Opinion of the European Economic and Social Committee on the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Central Bank — EMU@10: successes and challenges after 10 years of Economic and Monetary Union

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On 7 May 2008 the Commission decided to consult the European Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the

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The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 5 March 2009. The rapporteur was Mr BURANI.

At its 452nd plenary session, held on 24-25 March 2009 (meeting of 24 March), the European Economic and Social Committee adopted the following opinion by 79 votes to one with 17 abstentions.

1. **Summary and conclusions**

1.1 With this opinion the EESC comments on the Commission Communication which describes the successes of Economic and Monetary Union (EMU) ten years on from its launch and highlights the challenges facing us in the future. The Communication was drafted before the full extent of the current crisis became apparent. The EESC has, as far as possible, avoided being led by current events to comment on points outside the scope of the Commission's text. Topical events will be dealt with in other opinions.

1.2 Initial expectations have not all been met. The optimism felt when EMU was launched has been dampened by adverse economic trends: objective factors which were to a large extent unrelated to the single currency. The public has not always been properly informed and has in part been influenced by continued mistrust of the European Union, and it has thus blamed the euro for factors slowing down the economy which are in reality unrelated to euro issues.

1.3 One undoubted success of monetary union is that it has anchored long-run inflation expectations at close to the definition of price stability; moreover, general interest-rate cuts have contributed to economic growth. Then integration of the financial markets has helped to bring to Europe an economic crisis which originated elsewhere.

1.4 Despite the fact that the euro is the second international currency, the Eurogroup and the ECB do not play an institutional role in international economic and financial organisations. There are various reasons for this, but one factor is that Member States which are part of the euro area (and others that are not) do participate in these organisations. Better economic governance would in theory be more possible if these two institutions were represented in international bodies.

1.5 Within the EU, future challenges consist mainly of making up the shortfall of the past ten years: the disparities between EMU counters in terms of inflation and labour costs, and the as yet incomplete integration of the goods and services markets. The first aim should be addressed as part of a series of national programmes which, with due regard for the Stability and Growth Pact, work towards convergence agreed on by governments and the social partners. The second should be addressed in a study which sets out the inherent, natural limits to integration, beyond which it actually becomes impossible or too burdensome.

1.6 Internationally, EMU is facing political and competition challenges which it will have to tackle with programmes in the area of domestic budget policy and better integration of structural reforms, by reinforcing the international role of the euro and, lastly, with effective economic governance. With regard to this last point, attention should be drawn to public spending, competitiveness and social systems – three areas in which uniform action is difficult due to the diverse situations in the Member States.

1.7 As regards financial governance, the EESC calls for an overhaul of all the policies on which market practices have thus far been based: the early origins of the financial crisis caused by subprime lending, which has itself been exacerbated by the economic crisis, lie in the placing on the market of products which are by their very nature unreliable. This was the result of misinterpretation of the market-economy approach, which should not be abandoned but which certainly needs rules to regulate it.

2. **Introduction**

2.1 In May 2008 the Commission published a Communication which takes stock of the first decade of operational Economic and Monetary Union (EMU) and outlines a political agenda for the second decade [1]. The Communication was published in the second issue of *European Economy* [2] and was accompanied by an analysis (over 300 pages) of the subject. The EESC is one of the institutions to which the Communication is addressed and thanks the Commission for giving it the opportunity to express its point of view. It hopes that its comments will be taken in the spirit in which they are intended – as an attempt to make a constructive contribution to the debate.

2.2 The analysis is a valuable help in understanding the issues described in the Communication, shedding light on the Commission's statements; it is an econometric and financial analytical paper with a small, specialist readership. The EESC has taken note of it and refers to it in relation to a number of issues requiring detailed analysis.

2.3 The EESC comments on a number of the Commission's points, taking them in the order in which they appear in the Communication, in the hope that its comments will be useful and seen as an active contribution from the social partners represented by the EESC.

