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THE ECONOMIC AND MONETARY UNION

What is the Economic and Monetary Union?

The Economic and Monetary Union (EMU), launched in 1992, involves the coordination of economic and fiscal policies, a common monetary policy, and a common currency, the euro. Whilst all EU Member States take part in the economic union, some countries have taken integration further and adopted the euro. Together, these countries make up the euro area.[1]

The operations and management of the EMU are designed to support sustainable economic growth and high employment through economic and monetary policy. This involves four main economic activities:

- implementing an effective monetary policy for the euro area with the objective of price stability
- coordinating economic and fiscal policies in EU countries
- ensuring the single market runs smoothly
- supervising and monitoring financial institutions[2]

History

Timeline[3]

1978	The Werner Report sets out a process on how to achieve a monetary and currency union.
	Governments set up the Exchange Rate Mechanism (ERM) to reduce volatility between European currencies.
1989	The Delors Report maps out the road to EMU in three stages:
1990	Start of 1st stage of EMU: closer economic policy coordination and liberalisation of capital movements.
	Britain joins the ERM.
1992	Maastricht Treaty setting up the EU and committing EU countries to EMU.
1994	Start of 2nd stage of EMU: creation of the European Monetary Institute (EMI), a precursor to the ECB.
	Member states are required to work to fulfil the five convergence criteria.
1995	European leaders agree to call the new single currency the euro. Stage 3 of EMU is set out.

1 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/economic-and-monetary-union/what-economic-and-monetary-union-emu_en
2 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/economic-and-monetary-union/how-economic-and-monetary-union-works_en
3 https://www.europarl.europa.eu/RegData/etudes/IDAN/2016/578970/IPOL_IDA(2016)578970_EN.pdf p11

1997	The Stability and Growth Pact is agreed at the Amsterdam EU summit, to ensure that Member States maintain budgetary discipline in the EMU. The European Council also agrees on the revised exchange rate mechanism (ERM II), which links the euro and currencies of non-participating member states.
1998	The European Council agrees to launch the third stage of EMU on 1 January 1999 and states that 11 of the 15 Member States meet the criteria to adopt the single currency. It establishes the ECB, which replaces the EMI as of 1 June 1998.
1999	Start of 3rd stage of EMU: the euro is launched as a virtual currency for 11 Member States.
2000	Full introduction of euro notes and coins.

Crisis

A specific feature of the monetary union has been the large (private and public) capital flows which took place in the decade before the financial crisis between the "core" and the "periphery" of EMU, with the latter borrowing massively from abroad. When the crisis started in mid-2007, there was an abrupt reduction in cross-border lending. This led to a deterioration in the financial position of banks in the countries depending on foreign lending. As governments stepped in to save their banks, government deficits increased, also due to lower growth, and economic imbalances widened. The current account/financial crisis mutated into a government debt crisis. EMU mattered because (rising) cross-country imbalances were supposed to self-adjust. It did not happen. The lack of a governance framework and of an automatic shock absorption mechanism (either temporary or permanent) to deal with the impact of EMU-wide and country-specific shocks amplified the effects and the persistence of the crisis.[4]

Reforming and completing the EMU

The financial and economic crisis exposed the underlying weaknesses in the governance structure of the EMU. It showed that national economic policies are a matter of vital common interest in a monetary union. Lax policies by a Member State can have dangerous spillover effects, jeopardising the stability in the whole euro area system.[5]

In 2015, the European Commission published the report, 'Completing Europe's Economic and Monetary Union', which proposed a two-stage implementation process with measures for economic, financial, fiscal and political union.

[4] https://www.europarl.europa.eu/RegData/etudes/IDAN/2016/578970/IPOL_IDA(2016)578970_EN.pdf p4
[5] https://ec.europa.eu/epsc/publications/five-presidents-report-series/better-economic-governance_en

Stage 1 (until 2017) comprised reforms that built on existing instruments and could be implemented within the current legal framework: completing the Banking Union, launching the Capital Market Union and streamlining the European Semester.

