Contributions from the Sherpas of the Member States to the Five Presidents' Report

UNITED KINGDOM

First Contribution

Analytical note on Four Presidents' Report – UK Response

We welcome the work being done by the Four Presidents to strengthen the single currency for the long term, and the fact that this is being done in consultation with all Member States. We want to see a stable and prosperous euro area, and to ensure that the EU's wider economic governance framework is fit to face the challenges of the future.

We broadly share the analysis presented in the analytical note. There have been common responses across the EU and the advanced economies, of strengthened financial regulation, necessary fiscal consolidation, and structural reform to raise competitiveness. It is important to distinguish between those elements of the response which are specific to those in the euro area and those with more general application.

In the euro area, we welcome the very significant steps already taken, including the creation and use of the ESM, the flexibility the ECB has shown in responding robustly to the crisis within its existing mandate, the Single Supervisory Mechanism and the Single Resolution Mechanism, as well as the strengthening of fiscal governance and the Macroeconomic Imbalances Procedure. Given many of these reforms are recent, key elements of this new governance framework remain untested. Effective implementation, if or when their mechanisms are required, will be important in terms of reinforcing credibility and confidence.

However, we also agree with the underlying premise of the Four Presidencies exercise that "*closer coordination of economic policies is essential to ensure the smooth functioning of the Economic and Monetary Union*". It is a statement of fact that the degree of economic and fiscal integration in the single currency remains much lower than that of other currency unions, for example the United States, or indeed the UK itself, so further steps are likely to be necessary to refine the system, reduce risks, and respond to future shocks. These matters of governance, while important in terms of the stability and strength of the euro area, are in themselves a means to a wider goal of greater prosperity for Europe; and that goal will depend on wider economic policy reform at the EU level as a whole.

Further steps towards integration in the euro area are primarily a matter for euro area Member States to determine, and we respect that. We have not, therefore, sought to answer each specific question in turn. However, all members of the EU have an interest in them and a common desire for them to succeed. With that in mind, we would like to set out some general comments and observations on the questions posed. These are based on our position as a major EU economy, with the largest wholesale financial centres in Europe, and as a Member State who has had to deal with a deep financial crisis and a serious fiscal challenge in recent years. This also draws on the very substantial evidence gathered as part of the UK's Review of the Balance of Competences report on Economic and Monetary Policy (available here)[1].

First, on **governance and institutions**, out of necessity, very substantial new elements have been introduced in the last five years in a way that goes beyond the existing assumptions and structures of the Lisbon Treaty, including for example through the separate entity of the ESM, the TSCG, and the Intergovernmental Agreement on the SRM. Further, the Single Supervisory Mechanism has been

[1] https://www.gov.uk/government/consultations/economic-and-monetary-policy-review-of-the-balance-of-competences

designed in a way that recognises the likely desire of some Member States to join, even if they do not use the single currency. As these new structures and institutions gradually become part of the European framework, and as the euro area considers potential further steps as part of this Four Presidents' process, an important element should be to give proper consideration to ensuring the interests of both euro area member states and non-euro area member states (including those, unlike the UK, who may wish to join the euro) are fully respected, and that the rights of all are properly protected. There is a common opportunity for all member states to ensure a stable and sustainable framework that enables the euro area and the European Union as a whole to function effectively and efficiently.

As the UK Chancellor and German Finance Minister Wolfgang Schäuble put it, in a joint article for the Financial Times last year, "*future EU reform … must include reform of the governance framework to put euro area integration on a sound legal basis, and guarantee fairness for those EU countries inside the single market but outside the single currency."*

This need has been recognised by the European Council on a number of occasions. For example:

- In December 2013 the European Council agreed that work to strengthen EMU needs to move forward "in full respect of the integrity of the Single Market while ensuring a level playing-field between EU Member States. It will be open and transparent towards Member States not using the single currency".

- In June 2014 they explicitly recognised that the EU needs to allow for "different paths of integration for different countries, allowing those that want to deepen integration to move ahead, while respecting the wish of those who do not want to deepen any further".

Consideration of this should be part of the conclusions of this Four Presidents' report and be a specific part of any follow on work. Important elements of this should include the recognition that the EU is a multi-currency union, reinforcement of the principle of non-discrimination on grounds of currency or geographical location; the protection of the fundamental integrity of the Single Market at EU level; and transparency around procedures

Second, on **rules and the legal framework**, a key lesson of the financial crisis is the need to give financial markets, the wider private sector and national citizens, the clearest possible understanding of the policy framework ex ante; so that all actors have a clear understanding of the likely policy response in the event of problems and can plan their approach accordingly. The hierarchies now agreed as part of the Single Resolution Mechanism are a good example of this approach, as are the mechanisms which have evolved through the Troika process to govern the use of the ESM. On fiscal policy, rules and processes have evolved very rapidly during the crisis. While each measure taken in isolation has merits, the system of fiscal rules is now extremely complicated, which in turn makes it hard to implement them on a clear and consistent basis, and harder still to relate them to national budgetary processes. There is a common interest in ensuring transparency in implementation as a way of maintaining consistency around the framework, flexibility within it and its credibility.

We note also that the development of the 6 pack rules around fiscal policy, as well as the Macroeconomic Imbalances Procedure, was done at the level of the 28, while respecting the different challenges faced by euro area members, as was the European response to the need to strengthen financial regulation and move towards common global standards in the light of the financial crisis. It is essential that any further development of rules in these areas for the euro area are considered alongside our wider shared objectives of promoting financial stability and maximising the growth potential of the EU as a whole.

Third, on **structural reform and wider prosperity**, as set out above, the questions of euro area governance are only part of the necessary agenda at national and European level to raise the prosperity of Europe as a whole. With this in mind, we particularly support the note's conclusions on the benefits of a consistent economic strategy focussed on the "virtuous triangle" of structural reforms, investment and fiscal responsibility – the priority areas identified in the recent Annual Growth Survey. We support the conclusion that the functioning of the Single Market needs to be improved, particularly by prioritising measures to enhance capital market integration, which can both increase access to finance and strengthen financial resilience. We should continue to complement the agenda on governance, with the policy agenda on raising competitiveness, completing the Single Market and expanding trade. While, of course, all of these issues are of importance to the euro area, they are issues for the EU as a whole, and should continue to be taken forward in an EU 28 rather than Eurozone context.

Alongside this, we should continue to look at ways to increase the effectiveness of the European semester through ruthless prioritisation and improvements in governance aimed at increasing national ownership. While the streamlining of the process this year is a step forwards, more still needs to be done. In particular: we should make greater use of globally-recognised competitiveness indicators of the kind used in the presentation to the February European Council, on ease of doing business, productivity and labour market efficiency; we should integrate analysis from external organisations, including the OECD and IMF, more closely into EU processes; we should prioritise the implementation of measures to improve the investment climate for private investment, to support and complement the new EFSI; for euro area Member States in particular, there should be a stronger focus on financial integration and creating flexible and responsive labour markets; and the impact assessment for all EU legislative proposals should include an analysis of the impact of the measures on competitiveness across the EU and the smooth functioning of the single currency.

And finally, to increase national ownership, recommendations by the Council could be less prescriptive in nature - while it is legitimate for the Commission to take a prescriptive approach to diagnosing problems or suggesting desired outcomes, the pathway to achieving those outcomes should be for Member States to choose.

We look forward to discussing this further with colleagues, and to the Four Presidents engaging further with all EU Member States as their conclusions develop.