Strengthening the Institutional Architecture of the Economic and Monetary Union

Edited by Marco Buti, Gabriele Giudice and José Leandro

A VoxEU.org Book

CEPR Press

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Introduction

Marco Buti, Gabriele Giudice and José Leandro
European Commission; European Commission; EBRD

Following years of sustained growth, policymakers in Europe – and beyond – have been unexpectedly confronted with the largest health, economic and social challenges since WWII, threatening the stability of the European Union and its Economic and Monetary Union (EMU). The crisis generated by the Covid-19 pandemic has required rapid and strong action. It also entails key choices, including on how the EU could help mitigate the impact of Covid-19, foster the economic recovery and support the double green and digital transitions.

In September 2019, before the crisis struck, the Directorate General for Economy and Finance of the European Commission organised a workshop on strengthening the institutional architecture of the EMU. This eBook presents the main ideas discussed in the workshop. The workshop took stock of the debate on key challenges and the future of EMU's institutional architecture and sketched out the directions in which the reforms could go. It dealt more in depth with two of the ideas debated in the public sphere at the time: that of a euro area treasury and of a European Minister or High Representative for Economy and Finance. The discussions, which took place at that time, are still relevant and the proceedings are presented here.

The weaknesses and solutions discussed in the workshop are still relevant in the economic context reshaped by the Covid-19 crisis. The crisis has shed a light on an incomplete institutional architecture of the EMU and revealed that public opinion expects the EU to deliver in emergency situations. Steps taken in response to the current crisis could bring progress with the EMU deepening agenda. As containment measures are gradually lifted, there is a need to complement national action to rapidly bring those who lost their jobs back into employment, minimise scars from a prolonged shortfall in investment and compensate for the differences in the policy space among Member States. This is why the Commission has proposed a recovery instrument, called Next Generation EU, to top up the multiannual EU budget. This new package is firmly built on the community method, with the EU budget as the main vehicle for providing funds to citizens, firms and Member States. It envisages sizeable grants and loans to Member States to carry out reforms and investment to be defined in national annual plans to be agreed with the Commission. This eBook contributes to the reflection to identify those reforms that, beyond addressing the more immediate needs, can deliver sustainable progress on the institutional set-up of EMU.

Part I of this eBook provides an overview of possible solutions for addressing weaknesses in the EMU institutional architecture. While it may still seem difficult to many, the moment seems propitious for striking grand institutional bargain on EMU, according to Henrik Enderlein. To do so, the debate should consider, along the immediate steps to rebound from the lockdown, other equally important areas – investment to face climate change and support digitalisation; completing the Single Market, including for capital; and the international role of the euro – that can also contribute to EMU stability, but in a different way. Among the areas which deserve attention, Stefano Micossi includes the internal market, the coordination of wage policies and the surveillance of macroeconomic imbalance. Without acting in such a broader perspective, important spillovers across countries would dampen growth. Excessive savings in Germany mean that the euro area's anchor economy exports 'lowflation' to other euro area Member States. Wage coordination between the euro area's economies, a budget that would transform excessive savings into investment, a more effective implementation of the Macroeconomic Imbalances Procedure, and achieving the internal market for services would avoid imbalances and revive growth in the EMU. Tuomas Saarenheimo cautions against jumping too far with some institutional reforms in the absence of many fundamental preconditions in the EU. Without them, the European elections cannot become an effective channel for democratic accountability. This aspect is especially relevant in the debate on EMU deepening, because the latter increasingly involves decisions on public funds, which should and will get politicised, one way or another.

Part II asks whether – and for what purpose – a euro area treasury could be part of a revamped institutional architecture. Niels Thygesen provides a longer-term perspective on the reasons why a debate on a treasury did not really take off in the 1970s (when first steps towards policy coordination were discussed in the Werner and MacDougall reports), in the following decade when the basis for the EMU was established, or after the eruption of the financial crisis. This was due to the focus on centralising monetary policy, the resistance to even a limited transfer of fiscal sovereignty, and the initial beliefs that stabilisation in the EMU would be taken care of by joint monetary policy and by national automatic stabilisers, so coordination of fiscal policies would be sufficient. However, the combination of tasks that have now accumulated – comprising potential revisions of fiscal governance, more or less conditional lending to governments, and responsibility for financial stability – is creating a new occasion to reconsider the case for an EMU Treasury. Hans-Joachim Klöckers and Sander Tordoir present possible functions of a euro area treasury and desirable principles on which it could be built, using as a possible benchmark the responsibilities of treasuries in existing federations (the US and Germany). Joerg Bibow argues that a treasury could be there to manage a euro area budget, which would debt-finance public investment. This would break the 'bank–sovereign doom loop', raise the euro area's capacity to withstand shocks and provide the missing common safe asset without mutualising existing debts. Finally, while Lucas Guttenberg considers that the main problem for the euro area is that it still lacks a common fiscal policy, he is less convinced by the establishment of a new euro area treasury, both because he sees it as unnecessary (as current institutions can play that role) and because he is wary of assigning the handling of a common fiscal policy to technocrats operating within an intergovernmental setting.

Part III raises the question of whether the time is ripe for a European Minister of/ High Representative for Economy and Finance. René Repasi identifies a democratic accountability gap in EMU and finds that a European Minister, as proposed by the Commission in 2017, would improve the flow of information and streamline the political behaviour of the main actors in EMU, but would not give the European Parliament new instruments for accountability. Federico Fabbrini considers that any new reform should be primarily conceived in light of the constitutional principle of good governance, meaning that institutions should be assigned specific functions and should respect the principle of separation of powers. Finally, Daniel Gros proposes developing the external dimension of the EMU's institutional architecture, moving to unified euro area representation at the IMF assured by the European Stability Mechanism. Such a solution would require an amendment to the ESM Treaty, but not necessarily to the IMF's Articles of Agreement.

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Marco Buti is Head of Cabinet of Commissioner Paolo Gentiloni who is responsible in the European Commission for economic affairs and taxation. From December 2008 until November 2019, he was Director General for Economic and Financial Affairs at the European Commission. He was educated at the Universities of Florence and Oxford. Since 1987, when he joined the European Commission, he held various positions including that of economic advisor to the Commission President. He has been visiting professor at the Université Libre de Bruxelles, the University of Florence and at the European University Institute. He has published extensively on EMU, macroeconomic policies, structural reforms, welfare state, and unemployment.

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Part I

Weaknesses of the EMU institutional architecture and possible solutions

1 Time to move on: The discussion about EMU deepening needs to change

Henrik Enderlein
Hertie School and Jacques Delors Centre

The spring of 2020 marks the 10th anniversary of the start of the euro area crisis. It was in the early months of 2010 that the true dimension of the debt level in Greece became apparent, followed quickly by a massive deterioration in public finances in Ireland, Portugal, Spain and also Italy. What later became known as '(re)denomination risk' – i.e. the putting into question membership of the currency union – got priced into risk premia of euro area sovereign debt. On the night of 9 May 2010, one of the largest rescue packages in financial history was adopted when €750 billion were put on the table in a joint signalling exercise by EU member states, the European Commission and the IMF. The ECB started its purchasing of sovereign bonds of crisis countries within the framework of its Securities Market Programme. The European Financial Stability Facility was created, and would later turn into the European Stability Mechanism (ESM).

The euro area crisis can be structured into five main phases. The first phase was the outbreak of the Great Recession, which started in the summer of 2007. This phase shook the euro area dramatically, but some of the later crisis countries, such as Spain, were still considered to be very stable. The second phase was the outbreak of the euro area crisis between very late 2009 and late 2010. During this phase, the euro was put into question, but first steps were taken to stabilise the single currency. The third phase was the escalation phase. It started with the 'Deauville moment' in late October 2010 when Angela Merkel and Nicolas Sarkozy agreed to create the ESM – but with the implicit signal that euro area country debt could be restructured. This phase amplified the dangerous 'doom loop' between banks and sovereigns. It culminated in the Greek sovereign debt restructuring of 2012. Phase four started with the Mario Draghi's "whatever it takes" moment, which came just weeks after the decision by EU governments to build the euro area Banking Union. This phase, which calmed the crisis significantly, lasted until the summer of 2015 and ended with another escalation in Greece that almost triggered 'Grexit'. The fifth phase can be labelled the aftermath phase. It was characterised by large institutional discussions about how to make the euro area more resilient, starting with the Five Presidents' Report in the autumn of 2015 (Juncker et al. 2015) and leading to a multitude of recommendations on how to improve the Economic and Monetary Union (EMU) (with concepts such as the euro area budget, a finance minister, unemployment insurance, deposit insurance, a cyclical stabilisation mechanism, and so on).[1]

It is now time to recognise that this fifth phase is at an end and that attempts to fundamentally reform EMU have simply not succeeded. The agreements reached by the European Council in December 2018 on reforming the ESM and creating a minuscule euro area budget are no more than tweaks at the margins. None of the big structural steps that were discussed since 2015 has been implemented. The euro area crisis is over. The quick-fix institutional framework that was built during the crisis is still in place and makes the euro area more stable. But we are far away from a more structurally sound EMU, encompassing fiscal union, banking union, and political union alongside monetary union.

I am part of a group of 14 French and German economists who, in early 2018, proposed what we considered to be a balanced package of reforms combining more risk-sharing and market discipline (Bénassy-Quéré et al. 2018; for reactions and discussions, see Pisani-Ferry and Zettelmeyer 2019).

But let me be blunt: the likelihood that such a package, or its main elements, will be adopted any time soon is essentially zero. It is time to acknowledge this. With the start of the new Commission and a change at the top of the ECB and the European Council, it is time to turn the page. It is time to move on.

Don't look backwards: Next time will be different

To avoid misunderstandings: I consider that the euro area remains vulnerable. The next crisis, which will definitely come (whether in six weeks, six months, or six years), will have the potential to severely hurt or even destroy the single currency. But it is time to accept that until the outbreak of the next crisis, there will not be any political will to get serious on fully-fledged institutional reforms.

1 See, for example, Caudal (2013) on a euro area budget; Enderlein and Haas (2015) on a finance minister; Beblavý et al. (2015) on unemployment insurance; Brunnermeier et al. (2017) on a safe asset; Carmassi et al. (2018) on deposit insurance; and Arnold et al. (2018) on a cyclical stabilisation mechanism.

So, what should be done between now and the next crisis? First, it is time to understand that the next crisis will be very different from the last one. This statement is more than a truism. Too many policymakers and observers have a fundamentally backward-looking appreciation of the vulnerabilities of the euro area. But things have changed. It is time to forget some of the core elements that shaped the first crisis decade.

1. **Forget Frankfurt.** It was the ECB that rescued the euro and the euro area in the last crisis. However, relying on ECB stabilisation in the next crisis would be dangerous for three reasons. First, the ECB has reached the limits of its conventional monetary policy. In 2007, at the start of the last crisis, the leading ECB interest rate was at 4%. The monetary stimulus from lowering this rate was considerable and played a major role during the crisis. Today, interest rates across the euro area are negative. There is no room for further conventional monetary stimulus. Second, unconventional measures have also reached their limits. The ECB has purchased EU government bonds up to nearly 33% of all sovereign bonds issued in the euro area. While purchases can theoretically continue, their marginal economic effects will be much lower and will approach zero as time goes by. Third, outright monetary transactions (OMT), which remain the key unused instrument in the ECB's toolkit, are unlikely to work in the next crisis. The activation of OMT would require fully-fledged ESM programmes in crisis countries, requiring not only considerable firepower from the ESM but also political cooperation from the crisis country. This would require political decision-taking in national capitals, not by an independent monetary policy institution in Frankfurt.
2. **Forget the last crisis**. Too many actors in the euro area still look at the political configuration of the euro area through the lens of 'north versus south' or 'creditor versus debtor' countries and discuss proposals mainly as struggles between 'transfers versus discipline', 'moral hazard versus bailout' or 'risk-sharing versus risk reduction'. These categorisations have become flawed. In areas such as banking union, capital markets union or even in the area of growth and innovation, the 2020 euro area looks very different from the crisis period. Is today's most vulnerable systemically important bank in the euro area still located in a former crisis country? Is economic dynamism in the 'north' really higher than in the 'south'? Should country debt levels and deficits still receive as much emphasis as they did in 2011 in an economic context of structurally low interest rates?
3. **Forget the grand institutional discussions**. As previously discussed, continuing debates on the highly politicised topics mentioned above (a euro area budget, unemployment insurance, etc.) are unlikely to produce tangible results. It might

be smarter to move these topics to the backburner for a while and open new types of discussions that would strengthen EMU rather than bringing back yesterday's battles.

Looking ahead: Three recommendations

In which policy areas can the EMU make progress in the next five years without looking backwards, without fighting old battles, and without misjudging the real benefits of a given institutional reform? I see three main areas to prioritise in coming discussions.

