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Completing the EMU – the next steps

Towards greater resilience and stronger recovery capacity through developing unemployment insurance in the eurozone

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This paper argues that

- Europe's monetary union is still in the danger zone
- Broader questions on EMU architecture and governance are waiting for answers
- EMU 1.0 came to an end in 2012 because its design flaws were not addressed earlier
- EMU reconstruction has begun, but remains incomplete and this is dangerous
- Strengthening the social dimension of the EMU has become a necessity
- Recent measures can secure growth in the short run but not long-term sustainability
- Without automatic stabilisers the EMU will not overcome its dangerous divergences
- Options for automatic stabilisers exist, calling for political consideration and decision
- A workable model for a basic European unemployment insurance scheme has been designed
- Basic European unemployment insurance constitutes the best option
- Solidarity within the EMU matters for both economics and politics

This paper follows-up on earlier articles and speeches of the author on the same subject:

- Basic European Unemployment Insurance - The Best Way Forward in Strengthening the EMU's Resilience and Europe's Recovery, Intereconomics Volume 49, July/August 2014, Number 4
- Can we go beyond the Maastricht ortodoxy? In. voxeu.org 13 December, 2013
- http://www.voxeu.org/article/can-we-move-beyond-maastricht-orthodoxy
- Is high unemployment here to stay? In. Europe's World, March 26 2015, Spring 2015
- Speech at the ETUC Conference „Celebrating the past, looking to the future", Europeans want and deserve a monetary union with a human face (Madrid, 28 January 2013)
- Speech at the Hertie School of Governance (Berlin, June 2014)
- Speech at the Vienna University for Economics and Business (Vienna, September 2014)
- Speech at the University of Helsinki (Helsinki, October 2014)

Europe's monetary union is still in the danger zone

European monetary cooperation disintegrated twice: in the early 1970s, and in the early 1990s. The fact that national currencies have been abolished inside the euro area in itself is not sufficient guarantee against another disintegration.

The recent crisis has seen waves of speculation against one or several members of the EMU, risking a chain reaction of withdrawals and the spectre of deconstruction, despite unprecedented sacrifices people have made for sustaining the single currency and the membership of their country in it.

A possible break-down, or dissolution of the euro has been mainly discussed in terms of a crash of one or several member states and the resulting need to introduce a new national currency. This is, however not the only way the single currency could die.

Just like the life of humans can end in various ways, a currency union can also be a victim of different diseases. Through reforms (notably the Banking Union) and one-off, discretionary measures (by the ECB mainly), the risk of a heart attack has been diminished. However, the risk of cancer is still there, and has probably increased in the meantime.

The divergence that has developed within the euro area between core and periphery is the main threat to the existence of the single currency and to the stability of the EU as a whole. Hence, there is a need for further strengthening of the EMU architecture, and in particular to strengthen its social dimension.

This ambition goes beyond securing the short-term survival of the single currency. The longer-term economic performance and social outcomes of the EMU have to be improved significantly. Without such an improvement, rising nationalist sentiment will continue to turn against either the single currency, or the European Union, or both.

Therefore, the next period should see the development of a forward-looking, though limited mechanism of solidarity that would strengthen people's and markets' confidence in Europe's monetary and political union. In the next two years, there is a window of opportunity to discuss a substantial reconstruction of the EMU and to make some crucial steps in practice.

The work ahead should not only focus on avoiding another heart attack, but on changes needed for truly improving resilience, performance and cohesion in Europe. Should this process conclude with a major step towards risk sharing within the EMU, citizens, markets and all other stakeholders would understand that the commitment of member states to the single currency is real, and the process is irreversible?

Better governance is necessary (e.g. enforcing adjustment in surplus countries), but in the absence of risk sharing instruments, political support for handing over competences to a stronger governance structure at the EU cannot be taken for granted. Proper functioning and public acceptance of the EMU can only be guaranteed if steps to strengthen discipline, solidarity and legitimacy are taken simultaneously.

