



Italian Position Paper

Reforming the European Monetary Union in a stronger European Union

Recent geopolitical developments together with the great economic and financial crisis have put the European project under tension. In the urgency of the crisis some important institutional reforms have been delivered but a bold and ambitious policy action is now required. Italy proposes:

- A new approach to European public goods, namely by providing and funding
 - the co-management and co-financing of migration policy at European borders;
 - a fully implemented European Defence Action Plan;
 - scaled up internal and external security capabilities;
 - a permanent Juncker plan focused on innovation-driven investments with relevant across Member States externalities. In this perspective, a coordinated corporate taxation policy is key;
 - an enhanced across Europe mobility of young generations and a “no European child is left behind” programme.
- To improve the fiscal framework in order to boost structural reforms and investments;
- To draw the implications of an Euroarea fiscal stance in policy recommendations to Member States;
- To deal with macroeconomic imbalances in a symmetric and more effective way;
- A stabilization function for the Euroarea;
- To complete the Banking Union;
- A new role for the European Stability Mechanism;
- A European Finance Minister.

After 60 years of peace and growth ...

Sixty years ago, six European countries decided to embark on an integration path to achieve two fundamental public goods: a lasting peace and a continuous improvement of the living conditions. Unquestionably, these 60 years of European integration gave us the longest period of peace our continent has ever known; overall, it has been a formidable season of economic and social development that has also made Europe the world's most successful region in offering an extensive and solid social security net.

However, recent geopolitical developments together with the great economic and financial crisis have put the European project under tension. In the urgency of the crisis some important institutional reforms have been delivered but, despite undeniable progress and efforts, a further change of gear is now necessary to definitely overcome the legacy of the crisis, to boost jobs creation especially among the young and promote convergence to strengthen a sustainable and inclusive growth.

ambitious policy action is required to re-launch European integration.

Political risks and uncertainties, raising from populist and nationalist threats, geopolitical tensions and trade frictions challenge the very essence of our common adventure. A bold and ambitious policy action is required. European institutions have to deliver common public goods – in order to regain the consensus of our citizens.

The reform/reshape of the EMU is part and parcel of this process since a smooth functioning of the currency union and a strengthened European Union are mutually self-sustaining.

The elements required to make the European Union stronger and to complete the Economic and Monetary Union are the following:

1. Improvements in economic governance to increase growth potential and boost convergence;
2. A new approach to the European Union public goods;
3. Introducing a stabilization function for the Euroarea;
4. Completing the Banking Union;
5. A coherent new institutional architecture

1. Improvements in economic governance to increase growth potential and boost convergence

To support a sustained and inclusive pace of growth ...

A **comprehensive policy approach** is required to support a sustained and inclusive pace of growth. Growth-friendly macroeconomic policies need to be matched by relevant structural reforms. In highly integrated economies, decisive coordinated policy action is especially needed to address macroeconomic imbalances, promote more convergence and resilience to shocks.

The aftermath of the great crisis vividly showed that the **European economies were not equipped with the right tools** to cope with large shocks. Fiscal policies in particular have generally disappointed in their stabilization function, being often pro-cyclical and over-burdening monetary policy; moreover, at the peak of the crisis some Member States experienced serious difficulties in accessing the market, that hampered the basic functioning of the automatic stabilizers when they were mostly needed. These dynamics

accelerated the divergence process especially within the Euro area, weakening the growth potential via a reduction in investment in fixed and human capital.

the EU needs to amend its fiscal rules and the MIP, also designing a Euroarea fiscal capacity.

The reforms agreed in response to the crisis (notably the strengthening of the governance framework, the reform of the regulatory and supervisory framework, the establishment of financial mechanisms, notably the European Stability Mechanism - ESM) are encouraging but partial steps, insufficient to effectively endow the Union with the much needed tools to steer convergence, growth and resilience to shocks. It is time to intervene and amend the fiscal rules and the macroeconomic imbalance procedure (MIP), paving also the way for the design of a Euro area fiscal capacity.

Fiscal rules. – The framework of fiscal rules should provide the **right incentives to growth-friendly fiscal policy and to continuous reform effort.**

Overall, the fiscal rules provided by the Stability and Growth Pact evolved to adapt to changes in the economic scenario especially when structural breakups occur. The introduction of specific incentives to support investment and reform implementation has been a positive development to better link growth friendly policies and long term-sustainability, but they have been limited in time.