1. **Investments**. The current context of low or negative rates in combination with historical investment challenges stemming from climate change and digitalisation calls for investments, both public and private. A joint initiative across euro area governments that has both a regulatory component to encourage private investments, and also a budgetary component to boost public spending where needed, could be an important element. While the general rules on fiscal policy in EMU and as enshrined in the Treaties should not be changed at this juncture, it could well be appropriate to complement the existing framework with a recognition of instruments to respond to 'once-in-a-generation' investment needs. Euro area governments could and should agree on lists of investments that could be covered under such a scheme, thereby bringing an explicit recognition of future-oriented spending into the fiscal equation, where it is currently not recognised.
2. **Completing the single market, including for capital**. Many of the vulnerabilities of EMU stem from the relative lack of economic integration among the 19 euro area countries. While it has become apparent that the integration of fiscal policies is politically too challenging at this stage given the potential redistributive implications, progress is possible in market integration. Elements could include: (i) regulatory convergence in 'borderless sectors', based on a single rulebook and a single regulator, with a special focus on all areas involving data, digital processes, or consumer protection (Enderlein and Pisani-Ferry 2014); (ii) tax policy coordination, especially on corporate taxes, leading in the medium term to a fully-fledged common corporate tax base, minimum taxation levels and maximum taxation transparency within the Single Market; (iii) integrating European capital markets in a truly integrated savings and investment space with no regulatory or legal barriers to hamper the free flow of all types of capital within the Single Market; and (iv) more streamlined insolvency legislation within the Single Market to facilitate cross-border investments. This list could be much longer – there are many areas where the functioning of the single market could be improved further, thereby contributing to more cyclical convergence in the euro area and helping the functioning of the single currency.

3. **The international role of the euro**. The euro is the second international currency after the US dollar, but relative to the economic weight of the euro area, it significantly underperforms. It lags far behind the dollar as an international store of value, in global financial transactions, and as a trade invoicing currency, especially in key energy and commodity markets. Strengthening the international role of the euro in these areas would have both economic benefits – for example, by decreasing transaction costs and currency risk for EU businesses in international trade – and foreign policy benefits. In particular, there is increasing interest from policymakers at the national and EU levels in the strategic benefits of a stronger international euro. These include bolstering European economic sovereignty and making the EU less vulnerable to the 'weaponisation' of economic power by others such as the US and China. However, these strategic benefits cannot be achieved without completing the necessary groundwork, which includes the integration of European capital markets as well as at least thinking about a common European safe asset offering a euro equivalent to US Treasury bonds.

Conclusion

The joint start of new presidents and teams at the European Commission, the European Council, the ECB and the European Parliament should be seen as an opportunity to change the nature of the debate on EMU. The single currency is still vulnerable, but continuing old and backward-looking discussions is not the right way to proceed. Too much time and too much political capital is spent on discussions that will not lead to satisfactory results any time soon. It is time to acknowledge that striking grand institutional bargains on EMU is all but impossible at this stage. The implication is that it is time to refocus the debates towards other equally important areas that can also contribute to EMU stability, but in a different way. It is time to move on.

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About the author

Henrik Enderlein is President and Professor of Political Economy at the Hertie School as well as Director of the Jacques Delors Centre. His research focuses on economic policy-making in Europe, in particular the euro, the EU budget, financial crises and fiscal federalism. In 2012/2013 he was the Pierre Keller Visiting Professor of Public Policy at Harvard Kennedy School and the Weatherhead Center for International Affairs. In 2006/2007 he was Fulbright Distinguished Chair in Duke University's political science department. In 2003, Enderlein was awarded the Max Planck Society's Otto-Hahn Medal for outstanding achievements by young scientists. He prepared his PhD at the Max Planck Institute for the Study of Societies in Cologne, and holds degrees from Sciences Po in Paris and Columbia University in New York. Prior to his academic career, he was an economist at the European Central Bank in Frankfurt.

2 Raising growth in the euro area

Stefano Micossi
Assonime

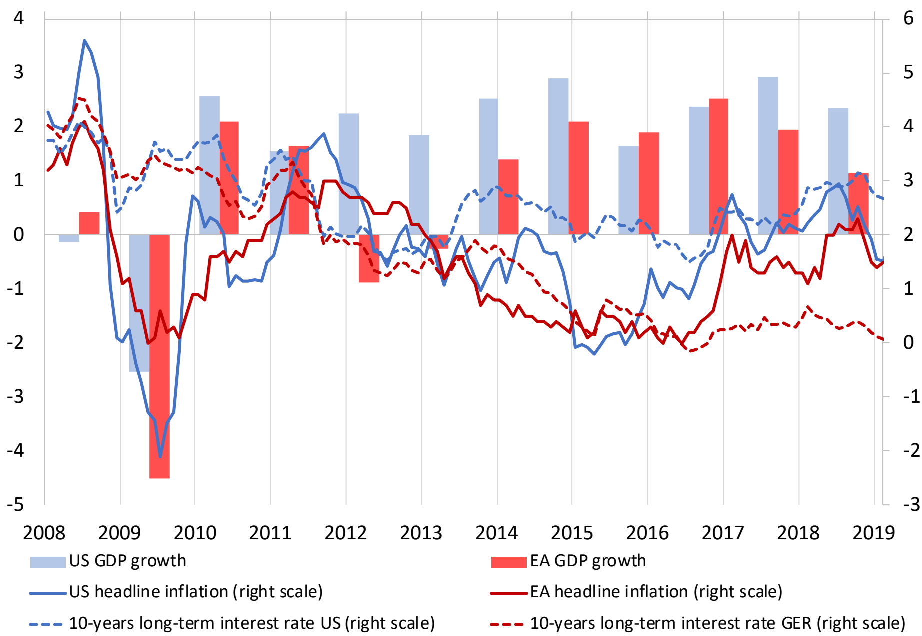
The economic policy debate in Europe – or rather in the euro area – seems deadlocked. We would like higher growth of domestic demand and incomes, but monetary policy doesn't work anymore; fiscal policy is not available because of political constraints; and structural reform resembles the mythical phoenix, unable to rise from the ashes until someone gives it concrete content.

In this chapter, I argue that the euro area suffers from a special disease that sets it apart from the US and the other advanced economies, because its economic policies are constrained by the massive excess savings of its anchor economy, Germany. This is in turn the result of a single-minded export orientation of the economy for over two decades that, through the common currency, constrains growth in domestic demand in the rest of the area, and notably in the less competitive economies. Therefore, there is no way out of the present predicament of low growth and low inflation in the euro area unless Germany reduces its excess savings and raises domestic demand and incomes, clearing the way for other euro participants to follow suit. A thoroughfare to get there is offered by opening the services sector to integration and competition in the internal market and accepting the long-delayed consolidation of the network services industry in Germany and the entire euro area. My argument is based on four exhibits of evidence.

Lowflation in the euro area

The first exhibit is that in the general lowflation environment that has prevailed in the advanced world in recent years, the euro area seems to have suffered from a more acute disease – despite its increasingly aggressive monetary expansion with unconventional tools. Figure 1 shows that in recent years, GDP growth and headline inflation in the euro area have indeed fallen systematically below that observed in the US (except for GDP growth in 2016-17; see Figure 1), while long-term interest rates have been well lower. Eventually, since the end of 2018 interest rates have fallen below zero even on long maturities (ten years and beyond) in Germany, the Netherlands and France – a phenomenon unknown in the US (as well as in the UK, where the financial structure is in many ways more similar to that of the US).

Figure 1 Headline inflation (year-on-year percentage change), ten-year long-term interest rate and GDP annual growth (%)

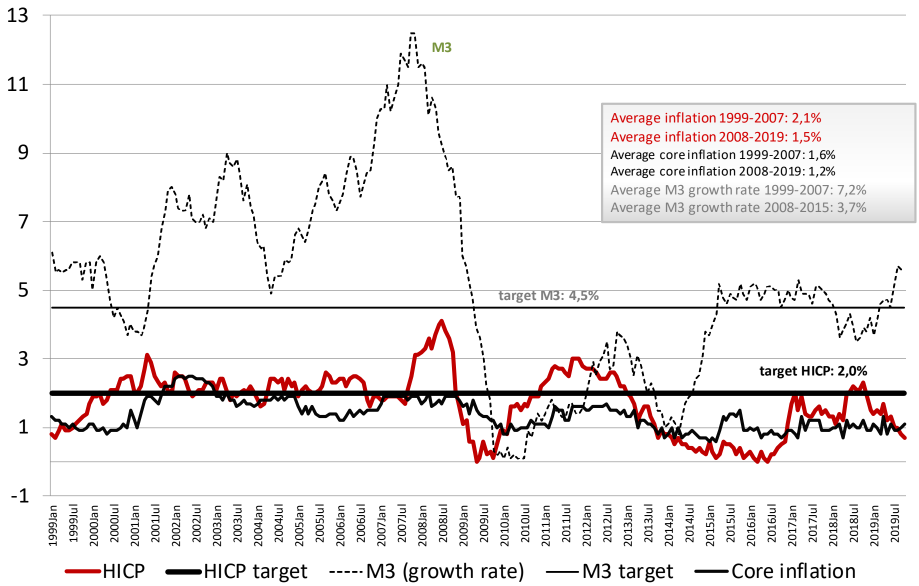


Source: OECD For inflation and interest rate monthly data; IMF for GDP growth annual data.

The current external surplus is the counterpart of massive excessive saving in the German economy, which must be seen as the principal cause of low interest rates. The ECB may have contributed marginally to lowering rates and flattening the maturity curve, but by established macroeconomic models cannot be held responsible for the bulk of the precipitous fall in rates since the financial crisis.

Meanwhile, the ECB has been failing in its inflation objective by increasing margins over the successive tenures of its three presidents, Wim Duisenberg, Jean-Claude Trichet and Mario Draghi. The shortfall from the (close to) 2% inflation target has risen in the Draghi years (2011-2019) to 50%, with headline inflation stubbornly hovering just above 1% and core inflation even lower (Figure 2).

Figure 2 ECB monetary policy: inflation, core inflation and money growth in the euro area, January 1999-October 2019 (%)



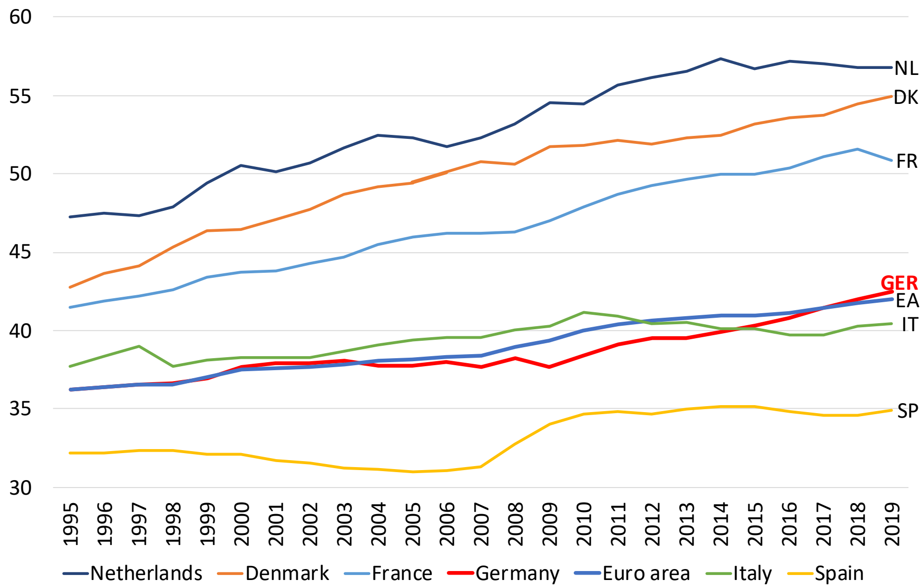
Note: Monthly data.
Source: ECB

Bini Smaghi (2020) has convincingly argued that the ECB monetary policy has remained too restrictive in the years following the twin financial crises in Europe, at all events most of the time more restrictive than in the US. However, this does not seem to offer a sufficient explanation for the unsatisfactory monetary developments in the euro area. This raises the question of the possible role played by structural factors at work in the German economy as well in its euro partner countries.

Export success in the German economy has come at a cost

The second exhibit concerns the export success of the German economy, which to an important extent was based on labour market reforms enacted in successive waves since the mid-1990s. Their main effect was to lower wage growth dramatically, most notably in the services sector. Following the Hartz reform of the early 2000s, over 7 million Germans found themselves employed with mini-job contracts paying €5-600 per month. Furthermore, wage increases fell systematically well below productivity increases (Micossi et al 2018). Cheap labour has allowed the slowdown of the transfer of manufacturing jobs to low-labour cost areas, but has also entailed slower growth of domestic demand. The German economy has thus evolved into a rich manufacturing economy with poor workers. Figure 3 shows that the average hourly wage level in Germany has been aligning with that of Italy, a country with much lower labour productivity, and falling well below the high-productivity economies of the euro area.

Figure 3 Real compensation per employee (thousands of euros)



Source: Ameco.

