

A "FEDERALISM BY EXCEPTION" FOR THE EURO ZONE



Eulalia Rubio | Senior Research Fellow at Notre Europe - Jacques Delors Institute

Notre Europe - Jacques Delors Institute offers you the synthesis of the conference-debate on the Report by the Tommaso Padoa-Schioppa Group, "Completing the Euro: A road map towards fiscal union in Europe", which took place in Paris on 25 September 2012. Three members of the group, Henrik Enderlein, Jean-Claude Piris and Maria João Rodrigues, participated in the debate which was moderated by Catherine Chatignoux.

Notre Europe - Jacques Delors Institute organised a conference-debate in Paris on 25 September 2012 on the Report by the Tommaso Padoa-Schioppa group entitled, "Completing the Euro: A road map towards fiscal union in Europe". Gathering around one hundred participants, the conference took place in presence of three members of the Tommaso Padoa-Schioppa group:

- **Henrik Enderlein**, general coordinator of the group, professor of political economy at the Hertie School of Governance (Berlin) and visiting professor at the Harvard Kennedy School (Harvard University);
- **Jean-Claude Piris**, former director general of the EU Council's Legal Service;
- **Maria João Rodrigues**, former minister for employment of Portugal.

Following an introduction by **Yves Bertoncini**, director of Notre Europe - Jacques Delors Institute, **Henrik Enderlein** used a "PowerPoint" presentation to offer participants a succinct description of the Report's content. The Report offers an in-depth analysis of the causes of the crisis, before defining three major obstacles to the proper functioning of the euro zone, and proposing four political actions in different fields to overcome those obstacles:

1. a deepening of the *single market* to permit the real exchange rate channel to function better;
2. the creation of an *anti-cyclical stabilisation insurance fund* to counterbalance the pro-cyclical effect of the ECB's action;
3. the creation of a *European Debt Agency (EDA)* to guarantee member countries access to bond markets in times of crisis, in return for a gradual transfer of sovereignty;
4. the establishment of a *banking union* within the EMU, comprising a single bank supervisory authority for EMU member states and a European bank deposit fund having also capacity to resolve banking crises.

The conference has concluded with a question-and-answer session with the audience, chaired by **Catherine Chatignoux**, deputy editor-in-chief of French daily *Les Echos*'s international section. This summary sets out to review the key issues addressed during the question-and-answer session.

1. The anti-cyclical stabilisation insurance fund: instructions for use

The Padoa-Schioppa Report proposes the creation of an anti-cyclical stabilisation insurance fund to attenuate cyclical imbalances among the euro zone's member states. The mechanism would be set up at the EMU level, offering financial support to member countries in the grip of a serious temporary recession. Several participants questioned the Padoa-Schioppa group's members on the specific content of this insurance system, in particular on the kind of financial support that such a fund would offer and on how to prevent it from leading to a permanent transfers from wealthier countries to poorer countries.

The members of the Padoa-Schioppa group pointed out that the Report does not go into the technical details of the fund but it proposes a few general guidelines. First of all, it would be a fund handling transfers between member states. The states would pay contributions into the fund when the economic situation is buoyant, and the states would receive money in the event of a recession. The alternative option, consisting of an "interpersonal" fund (for instance in the shape of a European unemployment insurance scheme), was discarded because it would not function symmetrically on account of the absence of any major harmonisation in the sphere of labour market regulations. Another fundamental principle is that the fund would function almost automatically, on the basis of a set of explicit objective criteria, so

as to avoid being subject to any direct political influence. And lastly, the amount that the fund would pay out to a country would have to be strictly limited.

2. The European Debt Agency and the transfer of sovereignty, a move in the direction of "federalism by exception"

Several participants questioned the members of the group on the functioning of the European Debt Agency (EDA) as proposed in the Report. Some of them wondered whether a mutualisation of the public debt at 10% of the GDP of the countries in the euro zone – as proposed in the Report – would be sufficient to stabilise the sovereign debt markets in Europe. Others voiced their concern regarding the transfer of sovereignty demanded of member states to offset the funding of their debt through the EDA.

