozone's ability to agree on a timeline (see chart 1, sources: Deutsche Bank, European Council, European Parliament) and concrete steps for further integration being seriously hampered by the absence of and uncertainty regarding a new German government and a lack of consensus among EA members.³

The Commission communication focuses on four areas of reforms – (i) creation of a European Monetary Fund, (ii) integration of the Fiscal Compact into EU law, (iii) a Eurozone budget line in the EU budget and (iv) a European Minister of Economy and Finance. The proposals are to be discussed by EU heads of state at next week's European Council meeting but as the Eurogroup finance ministers did not have the chance to look at the proposals beforehand, the discussion is unlikely to be full-hearted. The Commission aims at "concrete decisions" to be taken already six months later at the June 2018 Council meeting.

A European Monetary Fund

A repurposing of the euro area's bailout fund – the ESM - as a European Monetary Fund (EMF) with an extended mandate has been amongst the most discussed ideas for reforming the currency union over the last months. Key European players, including the European Commission, the German and the French government all paid lip service to the idea, even though in terms of future functions and governance of such an enhanced institution, views in Europe vary substantially.⁴ From the Commission's perspective, transferring the ESM/EMF into EU law is a clear priority while their communication also elaborates on potential functions of a future EMF.

— **Integration in EU treaties** - the ESM was created in 2012 to provide financial assistance to euro area member states that are in or are facing "severe financing problems". The ESM treaty was signed as an intergovernmental treaty (it is not part of EU law) between euro area members, taking over the responsibilities of the temporary European Financial Stability Facility (EFSF). The Commission is pushing for "strengthened institutional anchoring" by integrating the ESM and future EMF into the EU treaties. As it rightly shies away from a full-blown revision

¹ See European Commission (06 Dec 2017).

² See European Commission (13 Sep 2017).

³ See Focus Europe (01 Dec, 2017): "EU Politics: Germany's political impasse spoils EMU reform timeline".

⁴ See Focus Europe (03 Nov 2017): "European integration and the role of the ESM".



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of the EU treaty, it proposes the changes under the so-called Passarelle clause of Art. 352 TFEU that allow alteration of legislative procedures without a formal amendment of the treaties. However, arguing that this "action is necessary for the financial stability of the euro area" is not really convincing given the constructive role of the ESM during the euro crisis and in the end deflects from the fact that the Commission (and the European Parliament) seeks to strengthen their say in ESM/EMF matters once it becomes a union body.

- The proposal also sees the EMF – alongside the Commission – as more directly involved in the **management of financial assistance** programs which reflects the fact that the IMF and the ECB are retracting from their role in the previously called Troika in terms of supervising the bail-out programs. Not discussed are ideas to involve the EMF in monitoring member states' compliance with the Fiscal Compact, as called for by former German Finance Minister Wolfgang Schäuble in his October "non-paper" on the future of EMU. Clearly, the Commission has no interest in transferring its own responsibility of monitoring member states' compliance with the fiscal framework to the ESM.
- **A credit line to the Single Resolution Fund (SRF)** as a last resort backstop to banking union as already agreed upon by EA members in 2013. The proposal to anchor this backstop of around EUR 55bn with the EMF in principle was endorsed already by the former German Finance Minister, even though he explicitly made it conditional on "stepped up" risk reduction in the banking sector beforehand – referring above all to the role of NPLs in banks' balance sheets.
- **Faster decision making** – the current voting rules that require unanimity are to be kept for "all major decisions with financial impact" while the unanimity rule could be replaced with a supermajority of 85% (currently 80%) for decisions on stability support, disbursements and deployment of the backstop (this would effectively give Germany France and Italy a veto as their respective capital shares in the ESM exceed 15%). Member states are likely to be reluctant to accept such a majority rule. More so, in a number of smaller member states, parliamentary approval of disbursements is required rendering any outvoting of them invalid.
- Quite tellingly, some of the more **far-reaching or controversial proposals** regarding the future role of the EMF have been left very broad or not mentioned at all. The communication contains one sentence on the possibility of developing new financial instruments in the context of a stabilization function but does not go into any further details. The possibility of a backstop for the controversial European Deposit Insurance is left unmentioned. The same applies to calls for including a (automatic) debt restructuring mechanism in the framework of the ESM such as by Bruegel and the German Bundesbank.

