

Summary

The Economic and monetary union that Sweden voted on in a referendum in 2003 has changed. The purpose of this report is to describe how the EMU has changed. The strongest impetus for reform has come from the euro crisis. Some lesser changes have been driven by other factors. The report identifies ten changes:

1. *The European Central Bank* has matured as an institution and used instruments that were not anticipated from the outset.
2. *Sound public finances* have been at the centre of several reforms, particularly the Stability and Growth Pact.
3. *Economic policy coordination* has been expanded and equipped with new policy instruments.
4. *The European Stability Mechanism* has been established to provide emergency loans to eurozone countries.
5. *The Banking Union* means that much of the supervision and crisis management has been shifted to the EU level.
6. *The Eurogroup* and the governance of the euro area have been strengthened.
7. *The euro's role* as the second most important global currency is established.
8. *The process for adopting the euro* has been tightened.
9. *The composition of the “ins and outs” groups* has changed due to eurozone enlargement and Brexit.
10. *A strong political will* to keep the euro area together has been manifested.

The euro crisis threatened the euro's survival

The euro crisis, preceded by the global financial crisis, began with the discovery in the autumn of 2009 that Greece's public finances were in significantly worse shape than statistics had previously indicated. In the spring of 2010, it became necessary to hastily improvise comprehensive support programs for Greece from the eurozone countries and the IMF. The ECB began selectively purchasing government bonds. A temporary stability mechanism, the EFSF, was quickly established. Support programs for Ireland and Portugal followed. The crisis deepened when Germany and France began discussing debt restructuring. The ECB provided liquidity to the banks. In 2011, the euro crisis continued with a series of dramatic meetings. A Greek debt restructuring was carried out in 2012, the largest ever. That same year, Spain received a bailout program.

In the spring of 2012, the euro crisis deepened. That summer, important steps were taken toward a solution. A banking union with centralized supervision was agreed upon in principle. ECB President Mario Draghi delivered his famous "whatever it takes" speech. In the autumn of 2012, the permanent stability mechanism, the ESM, became operational. The next crisis-hit country was Cyprus, which received emergency loans in 2013. At that point, the strategy was changed, and a "bail-in" was applied to the banks, meaning that bank shareholders and certain investors, rather than the taxpayers, had to cover the losses. The Greek crisis worsened in 2015, when a new Greek government refused to accept the terms of the adjustment program. Greece came close to being forced to leave the eurozone in the summer of 2015. After a complete Greek policy reversal, the euro crisis could be considered over. Today, the countries that received support programmes are among the eurozone's better-performing economies.

Restrictive regulatory framework

When eurozone policymakers sought to manage the crisis, they were constrained by the EMU's regulatory framework, which is enshrined in the Treaty. Legal proceedings before the European Court of Justice and Germany's Constitutional Court played a significant role. A key rule is the prohibition on the EU and its Member States

assuming or taking responsibility for a Member State's public debt. However, it is not prohibited to give a loan to a crisis-stricken Member State, provided that the loan is subject to strict conditions so that incentives for sound public finances are maintained. Another restriction is the prohibition on monetary financing. This means that the ECB may not directly finance a Member State's budget deficit. However, for monetary policy purposes, the ECB may purchase government bonds on the secondary market, a measure that proved highly significant during the euro crisis. The ECB's bond purchases were subject to legal review during the crisis.

Reforms and reform proposals that did not materialize

During the euro crisis, a series of proposals for reforming the EMU were put forward. Activity was intense among think tanks, Member States, and within the EU system. As early as the spring of 2010, work began on a package of legislative acts that became known as the "six-pack." This entailed a tightening of the Stability and Growth Pact and a completely new instrument, the Macroeconomic Imbalance Procedure. Strict sanctions were established for eurozone countries. A permanent stability mechanism was also included in the package. The medium-term objective for public finances was tightened through the intergovernmental agreement on the Fiscal Compact. "The Four Presidents' Report", containing proposals on fiscal policy, economic policy coordination, and the banking union, was released in 2012. At that time, the Commission also presented a package of proposals that became known as the Blueprint. It contained a number of far-reaching proposals with a federalist orientation that were not accepted. A major comprehensive approach was taken in 2015 with the "Five Presidents' Report", which contained a series of proposals, including a fiscal stabilization function that was never implemented. The report was not approved as a roadmap, but some of the proposals lived on. During the euro crisis, proposals for joint borrowing were also put forward but not realized.

