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25 YEARS AFTER THE DELORS REPORT:

WHICH LESSONS FOR ECONOMIC AND MONETARY UNION?

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RESUME

In April 1989, a "Committee for the Study of Economic and Monetary Union", chaired by the then President of the Commission, Jacques Delors, and including all 12 European Community central bank governors, published a report that set the basis of the current Economic and monetary union (EMU). The report analyzed the principal features and implications of building up an Economic and monetary union and proposed a three-stage approach to move towards EMU.

"THE MAIN LESSON FROM THE REPORT IS THAT A MONETARY UNION CANNOT FUNCTION AS A STANDALONE ELEMENT"

25 years after its publication and at the moment when EMU governance is undergoing a fundamental change in the context of the major crisis, what lessons can be drawn by looking backward to the Delors Report? Is the Report still topical in its analysis of implications and requirements to create an Economic and monetary union? How does the Report's content relate to the origins of the crisis and some of the EMU deficiencies as revealed by the crisis? Are the Report's proposals still appropriate now that we can no longer work on the assumption that all EU members will soon become members of the euro-area?

In this paper, we aim to shed some light to these questions by confronting the proposals contained in the Delors Report with what was finally agreed in Maastricht, and assessing both in the light of current debates on EMU governance. Overall, the analysis shows that the Report was right, even premonitory, in pointing out certain risks recently revealed by the crisis whereas it failed to recognize others. The main lesson from the Report, however, is that a monetary union cannot function as a standalone element. Rather than insisting only on monetary stability as the core of EMU, the Report presents a more encompassing approach to EMU, arguing that monetary union required (i) some degree of political integration, (ii) a clear role of the EU level as a steering mechanism on macroeconomic and budgetary matters, (iii) an emphasis in economic policy making on convergence in EMU.

Finally, there is a lesson to be drawn from the Delors Report concerning the method. Whereas many factors explain the creation of EMU, the Delors Committee made an important contribution in providing technical legitimation and ensuring political direction to the project. In this respect, it could serve as a role model for further efforts to reform EMU.

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INTRODUCTION

In June 1988, the European Council created a Committee chaired by the President of the Commission, Jacques Delors, and including all 12 central bank governors of the then European Community, giving it the objective of "studying and proposing concrete stages leading towards an Economic and monetary union"[1]. The work of this Committee concluded in April 1989 with the publication of a report unanimously approved by its members. The Report, commonly known as "Delors Report"[2], analyzed the principal features and implications of an Economic and monetary union in Europe (henceforth EMU) and proposed a three-stage approach to move towards EMU.

The Delors Report was formally endorsed at the European Council of Madrid in June 1989, and set the basis for the EMU provisions of the Maastricht Treaty. Yet, not all recommendations made in the report found its way into the Treaty: some of them were ignored or weakened during the Treaty negotiations or in subsequent legislative developments.

In the midst of the recent crisis, German Chancellor Angela Merkel recalled the importance of the Report in a speech at the European Parliament, emphasizing the Delors Committee's suggestion to give equal weight to the two pillars of economic and monetary union and pointing out that a "monetary union without a sufficient degree of convergence of economic policies is unlikely to be durable and could be damaging to the Community"[3]. That perspective, which is quite far-reaching, is the starting point of our assessment: 25 years after its publication and at the moment when EMU governance is undergoing a fundamental change in the context of the major crisis, we ask what lessons can be drawn by looking backward to the Delors Report. Is the Report still topical in its analysis of implications and requirements to create an Economic and monetary union? How does the Report's content relate to the origins of the crisis and some of the deficiencies of the EMU framework as revealed by the crisis? We also look at the implications of EU enlargement for the euro-area framework: contrary to the initial expectation surrounding the work in the Delors Committee and the negotiations on the Maastricht Treaty, we can today no longer work on the assumptions that all EU members will soon become members of the euro-area. There is a direct impact of this new context on the relationship between the single market and the single currency.

We seek to shed light on those issues by confronting the proposals contained in the Delors Report with what was finally agreed in Maastricht, then assessing both in the light of current debates on EMU governance. To a certain extent, there is an anachronism in what we try to do. From today's perspective we look at what was written in a Report published 25 years ago. Two things are clearly missing in our analysis.

First, we do not pay enough tribute to the extraordinary achievement of the Delors Report in pushing forward ideas and proposals that were far-reaching and revolutionary at the time of its publication. Almost no one believed in the late 1980s that a decade later monetary union in Europe would have become reality. The simple endeavor to prepare a Report on monetary union in that specific historical context against most odds and against fierce political resistance from many actors in Europe would deserve a detailed assessment of why and how certain proposals made it into the Report and others didn't. Also, the fact that there was unanimous

1. European Council meeting in Hannover, 27-28 June, 1988, conclusions of the Presidency
2. Its official name is "Report on European Economic and monetary union"
3. "Let me remind you that in his 1989 report on the establishment of economic and monetary union, the then Commission President Jacques Delors pointed out the importance of the two pillars of economic and monetary union because, and I quote, "[…] monetary union without a sufficient degree of convergence of economic policies is unlikely to be durable and could be damaging to the Community." That's what Jacques Delors said back in 1989.The crisis has shown how right Jacques Delors' analysis was" Speech by Federal Chancellor Angela Merkel in the European Parliament in Brussels, November 7 2012 (http://www.bundesregierung.de/ContentArchiv/EN/Archiv17/Reden/2012/2012-11-07-merkel-eu.html)

support of the Report despite manifold hesitations across Europe is remarkable and could require further discussions. However, such an assessment is not part of our paper. We simply take the Delors Report "as is" to assess what we can learn from it from today's perspective.

Second, we do not take proper account of the historical context shaping the actual implementation of monetary union in the Maastricht Treaty. Also we do not cover the debates or events during the short decade between the publication of the Delors Report and the start of stage three of monetary union (e.g. EMS crisis in 1992/1993, debate on the Stability and Growth Pact, or debate on the number of members in EMU). or the Here again: our aim is not to write a history of EMU but to confront the state of knowledge and initial expectations put forward in the Report with what we have learnt on EMU over time.

