

Reforming the governance of the Economic and Monetary Union: the issues

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Summary

The adoption of the Next Generation EU (NGEU) may represent a substantial change in the process of European integration, especially in the reform of the Economic and Monetary Union (EMU), including financial, fiscal and political unions. The NGEU forms part of the EU response to COVID-19, a non-economic and global shock with asymmetric economic effects. Whereas some member states, such as Germany, may return to pre-COVID levels of output in 2021, others might not do so until the end of 2022. In some countries, levels of public debt have reached record highs, deficits are running significantly above 3% of GDP and public accounts are highly unbalanced in structural terms. In such circumstances, strict compliance with the requirements imposed by the Stability and Growth Pact (SGP) would lead to a severe and prolonged economic contraction in the EU. It is hardly surprising therefore that the debate in the EU focuses particularly on reform of the fiscal rules. However, the various elements of EMU governance are intimately interlinked and any proposal for a partial reform should come within the framework of a comprehensive reform of EMU. This paper sets out a series of questions for the EMU reform debate, including the Banking Union, the Capital Markets Union, the European Semester and political union (PU). The aim is to stimulate the debate among Spanish experts to prepare agreed proposals for reforming the economic governance of the EU, especially the SGP.

Discussion points for reforming the governance of the Economic and Monetary Union

The economic –fiscal, monetary and regulatory– measures adopted in the EU to offset the effects of COVID-19 could represent a turning point, if not a paradigm shift, in the process of European integration.

This Working Paper seeks to pose a series of questions aimed at guiding the reflection of a group of Spanish experts to draw up agreed proposals for the design of the post-COVID-19 economic governance of the Economic and Monetary Union (EMU). The elements discussed in this paper to identify a wide-ranging series of issues for debate are framed, on the one hand, within the nature of the crisis and how it interacts with structural aspects of member States' economies and, on the other hand, within the EU's economic, political and institutional response, particularly, but not exclusively, in the Next Generation EU (NGEU). The type of proposals that may be drawn up depends fundamentally on the extent to which such a political response represents a profound change in the consensus regarding the future of the EU (the so-called 'Hamiltonian moment'), which could lead to a qualitative leap in the process of European integration –a significant transformation in the institutional architecture of the Union–, or whether it just represents a one-off change in the political moment of the EU. In the latter case, the EU's response would at least help remove some of the existing stumbling blocks to the proper working of the current EMU architecture through incremental and gradual changes towards a deeper and better-functioning economic integration.

(1) A global but asymmetric shock

The shock unleashed by COVID-19 is exogenous and non-economic in origin. It is not the outcome of an accumulation of economic, fiscal or financial imbalances. Nor does it

stem from deficiencies in regulatory frameworks or their defective application. In this case, unlike what occurred in the 2011 debt crisis, the shock was not triggered by economic policy mistakes.

First, the economic shock is global: all the large economies, except China, have sunk into deep recessions in 2020.

Secondly, the figures recorded since the Second World war show that this recession is of historic proportions.

But third, although it is global, the crisis is asymmetric. Albeit with quantitative differences of varying dimensions, the majority of analysts concur that the US and the global economy will return to pre-COVID levels of output in the second or third quarters of this year, followed by world trade and Japan.¹ The euro area and the UK will do so towards the end of next year or early 2023. In the case of the euro area the differences between its members are also significant.² Whereas Germany will emerge from the recession already in 2021, and the Netherlands and France should regain pre-COVID-19 activity levels by the end of this year or early 2022, Spain and Italy should wait until the end of next year. Meanwhile, some medium-sized and small countries in the euro area, including the Baltic States and Finland, and to a lesser extent Austria and Belgium, are suffering a less pronounced recession than peripheral countries of comparable size such as Portugal and Greece, due to their greater economic specialisation in tourism and other proximity services.

Last but not least, the reasons for these asymmetries seem to reside not only in the differences in countries' productive structures –which make them more exposed to mobility constraints– but also in a series of short- and long-term factors. Thus –and this applies not only to the euro area but also to the global economy–, hysteresis effects (the persistence over time of the cyclical damage inflicted on production and employment) may be greater in some countries than in others. The high level of uncertainty surrounding the evolution and effects of the pandemic could hamper investment, while negative employment expectations could increase precautionary savings and delay the recovery of consumption, which could lead to a vicious circle of low demand, low growth and negative investors' expectations ending up with a reduction in potential growth.

Hysteresis effects are more likely to take place in countries beset by structural problems. There are many examples of such structural problems, but low productivity would be an obvious one, as it appears to be the case of Italy or Spain, among other countries. In the Spanish case it is also worth mentioning the functioning of the labour market, which generates unemployment levels in recessions unknown in advanced economies.³

¹ See IMF (2021), *World Economic Outlook Update*, January. According to the OECD (see *OECD Economic Outlook, Interim Report*, March 2021) these forecasts, especially for the US, may improve in 2021 thanks to the US\$1.9 trillion stimulus package approved by the Biden Administration. The IMF's WEO of April represents a significant upward revision of the global economic prospects.

² See European Commission (2021a), 'European Economic Forecasts: Spring 2021', *European Economy, Institutional Paper*, 149, May.

³ See, among many others, ORFIN (2021), 'Previsiones económicas 1er trimestre 2021', monthly report.

Another vulnerability affecting some euro area economies concerns public finances. After five years of sustained expansion, between 2014 and 2019, no significant headway has been made in correcting the structural differences between expenditures and revenues and the gap is only widening with the pandemic. Once again, Italy and Spain provide archetypical examples of a lack of fiscal discipline. However, fiscal imbalances are almost non-existent in other members of the euro area, including most of the countries already mentioned that are suffering a less pronounced and prolonged crisis. In short, both the economic effects of COVID-19 and its implications for public finances could aggravate the risks of fragmentation in the euro area.

(2) The EU's reaction and the Next Generation EU

Although with certain well-known reluctant positions in some member States, so far such risks of fragmentation have given rise to a crisis narrative in Europe different from the one that dominated the financial crisis of 2009 and the debt crisis in 2011. First, the moral hazard issues that triggered the debt crisis in the euro area are no longer considered. The shock is not economic in its origin and there are neither good nor bad students. Secondly, monetary policy is insufficient to solve this crisis and there is a need for fiscal policy to take over. Thirdly, as far as fiscal policy is concerned, horizontal coordination will not be enough. This type of coordination took place in 2009 when the Commission promoted a fiscal expansion of 1.5% of GDP.⁴ The expansion was funded by the resources available to each member State. In the current situation, given the depth of the recession and its budgetary effects, vertical coordination is required, in other words there is a need for a fiscal capacity common to the EU. Ultimately the interaction between the asymmetric effects of the crisis, possible hysteresis effects and economic vulnerabilities have made it evident that recovery from the crisis will require rather more than financial measures. What is needed is a coherent package of monetary, fiscal and structural measures that restores output to pre-COVID levels, repairs the state of public finances, avoids financial fragmentation and addresses member States' structural vulnerabilities.

