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Reflections on the Commission's euro reflection paper: let's get the sequencing right

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The European Commission has finally published its much-awaited reflection paper on the future reform of the European Economic and Monetary Union (EMU). It is a good read. It *reflects* reasonably well the current debates on what needs to be done to strengthen the single currency. Unfortunately, it does not offer a *reflection* on why the Eurozone suffered more the effects of the global financial crisis than the US, which was the epicentre of the crisis. Perhaps doing so would have helped to set the right priorities.

I agree with much of what is written in the first sections of the paper. For instance, that 'as robust as it is today, **the EMU remains incomplete**' (p. 7), that 'we simply cannot afford to wait for another crisis before finding the collective will to act' (p. 7) and that the crisis 'has had far-reaching social consequences, particularly in the countries having had to adjust most during the crisis. [Consequently], for the first time since the Second World War, there is a real risk that the generation of today's young adults ends up less well-off than their parents' (p. 12).

But, alas, in the paper there is no explanation about why the Eurozone ended up in the mess it got itself into. Arguably it had a lot to do with the (wrong) policies implemented in the member states before, and at a European level, during the crisis, rather than with the institutional set up of the eurozone itself. In any case, the past is past and it cannot be changed. Now the focus should be on the future and, in this regard, it is good to know that the Commission identifies the **correct 'guiding principles for deepening EMU'** (p. 18).

These are: (1) the pursuit of jobs, growth, social fairness, economic convergence and financial stability; (2) the inclusion of all member states (hence also the non-eurozone members) in the forthcoming deepening process; (3) finding the right balance between solidarity and responsibility, in other words, between risk reduction and risk-sharing; and (4), finally and perhaps more importantly, the need to make EMU decision-making more transparent, democratic and accountable.

This is all fine. Where I see problems, however, is in the **sequencing** of the reforms. The Commission is right that one of the first priorities should be to complete the single rule book of the banking union, undertake further risk reduction and develop a European-wide strategy to deal with the non-performing loans, which should include efficient supervision, the creation of secondary markets for distressed assets, quicker insolvency procedures and effective bank restructuring operations (p. 21).

But believing that from now till 2019 it will be possible to establish a European Deposit Insurance Scheme, a full capital-markets union and a risk-free sovereign bond-backed (synthetic) security is wishful thinking.

There will be very little progress on these issues because they all imply a fiscal and political commitment (essentially mutual trust) among member states that is —thus far— absent. The creation of a structured European sovereign-debt bond, even if it does not imply debt mutualisation (as the authors of the ESBies proposal argue), will not happen because Germany is opposed to anything which could remotely smell of eurobonds and because the credit rating agency Moody's has already said it will not give it the AAA label, making it essentially a non-risk-free bond, which defeats the purpose of the exercise from the start.

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The fact is that we have arrived at a point where the completion of the financial union first requires further steps in the integration of the other unions. This is the case of the economic union. Here the Commission makes a number of valid points. Convergence between the member states is absolutely necessary and a precondition to creating the trust necessary to build enhanced risk-sharing. Furthermore, convergence needs to be defined, not only on nominal macroeconomic indicators but also on improvements in key areas such as employment, education, welfare systems, product and services markets, public administration and the judicial system (p. 24).

This is a comprehensive and ambitious approach on reforms that is welcome. The objective should not be to create homogenised models of capitalism but rather having minimum common principles of **good governance** everywhere. Here, as rightly suggested by the Commission, the European semester and its benchmarking and country-specific reform proposals could be utilised in a much more efficient way. Since creating a common Eurozone treasury is very difficult for now, it is important to utilise the current European Structural and Investment Funds and design the next Multiannual Financial Framework so as to link the disbursement of funds to the successful implementation of productivity-enhancing reforms (p. 25).

Of course, to be successful these reforms need to count on the necessary ownership and legitimacy in the countries where they need to be implemented (this should be the most important *reflection* of the crisis). In order to improve this aspect, the Commission is right that the Eurogroup needs to be more transparent, have a permanent chair (as we proposed at Elcano some time ago) and be more accountable to the European Parliament (p. 28). The question, however, is whether this will be enough. As mentioned, the Commission's euro reflection paper, by not reflecting on the real causes of the depth of the crisis in the Eurozone, fails to address perhaps the most fundamental problem in the EMU right now: the suboptimal organisation of its political union.

This is *reflected* in the paper. As with the two Presidents' reports, the section on how to improve the Union's **democratic legitimacy** is rather short and vague. The priority is on technical reforms and not on the politics of EMU, which are left underdeveloped and deferred to the future. But such a sequencing is problematic. Emmanuel Macron's campaign pledges and subsequent election show that this is the time to discuss the creation of a eurozone parliament. If the (sometimes difficult and painful) reforms decided at the Eurogroup level are to be implemented at the national level —not least in Greece—, it is important that they are voted at the European level too. So why not have them voted by a eurozone parliament or at least a commission for eurozone affairs in the EU Parliament?

To sum up, at this stage it is important to think harder on how to improve and strengthen the political union. To generate **trust**. Only in this way will there be a greater momentum and willingness to introduce the technical solutions that most economists agree upon, whether a European Deposit Insurance Scheme, a macroeconomic stabiliser such as a European unemployment re-insurance fund, the right framework to have stable fiscal positions and productivity-enhancing reforms, or even Eurobonds and a European treasury. What is difficult to see is EMU member states agreeing on a joint representation at the IMF if they cannot even agree on how to make joint decisions more efficiently, democratically and cohesively in the EMU itself. That is why it is so important to get the sequencing right.