Workshop summary

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While the monetary dimension of Europe's Economic and Monetary Union (EMU) was fully implemented in 1999, the economic dimension is still work in progress. But how much pooling of decision making is really necessary? And, how should such a shared stewardship be designed to ensure a smoothly functioning EMU? In early September 2015, international experts discussed these questions at a workshop organized by the Oesterreichische Nationalbank (OeNB) in cooperation with the Euro50 Group, which drew more than 180 participants.

The starting point for the debate was the *Five Presidents' report* "Completing Europe's Economic and Monetary Union" released in mid-2015, in which the presidents of the European Commission, the European Council, the Eurogroup, the European Central Bank and the European Parliament presented a long-awaited road map for deepening EMU. To put EMU on a more solid foundation, they propose gradually complementing today's economic and fiscal rules with further sovereignty sharing within common institutions. This process encompassing two stages in which the four areas economic, financial, fiscal and political union should be strengthened is slated to culminate by 2025 in the establishment of a euro area treasury for collective decision making.

Through the lens of economic theory, the workshop looked at various EMU reform proposals, covering, for instance, compensatory mechanisms for stabilizing Member States' economies during asymmetric shocks, productivity-oriented wage-setting rules, financial integration, shared debt management, golden rules for public investment and a budget for the euro area. Almost all of the 20 presented papers had been selected from a pool of around 50 high-quality submissions received in response to a call for papers. Notwithstanding some disagreement on the desirability or feasibility of several proposals, a consensus emerged about the need for a fiscal and economic policy framework that combines risk reduction (discipline) and risk sharing across the euro area countries (solidarity).

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What governance for the euro area?

In his opening remarks, OeNB Governor *Ewald Nowotny* stressed that – on the eve of the EU finance ministers' first debate of the Five Presidents' Report – both the topic and the timing of the workshop were right on target. In his view, the fact that the so-called sovereign debt crisis occurred in Europe – by far not the only indebted region – was connected to EMU's incomplete institutional setting. The four pillars of the Five Presidents' report zero in on exactly such unsolved issues. While progress on banking union has already been remarkably smooth, achieving a fiscal union will be more challenging as budgetary policies are the crown jewels of parliamentary democracy. Nowotny cautioned that the proposed reforms will meet with a reality that varies greatly among Member States, warning against alarmist voices that call for immediate radical change under the threat of broad failure. In the EU, change takes time as it could be vetoed by any single Member State. In light of this important fact, Nowotny commended the step-by-step approach taken by the authors of the Five Presidents' Report, who wisely distinguish between two stages: (1) changes within the existing legal framework and (2) a long-term perspective involving a Treaty change.

Paul De Grauwe, Professor at the London School of Economics and Political Science (LSE), pointed out that the sovereign debt crisis originated from a classical boom-bust story. A misdiagnosis of government profligacy, however, led to excessive austerity in the periphery without fiscal stimulus in the center, which resulted in the euro area's economic stagnation. De Grauwe identified three design failures of EMU that, following the euro's introduction, weakened its members. First, a monetary union with national fiscal policies exacerbated "national animal spirits." Second, monetary and fiscal stabilizers that had existed at the national level were stripped away from the Member States. Third, the interdependence of illiquid sovereigns and illiquid banks had led to a diabolical loop. De Grauwe sketched three areas where EMU is in need of a redesign. First, the ECB should act as a lender of last resort; as a matter of fact, its readiness to buy sovereigns' debt in times of illiquidity has already proved spectacularly successful in calming bond markets. Second, coordination of macroeconomic policies should aim at redressing both losses in competitiveness and asset bubbles. The EU's current Macroeconomic Imbalance Procedure (MIP), however, is being implemented in an asymmetric way by putting deficit countries rather than surplus countries under pressure, which creates a deflationary bias and contributes to stagnation. Third, a budgetary union is needed to pool national debt by shifting the balance of power back from financial markets to the states and public institutions; and to create an insurance mechanism that transfers resources to countries hit by negative economic shocks, while taking moral hazard duly into account. There clearly is a tradeoff between budgetary union and flexibility; but flexibility is unpopular and inappropriate in cases of demand shocks.

