Briefing

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Deepening EMU and fiscal union

Risk sharing versus risk reduction

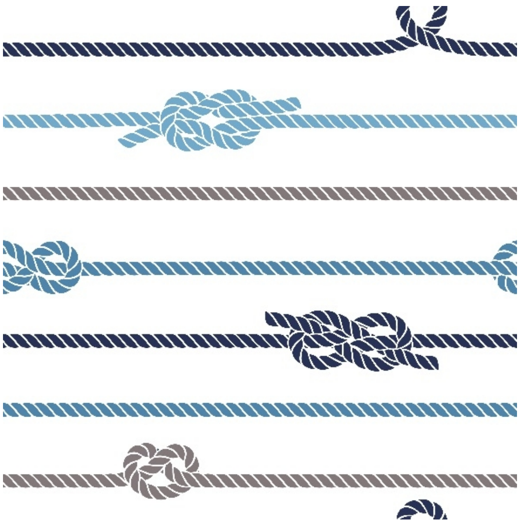
SUMMARY

The debate on how to deepen economic and monetary union (EMU) is in full swing, despite gradual recovery since 2015 from the 2007-2008 crisis. There is controversy surrounding whether delegation of monetary sovereignty to EMU necessarily entails some euro-area fiscal stabilisation competences and, if so, what kind. Proposals for such a mechanism range from (re)insurance solutions, investment strategies and funding instruments, to actual budgetary competence for the euro area.

Current research supports a stronger EMU fiscal union and the introduction of stabilising policy instruments. However, the capacity to absorb future shocks will also depend on the ability to off-set diverging trends between Member States, caused by different economic systems and labour market institutions. Despite recent signs of economic recovery, divergence may prove difficult to reverse.

In June 2015, the Five Presidents' Report contributed to the debate about a euro-area 'fiscal union' by suggesting the development of a fiscal stabilisation function by 2025. Initially announced as a white paper, the European Commission's reflection paper on the 'deepening of the economic and monetary union', presented on 31 May 2017, does not formulate concrete steps, as envisaged in the 2015 report. Instead it offers four guiding principles on how to build the future EMU architecture. 'At the latest' by 2025, a 'central stabilisation function' could take the form of a European investment protection scheme or a European unemployment reinsurance scheme.

This briefing is one in a series on the European Commission's reflection papers following up the March 2017 White Paper on the future of Europe.



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Context

After 2010, the financial crisis of 2007-2008 transformed into a debt crisis in some euro-area Member States. Even seven years later, and with the economic and monetary union gradually recovering since 2015, the debate on how to deepen or 'complete' EMU is still in full swing.[1] Until 2008, 'debt-driven growth', real-estate bubbles and private debt developments contributed to idiosyncratic shocks in some countries. However, substantial controversy surrounds the question of whether the delegation of monetary sovereignty to the EMU necessarily requires some euro-area fiscal stabilisation competences as well, and if so, what shape these should take.[2]

Following up on discussions at European Union (EU) level, which formally began in June 2012 with the report of then European Council President Herman Van Rompuy,[3] on 31 May 2017 the European Commission presented a reflection paper on the 'deepening of the economic and monetary union'. It contains some considerations regarding future integrationist steps, including elements to deepen EMU's fiscal union.

Many of the current policy proposals to further delegate such competences to the euro-area level, and thus to widen the scope of **risk sharing** among its members, differ when it comes to assessments of a complementary amount of **risk reduction** within them.

Risk reduction and risk sharing in EMU

The economic rationale for a fiscal union

The economic rationale for an, at least partial, common fiscal policy hinges on two aspects. The first is **interdependence**: Member States remain responsible for their national fiscal policy. However, the euro area's interdependence and its unified monetary policy create concerns regarding the aggregate fiscal stance.[4] As a result, during (asymmetric) economic downturns, national efforts alone may prove to be insufficient and growing economic divergence only exacerbates this threat. While overall real GDP growth in the euro area seems to be growing again,[5] the economic divergence between Member States within the monetary union has increased since 2008.

The second economic argument relates to the **size of the necessary shock absorption**: compared with the United States of America (USA), the euro area has only one third of the capacity to mitigate and smooth out output shocks, both through financial and labour market incomes generated across borders and through cross-border fiscal transfers.[6]

Therefore, some argue that a fiscal capacity, for instance a common unemployment insurance, would help to increase this resilience through increased risk-sharing.[7] In essence, much of the debate follows two quite different approaches: one line of reasoning focuses mostly on the economic task of how to contain harmful spill-over of idiosyncratic shocks from one Member State to another, or just 'to contain the contagion'. At the same time, it aims to mitigate the negative downturn in a country hit by an asymmetric shock. Proponents of this *macroeconomic* view consider for instance (mostly automatic) stabilisation instruments such as European unemployment insurance, or some emergency funding (such as a 'rainy day fund') at EU or euro-area level. The main concern is to find **appropriate tools to de-politicise fiscal policy coordination**.