On the other hand the unusual characteristics of the current recovery, still influenced by the legacy of the crisis, and the difficulties and uncertainties affecting the estimates of structural variables have put into question the appropriateness of the policy guidance given to countries, also undermining its ownership. Improvements in the methodology to identify cyclical conditions, including the swift implementation of a country-specific approach in the definition of output gaps are necessary.

Thanks to an implementation of the Stability and Growth Pact which has given more leeway to economic judgment within the existing rules, the negative impact of the crisis on public finances has been successfully offset and currently deficit is below 3% in almost all Member States, while debt is on a declining path. Restoring a sustainable pace of growth and job creation is now the highest priority and also the most effective way to keep debt on a sustainable path.

The investment and structural reform clauses should be more accessible ...

The **Commission's communication on flexibility** in the Stability and Growth Pact marked a step forward in improving the policy mix by providing incentives for reforms and investment. It strengthens the coordination between structural and fiscal policies triggering a virtuous circle: structural action and investment boost medium-term growth thus supporting consolidation of public finances. However, the effectiveness of the current flexibility clauses is limited as prerequisites to access the incentive are far too strict and their time horizon is not consistent with the multiannual dimension of investment and reforms. **The investment clause and the structural reforms clause should be swiftly extended and made** more accessible, while a multiannual approach should be promoted.

Criticism on the complexity of the existing framework of rules has prompted a debate on simplification that finds in a **larger role of markets** in enforcing fiscal discipline an apparently easy solution. This is not the right approach. The pro-cyclicality of markets' assessment can negatively contribute to turn a financial crisis into an economic one and can harshen the depth and length of the recession.

Actually, during the last crisis, specific policy decisions on sovereign debt treatment have triggered an escalation of financial instability in the Euroarea leading to the loss of market access by several Euroarea Member States with higher costs in terms of financial assistance provisions, while further weakening the overall economic performance of the Euroarea.

Indeed current spreads among sovereign bonds show, despite the unconventional monetary policy in place, that market incentives to a responsible fiscal policy are already in place. Experience warns against further measures that would be pro-cyclical, counterproductive and detrimental to financial stability.

while a more effective implementation of the MIP will address Euroarea imbalances.

Macroeconomic Imbalances Procedure (MIP). – The framework of the MIP, while proving to be a useful tool in supporting domestic reform efforts, has not been effective in addressing – especially **in the Euroarea** – the **serious imbalances** represented by current account surpluses.

Despite being developed in the wake of the crisis with the aim to detect and manage other sources of imbalances than those already under the scope of the excessive deficit procedure, the MIP has only partially succeeded in focussing policy makers' attention on a broader range of issues. The negative spillovers stemming from the asymmetries in the requirements to surpluses and deficit countries have not been considered in the framework, thus entrenching the deflationary environment, increasing the adjustment costs for the deficit countries and overburdening the single monetary policy.

A more effective implementation of the MIP procedure is therefore warranted, including more decisive policy action to boost domestic demand and improve wage setting mechanisms where appropriate, to achieve a policy mix that maximises the collective interest of the Member states.

The way forward. – The overall approach is still suboptimal and there is room for improvements to achieve the right balance between sustainability and stabilization especially in the Euroarea and to effectively pursue the objective of convergence.

Within the Euroarea, the fiscal stance goes beyond the mere sum of national performances. A close link should be established between the analysis and policy recommendations at the aggregate level and their implications for individual countries, taking into account the spillover effects of national fiscal stances on the Euroarea at large.

The EMU should be endowed with an aggregate fiscal stance and stabilization function managed by a European Finance Minister.

In the long run, the current framework will have to evolve in a much simpler **institution-based architecture** with the definition and recommendation of an aggregate fiscal stance and fiscal stabilization both managed by a European Minister of Finance subject to democratic and parliamentary control. Increased degrees of fiscal integration towards a genuine **fiscal union** will imply significant transfers of sovereignty towards the establishment of a **political union**. At that stage, the European Finance Minister will have the responsibility of the implementation of the fiscal stance in the Euroarea and of its optimal distribution across countries.

A **continuous reform effort** in all Member States is key to favour convergence and positive spillovers, especially in the Euroarea where it represents a crucial ingredient to strengthen the monetary union and its capacity to adjust to shocks. The added value of

coordinated reform effort at EU and national level should be fully exploited, with the definition of specific multiannual action plans.