Broader questions on EMU architecture and governance are waiting for answers

Before leaving office, Commission President Jose Manuel Barroso identified EMU reform as the most important task for the next period[2]. And shortly after entering office, in February 2015, President Jean-Claude Juncker submitted an "analytical note[3]" to the European Council about the deepening of the EMU. Reactions to this document, and its follow-up in June 2015 will determine the directions of thinking and policy on EMU reform in the foreseeable period.

2 JMDB: On Europe. Speech at Humboldt University, 8 May 2014.

3 The analytical note was prepared in close cooperation with European Council President Donald Tusk, Eurogroup President Jeroen Dijsselbloem, and European Central Bank President Mario Draghi. It doesn't call for separate institutions, or a budget for the eurozone, or mention a potential EU treaty change. But it does raise a number of questions which potentially lead in those directions.

Indeed, the last five years have transformed our system tremendously, implicitly or explicitly questioning established views or mechanisms, and some fundamental questions are now awaiting answers. For example, we need to ask ourselves whether the EMU in the foreseeable future can manage its financial and fiscal stability without the assistance of the International Monetary Fund. In 2009-10, IMF involvement was not automatic, and reliance on IMF facilities should be seen as an imperfection.

Secondly: can Europe return to a more consistent application of the no-bailout principle? What would improve the credibility of this rule, and what should be the appropriate role of bankruptcy procedures within the EMU?

Third: can the EU retain the close link between the EU as a single market and the Eurozone as a monetary union? Or should we accept in more general terms that the euro and the EU are two distinct projects? At the time of Delors, there was no separation between the deepening of the single market and the creation of the single currency, and the gap that has developed raises a number of questions, especially in connection with the vision of a political union.

There has been a widely shared understanding since 2010 that the reinforcement of the EMU requires stronger cooperation, i.e. "more Europe". The latter, however, has been seen as a difficult political task in the face of rising euroscepticism and welfare chauvinism. The paradox involved is the following: the longer the EMU is allowed to malfunction, the more ammunition will be provided for anti-euro parties that claim that having a single currency is not the best scenario for Europe.

Leadership is required to promote solutions that may not sound obvious, but which are necessary to leave behind the quagmire. We need less muddling through and more systemic reform for a proper European recovery. The EU cannot live together for too long with the risk of monetary breakdown, which also would mean social and political breakdown.

With the status quo more and more unsustainable economically and politically, the EU has to choose between monetary deconstruction and reconstruction. The first would compromise some of the key principles of the EU. The second means sorting out the fundamental problems that have caused losses to our economies and frustration to our societies in recent years. Choosing this alternative means going to the root causes of our economic, social, and now also political troubles.

EMU 1.0 came to an end in 2012 because its design flaws were not addressed earlier

Lessons of monetary instability from the 1970s and the early 1990s did not feed into the new design process of the EMU in the early 1990s. The Economic and Monetary Union was enshrined in the Maastricht Treaty of February 1992, foreseeing the creation of a European Central Bank and launch of a single currency at the end of a convergence process. Concerns about the need for a fiscal capacity or a political union were ignored or sidelined[4].

It was assumed or hoped that individual national governments would always be able to conduct the right fiscal policy for their country, by tightening budgets in good times and accumulating debt in bad times. It was also assumed that the free movement of finance would work towards some kind of equilibrium. The focus on fiscal rules was reinforced by the establishment of the Stability and Growth Pact in 1996-7.

The weaknesses of the Maastricht design were exposed by the financial and economic crisis of the last decade, but not immediately. In fact, Europe managed to mitigate the fallout from the 2008 financial market meltdown better than the United States. However, as the banking crisis started to translate into a sovereign debt crisis, Europe's monetary architecture started to unravel.

Since the onset of the sovereign debt crisis in 2010, economic developments in the EU decoupled from the rest of the industrialised world. Further macroeconomic instability and a second European recession can only be explained by the incomplete design of the EMU 1.0, since it lacks the key instruments which countries have historically used to generate a recovery, and offers nothing to replace them.