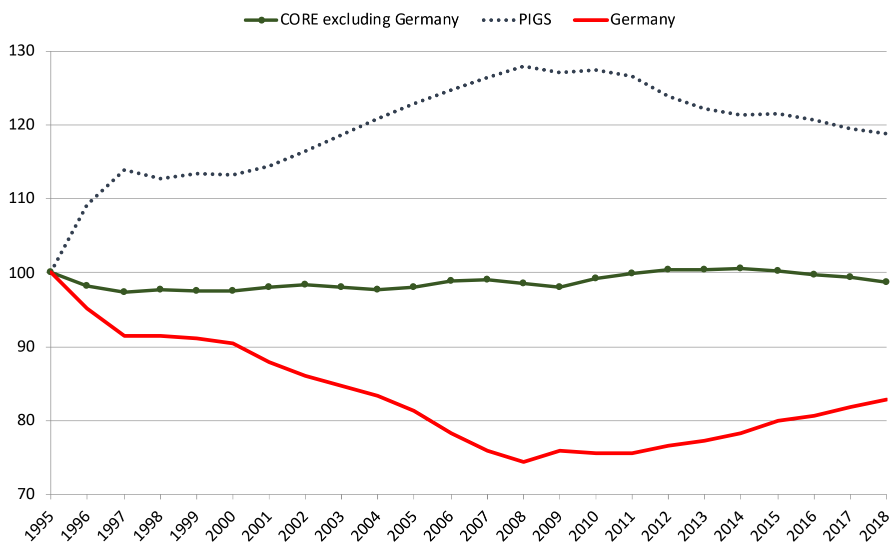
The resulting rise in the share of profits has not led to higher investments. After falling by some 4 percentage points of GDP after the financial crisis, corporate investments have barely returned to 60% of the pre-crisis years. Higher profit rates and reduced investment have been main factors in generating excess savings, together with the shift in the public sector balance from deficit to surplus (Micossi et al. 2018).

Low investment has left corporate Germany falling behind in the competitive race set in motion by the digital transformation (with especially severe consequences for its automotive industry; see Keohane et al. 2019). Meanwhile, massive reliance on exports has exposed the German economy to the adverse effects of slowing demand in China as well as to the protectionist backlash by the US administration.

The deflationary impact on euro area partners

The third exhibit is that the German economy has systematically exported deflation to the rest of the euro area through two main channels (Micossi 2016, Micossi et al. 2018). The first channel is the substantial fall of the relative price of German goods within the area, which has maintained strong competitive pressure on all euro partners (Figure 4), forcing lower wages and demand deflation throughout the area. This effect has been reinforced in weaker economies by the balance-of-payments constraint that obliged them to turn their current external deficits into surpluses by further restraining domestic demand.[1]

Figure 4 Real effective exchange rate (1995=100)



Note: REERs deflated by unit labour costs in the total economy and computed with respect to EZ 19 trading partners. CORE countries are Austria, Belgium, France, Finland and the Netherlands.

Source: Eurostat.

The single currency has effectively eliminated the external adjustment mechanism for surplus countries, whose money supply is no longer put under pressure by capital inflows into Germany (Micossi et al. 2018). The latter, however, have been the key factor pushing German interest rates into negative territory, with mounting adverse consequence for domestic financial institutions and private savers.

1 The balance of payments constraint was expected to disappear within the single currency, in analogy with the experience of the US. What had not been anticipated is that to each participating country the euro is in a sense a foreign currency, since its supply is under the control of an external independent actor, the ECB, and cannot be used to meet financial strains hitting individual participants.

Table 1 Value added, productivity and compensation per employee (average growth, %)

	1990-1999		2000-2008		2009-2018	
	Germany	Euro area excl. Germany	Germany	Euro area excl. Germany	Germany	Euro area excl. Germany
TOTAL ECONOMY						
Gross value added growth	1.5	2.8*	1.7	2.2	1.3	0.6
Productivity (GVA per hour worked)	1.9	1.0*	1.6	0.9	0.7	0.9
Real compensation per employee	1.1	1.0	0.4	0.7	0.9	0.6
MANUFACTURING						
Gross value added growth	-0.6	2.5	2.6	1.7	2.1	0.8
Productivity (GVA per hour worked)	2.5	2.3*	3.2	2.7	1.8	2.6
Real compensation per employee	2.7	1.4	1.2	0.8	0.7	1.2
SERVICES						
Gross value added growth	2.6	2.9*	1.8	2.4	1.1	0.9
Productivity (GVA per hour worked)	1.9	0.7*	1.0	0.5	0.4	0.5
Real compensation per employee	0.8	0.9*	0.3	0.7	1.1	0.5

Note: *1995-1999.

Source: Ameco.

Table 1 presents key growth data in the euro area since its inception. As may be seen, over time growth in the rest of the euro area was brought down to the German rate, while it had in general remained above it in the pre-euro years. Real wages in the euro area had outpaced those of Germany up to the 2008 financial crisis, but then fell under in 2009-18. This has not impeded higher growth in some participating countries, such as Ireland, as the deflationary impact has concentrated on the less-competitive economies.

The missing internal market for services

The fourth exhibit concerns the behaviour of the services sector. Table 1 highlights the different behaviour of growth, productivity and wages in manufacturing versus services. As can be seen, everywhere in the euro area the slowdown in growth is stronger in services, which also display lower productivity and wage growth (despite some recovery in Germany in the latest period). Since services represent over 70% of value added in the economy, the adverse impact on the overall economic performance of the area is clear.

The explanation for this underperformance of the services sector is quite obvious: the sector still is largely closed to competition and integration in the internal market, which has discouraged investment and slowed productivity gains, as extensively documented in OECD (2018).

Especially important in this context are the network services (energy, transport and communications), where the industrial structure still is highly fragmented, leading to higher prices and lower investment (Brons et al. 2018). This is true even in activities where regulatory policies have been effective in promoting competition, but cross-border consolidation has not taken place due to political resistance, weakening the incumbents and pushing them into high indebtedness (as in telecoms and air transport).

In the energy sector, large national champions have been effective at guarding their local monopolies or oligopolies and on occasion have thrived through their bilateral relations with large exporting countries outside the EU, hampering development of an integrated market for electricity, oil and gas. In all these areas there are enormous unexploited opportunities for productivity gains and private investment from opening the way to cross-border consolidation and the creation of a truly integrated European market.

In conclusion

The evidence that has been presented in this chapter indicates that lowflation and dismal growth assume special connotations in the euro area due, on the one hand, to Germany's excess savings and the single-minded export orientation of its economy and, on the other, to failure to open and integrate the services sector.

The development of the internal market for services offers a way out from the present predicament without hurting the competitiveness of manufacturing. It would foster the required reorientation of the European economy towards domestic demand, it would loosen the competitive pressure on the manufacturing sectors of weaker economies, and it would open prairies to private investment and the deployment of new technologies, including digital technologies. It would also help reduce the excess savings that are the main culprit for low interest rates and defuse the mounting protectionist pressures against European manufacturing exports.

The reorientation of demand towards its domestic components, in Germany and elsewhere, should be encouraged and fostered by more effective application of the Macroeconomic Imbalances Procedure, which so far has entirely failed in helping to correct excessive external surpluses in Germany and elsewhere in the euro area, as well as encouraging less restrictive budgetary policies in countries with strong budgetary positions.

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About the author

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3 Democratic constraints on EMU

Tuomas Saarenheimo[1]
Euro Working Group

The workshop on the EMU institutional architecture held in Brussels in September 2019 raised a very important question on the relationship between EMU deepening and democratic accountability. This is not the first time that democratic accountability has been mentioned in EMU discussions; in fact, the concept can be found in several high-level documents. Yet, in the actual policy discussions it has been all but absent. My starting point is that there is a shortage of democratic accountability in the EU in general. This shortage manifests itself also in the field of EMU, and it limits our ability to put in place structures similar to those that support the stability of more established monetary unions.

The discussion on the EU's 'democratic deficit' emerged in the 1990s, and not much has changed fundamentally since then. While the European Parliament has received more powers and is elected in free and fair elections, the Union still lacks many other fundamental preconditions that would turn those elections into an effective channel of democratic accountability. It still lacks a proper political party system that at the national level forms the basis for political organisation. The European Parliament's political groupings are not an effective substitute for a functioning, vertically integrated party structure. They lack clearly defined political programmes that would organise the debate and mobilise voters in elections. The EU also lacks a political opposition, which would provide the voters with a source of criticism of, and an alternative to, the policies of the incumbent power. Finally, it lacks a true European media that would keep the electorate informed about what is going in the EU. As a result, it is difficult for the ordinary voter to stay informed about what is being decided by the EU, who is responsible for the decisions, what the alternatives are, and how the available voting options at the European elections map to different European policies. In short, the voter lacks the effective means to hold EU decision makers accountable.

1 Tuomas Saarenheimo's contribution is based on intervention in the workshop when he was the Permanent Undersecretary at Finland's Ministry of Finance.

So, what does that mean for the EU's ability to act? That depends on what it seeks to do. First, the EU does not have to rely on democratic accountability alone to legitimise its decisions; it can also derive legitimacy from results. For example, the delegation of trade policies was a significant transfer of political power to the EU. Yet, arguably, it has been thoroughly legitimised over time by the positive economic effects of a coherent EU trade policy.

Second, not all decision making needs to be democratically accountable. Democratic accountability is desirable – and indeed essential – mainly for decision making with political content. There are plenty of areas falling under technical regulation and implementation where the EU has flourished. In such areas, direct democratic accountability for each decision taken is not only unnecessary, but indeed undesirable. Most of the EU's regulatory apparatus belongs to this category. The agencies established to facilitate the functioning of the Single Market bring clear benefits, mostly without raising significant issues of democracy.

There are similar examples in the field of EMU. The Banking Union, with the Single Supervisory Mechanism (SSM), the Single Resolution Board (SRB), and the (European Supervisory Agencies (ESAs), consists of technocratic entities implementing their individual legal mandates. The same is true of the Commission in its capacity as competition authority, and the ECB as monetary authority. These entities serve administrative functions that in most developed countries have been considered administrative rather than political, and are therefore delegated to specialised technocratic agencies. Their decisions can be important and consequential, and they can sometimes get entangled in political disputes. But they are still fundamentally about implementing laws, which is not a political choice but an administrative duty and, as such, does not need to be directly democratically legitimised.

In its other dimensions, however, the EMU deepening agenda has entered into far more difficult areas. The focus on structural convergence and fiscal risk sharing has brought EMU into areas that are not administrative or technical but deep in the political domain. It is here that democratic accountability considerations are central. Yet, the issue has so far been curiously absent from the discussions.

The work on a euro area fiscal union illustrates this point. The debate is framed in terms of abstract concepts such as 'central fiscal capacity', 'stabilisation function', or 'safe asset'. Hidden behind these sterile euphemisms lie structures that would potentially govern the flow of substantial amounts of public resources between member states. There is practically no discussion about the democratic structures that would be needed to legitimate their operation. The presumption seems to be that the euro area fiscal union would be run by administrative fiat or through mechanistic rules.

In my view, it is an illusion to think that significant decisions on public funds could be made in a purely administrative manner, without political involvement. Such decisions have actual and visible consequences for the electorates in member states. They divide and mobilise voters in elections. In democratic societies, such decisions not only belong to elected bodies, they will get politicised, one way or another, regardless of how the system is set up. Decisions handed out from Brussels would get politically weaponised at the national level. Consequently, political considerations would also eventually start to dominate EU decision making. To understand how this would play out, one needs to look no further than to the implementation of EU fiscal rules.

When it can be anticipated that the use of significant public power cannot be confined to a clear legal mandate but is instead likely to get politicised, then the politics should be made explicit and subject to democratic controls. The worst alternative is a sham technocracy – an ostensibly rules-based administrative system but one where rules are bent and important decisions shaped by a politicised process, without proper mechanisms of accountability.

The case for a stronger EU role in structural and fiscal policies is in many ways convincing. It would be beneficial from several viewpoints, including the functioning of the Single Market, management of economic externalities, and environmental and social considerations. However, from the viewpoint of democratic accountability and the legitimacy of those policies, it matters how this is done.

Since the financial crisis, such a stronger EU role has been gradually introduced into EU law, embedded in the European Semester and as conditionality attached to EU funds. The formal (Treaty-based) policy competences have not been touched. Instead, the EU has received more tools to interfere, with the threat of sanctions or financial incentives, in the way member states exercise their national policy competence. Taken too far, the outcome is blurred lines of responsibility and a breakdown of democratic accountability. Voters will find it increasingly difficult to understand who is responsible for decisions. The EU gets drawn into national political disputes and finds itself navigating through political minefields, trying not to antagonise national electorates.

Increasing the EU's powers in fiscal and structural policies without proper democratic accountability creates fragilities. At best, the result is just that EU laws are left unenforced, as has been the case with much of the European Semester. In other contexts, the stakes can be higher and the fragilities more dangerous.

This is particularly the case with the proposals for a euro area ‘safe asset’. In a typical model, euro area countries would borrow jointly and pass the funds on to each member state, up to a predetermined limit. To avoid rampant free-riding, the system relies heavily on its ability to credibly enforce the limit, including in times of stress. So how credible would the limit be in practice? Imagine a country is up against its ‘safe’ borrowing limit and finds itself unable to issue debt in its own name. The euro area would face a choice between three options. It could persuade the country to accept a macroeconomic adjustment programme with conditionality, which the country would probably be very reluctant to do. Alternatively, it could do nothing and see the country face a costly default, potentially losing a significant part of its own exposure to the country. Or it could allow the country to exceed its borrowing limit, just this once. The larger the existing exposure through the safe asset, the greater the pressure for forbearance, throwing good money after bad, to keep the country liquid. The limits would quickly lose their credibility, and the safe asset would become a source of division between euro area countries.