Stage 2 (until 2025 at the latest) encompasses reforms that require amendments to existing treaties: formalising and making more binding the convergence process for the economic union; setting up a macroeconomic stabilisation mechanism for the fiscal union; strengthening accountability and legitimacy for the political union.[6]

Progress to strengthen the EMU so far:[7]

Economic Union

- Macroeconomic Imbalances Procedure: early identification of threats to stability
- Revamped European Semester with more emphasis on social issues
- Euro area recommendations
- Structural Reform Support Service: technical support for reforms in Member States
- European Pillar of Social Rights: principles to support fair and well-functioning labour markets and welfare systems
- Social impact assessment for the latest stability support programme for Greece
- National Productivity Boards to monitor productivity/competitiveness developments
- Proposals to establish dedicated budgetary instruments for the EMU

Financial Union

- Harmonised rules for a more resilient, transparent and efficient financial sector
- Banking Package: reforms that aim to strengthen the resilience and the resolvability of EU banks, including a proposal for a European Deposit Insurance Scheme
- Harmonised rules for deposit insurance: deposits protected up to €100,000
- Single Supervisory Mechanism/Single Resolution Mechanism: centralised supervision and resolution of banks in the euro area
- Capital Markets Union: new rules to promote capital mobility and private risk sharing. Strengthen access to finance by boosting market-based funding, in particular for innovation and start-ups

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[6] https://www.europarl.europa.eu/RegData/etudes/IDAN/2016/578970/IPOL_IDA(2016)578970_EN.pdf p16
[7] https://ec.europa.eu/info/sites/info/files/economy-finance/factsheet_economic_and_monetary_union.pdf

Fiscal Union

- Financial support for Member States in difficulty: various rescue funds leading to the European Stability Mechanism
- 2-Pack/6-Pack legislation: stronger budgetary surveillance and focus on debt
- European Fiscal Board: independent advice on the implementation of EU fiscal rules and euro area fiscal stance
- Simplifying fiscal rules with a greater focus on the public expenditure benchmark
- Flexibility within the Stability and Growth Pact: to support investment and reforms and to better reflect economic cycles

Political Union

- Increased ownership: intensified dialogue with the European Parliament, national parliaments, national governments and stakeholders
- More opportunities for social partners to discuss priorities
- Stronger focus on the international role of the euro and proposal to strengthen the external representation of the euro area
- Proposals to integrate intergovernmental agreements into EU law and to strengthen efficiency and accountability through a European Minister of Economy and Finance

Remaining challenges

- Budgetary Instrument for Convergence and Competitiveness (BICC)

Anchored within the EU budget, this instrument will support euro area Member States in their structural reforms and investment. Member States will submit to the Commission on a voluntary basis their investment and reform proposals, and if the proposals meet the transparent criteria, the Member State will receive financial support, subject to meeting agreed milestones.

- Reform of the European Stability Mechanism (ESM)

The ongoing reform of the ESM Treaty is meant to further strengthen crisis prevention and resolution in the euro area. This will include clarifying the eligibility conditions for ESM support, ensuring an operational and effective common backstop to the Single Resolution Fund in the form of a credit line, and provision of liquidity in resolution.

- Banking Union

The Banking Union was always intended to consist of three pillars – single supervision, single resolution, and a single deposit insurance scheme. Both the Single Supervisory Mechanism and the Single Resolution Mechanism are already operational but there has been little progress on the third pillar: a common depositor protection mechanism. Guaranteeing deposits on a European level would ensure that all deposits are equally protected across the Banking Union and thereby strengthen the confidence of depositors and mitigate the risk of bank runs. While significant progress has been achieved in harmonising the Single Rulebook, more should be done to remove unnecessary obstacles to the cross-border integration of the banking system.

- Capital Markets Union

The Capital Markets Union contributes to stability and resilience of the financial system and aims to get money - investments and savings - to flow more easily across the EU so that it can benefit consumers, companies and investors in a sustainable way. The European Parliament and the Council have now agreed 11 out of 13 legislative proposals. The agreed legislation must now be implemented.

- Economic Surveillance

In recent years, the fiscal deficit and debt of the euro area as a whole have been considerably reduced. The Commission will take stock of the implementation of the framework for economic and fiscal surveillance with the review of the two-pack and six-pack legislations, which should eventually pave the way towards simpler EU fiscal rules. The review could also provide the basis for further improvements in the transparency and effectiveness of the policy coordination framework and to reinforce the social dimension of the surveillance framework.

- Institutional Strengthening

To increase transparency and democratic accountability, the Commission proposed to appoint the same person for the positions of the Vice-President of the Commission in charge of Economic and Monetary Union and the President of the Eurogroup. In addition, the ESM should be integrated in the EU legal framework over time and a euro area Treasury could take shape, to access financial markets on behalf of its members to fund part of their regular refinancing needs.

- Fiscal Stabilisation

One lesson of the crisis was that the current framework is ill-equipped to tackle very large country-specific or euro area-wide shocks. A common stabilisation function would be an important complement to national budgets. In 2018, the Commission made a proposal for an up to €30 billion European Investment Stabilisation Function to stabilise public investment levels in the event of severe economic shocks. This proposal remains relevant and should be seen as a complement to the Budgetary Instrument of Convergence and Competitiveness for the euro area.