COMMENT TO
"JUST ROUND THE CORNER? PROS, CONS, AND IMPLEMENTATION ISSUES OF A FISCAL UNION FOR THE EURO AREA" BY FABRIZIO BALASSONE, SANDRO MOMIGLIANO, MARZIA ROMANELLI AND PIETRO TOMMASINO

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1 Main messages of the paper

This paper by Balassone and others provides a comprehensive and up-to-date picture of the current state of affairs in the debate on a fiscal union for the Euro area. The paper highlights that both economic theory and lessons from the recent Euro crisis point to a need for further progress in a number of respects, in particular:

- Greater convergence of national fiscal and structural policies

  The paper notes that the institutional architecture to promote such convergence has already been put largely in place. The main steps have been the adoption by most EU members of the Fiscal Compact; the promulgation of the so-called Six-Pack and Two-Pack regulations; the creation of a number of new Independent Fiscal Councils; and the implementation of a Macroeconomic Imbalance Procedure. Questions remain, however, on how effective the new architecture will prove in practice. The test will be in its implementation and enforcement in the years ahead.
- Putting in place the three key planks of a banking union:
  - A single supervisory mechanism: this is now well on its way
  - A single resolution mechanism: after protracted negotiations, some progress has taken place in the more recent months, but the firepower of the single resolution fund remains inadequate, since it lacks a true mutualized fiscal backstop
  - Harmonization of national deposit insurance and other banking crisis management tools: progress has been made with the recent promulgation by the EC of the Bank Recovery and Resolution Directive
- The design and implementation of the building blocks of a fiscal union for the Euro area

  A key component of a fiscal union would be the creation of effective mechanisms to counteract temporary country-specific shocks. The paper discusses a number of options in this respect:
  - The European Stabilization Mechanism: this is certainly a useful tool, but, as currently structured, it deals mainly with crisis cases
  - A Euro area-wide rainy-day fund? The paper notes the difficulty of identifying in practice truly cyclical shocks
  - A centralization of unemployment benefits? The paper argues that it would provide only a partial safety net, with limited stabilizing power. Its effective implementation would require greater harmonization of labor market institutions and practices
  - A centralized notional defined contributions (NDC) pension scheme for the Euro area? The paper views this option as more promising in the long run, since it would have significant benefits:
    - A substantial size, and thus stabilizing power, at a cruising speed
    - Would facilitate labor mobility and strengthen trust within the EA, including confidence about fiscal sustainability

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The paper also discusses some more ambitious proposals for a fiscal union (e.g., a substantial expansion of EU budget; a mutualization of part of existing public debt; the issuance of Eurobonds), but considers them unlikely to fly politically.

2 Main comments

I liked the paper, not only because of its comprehensiveness, timeliness and readability, but also because I found its analysis thoughtful, and agree with many of its conclusions. In particular, I share the view that, unfortunately, progress in the directions outlined in the paper is likely to be slow, since the Euro crisis, and therefore the sense of urgency in strengthening the resilience of the Euro area to shocks, are receding; and Euro-skeptics are gaining political ground in many countries.

I agree with the paper's comments on the difficulties and limitations of rainy-day funds, and of a centralization of unemployment benefits, but would favor some initial limited experimentation with such mechanisms. I would also see some scope for a limited Euro area-wide investment fund, to finance infrastructure projects with clear positive cross-border externalities, which could be also used as a counter-cyclical tool.

The paper's proposal for a centralized system of NDC pensions is intriguing, but, in my view, even less likely to fly than other options dismissed by the paper as politically unrealistic. I agree that the potential advantages of such a system on a cruising speed would be significant, although its stabilizing power would be concentrated on the revenue side. But how to get there is the key question, which is largely not addressed by the paper. I would note that:

- The current pension systems in the Euro area vary widely in terms of key parameters (coverage; retirement age; replacement rates; indexation systems); and the mix of defined-contributions and defined-benefits, and of pay–as-you-go and pre-funding regimes
- The move to a uniform centralized NDC system would likely have major fiscal and distributional consequences. Substantial technical work would be needed to answer this questions in a minimally satisfactory manner, and the answer would likely be very different across Euro area members
- Even at the national level, pension reforms are among the most difficult ones in political economy terms**.** Finding the social and political consensus at the Euro area level on a fundamental change such as that proposed in the paper seems to me likely to be a daunting task.