The challenges faced by the euro area are not unique. They are typical problems of fiscal federalism, faced and dealt with by dozens of federations around the world and over time. There is plenty of experience and a good understanding of what works and what does not. What works is a system with clear assignment of powers between the federal and state level, with sources of income commensurate with powers and clear lines of accountability at each level.

I believe this is the direction in which integration should move within the EU as well. It will require much political integration and will not happen fast. But it would ensure a solid democratic basis for integration.

About the author

Tuomas Saarenheimo has been the President of the Euro Working Group (EWG) since April 2020. The EWG prepares the meetings of the Eurogroup and coordinates on euro-area specific matters. It is composed of senior representatives of the euro-area member states of the Economic and Financial Committee, the European Commission and the European Central Bank. Tuomas Saarenheimo also serves as the President of the Economic and Financial Committee, which prepares the ECOFIN Council and promotes policy coordination among EU member states.

Until April 2020, he was Permanent Under-Secretary at the Ministry of Finance, Finland, responsible for International and Financial matters. He joined the Ministry in 2013. In this position he was member of the EU Economic and Financial Committee, the Eurogroup Working Group, the Board of Directors of the European Stability Mechanism, and the Board of Directors of the European Financial Stability Facility. Prior to joining the Ministry of Finance, Mr Saarenheimo served several spells at the Bank of Finland, ending as Chief Economist and Head of Monetary Policy and Research. He has also held positions as Executive Director for Nordic and Baltic countries at the International Monetary Fund, as National Expert at the European Commission and as researcher at the University of Helsinki. Mr Saarenheimo graduated in 1989 from the University of Helsinki, where he also gained PhD in Economics in 1994.

Part II

A euro area treasury as part of a revamped institutional architecture?

4 Why has a euro area treasury not yet taken shape?

Niels Thygesen[1]
European Fiscal Board and University of Copenhagen

The European Commission's Directorate-General for Economic and Financial Affairs (DG ECFIN) is to be praised for its initiative to look beyond short-term policy issues and ask what place there could be for a euro area treasury as the institutional architecture evolves. Although I come from Northern Europe, where institutional issues are normally seen as a distraction from the more pragmatic task of gradually developing substantive areas of cooperation before asking what institutional architecture might be better suited for dealing with them, there is clear merit in asking the question.

Why is it that, despite a number of bold reflections on the European dimension of economic policy, there has – with the essential exception of the set-up of the ECB – been very little ambition to examine other institutional implications of EU integration? In this chapter, I shall do so by looking briefly at six examples from periods of major policy initiatives that might have inspired such examinations.

The first example goes back half a century to the Werner Report of 1970 on Economic and Monetary Union (EMU), to be realised in three stages over the decade up to 1980. A key feature of that proposal was the set-up not only of a common central banking system, modelled on the Federal Reserve, but also of "a centre of decision for economic policy". This parallelism between the evolution of the framework for monetary and other macroeconomic policies has rightly been identified as the major achievement of the Werner Report. But the design of the new centre was not spelled out for at least two reasons: (1) the Werner Report was primarily concerned with the first of the three stages in the EMU process, in which new institutions would have been premature; and (2) the tasks of the centre – mainly to provide guidance for the levels and direction of (public and external) balances and their finances – were seen to be manageable, even

1 The remarks in this chapter are made in a personal capacity and do not necessarily reflect the views of the insitutions with which the author is affiliated.

in the final stage, by an upgraded Council of Finance Ministers (ECOFIN) without the support of a federal Treasury – a notion absent in text as well as in spirit from this first effort to launch EMU.

It was no doubt wise of Pierre Werner and his co-authors not to go into any institutional details. The resistance to any such designs soon proved to be fierce, not least from France. Even in the absence of the dramatic shocks that hit the international economy from 1971 on, it seems highly unlikely that the then six, soon to be nine, member states could have agreed on even the limited transfer of fiscal sovereignty implied by the Werner Report. The legacy of this first effort was confined to the ambition to retain an intra-EU system of exchange rates within narrow margins and a European Monetary Cooperation Fund (EMCF) to "manage" short- and medium-term credits between central banks. It seems appropriate to use quotation marks here, since it was very unclear whether central banks or governments would be in charge of the EMCF, which ended up as a book-keeping agency for central banks rather than as an embryonic balance-of-payments support function managed at the political level as a classical treasury function.

The second example of a political initiative that could have resulted in a more explicit debate on a possible role for an EU treasury came around 1977. When the first major energy price hike had killed all hopes of continuing a process towards EMU by 1980, an ambition arose in some EU circles, not least within the Commission, to break new ground by bringing fiscal integration closer to the centre of attention – not in parallel with monetary integration, but as a prerequisite for the latter. For a few years (1975-77), fiscal federalism was studied attentively, going well beyond macroeconomic stabilisation to the other main dimensions of public finance in the sense of Musgrave – to the impact on the allocation of resources and on the distribution of income. It was argued, notably in the MacDougall Report of 1977, that a "pre-federal" budget of at least 2-2.5% of aggregate GDP should be envisaged for the European Community. It would serve minimal functions of stabilisation – as an unemployment insurance mechanism – and take early steps towards realising some of the efficiencies of scale within reach, as expenditures shift from the sub-federal to the federal level in large countries. Though the report also looked at the longer-term prospects for a common and much larger budget, the focus on the pre-federal phase justified, as had been the case in the Werner Report, neglect of the institutional implications of the longer-term proposals.

Commission President Roy Jenkins – the only president of UK origin in European history – embraced these inspirations from fiscal federalism and went further, notably in his speech at the European University Institute in Florence in November 1977, by linking such plans to a revival of monetary union. The *Economist* described his views as “a bridge too far”. In any case, Jenkins was soon sidelined by two factors: the size of the common fiscal resources outlined, which deterred most governments from pursuing any further debate; and the initiative of Chancellor Helmut Schmidt and President Valery Giscard d’Estaing in early 1978 to refocus the debate on monetary integration.

The Schmidt-Giscard initiative provided the third opportunity to consider a European Treasury function – not in order to put into operation the European Monetary System (EMS), which remained a coordination mechanism for the participating central banks, but to arrive at the second stage of the EMS and the set-up of a European Monetary Fund (EMF) to provide medium-term balance-of-payments financing for participants. The two initiators had little sympathy for the notion of independent central banks; they thought that such a mechanism could be provided by extending the very short mutual liquidity support for EMS central banks. Their national officials, and particularly the governors, killed any further discussions on the EMF over the course of 1980. Balance-of-payments support was to remain demarcated as a conditional and exclusively political activity, and there was no readiness to consider how such a responsibility could be designed. In any case , in the course of 1981-2 both of the EMS fathers disappeared from the political scene – and with them a possible Franco-German joint push to put the main emphasis in integration efforts on the fiscal side; the debate of a Treasury function once more seemed superfluous.

A fourth opportunity to start the debate arose with the plans for EMU five years later, but the need for a joint treasury remained beyond the perceptions of what was required. The focus was on centralising monetary policy in view of both the gradual build-up of the Single Market, seen as too demanding with continuing exchange-rate risks, and the need to better protect European currencies against external monetary disturbances. In contrast, the spillover effects of national fiscal policies were seen as modest, justifying arm’s-length relations and reliance on fiscal rules to prevent major divergence. Stabilisation in EMU would be taken care of by joint monetary policy and by national automatic stabilisers, which are large in most parts of Europe. Cross-border spillovers of national fiscal policies were seen as limited in normal circumstances, and ambitions for fiscal federalism had disappeared. The principle of “subsidiarity”, canonised in the Maastricht Treaty, was not synonymous with full decentralisation of fiscal policy, as explained with admirable clarity in a CEPR report; the emphasis in 1992 was on differences in national policy preferences and on the expected difficulties of making European institutions sufficiently accountable. That pointed towards coordination at most, rather than centralisation, of fiscal authority.

Obviously, another factor was also at work in shaping this attitude. Working towards a common currency and an independent central bank to manage it had drained the willingness to consider transfers of sovereignty in other areas. Even the design of the coming ECB reflected that attitude: it was particularly purist in eliminating from the agenda any ECB responsibility in three areas that could have upset the pursuit of the main task of a monetary policy with price stability as its medium-term objective: foreign-exchange interventions, lender-of-last-resort support for national governments, and financial rescue and supervisory operations. More remarkably, there was no recognition that these tasks, usually performed by central banks, might then be have to be taken on by other European institutions; they were simply regarded as unnecessary. Each of them, and particularly the three in combination, could have formed an agenda for a treasury role in EMU next to that of the ECB.

Gradually, two of the possible areas for common responsibility have crept back on the European/EMU agenda, though still in a fragmented way which has not inspired reflections on a joint treasury. The first to do so – and hence the fifth opportunity for such reflections – was financial regulation and supervision. As focus in integration of markets extended beyond goods to services, not least financial services, it was recognised from about 2001 that there was a need to see regulation and supervision of financial markets and institutions as more than an overwhelmingly national task. Initially, an EU perspective was seen as necessary to break up financial fragmentation, hence achieving the gains of a Single Market. But with the onset of the financial crisis from 2008, massively destabilising capital flows and overbanking leading to weak banks, the emphasis was also on the need to take on responsibilities for financial stability that the ECB was not to assume. Paradoxically, by 2012 the task of supervising the large banks in the banking union – so far, only EMU-participating countries – ended up in the ECB anyway, since this was the only way it could be done in the absence of highly unlikely Treaty revisions; luckily, the drafters of the Treaty had left a small opening for the ECB beyond its purely advisory one.

Finally, and about the same time, the exclusion of a lender-of-last-resort role for the ECB implied that assisting some EMU participants in regaining access to financial markets motivated the setting-up of a public safety net for EMU countries in the shape of what has now become the European Stability Mechanism (ESM). This significant function unfortunately had to be organised in an intergovernmental organisation outside the Treaty framework, once more obviating in this sixth opportunity the need for a treasury in EMU itself. The Commission tried in December 2017, notably as part of a more comprehensive overhaul of the legal framework to prepare for a deepening of EMU, to bring the ESM into the Treaty framework, recreating the terminology of the Schmidt-Giscard initiative of the EMF and the analogy to a regional IMF. However, this initiative has not moved onto the agenda of the Council.

What are the potential lessons of this long story of six opportunities over half a century which never led to serious discussions of a European treasury? One clear lesson is that consideration of institutional developments requires major evolution in at least one policy area; quite appropriately, discussions of such initiatives *follow* rather than *lead* substantive changes in the perceived need to go beyond cooperation. Monitoring of national fiscal policies as in the Maastricht Treaty, or even a centre for deciding on them at the European level as in the Werner Report, are not seen as requiring institutional innovations. The hope seems inevitably to be that "coordination" exercised through the Council/Eurogroup will suffice. However, the combination of tasks that have now accumulated – comprising potential revisions of fiscal governance, more or less conditional lending to governments, responsibility for financial stability, and perhaps also responsibility for an international euro and its exchange rate vis-à-vis third currencies in an increasingly unstable environment – is creating a new occasion to reconsider the case for an EMU treasury. This time, the range of tasks may prove capable of modifying the firm reservations of most member states about engaging in institutional developments. This reluctance seems to be the most illustrative lesson to be drawn from the six historical occasions when a European treasury might have been considered, but was not.

About the author

Niels Thygesen is Chairman of the European Fiscal Board and Professor Emeritus of International Economics at the University of Copenhagen. He obtained his undergraduate and graduate degrees there and an MPA from Harvard University. After working for the Danish government, Harvard's Development Advisory Service (in Malaysia), and the OECD in Paris, he held a Chair at the University of Copenhagen for more than 30 years, serving also as Adviser to the Governor of Danmarks Nationalbank, Chair of the Danish Economic Council and member of various expert groups on European monetary and financial integration – the subject area of most of his research and publications over the last four decades – and international economics. He was an independent member of the Delors Committee which prepared the outline of Economic and Monetary Union in Europe in 1988-9, a member of the committee advising the government of Sweden on an exit from the crisis of the early 1990s, a member of the Group of Independent Experts evaluating IMF surveillance following the Asian crisis, and he chaired the Economic and Development Review Committee of the OECD which evaluates the economic performance and policies of member states in 2000-8. He is a Founder Member of the European Shadow Financial Regulatory Committee since 1998 and the only Honorary fellow of the Danish Economic Association.

5 Designing a euro area treasury

Hans-Joachim Klöckers and Sander Tordoir[1]
ECB

The Five Presidents' Report considered a euro area treasury one of the key elements for the steady state of Economic and Monetary Union (EMU) (Juncker et al. 2015). Nevertheless, with the exception of the Commission communication on a European Minister of Economy and Finance (European Commission 2017), the euro area treasury has received little attention in the debate on deepening EMU recently. This contrasts with a growing body of economic research that underlines that institutions fundamentally matter for economic outcomes (Acemoglu and Robinson 2019).

The time may not be ripe yet to set up such a treasury. However, if ongoing reforms to the EMU architecture are implemented without sufficient regard for institutional design, the EMU landscape might end up littered with a complex and non-transparent mix of rules, supranational authorities and intergovernmental bodies. This could lead to sub-optimal governance with unclear accountability arrangements, eventually also complicating the conduct of the ECB's single monetary policy.