Referring to the transfer of sovereignty issue, Jean-Claude Piris explained that the Padoa-Schioppa Report is grounded in respect for the principle of sovereignty. It does not suggest creating a federal union because such a thing is not necessary and in any case a majority of the Union's citizens do not want it. Yet it does propose a kind of partial federation in certain specific areas such as the budgetary sphere, because it considers that to be crucial to the euro zone's survival.

Henrik Enderlein completed Jean-Claude Piris's explanations by specifying that the Report proposes a sort of "federalism by exception": in other words, only those member states seeking EDA funding worth over 20% of their GDP would be obliged to transfer a part of their budgetary sovereignty to the Agency. Moreover, that transfer would be gradual: in the first instalments (when a member state seeks funding worth between 20 and 30% of its GDP), it will consist into signing a memorandum of understanding like the troika's current programmes. Only when a country seeks funding worth over 60% of its GDP would total budgetary sovereignty be transferred to the EDA, and even then, the country could always refuse that transfer (which would, however, necessarily mean that it could no longer aspire to EDA funding and that it would thus default).

Several participants also wondered what would happen in concrete terms in the event of a total transfer of sovereignty. Jean-Claude Piris explained that if that

were to happen, the Report suggests that the "euro-zone finance minister" take control over the country's budget policy. The decisions of this "European minister" would be subject to democratic control exercised by a mixed commission comprising representatives of the European Parliament and representatives of the euro zone's 17 national parliaments.

3. New forms of cooperation, new treaty?

The debate also addressed the legal and institutional implications of the reform of the EMU. According to Jean-Claude Piris, a revision of the EU treaty is not necessary for the kind of in-depth reform of the EMU proposed in the Padoa-Schioppa Report. Some of the measures proposed in the Report can be implemented under the terms of the current treaty on the basis of a cooperation deal among euro zone member states, either in the context of an enhanced cooperation, or on the basis of Article 136 in the TFEU (which countenances, in particular, the possibility of strengthening budgetary supervision and coordination among euro-zone member countries). Where proposals falling outside the EU's competences are concerned, there is nothing to prevent member states from exercising them either separately or in coordination with others – hence the idea of drafting a new 17-strong intergovernmental treaty.

Jean-Claude Piris pointed out that the word "intergovernmental" is not synonymous with something entirely separate from the EU's institutional architecture. A treaty of this kind would need to maintain such significant advances of a "Community" nature as the qualified majority vote, the power of initiative and monitoring by an independent authority and supervision by a European legal authority. Moreover, "intergovernmental" does not mean that this treaty would be external to the EU for ever. Ideally, this new legal architecture, or intergovernmental treaty, should be built into the EU's traditional legal architecture in the future, as planned for the TSCG, for instance.

Lastly, Jean-Claude Piris voiced the opinion that the signing of such a treaty would probably demand changes to national constitutions in certain countries, particularly in Germany. This would require qualified majority voting or referenda. While some participants warned against calling such "high risk" referenda (one member of the audience called them

"traps" that needed to be avoided), others highlighted the healthy, democratic nature of such events. Thus, for instance, one member of the audience explained that the recent referendum on the Treaty for Stability, Coordination and Governance (TSCG) in Ireland had sparked a very real debate on that treaty, forcing the pro-Europeans to go into detail and to persuade the electorate of the treaty's benefits.

4. How to address the structural differences within the euro zone?

One of the ideas inspiring the Tommaso Padoa-Schioppa group's Report is that not all economic differences within the euro zone are equally negative. In particular, the Report distinguishes between structural differences and cyclical differences. According to the Report, while cyclical differences can seriously hamper the proper functioning of the euro zone, structural differences are not so damaging. It may be desirable to remedy them from a political point of view, but doing so is by no means crucial to the EMU's survival.

This distinction between structural and cyclical differences was object of debate in the presentation of the Report in Paris. Some participants noted that the euro-zone member countries in deepest water today are precisely those with the weakest and least competitive economies, which might suggest that structural differences are also, in part, what lies at the root of the crisis.