According to De Grauwe, the current integration fatigue has, by default, given rise to a hegemonic political union, where creditor nations rule, i.e. impose their economic policy preferences on debtor countries. Since such a union is unsustainable, a democratic process of political unification is necessary.

Otmar Issing, former Member of the Executive Board of the ECB and President of the Center for Financial Studies, noted that some elements of banking union have already fueled intense controversy. In his view, the Five Presidents' report does not make a case for a fully-fledged fiscal and political union, but only for steps in this direction, including a macroeconomic stabilization fund and a euro area treasury. Issing maintained that a partial transfer of national fiscal sovereignty must rely on arrangements for democratic accountability, legitimacy and institutional strengthening. A number of institutional arrangements presented in the said report, such as closer cooperation between the European Parliament, national parliaments and the European Commission, are indeed moves in the direction of a political union. However, limited transfer of fiscal sovereignty combined with limited democratic legitimacy is a dangerous path to follow. Issing warned that limited democratic legitimacy will prevail as long as the transfer of fiscal sovereignty is not based on changes in national constitutions.

Completing Europe's EMU – where do we stand?

Representatives of all institutions that contributed to the drafting of the Five Presidents' report as well as two renowned academics gave insights into the various underlying perspectives and strategies in a policy panel.

Othmar Karas, Member of the European Parliament, advocated EMU deepening with a strengthened political union as its final goal. EU citizens do not accept intergovernmental quick fixes outside the Community framework as legitimate options. Input and output legitimacy must be improved by, among other things, transparent and clear rules, a European Monetary Fund instead of the "Troika," stronger control by the European Parliament and improved accountability. While commending the Report, he insisted that the proposed competitiveness authorities require binding rules to be taken seriously.

Jose Eduardo Leandro, Principal Adviser in the European Commission, explained the rationale behind the Five Presidents' report: The incompleteness of EMU fuels doubts about its long-term viability, which in turn hampers the euro area's short-term recovery. Slow relative price adjustments and insufficient national fiscal stabilizers make some risk sharing indispensable. The report is sequenced to strengthen first private-sector risk sharing (financial union) and later public risk sharing, as further structural convergence will emerge. In mature currency unions like the U.S.A., 80% of shocks are smoothed across states, one-third of which

through fiscal channels, and the rest via financial, product and labor markets. Europe, in contrast, manages to smooth only 40% of shocks.

Frank Smets, Counsellor to the President of the ECB, said that the ECB has been playing a visible role in managing the crisis since 2010, thanks to its independence, supranational setup and clear mandate. However, the functioning of EMU came under question when other players delivered too little too late, given that democratic decision making takes time. EMU should move from a rules-based framework to institutional decision making. The proposal to create a treasury for the euro area points in that direction, requiring appropriate legitimacy and accountability. The banking union needs a Single Restructuring Fund (SRF) with a fiscal backstop and a European Deposit Insurance Scheme (EDIS), and should be complemented by a capital markets union (CMU) to strengthen private risk sharing. Weakening the banks-sovereigns link would reestablish market discipline over sovereigns by making the no-bailout rule credible.

Christina Jordan, Economic Advisor in the Cabinet of the President of the European Council, said that the Five Presidents' report strikes a balance between ambition and realism. The starting point is already strengthened economic governance notwithstanding implementation lags. Looking at Member States' developments had made it clear that the timing was just not right to reach agreement on a Treaty change. Therefore, the President of the European Council focused on the completion of banking union to weaken boom and bust cycles.

Niels Thygesen, Professor at the University of Copenhagen, argued that the Five Presidents' report goes beyond political realism and overemphasizes the need for solidarity. While banking union might be a good substitute for fiscal union, the former nevertheless requires some fiscal backup, at least temporarily, until contributions from the financial sector will have been built up. However, he questioned the need for deposit insurance against the backdrop of a credible bail-in rule. Expressing uneasiness about fiscal integration, he noted that already the Delors Committee (of which he had been a member) had failed to agree on a proper aggregate fiscal stance. He urged more short-term generosity, but, at the same time, emphasized long-term self-reliance.