This is the narrative that seems to underlie the response currently given by the EU as a whole from the outset of the crisis. First, on 19 March 2020, the Commission withdrew the main regulatory barriers that would have prevented national governments from giving public aid to their economies. In particular, it simplified and streamlined the state-aid framework and proposed the activation of the Stability and Growth Pact (SGP) escape clause, which was endorsed by the Council. For its part the ECB announced, among other measures, a new programme for purchasing sovereign debt in the secondary market – the Pandemic Emergency Purchase Programme (PEPP) – which, after various extensions, now totals €1.85 trillion, and comes on top of the remaining €120 billion from the pre-existing Asset Purchase Programme (APP)–. The European Stability Mechanism (ESM) made credit lines –Pandemic Crisis Support (PCS)– available to euro area members for up to 2% of GDP at favourable terms and free of macroeconomic conditions to fund direct and indirect healthcare costs. The Council approved a counter-cyclical instrument known as SURE (instrument for temporary Support to mitigate Unemployment Risks in an Emergency), for a total of up to €100 billion to fund temporary

⁴ See European Commission (2008), *A European Economic Recovery Plan*, COM (2008) 800.

unemployment programmes, such as furloughs (ERTEs in Spain), financed with EU debt. The European Investment Bank offered credit lines to European SMEs of up to €200 billion and the Commission streamlined the use of the still unspent remainder of the EU budget in 2020, accounting for an additional amount of €70 billion. Lastly, the member states adopted discretionary fiscal expansionary measures of more than €0.5 trillion – around 4.2% of the EU's combined GDP–, while on top of them the automatic stabilisers were allowed to operate fully: member States approved liquidity lines and other aid for businesses worth €2.5 trillion.⁵

The Council's adoption of Next Generation EU (NGEU), an aid package of up to €750 billion, funded by debt issued by the Commission, of which €390 billion consists of direct transfers, is a radical change in the way economic crisis in the EU is being handled. First, the debt generated by the NGEU is mutualised debt, which represents the breaking of an up-to-now sacrosanct taboo. Secondly, more than 50% of the debt is distributed in the form of transfers in accordance with the population, per capita GDP, unemployment rate and severity of the recession, which fulfils some of the requirements that a central fiscal capacity should comply with. Lastly, it strengthens and promotes structural reforms, because these transfers are conditional on carrying out the most urgent structural reforms in each country. In this respect, the NGEU is consistent with the narrative of the crisis as spelled out above, while simultaneously promoting the transformation of EU economies by supporting the ecological and digital transition.⁶

These characteristics of the NGEU, especially debt mutualisation and its possible role as the EU's fiscal capacity, have led some observers to detect a radical paradigm shift in the construction of the EU,⁷ which in turn has revived the debate about reform of EMU governance.

Some have gone as far as to discern a sort of 'Hamiltonian moment' in the EU. Although the NGEU is in principle a one-off event, it is thought that once the debt mutualisation taboo has been broken, other community debt issuances or the purchase of part of the existing national debt might follow. The NGEU could therefore be considered as the manifestation of a fundamental change in attitude towards a possible decisive acceleration in the integration process.

For other commentators, the NGEU would be no more than the manifestation of a specific political moment conducive to at least partly breaking with the dividing dynamics between creditors and debtors that have prevailed over the past decade, and would open

⁵ For a detailed analysis of EU member States' response to COVID-19 see the European Commission (2021b), 'Report on Public Finances in EMU, 2020', European Economy, *Institutional Paper*, 147, February.

⁶ In addition to the aforementioned European Commission (2021b), see European Council (2020), *Special meeting of the European Council (17, 18, 19, 20 and 21 July 2020) – conclusions*, EUCO 10/20, 21/VII/2020; European Commission (2020), *Annual Sustainable Growth Strategy 2021*, COM (2020), 17/IX/2020; and Enrique Feás & Federico Steinberg (2021), 'The European Recovery Plan: the figures for Spain', ARI n° 35/2021, Elcano Royal Institute, http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/ari35-2021-feas-steinberg-european-recovery-plan-figures-for-spain.

⁷ For the most recent example, see Lucas Guttenberg, Johannes Hemker & Sander Tordoir (2021), 'Everything will be different: how the pandemic is changing EU economic governance', Policy Brief, Hertie School.

the way to partial but highly necessary reforms in the EMU. Such observers would consider any attempt to draw conclusions about the implications of the NGEU for the EU integration process as premature.

It may be argued, however, that the factors traditionally underlying the division between creditors and debtors⁸ remain in place and in fact might have been aggravated with the COVID-19 crisis. After all, the debtors are those that are suffering the deepest recessions, whereas the traditional creditors are regaining their pre-COVID activity levels faster. This fragmentation would also apply to public finances. The debtors, which had already entered the crisis with higher levels of public debt, have seen their debt levels reach historic highs. Among the creditors, debt levels have increased as well, but remain relatively low.

In other words, although the NGEU can serve as a lever for reform, the profoundly divergent, not to say opposing, interests separating 'frugal' creditors from 'prodigal' debtors could maintain –if not indeed deepen– the divide between both groups and frustrate any attempt at reforming EMU governance when normality resumes. In such a case, possible reform progress would only materialise in the context of future crises.

It could be considered, however, that the COVID-19 crisis has introduced new elements that could blur this division between debtors and creditors. Germany, the typical creditor during the financial crisis, has shown an unmistakably supportive attitude towards the debtors in the present crisis. But at the same time, France has tried to break the creditor-debtor division through bilateral agreements with Germany, although attempts to revive the Franco-German axis have had little success so far. Every time these agreements have reached the Eurogroup in inclusive format they have been systematically and simultaneously rejected by the 'frugal' nations and the 'pre-ins'. Meanwhile, the recent appointment of Mario Draghi as President of the Italian Cabinet may, given his prestige, lead to a new dynamic in the European Council/Euro Summit.

To what extent can the attitude and resolve of Germany in the approval of the NGEU indicate a permanent change in its stance? How might the German elections in September 2021 affect the German position? Is it worth considering a confluence of Franco-Italian interests, at the same time as the Franco-German axis is strengthened, under the French Presidency? What role should Spain play?

