THE TRILATERAL COMMISSION (EUROPE)

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CREDIBLE EUROPEAN GOVERNANCE

DISCUSSION DRAFT

FOR THE EUROPEAN MEETING IN KRAKÓW ON 26 OCTOBER 2013

As the European Group of the Trilateral Commission meets in the heart of Europe – Kraków in Poland – a few months before the May 2014 European Parliament elections, it seems appropriate to propose new avenues to strengthen Economic and Monetary Union. 2014 with the European Parliament election to be followed by a new Commission and a new President of the European Council will imply significant potential changes between the EU's key players and institutions: it will be a decisive year for the European Union. The EP electoral campaign is thus a unique opportunity to discuss concrete proposals for building *credible European governance*, in particular for the euro area.

In these demanding times for the Europeans, with unemployment at unprecedented levels, especially in some euro area countries, it is important to recall the historic path taken which has fostered peace, prosperity and stability on the continent for almost two-thirds of a century: Today's stakes for Europe are as decisive as they were after World War Two. As regards the longer-term future of our continent, history is not yet written. Fostering European unity with an historical perspective, as resolutely as our Founding Fathers launched the Union more than sixty years ago with such remarkable success, remains of the essence.

The report is divided into four parts. The first tries to answer the question of what went wrong with the governance of the euro area and how it contributed to the crisis. The second part describes the economic and governance measures which have been taken in response to the crisis and why, although very important, they remain insufficient. Part three then puts forward what the Task Force believes should be done in the coming months to meet the current challenges of the euro area. Finally part four explores potential scenarios and avenues that might be taken in the future to ensure the economic and political credibility of the new governance system.

I. WHAT WENT WRONG?

In a nutshell, the combination of important socio-economic differences between countries and inadequate governance is what led to the crisis and has hampered its resolution since.

Two polar views remain prevalent. For some the system was fundamentally flawed from the start inasmuch as any monetary union requires a political union. The solution is thus "*more* Europe". For others the system was *not* fundamentally flawed. A monetary union can work among sovereign states provided commitments are respected which was not to be the case. Hence the need for a "*better* Europe". The challenge will be to explore ways combining "better" and "more" Europe.

Already well before the crisis, all EU countries were confronted with the necessity to adapt their economies (and their societies) to the realities of the 21st century epitomized by globalization and the increasing prominence of the "emerging countries"; the ageing of their population and its effects on public finances; global environmental and natural resource constraints.

The three major advances in European integration of the last twenty years – *the Single Market, the euro and the Eastern enlargement* – should have helped EU countries to be better equipped to deal with the looming challenges. There was definitely some progress in some countries, but much less in others. The contrast is especially visible inside the euro area, where the combination of the Single Market with the single currency (and enlargement) has been an instrument for change in Germany and small Northern countries, but has had the opposite effect in the Southern countries that benefited from large capital inflows thanks to the euro (and also lost market share vis-à-vis the new Eastern EU members). As is often the case, France lies somewhere in-between the patterns of the North and of the South. This does not mean, however, that the euro has not generated important benefits for all.

Europe needs firstly to keep *perspective* and recall where it stood when it launched the Euro. Europe must also analyse carefully the *sources* of its competitiveness losses. The

root cause of the problem with the euro area lies in the combination of two incompatible factors: wide economic and institutional differences among its members as well as insufficient appreciation of the consequences for the governance of the euro area.

Looking at *wide economic and institutional differences among its members* it was clear at the start of the euro that there were two groups of countries: those that issued currencies having fully converged with the Deutsche Mark and the others. These two groups of countries featured substantially different socio-economic models that resulted in different macroeconomic policies and outcomes. As it turns out the countries outside the DM-zone, like Greece, Italy, Spain and Portugal, were also among those that were the keenest to join the euro. There was one central motivation for this, namely ensuring continued growth and convergence in living standards as well as having a stable currency. However there were probably two different views in these countries about how the euro could bring about this objective.

First, there were those who viewed the adoption of the euro as a means to modernize their countries' antiquated socio-economic models and establish a sustainable model capable of delivering higher incomes to their population in a world undergoing global transformations; in sum, relying on euro area governance to impose sound and wise macroeconomic policies. *Second,* there were those who simply equated the adoption of the euro with the living standards enjoyed by the countries in the core currencies group and were incapable of seeing that their living standards are the product of successful socio-economic institutions and productivity progress that take time and effort to put in place. Unfortunately the Maastricht convergence criteria did not help by forgetting any monitoring of the competitiveness indicators. Hence it was enough to reach certain macroeconomic outcomes to join the euro, even though such outcomes were clearly temporary and unsustainable in view of the underlying weak socio-economic structures.