Waltraud Schelkle, Professor at LSE, registered an unprecedented divorce between the pillars of EMU luckily tackled by the Five Presidents' report by advocating a minimum of joint fiscal stabilization. She preferred talking about risk sharing rather than solidarity just as insurance against accidents is needed rather than generosity in cases of self-inflicted harm. Risk sharing should be mandatory and cover unspecified contingencies, as the next crisis might not originate from the banking system. She suspected that some of EMU's design flaws actually were flaws by design as creditors benefitted handsomely from the southern overheating while avoiding most of the costs of the subsequent damage. Correcting these flaws implies a fiscal underwriting of the banking union, promoting diversity instead of

the home bias in sovereign bond markets, and reinsuring the SRF by a credit line from the European Stability Mechanism (ESM), which should have a banking license, as only unlimited capacity would discourage speculators.

The debate that ensued covered various issues, such as the importance of a clear long-term vision for investors, the interpretation of "structural" convergence, the rationale of insurance to limit contagion, the issue of how to gain sovereignty by sharing it, the danger of sovereign debt restructuring in the absence of a safe asset, the role of macroprudential policies to check imbalances, the need to streamline the European Semester and the urgency to start a proper public debate.

EMU governance

Jakob de Haan, De Nederlandsche Bank, presented a paper titled *Reforming the architecture of EMU: ensuring stability in Europe.* The euro area crisis was not primarily driven by public debt but by diverging financial cycles and a lack of provisions for crisis resolution. Capital inflows to peripheral countries that were mainly used for nonproductive investment (housing) were mistaken for desirable financial integration. The subsequent rescuing of the financial sector impaired public finances more than a normal downswing in a business cycle would have. Although all major weaknesses of EMU had already been addressed at the EU level, clear imbalance criteria and enforcement instruments were still missing. De Haan outlined his preferred solution, namely to replace the Stability and Growth Pact (SGP) by Eurobonds and to give the European Council, rather than national sovereigns, the power to borrow in times of crisis. This would ensure compliance and allow for tackling asymmetric shocks with only a limited transfer of sovereignty.

Marek Dabrowski, Center for Social and Economic Research (CASE) in Warsaw, presented a paper entitled *Monetary Union and fiscal and macroeconomic governance.* He suggested that further fiscal and political integration in EMU should be guided by a cost-benefit analysis based on the theory of fiscal federalism. Applying the principle of subsidiarity to EMU, he identified potential benefits only in the centralization of deposit insurance and bank resolution. In his view, monetary unions could exist with no or limited fiscal union, as the latter faces political constraints anyway. Within EMU, neither market discipline nor fiscal rules seem to work – despite strengthened governance arrangements – due to a collective action problem, as many countries exceed the 3% deficit threshold. His preferred solution would therefore be the restoration of the no-bailout rule, supplemented by clear and consistently enforced fiscal rules.

Economic Union

Stefan Ederer, Austrian Institute of Economic Research (WIFO), presented his paper *Macroeconomic imbalances and institutional reforms in EMU.* Diverging unit labor costs within the euro area made the core relatively competitive vis-à-vis the periphery, with France in the middle. At the same time, domestic demand in the core made only a negligible contribution to growth, while it played a key role in the periphery. EMU exacerbated these trends through the real interest rate channel, a common exchange rate, the common monetary policy and uncoordinated wage setting. During the euro area crisis, deflationary adjustment and fiscal consolidation were applied in the south, but were not counterweighted by adequate policies in the north. An expansionary adjustment strategy would require a banking union, a lender of last resort, debt mutualization, coordinated wage policies, and an industrial policy in the south financed by the north.

Andrew Watt, Macroeconomic Policy Institute (IMK) in Düsseldorf, presented his paper *Quantitative easing with bite: a proposal for conditional overt monetary financing of public investment.* Conventional monetary policy has nearly been exhausted and fiscal policy too hamstrung by rules to deal with the current shortfall in aggregate demand. When other methods fail to prevent Europe's "Japanization," monetary financing, often regarded as a mortal sin, is an effective way to raise nominal GDP and reduce debt ratios. Its inherent risks could be avoided by careful policy design, and by giving the ECB the final say. Currently, central bank balance-sheet losses are not critical and inflation clearly is too low. Restricting asset purchases to secondary markets would ensure compliance with the Treaty ban on direct monetary financing. Given today's high fiscal multipliers, the ECB should purchase bonds issued by the European Investment Bank and, thus, finance new projects that reflect the Europe 2020 strategy.