3. **The Communication: a historic step**

3.1 The paper starts by saying that EMU 'sent a **very powerful political signal** to European citizens and to the rest of the world that Europe was capable of taking far-reaching decisions' and that 'ten years into its existence, the euro is a **resounding success**'. These statements seem **inappropriate as they are presented in the Communication**: an expression of satisfaction is convincing as a conclusion where evidence has been given but counterproductive if presented as a premise. The EESC essentially agrees with the content of the statements but would have preferred to see them presented at the end rather than as a premise.

3.2 Modifying this, the Commission notes that **so far the euro 'has fallen short of some initial expectations'** because of too slow a growth in productivity, globalisation and scarcity of natural resources, climate change and the ageing population - all issues which 'place additional strains on the capacity of our economies to grow'. At first glance these statements seem to establish a link - although this is certainly not the Commission's intention - between global socio-economic trends and the euro's failure to meet expectations.

3.2.1 Further on (page 7), the Commission regrets that '**the euro is often used** [by the public] **as a scapegoat** for poor economic performances that in reality result from inappropriate economic policies at the national level', thus rightly making a distinction between economic trends and euro issues. It would have been more useful in terms of promoting the euro to explain that the single currency is suffering – as are most other currencies, to a greater or lesser degree - from a **global economic trend which is affecting monetary policy**.

3.2.2 Monetary policy, in particular EMU policy, cannot alone resolve the difficulties of **integrated global markets**, in which problems spread from market to market in real time in a domino effect. Markets outside Europe have operated for too long on the basis of an excessively hands-off approach to the market economy in both the economic and financial sectors. A free market needs **rules** laying down constraints which cannot be disregarded and effective **surveillance** to ensure that they are observed: Europe has met these two requirements to a large extent but, regrettably, the same cannot be said of others.

4. **The main successes of the first ten years**

4.1 The Commission rightly stresses that monetary policy has '**anchored long-run inflation expectations** at close to the ECB's definition of price stability'. It admits that inflation has increased recently, 'mainly due to soaring oil and commodity prices', but predicts a 'return to low inflation … once these external pressures unwind', as has happened recently. As regards **interest rates**, it attributes **tighter credit conditions for households and businesses** to turbulence in financial markets, and here, too, 'a return to … more normal credit conditions is expected, even though oil … prices may continue to trend up …'.

[1] COM(2008) 238 final

[2] European Economy 2/2008, *EMU@10, Successes and Challenges after 10 Years of Economic and Monetary Union*, Economic and Financial Affairs Directorate-General.

4.1.1 The vast majority of observers predict a long-term crisis and do not forecast how long it will take national economies, particularly those of Western countries, to recover; regrettably, the ever-changing nature of the world geopolitical picture reduces econometric forecasts to a mere exchange of views. The EESC wishes to draw attention to one point of the Communication in particular: the Commission disapproves of the way inflation has led to tighter credit conditions for households and businesses, but **it does not mention the fact that, as well as being credit users, families are also savers**, contributing their investments to economic growth and, ultimately, to financing the public debt and businesses.

4.1.2 **Interest rates for savings**, in the form of both bank deposits and securities, have **risen more slowly than inflation**: once tax has been taken off, this leads to considerable erosion of **purchasing power**, while the capital invested loses value. The huge losses sustained by stock markets have, however, encouraged families to seek more secure investment in conventional savings deposits despite low return and erosion of capital.

4.2 The EESC agrees with the Commission when it lists the benefits brought by the euro: the Stability and Growth Pact, reformed in 2005, led Member States to adopt fiscal policies which support macroeconomic stability in EMU, fostering economic and market integration and causing the euro to act as '**a powerful catalyst for financial market integration**'. However, this integration, which 'has improved the euro area's resilience against adverse external developments', warrants some reflection.

4.2.1 While it is true that EMU has made it possible to build a strong integrated financial market which is certainly more resilient to adverse external events in a number of individual national markets, it should be borne in mind that integration within EMU also goes hand in hand with close, **complex connections with global markets**. The Commission points out that 'the euro area appears protected from the worst of the present global financial turbulence', but this turbulence, first and foremost in the area of subprime lending, has been imported from external markets and caused by situations unrelated to EMU.

