Response to Commission Reflections on Deepening EMU: "Eurobills" as a Safe Asset that blends Fiscal Rules progressively with Market Discipline

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Summary and Conclusion

- **The electoral calendar of EU27: a rare period of stability seems to lie ahead.** After the French Presidential/Parliamentary elections and the strong likelihood of a fourth term for Chancellor Merkel, EU27's politicians have reason to feel that anti-EU populist surge has passed its peak.
- **The economy is now in its fourth year of expansion – providing space for visionary ideas to re-appear from the shadows.** The policy prescriptions of the 2015 Five Presidents Report are now being discussed with a view to implementation during its `Stage 2' – by 2025. A grand bargain of major economic reform in France – if carried through – should be met with some positive German support for deeper financial integration in the Eurozone as the riskiness of integration declines – from both governments and banks.
- The European Commission's Reflection Paper on deepening the EMU laid out possible actions for further analysis and the economic rationale was analysed in greater depth in a Vox paper[1].
- **The principles required for progress in deepening EMU are clear and include:**
    - No mutualisation of debts;
    - Respect for the post-crisis economic governance system (Maastricht 2.0);
    - A proper role for market discipline;
    - "Safe asset" to reduce the `doom loop' between banks and their government;
    - Financial solidarity with states that respect the rules yet lose market access.

My plan for a Temporary Eurobill Fund (TEF) satisfies these principles. There should now be further [2] examination of its mechanics as the TEF would be a "concrete achievement".

The purpose of this paper is to consider what `nuts and bolts' could be fixed – simply and quickly - in the `engine room' to assist the overall policy objectives – set out in the Appendix. But these mechanisms should be framed in the context of Schuman's celebrated 1950 dictum 'Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity.'

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[1] http://voxeu.org/article/completing-emu by Buti, Deroose, Leandro and Giudice – July 2017

[2] This plan was examined by a European Commission Expert Group that included this author, and published its final report in March 2014. http://europa.eu/rapid/press-release_IP-14-342_en.htm

Graham Bishop's Plan for a Temporary Eurobill Fund (TEF) could be a modest, first step along this road by building trust amongst states and with citizens:

- Participating states would borrow from the Fund – at their own risk – for up to two years.
- The legal format would follow the tried and tested template of the ESM but would NOT require a change to the TFEU.
- The costs would be minimal and the TEF could be functioning before the 2019 EP elections – as the ECB winds down its QE purchases of sovereign debt amidst rising interest rates.

However, it is clear that some outcomes must be avoided, as they will be unacceptable in major states such as Germany and France. In particular, anything that results in the €3 trillion annual output of the German economy taking on a `joint and several liability' –"mutualisation" - for €8 trillion of Eurozone public debt is manifestly impossible. That would be equally unacceptable to France with its €2 trillion economy, and markets would regard any such guarantees from smaller economies as utterly implausible.

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How does the Graham Bishop Plan for a Temporary Eurobill Fund (TEF) assist the policy objectives in the Five Presidents' Report?

The structure and governance of the TEF – in reality – provide a comprehensive political, economic and financial plan to deepen the Economic and Monetary Union, quite apart from meeting the technical need for a `safe asset' for banks. The TEF would be an early `concrete step' in an institutional infrastructure to encourage consistency in national economic policies. **An explicit goal of this institution is to build trust "among Member States, between Member States and EU institutions, and with the general public".**

In due course, the political governance could reflect the Community method rather than the initial inter-governmental approach. Its European Treasury function could indeed transform into the locus of European "collective decision-making" between the European Parliament and Eurogroup. As and when a "European Finance Minister" is appointed, that person would naturally chair the TEF's decision-making body. The revamped European Semester process could readily provide a mechanism to manage some of the `European' liabilities created by the TEF. Accountability to the European peoples, and corresponding liability for `moral hazard'[3], would both be at the European level.

Beyond the direct benefits to financial integration and stability, this Eurobill plan can provide the savers of Europe as a whole with a cheap, safe, savings vehicle. It would provide - state-by-state - a concrete mechanism to: (i) reward good economic `homework' according to the fiscal rules (ii) progressively – but slowly - penalise lack of effort (iii) operate with the grain of market discipline to graduate the carrot and stick incentives for each state and (iv) minimise the eventual costs if a state insists on pursuing economic policies that are likely to end `badly'.