The paper is structured as follows. Section 1 briefly describes the historical context leading to the publication of the Delors Report and its significance in the road to EMU. Section 2 summarizes the main propositions of the Delors Report. In Section 3 we re-visit the Delors Committee's perceptions, and solutions proposed, to three challenges which are now at the heart of EMU debates: how to ensure fiscal discipline, how to prevent and correct major EMU imbalances and how to guarantee financial stability. We compare the Report's proposals to what was finally agreed in Maastricht, and discuss them against the evidence of what we have learnt on the functioning of EMU over time, particularly during the recent crisis. We conclude in section 4, by drawing from this analysis some lessons for the current process of EMU reform.

1. The significance of the Delors Report in the road towards EMU

"THE DECISION TO SET UP A COMMITTEE TO STUDY HOW TO MOVE TOWARDS EMU WAS TAKEN AT THE HANNOVER EUROPEAN COUNCIL IN JUNE 1988"

While the first attempts to create an Economic and monetary union in the European Community (EC) date back to the 1970s, proposals to proceed towards a monetary union were no longer on top of the EC agenda when Jacques Delors arrived at the Presidency of the European Commission in 1984. Less than a decade later, however, the Maastricht Treaty was signed. EU integration research has sought to explain that fundamental shift as a consequence of a set of economic and political factors – a new consensus among EC governments on monetarism and sound public finances, the tensions generated by the dominance of the D-mark at the heart of the European Monetary System (EMS) and the prospect of free movement of capitals as part of the 1992 Single market project, potentially endangering the stability of the EMS[1]. From an institutional perspective, however, it is clearly the Delors Report that brought those elements together and paved the way for monetary union.

The decision to set up a technical committee to study how to move towards EMU was taken at the Hannover European Council in June 1988. Since the early 1988, several political factors had created a political climate favorable to the idea of monetary union[2]. Aware of this fact, the then president of the Commission Jacques Delors convinced the German Chancellor Helmut Kohl – then in charge of the EC presidency - to seize the opportunity to push for EMU. Time however was not ripe for a political decision by the European Council: rather than opening a discussion on whether or not moving to EMU, Kohl convinced his colleagues on the opportunity set up a technical working group to discuss the feasibility of EMU.

Following the suggestion of Jacques Delors, it was decided that the Committee would be mostly composed of EC central bank governors. By inviting them to reflect on how EMU could be realized (rather than whether EMU was desirable), the Committee succeeded in enhancing the technical credibility of the EMU project while at the same time 'binding' central bankers to it.

The European Council entrusted to Jacques Delors the task of chairing the Committee and nominated four additional members to the Committee: Frans Andriessen (Vice President of the European Commission) and three independent experts: Alexander Lamfalussy (General Manager of the Bank for International Settlements), Miguel Boyer (President of Banco Exterior de España), and Niels Thygesen (Professor of Economics in Copenhagen). The rapporteurs, selected by Jacques Delors, were Tommaso Padoa-Schioppa and Gunter D. Baer, high-level officials at DG Ecfin and the Bundesbank respectively.

The Committee met in Basle at the end of the regular meetings of the Committee of the EC central bank governors. After nine months of deliberations, in April 1989 it came up with a 38-page report which was unanimously approved by its members.

In June 1989, the European Council meeting in Madrid formally endorsed the Report as "a good basis for further work"[3]. It very concretely adopted the provisions necessary for the launch of the first stage towards EMU (as proposed by the Delors Report) and agreed in principle to an Intergovernmental Conference (IGC) to determine the Treaty changes necessary to realize the second and third stages towards EMU, although no date was fixed for the IGC. The date was finally fixed in December 1989, when the European Council agreed to convene this IGC "before the end of 1990"[4]. Negotiations on the new Treaty opened in December 1990 in Rome, and concluded one year later in Maastricht. Following delays in the ratification processes at the national level, the Maastricht Treaty came finally came into effect on 1 November 1993.

1. Dyson and Featherstone (1999), *The Road to Maastricht: Negotiating Economic and Monetary Union*, Oxford: Oxford University Press; Jakbo, N (1999), "In the name of the Market: how the European Commission paved the way for monetary union", Journal of European Public Policy 6:3 September 1999, pp. 475-95.
2. In early 1988 several memoranda circulated between French, Italian and German Ministers criticizing the constraints of the EMS and calling for reform. At the same time, at the initiative of former German and French presidents Helmut Schmidt and Valéry Giscard d'Estaign, a group of EC politicians, bankers and industrialists had started to organize themselves in the "Association for the Monetary Union" to lobby for EMU. For more details see Dyson and Featherstone (op. cit.)
3. Conclusions of the European Council in Madrid on 26/27 June 1989 B.2...
4. The decision to set a date was highly influenced by the fall of the Berlin Wall in November 1989 and the prospect of German Reunification. The latter put enormous pressure on Germany to reaffirm its commitment to European unification, by naming an early date for the IGC on EMU (Dyson et al, op. cit, p. 4).

2. A summary of the Delors Report

The Delors Report is structured in three chapters. The first chapter analyzes past experiences and current developments in economic and monetary integration in the EC and spells out the economic rationale to move towards EMU. The second chapter constitutes the bulk of the report. It examines the principal features and implications of creating an Economic and monetary union, and the transfers of sovereignty which it would entail. Finally, the third chapter proposes the realization of economic and monetary union in three stages.

> "AN ECONOMIC AND MONETARY UNION AS A 'NATURAL CONSEQUENCE OF THE COMMITMENT TO CREATE A MARKET WITHOUT FRONTIERS' "

While not making a clear-cut case for absolute necessity of EMU, the Report sees the move towards an economic and monetary union as a "natural consequence of the commitment to create a market without frontiers" (paragraph 14).[5] As in the Werner Report (1970), "monetary union" is defined as a currency regime with fully convertible currencies, complete freedom of capital movements and irrevocably fixed exchange rates, i.e. a de-facto monetary union with different currencies. While the Delors Report thus does not see the single currency as an indispensable element of a monetary union, it considers the latter desirable "for economic as well as psychological and political reasons" (paragraph 23). At the same time, it stresses that a true monetary union requires a common monetary policy, and recommends for this purpose the creation of a single monetary institution[6]. Modelled at the image of the Bundesbank, this has to be mainly committed to the objective of price stability and be independent of political instructions.

"Economic union" in the Report is defined in terms of four basic elements: (1) the single market, (2) competition policies and other measures aimed at strengthening market mechanisms, (3) common regional and structural policies and (4) macroeconomic policy co-ordination, "including binding rules for budgetary policies" (paragraph 25).