No Eurozone budget but a line in the EU budget

In the Communication on new budgetary instruments for the euro area, the Commission discusses four options which it regards essential for a deeper monetary union. Apart from the already mentioned backstop for the Banking Union through the ESM/EMF and a convergence facility for member states yet to join the euro, it calls for (i) a tool to support reform efforts in member states and (ii) a general stabilisation function to maintain investment levels in the event of asymmetric shocks.

- The Commission intends to introduce a new "**reform delivery tool**" under the next Multiannual Financial Framework, i.e. post 2020, that will set



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financial incentives for member states that commit to reforms discussed with the COM in the context of the European Semester and agreed in reform commitments. This seems to echo a proposal (so-called "Vertragspartnerschaften") put forward by the German government back in 2013 to incentivize member states to tackle structural reforms across the board. It failed, however, to get the backing of the euro area partners at that time with one side arguing that countries should not be compensated for reforms which are in their own interest and the other side being concerned about interference in national sovereignty - plus the question of fund raising. The discussion has gained momentum, though, also in the context of linking the allocation of existing Structural and Investment Funds to the receiving member state's compliance with policy recommendations of the COM and respectively the Council. Sensibly implemented, this move has at least the potential to improve competitiveness and crisis resilience on a national level. It should be noted, though, that the COM at the same time will continue to make use of the inbuilt flexibility in the fiscal rules in support for reforms, implying that it is prepared to accept a deviation from the budget deficit rule and the MTO in return for reforms. This could mean a double reward for reforms.

- **On the general stabilization function**, the COM has dismissed ideas of a common unemployment insurance or a single EA budget. Instead it intends to make a proposal by May 2018 for a stabilization function within the general EU budget which is supposed to help maintain investment levels in the case of an asymmetric shock. While the COM refrains from putting a number to it, it refers to estimates that such a capacity should reach 1% of GDP to be meaningful. Without conditionality, the use of this funds should be subject to clearly defined eligibility criteria. Apart from the controversial debate on the need for such a stabilization function, comments from a number of member states on such a tool have been quite critical over the past. In presenting the proposal on Wednesday, Budgetary Commissioner Oettinger already admitted that he sees a low preparedness by member states to help raise the funds for such a stabilization line.

European Minister of Economy and Finance

A proposal strongly promoted by French President Macron is to create the function of a European Minister of Economy and Finance. The idea is to merge the positions of a Commissioner and the President of the Eurogroup – currently elected among the EU's national Finance Ministers.

- From the Commission's perspective, this would help to reduce the increasingly complex governance of the EMU, strengthen policy coordination and fiscal surveillance and bolster accountability towards the European parliament. This "**double-hatted**" role would also be in charge of overseeing the EU and euro area budgetary instruments, including (newly created) stabilization functions. As the Commission argues, creating this combined function is already possible under the current EU Treaties. They propose to implement the function with the appointment of the next Commission in 2019 together with an informal agreement of the Eurogroup to elect the responsible Commissioner/Minister as its President for two following (two-year) terms.
- Besides the symbolic value that the creation of an EU finance minister might have for further EMU integration, the functional advantages of such a position can be debated. As Guntram Wolff from the Brussels-based think tank Bruegel pointed out a few days ago⁵, the position would be rather

⁵ See Politico (03 Dec 2017).



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toothless regarding both the enforcement of stronger fiscal discipline and the provision of fiscal means. In addition, it would blur the separation between the European Commission and European Council. As the President of the Eurogroup also chairs the ESM Board of Governors, it would also bring a future European Monetary Fund under close EC coordination. It might therefore be more sensible to make - as also proposed by Bruegel (and suggested in the Commission's June paper on EMU reforms⁶) – the Eurogroup President an independent full-time position that would also report to the European Parliament (alongside the ECB president). This would allow the Eurogroup chairman to fill her or his mandate undistracted from national responsibilities and would be a way give the currently informal Eurogroup a formal status.

Integrating Fiscal Compact into EU legal framework

The least controversial proposal in the Commission's reform package is probably the integration of the "substance" of the Treaty on Stability, Coordination and Governance (or just the Fiscal Compact, the treaty's key chapter) into EU law. Similar to the ESM, the Treaty was signed in 2012 against the background of the European sovereign debt crisis as an intergovernmental treaty. The implementation into EU law is explicitly foreseen in January 2018.