What is the TEF?

(The most recent 14-page detailed description of mechanics of this plan is here[4]. Graham Bishop has been working on this plan since 2012 after the earlier work by the European League for Economic Cooperation (ELEC)).

Without amending the Treaty on the Functioning of the European Union (TFEU), the TEF is an immediate concrete mechanism to:

- Provide important benefits for consumers by providing a cheap, safe, savings vehicle.
- Be an institution binding the euro area further into economic policy co-ordination and convergence – thereby encouraging fiscal stabilisation; deepen the financial integration inherent in both Banking Union and Capital Market Union (CMU); and buttress financial stability of both banks and governments.
- Be initiated as a modest stepping-stone; be scaled up during Stage 2 towards becoming a *de facto* European Treasury with *Communautaire* political governance – perhaps even providing a modest short-term `fiscal capacity'.
- If successful, the maturity range could be extended beyond two years.
- If unsuccessful, be easily reversed (even to extinction) within two years.

[3] What is `moral hazard'? US economist Paul Krugman defined it, rather pithily, as 'any situation in which one person makes the decision about how much risk to take while someone else bears the cost if things go badly'.

[4] http://www.grahambishop.com/StaticPage.aspx?SAID=565

- It would follow a similar **legal structure** to that of the ESM with *pro rata* callable capital - but with a crucial difference: only euro states in `good standing' could borrow from it - so each state remains fully responsible for its own debts. Editing the ESM text as a template for a suitable legal form is a simple matter.

The **economic structure** would be the plainest vanilla. The Fund would borrow from the markets - matching quantities and maturities requested by borrower states – for maturities ranging up to two years. The key step is that participants would bind themselves to borrow <u>all</u> new funds in this maturity range <u>only</u> from the TEF (with the possible exception of very short-term cash management facilities. But once the TEF builds up in size it should be able to offer centralised cash management – thereby providing an obvious, basic "European Treasury" function.) There would be limits on the maturity structure of a state's debts.

(The commitment to borrow <u>all</u> new short term funds from the TEF is the most rigorous form as it enhances the solidarity of the members against the `splitting of their credit' at any moment of intense crisis and market pressure. The political decision to be rigorous has already been taken: All EZ states have bound themselves quite tightly since the crisis (via the 6 Pack/2 Pack/TSCG) to pursue agreed sound economic polices – as set out annually in the Country Specific Recommendations. If they really intend to keep these promises, why would they refrain from binding themselves a little further in a way that gives distinct advantages – especially as an insurance policy against financial instability? Many observers do not seem to realise the degree of binding that has already been entrenched e.g. agreeing to reduce public debt annually by 1/20th of any excess over 60% of GDP

Moreover, if there is only one issuer of short-term government debt in the market, then there is no need to be concerned about credit ratings as the market price will reflect the views of the most well-informed investors in the world – rather than those of a rating agency. "Mechanistic" references to credit rating requirements should have been removed already from CRD/CRR/Solvency II etc. Additionally, the potential first losses would be borne by the top-rated ESM.)

Blending fiscal rules progressively with market discipline: The governance structure

Economic policy co-ordination: The TEF would be an institution that binds the participating euro area states into closer financial solidarity – thus encouraging greater observance of the economic governance commitments and stabilising public finances. So the existing fiscal rules are the starting point for co-ordination, but a key advantage is the predictable and progressive involvement of "market discipline". Of course, if a state insists on pursing unsound policies then no "mechanism" can save it from the eventual, natural consequences of its own policy choices.

The TEF would give ultimate powers to the finance ministers of participating states – making them the Fund's Political Decision Makers (PDMs). The PDMs would authorise the purchase of a maximum amount of a state's bills during the year ahead to fund the budgetary needs reflected in the cash-flow forecasts provided under the 2012 Treaty on Stability, Co-ordination and Governance (TSCG) - more popularly called the Fiscal Stability Treaty. When operating fully, these flows would build the TEF up to more than €600 billion outstanding. The TEF's governance structure is specifically designed to reward compliance with EU economic policy rules by providing a modest cost-saving for many states.

