

The European Commission published in May the “Reflection paper on the deepening of the Economic and Monetary Union”, in order to stimulate the debate on the necessary elements to improve the functioning of the Economic and Monetary Union and its ability to adjust to shocks. In the paper, based on the “Five Presidents’ report” published in June 2015, the Commission recalls that the process of reform of the institutional architecture of EMU, necessary to support its medium and long-term prospects, is far from completion. To make further progress, the report proposes a plan of action based on three areas (financial, economic and fiscal union), accompanied by a strengthening of democratic accountability and of the euro area institutions. The actions, as detailed in the adjoining table, would be carried out in two stages: the first, which would last up until the 2019 elections to the European Parliament,

when a drive would be made to complete initiatives that are already under way (some of which should be concluded in 2017); for the second stage, until 2025, a still relatively open set of ambitious proposals is presented.

In relation to financial union, the Commission’s proposals seek to increase financial integration, strengthen the private risk sharing mechanisms and weaken the ties between banking and sovereign risk. First, the paper recalls the need to complete the banking union with the introduction of those elements that are missing: (i) the establishment of a common financial backstop to the Single Resolution Fund (SRF) to give credibility to its ability to address serious crisis situations, for example, through a European Stability Mechanism facility; and (ii) the creation of a European deposit

Table
REPORT RECOMMENDATIONS

Area	Recommendations for the first stage (2017-2019)	Recommendations for the second stage (2020-2025)
Financial union	Banking union	Continued implementation of capital markets union initiatives
	Implementation of risk-reducing measures for the financial sector	Roll-out of the European Deposit Insurance Scheme
	European strategy for non-performing loans	Transition to the issuance of a European safe asset
	Setting up of a common backstop for the Single Resolution Fund	Finalisation of changes to the regulatory treatment of the financial sector’s holdings of public debt securities
	Decision on the features of the European Deposit Insurance Scheme	
	Capital markets union	
	Finalisation of the initiatives under way in this area	
	Review of national supervisory authorities, as first step towards the creation of a single European capital markets supervisor	
	Start of work to establish sovereign-bond backed securities for the euro area	
	Economic and fiscal union	Further strengthening the European Semester, focusing more on the aggregate euro area dimension and technical assistance to Member States from the European Union
Preparation of the new multiannual financial framework for the European Union: greater link between national reforms and EU funding		Implementation of the new EU multiannual financial framework, with stronger focus on the incentives for reforms
Reflection on establishing a macroeconomic stabilisation function		Design, preparation and implementation of a fiscal stabilisation function
Strengthening of the democratic accountability of euro area institutions	Strengthening the dialogue with the European Parliament	Appointment of a full-time permanent chair of the Eurogroup
	Progress towards a single external representation of the euro area	Transformation of the Eurogroup into a Council configuration
	Proposal to integrate the Fiscal Compact into the EU legal framework	Unified external representation of the euro area
		Integration of existing intergovernmental arrangements in the EU legal framework
		Setting-up of a euro area Treasury
	Setting-up of a European Monetary Fund	

SOURCE: Banco de España.

insurance scheme which would give depositors confidence in the event of bank crises. In addition, in order to weaken the sovereign-banking link, the Commission suggests creating financial assets backed by the public debt of all the euro area countries, which in the short term would not involve risk mutualisation but which could possibly give rise to a common debt instrument. Lastly, the report calls for speedy completion of the capital markets union initiatives currently under way, which are intended to enable greater diversification of public sector financing sources, thus avoiding their excessive dependence on the banking system, and to strengthen private risk sharing mechanisms. Finally, the approval of a European framework for insolvency and a common strategy to lighten the burden that non-performing loans still entail for bank balance sheets is proposed.

In the area of economic and fiscal union, the Commission's proposals seek to stimulate the process of economic and social convergence among the euro area countries, so that their economies become more resilient to shocks and the long-term stability of the EMU is ensured. To encourage such convergence, the Commission proposes strengthening the coordination of economic policies within the framework of the European Semester, giving greater importance to the euro area dimension as a whole. Also, it mentions the possibility, already envisaged in the Five Presidents' report, of making this convergence process more formal and binding, by establishing "standards" for important aspects (such as the quality of public spending, investment in education and training, the opening of product and service markets, the efficiency and justice of tax systems and social benefits), and reinforcing the link between the degree of progress with national reforms and the volume of funding received from the EU budget.

It is also proposed to create a macroeconomic stabilisation function for the euro area, with restricted access to those countries that achieve minimum progress on structural convergence. This function would consist of a supranational stabilisation mechanism to complement the stabilising actions of national budgets. The European Commission suggests various alternative designs, including a European unemployment insurance system or an investment protection scheme.¹ In the longer term the possibility of creating a European Treasury is considered (which would be responsible for the economic and budgetary supervision of the euro area, the coordination of the issuance of the European safe asset and management of the macroeconomic stabilisation function) and of a European monetary fund (which would take over the current duties of the European Stability Mechanism), in which the future common financial support mechanism of the SRF could be incorporated.

Finally, the report makes recommendations in relation to strengthening the democratic accountability of the EMU and strengthening its institutions, which lead progressively to greater political integration in the euro area. In this respect, the desirability of strengthening the supervisory capacity of the European Parliament is considered, as well as the integration of the current intergovernmental treaties within the legal framework of the European Union.

¹ Chapter 4 of the 2016 *Annual Report of the Banco de España* discusses the various alternative designs for this type of fund and shows how with relatively moderate contributions a capacity to stabilise asymmetric shocks similar to that existing in the United States would have been achieved.