Waiting for the Five Presidents’ Report on the Future of the Monetary Union: What do we need to know?

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At the European Summit on 25-26 June Jean-Claude Juncker, the President of the European Commission, will be presenting a report on the future of the Economic and Monetary Union (EMU). It has been drawn up by the presidents of the EU Commission, the European Council, the European Central Bank, the European Parliament, and the Eurogroup, and is a sequel to the “Four Presidents’ Report” on the same topic that was compiled without the participation of the President of the European Parliament and presented in 2012. In this Flashlight we provide answers to key questions about the forthcoming report.

What is the Five Presidents’ Report about? And how does it differ from earlier reports on EMU reform?

There is general agreement on the need for reforms within the euro area. In the long run the retention of the current institutional structure is not a viable proposition. Several EU actors have already submitted specific proposals for reform. In 2012 van Rompuy, the then President of the European Council, published a report in conjunction with the leaders of the other EU institutions (the “Four Presidents’ Report”). The Commission contributed a blueprint for “a deep and genuine Economic and Monetary Union”.
The initiatives described a number of very useful reforms. However, they failed to generate very much support and were unable to keep up the political momentum.

The new Commission has now decided to resuscitate the reform debate. In February 2015 President Juncker presented a short “Analytical Note” that, although it contained a number of pertinent questions, merely restated what the problems are. After a series of consultations in recent months with the sherpas (who are the advisors of the national governments), Juncker has now announced a new report. It has an unwieldy title, “Report on Next Steps on Better Economic Governance in the Euro Area,” but will probably be known as the “Five Presidents’ Report,” or perhaps the “Juncker Report” because it has been drawn up by the President of the European Commission in conjunction with the heads of the European Central Bank, the Eurogroup, the European Council, and the European Parliament.

Have the reforms introduced in the euro area in the recent past been insufficient?

It is true that a great deal has already been achieved. For example, the EU has tightened the fiscal rules, especially as they relate to the members of the euro area. A Macroeconomic Imbalance Procedure (MIP) has been established within the framework of the European Semester in order to monitor (and ultimately to reduce) the imbalances between the member states. The EU has also created the European Stability Mechanism (ESM), a permanent institution that provides financial assistance to euro area countries in crisis. The Banking Union was established in May 2014 after a lengthy series of negotiations. These are substantial changes, and they are a remarkable achievement.

However, the reform process seems to have come to a standstill. We do not believe that the present architecture can provide long-term stability. For example, the current mechanism for dealing with countries in crisis, which relies heavily on intergovernmental negotiations, is clearly not working particularly well. In many member states, there has been mounting discontent as a result of the EU’s hard-handed approach. And in many of them there continue to be serious economic problems. Private sector imbalances persist. The recovery is still rather weak. And structural reforms are behind schedule. Jean-Claude Juncker and ECB President Mario Draghi now seem determined to introduce further reforms. There is a renewed sense of urgency, and it is entirely justified.

What issues does the report need to address?

In order to strengthen the monetary union, there is a need for specific proposals in five areas. These are as follows:

- Achieving real and indeed greater structural convergence between the member states;
- Dealing with the moral hazard problem and free-riding by member states;
- Moving towards greater fiscal and financial risk-sharing by the member states;
- Monitoring more effectively the way in which these structures operate, e.g. with the help of indicators that measure economic convergence accurately; and
- Addressing the “social dimension” of the EMU. Euro area stability is not an end in itself, but is supposed to contribute to the social, economic, and political welfare of its citizens.

Perhaps most importantly, the report should submit proposals on how to enhance the legitimacy of the EMU in general and of the ESM and the Troika in particular. Much of what is happening within the framework of the EMU is perceived to be lacking in legitimacy and devoid of accountability. There is clearly a gap between the democratic processes and the technocratic side of the monetary union, the economic union, and the banking union.
Can the plan succeed? And are the member states willing to move ahead with reforms in the euro area?

Currently the member states do not seem to be very interested in reform, even though there is broad, albeit rather vague agreement among them that the present economic governance framework is not delivering satisfactory results. However, the preparation of the report and the consultations with the member states have shown that there is a fundamental lack of consensus in two areas. Are the existing rules and institutions (theoretically) sufficient to promote economic convergence? And do they provide enough protection when there is a crisis? The member states also disagree when it comes to the timing of reforms and the way in which they are introduced. In general terms there are three groups of countries.

A number of member states believe that the euro area does not need more changes, and that at this stage policy-makers should concentrate on the correct implementation of the reforms that have been launched over the past five years. The Netherlands and Finland tend to be associated with this position. They speak on behalf of a group of smaller countries which want to retain the old “rules-based” system.