More importantly, the action of purchasing a state's bills would send a very clear signal of approval to market participants.

As a separate decision, the PDMs would be empowered to buy-in a state's longer-term bonds as their remaining life fell below two years – or probably even shorter for initial experiments. Such actions would be intended explicitly to create a single euro yield curve for the safest asset in the Eurozone – for a term of up to two years but certainly influencing yields further along the curve. The action of including a state's securities in this purchase programme would send a particularly strong signal of approval of its economic policies as the TEF could expand to around €2 trillion in the fullness of time – becoming a *de facto* European Treasury. It would then be about the same size as the ECB's current QE programme but would own <u>all</u> under two-year government securities, rather than the QE programme's ownership of up to a third of over two-year bonds.

However, there is another side to this coin: if the PDMs became concerned about a state deviating from the agreed rules, they might fail to agree on buying-in further securities as their remaining life fell into the purchase parameters. The natural flow of redemptions would steadily reduce the Fund's exposure to a state – **unless the PDMs made a positive decision to replace these redemptions with new purchases**. The absence of such a decision would send a clear message to the markets holding the other [70%] of the state's debts. Market participants have now learnt that the debts of a government consistently pursuing unsound policies are very risky. With public debts averaging close to 100% of GDP, a significant normalisation of interest rates may well re-kindle fears about public debt if additional debts are seen as an easy substitute for genuine economic reform.

<u>This goverence procedure creates a two-stage discipline mechanism</u>. The initial decisions not to buy-in bonds below a chosen maturity would send a message of concern that would be reflected in a widening yield spread for short term bonds versus the TEF curve – a signal, rather than a significant cost, to the offending state. If the PDMs concerns reflected budgetary overshoots, then the TEF would provide an effective, market-driven (so virtually automatic when the yield curve is positive) penalty for breach of fiscal agreements within the European Semester process. The penalty would be gently progressive as only `excess' borrowing would take place at the longer end of a positive yield curve. This would represent an increasingly strong sanction but not be suddenly, and catastrophically, de-stabilising. The state would face a <u>lengthy</u> period of an increasingly steep slope rather than suddenly falling off a cliff.

➢ Supporting the financial stability of governments: removing roll-over risk

The ECB's QE programme specifically excludes securities with a remaining life of less than two years so the TEF would be outside the current QE programme. If necessary in the future, TEF bills would be a natural public asset for the ECB to purchase as they would <u>not</u> represent monetary finance of governments and the state-by-state exposure would already have been agreed by the politically-accountable PDMs.

If the Fund's PDMs were sufficiently confident of a state's policies and had authorised the `buying-in' of a state's bonds with a <u>remaining life</u> of less than two years, then virtually all of a bond issue would be held by the Fund as the issue came up for repayment. Permitting a state to meet that roll-over within the Fund by the TEF purchasing new bills from the under-pressure government would entirely remove roll-over risk at times of economic uncertainty - enhancing the financial stability of governments.

NOTE: There must be rules to set (i) a minimum average life of a government's debt (ii) a maximum percentage of the debt that is less than two years remaining life and (iii) an absolute cap on a state's borrowing from the TEF so that it never exceeds the remaining lending capacity of the ESM to offer a programme to pay off the state's obligations to the TEF.

➢ Supporting the financial stability of banks: a "safe asset" for Eurozone banks

Banking Union would be reinforced because TEF bills would be the most natural High Quality Liquid Asset (HQLA) for banks to hold to meet Capital Requirement Regulation liquidity rules, as they would be the safest, most liquid asset in the euro area. Based on the ESM template, supervisors should allow a 0% risk weight for claims on the TEF. Therefore banks would be safer: directly by reducing the doom loop with their national government; and indirectly by encouraging sound economic policies.