While it was clear that such diversity meant that the euro area was far from being an optimum currency area (OCA), there was also insufficient appreciation of the consequences for the governance of the euro area.

Inevitably comparisons were made between the euro area and the United States, but the general feeling was and remains that economic diversity among euro members is no more prevalent than between US states, at least as far as inflation and GDP growth are concerned. But this misses the point of the OCA theory, which is that the loss of the exchange rate instrument may be problematic if the members of a monetary union are sufficiently different to suffer from asymmetric shocks and do not have sufficient stabilisation mechanisms. Even if one assumes that the likelihood of an asymmetric shock in the euro area was no greater than in the United States, it remains that the euro area was far less equipped than the US to accommodate such shock. First, markets are far more integrated and flexible in the US, and therefore better able to absorb shocks in the absence of the exchange rate instrument, than in the euro area. An obvious example in the US is its labour mobility within a common language area. Second, in contrast with the US, there is no "federal" fiscal stabilisation mechanism in the euro area. Third, last but not least, there is a full integration at the level of the federation of the financial sector.

The Stability and Growth Pact (SGP) can be viewed as an attempt to create a fiscal stabilisation mechanism in the euro area but it was very imperfect for several reasons. To start the Maastricht framework had no pillar to monitor the level of competitiveness between member countries, not to mention a totally weak sanctions regime and operational effectiveness with the compounding strong rebuttal of France and Germany under Italian EU presidency in 2003-2004.

Another reason is that the notion of "close to balance or in surplus" was never understood by politicians (perhaps with the exception of finance ministers) and the public, and therefore politically difficult to implement for the European authorities in charge of monitoring the application of the SGP. Yet another reason is that, as the cases of Ireland and Spain demonstrate, countries can suffer severe fiscal shocks even if they respect the SGP, which implies that *a European stabilisation mechanism* should have existed. Nonetheless it is likely that if the SGP had functioned according to the rules some of the current problems could have been avoided. That's certainly the case for Italy and Portugal, but also for Greece, where (despite the manipulation of statistics) what was actually known about the situation was sufficient to demand corrective action.

The situation of Ireland and Spain, but also of other euro area countries that currently suffer from a combination of sovereign debt and banking crises, point to another deficiency in the governance of the euro area. The European monetary union was created at a time when financial crises were hardly on the radar screens of Central Banks or for that matter on the screen of the international community and the mainstream of economists. The result was that the creation of the European monetary union was not accompanied by the creation of a European *banking union*. When the financial crisis hit the United States and Europe in 2007 and 2008 the euro area was able to address its banking problems only at national level because of the absence of a European bank supervisor and a European resolution and deposit insurance mechanism. Had a European banking union existed at the time, the euro area would have been able to avoid the systemic risk associated with the negative feedback loop between the banks and their sovereigns that still prevails today.

Different initial conditions in the core and in the periphery are what led to the credit boom in the periphery financed by capital flows from the core, which led to increasing competitiveness problems within the euro area that were insufficiently monitored and even more difficult to counter. As a result, current-account balances and net foreign assets positions diverged to an unprecedented degree between the core (in surplus) and the periphery (in deficit). When the financial crisis came, private capital flows from the core to the periphery suddenly stopped leaving behind them a mountain of external (private and public) debt in the periphery owed to creditors in the core countries.

Instead of producing real convergence between the core and the periphery as was expected, the single currency area had in fact authorized the building up of economic and financial booms in a number of countries and added a new problem in the form of a debt mountain. The system had not only failed to prevent the problems from occurring, it was also unprepared to address them once the global financial crisis erupted and revealed in the open these weaknesses.

II. WHAT HAS BEEN DONE TO MANAGE THE CRISIS

Today, the debt crisis seems, at last and least, "under control".

It has been a long and painful journey since the crisis began in Greece in early 2010 and then spread to other peripheral countries. In the beginning the European authorities put in place a number of mechanisms to try and solve the crisis but the response, as the Managing Director of the IMF told European leaders in December 2010, was "piecemeal" and not adequate. What was needed, he argued, was a "comprehensive solution".

