WRR

WETENSCHAPPELIJKE RAAD VOOR HET REGERINGSBELEID

*Nederland en de Europese Unies*
*Synopsis seminar 1*

**De euro op z'n kant**
**Is er een middenweg tussen uiteenvallen en *one size fits none*?**

*Hoe zou de monetaire Unie zich verder kunnen ontwikkelen en wat zijn daarbij de relevante Nederlandse belangen? Dient de Eurozone hervormd te worden in de richting van een vergrote flexibiliteit die rekening houdt met de ontstane divergentie tussen de lidstaten? Wat zijn daartoe reële opties, wat zijn de voor- en nadelen en hoe verhoudt implementatie zich tot het probleem van transitierisico's?*

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After having heard the distinguished speakers Harold James, Arnoud Boot and Arthur van Riel during the first part of the seminar, the audience was invited to join the discussion on three policy options for the future of the European Monetary Union (EMU). The three options did not include break-up scenarios, but all required some form of a banking union and shared the problem of legacy debt. The question remains how to deal with future debt, taking into consideration existing attitudes towards bail-outs, surveillance and ex-ante risk coverage. The options were not claimed to be exhaustive, but aimed to offer a fair choice that reflects the spectrum of opinions. The transition part may cause problems, but that is the case with all three options.

1. *Further steps towards fiscal union*
   The first option is that of further steps towards a fiscal union and central policy coordination, as part of the 'one country solution'. This effectively adopts the viewpoint that a monetary union requests a political union and EMU may become one through political decision-making. In this option re-convergence is achieved through central policy coordination and the fiscal union is used to counter shocks. Since the member states remain the main actors and their actions serve a collective interest in the presence of spill-over risks, the option still requires conditional bail-outs, even in the case of a partial banking union. The option also maintains the current macro-economic policy stance of effective one-sided adjustment. In effect, the current member states will become more like provinces of a federal Europe. A comparison with the Dutch Republic or the US may suggest that pooled sovereignty could be limited to a fiscal union only, but in the EU this seems unlikely without an adjusted definition and monitoring of the distribution of competences.

2. *EMU-light*
   The second option is the creation of a banking union and the maintenance of the euro, but without an insurance mechanism. This shifts the focus from sovereigns to banks by means of the banking union, and limits liabilities on existing debt through bail-in resolutions. In this case countries can fail without triggering a stability crisis as long as financial institutions remain standing. Once in trouble, they can also opt to leave.

3. *Fuzzy Europe: macro-economic rebalancing and institutional flexibility*
   On the basis of the literature on currency arrangements between sovereign states, subsidiarity, governance and US monetary history, the third options challenges the assumptions underlying option 1 and the fact that it pre-selects on a centralist model. At the same time it underlines that option 2 does not entail enough to hold EMU together, as divergence, legacy debt and the political economy of member state interests prevent the equilibrium condition of a clean distribution of responsibilities from being reached. Against this background it suggests a decentralised system policy of coordination, differentiated collateral requirements

and other forms of regional differentiation in monetary policy, debt relief through a permanent interest free loan on the books of the ECB, shock absorption through an insurance mechanism aimed at individual risk, and two sided macro-adjustment.

The discussion opened by examining the definition of a fiscal union and a debate on whether or not this should be combined with the instruments of a banking union and an insurance mechanism. Where does the money for an insurance mechanism come from? At the moment we finance the current mechanisms with money from the member states, but we might opt for a fiscal system in which European taxes are raised. A fiscal union could be limited to a deposit insurance for and through the banks only. In the end, a fiscal union is about mutual guarantees: ex-ante through taxes and a higher central budget or ex-post through bail-outs or inflation. The necessity of an additional fiscal union is questioned. The banking union as a form of mutualisation of risk could perfectly function separately from a fiscal union. Rules are necessary to maintain the European cooperation, but a growth of European budget, or even more far-reaching, European fiscal policy, is not a condition for European cooperation. Use of a banking union as a panacea is considered fashionable.

Before the start of the discussion on the separate policy options, a remark from the audience asked for a voting advice. Three conditions for an eligible option from a Dutch perspective were stated: (1) there should be a minimal transfer of sovereignty; (2) the necessary fiscal facility should be as small as possible; and (3) it should opt for the maximum amount of discipline for the countries involved. Combining these three conditions should lead to the best option.

1. *Further steps towards fiscal union*

This option seems to be a logical construction, and from the three options the most stable one. More centralisation is needed to shape the conditions for a European state. The propositions from European Council president Herman van Rompuy could be realised, but it will have a doubtful effect and in any case, policy makers will have to ignore the opinion of the people. Centralisation brings the hypothetical advantages of, among other things, a more even distribution of welfare and an improved functioning of the internal market. A comparison of these advantages with the current US-situation showed that still some states perform better than others and large regional differences are present.