The `doom loop' between banks and their sovereign would be cut by more than a third - at a stroke – by substituting "European" TEF bills for domestic government paper. This will make it much easier to tackle the remaining two-thirds of longer-dated inter-linkage that is necessary to restore the credibility of the `no bail out rule'. Having cut the doom loop so substantially, it would be essential to modify the rules on `large exposure limits' for financial institutions so that the discipline of the capital market cannot be evaded in the future by `encouraging' local banks to purchase excessive quantities of bonds.

The Commission's Reflection Report dwells at length on the minimum need for the creation of a `safe asset' that would help reduce the doom loop between banks and their sovereign. In addition, such a reduction might reduce the need for banks to feel they must re-focus their balance sheet on their home country to avoid any risk of a disastrous split in the currency composition of assets and liabilities if the euro area broke up. So the creation of a safe asset is seen as a requirement for the successful completion of banking union – at the very least.

However, the TEF would offer benefits beyond the basic, technical need for HQLA as it would enhance the integration of the euro area's money and short term bond markets, whilst providing an anchor for medium term bonds. For equities, the removal of a significant risk of dis-integration of a part of the assets held by financial institutions (themselves a significant proportion of the main equity indices) should be a useful integrative impulse.

The Commission Report focusses its `nuts and bolts' attention mainly on considering a plan for Sovereign Backed Bonds (SBBs) – see comments below. The need for "safe assets" is clear and was analysed by the Expert Group on DRF and Eurobills in 2014. This author was a member of that group and presented his plan for a Temporary Eurobill Fund that would be a `safe asset' as well as providing several other policy benefits. **Encouragingly, the Commission has undertaken to reflect on options other than just SBBs.**

Source: *Expert Group on Debt Redemption Fund and Eurobills*; Final Report - 31 March 2014

Safe asset

There is no asset that is completely risk-free, as all assets are subject to risks which should be accurately reflected in their prices. A **safe asset** from an investor perspective should provide full protection from credit, market, and idiosyncratic risk. In other words, it must be a liquid asset that has minimal risk of default (and that minimal risk should not be positively correlated with risk of other financial assets). In the Basel III framework[1] a high-quality liquid asset is defined as an asset that can be easily and immediately converted into cash at little or no loss of value. The concept of `marketability' is therefore key. High-quality liquid assets should also ideally be eligible at central banks for intraday liquidity needs and overnight liquidity facilities.

Safe assets play an important role in the financial system. One of their main uses is as high-quality collateral for repos, central bank repos and over-the-counter derivative transactions. Safe assets provide a benchmark for the entire financial markets, i.e. a reference rate for the pricing, hedging and valuation of risky assets, and a basis for assessing of performance. Safe assets also play a role in central banks' liquidity operations[2]. In portfolio allocation they are used as a store of value. In banks and, to a lesser extent in insurance companies and pension funds, safe assets play a key role in day-to-day asset-liability management. In the case of banks the high demand for safe assets is also related to prudential regulation, and as recently globally reinforced by Basel III, i.e. for liquidity requirements.

During the financial crisis, flight to quality, the decline of the perceived safety of public debt of developed economies and the related increase in price of safety put the focus on a possibly increasing shortage of safe assets. Against this background, several proposals were made since 2011 with the main aim of creating a safe asset. Amongst those were, on the one hand, proposals to create eurobills. On the other hand, in 2011 a group of economists presented a proposal for creating European Safe Bond (so-called ESBies), a particularly safe asset created by pooling and tranching euro-area government debt.[3]

1 Basel Committee on Banking Supervision, Basel III: International framework for liquidity risk measurement, standards and monitoring, December 2010
2 IMF, Global Financial Stability Report, April 2012
3 The euro-nomics group, European Safe Bonds (ESBies), http://euro-nomics.com/wp-content/uploads/2011/09/ESBiesWEBsept262011.pdf

➢ Supporting the euro's role as a global financial asset: comparable with US T-bills

The TEF would be a globally significant market sector. According to Bloomberg data, the US has a much shorter maturity public debt than the EZ so the US is inevitably going to be more liquid in the shorter maturities. However, if the TEF were at its full size, then say a monthly bill in year 2 could be around €60 billion – not dissimilar to the €65 billion US Treasury one year bills. The year 1 issues could reach €100 billion – again if all were split into monthly issues. Splitting TEF issuance into a standard monthly issue would give rise to a minor maturity mismatch. However, in a positive yield curve world, issuing say an 11-month bill to fund the purchase of an "11 month and 29 days" remaining life bond would give a useful carry-trade profit.