Initiatives at EU level should be complementing national investment and domestic action for the implementation of the European Semester Recommendations according to the overall policy guidelines. To maximise the positive impact on potential growth they should support the completion of the Single Market, improve the business environment, promote a better functioning of the public administration and of the judicial system, focus on research, education, mobility and knowledge-based initiatives to improve human capital.

Financial support of reforms should be envisaged. Therefore, **financial support of country-specific reforms** should be envisaged providing incentives to implement reforms that foster convergence in a multiannual perspective, to overcome the short time horizon implicit in current rules as well as to improve the ownership of the process.

2. A new approach to the European Union public goods

Common challenges are better served at the EU level ... In several cases common challenges are better served at European level because they would benefit from spillovers across Member States. European Union public goods whose supply should be stepped-up by a strengthened EU budget are:

- **Management of EU borders:** despite many initiatives taken in the recent past, with the direct contribution of countries in the frontline and specifically by Italy with regard to the Libyan migration route, an effective response at the European borders requires a common action. As far as migration is concerned, being the European frontier an EU public good, it needs to be (co)managed and (co)financed by the EU;
- **Defence:** the challenges stemming from the uncertain global geopolitical scenario, including Brexit and new forms of terrorism threat call for a strengthened cooperation in the field of European Union's defence. Relevant steps in this direction have already been taken at EU level, starting from the European Union Global Strategy (EUGS) proposed by the High Representative and approved in June 2016. In addition, as solicited by the European Defence Action Plan (EDAP) issued by the European Commission in November 2016, the development of joint research and joint capabilities and of an efficient and competitive internal market in this area can significantly contribute to the achievement of a more effective coordinated action. A growing cooperation among Member States to develop and acquire key defence equipment is expected to ensure value for money and a more efficient defence spending thanks to economies of scale. To this end, great importance should be attached to the full implementation of the European Defence Fund (EDF) and to the development of a related, proper and flexible, financial toolbox to support investment in joint research and the joint development of defence equipment and technologies;
- **Security:** an effective development of internal and external security capabilities, including cyber-security, and the fight against terrorism financing require a European effort towards more coordinated and centralized policies;
- **Common investment initiatives** for projects with relevant spillovers across Member States should be implemented to support a **stronger and more convergent real**

economy. The **Juncker plan** should be further exploited and become permanent to reinforce EU-wide job-creation and innovation-driven investments.

They include a strengthened investment strategy to spur growth potential, with a focus on cross border initiatives, actions to ensure a strong and competitive industrial base to the Single market and its completion especially as concerns the Innovation Union, the Digital Union, the Energy Union and the Capital Market Union.

Within this framework, the **role of the European Investment Bank** is crucial and the scope and the size of its activity need to remain aligned with the objectives of the European Union policies.

The implementation of an effective investment strategy in the internal market would also require closer coordination in the area of taxation. Advancing the CCCTB proposal would improve the functioning of the internal market and foster investment by establishing a certain, stable and coherent tax environment for business operating cross border. In addition, common initiatives aimed at implementing a consistent tax framework for the digital economy would favour the realization of the Digital Union.

➤ **Strengthening the European citizenship:** EU programmes investing into young and future generations are key to reinforce integration across Member States. Additional resources should be mobilized to promote European mobility, notably through Erasmus programmes, and to launch new transnational cultural initiatives, contributing to the development of a true sense of European citizenship and identity.

Furthermore, all the needy European children should be entitled to a Europe-wide, basic income, showing the commitment of EU institutions towards future generations; for example, each child would receive a certain fraction of the country's median income to support her/his study and living standards, thus ensuring that **no European child is left behind.**

financing public goods in a stepped-up common budget. EU The EU budget performs a key role through its **cohesion policy** to support convergence and boost the growth potential of the European economies. In perspective, its role in financing the European common goods should be stepped up in the new Multiannual Financial Framework. This calls into questions the **size of the overall budget and its financing.**

The size of the EU budget should be adequate to meet the political priorities and to face new challenges. It is also essential to establish a more transparent and flexible system, based on “genuine” own resources, to quickly react to new crises and evolving priorities. A further simplification of the financial rules should be enacted, to reduce the burden on the beneficiaries thus increasing the effectiveness of the EU policies.

The following **possibilities should be explored**, combining far-reaching political ambition with a pragmatic approach.