A. Measures taken on the institutional front

In February 2011, there was a first attempt to sketch out what such a comprehensive solution should look like. "A Comprehensive Approach to the Euro-Area Debt Crisis"[1] proposed a three-pronged strategy aimed at restoring banking-sector soundness, restoring sovereign debt sustainability and fostering growth and competitiveness. Unfortunately the response by European leaders remained for a while reactive and piecemeal instead of pro-active and comprehensive. As a result, the public in general and markets in particular stayed unconvinced that Europe had sufficient understanding of the problem at hand and the political determination to resolve it.

The turnaround came in the summer of 2012 with three closely related initiatives, taking place at a moment when the adjustment of macro policies in the countries concerned started to be visible, in particular as regards the diminishing of current account deficits.

First came the June summit where President Van Rompuy presented his *"Towards a Genuine Economic and Monetary Union"*[2] prepared in close cooperation with the presidents of the European Commission, the Eurogroup and the European Central Bank. They insisted that the resolution of the crisis demanded not only immediate action on

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[1] Darvas, Pisani-Ferry and Sapir (2011)
[2] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

three fronts – economic, financial and fiscal – but also a longer term "vision for a stable and prosperous EMU" based on four building blocks or "four unions".

These four elements comprise, to start with, an *integrated economic policy framework* -- the "economic union" -- which has sufficient mechanisms to ensure that national and European policies are in place that promote sustainable growth, employment and competitiveness. *An integrated financial framework* -- the "banking union" – is also required to ensure financial stability, as well as an *integrated budgetary framework* -- the "fiscal union" -- to ensure sound fiscal policy-making at the national and European levels. Last but not the least, a *framework for democratic legitimacy and accountability of decision-making* -- the "political union" -- will need to be designed for a joint exercise of sovereignty of common policies and solidarity within the EMU in the fields of economic, financial and fiscal policies.

However, the tighter and more radical are the measures taken in the three aforementioned economic, banking and fiscal unions, the greater will become the political issue for each. Hence, "politics" necessarily raises its head when addressing these specific unions. A "political union" is not the outcome of these three unions: it is already prevalent in each stage. Setting up a banking and fiscal union imply addressing concomitantly high politics which must be addressed in parallel and not sequentially.

Although they did not explicitly endorse the report (which was only the first in a process that continued with a second report issued by President Van Rompuy in December 2012 and was to culminate with a final report in June 2013), European leaders took an important step forward by supporting the creation of a Single Supervisory Mechanism (SSM) as a first stage towards a full banking union.

The second initiative was the confirmation by Germany that the *European Stability Mechanism (ESM)* could purchase Treasuries with appropriate conditionality and the visit by Chancellor Merkel to Athens in September 2012 underlining Germany's political determination to preserve the integrity of the euro area.

The third initiative was the declaration by President Draghi in July 2012 that the *European Central Bank* would do *"whatever it takes within the context of our mandate"* to preserve the euro. This initiative was credible because the ECB had already twice (in May 2010 for Greece, Ireland and Portugal, and in August 2011 for Italy and Spain) purchased Treasuries to counter disruptive forces. This was translated by the ECB decision to create temporarily an Outright Monetary Transactions (OMT) programme in September 2012.

Taken together these three initiatives constitute decisive steps towards the comprehensive solution that was needed and have clearly been welcomed as such by market operators.

B. Measures taken on the economic front

Prior to the crisis, they were important divergences in competitiveness and a huge built-up of external imbalances between the core and the periphery. Since the start of the crisis and especially since the introduction of the Troika programmes, peripheral debtor countries have improved their competitiveness position and reduced their external imbalances.

Competitiveness remains central when addressing Europe's flaws and requires a long-term perspective – coherence and perseverance -- in order to allow for political reform to be acceptable to both a wary public opinion and to maintaining credit worthiness in the financial markets. *Convergence* of European economies – whilst respecting the overall guiding principle of subsidiarity – is equally critical.

But *responsibilities* need to be shared between both creditor and debtor countries when searching for euro area solutions. Not only because all countries in the Eurogroup -- including the core countries – proved incapable or unwilling to apply the existing governance (SGP) but also because they benefitted from the existence of the single currency area guaranteeing them absence of exchange rate risk in the euro area. Germany in particular – but not only Germany – is a case in point.