What are its other policy benefits?

For Political Stakeholders

- **Citizens:** Providing a simple, understandable, easily accessible, low-cost, safe savings product to all EZ citizens – providing a direct service to the most influential citizens. Over time, the minimum denomination of the bills should be set low enough so that most individual citizens could invest their retirement savings – creating a "European" vehicle for savers. This should create a vested interest in the success of `Europe' – a step towards a European *demos*. A minor practical benefit - but perhaps looming larger – helping restore citizen's trust in financial markets.
- **Nations:** The broadening of the `common interest' of each EU member in the economic policies pursued by fellow members would be accelerated. The post-2008 economic governance reforms reflected in the European Semester process have already given a

collective oversight of budgetary polices. The political decisions of the TEF about permission to borrow from it would deepen that oversight substantially – via both the signalling effect and cash implications.

For Economic Stakeholders:

- **European Treasury:** Government debt management offices (DMOs) face particular challenges from short-term fluctuations in cash flows as large tax payments do not necessarily coincide with major, lumpy expenditure items. So they may need to swing from large deposits to day-by-day borrowings. The most basic function of a "treasury" is to cope with these swings. At a European level, some of these national swings may be able to be offset by a DMO purchasing very short-term bills from the TEF, or selling bills to the DMO to absorb temporary liquidity. If the system overall is still not in balance, then the TEF could supply that most basic of Treasury `smoothing' functions by its own transactions with banks and capital markets.
- **Capital Market Union/institutional investors:**
  - The TEF would underpin CMU by providing a least-risk, highly liquid yield curve out to two years – and effectively significantly longer. Moreover, the euro-denominated CMU component would be boosted as all financial institutions – insurance companies, pension funds, corporations and mutual funds – would have a `European' asset to satisfy their legitimate economic needs for holding short-dated safe and liquid securities.
  - The existence of a yield curve for the safest and most liquid asset would naturally encourage the markets to innovate products with somewhat higher credit risk, and thus return. As the euro area economy recovers and interest rates move to `normal' levels, such a yield curve will return to central importance and provide the foundation for `good' securitisation of, say, packages of loans to SMEs that would back commercial paper issued by banks and non-banks – as envisaged in the Commission's Securitisation proposal, as part of CMU. The ECB's easy money policy could then reach SMEs across the entire euro area.
  - Additionally, a public authority would provide reference pricing based on massive activity for all financial contracts that need to specify an interest rate for any particular short maturity. That would include the variable interest rate on say longer-term mortgages and bonds.

What are the safeguards?

- ✓ **Voluntary participation by states:** Participation would be open to all euro area states in "good standing" so not subject to an ESM programme - but not all EZ states have to join at the outset. A binding Inter-Governmental Agreement (IGA) between participating states would be required if "all" under two-year paper must be sold to the TEF.
- ✓ **Democratic control by national parliaments renewing the mandate:** The "temporary" aspect is appropriate to allow national Parliaments to review the functioning of the Fund - through good times and bad, and its impact on their nation's public expenditure. If things go well, the Fund could be made permanent and both functions and scale enhanced. Eventually, it could be incorporated into the Treaty structure of the European Union.

- ✓ **Self-liquidating – swiftly if necessary:** If "things do not go well", then the political decision-makers would cease to issue new bills and release any obligations to issue short-term bills via the Fund. Most of the fund would automatically mature within a year – all of it within two years.
- ✓ **ESM backstop:** If a state became unable to repay its obligations to the TEF – despite the panoply of economic governance coordination measures - then that state would be offered an ESM programme with the TEF's claims met first as – by definition – they will be the first claims falling due. The ESM already has Preferred Creditor Status so the TEF's security would be doubly re-enforced. Correspondingly, no state would be allowed to have obligations to the TEF that exceeded the ESM's remaining lending capacity thus <u>capping each state's commitment to such collective financial operations at its existing maximum contribution to the ESM.</u>

What are the Costs?