The Report stresses in various parts the importance of ensuring an adequate balance between economic and monetary union. It emphasizes the need to implement them in parallel, as "the process of achieving monetary union is only conceivable if a high degree of economic convergence is attained" (paragraph 19). In particular, the completion of the single market program and the reduction of existing disparities "through programs of budgetary consolidation to those countries concerned and more effective structural and regional policies" (paragraph 51) are seen as necessary conditions to move from stage 1 to stage 2 in the road to EMU.

At the third stage of EMU, a well-functioning economic pillar is considered essential to limit the scope for divergences and permit the determination of an overall policy stance for the Community as a whole. In the absence of the exchange rate instrument, the Report emphasizes the importance of labor mobility, together with wage and price flexibility at the national level, to prevent and correct economic imbalances. However, it also recognizes that, "in order to reduce adjustment burdens temporarily, it might be necessary in certain circumstances to provide financing flows through official channels (...) granted on terms and conditions that would prompt the recipient to intensify its adjustment efforts" (paragraph 29).

Apart from completing the single market and introducing national wage and price flexibility measures, the Report considers essential to set a framework for macro-economic policy co-ordination in the last stage of EMU. In the general macro-economic field, "a common overall assessment of the short-term and medium-term economic developments in the Community would need to be agreed periodically and would constitute

5. In fact, one of the key messages in chapter one was that the completion of the single market program, and particularly the full liberalization of capital movements, would quickly translate into exchange rate tensions thus making necessary "more intensive and effective policy co-ordination" (p. 11). The latter was in fact a formulation of the Padoa-Schioppa's theorem of the "inconsistent quartet", already formulated in the 1987 Padoa Schioppa's Report (Padoa Schioppa, T-, 1987, *"Efficiency, Stability and Equity: A Strategy for the Evolution of the Economic System of the European Community"*, Brussels: Commission of the European Communities,).
6. Note that the latter was slightly contradiction with the statement that the single currency is not a necessary element of a monetary union, as "once monetary policy decisions are made and implemented by a single entity (..) the different currencies amount in practice to a non-decimal fractional currency" (Padoa Schioppa, T.1990, "Monetary Union and Competition", in *The Road to Monetary Union in Europe: The Emperor, the Kings and the Genies*, Oxford: Oxford University Press, pp. 126-140).

the framework for a better coordination of national policies". This framework should put the Community "in a position to monitor its overall economic situation, to assess the consistency of developments in individual countries with regard to common objectives and to formulate guidelines for policy". In the budgetary field, binding rules are required to prevent divergent fiscal developments. In particular, the Report recommends the establishment of rules to "impose effective upper limits on budget deficits (...), exclude access to direct central bank credit and other forms of monetary financing (...) and limit recourse to external borrowing in non-community currencies". Finally, given the small size of the Community budget, the arrangements for budgetary policy co-ordination were also expected to serve to determine an overall fiscal policy stance, thus enabling the Community "to conduct a coherent mix of fiscal and monetary policies" (paragraph 30).

The Report also discusses the implications of setting up EMU for the Community's role in the world economy. It emphasizes the need to give to the Community the capacity to "speak with one voice" in the international fora, "in order to make full use of its position in the world economy and to exert influence on the functioning of the international economic system" (paragraph 38).

On the precise institutional arrangements, a lot of attention is devoted to describe the mandate, functions and principles that should govern the new central monetary authority. In particular, the Report recommends the creation of a rather "federal" structure (the European System of Central Banks – "ESCB"), consisting of a central institution and the national central banks. The new monetary authority has to be committed to price stability and, "subject to the foregoing (...) support the general economic policy set at the Community level", and it should also "participate in the coordination of banking supervision policies" (paragraph 32). The Report emphasizes the need to guarantee the ESCB's political independence while at the same time calling for its democratic accountability vis-à-vis the European Parliament and the European Council. In contrast, few details are given with respect to the institutional changes required in the economic field: the Report basically states that there would be no need for a new institution but that the new Treaty "would have to provide for additional or changed roles for the existing bodies in the light of the policy functions they would have to fulfil in an economic and monetary union" (paragraph 33). In any case, any transfer of sovereignty has to be as limited as possible, following the subsidiarity principle (paragraph 20), and the new institutional framework for the management of EMU has to be "properly embedded in the democratic process" (paragraph 31). In particular, the Report considers that the European Parliament has to be involved[7] in the adoption of directly enforceable decisions aimed "to impose constraints on national budgets (…); to make discretionary changes in Community resources to supplement structural transfers to Member States or to influence the overall policy stance in the Community; and to apply to existing Community structural policies and to Community loans (…) terms and conditions that would prompt member countries to intensify their adjustment efforts" (paragraph 59)

Finally, the third chapter of the Report proposes a three-step approach to move towards EMU. While describing the economic and institutional conditions necessary to move from one stage to the next, the Report stresses that any such change "cannot be defined precisely in advance; nor it is possible to foresee today when these conditions will be realized". In coherence with this vision, it warns against the setting of explicit deadlines and considers that the decisions to move from one stage to the next would have to "involve an appraisal by the Council" (paragraph 43). The Report is equally cautious with respect to the question of participation. Whereas the commitment of all members of the Community to EMU is perceived as very important to ensure the credibility of the project, the Report emphasizes the need to "allow for a degree of flexibility concerning the date and conditions on which some member countries would join certain arrangements" (paragraph 44).

7. Note that this 'involvement' was not expected to reach the point of giving to the European Parliament a right of veto. In particular, the Report recommended the use of the old EC cooperation procedure to adopt the decisions cited in paragraph 59. Under this procedure, abolished by the Lisbon treaty, the Council could, with the support of Parliament and acting on a proposal by the Commission, adopt a legislative proposal by a qualified majority, but the Council could also overrule a rejection of a proposed law by the Parliament by adopting a proposal unanimously

3. A closer look: what the Report said and didn't say on fiscal policies, EMU divergences and financial stability

The current crisis in the euro area has exposed important gaps in the initial EMU design. In particular, there is now a wide-spread consensus that the EMU architecture as set up in the Maastricht Treaty had in-built institutional deficiencies. Three elements are frequently listed in this respect: (1) the lack of an appropriate EMU fiscal framework, (2) the impossibility of EMU to prevent and correct imbalances, (3) the absence of provisions in EMU to guarantee financial stability[8]. To what extent are these gaps and design deficiencies a heritage of the Delors Report? In the following we will try to answer this question by analyzing what was proposed in the Delors Report on these three issues. We will confront it to what was finally agreed in Maastricht and beyond, and discuss them in the light of what have we learnt on the functioning of EMU over the last year.