This option would also mean that Europe will integrate its economic power, finally resulting in a situation in which Kissinger could have been able to call Europe. Initially it sounds like an ideal situation, but politicians would never be able to push this process of centralisation through, unless Europe would be faced with a crisis that is much worse than the crisis faced today. This option needs at least a transition period of 15 years to accomplish a European state. Others feel that this is probably too soon.

The unanswered question remains whether in the end, 'Europe as country' is inevitable or not. It could be the best option if we succeed in creating a flexible labour market. An increase in European labour mobility is visible, but because people do not feel European, they do not want labour mobility. Politically speaking, one has to deal with the principle of sovereignty. Convergence between national democratic systems is needed. The French political system is very different from the German political system, perhaps too different to integrate them. On the other hand, the beginnings of EMU were built on a bad French-German relationship, so a good relationship does not seem to be a condition for further European centralisation. And what happens to the individual nation states if, at one point in future, they are not able to manage themselves anymore? If countries become provinces of Europe, it is not automatically possible to manage them by using the same institutions.

2. *EMU-light*

This option may be seen as a clean and technocratic option. Of course, less transparency means more chance of its acceptance by public. However, the question was raised whether it is a sustainable option. And how big would the problem be if, after a period of time, it turns out not to be a sustainable option. At the moment, there is not enough time to consider what we would like to change in the future, and this option gives us time to think about and implement a better solution before a next crisis occurs.

To make a banking union work, a safe asset is needed that finances the first 30% of governmental debt. In this regard, the question is: who is going to issue the bonds or collect the money? Is that a task and competence of the member states, or should Eurobonds or a bank-deposit insurance mechanism be installed? And is this enough to solve or postpone the current crisis? A European banking union should encourage pan-European banks that operate less regional than banks do now. It might be the solution for banks that are too big to be saved by a nation state. These pan-European banks could lead to more consolidated banks that are stable enough to help themselves in times of crisis. If this situation is accomplished, this policy option is a rather good, but if not, the risk is that states could go bankrupt more easily. And what does it mean for the banking union if a country steps out of the union and the banks invested a lot in the debt of such a country? The European member states need to make rule about the claims banks can make in case a country steps out. Seminar 2 '*I want my sovereignty back. Wat is de waarde van het EU-lidmaatschap van het Verenigd Koninkrijk voor Nederland?*' on November 4, 2013 will address this issue inter alia.

Some attendees agreed on the fact that EMU-light is an incomplete option, a full banking union to make it work is needed. EMU-light lacks an insurance mechanism and a banking union without the insurance mechanism breaks the traditional bond between the public and the private sector when it comes to banks. Besides, attendees hesitated about not having a break up policy. They do not believe a system of parallel currencies would be a sustainable one. Why would a country choose for the parallel currency option? If a country wants to step out the EMU, it would leave the Eurozone completely, devalue its currency and slash its debt through a different denomination. As a semi-permanent solution, capital controls offend the idea of Europe and its free market, suspending the acquired freedom of capital.

*3. Fuzzy Europe: macro-economic rebalancing and institutional flexibility*

The third option challenges the key assumptions of both other approaches. First, it underlines that overcoming the structural problems engendered by debt and divergence are essential to the coherence of EMU. Historically speaking it could be done. Having possibilities for a differentiated policy or a regional model of central banking, similar to the early Federal Reserve, may lead to adjusted policy targets such as the cyclically differentiated inflation target. A more flexible monetary policy leaves the option for diverse policies between member states. Countries that need a decrease of wages are not bound to the disciplined policies of the EU (mostly stimulated by northern member states) that aims at avoiding large inflation rates. An advantage of this option is that adjustments to the periphery is more realistic when two-sided policy is possible, because higher inflation rates will enable the real wage decreases that are necessary to stay (or become) competitive.

It was considered to be an advantage that this option addresses the consideration of regaining more national responsibility. However, it was objected by some that once we start unravelling what we have built so far, it may become difficult to stop the process. Is it possible to stop the process of unravelling once you have started it? It was argued that in this option, it is more about organising it differently instead of regaining our sovereignty. Regarding accountability to the public, the public may actually like this option.