Henrik Enderlein replied that, while it is true that there is a competitiveness gap issue today, that gap is not a reflection of different historical models or patterns of economic specialisation but, rather, the result of persistent cyclical differences (or to put it more accurately, of persistent inflation differentials generated by the common monetary policy's asymmetrical impact on the countries in the euro zone). As he explained, it is not structural fundamentals which have led to a loss of competitiveness in the Irish economy, but the fact that the Irish economy has been having to cope with very low interest rates for a very long time.

Henrik Enderlein also pointed out that the issue of structural differences was a topic of debate during the negotiations preceding the creation of the EMU. At that time, France and Germany held opposing

positions: Germany wanted the economies to come closer together before a common currency was established, while France was in favour of creating a common currency at once, with economic rapprochement following in its wake through a strengthened economic governance of the euro zone (or "economic government"). The compromise finally thrashed out was that the euro should be created at once, but without the French requirement of strengthened governance, which was quite simply the worst possible solution as far as convergence was concerned.

The issue of convergence was also raised by Maria João Rodrigues. According to the former Portuguese minister for employment, convergence does not simply involve a rapprochement among the EMU economies, it also involves propelling those economies forward together toward the same future horizon. In this connection, she highlighted the importance of the EU2020 strategy, which is designed to impart a fresh boost to Europe's economy on a new basis rooted in green, smart and inclusive growth. If we subscribe to the goals of the EU2020 strategy, she concluded, we need to ensure that all of the EU member states have the necessary tools and capabilities to address and to implement those kinds of changes.

5. Do we need more convergence in the area of social and welfare policies?

During the discussion on issues connected with convergence, one question was specifically raised as to whether the creation of a common currency does not make it necessary to have a greater degree of harmonisation in the area of social and welfare policy. Several participants voiced the belief that some convergence in social protection systems, welfare benefit levels or labour market regulations is crucial on two counts: in functional terms, because differences in social protection systems lead to distortions in the proper functioning of a currency zone; and in political terms, because "solid" member states will not be inclined to display greater solidarity towards countries in difficulty unless those countries reform their social protection systems to make them financially sustainable.

In this context, a proposal was raised during the discussion: the creation of a "European social snake" along the lines of the "monetary snake" which paved the way for membership of the single currency. It

would consist into defining, for a certain number of social indicators (for instance, retirement age), an area marked out by an upper and lower level within which all of the member states would be obliged to set their choices.

The idea of creating a “social snake” was debated by the members of the Padoa-Schioppa group. Jean-Claude Piris noted that the treaty’s references to the coordination of “economic policies” within the EMU could serve as a potential basis for the coordination of social and welfare policies. Maria João Rodrigues stated the case for the creation of a “social corridor”, but she went on to warn of the difficulties involved in defining appropriate objectives and indicators, not to mention the upper and lower levels for each indicator. And lastly, Henrik Enderlein stressed that while he is fairly favourable from a personal standpoint,

it is a political decision rather than a functional requirement to ensure the euro zone’s survival. In this sense, he pointed out that welfare and social policies in the United States are largely conducted at state level. There is a huge difference in the levels of social protection and health care from one state to the next, yet that situation is far from being a source of serious malfunctioning for the American economy as a whole. What does ensure the proper functioning of the American economy is the existence of certain stabilisers at the federal level (a common unemployment insurance system, a federal budget), the fact that it can count on a totally integrated single market, and the existence of a genuine banking union. If we had all of those factors at the European level, he argued, it would not be necessary to harmonise social and welfare policies.

The PowerPoint presentation of Henrik Enderlein on the content of the Report of the Tommaso Padoa-Schioppa group is available on *Notre Europe - Jacques Delors Institute*'s website.

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PREMIER MINISTRE



Compagnia di San Paolo



MACIF



info@notre-europe.eu
19 rue de Milan
75009 Paris - France
www.notre-europe.eu