Against this background, in this chapter we first take a look at the tasks treasuries typically perform in existing mature federations such as the US or Germany. We then discuss the rationale for a euro area treasury and desirable principles for its functioning, before designing on that basis a first best solution for a euro area treasury. We end by discussing some transitional aspects before concluding.

1 The views expressed here are our own and do not necessarily represent the ECB's view. We thank M Dyckerhoff, J F Jamet, A Giovannini, and J Lindner and for their useful suggestions and comments.

A comparison with existing federations

The US and German treasuries represent the accumulation of decades of experience with institution-building and policy learning, from which Europe's much younger monetary union can learn. As illustrated in a stylised way in Figure 1, these treasuries are responsible for administering six broad tasks: 1) managing federal finances and debt; 2) preparing tax legislation, including harmonised tax bases for sub-federal entities; 3) managing a large central budget and its interactions with sub-federal fiscal entities in a clear framework; 4) being in charge of macro-stabilisation and crisis management; 5) preparing financial legislation; and 6) providing unified external representation.

Figure 1 also shows the current euro area set-up for comparison. The euro area does not have one single treasury – it has 19 national ones and a small EU-wide one encompassing all 28 current EU member states. National fiscal policies are subject to European rules, reflecting that such policies can have adverse spillovers and therefore constitute an area of common concern. Meanwhile, the burden of stabilising the business cycle remains largely at the national level as regards fiscal policy, while a European crisis management framework has been established based on intergovernmental decision-making, and financial legislation is party promulgated by national and partly by European legislators. Finally, the euro area suffers from a lack of unified external representation.

The comparison has to be read with some caution: the euro area is not a federation and will likely remain more decentralised than the US or German model. But the experience since 2008 has laid bare fault lines in the euro area governance which other jurisdictions do not have. The comparison with existing – and functioning – federations is thus a useful means of inspiration to identify institutional shortcomings of EMU, even if EMU might end up pursuing a *sui generis* solution.

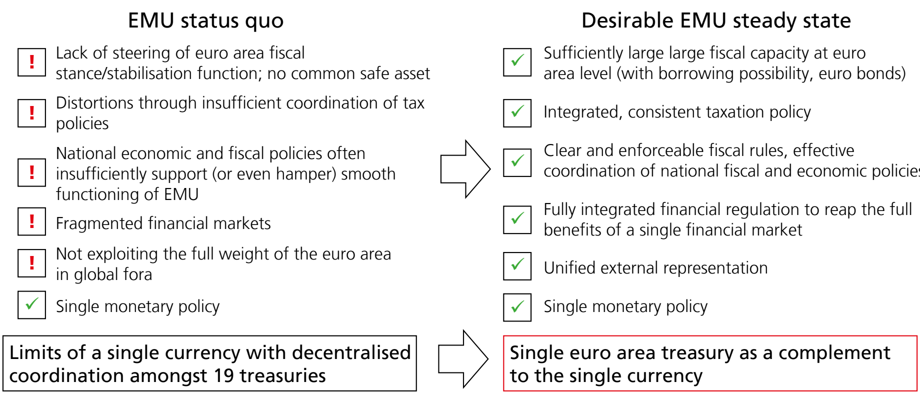
Figure 1 Functions of a treasury: Comparison with existing federations

	Public finance	Tax legislation	Interaction with sub-federal entities	Stabilisation and crisis management	Financial legislation	External representation
US treasury DE treasury	Manage federal finances and debt	Prepare tax legislation, incl. harmonised tax bases for sub-federal taxes	Large federal budget interacts within clear framework with sub-federal entities	In charge of macro-stabilisation and crisis management	Prepare financial legislation	Provide unified external representation
EA current set-up	No EA budget; small EU budget (incl. small debt)	Some coordination on national taxation legislations, no EA taxes	Only limited ability to steer aggregate fiscal stance through national fiscal policies; mixed effectiveness of fiscal rules	No EA-wide macro-stabilisation tool; crisis management by ESM (but based on IGA)	COM can prepare EU financial legislation (but directives are less binding than regulations and single market legislation not yet complete)	No unified euro area external representation

The rationale for a euro area treasury

The economic challenges faced by the euro area are outlined in the left-hand side of Figure 2. These challenges have one common denominator: coordination failures. There is currently no effective framework in place to steer the euro area fiscal stance. The insufficient coordination of tax policies results in distortions to the functioning of the Single Market. As evidenced by the sovereign debt crisis and a series of IMF/EU adjustment programmes for individual euro area countries, inadequate national economic and fiscal policies can endanger the smooth functioning of EMU. Financial markets are still very fragmented, which reduces their depth and ability to absorb shocks, and the euro area is not exploiting its full weight in global fora. In short, the overly decentralised governance of EMU suffers from deficiencies which need to be addressed to make it more resilient in the long run.

Figure 2 Rationale for a euro area treasury



Indeed, institutions tasked with euro area governance, especially the European Commission, do not have sufficient legal powers and – in part due to this lack of powers – do not have enough political capital to ensure that the euro area perspective prevails over national preferences. For example, the Commission can trigger corrective procedures, such as the Excessive Deficit Procedure (EDP), which can result in sanctions, but it cannot take fiscal decisions which override national choices. In addition to their mixed effectiveness, the current governance structure also suffers from low efficiency. The number of veto players is high, there is a lack of clarity on who is responsible for enforcement, and parliamentary involvement is underdeveloped (Bénassy-Quéré et al. 2019).

Against this background, the right-hand side of Figure 2 illustrates what could be desirable features of a steady-state EMU euro area treasury.

A first such element would be a central fiscal capacity which would allow steering the euro area aggregate fiscal stance (ECB 2018). By design, decentralised coordination using fiscal rules cannot always lead to an adequate fiscal stance for the euro area. By their mandate, national policymakers react primarily to national and not to euro area developments. Even if national policymakers were to internalise euro area needs, the positive effect of fiscal stabilisation in one country on its neighbours would be rather small. That is why an incentive-compatible common fiscal instrument managed by a euro area treasury is a necessary complement to a single monetary policy.

Other desirable steady-state elements would be an integrated and consistent taxation policy, clear, enforceable fiscal rules and effective coordination of national fiscal and economic policies, a fully integrated financial regulation, and a unified external representation to complement the single monetary policy (Coeuré 2015).

Desirable principles for a euro area treasury

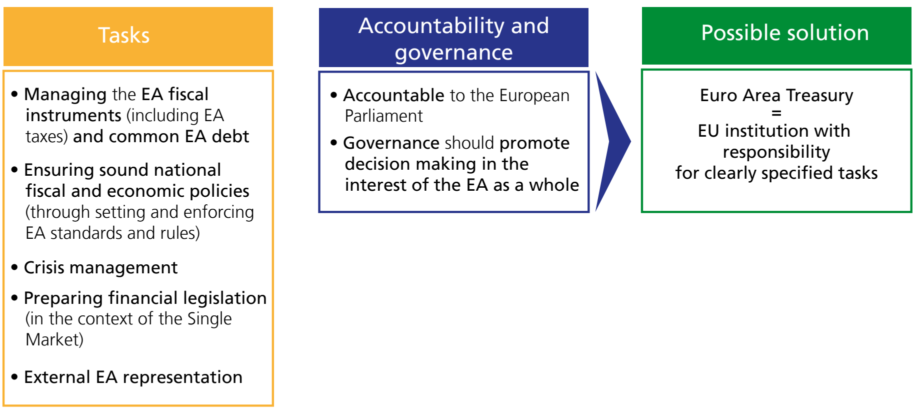
The design of a euro area treasury would ideally fulfil six principles:

- **A euro area mandate**. The treasury should be equipped with a clear euro area mandate and decisions should be driven by euro area interests only, akin to the mandate of the ECB.
- **Subsidiarity**. The treasury should, however, only be responsible for those euro area tasks that cannot be adequately performed by the member states' treasuries.
- **Effectiveness**. The treasury should be equipped with genuine competences, instruments and rules-enforcement capability.
- **Efficiency**. The institutional infrastructure should be able to facilitate decisions that are fully implemented in a timely manner.
- **Clarity**. The set-up should be clear enough for the general public to understand what the treasury is responsible for and, critically, what it is not responsible for.
- **Democratic legitimacy**. The treasury should be steered by, and accountable to, the European Parliament and subject to judicial control of the European Court of Justice (ECJ).

Design of a first-best solution

Drawing on the comparison with existing federations, the drawbacks of the current euro area setup, and desirable design principles, a first-best solution for a euro area treasury is sketched out in Figure 3.

Figure 3 A design of a first best solution for a euro area treasury



Certainly, Figure 3 offers only a simplified sketch of the tasks and governance arrangements for a euro area treasury. While preparing a euro area solution will undoubtedly be much more complex, the figure serves the purpose of showing the ultimate direction which the work could pursue.

Transitional aspects

Moving towards a euro area treasury will be challenging and will take time. Therefore, it is important to also think about the transition. Three aspects can be highlighted here:

First, economic, fiscal and financial convergence will facilitate the evolution towards a treasury. Convergence is essential to build the foundation for an economically sustainable EMU. It will therefore also help build the trust between member states needed to share more competences. Such a process could be more formalised, as was envisaged in the Five Presidents' Report.

Second, during the transition towards a supranational treasury, there can be increased operational and analytical cooperation between national treasuries over time, as opposed to the current interactions in EU fora which are mostly at the ministerial and managerial level. It could be considered whether this process should be structured akin to the second phase of EMU, where the European Monetary Institute prepared the establishment of the ECB. The ESM and the Committee on EU Sovereign Debt Markets (ESDM), for example, could gradually become a system of debt management offices.

Third, there will be trade-offs between using the community method or intergovernmental approaches in the transition. While the latter may lead to faster progress, it requires unanimity in decision-making which will not be conducive to taking bold decisions. In other words, while the community method should guide the final solution, it will have to be seen whether to resort to an intergovernmental mechanism in the transition. From this perspective, national and European parliaments will have to cooperate more to ensure the legitimacy of the greater sharing of sovereignty (de Guindos 2019).

Conclusion

Setting up a treasury would embody a shift towards institutional decision-making, which holds key advantages over a primarily rules-based system of economic governance (Draghi 2019). Rules need to be applied strictly to be effective and credible. However, particularly in the context of the EU Treaties, rules are static and cannot be updated quickly in response to new economic challenges. They tend to lose credibility if they are broken or loosely applied. By contrast, institutions can be agile as they are bound not by specific actions but by overarching objectives. Institutions rely on this agility to fulfil their objectives and, ultimately, for their credibility. As such, institutions can be both flexible and credible whereas rules face a fundamental trade-off between the two. In addition, institutions can be subject to clearer democratic accountability and scrutiny than rules, as elected representatives and citizens can more evidently see the link between decisions and those responsible for taking them.

Whilst a euro area treasury is a long-term goal, to steer the transition in the right direction it is helpful to postulate a vision of what a first-best solution would look like already, based on the shortcomings of the current system.

First, a treasury should be designed to address common economic challenges where decentralised coordination runs into limits. Prime candidates for the treasury's tasks thus include steering and stabilising the euro area aggregate fiscal stance, crisis management, ensuring harmonisation of financial and tax legislation, imposing limits on national economic and fiscal policies which have harmful spillovers for the euro area as a whole, as well as serving the unified external representation.

Second, adhering to key institutional design principles (a euro area focus, subsidiarity, effectiveness, efficiency, clarify and democratic legitimacy) are important for the success of a treasury.

Third, the setting up of a euro area treasury should not involve moral hazard and set disincentives for the conduct of national fiscal policies. It therefore needs be accompanied by mechanisms imposing stricter fiscal discipline on member states than exist nowadays.

Finally, a treasury should be given genuine euro area competences to conduct its tasks. A horizontal shifting of existing roles, whilst keeping the current division of competences between the national and the European level intact, is a cosmetic solution which is unlikely to address the underlying problems.

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6 A Euro Treasury: Essential, and rather straightforward

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The Maastricht euro has not delivered on its promises. The euro area was unique in suffering a double-dip recession after 2008. Its belated recovery since 2013 has been fragile and uneven, and remains incomplete even today; as the global environment has turned unfriendly.

A triad of key deficiencies can be identified that were chiefly responsible for this outcome. First, during the euro's first decade, failure to prevent divergences in competitiveness and the corresponding build-up of imbalances created grave financial fragilities, preparing the ground for crisis. Second, when crisis struck, triggered abroad by the Lehman Brothers event, euro area banks and their national sovereigns were seen in a devilish embrace. As soon as one of the two was struggling, the 'bank-sovereign doom loop' saw to it that both would sink together – with contagion swiftly spreading area-wide. Third, the euro area was lacking in effective means to overcome the crisis and restore vibrant growth. Hit by a severe symmetric shock, the fiscal policies of member countries amplified the downturn by crushing public investment and much more, while the ECB was hampered in its liquidity support and monetary policy response, too.