*Conclusions*

| | Which is your policy preference from a Dutch perspective? | Which of the policy options do you hate most? |
|---|---|---|
| *Option 1* | 6 | 9 |
| *Option 2* | 6 | 3 |
| *Option 3* | 12 | 5 |
| *Abstention* | - | 7 |

The attendees of the debate were expected to show their colours by voting on one of the options. The result shows that the option with European fuzziness, presented by an American, was not considered to be a bad policy option. But the unclear result of the voting, made Professor Harold James think of the quote: 'to think is to say no' (Chartier, 1868–1951). For now, all policy options sound very horrible, which makes is difficult to vote for one. One of the major contributions of this seminar and discussion was that there is so much more to choose from than we thought before this evening.

It remained a point of discussion whether someone needs to know what the risks of a policy option are before voting for it, or not. It is a fact that people take up insurance without knowing their individual risks to a precise degree. But does this apply to Europe? The problem in these kinds of discussions appears to be: the more you know about Europe and its problems, the less likely it is you have a solution. However, the European problem imposes a shared responsibility. Professor James ended the discussion by mentioning the importance of solidarity in Europe.

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WRR

Project

Nederland en de Europese Unies

**In het najaar 2013 start de WRR een reeks seminars waarin de toekomst van de Europese Unie(s) centraal staat. Door onderdelen er uit te lichten, zoals de EMU, de politieke unie en de interne markt wil de raad een unieke bijdrage leveren aan het Nederlandse debat over 'Europa'.**

Het debat over de Europese Unie is zeer gepolitiseerd. Doel van dit WRR-project is om bij te dragen aan de structurering van het debat door relevante vragen op te werpen, discussies van objectieve kennis te voorzien en eventueel een aantal opties (scenario's) te analyseren. De WRR vervult een faciliterende en neutrale rol waarbij gezocht wordt naar een balans tussen voor- en tegenstanders.
Inhoudelijk ligt het zwaartepunt voor de WRR voorlopig bij de economische unie (EU28), de monetaire unie (EU17) en de politieke unie. De eerste drie seminars hebben een afgebakende focus op deze domeinen. Daarna volgt een conferentie dat gericht is op het grotere thema van de toekomst van de politieke unie.

Belangrijke vragen zijn:

- hoe zou de monetaire Unie zich verder kunnen ontwikkelen en wat zijn daarbij de relevante Nederlandse belangen?
- dient de Eurozone hervormd te worden in de richting van een vergrote flexibiliteit die rekening houdt met de ontstane divergentie tussen de lidstaten? Wat zijn daartoe reële opties, wat zijn de voor- en nadelen en hoe verhoudt implementatie zich tot het probleem van transitierisico's?
- hoe kan de economische Unie zich verder ontwikkelen als Engeland zich 'terugtrekt' en wat zijn daarbij de relevante Nederlandse belangen?
- wat zijn de opties voor de verdere vormgeving en staatkundige inrichting van de Unie? En wat zijn de relevante Nederlandse belangen en uitgangspunten bij elk van die opties?

Seminar 1: *De euro op z'n kant*

Download hier (audiobestand) de lezing van professor Harold James

Download hier (audiobstand) de lezing van professor Arnoud Boot

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Interested in the presentations from Professor Harold James and Professor Arnoud Boot? Download the podcasts at **www.wrr.nl.**

**Further reading:**


- Harold James (2012)
  Lessons for the Euro from History (*Julis-Rabinowitz Center for Public Policy and Finance Conference, "European Crisis: Historical Parallels and Economic Lessons").*

- Harold James (2012)
  'Design Flaws of the Euro' The T.K. Whitaker Lecture

- Kevin O'Rourke en Alan Taylor (2013)
  Cross of Euros (The Journal of Economic Perspectives)

- Michael D. Bordo and Lars Jonung (1999)
  The Future of EMU: what does the History of Monetary Unions Tell us? (NBER working paper 7365)

- Sylvester Eijffinger en Edin Mujagic (2010)
  Eurozone groeit uit elkaar (Economisch-Statistische Berichten)

- Heiner Flassbeck and Friederike Spiecker (2011)
  The Euro – a Story of Misunderstanding (Intereconomics)

- Barry Eichengreen and Charles Wyplosz (1998)
  The Stability Pact. More than a Minor Nuisance? (Economic Policy)

- Willem Buiter (2006)
  The 'Sense and Nonsense of Maastricht' revisited (The Journal of Common Market Studies)

- Charles Wyplosz (2013)
  Europe's Quest for Fiscal Discipline (European Commission, Economic Papers)


**Next seminar**

*'I want my sovereignty back'*
*Wat is de waarde van het EU-lidmaatschap van het Verenigd Koninkrijk voor Nederland?*

Tijd: 4 november 2013, 17.00-20.00u
Plaats: Academiezaal van de WRR, Buitenhof 34, 's-Gravenhage
Sprekers: Vivien Pertusot (IFRI), Tom de Bruijn (Raad van State), Arjen van Witteloostuijn (CentER)