3.1. EMU fiscal framework

There is no doubt that Maastricht's provisions on fiscal discipline were largely based on the Delors Report. In particular, the choice made in Maastricht to ensure fiscal discipline through a system combining 'market-based' elements with elements of hierarchical control (binding rules) comes from the Report.

It is interesting to note that the Report's decision to opt for a mix between market-based and hierarchical-based elements stemmed from a certain skepticism on the capacity of markets to exert an adequate pressure on national budgetary policies. In a paragraph that now sounds quite premonitory, the Report alerted about the dangers of relying too much on market pressures in the following terms:

"To some extent market forces can exert a disciplinary influence (.... However, experience suggests that market perceptions do not necessarily provide strong and compelling signals and that access to a large capital market may for some time even facilitate the financing of economic imbalances. Rather than leading to a gradual adaptation of borrowing costs, market views about the creditworthiness of official borrowers tend to change abruptly and result in the closure of access of market financing. The constrains imposed by market forces might either be too slow and weak or too sudden and disruptive" (paragraph 30)

"THE MIX BETWEEN MARKET ELEMENTS AND HIERARCHICAL ELEMENTS WAS TAKEN ON BOARD IN THE MAASTRICHT TREATY"

The mix between market elements and hierarchical elements was taken on board in the Maastricht Treaty. The Delors Committee had considered of utmost importance to forbid any type of monetary financing of public deficits and that clause is directly contained in the Treaty. Quite notably, however, nothing was said in the Delors Report about the need to forbid a 'bail-out' coming from other EC member states or the EC institutions (the famous 'non bail out' clause included in the Maastricht Treaty).

As concerns fiscal rules, these were expected to fulfill a double role: ensuring fiscal discipline but also allowing the definition of a common fiscal policy stance at the EMU level. As far as fiscal discipline is concerned, the Report recommended imposing upper limits on budget deficits but did not specify the specific rules, procedure or eventual sanctions to be imposed in case of infringement. Debt levels, on the other hand, were largely absent from the report. This lack of attention given to debt sustainability issues is clearly remarkable from today's perspective.

The Delors Report was highly explicit, however, with regard to the binding character of fiscal rules. Paragraph 59 argues that "the rules and procedures of the Community in the macroeconomic and budgetary field would become binding". The Excessive Deficit Procedure established in the Maastricht Treaty and

8. For an analysis of the different causes of the crisis see for example the Report of the "Padoa-Schioppa Group" (Completing the euro: A roadmap towards fiscal union in Europe)

later on the Stability and Growth Pact (SGP) approved in 1997 fall short of being binding rules of that kind. They do spell out limits, but do not allow the EU level to set prescriptive guidelines on the conduct of macro-economic and budgetary policies. The Delors Report had advocated "constraints on national budgets to the extent that this was necessary to prevent imbalances", but at the same time called for "discretionary changes in Community resources (…) to supplement structural transfers to Member States or to influence the overall policy stance in the Community." And, perhaps most remarkably, asked for the European Parliament to be involved in the assessment of the fulfilment and implementation of those prescriptions.

With regard to common rules, the Maastricht Treaty introduced a detailed rule and procedure to control excessive deficits, with specific numerical targets and the possibility of sanctions (art 104c TEC, the so-called "excessive deficit procedure") but it only created the "Broad Economic Policy Guidelines" (BEPG) (art 103 TEC) to complement the clause that "Member States should treat their economic policies as a matter of common concern" (art 99 TEC). Neither the BEPG nor the general rule of "common concern" became the centre of fiscal policy co-ordination in EMU. The BEPG set out requirements on the appropriate conduct of fiscal policies (and other areas of economic policy making) to the Member States, yet Member States de facto retained their full autonomy to go against the recommendations of the BEPG. The Treaty did not foresee any provisions on sanctions or enforcement. The framework relied fully upon peer and public pressure – and there was no real involvement of the European Parliament in the implementation of the Excessive Deficit Procedure.

In 1997, prior to the introduction of the euro, the Maastricht Treaty's provisions on fiscal discipline (art 104c) were further strengthened with the approval of the SGP. In this context, some voices were raised calling for a parallel strengthening of art 103 TEC. In particular Jacques Delors himself who had already quitted the Commission at that time, submitted for reflection to the then Luxembourg EU presidency a draft proposal of "Economic Policy Co-ordination Pact" aimed at strengthening and concretising art 103 TEC provisions on macro-economic and budgetary co-ordination (see box). His proposal, however, was finally not taken into account.

BOX 1 ► Jacques Delors' proposal for a "Pact on Economic Policy Coordination"

By the summer of 1997 it had become clear that stage three of EMU would be implemented soon and that the monetary union would be relatively large and thus heterogeneous. At that moment, Jacques Delors published a paper in which he noted that the "organization of the monetary part of EMU [was] in stark contrast to the weak organization principles of the economic part". He emphasized that the framework didn't allow for a "real coordination of macro-economic policies at the European level" and formulated various proposals to strengthen the 'economic pillar' of EMU. The key proposals Delors put then forward were:

- To spell-out in more detail the institutional provisions underlying the actual coordination of economic policies foreseen in Art 103 through the signature of a "Pact" equivalent to the Stability and Growth Pact for Art 104c. This pact should, most notably concern the procedures for the exchange of information, common economic analyses, real cooperation on measures to take at the European or national levels;
- To set an agenda for structural policies and structural reform as suggested in the White Book of 1993 to enhance competitiveness, growth, and job creation;
- To orient public expenditure to sustainable growth and job creation while fully respecting the rules foreseen in the Stability and Growth Pact.

In this paper, Delors stressed that strengthening the economic pillar would not endanger the independence of the European Central Bank but on the contrary, assure its permanence over time. In creating a strong economic pillar, he argued, "Europe will increase its visibility and the transparency of its policy making process. It will be able to explain to its citizens the economic guidelines to follow and, by doing so, would take away the focus from the ECB that otherwise could become the scapegoat of criticism on economic policy-making in Europe."