First of all, the suggestions of the Monti Report on Own Resources, offer innovative proposals involving both the expenditure and the revenue side to **establish a link between common sectorial policies and specific forms of revenues** collected on the basis of an EU common framework (i.e. carbon taxation, energy taxation or digital

taxation). Additional sources could also involve a visa tax earmarked to migrants related expenditure or the establishment of a common corporate taxation.

Secondly, an alternative or combined source of financing could come from **stepping up national resources**. In this respect, it should be considered that the provision of common goods would increase the overall efficiency, saving part of the resources currently spent at the national level for the same purposes. Thanks to increasing returns to scale at the European level, more resources would be available for the EU budget, without increasing the overall tax burden on citizens, which instead could be possibly reduced.

3. Introducing a stabilization function in the Euro area

The Euroarea needs a stabilization function to smooth the fluctuations of the economic cycle ...

Although the collective response of the EMU to the economic and financial crisis has been remarkable, the area still suffers from vulnerabilities stemming from the **incompleteness of its construction** vis à vis other monetary unions, especially as regards the resilience to shocks.

While modest episodes of downturns can be addressed at national level with the operation of domestic stabilizers, the depth and length of the economic and financial crisis as well as its long lasting impact on growth potential, have proved the inadequacy of the current EMU framework to cope with more significant shocks. Internal adjustments mechanisms at play in the absence of the instrument of the exchange rate and of a balanced effort to support demand, have resulted in pro-cyclical policies and deflationary pressures that resulted in increased economic divergences across the EMU, while overburdening monetary policy.

It remains to be seen whether the current budget structure could fully serve the purpose of performing a stabilization function. The idea of building a specific EMU budget should not be ruled out. Without prejudice to possible developments in this direction, incremental steps should be taken starting from the current institutional setup.

A common stabilization mechanism to smooth the fluctuations of the economic cycle would ensure that countries under fiscal constraints do not have to cut automatic stabilizers and/or investment during severe crises when they are most warranted. The mechanism would support domestic adjustment processes and reduce overall negative spillovers. In addition, such a cyclical shock absorber would avoid cyclical downturns turning into permanent structural losses of output and employment. Even countries that do not directly benefit from the mechanism would gain in the medium term from a more stable macroeconomic environment, with strengthened demand and, in the long run, from better growth perspectives of the other countries.

avoiding permanent transfers and preventing moral hazard.

A rainy day fund. – A common stabilization instrument – via the creation of a rainy day fund – should be based on the principles to avoid unidirectional permanent transfers and prevent moral hazard. To this aim:

– The transfer of resources from the fund would be only made in the presence of **significant shocks** with resources transferred being proportional to the intensity of the shock.

- The entire transfer received must be **repaid over time** – thus concretely working as an interest-free loan; for this reason and because the mechanism is activated in response to cyclical movements only, and shocks tend to be evenly distributed among countries over the long term, there will be no countries that are net beneficiaries or net contributors for significant amounts over the long term.
- The **activation** of the mechanism should be **automatic** as much as possible so that the activation of the shared resources is largely outside the control of national governments and of discretionary decisions. Within this setting, beneficiary countries would still bear the responsibility of addressing structural imbalances while the **timeliness and predictability of the intervention** of the fund would maximise its effectiveness.

A rainy day fund triggered by cyclical increases in unemployment would satisfy these conditions. The establishment of the Fund would not require changes in the EU Treaty.

In addition, **the resources transferred to the beneficiary countries will be earmarked to policies in favour of the unemployed**, in respect of the specific characteristics of the national labour markets. The earmarking of resources to the unemployed would be particularly effective in rapidly tackling the impact of a severe economic downturn. Moreover, it would give a strong political signal of the commitment of policy makers to address the impact of shocks with a common response to address fragmentation among European citizens. The mechanism would counter the effects of asymmetric shocks but can also be designed to tackle symmetric shocks with the introduction of a common issuance capacity.

Furthermore, **the establishment of an unemployment scheme will enhance the implementation of reforms** that are key for a better functioning of the EMU. In the long run it could stimulate convergence of different labour market institutions, stimulate reforms to modernize the EU social model to promote and facilitate adjustments that are taking place all across the EU and add the European dimension which is necessary to achieve successful policy coordination.

At the same time, public investment should be protected during cyclical downturn.