Following the 2016 Brexit referendum, a fresh effort was made. The Commission presented thematic reports on the future of the EU, including one on the EMU. Some of the centralist proposals

from the Blueprint resurfaced, but they were not implemented this time either. In a 2019 assessment, the Commission nevertheless noted that there had been significant progress in making the EMU more robust. In recent years, there has been little discussion or activity regarding EMU reform. The major loan programs related to the Covid-19 crisis and military rearmament have been carried out within the EU27 framework.

Different economic philosophies in Germany and France

It is difficult to understand the reform of the EMU without mentioning the differences in mindset between Germany and France, the two most important countries in the EU. For decades, Germany has argued that countries must qualify for a common currency by achieving price stability and sound public finances. France has prioritized early institutional arrangements. The German model is usually referred to as “ordo-liberalism.” It is strongly represented in the Bundesbank, in the influential quality press, among economically minded lawyers, and in the Constitutional Court, but less so among academic economists. Ordo-liberalism was behind the German postwar economic miracle (*Wirtschaftswunder*). Part of this school of thought consists of market-liberal principles in the form of free competition and free trade. But it also includes ethical principles, such as the need for sound incentives (no *moral hazard*) and the requirement that responsibility and control go hand in hand. There is also a distrust of active stabilisation policy. The French approach is more pragmatic, Keynesian, and supportive of government intervention in the economy, with the state taking overall responsibility for economic policy. This means that a central bank with strong independence is viewed as problematic, and that economic policy should not be constrained by rigid rules. Put simply, France tends to view risk-sharing more positively, while Germany prioritizes reducing risks.

The ECB has changed

After nearly thirty years of operation, the ECB is a mature institution. The ECB has had to navigate periods of both too-high

and too-low inflation but has succeeded in delivering on its primary objective of price stability. The euro crisis presented the ECB with major challenges, and unconventional instruments – such as large-scale bond purchases and extensive liquidity injections into the banking system – became new features of the ECB’s operations. These actions led to controversies and legal disputes that have clarified the limits and conditions the ECB must adhere to. The ECB played a key role in managing the euro crisis. The ECB has demonstrated in practice that it assumes the role of *lender of last resort*, but within the applicable legal framework. The ECB has become a more transparent central bank through improved communication with both the public and experts, strengthened channels for the bank’s interaction with the European Parliament, and publication of accounts of ECB Governing Council meetings. Additionally, the ECB is adapting to technological developments in the financial sector by developing a digital euro and modernizing payment platforms.

Public finances

Several key reforms since 2003 have, in various ways, affected public finances. Sound public finances are particularly important in EMU. One reason is that the EMU is not intended to become a “transfer union.” Another reason is that the ECB’s monetary policy must not be distorted by weak public finances. There is also a risk that the euro could encourage free rider behaviour. Moreover, the euro crisis demonstrated that there is a harmful interaction between public finances and banks (*doom-loop*).

The fundamental EMU provision on *no-bail-out* remains in place, but it has been subject to legal clarifications. The Stability and Growth Pact has undergone a series of reforms. The most recent reform in 2024 was comprehensive and involved greater adaptation to each country’s specific conditions, with debt sustainability given greater weight. In the design and application of the Pact a balance has been sought between strictness with strong enforcement measures on the one hand, and economic realism and the competencies of the Member States on the other.

Reforms since 2003 have also addressed the statistical framework to counter inaccuracies and manipulation, strengthened the medium-term budgetary objective through the intergovernmental agreement on the Fiscal Compact, established rules for improved national budgetary frameworks, the design of government bonds, and, not least, the conditions for debt restructuring.

Despite all efforts, it must be concluded that public finances in the euro area are not in good shape. Deficits and public debt are too high in several cases. The Stability and Growth Pact has not been respected. The pandemic and geopolitical unrest have made the task more difficult, while good years have not been capitalized upon. It is also worth noting that certain centralizing proposals have not materialized, such as joint borrowing in the eurozone, a stabilization policy function, and a finance minister/finance ministry for the eurozone.

Economic policy coordination – divergences are countered, but the means are soft

The 2009 Lisbon Treaty brought significant changes to how economic policy coordination is carried out. Previously, cohesion applied to keep the EU together, but the model shifted so that eurozone countries were granted the authority to largely manage their own affairs. Additionally, expanded legal avenues were introduced to enable strengthening coordination and oversight. The next major impetus for reform came from the euro crisis, which demonstrated that serious consequences could arise if Member States' economic policies diverge too widely. A major reform took place through the "six-pack" in 2011, which introduced the European Semester as a cohesive framework for the various procedures. Even more important was that the policy instruments were strengthened with tangible sanctions. The Macroeconomic Imbalance Procedure was introduced to address a wider set of problems such as issues related to external imbalances and financial markets.