Imbalances in the euro area between surplus and deficit countries must therefore be addressed inasmuch as the burden of adjustment is borne exclusively by the deficit countries in the periphery. A degree of symmetry in the adjustment mechanism must be sought with the surplus countries also taking their part of responsibilities in correcting external imbalances.

Growing problems of *EU fragmentation and renationalization of minds and markets* must be recognized, also within the economies of the euro area including the divisive issue of "larger v. smaller countries", "Northern v. Southern" countries or – better worded -- between "creditor v. debtor" countries or "open and closed" economies: this centrifugal trend must be arrested or, at the very least, mastered.

C. Remaining challenges

Today the challenges that existed before the crisis are still present – the long shadow of Lehman Brothers, five years on, still lingers over all advanced economies including European economies -- but they have become both more acute and more difficult to handle, especially in the peripheral countries that have accumulated large external debts. In the core euro area countries the situation is somewhat better but the difficulties in the euro area also add to their problems. The result is that the single currency area (and also the EU) is blamed not only for its own deficiencies but also for the difficulties member countries are experiencing in adapting to the realities of the current world, which all advanced economies are called to do. For a significant part of public opinion, the Euro (and also to some extent the EU) has become part of the problem rather than of the solution. This is part of the debate on the occasion of the forthcoming European Parliament elections.

Yet, two big questions remain. One concerns *the implementation*, in the short- to medium-term, of decisions which have already been taken and which are absolutely necessary to come out of the crisis. The matter is essentially one of having countries in the euro area put order in their own house, but with the support on common mechanisms. There should be nothing here that requires treaty changes, though some

matters may challenge the limit of what is legally permissible and politically desirable under current arrangements.

The other question concerns the precise *shape and ambition of the banking union*, the fiscal union, the economic union and the political union that are necessary to ensure the long-term sustainability of EMU. Here the issue is about the construction of a common EMU house, but where each country retains important responsibilities. In all likelihood such construction, whatever its precise shape and ambition, would require a new treaty to give it both legal certainty and political legitimacy.

Clearly these two questions and their respective time horizons are closely intertwined. Without a durable solution to the crisis in the medium-term, there can be no common vision for the long-term. Conversely without a shared vision of what constitutes a "genuine EMU" in the long-term there can be no sustainable solution to the current crisis and its legacy problems.

The crisis can be surmounted if *trust* can be re-established through concrete short- and medium-term corrective measures and if there is the will to stay together based on a common long-term vision. *This entails a new commitment between the countries and the citizens of the euro area*, a commitment to abide by agreed rules -- including on the full implementation of decisions taken in common -- and to share sovereignty and responsibility whilst proposing various future avenues to the citizens of Europe.

III. WHAT *SHOULD* BE UNDERTAKEN IN THE COMING PERIOD

Previously raised expectations of a substantial concrete push forward on some of the most contentious issues related to building a GEMU have not entirely been met so far although EU leaders did signal recently their will to continue looking at "indicators and policy areas to be taken into account in the framework of a strengthened economic policy coordination" in October 2013, with "decisions" to be taken in December.

The June 2013 European Council recommendations to the euro area recognise a number of fiscal and macro-structural challenges, but do not fully exploit the options made

possible by the European economic governance framework within the mechanism of the "European Semester" including on labour market reform and fiscal governance. There are particular problems with the Council's suggestions for the euro area as whole, which are not (or not adequately) reflected by the country-specific recommendations. It remains hence unclear who will implement euro-area recommendations. A major drawback is that the Council recommendations do not give sufficient importance to symmetric intra-euro area adjustments. Also, reference to the euro area's "aggregate fiscal stance" seems rhetorical inasmuch as it is not defined and each country is advised to implement its own fiscal strategy without regard to its impact on other countries in the euro area. Last but not the least, insufficient attention is paid to demand management.

There are three priorities for the euro area countries corresponding to the economic, banking and fiscal pillars.

- Firstly, ***economic competitiveness must be restored***. Preserving cohesion of economic competitiveness inside the euro area is the first major task. The new *Macroeconomic Imbalance Procedure (MIP)* is fundamental and must be focused primarily on competitiveness in traded *and* non-traded sectors. It is this surveillance framework which will help ensuring that the single "nominal" currency area remains permanently close to a single "real" currency area.