The costs of setting up the TEF are likely to be minimal:

- Some EU legislation will be necessary and, ideally, an Inter-Governmental Agreement to bind participating states to issue all new under-two year debt through the TEF. This is the normal activity of legislatures so the incremental cost will be trivial.
- Operational costs will simply be those of issuing perhaps 30 new securities. Any of the existing Debt Agencies could do this with minimal incremental cost, as their servicing of existing issues would reduce. Alternatively, the ESM's facilities could be used as their activity is currently lower because the number of `active clients' is now down to one.

Have other Monetary Unions dealt with potential "sub-union" public defaults?

The simple answer is Yes. One of the first research papers by this author in 1989 on these topics dealt with the New York City default in 1975, the difficulties of Canadian Provinces in the 1980's and the Australian States in the 1930's.

Sovereign Backed Bonds (SBBs)

The Commission does not provide any detail on SBBs beyond saying that the concept is under discussion at the ESRB. However the Report include the specific point that "issuance would develop only gradually". Moreover and according to the ESRB, "preliminary analysis by the ESRB task force points to an initial upper limit on the size of the SBS market of approximately €1.5tn." At such a size, it would only be about the same size as the French government bond market and be around a tenth of the size of the US Treasury market. If an objective were to create an asset of comparable marketability to the US Treasury market, SBBs would not meet this goal.

The Commission also puts the development of such an asset in the post-2019 timeframe whereas the Foreword states that the Report is "setting out concrete steps that could be taken by the time of the European Parliament elections in 2019". Moreover, the Vox paper states "Nevertheless, the Reflection Paper acknowledges that SBBSs are unlikely to become sizeable enough to become the benchmark for European financial markets with the potential to be comparable to US treasuries or Japan's government bonds."

There is no need to wait so long to launch the Temporary Eurobill Fund if the political will becomes evident early next year. Citizens could already be holding their new cheap, safe "European asset" by the time of the elections – demonstrating the benefits of European financial integration.

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Appendix: Agreeing the Policy Objectives:

Five Presidents Report - June 2015

The Report set some ambitious goals as well as a clear timetable:

- **Stage 1** from July 2015 – June 2017 as a period of 'deepening by doing'.
- **Stage 2** (`completing EMU') should run from July 2017 to 2025 at the latest and include `concrete measures of a more far-reaching nature…for each euro area Member State to participate in a shock absorption mechanism for the euro area.'

The Five Presidents' Report laid out a two-stage process to completing EMU, and the Commission's October 2015 Communication added much detail to the Report's principles, which included "the European Parliament should organise itself to assume its role in matters pertaining especially to the euro area... However, as the euro area evolves towards a genuine EMU, some decisions will increasingly need to be made collectively while ensuring democratic accountability and legitimacy… A future euro-area treasury could be the place for such collective decision-making."

The Report also proposed a fiscal stabilisation function for the euro area with guiding principles:

1. "It should not lead to permanent transfers between countries…
2. Should not undermine the incentives for sound fiscal policy-making …
3. Be tightly linked to compliance with the broad EU governance framework…
4. Should not be an instrument for crisis management and
5. Should help to prevent crises - making future interventions by the ESM less likely."

Progress so far in `deepening by doing':

- **European Semester** – economic governance. The 2017 Semester has just drawn to a close and May ECOFIN welcomed "the Commission`s new multiannual assessment of CSR implementation, and that good progress on a large majority of recommendations has been made, but NOTES this has been uneven across policy areas, countries and over time."
- **Banking Union:** Great progress has been made - except on the proposal for common deposit insurance (EDIS). In November 2016, the Commission presented the Risk Reduction Measures Legislative Package (the "RRM Package") to refine the Banking Union further.
- **Capital Markets Union:** The Commission reports that "over the past 18 months, in accordance with the original timetable, the Commission has delivered more than half the measures (20 out of 33) announced in the CMU Action Plan."

Commission White Paper on the future of Europe - 1 March 2017:

The White Paper (see key extracts in the box below) underlined that its reflections will be on "the" basis of the Five Presidents' Report.

