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Which path leads to a reform of the euro?

Report of the Expert Group Future of the Eurozone, taking place at the International Expert Conference "Europe on the Move? Towards a progressive future!" of the Heinrich Böll Foundation on May 18, 2018

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Abstract:

Experts are largely in agreement that the euro must undergo further reform if it is to endure economically and politically. Exactly what path to reform it must take is a source of contention, however, especially in terms of the specific instruments and how they are communicated politically. This report collates arguments raised during the expert debate, identifies lines of conflict but also common ground, as well as paths to political reform which appear viable beyond the boundaries of the political camps. The report argues in favour of first achieving more clarity as to the aims of the euro reforms before debating their institutional arrangements in detail. The lack of clarity as to their function nurtures distrust and political resistance. It is not the instrument itself but the political goal that must take centre stage in the discussion. In addition, the report recommends using the EU's budget potential to strengthen the common currency. The current debate surrounding the EU's Multiannual Financial Framework (MFF) offers a solid opportunity for setting new priorities in this area.

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On 18 May 2018, experts from various countries in Europe gathered at the invitation of the Heinrich Böll Stiftung to discuss the state of the European Economic and Monetary Union. What is their assessment of the stability of the common currency and where do they see room for improvement?

Only satisfactory on the surface: the status quo

There was widespread consensus that, in spite of the current sound economic growth, the monetary union is in need of additional far-reaching reform. Economic aspects play an important role in this process: on the one hand, the participants believe that Europe's recovery is, in large part, due to external factors such as the relaxed monetary policy adopted by the European Central Bank, a weak euro and a low oil price. On the other hand, the recovery has been uneven. Although the average number of jobseekers in the EU is only slightly higher than at its pre-crisis level, this obscures the high youth unemployment rates found in a number of countries – especially in southern Europe.

Added to this come structural weaknesses in the architecture of the monetary union: the economies represented in the euro area continue not to even out economic imbalances automatically. Doing so would require either transfer payments or more far-reaching economic integration. Disparities in competitiveness and unilateral capital flows, which are reflected in the current account balance, therefore continue to have destructive potential. In the long term, these can – as happened during the last crisis – lead to certain countries slipping into excessive debt. The member states of the euro area currently tackle the issue by aiming for a current account surplus. However, several participants expressed their concern that a substantial surplus throughout the euro area might be unacceptable for the rest of the world – especially for the USA under President Trump.

The expert group also cited alarming political developments. The disappointment felt by many citizens at how the economy is developing and by a growing euroscepticism in the majority of member states was highlighted as arguments showing that swift action was necessary. At the same time, the ability of the President of France, Emmanuel Macron, to keep his country on a lasting, pro-European course is, in the view of many, dependent on what achievements can be made in reforming the European Union, even though these do not necessarily need to be attained within the common currency. There was disagreement as to whether the European Central Bank could step in a second time to save the euro if a crisis were to arise in the future or whether a political authority would be required.

Against this backdrop, a comprehensive reform of the monetary union would appear to be an absolute necessity. A debate also ensued, however, as to the risks that such action would entail. Reform fatigue among the German population, coupled with their waning approval of the European project, were repeatedly cited in this context. On the other hand, participants also pointed to polls suggesting that forty percent of all Germans do not regard Macron's reform proposals as being too far-reaching. In this context, politicians were called upon to compile a constructive reform agenda and advocate their own proposals rather than merely criticising approaches adopted by other countries. The political parties in Germany were especially attributed with being void of substance in this regard.

Conflicts on transfers and on communication strategies

The need for transfer payments played a key role in the discussion. Whilst some participants characterised substantial cash flows from richer to poorer regions within the monetary union as absolutely essential for it to function, others expressed deep scepticism as to their necessity and political feasibility. On numerous occasions, parallels were drawn to redistribution mechanisms in federal states such as the USA and Germany. Those with a positive assessment of the *Länderfinanzausgleich* – Germany's financial equalisation scheme between the Federal Government and the *Länder* – also tended to have a more optimistic view of the effectiveness of European transfer payments.

Closely linked to the subject of redistribution was the discussion concerning the appropriate form of political communication. Some participants were of the opinion that the German population needed to be given a wake-up call by presenting them with drastic images to highlight the risks involved in a potential break-up of the monetary union and by publicly discussing specific proposals for transfer payments. In turn, others viewed such an approach to be counter-productive and advised avoiding loaded words harking back to Europe's debt crisis. From this perspective, reforming the monetary union needs a narrative where mutual accusations of an excessive running-up of debt and excessive current account surpluses are not the focal point but rather a positive vision that readily and comprehensibly illustrates what the EU would achieve through extended powers and funds.

Countries in central and eastern Europe that have yet to introduce the euro perceive tighter integration within the euro area, especially through a separate eurozone budget, as a threat. Some participants saw a danger of political and economic marginalisation. Access to financial support, such as the EU Structural Funds, could especially deteriorate in the future if the wealthier member states do not shift their focus to supporting weaker euro area countries, it was argued. This, in turn, could turn the mood within the population against the EU and ultimately call the European Single Market into question.