  The European Commission's Macroeconomic Imbalance Procedure (MIP) needs however to be complemented by *national* procedures to monitor competitiveness in both the traded and non-traded areas of economic activity. More flexibility and more mobility are required in Europe and especially inside the EMU. For this purpose both European and national instruments must be fully mobilized.

  At the *European level*, the *Single Market* must be fully implemented at the service of both Europe's economy *and* its society as clearly reflected in Mario Monti's 2010 Report[3] to the President of the European Commission. The total

[3] A New Strategy for the Single Market at the Service of Europe's Economy and Society, 9 May 2010

absence of official member states' reactions to his report is a sad reality that must be remedied.

Thus, the necessary strengthening of the euro area cannot and must not come at the expense of the single market. On the contrary, strengthening the euro area and the single market must be viewed as complementary.

When talking about the "European Union", we must also be precise and distinguish between the EU 28 member countries and those that have adopted the Euro as their common currency, the 17 – next January to be 18 -- "euro area" countries to include also those destined by Treaty to join and often labelled as the "pre-ins". On-going structural reforms of the economy apply obviously to all 28 EU member countries – a responsibility resting first and foremost at the national level -- but it is within the smaller but enhanced and ambitious core grouping of the 17 euro area countries that the economic and budgetary "governance challenge" has to be met and where dramatic measures to overcome the crisis have been taken since the start of the crisis.

Last but not the least, the *structural reforms* proposed to enhance Europe's competitiveness in the "Europe 2020" Agenda must not meet with the same fate as was the "Lisbon Agenda": this time around, it must be fully respected and implemented.

Turning to the *national level*, the "subsidiarity principle" should therefore be the guiding principle defined in the Treaty as "In areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level." But EU rules are not sufficient. National competition authorities must also ensure greater competition especially in the non-traded activities.

Chancellor Merkel underlined that "If Europe today accounts for just over 7% of the world's population, produces around 25% of global GDP and has to finance 50% of global social spending, then it's obvious that it will have to work very hard to maintain its prosperity and way of life." This being the case, urgency is required in reforming the social models in Europe. Many ideas have been tabled and some are implemented in certain member countries of the Union. "Flexicurity" comes to mind -- an integrated strategy for enhancing, at the same time, flexibility and security in the labour market reconciling employers' need for a flexible workforce with workers' need for security. When addressing *competitiveness* of Europe's economy, improving the workings of the *welfare state* must remain central lest trust be lost with its citizens.

- Secondly, ***financial stability must be ensured***. Any economic union in the making must rely on a stable financial footing. The current setting-up of a *Banking Union* is an important first step in this direction. With the European economy so dependent on bank credit, the priority remains to solve the banking sector's problems.

The Council and the European Parliament have now agreed last December to set up a Single Supervisory Mechanism (SSM) which will be operational in late 2014 or early 2015. The Commission has put forward a legislative proposal for a *Single Resolution Mechanism* (SRM) which constitutes the next immediate and very important work in progress.

The first task of the ECB as part of the Single Supervisory Mechanism will be to conduct an Asset Quality Review of the banks that will come under its direct supervision. This should be a tough assessment of the assets held by banks. Based on this review, viable banks should be recapitalised from private sources. Public recapitalisation should be the exception and should not amount to bail-outs of shareholders or bank management.

One idea for the recapitalisation of banks in countries with no fiscal space could be to use more forcefully and effectively the current ESM, although keeping in

mind the legacy problems which, if handled solely within the ESM, would destroy the mechanism. The Eurogroup meeting in June 2013 showed a way forward whereby the ESM would be able to recapitalise banks in ESM member countries in which a government "is unable to provide financial assistance to the institutions in full without very adverse effects on its own fiscal sustainability". Currently, the ESM funds are not very active with a calmer situation on the sovereign debt markets. Room for manoeuvre is available to reinforce the capital of these banks, notably after coming serious stress tests.

- Thirdly, ***budgetary stability is required***. This budgetary stability – the fiscal union – is the third pillar on which the euro area must rely to overcome the current challenges. A raft of legislative measures was taken to reform the Stability and Growth pact (SGP) and to introduce new macroeconomic surveillance designed to address the weaknesses revealed by the economic and financial crisis. In proposing the setting-up up of a true "fiscal union", the Commission had prepared in November 2012 "A blueprint for a deep and genuine economic and monetary union"[4].