Another strand of the discussion leans more towards the *political* dimension of the issue: how to reduce governance complexity, enhance compliance and actively contribute to upward convergence. Since 2011 and in the aftermath of the euro-area crisis, established macroeconomic surveillance procedures have been substantially modified: the revised

European semester framework added to the existing Stability and Growth Pact an excessive deficit procedure and the macro-economic imbalance procedure, yet compliance did not increase. Key proposals adopting this political focus contain, for instance, a euro-area treasury or a dedicated budget for the euro area.

Policy options for a fiscal union

Table 1 provides a general overview of five different concepts of a fiscal capacity for the euro area. They differ according to, first, their rationale and the scope of stabilisation intended; second, whether pay-outs should be triggered automatically, or result from political decision-making (with discretion); third, sources of funding. The most-cited reform options are an **insurance against cyclical shocks** (measured as GDP output gap), and two versions to mitigate large swings in unemployment in the monetary union: a **genuine European unemployment insurance** could top up and continuously support national budgets in economic downturns, while an **unemployment re-insurance fund** would only kick in during extraordinary economic crises. Less 'technocratic' options seek to create means that would not only allow mitigation of major macroeconomic shocks, but also support structural reforms in Member States, enhance public investment, and increase domestic demand. Such a **public investment strategy** could build upon the existing European Fund for Strategic Investments (EFSI) framework and eventually become subordinated to a dedicated borrowing-lending institution, such as the European Stability Mechanism (ESM), or directly to the Commission. A European Parliament resolution suggests eventually transforming the ESM into a European monetary fund (see below). Finally, a dedicated **euro-area budget**, including some delegated competences for own resources, is advocated by those who consider it might become the nucleus for a genuine euro-area treasury.

To set up any minimum provision regarding unemployment protection at EU level would necessarily imply some form of harmonised labour law, while at the same time it might foster the convergence of European labour markets.[8]

Table 1 – Stylised overview of possible policy instruments

		Stabilisation scope	Payment trigger	Sources of funding
Absorbing cyclical shocks/'rainy day fund'		Macroeconomic	Automatic	Member States' contributions
Unemployment scheme	**European Unemployment Insurance**	Macroeconomic and social	Automatic	Member States' contributions, or individual contributions
	(Unemployment) Re-insurance fund	Macroeconomic	(Semi-)Automatic	Member States' contributions
Public investment strategy (European Monetary Fund)		Macro- and microeconomic	Discretionary	Member States' contributions, 'own resources', capital markets
Euro-area budget (Euro-area treasury)		Macro- and microeconomic	Discretionary	Member States' contributions, 'own resources', borrowing

Source: D'Alfonso, Stuchlik, 2016, p. 11. A 2016 IMF paper explores options for a 'central fiscal capacity' and applies a similar classification according to the level of political interference (automatic vs discretionary): 1) A so called 'tax-transfer scheme' that could take the form of targeting output gap or unemployment; 2) A 'borrowing-lending scheme' which would entail a central entity, similar to a multilateral bank, and mirrors the proposal of a public investment strategy in table 1; 3) Finally, a 'small euro-area budget' which would receive revenues in the form of contributions of Member States.

Insights from current research

Academic views and think-tanks

While most academic studies agree on the need to improve the euro area's institutional set-up, not all of them acknowledge the need to also strengthen its nascent fiscal union.

This stems from different views as to the main root causes that led to the 2007-2008 crisis in the first place. Becker and Fuest view **non-compliance with European rules**, such as the Stability and Growth Pact, as one of the main malign forces. The lack of effective banking regulation (and insolvency procedures for sovereigns) only exacerbated the problem. However, if the lack of Member State self-restraint holds true, then deepened coordination, as envisaged in the Five Presidents' Report (see below), will not be able to remedy the issue. Brunnermeier, James and Landau might consider this to be a somewhat typical German account while other countries, like France, have 'considered the euro-area framework as flexible, to be overseen by governments'. The authors trace 'philosophical differences' back to different government structures and traditions, arguing that, apart from different states' (*Realpolitik*) interests, an underlying 'battle of ideas' results in different notions of cornerstones of euro-area governance: rules versus discretion, liability versus solidarity, solvency versus liquidity, and austerity versus stimulus.

With a political economy perspective, Scharpf argues that some of the centrifugal forces witnessed since the crisis may rather relate to the **different 'business models'** of euro-area Member States, embodied in the question of whether gross domestic product (GDP) growth hinges rather on exports (and savings abroad) or domestic demand (see Table 2).[9] For instance, Germany's tradable sector is a much bigger share of its economy than in France, Spain or Italy (and it grew much faster since the introduction of the euro). Also, its specific collective bargaining structures allowed for wage restrictions during the recession in the 2003-2005 period and the years to follow.[10] Hence, Germany's export-driven recovery, coupled with fiscal consolidation measures after 2003, may not be an easily accessible blueprint for others to replicate and may be more idiosyncratic than assumed so far.