⁸ Or between frugal and prodigal nations, or between advocates of sharing risks and advocates of reducing them –these subgroups of member States are virtually interchangeable–.

In general, the debtor group has been pretty outspoken when specifying their proposals for sharing risks, but it has been much more unambiguous when it comes to establishing unequivocal commitments to reducing risks. Likewise, the creditors have stuck to the principle of risk reduction, but almost always in a relatively ambiguous way; they have generally been quite reluctant to spell out thresholds that would determine an acceptable risk reduction degree to pave the way for badly needed reforms.

What compromises would need to be offered in order to reduce risks or, equally, what conditions would need to be established to share them? What can be done to defuse the distrust felt by the creditors and the debtors' lack of credibility?

The NGEU could become a window opportunity for advocates of in-depth EMU reforms to show that they are capable of using EU funds efficiently in order to achieve the objectives for which they have been designed. The NGEU emerged from a long and difficult political discussion and all parties should honour their commitments. If the NGEU is not invested properly it will provide ammunition to those who believe that the conditions needed for significant risk sharing do not yet exist. These include the well-known frugal nations, but after the German elections it could cause Germany to revert to its pre-COVID positions and could push France away from a possible strategic alliance with Italy and Spain.

What contract would need to be designed in the EU to overcome this situation? From the perspective of both the creditors and the interests of the main beneficiaries, an appropriate use of the NGEU could require additionality –not investing funds in projects that were going to be carried out anyway–, exhaustiveness –investing them in full without spurning the loans–, administrative capacity –investing them in projects with considerable economic and social returns–, fiscal prudence –not using them to finance permanent current spending and/or the reduction of permanent taxation– and a reforming mindset –investing them within a framework of a small number of major reforms of the greatest priority, which would necessarily be different in each country given the specific bottlenecks that prevent faster productivity growth–.

Is it possible to consider the conditions of additionality, exhaustiveness, administrative capacity, fiscal prudence and a reforming mindset –possibly among other conditions– as necessary although probably not sufficient conditions for paving the way towards the reform of EMU governance?

(3) How to achieve deeper integration in the Economic and Monetary Union

We believe that the discussion of the various alternatives for deeper economic integration in the EU should be framed within the current economic and geopolitical contexts. The proposals may range from the Banking Union (BU) to the Fiscal Union (FU), and include progress towards the Capital Markets Union (CMU), without forgetting political union (PU). It goes without saying that the bulk of the discussion should be focused on reforming the EU fiscal rules –the SGP's preventive and corrective arms– and on the processes of coordinating economic policies in the EU through the European Semester, including the Macroeconomic Imbalance Procedure (MIP).

Although for obvious operational reasons the discussions should be articulated through thematic approaches, the proposals should be transversally coherent (across the various blocks of EMU). Most likely, the reform proposals may be partial and have different levels of ambition. In such a case, partial reforms should be put forward within a far-reaching and integrated vision of EMU reform.

(3.1) Achieving deeper integration in the single market

The process of monetary integration coincided with a significant development in global supply chains, which led at the same time to a productive diversification and a degree of synchronisation of economic cycles (greater over the length of the value chain than in the trade in finished goods).⁹ Despite the economic cycles in the euro area being more synchronised, however, it is evident that their amplitude has diverged, at least since the crisis.¹⁰

This is why it is essential to continue striving for deeper integration in the single market of goods and, in particular, services. However, the questioning of competition policy in relation to the debate about strategic autonomy and 'European champions', as well as the significant divergences in state aid stemming from the pandemic, threaten to introduce distortions into the single market with a tendency to perpetuate real divergences, corporate concentration and the risk associated with asymmetrical shocks to the Eurozone.

Is it possible to have 'European champions' without accentuating the asymmetries in the EU? Does Spain have to align itself mainly with Germany and France, the two engines of greater strategic autonomy, or seek alternative alliances with the Netherlands, the Nordic countries and perhaps Poland? Can Spain and Italy cooperate on a common position? How will a greater commitment to strategic autonomy affect transatlantic relations?

(3.2) Completing the Banking Union and the Capital Markets Union

Completing the BU and speeding up the CMU would facilitate the distribution of financial risks in the EU and reduce the risks of financial fragmentation. Pan-European banking services and entities, operating without geographical or regulatory barriers, would break the sovereign-bank nexus and would be more resilient to asymmetric shocks. At the same time, thanks to the geographical diversification of their business models, banks would be able to keep credit channels open even if some of the countries in which they operate suffered a shock.

⁹ A meta-analysis conducted by Campos *et al.* (2017) shows that membership of the monetary union accounts for at least half of the general increase in the correlation in the economic cycle between Eurozone countries since 1999. V. Campos *et al.* (2017), 'Business cycle synchronisation in a Currency Union: taking stock of the evidence', Bank of Finland Research Discussion Paper n° 28/2017.

¹⁰ V. Franks *et al.* (2018). 'Economic convergence in the Euro Area: coming together or drifting apart?', IMF Working Paper n° 18/10, International Monetary Fund.

Moreover, the BU and the CMU show numerous synergies. The development of capital markets requires a common savings market and a benchmark yield curve, while liquid, functional and deep capital markets would underpin the European banking system and business sector and strengthen the international role of the euro.

The direct risks posed by the pandemic to non-financial businesses and its implications for the banking system have acted as catalysts for approving, after two years of discussions, the Single Resolution Fund backstop and prompting the Council to accelerate efforts to adopt the European Deposit Insurance Scheme (EDIS).

What should be the conditions for a rapid adoption of the EDIS? How can the crisis management framework, including bank insolvency legislation, be improved? Does a possible enlargement of the scope of the common supervisory framework make sense?

The review of the regulatory treatment of sovereign exposures (RTSE) tends to be linked to progress towards the EDIS, because it is regarded as a key element for addressing the sovereign-bank nexus. At the same time, RTSE is considered as a necessary prerequisite for the introduction of a common safe asset. However, the RTSE is not devoid of controversy, especially in countries that are most indebted and are most in need of financing their sovereign debts by their 'national' banks.

What combination of reforms would be required for the most indebted countries to accept substantial modifications to the regulatory treatment of sovereign exposures (RTSE)?

Despite being a by-product of financing NGEU and SURE, the volume of high-quality debt –up to €850 billion– could constitute the embryo of a safe asset in the euro area and, as discussed below, the creation of a Central Fiscal Capacity (CFC) could significantly increase the volume of debt in circulation. The way markets have absorbed the first SURE issuances, totalling €90.3 billion, reveals an unmistakable investors' appetite for this type of debt.