Expansionary[5] fiscal policy in response to the 2008-9 financial crisis did not create a crisis of confidence around the EMU and the single currency. On the other hand, inconsistent measures following the revelation of Greek insolvency risk did. The EU response to the Greek insolvency crisis in 2010 was meant to put an end to financial instability. In reality, it turned out to be the beginning of the end phase of EMU 1.0 as it had been established in Maastricht.

Instead of containing the crisis, the Greek bailout was followed by similar interventions in Ireland and Portugal within one year. Speculation continued about sovereign debt restructuring and about possible exit of various countries from the euro zone, meaning that interest rates in the euro zone 'periphery' climbed to very high levels.

4 By comparison, another monetary union was being created in Europe in the early 1990s that was set up quite differently. It was the monetary union between East and West Germany, which was from the beginning founded on the acceptance of lasting fiscal transfers. Public spending would help to keep up aggregate demand in East Germany when many companies became uncompetitive under the Deutsche Mark and many working-age people moved to the West. Certainly, Germany is a country while Europe is not a country. But it is still remarkable that two very different monetary unions were launched in Europe nearly at the same time: one complete with political union and a very strong fiscal pillar, and the other one incomplete, with no collective mechanism for economic policy-making and no fiscal capacity at all.

5 When the global crisis escalated in autumn 2008, following the fall of Lehman Brothers, European governments agreed a coordinated stimulus known as the European Economic Recovery Plan, amounting to €200 billion or 1.5% of GDP, including through temporarily increased deficits of national budgets. Governments paid unemployment benefits to people who lost jobs, tried to maintain investments and refrained from raising taxes. This stimulus helped Europe to overcome the first deep recession, but could not be followed up in many countries when the sovereign debt crisis hit in 2010-11.

EMU reconstruction has begun, but remains incomplete and this is dangerous

In 2012, the Presidents of the European Council, the Commission, the ECB and the Eurogroup came forward with a long-term plan for the reconstruction of the EMU. Monetary reform became a key component of the EU recovery strategy.

The creation of a fiscal capacity at the level of the EMU was clearly foreseen in the Blueprint[6] for a deep and genuine EMU, which the European Commission put forward in November 2012. The subsequent report of the Four Presidents specified that such fiscal capacity should help the EMU to be able to absorb economic shocks.

As a first step in EMU reform, a banking union is in the process of being implemented, which will hopefully relieve pressure on government bailouts of major banks thanks to the application of the bail-in principle and a Single Resolution Mechanism at the European level, based on a strengthened common rulebook. To the extent that the banking union can be trusted to perform equally for all its Member States and their banks during financial crises, it would reduce financial fragmentation in the Single Market already today.

However, our minimalist banking union will do little to mitigate the EMU's bias towards internal devaluation as the predominant adjustment mechanism during balance-of-payments crises. Moreover, so long as sovereign debt levels in Europe remain high, governments may still find themselves forced towards pro-cyclical fiscal consolidation in times of a downturn.

Coordination of fiscal and structural policies within the EU was strengthened through the European Semester, the Six-Pack, Two-Pack and the Treaty on Stability, Coordination and Governance with the intention to reassure financial markets of the Member States' commitment to the EMU. However, many other elements of economic and political union remained lacking.

In the absence of a fiscal stimulus, a lender of last resort or revaluation within Europe's 'surplus' countries, countries experiencing balance of payment problems inevitably needed to undertake a devaluation in order to regain cost competitiveness and start attracting capital again. Indeed, the only option for the 'deficit' countries consistent with keeping the euro at that juncture was to pursue deep internal devaluation (and in some cases accept emergency bailouts), with clearly adverse effects on employment and the social situation.

The sovereign debt crisis since 2010 and the consolidation strategies implemented in response to it have weakened the effectiveness of automatic fiscal stabilisers at the national level, i.e. the ability of a state to immediately act in a countercyclical way as tax revenues drop and social expenditure increases. Because of the lack of a lender of last resort, a central budget or at least coordinated policies aiming to uphold aggregate demand across Europe, the sovereign debt crisis became an existential crisis of the monetary union, and of the EU as a whole.