4.2.2 In view of this, the issue raised by the Commission later on in the Communication becomes relevant: **the external influence of the Eurogroup, not just on economic governance but also on the institutions regulating the financial markets**. The subprime crisis was triggered by inappropriate credit practices and questionable securitisation systems, some of which are not in use in Europe: it therefore seems reasonable to ask whether the damage could have been avoided, or alleviated, if the **Eurogroup (or ECB) had been able to play an institutional role in global economic and financial organisations**.

4.2.3 This idea is underscored by the public support measures and the bankruptcy of major US financial groups with European subsidiaries, which raise sensitive competition and surveillance issues. However, the EESC is not alone in making this assertion: the Commission itself regrets 'the absence of a strong voice in international fora' but it does not say, still less comment on, how much - or how little - the Council has done to **give Europe this 'strong voice' in practice**.

4.3 There is no need to mention the 'significant benefits to its member countries engaged in a catching-up process': the Commission has addressed the issue in a previous Communication [1], on which the EESC has commented in an opinion [2].

4.4 The euro '**has … established itself as the world's second international currency**' and represents a quarter of world reserves; bank loans from euro-area banks to external beneficiaries make up 36 % of total loans, compared with 45 % from US banks. However, we cannot rest on our laurels: the importance of the euro, which according to all the forecasts is set to increase, must be converted into **tangible results and benefits**, first and foremost as regards **oil prices**. Dependence on this energy source is one of the brakes holding back the economies of the euro-area countries, some of them particularly severely. The price fluctuations are not solely due to producer countries' monopolistic policies: they are also caused by speculation and fluctuation of the dollar, which is no longer stable enough to be a reliable currency. We need to start reflecting on a strategy for **quoting oil prices in euros**, at least in transactions with EMU countries: however, this is a move which will not be problem-free, and should in any case be undertaken with caution. Success will not depend solely on the position of the euro but also on the bargaining power of Europe as a whole.

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(1) Communication from the Commission – *The EU Economy: 2006 Review - Strengthening the euro area: key policy priorities* COM(2006) 714 final.

(2) EESC Opinion on *The EU Economy: 2006 Review - Strengthening the euro area: key policy priorities* OJ C 10 of 15.1.2008, page 88.

4.5 Lastly, the Commission turns to **economic governance**, now possible thanks to the work of the Eurogroup, which has been even more effective now that it can count on a **permanent president**. However, internal governance of the euro is not enough to ensure its stability and prestige: the above comments highlight the need for 'external governance', which will only be possible (see points 4.2.2 and 4.4 above) **if the Eurogroup and the ECB can play an institutional role in international organisations**, particularly the International Monetary Fund. It is no longer acceptable for authorities which represent the single currency overall not to be entitled to vote.

5. EMU's remaining challenges

5.1 The EMU area's economy is in a period of recession, like the US economy and the economies of other European countries outside the EMU area: this is a situation which is common to the West and it would be misleading to attribute it to a direct or indirect effect of the euro. More detailed analysis reveals, however, that there are '**substantial and lasting differences across countries** in terms of inflation and unit labour costs'. The Commission attributes them to reasons which are now well-known: lack of responsiveness of prices and wages; poor achievement in the field of structural reforms; limited market integration and under-development of cross-border provision of services.

5.1.1 The EESC feels that the prospects for action in each of the above areas are largely dependent on the Member States and their social partners. At the same time, it calls on the Commission to launch a study on **the long-term possibilities of achieving integration of the goods and services markets**, both in the euro area and throughout the Community. Whatever principles the Commission might wish to uphold, **integration has an inherent, natural limit** which can never be crossed: despite the necessary endeavours to harmonise or remove competition and legislative barriers there will always be differences of social context, taxation, labour markets and language which cannot be eliminated.