There seems to be a degree of consensus about the need for a safe asset for the euro area, but:

What specific advantages would a safe asset in the euro area provide? To what extent does such a safe asset already exist and would it constitute the debt of the 'triple A' debtors? Could a safe asset serve as an additional instrument for monetary policy, using the yield curve?

Progress towards the CMU would diversify sources of finance for businesses and households and facilitate access to more efficient investment vehicles, including both variable and fixed cross-border income positions.

However, the process to complete the CMU would not be uncontroversial.

What common supervisory and trading regulations might the CMU require? How can progress be made on harmonising national insolvency frameworks? Is it necessary to reform taxation and property rights legislation?

(3.3) Fiscal Union: rules versus authority

The FU is the EU integration process that involves the most controversial elements from a political point of view and the most complex ones in technical terms. The degree of ambition also shapes the debate, ranging from those who argue that it would not be necessary to introduce any legislative changes whatsoever in the current situation, but simply to find out the best way to reinterpret the existing fiscal rules in the most possible flexible way, to those who conclude that any serious discussion of the fiscal framework inexorably leads to the dilemma of rules versus authority, and what resolves such a dilemma is the authority, ie the creation of a Treasury with an EU Finance Minister backed by the democratic legitimacy of the European Parliament and/or the national parliaments. Between these two extremes, there may be many particular issues that can be debated without losing sight of the ultimate goal, however it is conceived. These would include from a review of the fiscal rules, which seems to be unavoidable given the political difficulty of applying the existing framework with the record debt levels that countries will have accumulated during the pandemic, to the creation of a Central Fiscal Capacity (CFC).

(3.4) The fiscal rules and proposals to reform them

The general escape clause foreseen in the Stability and Growth Pact¹¹ is currently activated.¹² The clause enables member states to depart from the adjustment path towards the medium-term objective or MTO¹³ established in the Country-specific Recommendations (CSRs) given to each country by the Council in May within the framework of the European Semester.¹⁴ The escape clause also enables the automatic stabilisers to operate fully, while the authorities can take discretionary budgetary measures to support economic activity without defaulting on the preventive arm of the

¹¹ Both an exhaustive list of the rules governing the SGP and a detailed explanation of how the European Commission administers the pact can be found in European Commission (2019), 'Vade Mecum on the Stability & Growth Pact, 2019 Edition', European Economy, *Institutional Paper*, 101, April.

¹² See European Commission (2020), 'On the activation of the general escape clause of the Stability and Growth Pact', COM (2020) 123.

¹³ The Stability and Growth Pact requires that the member States specify an objective for their medium-term budgetary position in their stability and convergence programmes. The minimum medium-term objective is specific to each country with the aim of taking into account the differences in budgetary development and in the risks to the sustainability of public finances. The MTO is expressed in terms of the structural balance, which eradicates cyclical effects and one-off measures affecting the budget balance. member States can adopt more ambitious objectives than the minimum.

¹⁴ The European Semester is discussed in what follows.

SGP. In its communication to the Council of 3 March 2021,¹⁵ the Commission proposed to deactivate the clause when GDP in the EU regains its pre-COVID-19 levels, something that, according to its spring forecasts, might not take place before 2022 at the earliest. Furthermore, acknowledging the asymmetric nature of the recovery, the Commission believes that, once the escape clause has been deactivated, the current fiscal rules should be applied as flexibly as possible to those member States that have not by then regained pre-COVID-19 levels of output.

The clause does not, however, remove the obligation to avoid excessive deficits. In fact, the Commission will have to evaluate the stability and convergence programmes and, on the basis of the definitive budgetary data validated by Eurostat for 2020, draft the respective article 126(3) reports¹⁶ in spring 2021. The Commission stipulated in the aforementioned communication that it would carry out the evaluation taking into account the increased uncertainty, the fiscal response agreed by the EU and the country-specific recommendations adopted by the Council for 2021.

The reaction of the member States to offset the effects of the crisis has lifted public debt ratios to unprecedented levels, far away from the 60% threshold and without any clear prospect of falling back at a satisfactory speed. Both nominal and structural deficits have likewise skyrocketed, so that most countries are not only recording headline deficits above 3% of GDP, but their structural balances have also significantly departed from their respective MTOs. In these circumstances, strict compliance with the Treaty obligation to remedy excessive deficits –in terms of both deficit and debt– and the deactivation of the general escape clause might lead to a severe and prolonged fiscal contraction in the EU. A premature withdrawal of the fiscal stimuli would run diametrically counter to what should be done until the economic activity recovers the pre-COVID levels and output gaps close.

All in all, an immediate return to the current fiscal-rules framework does not seem feasible. The ‘new fiscal normality’ in the euro area could be described in terms of two alternative approaches. According to the first, there would not be an appetite for changing the rules, so that we should think of how to implement them appropriately given the economic situation. According to the second one, it should be possible to take advantage of the current economic and political conditions to move forward and agree a more or less profound reform of the EU’s fiscal framework. Obviously these two alternatives are not mutually exclusive, because the first alternative would buy time to discuss in-depth reform.

It would be possible to consider a political agreement enabling the existing rules to be applied with generous flexibility. Indeed, this was the Commission’s own proposal in March 2021, in which it suggested applying the fiscal rules with all the flexibility available to those countries that have not returned to pre-COVID-19 levels of output. Beyond this

¹⁵ See European Commission (2021c), ‘One year since the outbreak of COVID-19: fiscal policy response’, COM (2021) 105.

¹⁶ These are the reports that according to article 126, paragraph 3 of the EU Treaty the Commission needs to draw up when it notices evidence that the deficit planned by or observed in a member State can be deemed excessive. The budgetary balances observed for any given year are those notified by the member States in April of the following year, validated by Eurostat.

exceptional solution to an exceptional situation, it is possible to propose a sort of *sine die* hibernation for the Stability and Growth Pact until an agreement on reform can be found. Fulfilling the precepts of the Treaties, the excessive deficit procedures would be opened up, but the *adjustment path of the nominal deficit could be made dependent on the evolution of output*, and the 1/20 rule for reducing debt¹⁷ –which, if applied, would require austerity policies inappropriate to the current economic situation– would be replaced by reaching the MTO, conditional to the primordial goal of ensuring macroeconomic stability.

Should flexibility be applied to all member States, or only those that have not returned to pre-COVID levels of output? For how long? Only until regaining pre-COVID output levels? What implementation problems would widely different fiscal positions among euro area members pose? Would it not run the risk of widening the division between ‘frugal’ and ‘prodigal’ countries?