The incomplete EMU proved to be – at best – a structure for fair weather, but not for a financial and economic crisis. It represents a competitive disadvantage for Europe vis a vis the US and Japan. The excessive burden of adjustment in peripheral regions will continue to erode political support for the single currency, and the eventual break-down will only be a question of time.

Strengthening the social dimension of the EMU has become a necessity

Simultaneously with the establishment of the Banking Union, the social dimension of the EMU was looked at[7], driven by the understanding that the sovereign debt crisis since 2010 and the fiscal consolidation strategies implemented in response to it have substantially weakened the power of the welfare state. In particular, they have weakened the effectiveness of so-called automatic fiscal stabilisers at the national level.

Unemployment increased to 11 percent in the EU and 12 per cent in the euro area in 2013, but it became twice as high in the Eurozone periphery.

In adjusting countries, where economic growth was negative and unemployment was on the rise in 2011-13, poverty has also risen significantly. Demand for the services of food banks has grown and many young people lacking opportunities choose to emigrate, often to other continents, which by definition results in a loss of human capital for Europe as a whole.

The resulting social crises cannot be considered as a matter of subsidiarity. Social policy alone, even if national welfare systems are reformed, cannot handle the social consequences of the Eurozone crisis. Given the constraints which membership in a monetary union implies, it is fundamental to re-create possibilities of macroeconomic adjustment inside the euro zone whereby aggregate demand and economic growth can be maintained.

Divergences between the core and the periphery of the Eurozone (also called North-South imbalances) are a lot more dangerous for the sustainability of the EMU and the stability of the EU than East-West imbalances. The latter are linked to the wide income gap between old and new member states, which despite the crisis, have continued to diminish in the last five years.

When the Commission introduced a scoreboard in October 2013 of key employment and social indicators, this demonstrated that overall unemployment and youth unemployment and inactivity, along with income inequality and poverty all showed significant and dangerous divergence during the crisis, especially inside the euro area.

Why did Europe become so divided in terms of economic and social outcomes? A key factor has been the design of our EMU, with monetary policy being centralised at the European Central Bank, but fiscal and structural policies being predominantly under the responsibility of national governments, without there being any eurozone budget in

6 The Blueprint gave evidence that the Commission understood the root causes of the crisis and the necessity of reconstruction, even if it was bound to remain a rather technocratic document, as compared to the more political Thyssen report in the European Parliament, also encompassing the social dimension.

7 See European Commission Communication on strengthening the social dimension of the EMU, October 2013

place. This means that instruments that were historically used to limit the social impact of crises were not available any more, while there has been nothing newly introduced to replace them.

What this means is that without adequate macroeconomic intervention capacity, only limited temporary results will be achieved. Better governance and a stronger coordination of social policies are possible, but insufficient to restore the potential of convergence.

The social dimension of the EMU is crucial for the legitimacy of the European project but also – given the deep integration of our policies – for the legitimacy of Member States policies. But, it cannot be pursued in the same way as the social dimension of the single market. The latter is mainly a question of legislation, while strengthening the social dimension of the EMU is fundamentally a question of financial and monetary instruments.

Recent measures can secure growth in the short run but not long-term sustainability

As the new European Parliament and Commission were formed in 2014, the economic policy debate shifted to three key steps, all with a potential to improve economic performance. First discussions about the risk of deflation paved the way for the ECB to launch quantitative easing in the first quarter of 2015. As early as November 2015, a new investment plan (Juncker Plan) was announced in order to use the European Investment Bank and its leveraging potential for boosting investment. Simultaneously, a fine tuning of the fiscal rules allowed the Commission to take into account cyclical components of the macroeconomic situation and structural reforms.

These measures are all important to help Europe avoiding a third recession and the euro to survive the long crisis. However, all three have their limitations, therefore this package still falls short of putting the EMU on a truly sustainable basis.

Focusing on somewhat greater fiscal flexibility in the short term still cannot address the continuing fragility of the EMU and its bias towards internal devaluation as the predominant mechanism of adjustment to macroeconomic shocks. Somewhat greater leeway for national fiscal policies could temporarily support growth in some countries which are relatively close to the core of the euro zone, but it would not help those who have just exited adjustment programmes or are still implementing them.

