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The Future of EMU

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Why the euro area still needs fixing

1. Financial market still fragmented, hence:
   - More instability
   - Less growth over the long run
2. Mutual trust has been lost
   - Opaque and inefficient fiscal rules, disputes over ECB
   - ESM programmes: Resentment in both creditor and debtor countries
3. There will be new crises in the future
   - Macro policy toolbox is close to empty
   - Banks better capitalized but “doom loop” still present: no bail-out / no crisis conundrum
4. Macroeconomic re-convergence is not granted
   - European semester is weak
   - Medium-term surveillance is split between MIP and macro-prudential policy

The 7x7 Franco-German proposal

- Risk reduction **and** risk-sharing
  - More risk-sharing is necessary to make the no bail-out rule credible: (i) risk reduction is itself risky, and (ii) need to reduce the cost of debt restructuring
    - Diversification of bank exposures (private risk sharing), European deposit insurance (private), fiscal capacity (public), ESM precautionary lines (public)
  - Risk-sharing is compatible with good incentives
    - First loss borne by Member state
- Rules **and** market discipline
  - A spending rule: simpler, more robust and more counter-cyclical
  - Market sanctions (at the margin) rather than political sanctions
- Sovereign risk **but no** redenomination risk
  - Today: (almost) no lender of last resort for sovereigns → national banks act as buffers → sovereign and redenomination risks are intertwined due to the risk of a collateral shortage + deposit flight (e.g. Greece 2015)
  - Tomorrow: still no lender of last resort for sovereigns, but default possible within the euro area (in last resort); ECB to insure the redenomination risk (aside from political risk)

Fixing macroeconomic surveillance

- **More clarity in existing instruments**
  - SGP, MIP and Europe 2020 overlap in country-specific recommendations
  - Whereas MIP and macroprudential policy do not overlap
  - Possible solution: current account as a flagship, in-depth analysis, separation between medium term tools (at the margin) and long term tools (structural), involvement of ESRB
- **Structural reforms: a common project rather than a country-by-country support of structural reforms → a jobs union**
  - **Pillar 1**: convergence of national labor markets
    - Work contract: limited duality, layoff legislation, minimum wage, unemployment insurance, continuing education, institutional quality (job agencies, professional training, education)
  - **Pillar 2**: a European job market
    - Effective recognition of diplomas (through opposable European labelling), investments in human capital for occupations facing recruitment difficulties, full portability of pensions, of unemployment benefits and of continuous education entitlements, information technologies to reduce fraud
  - **Pillar 3**: solidarity between winners and losers
    - Structural losers: reshuffling the European globalization adjustment fund
    - Temporary losers: European unemployment insurance scheme