As with public finances, there is a tension between strong external pressure and national self-determination. The strictest means of pressure in the form of sanctions have never been used, and certain proposals for more binding coordination have been

rejected. In summary, one could say that there is, to some extent, a legalistic coordination. But even more, policy coordination can be regarded as a framework for collegial cooperation in which Member States have a vested interest in ensuring that they pursue economic policies compatible with the euro.

The Banking Union – centralization of supervision and crisis management

The banking union, with supervision centralized at the ECB and joint management of banking crises, represents the largest single transfer of powers within the EMU since 2003. The path to the banking union was difficult and it was preceded by initiatives that did not go as far. It was when the euro crisis worsened in the spring of 2012 that a shift occurred, leading eurozone countries to become prepared to relinquish national decision-making authority in this critical area. By then, a realization had emerged that the interdependence between governments and banks can be highly damaging.

The banking union means that the ECB is responsible for supervision, with the participation of national supervisory authorities. The ECB directly supervises the slightly more than one hundred significant banks in the euro area, while the others are supervised nationally under the ECB's oversight. Centralized supervision has led to a more formalistic approach and improved quality in many instances. Supervision is strictly separated from the ECB's monetary policy, with distinct decision-making structures. Member States outside the euro area may choose to participate in the banking union through "close cooperation."

The resolution mechanism is the second pillar of the banking union and includes a new authority in the form of the Single Resolution Board. There are also a Resolution Fund (not yet used) and a financial backstop (not yet implemented) that can provide funding during a banking crisis under certain conditions. Bank crises are managed through so-called resolution; a method agreed upon globally that is intended to mimic normal bankruptcy procedures while maintaining the banks' systemically important role in the economy. The resolution mechanism is less standardized than supervision.

A *single rulebook* governs supervision, bank crisis management, and other aspects of the financial markets throughout the EU, so in substance, a high degree of common rules applies. Thus, the same capital requirements apply. The financial position of banks in the euro area has improved since the banking union was introduced. Further building blocks of the banking union are under discussion, including a common deposit insurance (EDIS).

European Stability Mechanism (ESM) – even eurozone countries may need emergency loans

When Sweden held a referendum on the euro in 2003, there was no stability mechanism for eurozone countries. The assumption was that only countries with strong public finances would be allowed to adopt the euro, and such countries would not need emergency loans. This turned out not to be the case, as several eurozone countries ran into payment problems. This was deemed to threaten financial stability and even the cohesion and survival of the eurozone. After improvising with bilateral loans and a temporary mechanism, the permanent ESM was introduced in 2012, following legal adjustments and difficult negotiations.

Loans from the ESM may only be granted under strict conditions. For the most used form of support – loans – this entails a comprehensive economic policy adjustment programme that includes requirements for significant budgetary consolidation. In practice, the recipient country more or less loses its economic policy autonomy, which makes ESM support an unattractive option. There are various mechanisms to ensure the repayment of ESM loans. The five eurozone countries that have received stability support have all been able to restructure their economies in an orderly manner and have regained access to market financing on acceptable terms. All ESM programmes have been completed. The IMF has participated in five of the seven support programmes. No new ESM support has been decided upon since the third Greek programme in 2015.

The Eurogroup and stronger mechanisms for governing the euro area

The Eurogroup has existed since 1998, but at the time of Sweden's referendum, it played a modest role. With the Treaty of Lisbon, the Eurogroup gained a treaty-based status, though it remained an informal body. During the euro crisis, governance of the euro area was strengthened in various ways. The Eurogroup is now the central forum for the euro area's coordination of economic policy. The group forms policy on matters such as the expansion of the euro area, exchange rate issues, and crisis management. The Eurogroup's agreements can be formalized in the Ecofin Council. The Eurogroup has an elected chair, and its meetings are prepared by a special working group consisting of close associates of the finance ministers and led by an elected, full-time chair. The Eurogroup draws up work programmes and operates with a high degree of transparency, as agendas and many supporting documents are published. The Euro Summit is a new body where heads of state and government meet, but its activities are not as continuous as those of the Eurogroup. Sweden is sometimes invited when the Eurogroup and the Euro Summit meet in an inclusive format.