Making the economic and fiscal pillars work will require a combination of "rules and discretion". Rules are essential in a monetary union, but two pitfalls must be avoided: too much rigidity and too much flexibility. Finding the proper balance between rules and discretion should be the role of a strong and credible Commission whose expertise and impartiality is recognized by all parties with democratic legitimacy at the core. An independent and strong European Commission in charge of undertaking "ruthless truth-telling" is a must. But the latter institution is in the urgent need of regaining its moral authority based on expert analysis with the capacity and courage to tell the truth. Surveillance includes "naming and shaming", relevant also for preventing crises, which incidentally highlights also EU's diversity, as such a source of richness, but which carries inherent limitations: too great a diversity in certain areas will lead to a weakening or even disruption of the euro area project. Best practices should also be sought but not at the lowest common level! Past "cosiness" -- too much "politeness" in the words of Mario Monti -- with leaders clubbing within the Council must be avoided.

[4] Brussels, 30.11.2012 COM (2012) 777 final/2

IV. WHAT *COULD* BE PROPOSED FOR THE FUTURE

Setting up a true economic, banking and fiscal union inevitably raises the issue of the shape of a future “political union” with democratic legitimacy and accountability at its core.

The coming May 2014 European Parliament elections should be the occasion to infuse a strong democratic debate in the member countries on *where the Union is heading*. Here we simply want to discuss various scenarios and potential avenues.

Three broad positions can be highlighted in today’s debates on democratic legitimacy and accountability**.** The first position concerns of all euro-area members who belong to all the new economic mechanisms. The second comprises most other EU countries which belong to at least some of the new mechanisms. And the last group of countries comprises only one or perhaps two members: the United Kingdom and the Czech Republic, if the latter decides to stay outside the banking union as it did with the Fiscal Compact.

Some Europeans view “political union” through the lenses of a decentralised approach implying that the euro area single currency is one of member states retaining their national sovereignty. As such, what is needed is to ensure that they operate in a decentralised system creating understanding at the national level. This is a “minimal” union represented by the Maastricht Treaty albeit fully implemented. At the opposite end, other Europeans, learning from the crisis, call for true “political union” with far more decisions transferred to the EU level. In between the two positions are those Europeans who favour a “middle way”, with significantly more “political union”, but only in areas directly linked to the crisis, e.g. banking and fiscal union.

These different positions are not incompatible *per se* but their concomitant implementations create the debate which we are currently witnessing in Europe.

European governments recognize the necessity to be concrete in their proposals and take into account a proper and credible time frame. However all recognize that

returning to the original framework of the Maastricht Treaty is no longer on the table after so many new measures having been launched since the outbreak of the sovereign debt crisis. Consensus prevails that, in the short term, those important decisions taken so far must be fully and entirely respected. However, in the medium and longer terms, Europe must go forward and new avenues be explored if only because a longer term vision for the EMU institutional architecture is necessary to ensure the consistency of shorter term measures. Is a muddy middle of variable geometry and hybrids between federal and intergovernmental solutions still an affordable option for Europe? Also of great import to European citizens, the harsh economic and social measures taken so far need to be better explained and understood as necessary measures ushering in a better future.

In any case, a new commitment among sovereign states that goes beyond the Maastricht Treaty but falls short of a "political union" thus needs to be devised.

The key requirement right now is that *Europe and its Member States must continue put their houses in order* and tidy up their "messy rebuilding". The important decisions taken so far must be fully and entirely respected. Europe's current major challenges are to concentrate on executing correctly the current treaties with their obligations. Once these tasks have been addressed, Europe will need to respond to the medium and longer terms economic and social challenges by reaching out -- beyond the current treaties -- and proposing new sustainable avenues for the pursuit of the European unification project.

Whatever ***future scenarios are tabled and avenues taken***, Europe will have to meet three principles that are stressed, loud and clear, by public opinion in all our democracies: Be transparent! Ensure full democratic accountability! And fully respect the "subsidiarity principle"! This is all the more true as an "ever closer union" is for many governments no longer the hallmark of Europe: it is replaced today by the slogan "European where necessary, national where possible". Time to forge "closer union" has passed. For some countries – including founding members – Europe needs to become "smaller, leaner and meaner". Albeit this trend, the European project remains alive and

continues to move toward deeper integration with new members adopting the euro, Europe's biggest symbol of unity.