Other member states have suggested minor modifications of existing procedures such as the European Semester in order to improve structural reforms, e.g. by means of recommendations that focus on fewer priority targets. This would go hand in hand with efforts designed to enhance the ownership of reforms by giving greater leeway to domestic political processes, and to blunt the edge of popular protests against interference from Brussels by introducing coordinated social policies. A recent Franco-German initiative points in this direction. It is a pragmatic proposal that reflects the need to reach balanced compromises between the two countries. Yet this approach is clearly an intergovernmental one, and shows little sign of giving the Commission more rights when it comes to national economic policies.

Finally, a third group of member states is in agreement with the Commission and the European Parliament and believes that far-reaching steps are needed in order to ensure the long-term survival of the common currency. These could include new ways of promoting reforms via contractual agreements, increased sovereignty-sharing in the shape of a coordinated fiscal stance for the euro area, and extensive fiscal risk-sharing arrangements that could include European deposit scheme and a European unemployment insurance. The Portuguese prime minister has come out in favour of such a stance, which has received broad support from Italy.

Will it be necessary to amend the EU treaties?

At this stage this is not of crucial importance. Content is far more significant. A great deal of progress can in fact be made within the framework of the existing EU Treaties. It would seem to be a good idea to pursue this path, at least initially, since the treaties will probably not be amended before the end of the decade. However, it needs to be said that in the medium term fundamental reforms of the EMU will make it necessary to amend parts of the treaties.

What will be the impact of the Five Presidents’ Report? Is everything going to be different this time round?

There has not exactly been a dearth of proposals for reform in recent years and a great deal of political capital has been invested in the Greek crisis and the UK referendum.

The report will most likely be published (or leaked) before the European Summit on 25-26 June 2015. However, the “Grexit” debate continues to be high up on the agenda, and this could lead to a postponement of the report until October.

It is possible that external events will make it necessary to defer the publication of the report. Be that as it may, the future of the reform process will depend on two main factors. These are:
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- The specific content and aims of the report; and
- The ability of the member states to reach a consensus on the issue of reforms, and their willingness to carry on with the process.

**Scenario 1: Unambitious proposals followed by a lengthy consultation process**

The report contains proposals for immediate reforms which are limited to the few areas in which member states can reach agreement without further ado. A commitment to more market integration and some minor changes to the European Semester would be obvious topics. In order to appease the more ambitious member states, this would be supplemented with the prospect of a consultation process. A commission of experts would be given the task of preparing the groundwork for more sizeable reforms in the years ahead. A gradualist approach could have a very positive effect. It could prepare a consensus on a “grand reform” by making the kind of steady progress that in the course of time will win the trust of EU governments – and citizens. However, in this scenario there is a risk that the political momentum will peter out, and that it will have disappeared when the next major crisis hits the (still incomplete) euro area.

**Estimated likelihood: 20%**

**Scenario 2: The report as a starting-point for far-reaching reforms**

The report succeeds in striking the right sort of balance. It is as specific as possible on the one hand, but does not rule out the possibility of further debates and negotiations within and among the member states. It manages to take into account the aversion of the member states to amending the treaties at short notice, but simultaneously persuades them to adopt a clearly defined road map for reform. The report provides for a realistic way of conducting a much-needed debate on the level of the member states that will eventually lead to far-reaching governance reforms in the euro area.

**Estimated likelihood: 20%**

**Scenario 3: An ambitious initiative that quickly fades away and is forgotten**

The member states pay lip service to the report, but shortly afterwards it comes to grief in the Brussels corridors of power. There is a distinct possibility that the report will share the fate of previous initiatives, especially if the Commission and the other authors forge ahead with their ambitious and specific plans for reform in a bid to revive the momentum, but misjudge the willingness or otherwise of member states to introduce reforms and indeed their ability to reach a compromise. To all intents and purposes this scenario adds up to a missed opportunity for reform.

**Estimated likelihood: 60%**

In the long run EMU is not viable in its present form. Thus the Five Presidents’ Report could turn out to be an important initiative. President Juncker and President Draghi deserve credit for putting a great deal of energy into the process. The second scenario may be wishful thinking, but in the long term it would ultimately be in the best interests of all of the member states. For this reason we should not disregard this option.

However, at this juncture we continue to be sceptical about whether the member states will support the initiative. But something has to be done now, and not at some point in the distant future. The Commission should therefore proceed cautiously if it wishes to avoid the third – and most likely – scenario. And the member states for their part should not throw away this opportunity by refusing to follow the Commission’s lead.
Further information

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The pilot study “Repair and Prepare” can be downloaded at https://www.bertelsmann-stiftung.de/de/publikationen/publikation/did/repair-and-prepare/.

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