The euro is the second most important global currency

Compared to the situation in 2003, the euro's international role has not grown, but the euro is firmly established as a global currency. Doubts about the euro's survival appear to have vanished or are minimal. The euro holds the position of the second most important global currency, clearly behind the dollar but well ahead of other currencies. The euro's standing varies depending on the context, but as a denomination currency for trade it is comparable to the dollar, while in other respects it plays a lesser role.

The EU has raised its ambitions for its global standing, and this has been accentuated by recent geopolitical turmoil. The aim is to give the euro a greater global role. This is likely to be a long-term process, and it is hardly to be expected that the euro will achieve a position as strong as that of the dollar. The Commission has taken initiatives to strengthen the euro's global role. Recently, the ECB has shifted from its previously neutral stance to a more supportive approach. The forms of the euro area's participation in international

cooperation have become more established, and it is possible that they will evolve further. This may be significant in today's geopolitical situation, where monetary policy, trade, and security are sometimes intertwined. The Eurogroup is the most important forum for preparing international economic meetings, but some discussions take place in the EU27 format.

Tightened process for adopting the euro

The four convergence criteria and requirements regarding central bank legislation remain the same, but two important changes have nevertheless occurred since 2003. One change is that, in practice, the eurozone countries themselves decide whether a Member State may adopt the euro. The Treaty of Lisbon introduced a rule that eurozone countries must adopt a recommendation on whether a country should be allowed to introduce the euro, and then the Council of the EU decides (as before). The idea is to avoid repeating past mistakes of allowing overly weak Member States to adopt the euro.

The second change is a requirement, effective since 2018, that participation in the banking union must occur by entry into ERM2 at the latest. One reason for this is that the countries waiting to adopt the euro have weaknesses related to their financial sectors. For Sweden, the new requirement is of little practical significance, since joining the banking union will automatically follow from adopting the euro a bit later. However, the requirement is significant for the process, as legislation must be prepared well in advance of joining the banking union.

The “ins and outs” groups are both different

Since 2003, the euro area has expanded from 12 to 21 Member States. These expansions have taken place before, during, and after the euro crisis. Today, 6 of the 27 Member States remain outside the euro area, in some cases due to difficulties with economic convergence. In 2003, all three “outs” were advanced economies (Sweden, Denmark, United Kingdom). The United Kingdom, with its significant economic and political clout, is no longer there to defend

the interests of itself and other Member States outside the eurozone based on sometimes extreme positions. Following Brexit in 2020, the group of “outs” is heterogeneous and weakened, both economically and politically.

A strong political will to keep the eurozone together

The euro crisis could have ended differently. Some measures were difficult, especially for Germany. When push came to shove, the political will to preserve the euro and keep the eurozone together proved to be strong.

A transformed EMU

If one were to summarize the situation schematically and with simplifications, one could do so as follows. The ECB has expanded its role so that it now bears less resemblance to its original model, the Bundesbank. The importance of sound public finances carries even greater weight. The rules have been changed, but problems remain. Divergences in economic policy, in a broader sense, are viewed as more problematic, and the mechanisms to counteract them have been strengthened. The banking union is the biggest step toward integration, but the possibility of centralizing supervisory tasks was already present in the founding treaty that Sweden approved upon joining the EU. The fears of federalism, which have been prominent in the Swedish debate, can hardly be said to have materialized. Further steps in a federal direction have been debated but not realized, beyond the banking union. It has become clear that even eurozone countries can fail and fall into economic crisis and that they need safety nets. Eurozone countries have evolved into a more distinct group within the EU, through the Eurogroup and in other ways. A strong international role for the euro is a clearer ambition, but so far, the dollar remains dominant. The process for admitting new members has been tightened. The group of non-eurozone countries has become weaker and more heterogeneous.

Economic crises are recurring, but it is impossible to say when the next one will come or what form it will take. Much has been done to ensure the euro area can better withstand a crisis. To prevent

crises, efforts have been made to improve the monitoring of public finances and the coordination of economic policy. The banking system has been strengthened through the banking union. Crises can be managed with new instruments because the ECB has clarified its role as *lender of last resort*, fiscal policy flexibility has increased, the ESM has been established, and the banking union's Single Resolution Mechanism, with various arrangements, has been introduced. It is impossible to say whether this will be enough, but the euro area is better prepared than before.