> The White Paper is the European Commission's contribution to the Rome Summit. Like all anniversaries, Rome will be a natural time to reflect on the success of the last 60 years. However, it should also be viewed as the beginning of a process for the EU27 to decide together on the future of their Union.
>
> The European Commission will contribute to that discussion in the months ahead with a series of reflection papers on the following topics: these include… deepening the Economic

> and Monetary Union, **on the basis of the Five Presidents' Report of June 2015**; [*Author's emphasis*] … the future of EU finances. (Economic & Monetary Union: Incremental progress on improving the functioning of the euro area)

Rome Declaration by EU27 Heads of Government - 25 March 2017:

It laid out a solemn, decade-long agenda (see box below for some relevant extracts.)

> "We will make the European Union stronger and more resilient, through even greater unity and solidarity amongst us and the respect of common rules. Unity is both a necessity and our free choice…
>
> **We will act together, at different paces and intensity where necessary, while moving in the same direction, as we have done in the past, in line with the Treaties and keeping the door open to those who want to join later.** [*Author's emphasis*] Our Union is undivided and indivisible.
>
> 2. A prosperous and sustainable Europe: a Union which creates growth and jobs; a Union where a strong, connected and developing Single Market, embracing technological transformation, and a stable and further strengthened single currency open avenues … and working towards completing the Economic and Monetary Union; a Union where economies converge...
>
> We will promote a democratic, effective and transparent decision-making process and better delivery…
>
> We as Leaders, working together within the European Council and among our institutions, will ensure that today's agenda is implemented, so as to become tomorrow's reality. We have united for the better. Europe is our common future."

Commission Reflection Paper on Deepening the EMU – 31 May 2017

The Reflection Paper sets out some general goals – see extracts in box below – and also an explicit timetable to build up concrete actions during the period up to 2025.

However, it refers on several occasions to modifying the role of the ESM but does not discuss the difficulty posed by the need to amend the TFEU to change the ESM's role. On 25 March 2011, the European Council adopted Decision 2011/199/EU amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro. This added the following paragraph to TFEU Article 136: "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality". Until that "indispensable" test is removed, it is difficult to see how the ESM can be utilised in this new, integrated approach.

> "It does so by setting out concrete steps that could be taken by the time of the European Parliament elections in 2019…. But the euro area does not need only firefighters. It also needs builders and long-term architects… the EMU is stronger, it is not yet fully shock-proof."
>
> "More trust is needed across the board, among Member States, between Member States and EU institutions, and with the general public… But we simply cannot afford to wait for another crisis

before finding the collective will to act… There is not one, single answer. What is needed is an overall vision and clear sequencing of what needs to be done… Many ideas in this paper are largely about fixing the nuts and bolts in the euro's "engine room". But what is at stake is not technical: it is about making the euro deliver better for all."

"Major reforms have taken place to counter these risks but the so-called "feedback loop" between banks and their sovereign is still an issue for financial sector integration and stability.

► The good functioning of the single currency calls for:

i) sound public finances and the existence of fiscal buffers which help economies to be more resilient to shocks; ii) complementing common stabilisation tools at the level of the euro area as a whole; iii) the combination of market discipline and of a shared rulebook which would allow these rules to be more effective and simpler to understand and operate."

Commission President Juncker's State of the European Union – brochure: 13 September 2017

The State of the Union message re-enforced the commitment to deepen the EMU and included some relevant proposals (extract below). Curiously, it proposes to launch enabling legislation for SBBs next year but only launch exploratory work for developing a "safe asset" much later.

Priority 5: A deeper and fairer Economic and Monetary Union

<u>Initiatives to be launched and/or completed by end 2018</u>

-- *** Banking Union package.... and an enabling framework for the development of sovereign bond-backed securities to support further portfolio diversification in the banking sector.

<u>Initiatives to be launched with a 2025 perspective</u>

-- Communication on the possible creation of a permanent European Minister of Economy and Finance (Article 2 of Protocol No 14) and its institutional implications.

-- Exploratory work for the possible development of a euro area safe asset.