Common public investments. – Different forms of stabilization could also be envisaged with the aim of **favouring public investment to increase potential growth and, especially, protecting them during cyclical downturns**. Public investments would be effective as stabilizers in the medium term but it would be difficult to activate them in an automatic way to counter a downturn; therefore, they are likely to have a slower and more gradual impact on demand compared to unemployment policies. Stabilization through investment could then be **complementary** to the functioning of a mechanism aimed at supporting the unemployed.

An improved fiscal framework could be envisaged with the aim of ensuring stable investment flows over time, independently of the economic cycle. A double track approach should be promoted: strengthening the investment capacity of the EU and notably of the EMU, and promoting investment strategies at national level. A more accessible and expanded investment clause including a stable favourable treatment within the Stability and Growth Pact for national expenditure co-financed by the EU, would serve the purpose. In such a framework the Member State facing fiscal strains would not

suffer severe cuts in public investment expenditure, thus reducing hysteresis effects on growth potential.

4. Completing the Banking Union

To complete and strengthen the Banking Union ...

Completing and strengthening the Banking Union is essential to ensure effective transmission of the single monetary policy, better risk diversification across Member States and adequate financing of the economy. This in turn, supports the recovery of credit activity and boosts growth perspectives. The agreement reached on the way forward with the Luxembourg road map in June 2016 stresses the importance of **proceeding in parallel with risk sharing and risk reduction measures**.

Since the outburst of the economic and financial crisis, **a lot has been achieved to reduce risks**, notably by strengthening prudential safeguards of banks with increased capital and liquidity requirements; by reinforcing supervision through in-depth EU wide stress tests and by creating the Single Supervisory Mechanism. A further risk reduction package is currently under discussion in the Council. Moreover, by implementing domestic legislation following the Bank Recovery and Resolution Directive and with the establishment of the Single Resolution Mechanism, the risk for the involvement of the public sector has been significantly limited.

it is important to proceed in parallel with risk sharing and risk reduction.

The agreed road map should be followed with the implementation of the agreed risk sharing and risk reduction measures, including the initiatives foreseen in the 2017 Action plan on NPLs endorsed by the Ecofin.

To further reduce risks, besides the on-going process for the reduction of NPL – over the appropriate time horizon – and the improvement of the overall effectiveness of the insolvency frameworks, other aspects should be considered: to ensure more transparency in the banks' balance sheets **a new task force should be established to evaluate the risks of the illiquid securities** and of the adequacy of the internal models that banks use to value their assets, **especially the so-called “Level 3”** – complex derivatives, structured securities, but also simple bonds that don't have a specific market.

The package should be completed by the generalized use of IFRS for financial statement by all the banks in the Banking Union, including the less significant ones, in order to allow an effective comparability of the risks, and enhance the supervisory toolkit.

The framework is still far from being completed, i.e. **to be endowed with adequate risk sharing tools** to address systemic crises. In particular to ensure credibly a uniform degree of protection to depositors across the Banking Union, regardless of the Member State where the deposits are held a **European Deposit Insurance Scheme (EDIS)** needs to be established to provide full funding of the liquidity need for a pay-out event and cover all the related losses. The establishment of an effective common backstop to the **Single Resolution Fund (SRF)** is key to enhance its financial capacity and the overall credibility of the Single Resolution Mechanism, as agreed in 2013. Both measures would boost confidence in the Banking Union, which is the key ingredient for the success of banking systems and contribute, in turn, to reduce risks.

The common backstop to the SRF and the EDIS could be run by the ESM. The procedures to be established to provide financing should ensure a swift and timely

intervention. Given that both supervisory competences and the management of the SRF and the EDIS would be centralized at the European level, no conditionality on the MS where the concerned banks are based should be foreseen when the common backstop is called to intervene. The **size of the common backstop** should cover all the purposes for which the SRF and the EDIS can be used. In particular, both the SRF and the ESM, as its backstop, should provide liquidity support during the resolution. The common backstop has to be **fiscally neutral**.

Policymakers should avoid to trigger unwarranted financial instability ...

As far as **sovereigns** are concerned, the unilateral introduction of concentration caps or differentiated risk weights not in line with international standards should be avoided as it would trigger unwarranted financial instability to the detriment of the EU economy. Mechanisms for sovereign debt restructuring or the introduction of risk weights or limits on sovereign bonds held by banks could impact very negatively financial stability and increase pro-cyclicality, with the dire consequence of making the EMU more fragile.