Financial Union

Plamen Iossifov, International Monetary Fund, presented a paper titled *Opting into the banking union before euro adoption*. In his view, banking union, which internalizes cross-border externalities in supervision, is still incomplete, as it lacks a common fiscal backstop and a common deposit guarantee scheme. A payoff matrix of opt-in by non-euro area countries includes upsides, such as access to the future common backstop, information on parent banks, an improved perceived quality of supervision, and better home-host coordination. The downsides are loss of control over cross-border intragroup flows, inadequate representation in the governance of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) as well as no access to ECB liquidity and direct bank recapitalization. Unequal treatment in banking union structures and foreign bank dominance fuel potential opt-in members' skepticism about joining. Hence, giving opt-ins a greater

role in the SSM and providing them with access to the ECB's foreign exchange swap lines would raise the attractiveness of an opt-in.

The paper presented by *Paweł Smaga*, Narodowy Bank Polski, dealt with a similar question: *(When) should a non-euro country join the banking union?* The main benefits of joining banking union are increased stability, trust and quality of supervision, improved home-host relations, a reduction of the bank-sovereign nexus, lower compliance costs as well as centralized liquidity and capital management. The flip side are no representation in the Governing Council of the ECB and no access to ECB backstops (as both are restricted by the Treaty), dominance by home country interests, complicated decision-making processes within the SRM, the insufficient size and mutualization of the SRF, the absence of a single deposit guarantee scheme and no exit option. Treaty changes could improve this unfavorable balance. However, the opt-in decision also depends on ownership in banking assets, the capacity of national resolution funds, previous crisis experiences and the perspective of euro adoption. Hence, according to Smaga, Poland, the Czech Republic and Hungary have basically adopted a wait-and-see position, while Romania, Bulgaria and Denmark seem to be more willing to opt in.

Fiscal Union

This session was chaired by *Edmond Alphandéry*, former French Finance Minister and chair of the co-organizing Euro50 Group, who identified the need for a sovereign insolvency procedure as a key lesson from the Greek crisis.

Ad van Riet, ECB, presented his paper entitled *Market-preserving fiscal federalism in the European Monetary Union*. In theory, EMU was built on a "holy trinity" of a single market, a single currency and a single monetary policy combined with strong market discipline and a hard budget constraint. In practice, however, markets largely ignored diverging country fundamentals and hunted for easy yield in peripheral economies. In response to the euro area crisis, Member States adjusted their economies amid growing risks of policy renationalization and market fragmentation. While the governance framework for the euro area has already been enhanced to date, it still leaves some uncertainty about the integrity of the euro area. Hence, there is a need for a higher level of market-preserving fiscal federalism that builds on a hierarchy between European institutions and national governments and is subject to democratic control. This could foster sustainable economic convergence toward an optimal currency area.

Margit Schratzenstaller, WIFO, presented her paper *Sustainable tax policy beyond the tax ratio for the EU as a core element of a Fiscal Union*. Tax policy has, in her view, considerable potential to promote sustainable development along the lines of the Europe 2020 strategy. However, recent trends have been rather unfortunate, with the share of taxes on labor increasing and the share of taxes on

capital (and "sin" taxes) decreasing. Growing mobility of capital, goods and labor calls for EU-wide cooperation through coordination or harmonization of tax policies. Schratzenstaller highlighted that the long-standing proposal for a Common Consolidated Corporate Tax Base and more recent initiatives for country-by-country reporting should be complemented by minimum corporate tax rates (two-tier, favoring new Member States still undergoing a convergence process) as well as minimum rates for taxes that internalize negative externalities. Alternatively, the EU could directly levy taxes that cannot be effectively collected by individual countries, such as charges on air transport, the Financial Transaction Tax or an EU-wide carbon tax.

Kurt Bayer, WIFO, wrapped up the first day, pointing out the great variety of viewpoints on EMU's institutional shortcomings, while he missed a discussion about its macroeconomic policy deficiencies. In his view, the EMU policy mix – rather than just being directed toward individual countries – should target the euro area as a whole, whose fiscal stance is still contractionary in the seventh year of stagnation. The frequent misdiagnosis of budget deficits as a simple matter of discipline ignores how they relate to economic growth.