Respect for the principles of transparency, accountability and subsidiarity could well entail the Commission evolving in the longer term into an executive "Finance Ministry" for the euro area, with Budgetary resources. One could start at inter-governmental level, with the Eurogroup providing the "Minister", deploying resources from the ESM, which could in due course be repatriated within the EU Treaties as a Community tool, and the Minister a "Super-Commissioner", and with flagrant SGP/MIP breaches perhaps leading to sanctions such as the time-limited withdrawal of voting rights.

But we have to take fully into account the central issues of national sovereignty and democracy, which rests to-date within the Nation-State. Putting the cart before the horse would be inconsistent, counterproductive and could put into jeopardy any further advancement to "political union". Harmonisation, coordination and centralised decision-making without proper democratic checks and balances can lead to a result opposite to the one sought. In any case, all major possible changes are in the hands of the citizens. As Jean Monnet said: "People only accept change when they are faced with necessity, and only recognize necessity when a crisis is upon them".

Any way forward can only find *credibility* on the condition that the goals set out have been fulfilled! Europe must deliver on the goods proclaimed of higher competitiveness, growth & jobs, and on a banking union! *Stability* – both budgetary and financial -- as well as *growth and employment* must be restored and strengthened.

The way forward needs therefore to be carefully balanced as stressed recently by Italy's Prime Minister Enrico Letta whereby "we need to strike a fine balance between a realistic pragmatism and the right level of ambition for the future." In general, there is a need for greater responsibility and accountability in the system, but also for greater solidarity. *Shared responsibility* can become a problem if divergent results lead to a blurring of responsibility between member countries, but this shared responsibility cannot be avoided especially in the euro area: it must be organized in the best possible manner.

But how does one ally ***"sovereignty and solidarity".*** A new Union will require a different governance model inasmuch as *solidarity* will need to prevail lest the Monetary "Union" lose its very meaning. And, how can one combine EU-level ***"sovereignty with legitimacy"?*** The question of legitimacy needs to be raised with regards to parliamentary implementation – whether national or European -- at times when countries increasingly shed part of their national sovereignty.

Some argue that the euro area must go even further, towards an *"economic and fiscal federation by exception"* where if a country misbehaves, risking the stability of the euro area as a whole, as well as its own, would be subject to sanctions. But instead of imposing ineffective fines, binding measures on countries would be taken directly, at the level of the European institutions, with ultimate decisions democratically voted upon by the European Parliament. A democratic anchoring of such a measure is a must. To reinforce this parliamentary anchoring, a country unwilling or unable to abide by the decisions taken by the European institutions could appeal directly the European Parliament and wait for its final decision. In sum, instead of the activation procedure being launched *ex-ante* by the Commission it would be implemented *ex-post*. It should be recalled that limiting fiscal sovereignty was already in the Maastricht Treaty. The transfer of sovereignty would not only be accompanied by European solidarity but would also give food for thought to those member states trying to bypass their obligations.

All such proposals presuppose *greater solidarity* between Member States: enhanced *democratic accountability* would also be a prerequisite. Here the question of national sovereignty comes to the fore. Quoting Tommaso Padoa-Schioppa: "sovereignty ends when solvency ends", -- *de facto* but not *de jure* -- a concept already prevalent before the outbreak of the crisis.

The measures undertaken so far and detailed proposals tabled concern the euro area countries. But the European Union includes additional countries other than the 17 (18) members of this euro area. Any future "political union" will have to deal with all 28 member countries notably with regards to a necessary bridging of the "democratic deficit" present in the minds of many citizens.

An initial issue to be addressed will be the legitimacy of the *European Parliament* which needs to be reinforced vis-à-vis the recognized legitimacy of *National Parliaments:* where does ultimate legitimacy rest? Can the EP take solely decisions impacting on the "28-"?

The search for democratic accountability *within the euro area* is yet another issue to be tackled. Should a specific parliament such as a "Parliamentary Assembly" composed of national parliamentarians, or national MPs *and* European Parliament representatives, be envisaged? Or should a caucus of euro area EP members within the European Parliament be set up? What about those countries having not yet joined the euro area but who are destined by Treaty - the *"pre-ins"* – to join? Having a say at the table when new rules for the euro area and the 28- at large are being devised must surely be at the top of the political agenda; and what about the *"opted-out"* member countries?

Last but not the least, a *debate on competences* has also been launched by the *British Prime Minister* on Britain's future position in Europe where reference is made to the *Single Market*. This debate – now also extended to The Netherlands -- carries inherent virtues inasmuch as it impacts also on competences and responsibilities about the single currency area.

