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INTERNATIONAL PUBLIC POLICY INSTITUTE

Economic and Monetary Union: Implications for Scotland

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1. Introduction

This short paper sets out background to current EU policy on Economic and Monetary Union (EMU), looking at both the management of monetary policy focusing on the Euro and the parallel system for economic policy coordination which is primarily the responsibility of member states. It describes the way in which EU countries coordinate economic policy (notably through the Economic Reform Programmes and processes such as deficit reduction procedures) and how the EU institutions will support countries in the delivery of EU policies, including the mobilisation of investment funds to support EU policy priorities. It then looks as Scotland's experience, describes the most recent Scottish Economic Reform Programme 2016 and postulates that the close degree of alignment between Scottish and EU economic and social priorities would allow a basis for joint working if Scotland decides to pursue a more close approach to EU policies than the rest of the UK. It also notes that if Scotland pursues the independence in Europe option, Euro membership would not be an issue of substance in the early years and that the focus of EMU discussions would likely be on the need for a deficit reduction programme for Scotland.

2. EMU: Background and current practice

The European Treaties set out clear provisions for the adoption and management of a common currency (the euro) and for a parallel system of economic coordination. These obligations apply to all member States, but, on a transitional basis, Member States which do not fulfil the necessary conditions for the adoption of the euro are termed "Member States with a derogation". As of early 2017 there are 19 member states using the euro and the others are at various stages in the process[1] - the UK has a formal Derogation, as does Denmark, although the Danish krone is fixed to the euro. Work on economic policy coordination does not apply to EFTA member states within the EEA, but there are some overlaps given the participation of EEA member states in key European policies such as cohesion, investment and innovation.

The institutional setting for Economic and Monetary Union (EMU) is based on a dual structure. The competences for monetary policy and for exchange rate policy have been transferred to the euro area level with the introduction of the euro, while the competences for economic policy have largely remained the responsibility of national policy makers. The potentially substantial

[1] http://ec.europa.eu/economy_finance/euro/index_en.htm

spill-over effects in a monetary union require euro area countries to coordinate their economic policies particularly closely. This specific euro area dimension is recognised in the Lisbon Treaty, which contains a chapter dedicated to “provisions specific to Member States whose currency is the euro”. The Protocol on the Eurogroup, which is annexed to the Treaty, refers explicitly to the need “to develop ever-closer coordination of economic policies within the euro area”, so as to promote conditions for stronger economic growth in the EU as a whole. This includes coordination in the field of fiscal policies, where the euro area countries have agreed to enhance their surveillance in the framework of the Eurogroup. More specifically, the Eurogroup conducts an annual mid-term review on the appropriateness of budgetary policies in euro area countries ahead of the submission of draft national budgets for debate in national parliaments.

Much of the focus is naturally on how to stabilise and develop the euro given continuing uncertainty over its medium term future, but there are also a range of proposals on economic policy which are of considerable interest to non-euro countries. The key reason for this is that in the EU treaties the competences for monetary policy and for exchange rate policy have been transferred to the euro area level with the introduction of the euro, while the competences for economic policy have largely remained the responsibility of national policy makers. This recognises that economic policies – such as fiscal and structural policies – frequently need to take into account national characteristics and institutional settings.

Economic policy coordination has three key elements:

1. Integrated guidelines (currently contained in the Europe 2020 strategy which focuses on fostering sustainable and socially inclusive growth and employment) promoting reforms to help Member States to improve their productivity and competitiveness while, at the same time, making their economies more resilient to economic shocks. Member States produce National Reform Programmes and the Commission makes country specific recommendations, which are discussed by the European Council as part of the so called “European semester”.

2. The Stability and Growth Pact, including regular surveillance of public finances and an excessive deficit procedure to correct imbalances where they appear. This bites most directly on the Eurozone countries (including on strong regions such as Flanders, Bavaria and Catalonia and the Basque Country) but also impacts in a lesser way on countries at earlier stages in the European Monetary System.

3. Policy measures to support Member States in the delivery of their economic and monetary policy, including aligning available European funding, especially the European Structural and Investment Funds, with the objectives set out at national and EU level for economic policy. In recent years a particular focus has been to encourage

the European Investment Bank to support public and private investment where the ability at national level to do so has been limited by fiscal austerity measures.