Countering divergence through automatic stabilizers in EMU

László Andor, Hertie School of Governance, and former EU Commissioner for Employment, Social Affairs and Inclusion, argued that Europe's vicious circle of falling investment, economic stagnation, and erosion of human and physical capital cannot be broken without further reform of EMU. But as long as ever-greater surpluses in the core and internal devaluation in the periphery continue, Europe will remain stuck in its trap. The Five Presidents' report rightly emphasizes divergence as the main threat to EMU's very existence, but the proposals do not go far enough to reverse this development. Instead of relying on the IMF and ECB for euro area stabilization policies, he advocated deepening economic policy coordination to focus on policies optimizing growth and employment for the euro area as a whole. The legitimacy of more centralized EMU policymaking will require greater risk sharing and democratic accountability. Also, stronger common action is crucial to restore balanced economic prospects for euro area citizens. The euro area debt crisis has transformed European politics: far-right movements have been gaining in the north, and radical left movements in the south, and the pro-European mainstream has been shrinking while running out of political capital to undertake necessary EMU reforms. A dramatic cut in automatic stabilizers due to tightened economic governance led to the euro area recession of 2012–13, which was actually more brutal in terms of household incomes than the first recession of 2008–09. Unemployment and inequalities soared in particular in peripheral countries. Against this backdrop, then EU Commissioner Andor proposed a "Social Dimension of

EMU" in 2013, which mentioned a European automatic fiscal stabilization function. This proposal reflected his conviction that, without rules-based transfers, monetary union would disintegrate. Academic studies analyzed three main options for EMU-level automatic stabilizers: output gap-based schemes, a partial pooling of unemployment insurance systems and reinsurance for big shocks. Each of these options would have beneficial effects on economic growth and the most vulnerable euro area members, with each Member State deriving benefits over the cycle. Andor closed by saying that it is easier to change the Treaties than the laws of economics.

Automatic stabilizers

Francesca Carta, Banca d'Italia, presented a paper titled *A feasible unemployment-based shock absorber for the Euro Area.* In order to design a centralized shock absorber that stabilizes the business cycle, while being compatible and marked by limited cross-country redistribution, 72 different schemes were simulated and evaluated. The proposal builds on a notional euro area-wide unemployment insurance mimicking national-level insurance schemes by transfers at the macro level. It deals with problems of asymmetric information and moral hazard, recognizes subsidiarity considerations and restricts coverage to short-term unemployment and major shocks. The empirical results suggest that the best scheme would cover all unemployed at a replacement rate of 50% with a duration of up to eight months; its funding should be based on (dismissal) experience rating. Such a scheme would offer substantial stabilization without implying large and persistent cross-country redistribution; it could stimulate convergence in take-up rates and unemployment benefits across countries, with a positive impact on citizens.

Mathias Dolls, Centre for European Economic Research (ZEW), presented a paper entitled *An unemployment insurance scheme for the euro area? A comparison of different alternatives using micro data.* Counterfactual simulations for the EMU period quantified the tradeoff between automatic economic stabilization and cross-country transfers of a European unemployment scheme. The baseline features were: coverage of all new unemployed up to 12 months with a replacement rate of 50% and contributions from a payroll tax of 1.6%, which implied a relatively low budget of EUR 47 billion over the whole period. Such a scheme would have absorbed a significant fraction of the unemployment shock in the recent crisis in terms of household income, especially to the benefit of the young. Germany would have benefitted immediately after the introduction of the euro – the southern countries after 2008. A contingent benefit scheme that is only activated in the event of big unemployment shocks influences whether Member States are permanent net contributors or net recipients.

Coordinated wage policy

Paul Ramskogler, OeNB, delivered a presentation on *The trinity of wage setting in the European Monetary Union – a policy proposal*. He showed that in a currency union wage divergence results in external and domestic effects as nominal unit labor costs (ULC) are correlated with both current account balances and real GDP growth. The "golden rule" of internal stability seems to be insufficient for external stability in a heterogeneous EMU. Hence, he proposed a trinity wage benchmark comprising (1) an internal wage target (in line with productivity growth), (2) price stability (using the ECB target) and (3) a symmetrical external balance benchmark related to current account sustainability. Applying this model would have led to a lower divergence in current account imbalances and nominal ULC, with wages rising faster in Germany and more slowly in peripheral countries. While acknowledging the autonomy of social partners, nominal wage rigidities and non-price factors of competitiveness, this trinity rule will help achieve transnational stability within the currency union.