Today, most EU countries accept that the Euro represents what President Van Rompuy calls the "symbolic heart of the European Union". For the UK, however, the single market is the core of the EU. Can these two visions continue to coexist within the EU, now that the euro area is attempting to surmount its "existential crisis"? The single market may not be regarded as "the symbolic heart" of the EU by most Euro countries, but it is just as vital to their economic wellbeing as it is to other EU countries.

One of Europe's major challenges is to concentrate on executing correctly the current treaties with their obligations. Institutional changes, which have been ushered in over the past years, can and are driving change toward "political" union. The EU is a Union of sovereign states which has notably improved its governance but where additional measures are required. This should not inhibit the Union to look further down the road.

Finally, this contribution is *not an inward-looking parochial exercise*: After Greece's restructuring, the currency union has learnt the costs of dealing with sovereign insolvency without a game plan. European nations are already used to sharing some sovereignty. By taking the lead where others have failed, the euro area and the EU at large would show it could still play a crucial role in the development of international co-operation and global governance. Success and sustainability of the Euro is important not just for Europe but also for the world for both economic and political reasons.

As Europeans embark on a crucial European Parliament electoral campaign at times when the latest polls show a general distrust of authorities whether national or European, including distrust of the EU, amidst a continuing economic crisis, record unemployment in some economies particularly among the younger generations, and after five euro area bailouts, it is vital to arrest the impressive voter turnout decline over the years and infuse democratic legitimacy into the European project. "Differentiation" has to be recognized but the question remains on how to harmonize policies at EU level when trust is to be reinforced between and within member countries. As highlighted recently by Italy's Prime Minister Enrico Letta, "Here comes the most difficult part of the challenge. Can we realistically aim for deeper economic, financial and fiscal integration at a time in which the confidence in European institutions and the support for the European Union are at an all-time low?"

The euro area and the EU at large must show it can still have the wherewithal to play a crucial role in the development of international cooperation and global governance. But the danger prevails and must be resisted that by creating too great expectations by both EU institutions and Member States governments these will not be met.

On an institutional level, the European integration is accelerating. However, in political terms, the nation-state is staging an impressive comeback. For some, "less Europe" rather than a "more for better Europe" is the way ahead. The widening gap between these two trends can only be bridged if the European Union member countries are willing to introduce additional structural reforms as highlighted above. Finding the proper balance and the optimal allocation between short-term measures decided upon and to be implemented does not exclude the search for longer-term scenarios reaching

towards "political union" if only to remain true to the European Union's founding principles.

A new horizon must be drawn up and a new narrative expounded. Europeans are desperate to be given a sense of direction, purpose and hope. A banking union alone will not convince them. The current proposals tabled are for many citizens unreadable: transparency goes with clarity. It should be recalled that the Euro is a *means* to attain a higher goal. For many Europeans, the impression given by its leaders is the contrary. This must be dispelled. The 2014 European Parliament elections is a singular occasion not to be missed where a *New European Commitment* between the countries of the Union and their citizens is submitted.

In conclusion, Mario Monti invites us to "look at the future of Europe with the same optimism as was shown by our Founding Fathers. Then the challenges that a divided Europe coming out of a harrowing war had to face were hardly of less greater magnitude".

END

THE TRILATERAL PROCESS

The idea on preparing this special European project stemmed from Mario Monti -- then European Chairman of the Trilateral Commission -- and led to a first panel discussion, including with Rapporteur André Sapir, held on the occasion of The Hague meeting of the European Group on 13 November 2011. The Task Force was thereupon set up and held its inaugural meeting, hosted by Giuliano Amato, on 19 June 2012 in Rome followed by a second TF meeting in Paris on 4 October 2012. A first outline of the report was discussed at the European meeting in Helsinki on 3 November 2012. Extensive national consultations were thereupon undertaken throughout Europe within the overall membership in December 2012/January 2013. The third TF meeting was held in Brussels on 19 February 2013 to prepare the Berlin plenary meeting discussions on 15 March 2013. A new draft was then prepared over the summer and discussed at the fourth and last Task Force meeting in Brussels on 27 September 2013 to finalise the discussion draft presented by Chairman Jean-Claude Trichet at the European meeting in Kraków on 26 October 2013.

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