After years of scant headway in the ongoing reform of the institutional framework underpinning the single currency, the economic recovery and the current political outlook open a window of opportunity for progress towards the design of a more complete Economic and Monetary Union better equipped to absorb adverse shocks. The European Commission has taken the initiative in this respect and, on the basis of the 2015 Five Presidents' Report, it has tabled specific proposals for possible approval in the course of this year and early 2019,[1] before the current parliamentary legislature concludes, while other elements should be defined between 2020 and 2025 (see accompanying table).[2] At the same time, some alternatives have also been suggested in political and academic circles.[3] This box sets out the main elements under debate.

Banking and Financial Union

The weaknesses of banking systems and the force of the financial fragmentation processes that emerged during the recent crisis, along with evidence that in more complete monetary unions it is the private channels operating through financial markets that enable a greater proportion of risks to be shared[4], led the euro area governance reform agenda to place the initial emphasis on the need to complete the banking and financial union. Accordingly, notable progress has been made in the banking arena, through the creation of the Single Supervisory Mechanism and the Single Resolution Mechanism. But certain elements that are vital for preventing a climate of mistrust such as that experienced in the past from taking hold in future crises have yet to be set in place. Such elements include most notably the need to create a common backstop (or lender of last resort) for the Single Resolution Fund, should this Fund's resources not prove sufficient to tackle potential banking crises. In this connection, there is some political consensus on the EC's December 2017 proposal, which considers that it is the European Stability Mechanism (ESM) that should assume these functions, although possible arrangements and significant technical aspects are still under discussion.

There is less consensus, however, on the design of a European Deposit Insurance Scheme (EDIS), which the EC suggests be approved in the course of 2018. The major discrepancies focus on the degree to which risks would be shared at the end of the launch process, since set against the EC's initial proposal (2015)[5], which contemplated a full pooling of risks, other less ambitious alternatives suggest a model based on national insurance schemes, which would co-exist with an EDIS and would absorb the initial losses where necessary. Another essential element of the discussion is financing; while there is agreement that this should be through bank contributions weighted by such banks' risks, it has also been suggested that there should be differentiation based on national considerations to take into account the quality of the regulatory framework or the probability of one bank's problems ultimately spreading to others (CEPR, 2018). Lastly, some believe the creation of the EDIS should be conditional upon a prior reduction of European banks' exposure to sovereign debt.

Turning to the Capital Markets Union, the EC plans to set in train various initiatives before 2019 which, in principle, will not arouse major controversy. The aim here is to bring about a greater development and integration of European capital markets with various objectives in mind: to diversify sources of financing (including through the promotion of private equity funds), to strengthen investment in infrastructures, to enhance corporate bond market oversight and to improve access by small and medium-sized enterprises to funding.

Lastly, the conclusions reached by a High-Level Task Force of the European Systemic Risk Board[6] help highlight the advantages associated with the creation of securities backed by a diversified portfolio comprising sovereign debt of the euro area countries (Sovereign Bond-Backed Securities – SBBS). Unlike Eurobonds, these securities do not entail the joint liability of governments, but they would enable bank debt portfolios to be diversified and thereby weaken the link between this and sovereign debt. Nonetheless, the report also reveals the difficulties posed by their creation in the current regulatory framework. The EC will table a proposal for the creation of SBBS in spring 2018, postponing until later the debate on the possibility of introducing European public debt with joint and several liability.

Economic and Fiscal Union

As regards the Economic and Fiscal Union, the need is raised once again to strike a balance between reducing risks and creating risk-pooling mechanisms. In the former case, the EC intends to duplicate between 2018 and 2020 the structural reform support

1 The European Council at the end of June 2018 is expected to arrive at specific commitments in this respect.

2 See the "Reflection paper on the deepening of the economic and monetary union (EC, 2017); the Communication from the EC on "Completing the Banking Union (2017) and the December 2017 package [which contains a legislative proposal to transform the ESM into the European Monetary Fund or EMF, a communication on new budgetary instruments for the stability of the euro area within the European Union, a communication on the possible functions of a Minister of Economy and Finance, and a legislative proposal to include the so-called Fiscal Compact in the European legal framework (https://ec.europa.eu/info/publications/economy-finance/completing-europes-economic-and-monetary-union-policy-package_en)].

3 See, for example, the German non-paper for paving the way towards a Stability Union (2017), which takes up the position of the previous German government and, in the academic arena, CEPR(2018), *"Reconciling risk sharing with market discipline: A constructive approach to euro area reform"*, Policy Insight 91, http://bruegel.org/2018/01/reconciling-risk-sharing-with-market-discipline-a-constructive-approach-to-euro-area-reform/.

4 On risk-sharing mechanisms in the euro area and in the United States, see Chapter 4, *Annual Report 2016,* Banco de España.

5 CE (2015), Proposal for a Regulation of the European Parliament and of the Council in order to establish a European Deposit Insurance Scheme, COM 2015/0586. http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015PC0586.