In the same vein, posing constraints to financial intermediaries for holding sovereign exposures in their balance sheets, will hinder the functioning of both the financial system and the monetary policy, with destabilizing effects on the overall financial system. Both the whole European banking system and the European sovereign debt markets might be severely affected with a strong potential negative impact on the European real economy.

A more efficient contribution to reduce the doom loop between sovereign and bank could be pursued by through an easier access to the ESM direct recapitalization instrument whose current features and pre-requirements make it very difficult to use in practice.

while further strengthening and diversifying the sources of financing.

Additionally, **major progress has to be made in carrying forward ambitiously the Capital Markets Union** to further strengthen the system and facilitate diversifying sources of financing, especially for SMEs, and deepening the Single Market.

A well-functioning financial union, including a Banking Union endowed with the appropriate risk sharing tools and a fully-fledged Capital Markets Union, would contribute to better adjustments to shocks across the Euroarea, making the Economic and Monetary Union more robust and resilient. There is **no trade-off between a fiscal stabilization function and cross-border private sharing** through CMU and BU completion, as both are needed.

Furthermore, the Euroarea needs a **common safe asset** to smoothen the mechanisms of the financial union, reinforcing integration and financial stability; the different options on the table should be evaluated with an holistic approach, avoiding solutions that could undermine the incentives for sound national policies or increase the liquidity risks in some markets segments (via securitization and/or tranching).

5. A coherent new institutional architecture

A Fiscal Pillar will exploit the benefits of being part of the EMU, improving its adjustment capacity.

The elements and functions described in the previous chapters will represent the keystones of a new Fiscal Pillar which is necessary to fully exploit the benefits of being part of an economic integrated area, to boost its economic performance and to improve the adjustment capacity of the EMU.

The European fiscal pillar will **perform the following four functions** with three of them having a specific Euroarea dimension: 1) stepping up in the EU budget the provision of

European public goods that can be provided and financed more efficiently at EU level, hence ensuring increasing returns to scale; 2) supporting reforms to foster convergence towards and within the Euroarea; 3) shaping and recommending a coherent and internally balanced EMU aggregate fiscal stance; 4) stabilization of shocks in the monetary union.

A European Finance Minister, within the Commission, should chair the

To ensure in the single currency area the effectiveness of policymaking and a smooth decision and execution process, **the functions** having a specific Euro area dimension **should be managed by a European Finance Minister**. This new role should be enshrined within the European Commission – along the lines of the High representative. She/he will also chair the Eurogroup and ensure the consistency of the Union's external action in the economic and financial issues. A European Minister of Finance in charge of those functions should be politically accountable to the European Parliament.

while implementing the area fiscal stance.

In the long run, increased degrees of fiscal integration towards a genuine fiscal union will imply significant transfers of sovereignty towards the establishment of a political union. At that stage, the European Finance Minister will have the responsibility of the implementation of the fiscal stance in the Euroarea and of its optimal distribution across countries.

The financing of the Fiscal Pillar will be based on **stable revenues sources**. In the case of investments and stabilization function for symmetric shocks, financing should also include a mutualized mechanism which might entail issuance of common bonds.

The ESM should swiftly take the role of backstop to the Banking Union ...

The evolution of the European Stability Mechanism – The need to complete the Banking Union and the establishment of a common stabilization function call for reflections on the future role of the European Stability Mechanism.

First of all, the ESM should **take the role of common backstop to the Banking Union**, notably to the Single Resolution Fund and in perspective to the European Deposit Insurance Scheme. This is a priority as a common fiscal backstop is a fundamental pillar of the completion of the Banking Union and therefore of financial stability. As underlined by the European Commission, ESM has the lending capacity, the market operations knowledge and creditworthiness required to fulfil the common backstop function effectively. We should avoid that the discussion of future possible roles of the ESM bring uncertainty or further delays to this process.

The role of the ESM in the long term should guide the debate on possible evolutions in the shorter term, to avoid inconsistent decisions.

and be included in the community framework.

The inclusion of the ESM in the community framework – together with the streamlining of its governance – would respond to widespread requests of maximum transparency and democratic legitimacy of the decision-making processes and foster trust in our common European institutions.

ESM has performed well its role in crisis management and **only limited improvements are warranted** at this stage to better fine tune the division of tasks with the European Commission in programme design and implementation. Expanding the ESM functions to surveillance would inevitably imply duplication of functions with the Commission and be in contrast with existing legislative provisions.

