

Extract from:
Tommaso Padoa-Schioppa Group,
'Completing the euro - A road map towards fiscal union in Europe',
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Preliminary remarks: there is an urgent need to agree on a road map towards a fundamental transformation of Economic and Monetary Union

In April 1987, a Study Group on the “Integration Strategy of the European Community” chaired by Tommaso Padoa-Schioppa¹ published a report that later became the basis for Economic and Monetary Union in Europe. That report referred to four points that it considered to be *“the basis of the long-term ‘social contract’ between the Community and its Member States”*: (I) competitive markets, (II) monetary stability, (III) an equitable distribution of the gains in economic welfare, and (IV) actual growth performance. These four elements have indeed constituted the basis for further political and economic integration in Europe in the past 25 years.

Today, the members of the “Tommaso Padoa-Schioppa Group” consider that the European social contract is at risk. A break-up of the euro area can no longer be excluded. We are concerned that a possible process of monetary disintegration, once started, could prove impossible to stop and would therefore run the risk of leading to the process of political and economic disintegration in the euro area and the European Union. The ongoing crisis, which has been affecting the European

1. “Efficiency, Stability and Equity: A Strategy for the Evolution of the Economic System of the European Community”, Report of a study group appointed by the Commission of the European Communities, and presided by T. Padoa-Schioppa. April 1987.

Union and in particular the euro area for more than two years, thus poses a fundamental challenge to the four constitutive elements of recent European political and economic integration.

The principle of competitive markets in Europe, as currently based on the Four Freedoms, increasingly runs the risk of being called into question through a re-nationalisation of economic policies, possible protectionist tendencies, and a potential return to national currencies and competitive devaluations in the context of a euro area break-up. We consider the costs related to such a backward movement in European market integration to be prohibitive and fear that the end of a competitive market structure in Europe is likely to lower aggregate social welfare in the euro area.

The principle of monetary stability in Europe, as reflected in the original architecture of economic and monetary union of the Maastricht Treaty, is currently confronted with three dangerous scenarios: (I) First, there is a non-negligible risk of a return to national currencies. Should this risk materialise, this would imply a sudden end to monetary stability, as savings and assets of large parts of the population of the euro area would be subjected to a sudden change in price. (II) Second, there is considerable risk in the banking sectors of several euro area countries. Should the ongoing uncertainty in those systems translate into uncontrollable bank runs or massive cross-border capital flight, there would be a serious risk for bank deposits and thus again for the savings and assets of parts of the euro area population. (III) Third, the stability of the euro itself is seen by many as being put at risk in the context of rescue or stabilisation efforts that might involve a far-reaching monetisation of debt.

The principle of an equitable distribution of the gains in economic welfare in Europe, as reflected in the widely-agreed framework of the social market democracy (*Soziale Marktwirtschaft*) is currently put at risk. Inequalities, both within countries but even more so across countries are on the rise. Youth unemployment now affects more than half of the workforce in several euro area countries. A continued crisis in the euro area or a break-up of the single currency would be likely to further accentuate societal divisions in Europe.

Growth performance in the euro area is currently threatened at three different levels. (I) The crisis itself has already had a significant negative effect on growth

in the euro area. That trend is likely to continue in a context of uncertainty if there is no forward-looking, sustainable and long-term response to the crisis anytime soon. (II) A break-up of the euro area is likely to lower the degree of interconnectedness between economic agents in Europe. We would expect such a development to significantly hamper growth performance in the coming years. (III) The continued focus on short-term debt and deficit reduction runs the risk of lowering overall growth prospects in the euro area in the short to medium term. While excessive debt levels are neither desirable nor sustainable, we see the risk that excessive austerity could translate into a lost decade for growth in the euro area.

Against the background of these risks to the four main components of the European social contract, we present elements for reflection on how to make the euro area more resilient and restore confidence in the single currency. This Report focuses mainly on the long-term responses to the current challenges. It seeks to formulate the questions that will have to be answered so that the euro can become a long-term success. But even if our recommendations do not focus on the short term, our main message should be clear: in the context of crisis, long-term matters are urgent matters.

There were two guiding principles in the deliberations of the group. First, we all share the view that a step backward in the process of monetary integration is simply not an option. In the preceding paragraphs we have provided some elements justifying that principle, but in the core part of the Report we do not even consider the option to abandon the euro. Second, we have decided to derive our proposals from the principle: “As much political and economic union as necessary, but as little as possible.” We believe that the current crisis has been triggered by several dysfunctions inherent to the original framework of monetary union that need to be corrected. But in line with the principle of subsidiarity we also believe that the corrections should be limited to what is strictly necessary for the euro to operate more successfully. So we do not want to advocate “more Europe” for the simple purpose of strengthening the process of European integration. It is not our intention to advocate a European “super-state” or a strong supra-national power. We consider EMU to be incomplete in its current form and put forward elements that we consider indispensable to make the euro work. Not more, not less.