The euro's three shortcomings are connected, and each calls for a fiscal union of some kind. Prior to the euro, divergences in competitiveness were corrected by European Monetary System (EMS) parity realignments, which mitigated the possibility of serious imbalances. When the former East Germany lost competitiveness inside the German monetary and fiscal union through rapid wage and unit-labour cost increases, the intra-German transfer union automatically provided the offsetting public money flows to the east. When a united Germany subsequently boosted its competitiveness inside Europe's monetary union, private money flows seemed to act smoothly as an offset – until crisis struck and capital flows reversed, leaving balance sheets impaired and financial markets dysfunctional.

The ECB has kept the euro monetary union afloat through ample liquidity provision and – much delayed – record low interest rates. Complaints about these crisis policies are rampant in creditor countries. Yet, debtor defaults or fiscal transfers of one type or another are the only alternatives.

I emphasise this point because there is currently virtually no support for establishing a euro area transfer union (beyond the EU budget). The logical upshot is that rebalancing the euro area and preventing a repeat of divergences in competitiveness positions is more urgent than ever. In other words, absent any willingness to create a full-blown fiscal union, establishing an effective and symmetric Macroeconomic Imbalance Procedure will be critical (Bibow 2013a).

The focus now shifts to the remaining two defects. To address these, I propose a minimalist fiscal union that precludes the dreaded transfer union by design. How can the euro area end the bank-sovereign doom loop and boost the monetary union's capacity to counter shocks, including severe symmetric ones (Godley 1992, Goodhart 1998, European Fiscal Board 2019)? The insufficient level of public investment in the euro area, severely depressed by the lingering protracted austerity, and the looming climate change challenge deserve immediate and critical attention in this context.

The next step, therefore, is the establishment of a 'Euro Treasury' administering a small euro area budget that essentially runs on auto-pilot. The Euro Treasury would be rather straightforward in design. It would issue common euro bonds and distribute the money from their sale to euro area members as investment grants. The recipients would be bound to use these grants for public investment only. Investment grants would be based on members' euro area GDP shares. Members would also contribute to the interest service on the euro bonds issued by the Euro Treasury based on their GDP shares. This feature would avoid a transfer union by design. Each member would receive its investment grant and associated interest bill from the Euro Treasury based on its GDP share (Bibow 2013b).

As an example, based on the infamous Maastricht parameters, the initial volume of euro bond issuance and associated investment grants might be set at 3% of GDP and the initial volume might then grow at an annual rate of 5% ever after. If the assumptions implicit in the Maastricht Treaty hold, the common Euro treasury debt would converge to 60% of GDP over time. Of course, different parameters could be chosen. The aim is to safeguard and guarantee a sufficient and steady level of public investment – in sharp contrast to outcomes under the current regime. The point is that the proposal would start a minimalist fiscal union that can run on auto-pilot and precludes a transfer union.

Note that the Euro Treasury would thus deliver the missing 'common safe asset' for the monetary union. As the common safe asset, the euro bonds issued by the Euro Treasury would provide a common term structure of risk-free interest rates. Realising the ideal of a level playing field (as promised by the Single Market) and delivering a truly uniform monetary policy for the euro area (as promised by the euro) both hinge on this critical precondition.

The Euro Treasury would help to end the 'doom loop' as euro area banks would henceforth hold euro bonds instead of national government bonds as their safe asset. Euro bonds issued by the Euro Treasury would not only be made safe by the capacity to tax but also by the fact that the ECB could always purchase euro bonds in the open market for monetary policy purposes without facing legal challenges. These are critical features regarding financial stability and the effectiveness of monetary policy in the euro area. They are achieved not by mutualising existing national debts, but by financing a steady flow of future public investment spending.

That steady flow of debt-financed public investment spending is critical in and of itself for steadying GDP growth. A vital change in mindset is warranted. The idea of running perpetual balanced (structural) budgets as institutionalised by the current fiscal regime – the ill-named Stability and Growth Pact (SGP) and the so-called Fiscal Compact – is deeply flawed and doomed to fail. The fact that persistent attempts to follow through on it have only succeeded in crushing public investment (and much else besides) while public debt ratios today far exceed Maastricht levels is compelling evidence. Germany alone enjoys apparent success, but the country's persistent external imbalance is key to this supposedly virtuous outcome – to the detriment of others.

Accepting steady debt-financed public investment is nothing but a return to normalcy, a return to what used to be accepted as sound finance. Germany had the 'golden rule' of public finance written in its constitution until 2009 – when the country's political authorities and public got befuddled by the flawed ideas that have inspired the 'debt break' and 'black zero' policy. The Euro Treasury would establish the 'golden rule' that public investment should be debt financed as a fiscal anchor and engine of joint prosperity for the euro area.

Returning to a position of fiscal normalcy that features steady and sufficient debt-financed public investment will go a long way towards boosting recovery and stabilising GDP growth. The opportunity of restoring normal levels of public investment while meeting the climate change challenge is one not to be missed – a chance to do what is rather obviously the right thing to do.

The establishment of a Euro Treasury would bolster the euro area's capacity to cope with shocks, both symmetric and asymmetric. For returning to fiscal normalcy by organising steady debt-financed public investment through the Euro Treasury would finally enable member states to achieve their medium-term fiscal objectives. The current fiscal regime is unworkable and counterproductive. Results have shown that very clearly. The Euro Treasury would profoundly complement the current regime and make it workable.

By replacing the current SGP 'stick' (i.e. unenforceable penalties) with investment grants that provide the 'carrot' for good behaviour, the Euro Treasury would automatically withhold investment grants in cases of non-compliance with the fiscal rules, as symmetrically applied to current expenditures. Meanwhile, special tax provisions would generate revenue earmarked for servicing the Euro Treasury debt, perhaps bolstered by a deposit of international reserves.

The Euro Treasury would finally enable national debts to converge to low and safe levels – another critical element in ending the 'doom loop'. Member states would thereby see their fiscal space restored and with it their capacity to cope with milder symmetric and asymmetric shocks by letting automatic stabilisers work freely.

In case of severe common shocks, however, it would be advisable to temporarily use the Euro Treasury for making all-purpose grants beyond its steady investment grants. This, too, could be done automatically by following the old Maastricht rule that exempts 2% downturns. This would assure that any crisis-driven temporary rise in public debt is concentrated at the centre where it is safe, rather than at the national level. (Note that this would resemble the situation in the US, a functioning monetary union that has a large federal debt and low debt ratios at lower government levels; Bibow 2019.)

A Euro Treasury – the minimalist fiscal union sketched here – would heal two of the Maastricht euro's three critical deficiencies: ending the 'doom loop' and raising decisively the euro area's capacity to withstand shocks. Excluding a euro area transfer union by design, it would provide the missing common safe asset without mutualising existing debts. Restoring and safeguarding public investment at normal levels would help the euro area meet the climate change challenge along the way. A Euro Treasury is essential. The 'golden rule' is a straightforward way of doing it.

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7 We don’t need no institution: What the euro area requires is not a treasury but a common fiscal policy

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Every federation, indeed every country, has a treasury. Hence, the logic goes, the euro area also needs one to become a mature currency area on a par with, say, the United States. At first sight, this is a compelling argument. But, as I will argue here, it completely misses the point. It avoids the requisite debate on policies and competences and replaces it with an unnecessary one on institutions and processes. The euro area does not need new institutions at this stage; it needs a common fiscal policy. This is what we should focus our political energy on.

What does ‘treasury’ mean?

As with many euro area reform buzzwords, ‘treasury’ means different things to different people. Broadly, we can identify three versions now under discussion:

- *The ‘treasury’ as executor of fiscal policy*. In most countries, the term ‘treasury’ is used synonymously with ‘finance ministry’ (e.g. the US Department of the Treasury) or designates a part of it (e.g. the French DG Trésor). Thus, treasuries have traditionally been important players in the executive branches of democratic states. They usually fulfil two key fiscal policy tasks: first, they raise funds for the state either through taxes or by issuing debt; second, they administer public spending. But they cannot do so on their own; they need approval for everything they do from the legislative branch (i.e. from parliaments). This power of the purse is a cornerstone of modern parliamentary democracy. Therefore, in the traditional sense, a treasury is not a place for decision-making on fiscal policy, but for preparing and executing parliamentary decisions. In the context of the euro area, this would mean replicating national finance ministries at the European level, possibly with a euro area finance minister at the apex.

- *The ‘treasury’ as decision-maker on fiscal policy.* The specific debate on a euro area treasury has, however, departed from this traditional concept. The Five Presidents’ Report argued in 2015 that “as the euro area evolves towards a genuine EMU, some decisions will increasingly need to be made collectively while ensuring democratic accountability and legitimacy. A future euro area treasury could be the place for such collective decision-making” (Juncker et al. 2015). Here, the treasury is no longer primarily an executor of decisions taken elsewhere but a place where the real decisions are taken. It is also clearly not conceived as a traditional government department with a vertical hierarchy and a single decision-taker at the top, but as a collective decision-making body. Thus, this concept of ‘treasury’ is largely decoupled from its original meaning within a nation-state context.
- *The ‘treasury’ as common fiscal policy itself*. In both concepts described above, the ‘treasury’ is an institution to be established at the European level. But it seems that what many really have in mind when advocating for a euro area treasury is not a replication of a national finance ministry but of the fiscal competences of a nation state. ‘Treasury’ is used here as a synonym for the power to spend, to levy taxes and to borrow. If used in this sense, the discussion about a euro area treasury is really a discussion about the need for a common fiscal policy.

The three concepts above suggest that there are really three questions behind the main question of whether we need a euro area treasury: What competences should the euro area as such have with regards in terms of fiscal policy? Who should decide on fiscal policy at the euro area level? And who should implement these decisions?

Do we need a treasury in the sense of a common fiscal policy?

The short answer is yes. Whether the euro area needs a common fiscal instrument has been the subject of a long and intense debate over recent years. Most economists agree today that some form of common fiscal policy would be beneficial for the functioning of the euro area as it would complement the ECB’s monetary policy in the event of both asymmetric shocks and area-wide crises.[1] To call this a ‘treasury’ is a misnomer – we should call it a fiscal instrument, a fiscal capacity or, even better, a budget, because this is an expression that non-economists understand.

1 It is beyond the scope of this chapter to make a detailed case for a common fiscal policy. For an overview of the main arguments in the debate, see Guttenberg and Hemker (2018).

But if we get a common fiscal policy, the question is still who would decide on it and who would implement it. This is where the two next questions come into play.

Do we need a treasury as a place for collective decision-making on fiscal policy?

There are two types of fiscal policy decisions at the European level:

- The EU yields a certain degree of *vertical* decision-making power over national budgets. The Commission and Council apply the rules of the Stability and Growth Pact (SGP) based on EU regulations. In addition, the Eurogroup de facto exercises a veto power over national budgets of member states in ESM programmes. The question here is whether these vertical decision-making powers should be transferred to a new 'treasury'.
- A new common fiscal policy for the euro area would entail a transfer of *horizontal* decision-making powers to the European level. Proposals for such an instrument differ strongly as to the degree of discretion when it comes to spending. Some, such as a cyclical stabilisation fund or an unemployment reinsurance scheme, could be largely rules-based and require no or very little political action once up and running (e.g. Dolls 2018, Enderlein et al. 2013). Others, such as a fully-fledged euro area budget, would rely on continuous political decision-making (e.g. Funke et al. 2019). What they all have in common, however, is the need to collectively take decisions at the euro area level on the rules that guide the instrument. But who should take these decisions?

A priori, all these decisions could be taken within the existing institutional framework of the EU. The European Parliament and Council can take the big-ticket political decisions and can delegate implementation to the Commission. The Council can already today decide in euro area-only configurations on euro area-only matters, but the Parliament would need to find an appropriate set-up for this. However, after Brexit this is much more a symbolic than a substantial issue. Thus, in view of avoiding institutional duplication, there is a strong case for relying on the existing institutions for decisions on fiscal policy.

There are, however, two arguments for a separate, new treasury as a decision-making institution that deserve serious attention:

First, some argue that vertical decision-making should be left to a body of independent experts, as SGP enforcement has proven toothless because member states shy away from sanctioning each other. Following this line of reasoning, the treasury would be an ECB-like creature. However, this misses the fundamentally political nature of fiscal policy – such a body would have to overrule elected officials in a policy area where every choice can have massive distributional consequences. The question of how taxpayers' money is spent goes to the heart of how a society wishes to function. Experts, however brilliant, should not have the power to interfere with this without the appropriate political legitimacy. This is completely different from monetary policy, where the ECB exercises its mandate in a very narrow space and has full control over its own instruments. It does not have to overrule anyone. In addition, it is also not clear whether this would work from a political economy point of view. Monetary policy had already been delegated to experts at the national level before moving to the European level. Fiscal policy rests firmly with governments and parliaments. The Commission and Council do not have the political stomach to sanction member states. It is not clear why an independent body would have more political capital and legitimacy to do so. Thus, this avenue is not very promising.

The second strand of reasoning goes in the opposite direction. Some argue that member states should remain in control of fiscal policy decisions and thus need to create a treasury where, as in the ESM, they decide without any interference from the Commission or Parliament. Some even suggest turning the ESM into the treasury. Such an inter-governmentalisation of fiscal policymaking would be wrong for two reasons. First, both vertical and horizontal decision-making require parliamentary control; national parliaments are unable to exercise this control within a European perspective. Therefore, the Parliament should be fully involved in, for example, setting the rules for a future euro area budget and formulating the fiscal rules. Second, inter-governmental decision-making is a recipe for inertia and leads to inefficient outcomes. It is a major achievement of recent decades that almost all policy areas now fall within the ordinary legislative procedure. Deliberately rebuilding inter-governmental institutions would reverse this trend and set a dangerous precedent.