Moreover, there is no clear case for the introduction of further forms of burden sharing with the private sector in the access to financial assistance, as existing provisions in the ESM Treaty and the decision to include collective action clauses in all debt issuances since 2013 are already giving the possibility to address insolvency issues, on a case by case basis and only as a last resort, as it is appropriate in these circumstances. Further measures, including any attempt to formalize debt restructuring procedures, could trigger self-fulfilling disruptions and financial instability instead of promoting it, eventually putting tax payers money at risk. Moreover the political cost attached to an ESM program is itself more than sufficient to address potential moral hazard risks that are often quoted by the supporters of the introduction of such debt restructuring measures.

In addition, while the intergovernmental setting proved to be an efficient solution to rapidly establish a permanent firewall function in the wake of the financial crisis, the attribution of new functions in the absence of the guarantees of accountability provided by EU law would not be politically feasible at this stage. In any case, some improvements to the ESM governance – such as a more extended use of majority voting and further streamlining – could be introduced to increase the effectiveness of the decision-making process.

It should be tasked with the management of a rainy-day fund, part of a Euroarea budget line.

The ESM which is highly capitalised and endowed with significant resources, could then be tasked with **new roles as the management of the rainy-day fund** (i.e. the stabilization function) for the Euroarea acting as a cyclical shock absorber.

From an institutional point of view, **the fund should be managed by a Euroarea Treasury and could be part of a Euroarea budget line within the EU budget.** With a view to achieve this framework, transitional steps could be envisaged to start the implementation of a stabilization function, for example with a more limited capacity within the EU budget which could then be linked to the ESM once it is integrated in the EU law.

The roadmap

A determined common effort is needed to reinforce the European Union and the EMU with a coordinated action to accelerate growth and job creation, foster convergence and improve the functioning of the EMU and its capacity to adjust to shocks.

The proposals put forward must be read as a set of mutually reinforcing measures, each of them contributing to mitigate risks and imperfections surrounding the current framework. It is clear that it will be necessary to proceed one step at a time, combining an ambitious as well as pragmatic approach.

Action should be taken on **several fronts that are mutually reinforcing.**

1. Economic governance should ensure **positive incentives towards the implementation of reforms and investment** to boost potential growth and convergence. To ensure a coherent framework of growth-friendly rules and financial support to reforms in the EU budget – both for Euroarea and non-Euroarea countries: i) as far as fiscal rules are concerned, the investment and reform clauses should be swiftly extended and made more accessible; ii) a more effective implementation of the MIP procedure should be ensured.

2. In addition to convergence and cohesion policy, **the provision of European public goods within the EU budget should be stepped up**. To the same aim and until the revised EU budget is fully operational, national resources earmarked by Member states to the funding of those public goods with a EU dimension – i.e. human capital, common borders management, expenditures for defence and security – should be **favourably considered within the Stability and Growth Pact**. In the final phase, European public goods will be funded by European resources. Moreover, the Juncker plan should become a permanent instrument.

3. Following the agreed road map the **Banking Union should be completed** with no further delay, i.e. speeding-up the implementation of the common backstop to the Single resolution fund and the European deposit insurance scheme, in parallel with the completion of the agreed risk reduction measures in line with the June 2016 Council Conclusions. Work towards the implementation of the Capital Markets Union should also proceed quickly. The establishment of a fully-fledged financial union will significantly contribute to private risk sharing and therefore reinforce financial stability.

4. A **stabilization mechanism** needs to be established in the single currency area to tackle significant shocks that go beyond the absorption capacity of automatic stabilizers. It could take the form of a **Rainy Day Fund for Unemployment**. In a first phase, only asymmetric shocks will be tackled whereas in the final phase also symmetric ones will be dealt with, therefore implying the possible issuance of common bonds. The tool should be complemented by an improved fiscal framework supporting – on a permanent basis – public investment to boost the growth potential.

5. The new institutional architecture will envisage a **European Finance Minister** in charge a) of the surveillance of public finances, b) of the definition and recommendation of an aggregate fiscal stance for the Euroarea, c) of the management of the stabilization function and the potential issuance of common bonds.

In addition, the **European Stability Mechanism** will evolve from the current intergovernmental institution to be integrated within the EU legal framework, thus enhancing the accountability and democratic legitimacy of its operations and ensuring a more effective use of its resources. It will also perform the function of common fiscal backstop to the Banking Union and could manage the stabilization fund.

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