5.1.2 The purpose of the aforementioned study should be to steer the Commission and Member States towards defining a policy based on **ongoing assessment of the costs and benefits of harmonisation**: completion of the internal market and competitiveness cannot be the sole aim. The social and economic implications for individual countries and their adjustment capacities need to be taken into account.

5.2 Inflation aside, other elements which contribute to poor economic growth are **only indirectly affected by monetary policy**, and they are in any case outside the remit of the Eurogroup. The EESC therefore feels it would be wrong to blame the euro for an **economic situation which is common to euro-area and other countries**. Moreover, in none of these other countries has the public blamed the national currency, while a large part of the public in the euro area has blamed the single currency.

5.3 Against a generally encouraging and optimistic backdrop, one Commission statement gives cause for concern ([1]): 'beyond the fulfilment of initial expectations, the EMU policy agenda for the next decade will be marked by the emergence of **new global challenges which will have an amplifying effect on the weaknesses of EMU** outlined above'. It seems that, rather than 'the weaknesses of EMU', the real issue is the competitiveness of euro-area countries: the need to replace declining industries, research, innovation and human capital, along with rising food, energy and (to some extent) commodity prices, in a context of climate change, an ageing population and immigration. The issue is therefore, first and foremost, economic and social in nature.

5.3.1 All these aspects combine to form what the Commission calls '**policy challenges that are particularly compelling for the euro area**'. While it agrees with the Commission's analysis, the EESC interprets this statement as meaning that although the aforementioned problems do affect EMU policy, they are to be resolved at Community rather than Eurogroup level. In other words, the policies to be developed are to be 'European' while the Eurogroup's remit should be limited to direct (and coordinated) action relating to euro monetary issues alone.

6. A policy agenda for the second decade

6.1 The Commission paper outlines the agenda, stating that 'the experience of the first decade of EMU, while overall … successful, reveals a number of shortcomings that need to be addressed'. In addition to **consolidating macroeconomic stability**, it will be necessary to increase 'potential growth' and the 'welfare of citizens', protect the interests of the euro area in the global economy and ensure 'a smooth adjustment capacity' as new members join EMU.

([1]) COM(2008) 238 final. *EMU@10: successes and challenges after 10 years of Economic and Monetary Union*, section entitled *EMU's remaining challenges amplified by new global trends*, end of the fifth paragraph.

6.2 To achieve these objectives the Commission proposes a **three-pillar agenda**:

— a **domestic** agenda: including greater fiscal-policy coordination and surveillance and better integration of structural reform in overall EMU policy coordination;

— an **external agenda**: enhancing the euro area's role in global economic governance;

— **economic governance**, necessary to implement these two agendas.

6.3 As regards **domestic policy**, no essentially new principles are specified but guidelines for healthy governance, set out on a number of occasions in the past, are reiterated: sustainability of public finances and enhancement thereof in terms of rational use of expenditure and taxation systems, channelling them towards growth-friendly and competitiveness-enhancing activities. In addition to this, the Communication mentions the 'need to **broaden surveillance to address macroeconomic imbalances**' such as the growth of current account deficits and persistent inflation divergences. The Commission stresses that integration, particularly of the financial markets, has helped to consolidate EMU, but that it can also, if not accompanied by appropriate policies, amplify divergences among the participating countries.

6.3.1 The EESC agrees with this analysis but draws attention to the need to be realistic, in other words to take into account the difficulties of establishing principles which it will be possible to implement in practice.

6.3.2 **Public expenditure** is a key element. The Commission advocates 'laying down well-designed expenditure rules, which would allow the automatic fiscal stabilisers to operate within the limits of the SGP while attuning the composition of public expenditure to the structural and cyclical needs of the economy'. It is difficult to give practical effect to this recommendation in periods of turbulence whose length cannot yet be predicted. **Inflationary pressures** have impacted heavily on income distribution, salaries and investment and, ultimately, on **competitiveness and social systems**, but the extent of this differs widely between the various EMU countries. The make-up of the primary deficit varies from country to country, the balance of trade is increasingly affected by higher or lower energy costs, and there are substantial structural differences between pension schemes which are difficult to iron out when things are running normally and even more difficult to correct when they are not.

