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IN BRIEF

Keeping it Real: Building a Realistic and Inclusive Eurozone

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WHO DOUBTS THAT HISTORY DOESN'T REPEAT ITSELF? IN BRUSSELS, 2018 IS THE NEW 1989. EVERYBODY SEEMS TO HAVE A "BLUEPRINT" OR "VISION" FOR THE FUTURE OF THE EUROZONE. THE ONLY PROBLEM IS THAT THREE DECADES AFTER THE DELORS REPORT, EUROZONE LEADERS' RISK THE SUSTAINABILITY OF THE SINGLE CURRENCY AREA. THE REASON? POLITICAL GOALS RATHER THAN ECONOMIC PRIORITIES ARE GUIDING EUROZONE PROPOSALS. THE POSSIBLE RESULT? A REPEAT OF THE MISTAKES OF THE 1990S AND A EUROZONE STILL ILL-EQUIPPED TO DEAL WITH FUTURE CRISIS.

It's not a bad time to be an economist in Brussels. After years of bad news and the occasional crisis, the talk now is of growth and employment. Sure, there is President Trump, Italy, Brexit and a whole continent of issues, but at least the narrative has moved on from Eurozone collapse and the return of the franc. Into this breathing space has emerged a multitude of plans for "deepening Europe's Economic and Monetary Union" with President Juncker correctly acknowledging that the current economic climate presents the ideal opportunity to complete the Euro's institutional architecture.

In reality, the Commission's proposals seek to find some common ground between the sweeping vista presented by President Macron and the traditional German aversion to a "transfer union". However, President's Macron's laudable vision – "The German taboo is financial transfers, the French taboo is Treaty change. Ultimately, if we want Europe, both will happen" is underpinned by visions of a much greater political Europe. A vision which remains a little cloudier on the banks of the Spree in Berlin, not to mention in many other national capitals, notwithstanding the newish faces in the German government.

So, is a deeper political union required to strengthen the Euro and protect against future crises? In short, the answer is "No". But the danger remains that the political narrative of EMU reform is incorrectly seen as indispensable to its future. This may correctly have been the case in the early 1990's, but having weathered the storms of the past decade, the now established Eurozone requires the development of its institutional structure based on economic imperatives and political realities, not grander visions of a United States of Europe.

Three key issues need to be addressed in a coherent manner. First, ensure that the key weaknesses exposed by the crises of the past decade are rectified as soon as possible. This must also include dealing with legacy issues such as Greek debt sustainability. Second, to put in place an institutional framework which ensures that the Eurozone is more efficient in dealing with future shocks. Third, to retain inclusivity as a hallmark of all discussions on the future of EMU to reflect the importance of monetary union to all EU members. This is elementary in the context of an East-West divide in the EU which risks to get wider, with only 5 of the 11 formerly communist member states being inside the Eurozone.

Unfortunately, proposals relating to the creation of a Finance minister for the Eurozone, for a Eurozone budget, for European safe bonds and for Treaty change – while all relevant as part of a longer term debate on the Eurozone's future – do nothing to directly address the issue of ensuring the insulation, where possible, of public money from bailing out financial institutions. Would a Eurozone Finance minister or a Eurozone budget (that is painfully constructed to avoid the appearance of fiscal transfers and probably capped at a maximum of 1% of GDP) have prevented any government from needing to bailout banks over the past decade? Again the answer is "No". A fully completed and functioning Banking Union on the other hand would have played a major role in reducing the overall costs of these crises.

In other words, the priority now should be on fixing the obvious flaws in the existing Eurozone architecture. Namely, completing Banking Union based on the Commission's Roadmap from June 2016. Only then should detailed discussions on future visions/plans/blueprints for the Eurozone be engaged in. To progress detailed discussions before finalising a robust Banking Union risks exacerbating political tensions between national governments and, perhaps more importantly, threatens to undermine public confidence (and support) for the Euro project. The primary goal must be to ensure that the public trusts the European financial system, and understands that their savings are secure in its banking system. For this to achieved in a robust and defensible manner, a high level of inclusivity is required, especially towards the Central European non-members of the Eurozone.

In this regard, the shared views of eight Finance ministers on the future of EMU are very welcome. By proposing that priority be given to issues with the greatest convergence of opinion among national governments – finalising Banking Union and the development of a European Monetary Fund (EMF) – they recognise the importance of dealing with existing institutional weaknesses. They also, by focussing on the importance of structural reforms and compliance with existing Eurozone fiscal rules, correctly identify that it is national actions which must drive the future development of the Eurozone in the short to medium term.

It is this course that will help maintain public support and confidence in the Euro. At the current moment, the Euro requires neither Treaty change nor additional fiscal rules – simply ensuring compliance with existing rules is much more important.

The approach advocated by this "Northern Arc" of Finance ministers is also consistent with the historic precedent set by the Federal Reserve in the United States. There, during the Great Depression of the 1930s, the political system reacted quickly to underpin public confidence in the monetary system. One important component of rebuilding public trust was the creation, through the Banking Act of 1933, of the Federal Deposit Insurance Corporation (FDIC). The FDIC remains the institutional framework in the US for ensuring deposits up to $250,000 in US banks. Although facing considerable political opposition at the time, the FDIC has become a key element underpinning the stability, and public acceptance of, the US monetary union.

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In Europe however, the creation of a European Deposit Insurance Scheme (EDIS) remains unfulfilled notwithstanding its importance as the "Third Pillar" of an effective Banking Union. This specific proposal, rather than grander visions for the Eurozone in the decade to come, should be the underlying priority for politicians in the run up to the 2019 elections. After all, isn't the purpose of monetary union supposed to be securing and enhancing the prosperity of its citizens?

What should the much awaited Franco-German blueprint for the Euro contain? For a start, let's hope they avoid the lofty rhetoric that will ensure years of protracted negotiations on issues like a Eurozone budget and Finance minister. Even worse would be a typical Brussels fudge which sees the establishment of a Finance minister with no real power and a budget too small to make a difference. Both would damage, not enhance, Eurozone credibility. Rather, what is required is a realistic and inclusive approach to ensuring public and political support for the Euro remains intact, and is nurtured even in the non-members of the Eurozone.

Although at odds with Macron's image as Europe's current visionary (anybody remember Renzi?) what the Eurozone requires from its Franco-German leadership in 2018 is not a soaring ambition to use the Euro as a tool to drive Europe's political or fiscal integration. This was tried in the 1990s and the structural flaws it resulted in nearly tore the Eurozone apart over the past decade.

Although unlikely to grab huge headlines, a strong commitment to enforcing current fiscal rules, completing Banking Union, developing an EMF and maintaining national governments at the core of EMU would do more to enhance the Euro's credibility than yet another Eurozone vision.

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