Source: J Delors, *Pacte pour la coordination des politiques économiques*, Paris: Groupement d'études et de recherches Notre Europe, August 6 1997

In retrospect, what can we conclude concerning the fiscal framework proposed by the Delors Report?

First, the Report clearly went into the same broad direction as the Maastricht Treaty later on, focusing on limits and constraints to avoid fiscal free-riding. At the same time, however, the Report was much more advanced in terms of common binding rules aiming at a common fiscal stance at the level of the monetary union. The Maastricht Treaty clearly did not take up the recommendations in that respect.

Second, and on the other hand, what the Report did not consider was the issue of debt sustainability and the possibility of sovereign defaults or bailouts. It is not the absence of a 'non bail out clause' in the Report that is most remarkable, but rather that there is no discussion of the whole set of questions related to possible solvency crises and rescues, that was at the heart of the recent crisis.

From that point of view, the fiscal framework proposed by the Delors Committee shows some of the same built-in deficiency than that of Maastricht. It fails to recognise EMU governments' inherent vulnerability to self-fulfilling attacks when experiencing budgetary difficulties[9], as well as the potential contagion effects that might trigger the presence of sovereign default risks in one EMU country. In retrospect, one cannot really blame the members of the Committee Delors for that omission. To start with, the fact that countries not issuing debt in their own currency could become more prone to default was largely unknown at the time – the first analyses revealing this vulnerability did indeed appear in the late 1990s[10]. Besides, nobody could foresee at that time the degree of financial interdependence that would develop with the introduction of the euro and the growing exposure of banks to their sovereigns- and thus the important implications that a Eurozone debt default would entail[11].

Third, the Report clearly put more emphasis that the Maastricht Treaty on the need to take account of synergies and co-ordinate national macro-economic and budgetary policies to ensure the latter are geared towards the common interest. While concrete procedures on the coordination of macro-economic and budgetary policies are not outlined, the spirit of the Report is much more oriented towards common European approaches and guidelines than the Maastricht Treaty.

3.2. EMU divergences

The Report's proposals on EMU divergences can be grouped in two categories; those concerning the reduction of economic divergences in the transition to EMU and those concerning the way to deal with imbalances once the EMU in place.

Concerning the transition to EMU, a key message of the Report was the need to attain a certain degree of economic convergence before reaching the last stage of EMU. Contrary to what the Maastricht Treaty was later to prescribe, however, no explicit convergence conditions were mentioned for the passage to the final stage of the union. Nevertheless, the possibility was mentioned of "flexibility concerning the date and conditions to which some member countries would join certain arrangements", suggesting that the lack of convergence could delay the participation of some countries to the third stage of EMU.

According to the Report, economic convergence in the run-up to EMU had to be attained through "programs of budgetary consolidation in those countries concerned and more effective EC structural and regional policies" (paragraph 51). The latter were seen as indispensable to mitigate the negative effects that economic and monetary integration was expected to have on poorer regions. In particular, it was feared that transport costs and economies of scale would "favor a shift in economic activity away from less developed regions, especially if they were in the periphery of the Community, to the highly developed areas in the center" (para. 29). To countervail these effects, the Report emphasized the need to "equalize production conditions" in the Community by strengthening EC cohesion policies and developing major EC investment programs in areas such as physical infrastructures, communications, transportation and education" (para 29). Finally, the Report stressed the need to ensure the "efficient use" of EC cohesion funds: the performance of these funds had to be evaluated in stage two and "if necessary be adapted in the light of experience" (para 56).

The Report's expectations on the effects of the process of economic integration on poorer countries were half confirmed. It is true that the completion of the 1992 single market program did not provoke major geographical

9. De Grauwe, Paul (2011) 'Managing a fragile Eurozone', *CESifo Forum* 12 (2), 40-45
10. Eichengreen, Barry and Ricardo Hausmann (1999), "Exchange Rates and Financial Fragility," in New Challenges for Monetary Policy, Kansas City: Federal Reserve Bank of Kansas City, pp. 329-368.
11. Pisani Ferry 2011 The euro crisis and the new impossible trinity, Bruegel policy contribution, Issue 2012/01, January 2012

shifts in economic activity, but it led to increasing specialisation of countries along ranges of qualities within products, with richer and poorer countries specializing respectively in high and low quality products in the same industry[12]. Likewise, monetary union fuelled some process of economic specialization (i.e. the rise in construction in some EMU countries) although the latter was not due to transport costs and economies of scale but the effect of massive capital inflows to poorer economies.

> "A KEY MESSAGE OF THE REPORT WAS THE NEED TO ATTAIN A CERTAIN DEGREE OF ECONOMIC CONVERGENCE BEFORE REACHING THE LAST STAGE OF EMU"

Whereas the Report's expectations proved half right, the Report's recommendation to attain economic convergence before setting up the EMU was largely neglected. The approval of the so-called 2nd Delors Package led to an important increase of EC cohesion funds from 1993-1999, and under the pressure of the poorer EC countries, the Maastricht Treaty created a new cohesion instrument to help less-developed countries in the transition to EMU (the Cohesion Fund). However, no major EC investment programs were put into place in the run to EMU, and this despite the call made by the Commission in this respect. In particular, the European Commission under the presidency of Jacques Delors intended to continue the spirit of the Report on EMU and strengthen the economic pillar in order to have a dynamic equilibrium with the monetary pillar. That is why the Commission's 1993 White Paper for Growth, Competitiveness and Employment included a proposal to launch a major programme of infrastructures of Europe-wide interest in the fields of energy, transport and communication, partly financed through the emission of EU public bonds. This proposal however was not finally endorsed by the member states.

More importantly, with the establishment of the so-called "Maastricht convergence criteria"[13], the emphasis shifted from real to nominal convergence thus losing the overall philosophy of the Report's approach on convergence. In particular, the focus on nominal convergence translated into a short-sighted and narrow assessment of EC countries' economic readiness to proceed to stage 3. While many EC countries made impressive efforts to reduce their deficits and inflation levels over the 1990s, succeeding to meet the Maastricht nominal criteria, they did so by over-relying on one-off discretionary measures (privatizations, temporary tax increases, social pacts with the social partners to moderate wages…). Despite some warnings on the need to maintain the commitment to low deficits and moderate wages and prices over time by introducing structural reforms with lasting effects (for instance, in the Commission's Convergence Reports), the fact is that the approval of these reforms was not seen as a *'conditio sine qua non'* to enter into EMU[14].