6.3.3 To be realistic, the hoped-for **convergence** should be seen as a **medium- to long-term goal**. The EESC agrees that there is a 'clear need to **broaden surveillance to address macroeconomic imbalances**' using existing instruments, but warns against taking it for granted that they will be effective in the short term.

6.3.4 As regards **euro-area candidate countries**, the Commission plans to provide closer surveillance of their economic developments, in particular as regards the countries participating in the Exchange Rate Mechanism (ERM) II framework. No new elements are introduced here either: it is merely a question of making existing mechanisms more effective. One thing must be clear: once a country has met the criteria for joining EMU, accession is no longer optional – it is required by the Treaty of Accession. The current crisis could, moreover, cause some delay in meeting the criteria; in view of the priority of giving Europe a single currency, some flexibility might be advisable when assessing compliance with the criteria or adjusting them.

6.3.5 As regards **integration of the products, services and labour markets**, the Commission notes ongoing regulatory barriers and disparities in progress between countries. However, these aspects are not specific to the EMU area and should therefore be seen as part of the wider picture of the EU as a whole. As explained in point 5.1.1 above, there are inherent, natural limits to integration, and also other **limits brought about by economic and social constraints** in the various countries: these limits must be considered on a case-by-case basis and, where necessary, respected.

6.3.6 As regards the **financial markets**, the Communication states that 'the euro area can draw comparatively large benefits from promoting EU financial integration' but that 'further efforts are required to enhance the efficiency and liquidity of euro area financial markets'. The EESC notes that ECB policy in this area is exemplary and inspires confidence that it will be able to resist acute crises, as it has thus far. The effects of the US crisis could have been much worse if they had not been curbed by a **policy based on safeguarding the resilience and liquidity of markets**; regarding the surveillance structures, which failed to foresee, still less avert, the collapse of a number of major institutions, the EESC will refrain for the moment from passing judgment, pending further information which the market and the public are entitled to request.

6.3.6.1 With reference to the preceding point, the EESC notes that the US crisis was due to a market with inadequate rules and surveillance. Paradoxically, **the free market economy *par excellence* had to resort to aid from the public authorities** to face the disaster, receiving state aid and huge injections of liquid funds. This was a loss for the economy, for the national budget and for the American people, but above all for the credibility of a system.

6.4 As regards **external policy**, the Commission sets out an agenda intended **to enhance the euro area's international role**, implementing a strategy which is 'commensurate with the international status of its currency'. Moreover, it reiterates the call, already made on many occasions in the past, for it to '**speak with a single voice**' in all international currency forums. The EESC stresses once again its full support for the agenda: the fact that the euro's governing authorities cannot participate in global monetary institutions is **unacceptable** in both operational and – above all – political terms.

6.4.1 The Commission mentions resistance from 'other countries', which it believes see the EU and the euro area as over-represented in international organisations (in terms of both seats and voting power). Hesitant disclosures suggest that this resistance does exist and that pressure for greater representation from EU countries, both EMU members and non-EMU members, is neither strong nor coordinated. **The Eurogroup should speak convincingly, first and foremost in the Council**.

6.4.2 To weaken the resistance of non-EU countries there is **one step** that the EMU countries could take **which would have great symbolic value**: they could give up not their seats but their **right to an individual vote**. Logically, since the euro as a currency is governed by a single authority, **that authority alone should have the right to vote**. The social partners are entitled to information in this respect too; the reluctance to provide it is certainly due to sensitive political issues, but the silence and lack of transparency do nothing to further acceptance of Europe, still less of the euro.