Crucially, even a hypothetical 'investment clause' or a softer comparable mechanism would not really strengthen the resilience of the EMU against financial crises or other asymmetric shocks. It would not fix the problem of Eurozone governments facing the financial markets all on their own and being forced to respond to downturns with pro-cyclical fiscal consolidation. In other words, it would be a poor substitute for a genuine, sustainable solution.

The Investment Plan rightly puts new investment into the focus of economic policy, but requires further work to identify sectoral and geographical priorities, and an explicit link to the Europe 2020 strategy. The approach of overselling weak solutions has been tested with the 2012 Compact for Growth and Jobs: the results could be seen in outcomes of the 2014 European elections, and it should be avoided in this case.

The 2015-6 period, when presumably neither market hysteria, nor major Eurozone country elections put pressure on EU decision making, should be used for proper systemic improvements in the EMU architecture, beyond one-off and discretionary interventions. Only in this way the model can become more convincing for markets as well as citizens.

In order to strengthen economic confidence in Europe and people's trust in the European project, further serious steps are needed to strengthen the EMU's resilience against financial and economic shocks[8]. In particular, the EMU needs to become able to cope with economic shocks in a way that would be acceptable from the viewpoint of the EU's Treaty objectives such as balanced economic growth, full employment and social progress.

The ECB should be explicitly empowered to act as a true European institution and consider employment as much among its goals as price stability. However, monetary policy alone will not offer a full solution. Developing a fiscal capacity appears to be the most obvious step to deal with cyclicality and asymmetries, and thus boosting resilience and cohesion.

Without automatic stabilisers the EMU will not overcome its dangerous divergences

Making the EMU more resilient requires equipping it with a well-designed mechanism of fiscal transfers between Member States using the euro. Through such a scheme, it should be possible to create a European safety net for the welfare safety nets of individual Member States, strengthening the ability of national governments to support an economic recovery.

In a deflationary environment, a protracted period of low or negative growth will cause the decline of both human and fixed capital, which will in turn undermine the EU's growth potential. Unemployment caused by a cyclical downturn will become structural if the downturn is not tackled in time. Given the very limited chances of overcoming such imbalances through increased labour mobility in the EU, a rule-based stabiliser mechanism becomes a very desirable solution.

There are solutions capable of sorting out the macroeconomic bias against full employment in the EU, even though the political complexity of implementing these solutions should not be underestimated. The EU is, however, in a race against time if it is to make the single currency sustainable and legitimate. Discussion of automatic stabilisers and

8 The lack of sustainability of the somewhat reformed "Minimalist Monetary Union" is explained by Enderlein, Henrik, Joachim Fritz-Vannahme and Jörg Haas: Repair and prepare: Strengthening Europe's economies after the crisis, 30 January 2015, http://www.delorsinstitute.eu/011-20891-Repair-and-prepare-Strengthening-Europe-s-economies-after-the-crisis.html

EMU reform in general should therefore be seen as urgent, even if the necessary political momentum is not currently visible.

If short-term shocks and private sector deleveraging cannot be mitigated by autonomous monetary policy, they have to be absorbed by fiscal policy. Structural reforms cannot be the main answer to cyclical developments. Fiscal instruments are needed not to replace but to supplement other adjustment mechanisms, like structural reforms and labour mobility.

Structural reforms play an important role to respond to crisis but they primarily provide a boost to long-term growth potential, without a short-term capacity to stimulate the economy. In the history of emerging economy financial crises, they have always functioned in combination with currency devaluation.

Labour mobility in principle (in textbooks) offers a solution to imbalances, but in reality it can only play a minor role, especially in such a fragmented labour market as the EU. The euro zone crisis has triggered new migration of workforce, but often towards other continents, causing a long-term human capital loss to the EU.

An automatic stabiliser at the EMU level would help uphold aggregate demand at the right time, and it would help prevent short-term crises from unleashing longer-lasting divergence within the monetary union. It would provide an answer to the simple question of a disillusioned European voter: 'Where is Europe when we need it most?'