To a certain extent, this lack of concern about the introduction of structural, long-lasting reforms reflects the optimistic assumption that was dominant at that time about the effects of the single market and EMU on national product and labor market policies. In effect, before the creation of EMU, it was commonly believed that the mobility of factors spurred by the completion of the single market, together with the lack of exchange rate instrument in a single currency, would translate into more pressures for wage and price discipline at the national level. This idea was particularly well-exposed in the 1998 Convergence Report. When reflecting on the sustainability of the price performance' efforts undertaken by EC countries in 1990s, the Report noted that "EMU, through its implied institutional changes and new economic environment, is likely to safeguard and reinforce the results achieved in terms of price stability" (p. 72). In particular,

"The incentives for wage discipline will be improved since inappropriate wage increases will continue not to be accommodated by monetary, budgetary or exchange rate policies. An increase in wages faster than warranted by growth in productivity in a country (or region) would lead to a deterioration in competitiveness and investment profitability and therefore to reduced attractiveness as a production location. The country's (or region's) export performance would suffer, investment would be deterred and unemployment would increase. For these reasons, EMU is likely to result in a sustained wage behaviour consistent with job creation " (EC Commission Convergence Report 1998, p. 73).

12. Fontaigné, Lionel et al (1998),. INTRA-INDUSTRY TRADE AND THE SINGLE MARKET: QUALITY MATTERS, CEPR discussion paper 1959, September 1998
13. Maastricht's convergence criteria were focused on the level of inflation, level of public deficits, debt-to-GDP ratio, exchange rate stability and interest rates.
14. See European Commission's 1998 Convergence report (concluding the readiness of 11 out of 12 applying EC countries to enter into the third stage of EMU) and 2000 convergence report (assessing Greece's readiness to enter EMU in 2001).

Over time, this assumption proved wrong. Rather than a process of convergence spurred by the single market and EMU's disciplinary effect (the "real exchange rate effect"), initial differences in prices and wages exacerbated as a result of the pro-cyclical effects of the ECB's one size fits all' monetary policy (the "real interest rate effect"). The latter ended up being the main source of difficulties in the first decade of EMU[15].

This leads to the second issue at discussion: which were the Delors Report's expectations and recommendations on EMU imbalances? The first thing to notice is that the Report did not foresee the problem of 'endogenous asymmetries' resulting from the primacy of the real interest rate effect over the real exchange rate effect. However, it was a bit less optimistic than the 1998 Commission's Convergence Report on the single market's disciplinary effect on wages and prices.

In effect, while recognizing the importance of wage and price flexibility as mechanisms of adjustment in a single currency area, the members of the Delors Committee feared that, "with parities irrevocably fixed, foreign exchange markets would cease to be a source of pressure for national policy corrections when national economic disequilibria developed and persisted" (paragraph 26). They also alerted about the difficulties to measure and interpret economic imbalances within a single currency area, as "balance-of-payments figures, which are currently a highly visible and sensitive indicator of economic disequilibria, would no longer play such a significant role as a guidepost for policy-making" (paragraph 26.).

For all these reasons, the Report considered the possibility of dangerous disequilibria coming from "labor and cost developments" or "divergent economic policies", apart from the classic external country-specific shocks (paragraph 26). To prevent and correct these imbalances, two type of actions were recommended:

First, the establishment of a framework for monitoring and coordinating national economic policies. The precise features of this macro-economic coordination procedure were not detailed, but the Report indicated that "the rules and procedures of the Community in the macro-economic and budgetary field would become binding" in the third stage of EMU (paragraph 59 – see also above).

Second, the setup of a financial assistance mechanism to provide support to countries experiencing temporary difficulties. The Report was rather vague with respect to the specific features and nature of such financial assistance capacity. What is clear is that, given that the assumption at that time was that all EC countries would become members of the EMU, the members of the Committee did not envisage the creation of a mechanism "ex novo" to perform this task but allowing for a flexible use of the EC budget. In particular, the Report recommended giving to the Council and the European Parliament the capacity "to make discretionary changes in Community resources (through a procedure to be defined) to supplement structural transfers to member states", as well as to "apply to existing Community structural policies and to Community loans (…) terms and conditions that would prompt member countries to intensify their adjustment efforts" (para 59).

These two recommendations were largely neglected at the moment of negotiating Maastricht. On the one hand, contrary to the Report's philosophy to guarantee an adequate balance between the economic and the monetary pillar, the Maastricht Treaty's provisions on economic co-ordination ended up being very weak. In effect, in contrast with article 104 (which specified a detailed procedure to control deficits- the excessive deficit procedure – leading up to pecuniary sanctions), art 99 on economic co-ordination was a general-purpose provision with no legal basis for sanctions ("Member States shall regard their economic policies as a matter of common concern and shall co-ordinate them within the Council"). The result was the creation of a weak co-ordination process, relying on the definition of vague common guidelines (the Broad Economic Policy Guidelines- BEPGs) and allowing the Council to formulate non-binding recommendations. As concerning the creation of a fiscal macro-economic stabilization mechanism, despite the Commission's efforts to give technical credibility to the proposal[16], the idea was totally excluded from the Maastricht final deal as a result of the strong opposition of certain EC member states.

15. See Enderlein and al., Completing the Euro : A Road Map Towards Fiscal Union in Europe, *Studies and Reports, Notre Europe – Jacques Delors Institute*, June 2012
16. In the years after the publication of the Report the Commission published some studies detailing the features and potential costs of an eventual EMU macro-economic stabilization tool (see Pisani Ferry and Italianer, "Systèmes budgétaires et amortissement des chocs régionaux", Economie Prospective internationale, 1992)

Would the euro area be in better shape now had we followed the Delors Report's recommendations on EMU imbalances? A stronger mechanism of economic policy co-ordination might have helped prevent the build-up of large imbalances during the 2000s, but we cannot be totally sure of that. The experience with the SGP in 2003 shows that the possibility of sanctions do not prevent a breach of the rule, if those in charge of surveying the compliance with the rules are the same supposed to obey them[17]. In contrast, the existence of an EMU fiscal macro-economic facility would have probably made a difference. According to an estimation made by Enderlein et al (2012), had we had an EMU fiscal macro-economic scheme in place during the period 1999-2012, euro area business cycle divergences would have diminished by around 15% to 40%.