6 Report of the "High-level Task force on Safe Assets", 2018, European Systemic Risk Board.

programme already in place for EU Member States, reinforcing it as from 2020, when the new EU budgetary framework is agreed.

It is also intended to strengthen and simplify the European fiscal framework, to promote fulfilment of the rules and to generate sufficient leeway so as to deploy countercyclical fiscal policies in the face of adverse shocks. In this connection, the EC made a proposal in December to integrate the main elements of the Fiscal Compact into European legislation[7] and to improve the medium-term fiscal policy stance by establishing a commitment regarding the path of expenditure. However, simplifying the complex framework of rules comprising the current European fiscal arrangements, whose practical implementation is difficult, has been left till later.

All told, the difficulties entailed in coordinating common fiscal policy measures in severe crises, when the national stabilisers prove insufficient and monetary policy is constrained by the existence of an effective bound on the scope for interest rate cuts, mean that it might be advisable to introduce supranational fiscal mechanisms that contribute to increasing the shock-absorbing effectiveness of economic policies. In this respect, the recent literature considers various alternatives for moving towards such European fiscal capacity. The most ambitious proposals suggest creating a European

7 This agreement was introduced in 2013 to respond to the need to strengthen the European fiscal framework with national rules and to reinforce the synergies between the rules and national independent institutions. Its main elements include most notably the obligation to incorporate the balanced-budget commitment into national legislation.

EC initiatives to complete EMU	Possible calendar
Financial union	
Banking union	
Backstop for the Single Resolution Fund (SRF) through the ESM/EMF	Approval in 2018
European Deposit Insurance Scheme (EDIS)	
Reduction of risks	
Regulatory treatment of bank sovereign exposure	Mutual understanding mid-2018, coming into force in 2020-2025
Capital Markets Union and safe assets	
Various initiatives (European supervisory authorities, regulation of market infrastructures…)	Finalise legislation pending before mid-2019
European Sovereign Bond-Backed Securities —no common liability—, under study by the ESRB	EC proposal in spring 2018
Safe asset —common liability—	Mutual understanding by mid-2018, coming into force in 2020-2025
Economic and fiscal union	
Structural Reform support instrument	EC proposal in May 2018 for approval before mid-2019. All as part of new multi-year financial framework, 2020-2025
Specific convergence facility for non-euro area countries	
Common stabilisation function for investment in the event of asymmetric shocks	
Reinforcement of the Structural Reform Support Programme to 2020 (technical assistance for reforms and convergence by non-euro area countries)	Approval in 2018
Change in European structural and investment funds so that countries use reserve funds until 2020	
Simplification of the Stability and Growth Pact	Mutual understanding mid-2018, coming into force in 2020-2025
Political union	
Fiscal Compact Into Union law (including flexibility criteria)	Approval before mid-2019
European Monetary Fund (EMF) as a successor to the ESM	
Minister of Economy and Finance	Political discussion
European Treasury	Mutual understanding mid-2018, coming into force in 2020-2025

SOURCES: European Commission and Banco de España.

budget with functions geared to macroeconomic stabilisation, the funding of common expenditure (on defence and security) and revenue-raising and debt-issuance capacity.[8] Others consider establishing a new ESM credit line that can extend low-cost loans to countries facing particularly adverse cyclical circumstances.

The EC's December proposal considers the creation of a stabilisation function or a function for the safeguarding of public investment against asymmetric shocks. Although the instrument is not fully defined, the aim would be to prevent – through loans and subsidies charged to the EU budget – public investment from being the first victim of periods of economic slowdown. While it is a positive initiative, we should not lose sight of the potential advantages of alternative instruments, such as cyclical insurance funds or unemployment insurance arrangements; although they elicit greater controversy, these instruments enable a greater cyclical stabilisation capacity to be attained with a limited volume of resources.[9]

Finally, on the institutional front there is some consensus on transforming the ESM into a European Monetary Fund. This institution would assume greater responsibilities for overseeing the economic policies of countries that need financial assistance and would act as a lender of last resort to the Single Resolution Fund. Some proposals suggest that the future ESM should assume the economic policy oversight and coordination functions that the Treaty assigns to the European Commission, to strengthen the capacity to prevent future crises; but it seems the best way forward would involve cooperation between both institutions. Perhaps the most controversial aspect, however, is whether financial assistance from this institution should be conditional or not upon the automatic restructuring of debt, as the German proposal suggests and as the CEPR (2018) less categorically intimates. In this respect, the ESM itself has voiced its opposition to automatic mechanisms given the complexity of discerning in real time whether the country is facing liquidity or debt-sustainability problems and in light of the impact that the possibility of restructuring may have on financing costs.

8 See, for example, the article by several European economists, academics and former heads of European institutions, *"Blueprint for a democratic renewal of the Eurozone",* published in Político on 28 February 2018. https://www.politico.eu/article/opinion-blueprint-for-a-democratic-renewal-of-the-eurozone/

9 See Chapter 4, *Annual Report 2016,* Banco de España.