At the same time, a fiscal stabiliser would not represent 'more Europe' for its own sake, and certainly not more intrusion of Brussels into national policy-making. It would constitute a mechanism that strengthens the autonomy of each Member State precisely by stabilising the EMU, on the basis of transparent rules.

The involvement of social partners in the governance of the fiscal capacity would provide a concrete meaning for the strengthening of the social dimension and the participatory principle within the EU, also addressing concerns about the democratic deficit and technocratic economic governance in Europe.

Options for automatic stabilisers exist, calling for political consideration and decision

A number of options for Eurozone level automatic fiscal stabilisers have been proposed in the literature and in recent policy debates in Brussels. Various think tanks, public and private analytical units have contributed to this widening and deepening discussion. What most of them have in common is their focus on mitigating short-term cyclical downturns occurring in parts of the EMU, as opposed to compensating for structural differences among the EMU economies.

The idea of EMU-level automatic stabilisers is to be able to respond to asymmetric shocks or endogenous pressures in the monetary union and to uphold aggregate demand in the short term, before factors of production can be reorganised in the affected economy and recovery can resume. In other words, the point is to maintain enough spending during a downturn, before failed companies are turned around or replaced by new ones and before workers who lost their jobs can find new employment.

Governments will never be able to offset an economic downturn completely, and economic restructuring will need to happen anyway. However, the point is to minimise the overall economic and social damage, and to ensure that Europe's monetary fragility does not result in long-term competitive disadvantage.

Focusing fiscal transfers on mitigation of asymmetrically distributed cyclical shocks means that, over the long term, all participating Member States are likely to be both contributors to and beneficiaries of the scheme. But even if the balance is not exactly zero after a certain period of time, the effect that economic crises would be less deep and last less long would be good for all countries.

A variety of models can be designed when it comes to automatic stabilisers within the monetary union. However, before designing any model, a few key questions have to be answered. First: should the stabilisation mechanism compensate for income loss (based on the calculation of an income gap), or should it be linked to the rise of unemployment. Secondly, should the scheme function permanently (even if directions of transfers can frequently change), or should transfers be triggered by key indicators reaching a certain threshold (de facto semi-automatic stabilisation).

A scheme based on the concept of income insurance[9] is one option that has recently been explored by DG Ecfin experts. The CEPS think tank in Brussels has associated itself with the concept of reinsurance (triggering only in case of major downturn), while Bruegel has put online a "do it yourself" model, by which practically anyone can design his or her own preferred version alongside key parameters.

The importance of unemployment as a driving indicator should be emphasised. A major advantage of basing an EMU-level shock absorber on short-term unemployment is that this indicator very closely follows developments in the economic cycle. It is easily understandable and it is easily and promptly measurable (as compared, for instance, to the output gap). People understand very well that if periods of adjustment result in withdrawing support from the unemployed, the chances of new employment will diminish and the resulting human capital loss will just get greater, causing further damage to the growth potential of a country.

At the end, choices have to be made at the political level, with the involvement of social partners. In 2014, the debate on automatic stabilisers entered the political arena[10], and can feed into the considerations of EMU reconstruction in the coming period.

9 European Commission, DG Ecfin: Income insurance: a theoretical exercise with empirical application for the euro area, 23 March 2015

10 Under the Italian presidency, informal EPSCO discussed automatic stabilisers in July 2014 and informal ECOFIN in 2014. The first called for a Green Paper on EMU unemployment insurance.

A workable model for a basic European unemployment insurance scheme has been designed

The fiscal risk of cyclical downturns could be pooled at the level of the monetary union through a basic European unemployment insurance scheme, which would replace the corresponding part of existing national schemes. The levels of the contribution and of the benefit should represent a relatively low common denominator between the rules of national schemes[11]. The EMU-level scheme should clearly focus on cyclical unemployment caused by a drop in aggregate demand, as opposed to structural unemployment caused by skills mismatches, less efficient labour market institutions and the like.