3.3. Financial stability

"THE RISKS OF FINANCIAL MARKET STABILITY WERE LARGELY NEGLECTED IN BOTH THE DELORS REPORT AND THE MAASTRICHT TREATY"

The risks of financial market stability were largely neglected in both the Delors Report and the Maastricht Treaty. The Report did not include an analysis of the financial implications of setting up a single currency, and there was no mention to the specific challenges of ensuring financial stability in a monetary union. In coherence with this, it did not recommend any transfer of sovereignty in the field of financial regulation, supervision and banking resolution, apart from conferring to the new monetary authority (ESCB) a limited role on the coordination of national banking supervision authorities. The Report's approach on financial market stability was embraced by the Maastricht Treaty with few amendments. Art 105.5 stated that the ESCB "shall contribute to the smooth conduct of policies pursued by the competent authorities related to the prudential supervision of credit institutions and the stability of the financial system", though the Treaty did leave open the possibility for the Council to confer "specific tasks" to the ECB on financial supervision (art 105.6).

With the benefit of hindsight, the lack of attention given by the members of the Committee to financial stability risks is understandable. The risks of financial market instability were probably underestimated at that time, financial systems being much less developed and globalized in the early 1990s than today. Besides, some of the euro area's fragilities revealed by the crisis (such as the level of banks' exposure to their sovereigns' debts) could not be foreseen at the time of writing the Report. In fact, the assumption at the time was that the full liberalization of capital movements and later on the single currency would led to the creation of a truly pan-European financial system. The following paragraph, reflecting about the implications of a shift from national to a single monetary policy, reveals this underlying assumption:

"*Well before the decision to fix exchange rates permanently, the full liberalization of capital movements and financial market integration would have created a situation in which the coordination of monetary policy would have to be strengthened progressively. Once every banking institution in the Community is free to accept deposits from, and to grants loans to, any customer in the Community and in any of the national currencies, the large degree of territorial coincidence between a national central bank's area of jurisdiction, the area in which its currency is used and the area in which 'its' banking system operates will be lost. In these circumstances the effectiveness of national monetary policies will become increasingly dependent on cooperation among central banks*" (p. 16)

17. Ref some text of Padoa Schioppa?

TABLE 1 ➤ What the Delors Report said and didn't say on fiscal policies, EMU divergences and financial stability

	DELORS REPORT	MAASTRICHT TREATY	POST-MAASTRICTH AMENDMENTS
EMU FISCAL FRAMEWORK			
Debt sustainability issues	• No mention of the need for a 'non bail out' clause • Prohibition of monetary financing of public deficits • No binding rules on debt levels	• Introduction of 'non- bail out' clause (art. 104.b.1) • Prohibition of monetary financing of public deficits (art 104.1) • No binding rules on debt levels	• Debt developments taken into account in new fiscal rules ("six pack") • 'non bail out' clause formally maintained but since 2010 creation of intergovernmental mechanisms to provide financial assistance to EMU countries in difficulties (EFSF, EFSM, ESM)
Fiscal discipline rules	• Establishment of upper limits on deficits • European Parliament involved in the decisions imposing constrains on national budgets	• Excessive Deficit Procedure (art 104c), setting 3% nominal deficit as upper limit. • Decisions imposing constrains on national budgets adopted by the Council upon recommendation from the Commission	• Excessive Deficit Procedure strengthened with the approval of the Stability and Growth Pact (SGP) in 1997, reformed in 2005. • Since 2011, introduction of major reforms aimed at strengthening SGP rules, improving national budgetary frameworks and reinforcing Commission's capacity to monitor and assess national efforts to implement SGP (Fiscal Compact, "six pack", 'two pack').
Budgetary and macro-economic co-ordination	• Need to co-ordinate budgetary and macro-economic policies to define an adequate EMU fiscal policy stance and ensure coherent conduct of national economic policies. • Rules and procedures for budgetary and macro-economic coordination should be binding	• No prescriptive guidelines for the conduct of budgetary or macro-economic policies. • Broad Economic Policy Guidelines (ar 103), leading to the formulation of non-binding recommendations by the European Council	• Since 2000 economic co-ordination mostly focused on guiding member states' efforts to attain Lisbon strategy/EU2020 (lack of euro area dimension, lack of attention to budgetary issues) • Since 2011 coordination of all budgetary and economic policies takes place within a single framework of co-ordination (European Semester). However, guidelines on budgetary and economic policies rest for the most part non-binding (except for those related to the implementation of SGP and those formulated within the context of the new Macro Economic Imbalance Procedure- see below).
EMU DIVERGENCES			
Convergence process in the transition to EMU	• Need to attain a sufficient degree of economic convergence to enter into third stage of EMU. No fixed deadlines and quantitative criteria to enter third stage of EMU; need to allow for certain flexibility concerning entrance of some member states into EMU. • Need to expand and strengthen EC cohesion policies to accompany member states in the efforts to enter EMU. Need to put into place major common EC investment projects.	• Introduction of quantitative convergence criteria to determine country's readiness to enter third stage of EMU. Focus on nominal rather than real convergence (ie convergence on inflation and interest rates, levels of public deficits and debts and exchange rate stability) • Major expansion of EC cohesion policies (2nd Delors Package), creation of the Cohesion Fund to help EC countries in the transition to EMU... No major EC investment programs put into place in the run-up to EMU	• In 1998, 11 out of 12 applying EC members fulfil the criteria to enter into the third stage of EMU. The remaining EC applying country (Greece) will enter in 2001.
Measures to prevent and correct EMU imbalances	• Need to set up a binding framework to monitor economic developments and coordinate economic policies • Need to create an EC fiscal assistance instrument to help countries in temporary difficulties.	• Establishment of a weak procedure for economic monitoring and co.-ordination (Broad Economic Policy Guidelines -ar 103), based on formulation of broad guidelines and non-binding recommendations • Lack of EMU-level macro-economic capacity; responsibility for fiscal stabilization rests exclusively at the national level	• In 2011 creation of a new macro-economic surveillance procedure (Macro-Economic Imbalances Procedure) to monitor and correct dangerous imbalances. The procedure works on the basis of a numerical scoreboard and includes the possibility of sanctions.