The apparent impossibility of applying the current SGP in the present juncture, as well as the potentially undesirable implications of its hibernation, seem to argue in favour of the opening of reform negotiations in the Council. There appears to be a broad consensus that the current SGP is overly complex and opaque, and even ineffective at attaining its goals. The Pact is also asymmetrical. The obligation of member States is to consolidate public finances until reaching their MTO. Once the MTO has been attained or exceeded, nothing obliges national authorities to implement a counter-cyclical fiscal policy in the contracting phase of the cycle, something that has obvious implications for the euro area fiscal policy stance. Moreover, the current fiscal rules are based on a multiplicity of indicators, some observable, others not, and they are not always internally consistent. This means that a mechanical application of the Pact could lead to a package of recommendations inconsistent and inappropriate at the current economic juncture. There is a need for expert judgment, which may not always be highly transparent, and could open the door to political pressure and influence from the member States, thus damaging the credibility of the process. Almost all member States would agree that the SGP needs in-depth reforms to address these shortcomings. The consensus vanishes, however, as soon as specific proposals start to be discussed. For some, the current rules make it possible to avoid fiscal discipline –so better leave them as they are–, whereas others fear that a reform of the Pact would make it excessively flexible and lenient. The reform proposals run in a multitude of directions, so many that it is almost impossible to spell all of them out in a short document. Consequently, here we will only focus on a few of the most discussed reforms put forward in the literature, in particular:¹⁸ (a) fiscal standards; (b) observable indicators; (c) primary structural spending; (d) the golden rule; (e) the debt rule; (f) division of functions; and (g) a review of the utility of fiscal rules.

¹⁷ The Stability and Growth Pact establishes that member States with debt levels higher than the 60% threshold of GDP should reduce it every year by 1/20 of the difference between the current and the 60% levels.

¹⁸ Some of the proposed reforms of the SGP reviewed here were discussed by a group of mainly German and French economists at the CEPR (2018), ‘Reconciling risk sharing with market discipline: a constructive approach to euro area reform’, *CEPR Policy Insight* n° 91, January.

(a) Fiscal standards

Olivier Blanchard, Álvaro Leandro and Jeromin Zettelmeyer¹⁹ have recently proposed replacing fiscal rules with what they call fiscal standards. In this case, the fiscal rules are replaced by generic recommendations regarding the obligation of not running excessive deficits and/or ensuring the sustainability of public finances. An (independent) authority would regularly monitor the risks and, when necessary, propose corrective measures. The margin for discretion of authority would be restricted by secondary legislation and a specialised chamber at the Luxembourg Court of Justice would be responsible for settling any disagreements between national authorities and the fiscal authority. The parallelism with EU competition policy, especially state-aid control, is pretty obvious. In this case the debate turns around the rules-versus-authority dilemma. The problem would be not so much the current rules –their indicators, transparency or opacity– but the lack of authority to implement them.

Could an independent fiscal authority maintain fiscal discipline in the Union while at the same time enabling fiscal policy to fulfil its functions of stabilisation and sustainability? How can it be ensured that proceedings do not drag on endlessly, as often happens with decisions about state aid? Would the process just involve the fiscal authority and the national authority concerned, or would others be able to submit allegations, either to the fiscal authority or to the court? Should the fiscal authority need to concern itself with the fiscal stance of the euro area? How would the democratic role of the national parliaments in the approval of the budget be ensured? And the European Parliament? Is it possible to have a credible central fiscal authority without a central fiscal capacity?

(b) Observable indicators

An SGP based on observable indicators, such as the one that existed prior to the 2005 reform. Although it was described as ‘stupid’, it should be acknowledged that the original SGP of the Maastricht Treaty and the 1998 regulations already embedded main elements –including an escape clause– enabling fiscal policy –once the sustainability thresholds had been reached (public debt of 60%)– to fulfil both its stabilising function, even in extraordinary conditions, and its function of ensuring the sustainability of public finances without overlooking their quality. Non-compliance on the part of France and Germany triggered the 2005 reform, which possibly made the Pact more intelligent, but undoubtedly also more complex by introducing unobservable indicators. No doubt, the adoption of the Six Pack and the Two Pack²⁰ have increased the degree of complexity,

¹⁹ See O. Blanchard, A. Leandro & J. Zettelmeyer (2021), ‘¿Qué hacer con las reglas fiscales de la Unión Europea?’, *El Grand Continent*, 22/II/2021.

²⁰ The Six Pack and the Two Pack are both sets of legislative measures that introduced successive reforms into the SGP. The Six Pack was adopted in 2011 with the goal of strengthening the procedures to reduce deficits and debts. The Two Pack was added in 2013 to strengthen fiscal surveillance in the euro area, increase transparency, strengthen coordination of the budgetary cycle in the euro area and acknowledge the special needs of euro area members with financing problems. See European Commission (2019).

further enhanced by the reforms introduced by the Juncker Commission.²¹ It seems possible to discuss ways to return to a more transparent SGP, based on observable budgetary indicators, without going back to the simplicity and ‘stupidity’ that Prodi denounced. An interesting question might be as follows:

Which institution or authority should implement the SGP, such that nominal indicators with a strong cyclical component could be interpreted ‘intelligently’? Would it be possible, without changing the treaties, to transfer part of the responsibility to the Independent Fiscal Institutions (IFIs)? Should the 3% and 60% thresholds be reset? Would a change in the protocol be feasible within a reasonably short deadline?

(c) Expenditure benchmark

Other proposals, especially referring to the preventive arm, reject the simultaneous use of the structural balance and of the expenditure benchmark –a primary structural spending rule–²² to determine the adjustment path towards the MTO. The preference is for the latter indicator exclusively. It is argued that a spending rule would mitigate errors in estimating potential annual output, because it would be replaced by the 10-year average. Moreover, certain expenditures of a cyclical nature (unemployment) are excluded, so that adjustment towards the MTO does not entirely prevent the use of automatic stabilisers. The expenditure benchmark also excludes the co-funding of EU funds and replaces the public investment in the budgetary period concerned with an average level of the previous three years. As a rule based on primary spending, it excludes the burden of the debt and consequently the effects of monetary policy on the adjustment speed. However, even after the smoothing out of potential output, the spending rule is not observable, but rather needs to be estimated, and operates with structural variables, in other words it may not be as transparent as desired. Lastly, it should be acknowledged that it is difficult to compare the adjustment paths across member States because it does not refer to any scale parameter, so it is not easy to communicate; in fact, the Commission always translates the expenditure benchmark in terms of the structural balance.