One way to do this would be for the basic European unemployment benefit to be paid only for the first 6 months of unemployment. and the amount to represent 40% of the previous reference wage. These exact parameters would of course need to be discussed on the basis of thorough quantitative analysis of their projected performance and in view of the desired level of macroeconomic stabilisation.

The eligibility conditions of basic European unemployment insurance should not be too strict, so that also workers in short-term or part-time jobs could contribute and qualify for corresponding support. But in any case there should be clear conditionality in terms of the job-search and training effort.

Each Member State would of course be free to levy an additional contribution and pay out a higher or longer unemployment benefit on top of this European unemployment insurance, ensuring the maintenance, at least, of existing overall contribution and benefit rates. What the European scheme would do is to ensure a fairly basic standard of support during short-term unemployment.

This basic European unemployment insurance would help EMU Member States to share part of the financial risk associated with cyclical unemployment. Citizens would directly benefit from EU solidarity at times of hardship, and Member States would be required to upgrade their employment services and labour market institutions to the best EU standards.

The jobseekers would continue to interact with national authorities (public employment services). However, every month these national authorities would send to the European fund the basic contribution from all their employed workers. Likewise, every month the European fund would pay to the national authorities an amount corresponding to the sum of all the basic European unemployment benefit payments to be made that month in the country. In principle, each country would therefore make every month an overall contribution and receive an overall payment from the European scheme. In practice, these two could of course be offset and only the net balance would be paid.

The overall volume of such a basic scheme could be around 1% of GDP, mainly depending on the exact parameters such as duration and level of the benefit or the eligibility conditions. Of course, the net transfers from or into any particular country would be noticeably smaller, because drawdowns would be offset by contributions and vice versa.

The question who is a net contributor and a net beneficiary at any given point in time should be to some extent secondary. However, it is understandable that national politicians would probably want to make sure that their country is not permanently a net contributor, and especially that there are no free-riders in the scheme, i.e. countries that would be net beneficiaries most of the time.

The risk of 'lasting transfers' could be minimised through two mechanisms, which already exist in federal unemployment insurance systems elsewhere in the world, namely experience rating and clawbacks. Experience rating means that the contributor vs. beneficiary profile of each Member State in the scheme is monitored, and the contribution or drawdown parameters can be adjusted at the beginning of each period so as to bring the Member State closer to a projected balance with the scheme over the medium term. Clawbacks, on the other hand, enable to neutralise net transfers ex post, meaning that Member States are allowed to be net beneficiaries for several years, but then their contribution and/or drawdown rates are modified so as to compensate for the net transfers that had occurred.

The parameters of the scheme could be adjusted in response to actual experience. At the same time, governments, citizens as well as financial markets would be able to rely on the principle that an EMU country undergoing a cyclical downturn receives a limited fiscal transfer to support the cost of higher short-term unemployment.

Basic European unemployment insurance constitutes the best option

An automatic fiscal stabiliser in the form of basic European unemployment insurance would have a meaningful macroeconomic effect in counteracting a cyclical downturn. It would be based on a few basic parameters agreed in advance, and its functioning would be entirely predictable and calculable on the basis of these clear rules.

The fact that the scheme would trigger countercyclical transfers automatically and immediately is a major advantage compared to bailout programmes or bank rescues. These are always surrounded by uncertainty which pushes up their cost. The basic European unemployment insurance would be relatively cheap precisely because of its automaticity.

The size, predictability and automaticity also make the basic European unemployment insurance scheme a better alternative compared to discretionary fiscal instruments where a fiscal transfer would be provided in exchange for structural reforms. The 'catalogue' of reforms and corresponding financial support under such discretionary instruments would be very hard to define and the decision-making

11 The idea of a basic European unemployment benefit scheme has been pioneered and most clearly advocated by Sebastian Dullien and since 2012 it has been analysed by the European Commission's DG EMPL with the involvement of a number of external experts. Two conferences organized by the Bertelsmann Foundation in cooperation with DG EMPL (October 2013 and June 2014) explored the underlying problems and the available options in great detail.

process would be rather unpredictable, not to mention the political tensions arising around the approval of discretionary cross-country transfers.