FINANCIAL STABILITY			
Financial supervision and bank resolution	• Financial supervision and bank resolution should rest a national prerogative; only a modest role of ECB in coordinating national financial supervision authorities	• The ECB 'contributes' to the smooth conduct of financial supervision policies pursued by national authorities (art 105.5); however, the Council may decide by unanimity to confer "specific tasks" on financial supervision to the ECB (art 105.6)	• From November 2014, a new Single Bank Supervisory Authority, led by the ECB, will be in charge of directly supervise all major credit institutions of the euro area, and from 2016 a Single Bank Resolution mechanism, with central decision making powers and a single bank resolution fund, will be directly responsible for the processes of banking resolution of big banks in the euro area.

Contrary to this expectation, during the first decade of EMU we witnessed an unbalanced process of integration: the interbank market became highly integrated but retail banking, corporate and sovereign bonds and equity markets remained largely fragmented along national lines. The result was a system combining the problems of integration (high risks of contagion) with those of financial market fragmentation (unhealthy bank-sovereign links and an impaired transmission of monetary policy).

While it is clear that the Committee was not capable at that time to foresee this unbalanced process of integration, neither to envisage the major global implications of a US financial crisis, it is also true that the potential risks of maintaining a largely national approach on financial regulation and supervision within a single currency area were well-known at that time[18]. In fact, according to one member of the Delors Committee, during the meetings some members of the group alerted about these risks[19]. Indeed, as this member of the Committee recalls, the decision to maintain a national approach on financial supervision and banking resolution was not the result of cognitive gaps but mostly the consequence of EC central bank governors' opposition to see the new monetary authority involved in financial stability issues, "as they feared the latter would inevitably lead to onerous political oversight and constitute a threat to ESCB's autonomy".

4. Looking forward: which lessons for the current process of EMU reform?

Since 2010 the governance of EMU has been subjected to a major overhaul. A series of governance reforms have been approved to address the three in-built deficiencies mentioned above, and many more are under discussion. Since some of these reforms are perceived as a substantial transfer of sovereignty to the European level, two new important challenges for EMU governance haven arisen: how to deepen integration within the euro area while guaranteeing democratic legitimacy, and how to allow EMU countries to go further in the process of integration without endangering the economic interest of non-euro countries.

Can we draw some lessons for the current process of EMU reform by looking back to the Delors Report? Overall, the analysis above shows that the Report was right, even premonitory, in pointing out certain risks recently revealed by the crisis whereas it failed to recognize others. Some of the omissions in the Report were due to the historical context and looked justified given the historical context at the time of writing the Report – in particular with regard to the problem of debt burdens and the debate on possible bail-outs. But some assessments also derive from an arguably overly optimistic look at wage and price flexibilities n a monetary union. The Report describes economic and monetary union as two mutually reinforcing elements, leading to virtuous circle of deeper economic integration and thus a better functioning of monetary union. That assumption was considered realistic at the time in the context of macroeconomic studies putting a lot of emphasis on nominal flexibilities and automaticity of adjustment. With hindsight, the nominal rigidities in EMU proved

18. Padoa Schioppa, Tommaso (2004) *The Euro and its Central Bank: getting united after the Union*, Massachusetts: The MIT Press.
19. Thygesen, Niels, "TPS and european integration", speech at the conference in memory of Tommaso Padoa-Schioppa organized by the Banca d'Italia in Rome on December 16 2011.

much stronger than expected. This lesson should be given careful attention in the current process of further reforms of EMU.

The main lesson to draw from the Delors Report, however, is that a monetary union cannot function as a stand-alone element. The Report is very explicit in this respect and the relative omission of the banking and financial stability side in the Report strengthens that aspect even further: A monetary union that is not embedded in a far-reaching economic union and financial union (or banking union) is unlikely to function.

Rather than insisting only on monetary stability as the core of EMU, the Report presents a more encompassing approach to EMU, arguing that monetary union required (i) some degree of political integration, (ii) a clear role of the EU level as a steering mechanism on macroeconomic and budgetary matters, (iii) an emphasis in economic policy making on convergence in EMU.

It is striking that the current debate on the overhaul of EMU focuses on those very aspects. Yet as the current debate shows, there is no simple implementation of those issues, as long as three core challenges are not solved:

- Can EMU function under the assumption that no significant transfers of sovereignty from the national level to the EU level are necessary? This question not only relates to budgetary autonomy of Member States but also to the overall conduct of economic policy making in an economic union, where convergence is unlike to appear automatically from the creation of the single currency alone. If structural convergence requires policy convergence, then the mantra to consider the conduct of economic policy-making as a "matter of common concern" shifts to the heart of economic policy making in EMU. That shift was not foreseen in the Delors Report, but is clearly on top of the agenda in the reform of EMU.

- Can EMU function in a European Union, in which not all countries will enter into EMU? That question relates directly to the previous point. If the both the single market and economic policy coordination are considered the main vehicles for structural convergence in the monetary union, then the question of how to achieve further deepening of the single market while at the same time enhancing economic policy coordination has to be answered. Answering that question, however, raises the challenge of different speeds of integration in a Union in which a large number of countries do not participate in the single currency. The very premise of the Delors Report, namely that there is a direct link between the single market and the single currency is put into question by today's reality of political integration in Europe.

- As further coordination of economic policy-making requires procedural forms of legitimation, rather than the "output" based legitimacy, on which EMU has been based, the question of how to enhance democratic legitimacy of a deepened EMU is a crucial matter to be discussed. That challenge is again related to the previous point, because further political integration is not facilitated by the divide between euro area and non euro area members.

> "THE DELORS REPORT COULD SERVE AS A 'ROLE MODEL' FOR FURTHER EFFORTS TO REFORM EMU"

The last lesson we would like to draw is a lesson on method rather than on content. In the late 1980s, when the Delors Committee started to work, no one would have bet on the creation of a European monetary union in a relatively short spam of time. Monetary union was seen as utopian or as a goal for the very long term, and it was fiercely opposed by key stakeholders such as the Bundesbank or the UK Thatcher government. Ten years later, EMU was a reality. Of course many factors explain this historical success, but there is no doubt that the Delors Committee made an important contribution in providing a rigorous, concise and unbiased analysis of the requirements and implications of moving towards EMU. In this respect, it could serve as a 'role model' for further efforts to reform EMU.

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