Thus, neither strand of argument is convincing. A treasury as a place for decision-making is not necessary as current EU institutions can play that role, and it is not desirable as fiscal policy should neither be handled technocratically in an expert body nor be decided inter-governmentally in an ESM 2.0.

Do we need a treasury to execute fiscal policy decisions?

Finally, the question is whether we need a euro area treasury that would replicate the functions of national finance ministries – preparing legislation and executing political decisions. This could also include the management of jointly issued debt, just like treasuries at the national level are in charge of debt management. Here again, the first option would be to make use of the existing EU institutional framework – in this case, the Commission – before building new institutions. For all its flaws, the Commission is exceptionally skilled at one thing: bureaucracy. Therefore, it would be really hard to argue why the Commission should be circumvented when it comes to preparing and implementing political decisions. This is what it was built for, what it is best at. Thus, the case for a separate treasury to execute fiscal policy decisions is even weaker than the case for the treasury as fiscal decision-maker. Instead, the Commission DGs in charge of euro area matters could be brought under the single roof of a DG 'Treasury' that would prepare college decisions to implement the fiscal rules and administer the common fiscal instrument. Such a DG Treasury could be overseen by a euro area commissioner – or even a euro area finance minister. But here as well the rule should be for form to follow function. New shiny titles and institutional changes should be the consequence of increased competence and power, not their precursor.

Conclusion

The euro area does not need a separate treasury. The institutional set-up of the EU is well-equipped to decide on fiscal policy matters and to execute these decisions. The real problem is that the euro area still lacks a common fiscal policy. The current proposals on the table will not remedy this shortcoming (e.g. Coeuré 2019). This is where the focus of the euro area reform debate on fiscal matters should lie. However, proponents of such a common policy should avoid using 'treasury' as a synonym for a euro area fiscal instrument. This confuses the debate and suggests that changing the institutional framework is as important as a change in the policy toolbox – or even more so.

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Part III

Is the time ripe for a European Minister of/High Representative for Economy and Finance?

8 A European Minister of Economy and Finance: A means to improve the democratic legitimacy of EMU?

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The democratic legitimacy of the Economic and Monetary Union (EMU) is precarious. To be precise, it is not the legitimacy of the EMU as such that is precarious since it is set out in the Treaties, but of the acts adopted within EMU. Monetary policy acts are adopted by the ECB equipped with a primary law independence guarantee in Article 130 TFEU, which shields it against any sort of binding objections from parliament(s) and governments. In economic policy coordination, decision-making at the European level lacks any parliamentary control. This lack was compensated for by the fact that acts adopted within economic policy coordination are not legally binding. Non-compliance with acts adopted by the Council that address shortcomings in a member state's conduct of economic policy would mainly be sanctioned by means of public shaming. Policy choices made by national parliaments that diverge from the views adopted by European institutions would not entail any significant consequences. They could at worst lead to financial sanctions in case of serious budgetary disturbances in a country whose currency is the euro.

This original compromise between the lack of parliamentary control and the non-legally binding nature of economic policy acts was called off by the various reforms made in the aftermath of the recent economic and financial crisis. These reforms and the extension of EMU policymaking to measures of assistance for member states in financial distress installed a European system of mainly intergovernmental decision-making (in the shape of the European Council deciding on legislative files, the adoption of the ESM Treaty or the Fiscal Compact) with supranational implementation and supervision (in the shape of the 'troika' supervising financial assistance programmes, Banking Union, reversed qualified majority voting in economic policy coordination or the Macroeconomic Imbalance Procedure) (Dawson 2015). In this system, national parliaments are cast in the role of ex post legitimisers of policy decisions already taken by their respective governments at the intergovernmental level, and the European Parliament usually has no say in the control of supervisory and implementation activities of EU institutions or bodies.

Jürgen Habermas has called this system 'post-democratic executive federalism' (Habermas 2012). The system has three main implications (Crum 2013):

- Political processes within this system operate beyond effective parliamentary scrutiny.
- Decision-making follows a logic of international power rather than procedural principles, as enshrined in the EU Treaties for supranational decision-making (such as 'transparency, the equality of member states and their right to self-government').
- The primacy of national governments in EMU prevents, finally, the establishment of any sort of European political arena to debate policy choices.

A European Minister of Economy and Finance

One way that has been suggested to address the legitimacy gap in EMU is the establishment of a European Minister of Economy and Finance (European Commission 2017) or of a High Representative for Economy and Finance. The idea is to promote the Commissioner for Economic and Financial Affairs to a Vice-President of the European Commission and to merge this role with the role of the Chair of the Eurogroup. In this capacity, the European Minister would also chair the European Stability Mechanism (ESM) (Article 5(2) of the ESM Treaty). The creation of a European Minister is meant to contribute to improving EMU's democratic legitimacy because the European Commission is accountable to the European Parliament (European Commission 2017: 7) and would be available for dialogues with national parliaments.

Identifying the democratic accountability gap in EMU

Before discussing whether a European Minister is actually a suitable means to the end of improving the democratic legitimacy of EMU, one must first identify concrete gaps in the democratic accountability of executive actors involved in EMU. To do so, a two-tier accountability framework (Amtenbrink 1999: 335) will be applied. This framework distinguishes between *conditions* of accountability and *instruments* for accountability. The first tier refers to the quantity and quality of information that forms the basis for any judgement on the performance of agents involved in EMU. The second tier looks at the means to remedy the consequences of undesirable behaviour and to sanction it.

Instruments for accountability are the change of legal basis on which an agent acts, the overriding of decisions or policy choices made by an agent, the refusal of budgetary discharge or the change of the available budget, the (re-)appointment or dismissal of decision-makers and the ability to initiate judicial review.

Applying this benchmark against EMU reveals the imbalance between the two tiers that defines the democratic accountability gap. In particular, the European semester increased the flow of information between EU institutions and agencies, on the one hand, and the European Parliament on the other. Even institutions outside the EU legal framework, such as the ESM, participate, on a voluntary basis, in regular exchanges with the European Parliament (European Parliament 2018: 13).

Things get more complicated when it comes to consequences that the European Parliament may want to attach to a negative assessment of the performance of actors involved in EMU. The European Parliament cannot change the legal basis on which these actors operate in its own motion; the right to initiate any kind of legislative procedure lies exclusively with the European Commission (Article 17(2) TEU). The European Parliament may only adopt a legislative own-initiative report requesting the Commission to submit a legislative proposal. The Commission is under no obligation to comply with such a request and can therefore always refuse to submit any such proposal. Overriding decisions made by actors involved in EMU, as well as exercising pressure on them via their budgets, is ruled out by the current legislative tendency to grant all EU agencies an independence guarantee that is comparable to that of the ECB. The available instruments are hence reduced to the appointment and dismissal of decision-makers and the initiation of judicial review. Whilst the latter is available regarding many actors in EMU (except for the Eurogroup and the ESM), the former can hardly be considered an effective tool under the current rules defining EU agencies. Mostly, the chair and the vice-chair are appointed by the European Parliament after a hearing, but only upon a prior proposal by another institution (for example, the European Commission in the case of the Single Resolution Board). For the most part, dismissal procedures cannot be initiated by the European Parliament in its own motion but can only be asked from another institution (for example, in the case of the SRB, the European Parliament can inform the European Commission of potential reasons to remove a person, to which the Commission must respond).

In brief, the accountability gap in EMU derives from the fact that the European Parliament has few possibilities to attach consequences to any performance assessment. In other words, the European Parliament is a ‘toothless tiger’ that might be able to roar but not bite.

A European Minister as a suitable means to fill the identified gap?

The identification of the accountability gap in EMU leads to the question of whether a European Minister could fill this gap. The Minister would certainly improve once more the flow and the quality of information and strengthen the first tier of the accountability framework. When it comes to the second tier – instruments for accountability – the Minister would not address the issue of the lack of possibility to override decisions or policy choices made by actors involved in EMU or to change budgets, as both relate to the independence guarantee given to these actors. The Minister could have an impact on the possibility to change the legal basis for actors by committing himself to initiating legislative procedures in the area of EMU whenever the European Parliament requests it. But this was not suggested by the Commission in its communication on the role of minister. What remains is the personal political responsibility of the Minister vis-à-vis the European Parliament. Under the current Treaties, a single member of the Commission can only be held to account if the entire college is subject to a motion of censure under Article 234 TFEU. This increases the political costs for dismissing the Minister significantly. What remains is asking the President of the Commission to request the resignation of a single Commissioner under Article 17(6) TEU without being able to oblige her to do so. The principle of collective responsibility of the European Commission is opposed to the personal responsibility of the European Minister as an instrument for accountability. The establishment of a European Minister would thus change little regarding the weak second tier of the accountability situation in EMU.

Conclusion: The democratic potential of agencies instead of a European Minister

A European Minister of Economy and Finance would certainly help to streamline the political behaviour of the main actors in EMU (except for the ECB) that currently operate with their own (sometimes divergent) policy agendas. For this reason, appointing the current Commissioner for Economic and Financial Affairs as chair of the Eurogroup would already be a supportable idea without the need to call this convincing merger a 'minister'. Yet, the Minister wouldn't fill the accountability gap in EMU and hence wouldn't improve the democratic legitimacy of EMU. The place to improve the situation of democratic accountability in EMU is the legal framework of EU agencies. Being creatures of secondary law, nothing prevents the EU legislator from including overriding mechanisms in the founding regulations of these agencies, from granting more budgetary control rights to the European Parliament to introducing dismissal procedures that allow the European Parliament to initiate them. It is giving the European Parliament more teeth when it attaches consequences to the performance assessment of actors involved in EMU that will improve the democratic legitimacy of EMU at the European level.

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9 Strengthening EMU through institutional reforms: Constitutional engineering done right

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Europe's Economic and Monetary Union (EMU) remains incomplete (Draghi 2019). This is mainly due to a shortcoming in its institutional architecture (Fabbrini 2016). Despite a number of reforms introduced in the aftermath of the euro crisis, EMU remains asymmetric and lacks adequate decision-making structures on the fiscal and economic side. From this point of view, therefore, the proposals to strengthen the EMU's institutional architecture – including that advanced by the European Commission in December 2017 envisioning the creation of a European Minister of Economy and Finance (European Commission 2017a) – are welcome as they put square and centre the issue of institutional reforms in the debate on the future of the EU.

Nevertheless, proposals for institutional change are anything but technical matters, so a purely economics-driven analysis cannot suffice when thinking about new governance mechanisms. Rather, any new proposal for institutional reform should be primarily conceived in light of constitutional principles of good governance, and its wisdom should be measured by standards of democratic legitimacy and respect for the rule of law (Ginsburg 2012). In this chapter, I therefore sketch out from an EU constitutional law perspective some general guideposts that policymakers should follow when thinking about institutional reforms in EMU, and use these to evaluate specifically the Commission proposal to establish an EU Minister of Economy and Finance.

First, it is a basic principle of good governance that institutions should be assigned specific functions and be vested with the powers to execute these (Maduro 2012). From this point of view, the proposal to create a new executive authority in the EU – furthermore one named *Minister* of the Economy and Finance – only makes sense to the extent that it is attributed new powers. These should go beyond the competences already vested in the Commission to monitor the budgetary policy of member states (Article 126 TFEU), and they should also differ from the competences the Council already has to coordinate national economic policies (Article 5 TFEU), as well as from the informal tasks of the Eurogroup (Protocol No 14).

In other words, an EU Minister for the Economy and Finance is worth the effort only if this new body operates as a real EU treasury in charge of a genuine EU fiscal capacity – which should also be used for counter-cyclical stabilisation purposes to face symmetric and asymmetric shocks – as is the case in all other functioning federal unions (Fabbrini 2019). If, instead, the establishment of an EU Minister were to turn into a simple cosmetic rebranding of already existing competences, the operation would be at best useless – and at worst, damaging. In fact, by giving the job the symbolically significant title of 'minister', the reform would raise legitimate expectations among citizens about the responsibilities of this post, which would then be frustrated. In a time of populist backlash against the EU, we should be wary of pouring gasoline on the fire of the Eurosceptics' narrative.

Second, constitutional systems based on the rule of law abide by the principle of separation of powers, with each institution deriving its legitimacy through appropriate channels of ex ante input and ex post accountability (Pernice et al. 2017). From this perspective, the Commission proposal for institutional reform raises concerns – as already reflected in the ambiguous name of EU Minister or *High Representative* for the Economy and Finance. Indeed, the idea of making this new body a double-hatted authority – institutionally housed in the Commission but simultaneously at the helm of the Eurogroup – follows more a logic of *confusion*, rather than separation, of powers. Yet, leaving aside the question of whether a double-hatting mechanism – originally employed by the EU in foreign affairs – really works, this solution is problematic from a constitutional legitimacy point of view.