Bernd Brandl, University of Durham, presented the paper *The effects of institutional instability in collective bargaining: A long-term analysis of changing collective bargaining actors and structures*. The accelerated institutional reforms in collective bargaining (CB) structures evident since 2008 have often proved erratic and inconsistent. CB structures have differed widely for historical reasons: the corporatist perspective of the 1970s was later challenged by the "hump-shaped theory" implying optimality of either decentralized or centralized systems, followed by preference for coordinated intermediate systems and, finally, by a pluralistic consensus. The new European economic governance, however, merely pushes toward a decentralization and weakening of CB. Institutional reforms do not take transaction costs into account (loss in trust, efficacy). Empirical analysis has confirmed that instability is costly in terms of inflation and unemployment. Facing risks and uncertainty, policymakers should avoid repeatedly changing CB structures.

Capital market union

Régis Breton, Banque de France, presented a paper on *Monetary union with a single currency and imperfect credit market integration*. A monetary union is defined as a currency union plus a credit union. In EMU, retail credit markets largely remained in national domains and, as the crisis unfolded, a reversal of financial integration set in. Insufficient credit integration, however, undermines the benefits of the single currency. Governments cannot force banks to unify their credit policy if they are afraid of holding assets subject to different jurisdictions that might not automatically cooperate for collateral seizure across borders. When credit integration is insufficient, a currency union could be associated with higher

cross-border default incentives leading to more credit rationing and welfare losses. Reducing barriers to cross-border credit markets restores the optimality of the currency union.

Joseba Martinez, New York University, presented a theoretical paper titled *Does a currency union need a capital market union?* He examined whether banking union provides adequate insurance against asymmetric shocks. Assuming an idealized banking union with perfectly functioning credit markets (no spreads), credit-constrained borrowers and incomplete market clearing through prices, deleveraging shocks could have real economic effects. Whether a capital market union is a significant improvement over banking union depends on the type of shock: while banking union is key in a simple deleveraging shock, a capital market union offers added value in another normal type of shock. During major financial crises (at the zero lower bound of interest rates), a capital market union does not make much of a difference as such events call for more heavy weaponry.

Debt management

Giancarlo Corsetti, University of Cambridge, presented the paper *A new start for the eurozone: dealing with debt*. Despite severe fiscal retrenchment, euro area debt levels have not gone down and the risk premium genie is not yet completely back in the bottle. Worries about debt sustainability entailed growth problems and externalities for other Member States. Therefore, Corsetti proposed to designate a revenue source for debt buy-back through a temporary special redemption fund that is politically accountable at the euro area level. Dealing with legacy debt, this fund would bring all euro area countries out of the vulnerability zone in exchange for coordinated fiscal effort. It would issue partial Eurobonds, i.e. safe assets, to avoid sovereign market segmentation. Alternatively, the ECB could require from banks a diversification rule on euro area debt holdings in proportion to their share in euro area GDP. Financial markets would then issue risk-free synthetic assets in line with these ratios.

John Muellbauer, Nuffield College, Oxford, presented his paper entitled *Conditional eurobonds and eurozone reform*. He held that all it takes to switch the policy focus from austerity to productivity is rules-based risk spreads as derived from countries' fundamentals. Given the lack of democratic institutions for a fiscal union, technical solutions that create incentives through quasi-market signals are required. He proposed conditional eurobonds for all new borrowing that come with a collective underwriting guarantee and administratively set risk premiums based on economic fundamentals (i.e. unit labor costs, public and private debt, growth and inflation as well as house prices). Modeling how these fundamentals affect future growth showed a positive impact of competitiveness and low relative inflation, and a negative one of fiscal austerity and overshooting housing prices. In contrast, debt

levels proved relatively unimportant for growth until they became very high. Muellbauer's proposal would reward labor and product market reform.