The predictability, limited volume and limited duration of fiscal transfers would also make a basic European unemployment insurance scheme a much easier option than various scenarios for mutualisation of euro zone countries' sovereign debt. This feature is particularly important when Member States consider themselves in the role of a contributor rather than beneficiary.

With its automatic and countercyclical character, a basic European unemployment insurance scheme could boost market confidence in the EMU and thus help to avoid repeating vicious circles of downgrades, austerity and internal devaluation in the euro zone. It would help to uphold domestic demand and therefore – given the important trade interlinkages – economic growth in Europe as a whole, including in net contributor countries.

Like more flexible interpretation of the EMU's fiscal rules, partial pooling of fiscal risks at the EMU level would provide national governments with greater fiscal leeway. However, the big advantage of achieving countercyclical stimulus on the basis of cross-country transfers rather than more flexible rules for national budgets is precisely in the collective character of the EMU-level scheme.

While individual stimulus by countries with high debt-to-GDP ratios may run the risk of triggering further financial crises, increasing the resilience of the monetary union through the creation of a common fiscal capacity would reduce uncertainty about individual countries' solvency both in the short and in the longer term. In addition, a basic European unemployment insurance scheme would strengthen the EMU institutionally, politically and in terms of social cohesion.

Solidarity within the EMU matters for both economics and politics

Jürgen Habermas has issued passionate calls for solidarity in the period of the EMU crisis. He has repeatedly reminded us that solidarity is not charity; it is support provided to a fellow in difficulty, based on confidence that it may be reciprocated in the future.

Indeed, all models of EMU unemployment insurance suggest that in a sufficiently long time period (two-three decades), all countries would be net beneficiaries at least once.

The idea of basic European unemployment insurance represents an example of forward-looking solidarity. It is much better to help each other out in times of crisis than to put the fate of the union and of its individual members at stake whenever a financial crisis occurs.

The point is to make the EMU work in such a way that it allows every Member State to grow, even if exogenous factors or endogenous pressures happen to put it at a momentary disadvantage. A scheme of fiscal transfers that helps mitigate asymmetric shocks in the short term can help achieve precisely that.

If our EMU is meant to be irreversible, it must also be fair and it must be based on solidarity. We must pay attention to the employment and social outcomes, and try to prevent lasting divergence. For that, an automatic fiscal stabiliser is needed at the euro zone level.

The dogma of 'no fiscal transfers' in the EMU has to be dropped. In a system of a single market, high income countries have to support low income countries or regions. In a system of a monetary union, surplus countries have to support deficit countries.

Legitimacy partly comes from the process and partly from the outcomes. It is about institutions, but also about politics and values. The lack of economic opportunities, particularly for the young and long-term unemployed, and rising inequalities undermine social cohesion and trust.

National governments and the EU as a whole are losing legitimacy in the eyes of many workers and other citizens by failing to deliver what is expected from them, i.e. broadly shared prosperity and equal opportunity to improve one's situation. This may even translate into political instability at the national level, but also at EU level, where economic and social divergences can generate disunity.

If the Member States agree to pool more financial, budget and economic sovereignty, this inevitably calls for a clear framework for social coordination and convergence. Otherwise, it will only lead to fiercer competition between the Member States, lowering of social standards and the jeopardising of the social model.

In the absence of concrete initiatives towards a better functioning model, de-construction may well present itself as the more appealing option for voters towards the end of the decade. The consequences of this would be much more unpredictable than limited fiscal risk-sharing in a basic European unemployment insurance scheme.

Let us not forget that the single currency was never a purely financial or economic project. It was launched two decades ago with a strong political mandate to help keeping Europe united. However, the euro can only fulfil its unifying mission if the costs and the benefits of the EMU are more fairly distributed among the participating Member States, and if the rules of the game help to boost the growth potential of all of them. To deliver this, we need a new momentum for EMU reform, with counter-cyclical fiscal capacity in the focus.