The Commission is a supranational body that increasingly derives its legitimacy from European elections, whereas the Eurogroup is an intergovernmental body composed of representatives selected through separate national democratic process. The chains of legitimacy of the Commission and the Eurogroup are thus separate, so it would be impossible for the new EU Minister to impose his or her will on the Eurogroup – and vice versa, for the Eurogroup to trump the EU Minister. Conflating the responsibilities of these bodies, the idea of a High Representative blurs the lines of accountability. Rather than charging a future EU Minister of Economy and Finance with the responsibility to chair the Eurogroup, which only confuses *qui fait quoi*, therefore, this new authority should be institutionally grounded within the Commission itself and entrusted with adequate powers of its own.

Indeed, this is what the Commission suggested in May 2018 with its proposal for a European Investment Stabilisation Function (EISF) (European Commission 2018). While the Commission did not refer to the EU Minister in its proposal, it firmly vested within itself the task of taking decisions on the disbursement of EISF funds to support member states facing a sudden rise in unemployment. This solution, which separates the responsibility of the Commission as an executive authority from that of the Council as a controlling body, went from an institutional perspective in the right direction – as it shaped the contours of a supranational EMU treasury separate from those of the member states.

Institutional engineering done right, therefore, requires thinking carefully about the powers that should be assigned to nascent authorities, and about the mechanisms to check and legitimate them. While EMU remains incomplete and urgently needs institutional reforms, these should be designed in such a way that they do not create long-term constitutional problems. Indeed, as Alexander Hamilton famously wrote in Federalists Papers No. 1, good government and political constitutions should be established from reflection and choice, rather than depending on accident and force. Alas, much of EMU reform in the aftermath of the crisis has been the outcome of late-night summits, with little thinking through. Further strengthening EMU requires more than that.

The good news is that EU is currently in the midst of a lively debate about its future. The Commission itself launched this in March 2017 with its whitepaper on the Future of Europe (European Commission 2017b) and complemented it with specific proposals in the field of EMU too. Plans to strengthen EMU have also been advanced by the European Parliament and the member states – including France and Germany jointly (Meseberg Declaration 2018) – and the Eurogroup has now made progress towards a budgetary instrument for competitiveness and convergence. This opens up the space to complete EMU (Fabbrini and Ventoruzzo 2019). Moreover, Brexit – the convoluted process of the UK's withdrawal from the EU – creates a window of opportunity for constitutional reform in the EU (Fabbrini 2017).

The proposal to establish a European Minister of the Economy and Finance is a valuable idea which would go a long way towards rebalancing EMU and endowing it with proper institutions on the economic side. Yet, the project will be successful and worth the effort only if the EU Minister is vested with new powers to manage a genuine euro area fiscal capacity, and is spared from taking up the job of chairing the intergovernmental Eurogroup, which would only confuse the role's responsibilities and weaken its accountability.

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10 Completing the institutional architecture of EMU on the external side: The euro area representation at the IMF

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Most of the discussion on how to strengthen the institutional architecture of the euro area revolves around its internal aspects. Other contributions to this eBook discuss the creation of a High Representative for Economy and Finance (HREF) or of a euro area Treasury, but concentrating mostly on internal competences (demand management, control of excessive deficits, etc.).

This exclusive concentration on the internal aspects is not compatible with the declared intent of the new Commission to become a 'geopolitical' body, and the general realisation that in a world in which multilateral rules and institutions are under attack, the EU needs to be more proactive in defending its interests. The EU clearly has this capacity in the field of trade, but nothing similar exists in the monetary field. Member states continue to participate individually in all international financial institutions, although it is the ECB that runs monetary policy and supervises banks. For example, the ECB has only a non-voting observer status in the most important global financial institution, namely, the IMF.

Countries which have their own constituency at the IMF are usually represented by two persons: an Executive Director and an Alternate. Often the Executive Director comes from the national ministry of finance, whereas the Alternate comes from the national central bank. This leads to the awkward situation of the Alternate from Germany coming from the Bundesbank, although the ECB runs the monetary policy for the entire euro area, including Germany.

In this chapter I thus concentrate on the specific case of the euro area in the IMF.[1] There have been previous proposal for establishing a single membership (Aherne and Eichengreen 2007, Bini Smaghi 2004, 2006) and the underlying arguments are well known (Brandner and Grech 2009, de Gregorio et al. 2018, Giovannini et al. 2012, Gros 2017). In essence, Europe is both underrepresented (with no euro area seat) and overrepresented (by euro area member states individually).

However, the issue merits a revisit in the light of the fraying of global rules and institutions. The argument that a single seat or voice in the IMF would increase the influence of the EU at the global level has, if anything, been strengthened and there might be some additional considerations which go into the same direction.

The starting point must be that the existence of the European Stability Mechanism (ESM) makes it straightforward to overcome, at least in principle, the standard argument that the IMF deals mainly with fiscal issues, which remain in national hands. The direct fiscal implications and risks that arise from IMF operations are in reality insignificant because IMF quotas amount to about 1% of GDP and the IMF has never made large losses, given that its loans are super senior.

Concrete options for a unified euro area representation at the IMF

Two variants are a priori possible. The first could be implemented by a simple agreement among euro area countries without the need for Treaty changes and would preserve the current 'over-representation' of European countries. The second would require the consent of other members of the IMF and would lead to a lower quota.

Under a 'soft option', member states could formally keep their IMF membership – the most often-cited obstacle to a unified euro area representation at the IMF is that only countries are members of the IMF – but they would channel their quotas in the IMF via the ESM, which would hold their shares in a special trust fund and transmit all profits back to member states. In technical terms, the shares of individual member countries would be deposited at the ESM, which, as a holding company, would have these deposits on its liability side and the corresponding claims on the IMF on its asset side. Many euro area member countries also participate in agreements to lend the IMF additional resources should the quotas not be sufficient to cover lending arrangements,

1 In this chapter I do not discuss issues which are obviously related, like the European representation other global financial institutions, especially the World Bank or other development banks (the European Bank for Reconstruction and Development, the Asian Development Bank). For these institutions, one could make the argument that the EU should be represented rather than the euro area.

notably the New Arrangements to Borrow (NAB). The total committed by a number (11) of euro area members amounts to 45 billion SDR. This commitment to provide this sum to the IMF in times of need could easily be taken over by the ESM, which would then provide the funds directly to the IMF. Moreover, the ESM could easily pledge a somewhat larger sum because some member countries at present do not participate in the NAB. The 45 billion SDR pledged by euro area countries represents about 25% of the total of 180 billion pledged under the NAB. Although the euro area contribution is already higher than that of the US (28 billion SDR), a slight increase, when the ESM takes this obligation over, would provide a useful argument for keeping the actual quotas of euro area countries at their present levels, which is above the value that would result from a strict application of the quota.

A number of countries have also pledged additional funding, under a bilateral borrowing arrangement, should the NAB resources prove to be insufficient. EU member countries provide 40% of the total of over 300 billion SDR pledged under this scheme, but it is not certain whether it will be extended. The IMF would clearly need to have recourse to these bilateral borrowing arrangements (which has never been activated) in case of a major global financial crisis. The euro area is highly dependent on exports, which account for over one third of GDP. It would clearly be in the collective interest of the euro area to support the IMF in such a case.

Moreover, both the bilateral borrowing arrangements and the NAB are likely to be needed in times of financial market instability. These would also be times when some euro area member states are most likely to experience difficulties themselves. Channelling their contribution via the ESM would make it much easier for them to honour their commitments during difficult times.

A practical advantage of having the ESM represent the euro area at the IMF is that the staff of the ESM would be informed of ongoing IMF programmes (on which they would have to prepare opinions for the ESM representative at the IMF) and could learn from their successes and failures. This experience would also be useful in cases where the ESM needs to consider a new programme in the euro area itself (Gros 2017).

Both these aspects would require an amendment of the ESM Treaty, which at present specifies as its only purpose providing loans to member states in case of a threat to the financial stability of the euro area.

The Board of the ESM would then nominate one person who, in a 'personal union', would be the Executive Director sitting in for all the euro area constituencies. This might require some reshuffling of some constituencies where euro area members are together with third countries. But such a change in individual constituencies would not require the approval of the other members of the IMF.

The 'super' Euro Area Executive Director would then represent the fiscal interests of the euro area in the form of a de facto euro area 'super constituency'. The alternate to the euro area's collective constituency Executive Director would be nominated by the ECB (or rather, the Governing Council of the ECB). In this way, both the fiscal and the monetary authorities of Europe could cooperate in shaping the input of the euro area into the decisions of the Executive Board of the IMF. As a result, both the ECB (on monetary issues) and a politically accountable institution on fiscal matters (the Eurogroup) would represent the common interests of the euro area.

Under this option, the individual euro area members would, pro forma , maintain their present quotas and euro area member states would continue to be represented by their respective finance ministers individually on the Board of the IMF. But even this aspect could be taken care of without big institutional changes.

In December 2017, the Commission mooted the appointment of the same person to the positions of Vice-President of the Commission in charge of EMU and President of the Eurogroup. This person, representing both the euro area member states and the Commission, would also represent the euro area externally, including for example on the Board of Governors of the IMF.

A more radical option would be for member states to cease even formally being members of the IMF. In this case, the ESM could become a member of the IMF directly, with its own quota. The unified euro area quota would then be smaller than that of the aggregation which is the essence of the first option (Rakic 2019). Other aspects could remain as under the first option described above, including the nomination procedure for the representatives of the euro area on the Executive Board. Under this option, it would of course be preferable that the ESM be integrated into legal framework of the EU.

The IMF Executive Director would again be nominated by the ESM Board/Eurogroup and the Alternate could again come from the ECB.

There are clearly a number of challenges to be overcome for this idea to become feasible.[2] First, in order to provide for a euro area single membership, the IMF Articles of Agreement would need to be changed to allow the euro area to become a member of the Fund. This would need to gain the acceptance of three-fifths of the members of the IMF having 85% of the total voting share. Second, this approach would necessitate a new negotiation of the single quota of the euro area, which is likely to be reduced (by 3 to 4 percentage points) since intra-area trade would no longer count in the formula for the quota. The first, soft option, under which individual euro area members remain pro forma members of the IMF in their own right, seems preferable today since it would preserve a higher voting power for the euro area and not necessitate the agreement of the rest of the world.

The Commission had in the past made several proposals towards a more cohesive representation of the euro area in international for a (e.g. European Commission 2016). However, in its latest Communication on a stronger international role for the euro, these ideas are mentioned only *en passant* (European Commission 2018). The previous Commission proposals focussed on the Eurogroup and its president. This is understandable because the Eurogroup is embedded in the governance framework of EMU and gives the Commission an important role. But the Eurogroup is only an informal body. A better route would thus be to use the existing ESM, even if it has the disadvantage that it is inter-governmental in nature.

This intergovernmental nature also means the absence of any accountability to the European Parliament. This is certainly not ideal. But the important decisions would be taken by national finance ministers anyway in much the same way as in the Eurogroup. Moreover, the ESM will not remain intergovernmental forever. When it is integrated into the legal framework of the EU, democratic accountability towards the European Parliament could be strengthened. That might also be the point at which the single seat option can be envisaged.

The proposed way forward would also be compatible with the more ambitious Commission proposals to create a European Minister of Finance (European Commission 2017). If that proposal were to be accepted, it would only be natural that this 'Euro Minister' also represents the euro area in the Board of Governors of the IMF. A euro area Treasury could also evolve out of the pooling of IMF quotas. The pooling itself would not create additional resources and IMF quotas represent a rather passive investment worth a few percentage points of GDP. This would certainly not

2 It is not clear whether a Treaty change would be needed. The Treaty mentions only 'unified' representation, which may be interpreted as not covering the more tightly integrated 'single' representation for the euro area.

yield the flexible resources needed to conduct anti-cyclical policy at the euro area level. However, the existence of a trusted institution with experience in managing important financial resources might represent an important enabling condition if, in some crisis situation, more fiscal resources were to be made available at the euro area level.

But there is no need to wait for a complete reform of EMU architecture. A way to proceed already exists within today's incomplete legal framework..

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Following years of sustained growth, policymakers in Europe – and beyond – have been unexpectedly confronted with the largest health, economic and social challenges since WWII, threatening the stability of the European Union and its Economic and Monetary Union (EMU). The crisis generated by the Covid-19 pandemic has required rapid and strong action. It also entails key choices, including on how the EU could help mitigate the impact of Covid-19, foster the economic recovery and support the dual green and digital transitions.

In September 2019, before the crisis, the Directorate General for Economy and Finance of the European Commission organised a workshop on strengthening the institutional architecture of the EMU. This eBook presents the main ideas discussed at the workshop. The workshop took stock of the debate on key challenges and the future of EMU's institutional architecture and sketched out the directions in which the reforms could go. It dealt more in depth with two of the ideas debated in the public sphere at the time: that of a euro area treasury and of a European Minister or High Representative for Economy and Finance.

The weaknesses and solutions discussed in the workshop are still relevant in the economic context reshaped by the Covid-19 crisis. The crisis has shed a light on the EUM's incomplete institutional architecture and revealed that public opinion expects the EU to deliver in emergency situations. Steps taken in response to the current crisis could bring progress with the EMU deepening agenda. This eBook contributes to identifying those reforms that, beyond addressing the more immediate needs, can deliver sustainable progress on the institutional set-up of EMU.

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