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PRESIDENCY ISSUES NOTE

Deepening of the Economic and Monetary Union: The Issue of Convergence - What Are We Aiming at?

I. Background

"In these times of change, and aware of the concerns of our citizens, we commit to the Rome Agenda, and pledge to work towards (...) a Union where (...) a stable and further strengthened single currency open(s) avenues for growth, cohesion, competitiveness, innovation and exchange, especially for small and medium-sized enterprises; a Union promoting sustained and sustainable growth, through investment, structural reforms and working towards completing the Economic and Monetary Union; a Union where economies converge."

Rome Declaration, EU leaders, 25 March 2017

Genuine Economic and Monetary Union (EMU) where different economies converge and prosper in a framework of a common architecture is a longstanding goal.

Convergence contributes to the well-functioning of EMU, as well as to its socio-economic and political sustainability in the longer run. In turn, a well-functioning EMU supports sustainable convergence as it strengthens the incentives for, inter alia, cross-border trade and capital flows, technology and knowledge transfers, labour mobility and price arbitrage, all drivers of convergence.

Strengthening sustainable convergence among EU Member States occupies a centre stage in the debate on the completion of the EMU:

- The Four Presidents' Report "Towards a Genuine EMU" (2012), as well as the Five Presidents' Report "Completing Europe's EMU" emphasized the importance of EMU deepening.
- The European Commission 2017 White Paper , complemented by five reflection papers, presented possible scenarios for the future development of the EU.
- The December 2017 Package showed a renewed ambition for its deepening. Together with the ongoing initiatives to complete the Banking and Capital Markets Union, new ideas were presented on how to make the process of

economic governance more efficient and to how strengthen the EMU architecture.

- The Commission repeated many of these new ideas in its Communication of 14 February 2018 on 'A new, modern Multiannual Financial Framework for a European Union that delivers efficiently on its priorities post-2020'.
- The December 2017 Euro Summit reviewed these ideas. At the January 2018 ECOFIN meeting, Ministers agreed to respect the mandate given by the Leaders, focusing on the areas where discussions are more advanced. So, priority was given to completing the Banking Union and further developing the ESM. At the March 2018 Euro Summit, Leaders reaffirmed these political priorities.

II. The convergence concept

Further progress on economic convergence is essential for the good functioning of both the euro area and the EU. However, there are different notions of economic convergence.

Real convergence - moving towards similar income levels and higher living standards - is key to achieving the Union's objectives, but it is the result of policy actions and of other factors. This is why it is useful to look at other convergence concepts.

The **nominal convergence** criteria which a Member State needs to fulfil to be allowed to introduce the euro aim to capture the macroeconomic resilience of a country. Nevertheless, the attainment of these criteria and the adoption of the euro do not necessarily guarantee real and sustainable convergence.

Cyclical convergence relates to the business cycle synchronization of the European economies, simply meaning that euro area economies should be in the same stage of the business cycle. This is important for the smooth functioning of the EMU, as conducting a single monetary policy would be possibly less effective if countries are positioned differently over the economic cycle. This underscores the need for countries to build the necessary fiscal space to conduct counter-cyclical policies. Moreover, the experience with the implementation of the common fiscal rules has shown that it is not straightforward to produce an appropriate and unambiguous measure of a country's cyclical position.

Whereas nominal and cyclical convergence is important, they may not suffice to ensure sustainable convergence. This is why the Five Presidents' Report puts considerable emphasis on the need to pursue **structural convergence**. The Report suggests making the convergence process more binding. This would be achieved not through the harmonisation of policies across the board, but rather by agreeing on a set of common high-level standards that would be defined in the EU legislation. The

common standards should focus primarily on labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy (e.g. corporate tax base). Progress towards these standards would be monitored regularly. Country-Specific Recommendations would continue to be used in this context. Furthermore, the Macroeconomic Imbalance Procedure (MIP) could be utilised as a tool not only to prevent and correct imbalances but also to foster reforms and monitor progress in each euro area Member State towards these common standards.

The December 2017 Package states that: "*… ongoing work in the Council and in the Eurogroup on the benchmarking of policies and the identification of convergence standards should be reinforced during the next 18 months*."

III. Possible new instruments to promote convergence

In its Communication on a new and modern Multiannual Financial Framework (14 February 2018), the Commission points out that post-2020, the EU budget will need to play a role to strengthen the EMU and the EU as a whole notably through a 'reform delivery tool' and a 'convergence facility' as well as through a (macroeconomic) 'stabilisation function'.

Concrete proposals are expected to be put forward in May 2018. These would come in addition to the existing proposals to amend the Common Provisions Regulation and to increase the financial envelope of the Structural Reform Support Programme as well as the ongoing work on the further development of the ESM and the completion of the banking union.

IV. Questions for discussion:

i. How to ensure that sustainable convergence remains a policy target before and after euro adoption? What instruments could be used? How do they relate to the recent initiatives and suggestions to deepen the EMU?

ii. Which activities should be prioritized in order to further enhance sustainable convergence, and thereby, economic and financial integration?

iii. How to engage both euro "ins" and "outs" to prioritise a boost in their sustainable convergence?