²¹ The Commission supported a more flexible application of the existing rules and used the so-called margin of discretion to take into account the cyclical position of the economies in the process of adjusting towards the MTO. For the details see for example C. Martínez Mongay & M. de Manuel Aramendía (2020), ‘The EU fiscal rules during the Juncker Commission. Implementation, reform and challenges ahead’, in F. Fernández Méndez de Andés (Ed.), *The Euro in 2020. A Yearbook on the European Monetary Union*, chap. 6, IEAF/IFF and ICO.

²² The so-called ‘expenditure benchmark’ specifies the maximum growth rate of public spending after deducting interest payments on debt, as well as the effects of the cycle. This growth rate should not exceed potential GDP growth over the medium term. See European Commission (2019) for the details.

How could the expenditure benchmark criterion be modified to avoid these problems while maintaining its function of adjustment towards the MTO? Bearing in mind that the MTO is defined in terms of the structural balance, should the use of the expenditure benchmark entail the redefinition of the MTO and the adjustment path? What inconsistencies might arise with the minimum structural adjustment (as a benchmark) of 0.5% of GDP required in the secondary legislation? To what extent would the adoption of an expenditure benchmark make a debt rule redundant?

(d) The golden rule

Although there is a provision in the original SGP according to which investment expenditure should be taken into account in the corrective arm when deciding whether the deficit is excessive in the Article 126(3) reports, in many cases the correction of the excessive deficit and/or adjustment towards the MTO is carried out partially at least by reducing the level of public investment. Consequently, it has been suggested that a golden rule should be introduced to exclude public investment from the calculation of the public deficit in the SGP. Bearing in mind that the assumption underlying the golden rule of investment is that public investment speeds up growth, which, by increasing nominal GDP, passively finances public debts, a series of questions can be put forward:

Would the golden rule be applied to net or total investment? Does all public investment accelerate growth, or does it depend on the stock of public capital and the composition of the investment? Since spending on education, vocational training and research can be considered investments, should the golden rule apply to all this kind of spending? How should healthcare spending be treated? What would the implications be for the sustainability of public finances if education, healthcare and other expenditures were included in the golden rule?

(e) The debt rule

The stability versus sustainability dilemma has generated a series of proposals to improve the preventive arm. For some commentators, the fundamental objective the Pact must be to ensure the sustainability of public finances, something that requires introducing a long-term debt rule over the economic cycle, therefore without hampering the operation of the automatic stabilisers. This would require establishing a sustainable structural debt level for each country.²³ This proposal could raise the very general question of to what extent it represents an innovation with regard to the spending and deficit rule. In the end, it could be argued that, leaving aside 'below-the-line' financial engineering, the debt level is an endogenous variable to the budgetary process and therefore a debt rule would in one way or the other be equivalent to a deficit rule, an MTO but expressed in a different way.

²³ In their 'standards-based' approach, Blanchard *et al* (2020) refer to the likelihood of a certain level of debt in a country at a given moment being sustainable.

What advantages would a structural debt rule have compared to a structural balance or primary expenditure rule? What would it represent in terms of adjusting the primary balance? Why would member States have more incentives to respect a debt rule than a deficit or spending rule? How can the debt gap, positive or negative, between the current and the possible sustainable level be closed? What implications would a rule of this sort have for the fiscal policy stance of the euro area?

(f) Division of functions

Another approach to reform that deserves some thinking is the division of functions in the implementation of the corrective and preventive arms of the Pact. Based on the fact that the Commission has a well-defined role in applying article 126 of the Treaty, it has been suggested that the excessive deficit procedure should be the exclusive responsibility of the Commission, which would take care of correcting gross errors in the budgetary processes based on directly observable indicators. The preventive arm would be left in the hands of the IFIs, which would be responsible for maintaining budgetary equilibrium over the economic cycle. Within this context, one can wonder:

How can the mandate of independent fiscal institutions be modified to ensure their capacity to influence over domestic budgetary processes? How can it be ensured that the opinion of an independent fiscal authority outweighs a Council recommendation? Is there any evidence showing that governments of countries with budgetary imbalances have followed the recommendations of the independent fiscal authority? Have the recommendations of the IFIs been very different from the Council's? What indicators should they use? Who is responsible for the fiscal stance of the euro area?

(g) Review of the utility of the fiscal rules

A relatively general but no less legitimate issue is the usefulness of the fiscal rules. In other words, what are the rules designed for? To lead member states towards the budgetary equilibrium over the cycle and/or keep them there? The experience gained to date may suggest that the rules have not been very effective at bringing member States to their MTOs. Although the financial and debt crises, together with the pandemic, largely explain current excessive deficits, high debt levels and significant deviations from the MTOs, it might be argued that the real problem is lack of political will to rebalance public finances during good times.

Could it be that the SGP does not offer the incentives needed to ‘fix the roof while the sun is shining’? What incentives could be provided? What commitments should be required? Is it possible to conceive an authentic ‘Hamiltonian moment’ that would leave the public finances of all countries in equilibrium? In such a case, would simple rules suffice to maintain balanced public finances over the cycle, or would an authority be needed to ensure it?

(3.5) The creation of a Central Fiscal Capacity

According to the latest report from the European Fiscal Board, the COVID-19 crisis has underscored the need to strengthen the EMU. The report argues that a crucial element of such strengthening would be a permanent and genuine Central Fiscal Capacity (CFC).²⁴ The CFC would consist of an EU budget financed by its own resources and with the capacity to take on debt. The SURE and the NGEU could become the embryo of this budget. It would be modelled on the ill-fated Budgetary Instrument for Convergence and Competitiveness (BICC) approved by the Council in December 2018 but shelved after a long year of discussions.

A reference was made above to a possible link between the creation of a CFC and the reform of the fiscal rules, so the discussion now needs to focus on the architecture and governance of the CFC.

The first question to be asked could be what the purpose should be of a CFC. At least two goals have emerged from the debate.

The first goal is a counter-cyclical function of an automatic nature. As suggested at the Council meeting of December 2018, the instrument could consist of a European unemployment insurance scheme. Clearly the SURE experience would provide the basis for an instrument that would enable national unemployment schemes to be funded or at least co-funded by the CFC. Main issues revolve around whether this European unemployment insurance scheme would come with some sort of conditionality and the degree to which it would be automatic. It may also be questioned to what extent an unemployment insurance scheme on its own would provide sufficient macroeconomic stability or whether it would be necessary to add other elements on the expenditure and/or revenue side. For example, would it require the reforms of labour markets establishing a form of level playing field within the euro area? Should some form of macroeconomic conditionality be required within the framework of the SGP, whether reformed or not? Would it be activated automatically? On the basis of what indicator(s)? Would the whole euro area unemployment insurance scheme be funded by the CFC or only above a threshold, such as an average of unemployment levels in the past, and/or associated with extraordinary economic fluctuations?