- But even if in principle the legal status of the Fiscal Compact is strengthened as part of the EU treaties, experience has shown that in practice, also within the EU's institutional framework, the Commission has very limited power in enforcing budget discipline on member countries - and where it has the power it has been less consistent and leaned toward a more flexible and political interpretation of the rules. At the same time, concerns based on press reports a few days ago that the Commission's reform package might contain proposals to weaken the fiscal criteria of the Stability and Growth Pact did not turn out to be well founded⁷.

A heated debate to be expected - not next week, but all the more next year

None of the outlined reforms in the Commission's Wednesday press release came as a real surprise as they have been promoted repeatedly over the last months and discussed in some detail in the June reflection paper on the future of the EMU. But the Commission's reform package does provide valuable details at a time when the political debate on further EMU integration is generally being kept very broad and unspecific. This also applies to the French government that - despite President Macron's inspired Sorbonne speech on Europe's future - so far has not provided any details on French reform ambitions. The most in-depth contribution to the debate besides the Commission's communication so far has been the "non-paper" by former German Finance Minister Wolfgang Schäuble. But Schäuble does not head the Finance Ministry any more. And given the lack of a new German government as well as uncertainty regarding its future composition, the German position also remains vague only one week before EA heads of state are expected to agree on a roadmap for further EMU integration. Accordingly, the acting German Finance Minister, Peter Altmaier, only gave a reserved comment on the Commission's advance, stating that the German government would read the proposals very carefully and join the reform debate process next year with their

⁶ See also Focus Europe (June 09 2017).

⁷ See Spiegel (01 Dec 2017).



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own positions⁸. This gives more than a hint of what to expect from next week's Council meeting.

The Commission's timeline for reforms is very likely to be pushed back and it is questionable whether agreement on the bulk of reforms can be found, as planned, before a new Commission is appointed in 2019. But even if it appears premature, the publication of their detailed reform package might still not be entirely mistimed. The Commission has the right of legislative initiative but next to providing direction is probably equally interested in keeping alive the debate and momentum for EA reforms that gained strength after the French elections earlier this year.

The question remains whether the current roadmap to EMU integration is capable of addressing the identified shortcomings of the EMU. Measures that lead to the completion of banking/capital markets union, such as the fiscal backstop for the SRF, might be sensible but require substantial risk-reduction in national banking sectors *ex ante* to be accepted by all member states. Some of the proposed reforms such as integrating the Fiscal Compact into EU law are warranted under the aspect of legal consistency and avoidance of duplication. For other proposals, including the legal status of the ESM or future EMF, the argumentation with respect to democratic accountability and financial stability is much weaker.

Proposals regarding further fiscal integration will remain exposed to the "asymmetry between national sovereignty and common solidarity" as described by Banque de France Governor François Villeroy de Galhau and his German counterpart Jens Weidmann in a 2016 joint article⁹. There is probably little appetite among the EA members calling for more solidarity and risk-sharing for further transfers of sovereignty to Brussels when it comes to national economic policies. At the same time, members adamant on maintaining the spirit of Maastricht and fiscal discipline are unlikely to accept macroeconomic stabilization instruments either funded from the EU budget or financed through the EMF if they fear that this might set wrong incentives and lead to moral hazard and free-riding. With proposed reforms concentrating additional competencies at the Commission, it can also be debated if this really leads to a "more United and more Democratic Union" as propagated by Brussels. Critics of a stronger integration among EA members emphasize that rather than leading to more unity, this might further alienate EU members that so far have refrained from adopting the single currency. Others, like Dutch Prime Minister Rutte, also warned that European politics should not be based on "symbolism" and that "integration for integration's sake will only harm public support for the European Union"¹⁰. Given Germany's political impasse and the short review period for the Commission's proposals, the debate in next week's European Council meeting is unlikely to be full-hearted. It can be expected to become all the more heated next year though.

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⁸ See Euractiv (07 Dec 2017).

⁹ See Bundesbank (08 Feb 2016).

¹⁰ See Politico (02 Dec 2017).



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