



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

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PORTUGAL

First Contribution

***PREPARING FOR NEXT STEPS TOWARDS BETTER GOVERNANCE  
IN THE EURO AREA***

**Portuguese views**

The President of the European Commission and the President of the European Council have put the issue of how to advance integration in the Economic and Monetary Union (EMU) back on the agenda. Portugal looks forward to an early presentation of the 4 Presidents' Report ahead of the June 2015 European Council. In fact, the political discussion about how to advance in EMU integration must not be overlooked. Although the economic situation has clearly improved over the course of 2014 and, particularly, in the first months of 2015, member states should not lose the sense of urgency or moderate their level of ambition in discussing how to improve the functioning of the EMU.

After the successful conclusion of a large majority of the assistance programmes and the introduction of important urgent changes in the Euro Area architecture, this is actually the time to have a thorough and frank discussion about which lessons to learn from the past and about what still needs to be done. Much improvement has already taken place, for instance on strengthening and perfecting fiscal and economic coordination rules, on creating stability mechanisms, on advancing and integrating banking and financial regulation, although much remain to be done for the Euro Area to have a truly Banking Union, namely a Common Deposit Guarantee Scheme, and on reforming national economies.

However, the Euro Area is still facing both short-term and medium-term challenges and that should be reflected in the proposals to be presented in the Report, thus making sure that the Euro Area will be more resilient and better prepared to face any possible new crisis in the future.

The short-term challenges – strengthening the recovery of the Euro Zone – need to be achieved by political action at European and national level. The recent ECB measures are very positive and have significantly improved confidence. Similarly with the implementation of the Juncker Plan which must respect the foreseen timetable. These together with countries reforming their economies and adopting policies that are consistent with the Euro Area's common interest, the acceleration of economic growth may lead to a virtuous cycle that will not only further positively impact on the current business cycle but also contribute to dealing with legacy problems that are now in the process of being unwound.

To further strengthen the current recovery, member states will therefore benefit from an accommodative monetary policy and from a fiscal stand building on the flexibility and credibility of current rules. Without delay, each of the member states should use this flexibility to implement policy changes that increase output, reduce negative externalities and have positive spillover effects to other Euro Zone countries. Country Specific Recommendations should be streamlined in order to reflect these objectives and be consistent with progress within single market areas such as digital, energy and capital.

But there are at least two medium-term challenges that need an equally urgent response: first, the Euro Zone must be able to deliver more optimal results as a whole and for each of its constituent national economies; secondly, the functioning of the Euro Area should be improved in order to smoothen the risk of political fragmentation among member states.

On the first issue, the analytical note presented by the European Commission in February takes stock of the first 15 years of the Euro: diverging competitiveness trajectories and imperfect financial integration led to a gradual build-up of imbalances which ended in a sudden stop. Doubts about the true irreversibility of the Euro further magnified the crisis and forced countries to regain credibility, as the Euro Area strengthened common institutions but was not able to set a wider context of stronger growth. The most afflicted member states and the Euro Area as a whole have now regained stability and started to grow again, but our overall economic performance measured in terms of growth and employment is poor compared to other advanced economies.

So, the single currency has consistently delivered suboptimal results, both in boom and in bust times. This comes partly as a result of inadequate national policies that are being addressed by reinforcing budgetary rules and economic coordination, by implementing structural reforms and by closely aligning wage levels with productivity. But in overcoming the crisis, countries with external deficits have moved to a balanced position making the Euro Area as a whole to run a significant current account surplus. In short, from an aggregate point of view, internal imbalances have been replaced with external imbalances. This may help to prevent boom and bust cycles in Euro Zone countries, but falls short of promoting investment, creating employment and means our output gap is significantly below 0.

There are two possible ways to tackle these shortcomings and the good news is that they are not mutually exclusive. The first one is to continue deepening the Single Market and implementing structural reforms so that increases in productivity and higher expected returns gradually allocate investment back to European economies. But this takes time. The Single Market is more than 20 years old in 2015 and is still very incomplete in product and service markets. Factors will always be more constrained by national boundaries in the EU than, say, in the US.

The second is acknowledging that the current macroeconomic position of the Euro Zone is undesirable at the global level whereas internally it puts too much pressure on regaining competitiveness via deflationary adjustment which hinders growth and relies on sticky productivity/wage adjustments. This, in turn, requires that financial assistance to Euro Zone countries takes longer and costs more than previous historical experiences. Similarly, differences among national economies within the Euro Area both in their productivity levels and in their cyclical positions require a certain degree of fiscal intervention to foster convergence. Importantly, if that fiscal intervention is oriented toward further deepening the single market and delivering European public goods, the need of future fiscal intervention would actually be curtailed and the quality of our public policies would increase. Finally, a new common policy in the toolkit of the Euro Zone would alleviate the heavy lifting being currently demanded to monetary policy which, in any case, cannot be sufficiently granular to deliver the kind of positive shocks that are sometimes required.

Portugal argues that that kind of fiscal intervention should take place via a budgetary capacity for the Euro Zone. The exact design of a such an instrument is open to further discussion, but a few features should be granted: a Euro Zone-only instrument, but not putting into question the integrity of the single market; funded by own resources and in a fiscally-neutral way for member states; own resources based on economic sectors that have gained most from the common currency, and which have a strong transnational dimension.

There is also a political reasoning behind this. Euro Zone's institutions should be built in a way that limits ad hoc transfers among member states which are politically bruising and may ultimately lead to hard intergovernmental bargaining. That is something to be avoided, and in particular the Euro Zone, since the risk of fragmentation may become self-fulfilling and the irreversibility of the Euro is an intangible asset whose credibility rests on each of the member states and institutions.

The political argument calling for a budgetary capacity with own resources equally applies to the way the European Stability Mechanism (ESM) works. Member states and institutions should work in order to de-politicise the ESM and bring it more in line with a true European Monetary Fund, perceiving financial assistance as an ordinary instrument of a single currency area and limiting henceforth the bias toward looking at the ESM as a beefed-up version of bilateral financial assistance. The Eurogroup would of course play a political monitoring role and full conditionality to lending would apply but political arguments between creditors and debtors and fractures along national lines should be prevented in the future.