The second possible goal of the CFC, not mutually exclusive with the first, mirroring the NGEU, would consist of a permanent fund specialising in financing investments of pan-

²⁴ See European Fiscal Board (2020), *Annual Report 2020*. The report also includes a fairly comprehensive review of the relevant bibliography on the subject.

European interest and/or providing funds to member States to finance public investments during recessions. Due to the nature of the fund, its function as an automatic stabiliser would be less obvious, but, no doubt, it would contribute to address asymmetric or extraordinary shocks, thus avoiding public investment from becoming the victim of fiscal consolidation, as has often been the case in the past. The risk, as with all discretionary fiscal policies, would be time inconsistency, as investment projects take time to be implemented. In any event, as is happening now with the NGEU, their utility in preserving socially-necessary levels of public investment in bad times seem to be beyond any doubt. The issues that arise are similar to those surrounding a facility or fund to finance or co-finance unemployment schemes: the type of conditionality, if any, that should be established, the activation procedure, the indicators to be used for its activation and the institution charged with the task of administering the fund. Other related issues are its funding and governance. The initial proposals for a CFC consisted of a fund from which member States could obtain loans. The fund would be continually replenished as the member states repaid their loans. The possible need for a backstop was not given any in-depth analysis, while not being ruled out, although some proposals contemplated the possibility of replenishing the fund with debt guaranteed by the member States. The architecture of SURE and the NGEU have provided a different perspective. The CFC can be viewed as a permanent SURE or NGEU funded by the EU's own resources and with a capacity to issue debt. As in the case of SURE, the CFC could distribute these funds as transfers and/or loans. While the national automatic stabilisers would operate fully, the CFC would provide additional stabilisation by means of unemployment insurance, as well as discretionary investments through the investment fund.

The speed of decision-making in activating the CFC is crucial, as is becoming evident with the NGEU.

Would it be necessary to design mechanisms to make a timely identification of needs and delegate the decision to release funds to an independent institution? How would the CFC be activated? Automatically? At the request of a member State? Following a Council or Commission decision? What role should the European Parliament play? Should it play the typical role of all democratic parliaments and adopt the budget, including decisions about own resources?

Lastly, it is worth noting that most discussions surrounding the CFC take it for granted that its purpose is to provide macroeconomic stabilisation and/or investment support during recessions,²⁵ but:

What would a central fiscal capacity do during good times? Could it be used to help member States to balance their public finances over the cycle? Could it be used to convert national into EU debt? How would it obtain its revenues? Using joint debt issuance? Through new European taxes? Both?

²⁵ One issue that often gets left out of the discussion is that a 'stabilisation' item tends not to feature in national, regional, local or federal budgets. Budgets have items of expenditure and revenue, some of which prove to be countercyclical, even though this is not the function for which they were conceived.

(3.6) The function of the ESM

As mentioned above, the COVID-19 crisis and the possible associated risks for the banking system have accelerated the adoption of the backstop for the Single Resolution Fund. The same opportunity was taken to reform the founding treaties of the intergovernmental organisation, something that, among other things, clarified its role in cooperating with the Commission on future financial assistance programmes in the euro area. Moreover, the ESM had already reacted in the spring of 2020 by offering credit lines (PCS) of up to 2% of member states' GDP without any macroeconomic conditionality, which represented a significant change in the entity's *modus operandi*. However, the diametrically opposed ways member States have reacted to the ESM's PCS and the Council's SURE suggests that the pendulum is starting to swing against intergovernmental processes and in favour of community methods.

Indeed, whereas the demand for SURE loans has almost fully covered the available amount, not a single member State has applied for PCS loans. A possible explanation may be found in the effect of the ECB's PEPP, which enables member States to finance themselves in the markets at better conditions than those offered by the PCS. However, the possible political stigma associated with the ESM after the experience during financial and debt crises, as well as the rejection of decisions taken by opaque intergovernmental organisations could largely account for the failure of the PCS. At any event, it seems essential to rethink the way the ESM operates because the mere existence of an institution with a vast capital amount at its disposal and considerable lending capacity that member States avoid using seems dysfunctional in the EMU.

The ESM is an intergovernmental institution and, as a consequence, some commentators question whether it could form part of a new EMU architecture. This may be an important issue to discuss within the framework of a wide-ranging debate on the strengthening of the EMU and the Conference on the Future of Europe.

To what extent are we witnessing a change of preferences in favour of the EU approach and against the intergovernmental solutions that have prevailed over the past 10 years? Should the integration of the ESM in the EU Treaties be a *sine qua non* condition? What function would the ESM have if the BU and the CMU were completed and there were a genuine CFC? What would be the likelihood of needing a programme of financial assistance? Under what conditions could the ESM be the authority that administered the CFC and all the backstops needed for the SRF, the EDIS and the CFC? In the affirmative, should it become part of the Commission, or should it be part of the Council? How should it be controlled by the European Parliament?

(3.7) The European Semester

The European Semester (ES) is the coordination cycle for economic policies, whether fiscal or structural, within the EU. The ES includes the Macroeconomic Imbalance Procedure (MIP)²⁶ and unfolds in four phases. The Semester starts in autumn with the adoption of economic policy priorities for the EU. The autumn package also identifies countries that seem to display macroeconomic imbalances and sets out the recommendations for the euro area. In winter the country reports are published and it is decided which member States are recording macroeconomic imbalances and their severity. In spring, economic policy recommendations are adopted for each country, including budgetary policies. Lastly, euro area members need to reflect these recommendations in the budget plans submitted to the Commission in October.

In the context of the present paper, the question worth raising is the role of the Semester in the new EMU architecture. For some people the ES is dead²⁷ because in the next six years the entire process of coordinating economic policy in the EU will revolve around the NGEU. Alternatively, the changes introduced by the NGEU could introduce permanent improvements in the ES. Ultimately, it is not enough to announce the death of the ES; some discussion is needed as to whether or not a reformed EMU would need a process to coordinate economic policies, on top of the fiscal ones.