Unity on the subjects of the EU budget and national debt

The bulk of the expert group was of the opinion that a larger EU budget would aid the stability of the monetary union. Unlike a eurozone budget, it would avert the risk of non-euro members being pushed to the side. Here, too, however, the question was raised as to the purposes for which the funds would be used and what budgetary priorities should be set.

The roundtable was undivided in its opinion that any proposal to raise EU expenditure or transfer payments must specifically stipulate the aim of the measure in question: should the economy be stabilised in times of crisis? Should social hardships be mitigated? Will the EU assume tasks otherwise performed by the nation states, which it is more capable of performing than the individual members? Similar demands were made in respect of the specific institutional reforms, such as the European Monetary Fund (EMF). When should the EMF interject? Should it take on a disciplinary or supportive function, and using what instruments?

Many participants advocated the option of restructuring the national debt accrued by euro members. Very high debt levels in certain countries were not only identified as a risk factor should panic break out on the financial markets but also as a reason for a disparate distribution of power among the euro members. If the divide into creditor and debtor nations becomes entrenched, the monetary union will become politically fragile. The experts were also in agreement that any exits from the euro must be categorically ruled out, as obscurity on this point would heighten any future crisis. There was disagreement on the issue as to how debt reduction should be achieved. Some called for the ECB to adopt an active role, which they believe should buy up debts and allow these to be forfeited. Others called for a structured process under European supervision. Ad-hoc solutions, such as those in Greece, were also discussed.

Although the banking union was only addressed superficially, several participants emphasised its stabilising effect on the euro area and called for the banking union to be finalised through a common deposit guarantee and a backstop for the Single Resolution Fund. At the same time, participants reminded others that the restructuring and resolving of ailing banks must be conducted transparently despite the time constraints.

Debate the goals not the instruments – the path to reform

In spite of the participants' different geographical and political backgrounds, specific recommendations for further developing the monetary union can be derived.

Political communication is key. The experts are largely in agreement that the common currency remains imperfect and susceptible to risk. The reforms undertaken to date do not go far enough and, in the view of many EU member states, Germany's contribution to overcoming the crisis has been inadequate thus far. Conveying this message to a wider audience in Germany poses exceptional challenges: firstly, the crisis has gone virtually unnoticed in Germany and many citizens today are already under the impression that Germany has surpassed its obligations and become a role model in the euro area. Secondly, the impression must not be given that the common currency is beyond help and that focus must now be placed on damage limitation as opposed to further development.

With regard to content, it is important to set priorities in the decision-making process. First the aims of the reforms must be clearly fleshed out before their institutional arrangements are discussed. A wealth of political instruments is currently up for debate although their purpose is not entirely clear. For example, participants were unable to reach a consensus as to whether an EU finance minister would, first and foremost, bring discipline to national budgets or distribute European funds. Proposals such as the European Monetary Fund and the eurozone budget are facing a similar problem. The obscurity as to their function serves to nurture distrust and political resistance. It is not so much the instrument itself as the political goal that must take centre stage in this discussion. Were substantive goals, such as more effective coordination of economic policies, a swifter suppression of market panics or enhanced democratic legitimacy, to be made the centre of the issue, more flexibility would ensue in terms of the instruments, thus giving rise to greater potential consensus for their implementation.

Many issues with the euro area could be tackled within the EU as a whole, which would also cater to the concerns held by non-euro member states. The EU budget in particular offers great potential for realising this. The European Commission's current proposal of a Multiannual Financial Framework already includes a fund reserved for aiding reforms and offsetting economic shocks. This "eurozone budget" is available to all EU member states. However, it is far too small to have any impact in practice. This is, above all, due to the influence of the EU net contributors, which include Germany and France. They are seeking to pursue a continued restriction of the budget to one percent of the EU's gross national income. This limitation is curbing any realignment of the budget, as new expenditure can only be funded if cuts are made in other areas. It is equally misguided inasmuch as national tasks would be shifted to the European level and thus additional expenditure for the EU would be juxtaposed to cuts in national budgets.

That being said, the debate surrounding the EU budget must not be allowed to become enveloped in a dispute about the volume of expenditure but must clearly specify how additional funds could aid a more stable common currency. Again, it is worth making the argument from the perspective of the political goal. Disparities in competitiveness can be absorbed in part through higher structural funds. A common reserve fund for times of crisis can help counter highly detrimental mid-term cuts in public investments. By way of an alternative, the revenue system could be remodelled to ensure that contributions made by a country in times of crisis are curtailed. The clearer the political instrument is pegged to the purpose, the easier it is to explain to citizens.

Quite apart from all the merits of specific proposals, the monetary union will nevertheless need to face up to fundamental questions in the mid-term that were repeatedly hinted at in the arguments put forward by the expert group: should the member states divest more responsibility to Brussels and, as a quid pro quo, receive greater assistance when necessary? Or should they be given greater decision-making authority but be left to their own devices in times of crisis? Could both of these principles be combined?