EXECUTIVE SUMMARY

1. The crisis in the euro area has revealed fundamental problems in the design of the single currency area. Firstly, there was a lack of economic and fiscal policy discipline. And secondly, there was no credible mechanism to respond to crises. These institutional deficits contributed to economic imbalances in the economically heterogeneous currency area, which made the economies of some member state vulnerable and contributed to the deepening of the crisis.

2. Given these developments, **macroeconomic adjustment** was unavoidable in the crisis countries. This included fiscal consolidation and structural measures to enhance competitiveness. These steps were associated with painful cutbacks affecting the populations of the respective countries.

3. To support the crisis countries in this process and stabilise their financial systems, **adjustment programmes** were agreed with the affected countries. Ireland, Portugal, and Spain all successfully completed their programmes. However, the lack of progress and recent turbulence in Greece have prompted voices to question the crisis response in its entirety.

4. Yet the situation in Greece should not be taken as proof of failure of the **rescue policy** as such. Firstly, the crisis response averted a systemic crisis and thus maintained the cohesion of Monetary Union. Secondly, the time was used to implement reforms to make Monetary Union more resilient against economic crises. Thirdly, the economic situation in Ireland, Portugal, and Spain has improved markedly.

5. It has become evident in the past years that the euro area member countries are overwhelmingly **unwilling to give up national budget autonomy**. To provide a stable framework for the Monetary Union based on the principle of unity of liability and control, the German Council of Economic Experts has developed a long-term framework ("**Maastricht 2.0**", see Annual Economic Report 2012 paragraphs 173ff; Annual Economic Report 2013 paragraphs 269ff.).

   In recent years, **major reforms of the institutional framework** have been implemented which largely reflect the "Maastricht 2.0" idea. Among other things, these put emphasis on the national responsibility of euro member countries for sound public finances and international competitiveness.

6. Nevertheless, some of these reforms remain incomplete. The **banking union** needs to be strengthened through enhancement of the resolution regime and establishment of an integrated financial supervisor. The problem of the **bank-sovereign nexus** has yet to be fully solved. The privileged status of government bonds in banking regulation must therefore be phased out and the discretionary leeway of creditor bail-in rules reduced.

7. The crisis policies induced the **ECB to assume the role of crisis manager**. This sends the wrong signal as regards fiscal consolidation. Yet, the only way to address the legacy of high public debt ratios is strict adherence to **fiscal rules**.

8. For the no-bailout clause to become credible, an **insolvency mechanism** needs to be created that requires a maturity extension of government bonds as part of future adjustment programmes if public debt is not deemed sustainable. In the event of over-indebtedness or a material breach of fiscal rules, an ESM adjustment programme should only be approved after a debt haircut is imposed on private creditors. If a member country continually fails to cooperate, the stability and very existence of Monetary Union may be at risk. A country's exit from Monetary Union must therefore be possible as a **last resort**.

9. In contrast to these reforms, short-term measures to address acute problems harbour a serious long-term threat to the stability of the euro area. This also applies to reform proposals currently under discussion, such as establishing a fiscal capacity or a European unemployment insurance. The institutional framework of the single currency area can only ensure stability if it follows the **principle of unity of liability and control**. Reforms that stray from this guiding principle plant the seeds of further crises and may damage the process of European integration.

This is a translated version of the original German-language version, which is the sole authoritative text.