Public investment

Achim Truger, Berlin School of Economics and Law, presented his paper titled *Implementing the golden rule for public investment in Europe,* stating that the golden rule for debt-financed public investment is compatible with intergenerational fairness, as the following generation will also benefit. Although a pragmatic definition of public investment could comprise education, childcare, social work and integration, he took traditional investment in national accounts (mainly tangible assets) as a starting point. There is a clear economic case for public investment, as it boosts short-term growth through a high multiplier and its implied marginal (long-term) returns are substantial. In the EU fiscal framework, net public investment could be deducted from relevant deficit numbers of the Stability and Growth Pact. Since such a change would require a unanimous Council decision, a "silver rule" (labeled by WIFO Director Karl Aiginger) could in the meantime help governments undertake fiscal expansion by building on flexibility within the existing rules.

Zsolt Darvas, Bruegel, presented a paper titled *In sickness and in health: protecting and supporting public investment in Europe.* He proposed an asymmetric golden rule which would apply in a deep recession but not in good times. In his view, a golden rule is justified as public investment has declined dramatically during the crisis in the EU, while expanding in the U.S.A. and in other economies. Multipliers tend to be larger in recessions (exceeding 2 in deep recessions), which means that investment cuts are self-defeating. Arguments against the golden rule should also be taken into account, though, as it tends to maintain deficits for too long, leads to distortions toward physical infrastructure, renders it difficult to select the items it refers to, might incentivize cheating and involves insignificant amounts. Applying the rule only during a recession lowers the risk of reclassification. A more ambitious version would be a European instrument for cyclical stabilization.

Fiscal capacity

Paolo Pasimeni, European Commission, presented a paper entitled *The economic rationale of an EMU fiscal capacity.* He proposed a fiscal capacity linked to the Member States' intra-EMU external positions in order to cope with EMU's tendency to endogenously create imbalances and with its inherent deflationary bias. The negative correlation of the twin divergences in current account positions and unemployment rates among euro area countries suggests a cruel tradeoff in EMU: either growth with imbalances, or balance without growth. Although exports from

surplus to deficit countries benefitted from a "transfer union by financial markets" in the pre-crisis period, the adjustment after the "sudden stop" was asymmetrically undertaken by deficit countries alone. The resulting procyclicality and the lack of countervailing expansion in surplus countries evidenced EMU's inherent deflationary bias. Resolving this dilemma, a fiscal capacity financed by surplus countries would mitigate external imbalances and help correct them as well as improve demand management of the euro area aggregate.

Agnès Bénassy-Quéré, Paris School of Economics, gave a presentation on *Making sense of the fiscal union: a budget for the eurozone?* Of the key functions of fiscal federalism (allocation, stabilization and redistribution), the Five Presidents' report focused only on stabilization. So far, EMU has featured procyclical discretionary fiscal policy, heterogeneous automatic stabilizers, asymmetrical fiscal discipline and no instrument for the aggregate fiscal stance. There are three options: First, national policies could be improved by a symmetric notion of discipline (requiring deficits in surplus countries) or by allowing for some discretion (steered by a European Fiscal Board). Second, the ESM could automatically extend precautionary credit lines. Third, a federal instrument for macroeconomic stabilization could make countercyclical expenditures and back stabilization mechanisms (banking union, labor mobility), or it could even be a fully-fledged budget for allocation (e.g. refugees) and redistribution (humanitarian support for countries under stress).

In her wrap-up, *Sonja Puntscher-Riekmann*, Salzburg Centre of European Union Studies, referred to her upcoming research project on Member States' preferences for the future of EMU, arguing that political discourse matters as much as, if not more than, economic reasoning when it comes to the feasibility of EMU reform. She recalled that with any reforms proposed in recent years, progress has been limited and resistance severe. She agreed with President Juncker's statement that there is too little union in this Union. Too much focus has been put on comparing national positions instead of promoting the narrative of the euro area as a whole. Placing too much emphasis on electoral concerns will lead nowhere as there will be an election somewhere in Europe at any given time. It would be much more fruitful for political leaders to explain to their constituencies what needs to be done. Integration by stealth is probably over. Hiding in epistemic communities will not make Eurosceptic parties go away. Instead, it is time to engage in a thorough public debate.