6.5 The Commission Communication ends with what is perhaps the densest section in terms of content and implications: **governance of EMU**. It calls for 'strong involvement of all EU Member States within the ECOFIN Council' on economic policy, more thorough integration of EMU issues and 'a more consistent approach' in sectors within ECOFIN's remit: macroeconomic policy, financial markets and taxation.

6.5.1 Such an approach would appear self-evident. However, the EESC notes that the ECOFIN Council's decisions very rarely mention EMU as being directly or indirectly concerned by decisions. Economic policy and monetary policy are interdependent: the euro is not the only currency in the EU but it is the most important, not just because it represents a substantial group of countries but also because other Member States are likely to join it.

6.5.2 The Commission plays a key role in EMU governance: not just a supportive role ensuring effective operation but also in terms of budget and macroeconomic surveillance. The Commission proposes to step up its work and make it more effective, and to enhance its role in international forums. These roles will become wider and more effective with the **new Treaty**, which enables the Commission to '**adopt measures**' specific to EMU member countries on budgetary discipline and economic policy guidelines, as well as giving it surveillance tasks. In addition, Article 121 of the new Treaty gives the Commission the power to issue 'warnings' to a Member State when it deviates from the broad guidelines.

6.5.3 The EESC welcomes the Commission's undertaking and trusts that with the new Treaty it will be able to perform both its conventional and its new roles with the utmost effectiveness, enjoying all due respect. In particular, however, it calls on all economic and monetary authorities to learn from the US subprimes crisis and to decide to **give the policies which have thus far underpinned the operation of the financial markets a thorough overhaul**.

6.5.4 The events in the US have sparked a **systemic crisis** throughout the world. Europe has already been hard hit and the possibility of further shocks cannot be ruled out. It would be highly beneficial to analyse the crisis both from a macroeconomic perspective and from a historical perspective, **taking into account microeconomic considerations**. This two-pronged approach could reveal the underlying reasons for the crisis, which had been brewing for some time.

6.5.5 **100 % mortgages have always been available** in the United States, with related expenditure pushing the size of loans up considerably. In Europe, however, until a few decades ago most countries observed the need for caution and, in some cases, banking rules: the **maximum loan granted was 70-80 %**. The reason for this is clear: property prices might fall and reduce the value of the security.

6.5.6 Under the momentum of market liberalisation and, in particular, the competition unleashed by market integration, the '70 % rule' was abandoned in Europe too, although this has not thus far caused any major problems. Nevertheless, **the '100 % rule' is still unhealthy in prudential terms and as regards market ethics**. The 'easy credit' system leads anyone and everyone to buy property: if a crisis then threatens, 'weak' debtors stop making payments and this leads to a situation of **general over-indebtedness**. For its part, the credit provider acquires a mortgaged property whose value often does not cover the loan provided and therefore decides to sell it, but putting the property on the market further contributes to the downward pressure on the market.

6.5.7 **The interaction between economic crises and property-market crises is clear**, but when use of securitisation, 'packages' and 'subprimes' becomes general practice **it spreads across the whole financial market, generating an 'intersystemic' crisis** of unprecedented proportions. Then there is the legitimate fear that this will not be the end of the story: high debt levels among families, thanks to consumer credit and credit cards, are causing concern that another 'bubble' of unpredictable proportions will burst.

6.5.8 Leading political and monetary authorities in Europe have done their best to avoid even worse crises, **injecting liquid funds** and **taking over financial institutions**: this is an emergency which requires **state aid**, and therefore conflicts with the principle of an unregulated, free market economy which is subject to little surveillance.

6.5.9 In addition to addressing the crisis, there is now an urgent need to **look back into the past for the roots of the crisis**. Clear rules must be established on provision of mortgages and credit cards, more effective surveillance systems must be put in place, covering the diverse and non-transparent 'non-bank' sector, and a further assessment needs to be made of whether it is right to allow onto the securities market a large quantity of non-transparent products whose nature and reliability even the experts are unable to discern. It is not a question of abandoning the market economy, rather of giving it some rules.

Brussels, 24 March 2009.

The President
of the European Economic and Social Committee
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