Diverging or Uniting Europe?

We asked each of the speakers of the Workshop 3 questions about their statements. The answers can be found below. The Workshop was to discuss the situation and future of the EU and especially the Euro Area in the middle of a deep crisis. It is highly controversial among politicians as well as academics which way or ways out should be sought. Against this backdrop IMK organized its “Future of Europe” workshop bringing together academic scholars of economics and political science to discuss the relevant issues. The debate addressed several fundamental questions on a future Europe. A critical assessment was made of the economic policies implemented so far, because measures taken have deepened the rift among member countries rather than bridging it. This immediately leads to the question whether the Euro can be saved as a common currency. The structural heterogeneity of the Euro area with respect to wage and price formation as well as economic policy approaches speaks against it. It is difficult in the absence of convergence-promoting policies to preserve monetary stability under these circumstances. On the other hand, the growth potential of a joint currency and the undisputed high costs of a break up were seen as arguments in favour of keeping the Euro.

All this happens in a situation where uncertainty is significantly enhanced. Financial investors are desperately seeking safe assets they cannot find anymore. The reason is that government bonds can no longer play this role under new default rules. While some scholars find this appropriate to avoid moral hazard problems that might encourage national governments to get over indebted, others see it as a source of increased uncertainty that hampers investment and growth. This issue is a special case of more general question of utmost importance: Should European politics be re-nationalised or must it become more integrated to preserve a stable Europe, given that the status quo is not sustainable. The former provides a chance to reconcile diverging national interests with at least a reduced form of a European community. The latter would establish a new kind of European stability which results from a truly European perspective beyond national interests. A crisis in its original meaning is a situation where decisions have to be taken that will lead one way or the other. Presently it is still far from obvious which way should be taken. This suggests that the crisis will continue.
SHOULD EUROPEAN POLICY BECOME NATIONAL AGAIN?

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1. What do we need in the Euro area? A step back with a more renationalized policy approach? Or do we need further Europeanisation of policy?

The idea to renationalize risk as well as governance within the EMU, as represented by Philippe Legrain, Simon Wren-Lewis, Martin Sandbu and others, is tempting but in my view wrong. Renationalisation could be the optimal solution in case the door is entirely closed towards fiscal union. But even a partial fiscal union is superior to renationalisation (while keeping the single currency). Renationalisation would require a sophisticated risk management and resolution mechanism, in order to avoid that small and medium size member states appear again as “too big to fail” and trigger ad hoc sovereign lending solutions with counter-productive conditionality (such as in 2010). Renationalisation does not offer solutions to divergence which is the main threat to the sustainability and legitimacy of the EMU. If, however, the banking union cannot be completed and fiscal union cannot be launched, renationalization probably remains the only option, but at the end with the renationalization of currency as well.

2. In what fields do you see the necessity to change the European policy approach?

First of all, I do not think EMU reform can continue as a slow motion, incremental process. The Eurozone has not recovered properly from the long recession and we are headed towards the next downturn without having sufficiently reinforced our structures. At the same time, the Eurozone periphery, and especially Southern Europe still struggles with the social and political consequences of the crisis. Governability is in question in several countries. Hence the need for a more comprehensive approach to reforming and reinforcing the single currency, if we want to save it at all. The key question is how to create a (counter-cyclical) fiscal capacity through a combination of possible elements, like further relaxation of fiscal rules, establishment of automatic stabilisers, and the appointment of a eurozone finance minister.

3. What would be the benefits of such an approach?

Any major step towards a Eurozone fiscal safety net would trigger positive reactions from the financial markets, which always looked at the periphery countries with suspicion in the absence of clear commitment from the community as a whole to maintain solvency and integrity. Completing the banking union with deposit insurance would make it truly effective, and automatic fiscal stabilisers can reduce the negative economic and social impacts of any future downturn. Of course, the design of such schemes would matter a lot, but the tremendous expert work of the recent years has delivered sufficient preparations for rapid decision making, when the political momentum emerges for that.