Should the country reports be less homogeneous and more country-specific, like the IMF's Article IV consultations? As already occurs with the NGEU, should economic policies be the outcome of an intensive dialogue with EU institutions? Who should be responsible for the dialogue? Would this improved dialogue promote the political ownership of the reforms by the member States? What role should national parliaments and the European Parliament play?

The MIP was introduced in the aftermath of the financial crisis when it was confirmed that the countries that suffered the worst crises had accumulated the greatest macroeconomic imbalances (above all in the current account). Like the SGP, the MIP is under severe criticism. It is viewed as a complicated, bureaucratic, opaque and weak instrument. Although these criticisms are not without foundation, some of the supposed weaknesses of the MIP seem to be closely related with its objectives. No well-informed analysis of the fundamental aspects of any economy can be carried out on the basis of the observation and mechanical analyses of a few simple indicators. Expert judgement is required, which is almost always subject to controversy. In addition, the link between reforms and their economic effects is never obvious, even less if they are structural reforms, the effects of which tend to take place over the long-term and are difficult to isolate and observe directly. These difficulties come on top of the simultaneous consideration of flows and stocks. The effects of structural reforms and other policies do not tend to be immediate. An indefinite amount of time is needed between the adoption

²⁶ The procedure was adopted in the Six Pack. For a detailed description of the MIP and its legal foundations, see European Commission (2016), 'The macroeconomic imbalance procedure. Rationale, process, application: a compendium', *European Economy*, Institutional Paper, 039, November.

²⁷ This would be the position of Lucas Guttenberg, Johannes Hemker and Sander Tordoir, mentioned earlier.

of a structural measure, its implementation and its effect on the corresponding flow. Even more time usually elapses until the corresponding stock is significantly corrected. In short:

What role should be played by the Macroeconomic Imbalance Procedure, with or without the European Semester? How should it be reformed so that it effectively fulfils its role as identifier and corrector of macroeconomic imbalances?

Obviously, in this discussion, the rules versus authority dilemma arises as well.

(3.8) Institutional framework: the Eurogroup

Lastly, as far as the institutional framework is concerned, the role of the Eurogroup has been questioned. Two events might justify its disappearance. First, the UK's departure from the EU means that, in terms of economic weight, the difference between the composition of the Eurogroup and of the ECOFIN has been significantly reduced, so that taking decisions about the euro area is almost the same as deciding about the EU (and this will become even more the case as more countries join the euro). Secondly, in its inclusive format the Eurogroup is identical to the ECOFIN, so that there are issues that are *de facto* discussed twice. The only important difference is that the COREPER is in the ECOFIN, whereas the Eurogroup is prepared by the Economic and Financial Committee (EFC). Moreover, the EFC itself might be in doubt because, on the one hand, it has shown a procedural bias with little discussion of the substantive issues and, on the other, it has not been effective in making significant progress in deepening the EMU. Alternatively, it might be argued that as long as the pre-ins exist EMU would be incomplete, consequently an exclusive euro area discussion forum will be needed.

Does it make sense to maintain the Eurogroup alongside ECOFIN? Should the inclusive formats of either the Eurogroup or the EFC be retained? How can the procedural bias of these formations be avoided? What added value would a permanent Presidency of the Eurogroup now provide?

(4) Making progress on Political Union

Lastly, a comprehensive analysis of the euro area economic governance cannot avoid the issue of the political legitimacy of the process. The EU's democratic deficit is something that has been argued about since its creation,²⁸ but as progress is made towards 'an ever-closer union' and more sovereignty is shared –and the NGEU is travelling in this direction– addressing it has become unavoidable. The response to the euro crisis has meant major headway being made in European integration, both in terms of banking and fiscal union, and even in terms of the economy with the SGP and the European Semester; but, as Jürgen Habermas once said, this process may be described

²⁸ See the following article for a summary of the debates at the start of the 1990s: Karlheinz Neunreither (1994), 'The democratic deficit of the European Union: towards closer cooperation between the European Parliament and the National Parliaments', *Government and Opposition*, vol. 29, nr 3, p. 299-314.

as an 'executive federalism'²⁹ that does not have the democratic oversight needed for its sustainability over time. The resentment generated by the ESM and the Troika in many national parliaments is a good example of this.

In the 2012 Four Presidents' Report, aimed at a 'genuine' EMU (then still embroiled in the crisis) and led by the President of the European Council, Herman Van Rompuy,³⁰ there was a final section titled 'Strengthening democratic legitimacy and accountability' in which it was said that national parliaments were not well-placed to safeguard the common interests of the Union and that, if decision-making mechanisms were to be integrated further, and more competencies were to be transferred to the supranational level, it would be necessary to get the European Parliament more involved in the process. The Five Presidents' report, under the leadership of Jean-Claude Juncker³¹ in 2015, also insisted on this idea, but in practice it has not got through (in the NGEU, for example, the European Parliament can only give its opinion, not exercise a veto) and as the discussion surrounding the EU's own resources to repay the shared debt progresses, the voices calling for greater control at a European level can only grow louder.

It is also highly likely that tensions will emerge concerning the distribution and correct use of the NGEU funds. The European Commission will take charge of overseeing the process and will therefore hold enormous power and responsibility. What it invests in and how, and what reforms have to be carried out, will naturally involve (as is already evident) economic policy frictions that will generate new debates as to whether it is legitimate that a bureaucratic body like the Commission should take this type of decision, above all if at some point it is deemed that a member state is in breach of its plan and it is decided to suspend the release of further funding. The matter will become even more fraught if in the years ahead a national parliament –the Dutch for instance– deems that another country is not using the funds properly and calls on the Commission to intervene accordingly. The Conference on the Future of the EU should be the mechanism for addressing these issues of democratic legitimacy and accountability.

Will progress be made towards political union? Is it necessary to give more power to the European Parliament in general, and on matters related to the EMU in particular? Would it be advisable to have transverse lists in the next election? Should reform go even further, so that the President of the Commission is directly elected by the EU's citizens? How much of this can be achieved without changing the treaties?

These are political questions that go beyond the monetary and economic sphere, but if in order to overcome the dramatic effects of the pandemic, EU member States have decided to issue joint debt and explore the possibility of introducing European taxes to pay for them, discussion of such questions becomes inevitable.

²⁹ Jürgen Habermas (2012), *The Crisis of the European Union: A Response*, Wiley.

³⁰ Herman Van Rompuy *et al.* (2012), 'Towards a genuine Economic and Monetary Union', 12/XII/2012.

³¹ Jean-Claude Juncker *et al.* (2015), 'Completing Europe's Economic and Monetary Union', 22/VI/2015.