A key element of economic policy coordination focuses on key economic reforms in the goods and service sector, labour market and business environment. It also involves the European Fund for Strategic Investment (EFSI) as part of promoting public sector investment: Commission President Jean-Claude Juncker, in his State of the Union address to the European Parliament in September 2016, announced plans to increase the European Fund for Strategic Investment (EFSI): from its original 315 billion euros in 2015 to 500 billion by 2020 and 622 billion by 2022.

3. Scotland and Economic Reform

Assuming Scotland chooses to maintain close links to European economic policy, either under a UK wide approach which allows Scotland a margin of appreciation in its ability to link into EU structural and investment policies or by becoming an independent member of the EU, it seems likely that the way in which EMU develops could have a significant impact on the ability of the Scottish Government to influence EU decision making. Although Scotland is neither an EU member state at present nor is expected to be a Eurozone country in the near future, it does have significant experience in European economic policy coordination. The most obvious representation of this is the annual Scottish National Reform Programme (SNRP)[2] which has been published since 2011 by the Scottish Government as a complement to the UK National Reform Programme as its contribution to the European Semester. This approach, which has been welcomed by both stakeholders and the Commission, helps emphasise Scotland's positive engagement with the European Union. It also highlights particular areas where Scottish actions are making an important contribution to delivering the priorities of Europe 2020, and to share good practice with other EU countries.

Both Scotland's Economic Strategy and Europe 2020 are aligned in highlighting the central role of innovation in delivering smarter, sustainable and inclusive growth. Scotland is heavily involved in Horizon 2020, the European Union's programme for research and innovation. As a leading member of the Vanguard Initiative, Scotland is collaborating with other EU regions to develop innovative approaches to internationalisation and competitiveness in EU industry, which will help to find solutions to key issues holding back advances in EU countries. The Scottish Government also shares and supports the priority that the Commission gives to making the transition to a more low carbon, resource-efficient economy. The Scottish National Reform Programme sets out the measures the Scottish Government and its partners are taking forward to deliver on the EU ambitions: for example taking action to improve educational attainment;

[2] http://www.gov.scot/Resource/0049/00497957.pdf

helping to equip our young people for the labour market, reducing barriers to parents entering the labour market by expanding the number of funded hours of early learning and childcare; and encouraging the adoption of progressive workplace practices through promotion of the Scottish Business Pledge, an area where Scotland is keen to share experiences with European partners.

Setting out this policy alignment in such a clear way has had little impact to date as such on the European Council considerations of economic policy coordination – country specific recommendations for the UK have been sparse in recent years and formal responses from the Commission to the Scottish document as a whole have been limited. But the existence of the document provides a very firm basis for demonstrating Scotland's alignment with, and particular needs with respect to, EU wide objectives, especially with regard to EU funding programmes such as the structural and investment funds. We already know that Scotland has benefited considerably from policy related investment by the European Investment Bank – for example, with its recent investment of nearly 700 million euros in the Beatrice Offshore wind farm the EIB has become the largest investor in the low carbon sector in Scotland in recent years. The fact that Scotland can demonstrate policy coherence through its NRP means that whatever constitutional choice is taken Scotland remains well placed to align its domestic programmes with EU funding opportunities. This could be of particular value if Scotland seeks a closer relationship with the EU than the rest of the UK under the differentiated model put forward by the Scottish Government on 20 December[3].

As a footnote it is worth noting that, if, however, Scotland chooses the independence path and EU countries agree to consider a Scottish application, then this experience could be of particular benefit. Like other EU countries such as Sweden and Poland, Scotland will be in no rush to join the Euro, nor for that matter trigger the membership of the European Monetary system which is a necessary precursor to Euro membership. As a result of the low oil price currently prevailing, Scotland's most immediate issue in respect of EU economic and monetary policy will be its expected public sector deficit. Under the rules currently in place we can expect the EU to propose an excessive deficit procedure which will require the Scottish Government over a period of years to take economic and fiscal measures to reduce the deficit while promoting the overall aims of EMU to promote competitiveness, productivity and inclusive growth. This will be the context in which future EU political and financial, including investment support for Scotland's economy and its attitude to future monetary union will be decided.

[3] "Scotland's Place in Europe" http://www.gov.scot/Publications/2016/12/9234

About the author:

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