Table 2 – Exports as a % share of GDP in selected euro-area Member States

	1979	1989	1999	2008	2016
ES	13.77	16.68	26.40	25.32	33.07
EL	15.17	15.95	19.26	23.37	30.15
DE	**17.87**	**22.36**	**27.04**	**43.46**	**46.01**
FR	**20.58**	**21.48**	**25.72**	**27.39**	**29.26**
PT	21.19	29.46	26.47	31.13	40.29
IT	22.46	18.57	23.25	26.96	29.98
IE	44.47	58.87	86.72	84.15	120.0
NL	48.19	55.41	60.24	71.64	80.81

Source: Scharpf, F.-W., 2016, pp. 9 & 13, and author's compilation based on OECD data.

Equally, Veselý finds it unlikely to expect a reorientation to more domestic demand from 'northern' Member States with export-driven economies and a preference for sending savings overseas rather than spending them domestically. Instead, the issue of convergence needs to be taken more seriously and he advocates a joint approach to create a convergence code.[11] In his view, a budgetary capacity could address investment gaps and reforms and would help peripheral countries to 'upgrade their economies without suppressing domestic demand'. Wolff, of the Bruegel think-tank, considers increasing investment alone insufficient to justify a dedicated budget for the euro area, but he concedes that a discussion on euro-area fiscal policy is needed, since all proposals contain trade-offs.

But even when **fiscal consolidation** is actually happening, to define its 'success' may prove tricky: Haffert and Mehrtens challenge the customary assumption that fiscal consolidation will strengthen fiscal capacity. Their case study of public expenditure in six countries with sustained budget surpluses shows that 'surpluses were mostly achieved through expenditure cuts but predominantly used for tax cuts'.[12]

Another challenge for the euro stems from the dynamics of **financial imbalances**. A recent European Central Bank (ECB) working paper argues that these necessarily emerge between asymmetric Member States and that 'the magnitude of these long-term imbalances increases with the degree of cross-country heterogeneity'. However, it is not only economic fundamentals that seem to matter but also institutional differences. The paper finds that some of the pro-cyclicality of net capital inflows observed in the south of Europe is related to frictions in domestic credit markets. In relation to this, Erik Jones argues that monetary unions can indeed exist **without fiscal unions**. In his view, the importance of well-functioning (cross-border) capital markets and hence a deepened financial union by far outweighs the potentially stabilising effect of fiscal measures. Indeed, ECB data indicate higher risk-sharing potential from cross-border capital markets than from fiscal tools.

Drawing lessons from federal fiscal stabilisers in the USA, Alcidi and Thirion from the think-tank CEPS caution against superficial comparisons. Yet, in their view, unemployment insurance in the US 'shows that *ex ante* re-insurance of decentralised basic unemployment schemes can be achieved such that it limits the degree of inter-state solidarity to a large extent, while allowing for outright transfers in the face of large shocks'.

Recent economic developments in the euro area

According to most recent forecasts, the euro-area Member States are slowly recovering, with estimated GDP growth in 2017 of 1.7 % (see Appendix). However, in order to spur the reform debate around a possible fiscal union, Buti et al. argue that the specificity of this euro-area recovery remains relevant for the choice of future policy instruments. They find and warn against complacency. Despite a 'supportive policy environment' and 'favourable financing conditions' over the last five years, they consider the current recovery tendencies to be 'atypical' and 'constrained by legacies of the crisis such as high levels of private and public debt, large stocks of non-performing loans (NPLs) in the banking sector, and elevated unemployment in several countries. The slack present in the economy seems to go beyond what is suggested by headline data'. This slack is most obvious with regard to the labour market and subdued real wage growth, low bank profitability in several countries, and investment activity that is still below crisis levels.

Low bank profitability[13] relates not only to a high number of NPLs in some Member States (see Appendix), but also to the extraordinary low-interest rate environment steered by the ECB and growing regulatory compliance costs since 2010. Looking at aggregate data for the euro area, the ECB finds the level of financial integration still below pre-crisis levels.[14] From a policy-maker's perspective, according to the ECB, this highlights the importance of the capital markets union and completion of the banking union. The latter is not only incomplete with regard to its third pillar, a European Deposit Insurance Scheme (EDIS), but it is also struggling with consistent application of the new resolution framework.[15]

The 2007-2008 economic and financial crisis led to years of **under-investment and under-employment**. The European Investment Bank (EIB) reports that in some countries, real investment has been gradually recovering since 2010 and 2008 levels were reached at the end of 2015. However, in others, the recovery began only in 2013 and investment is still some 9 % below pre-crisis levels while in countries 'most hit by the crisis, investment remains some 27 % below the 2008 level'. The bank estimates an annual investment backlog of up to €435 billion just to reach pre-crisis levels. In this respect, EU financing activity through EFSI can just help to kick-start investment (and has other limitations, such as unbalanced regional coverage)[16] whereas the EU Structural and Investment Funds (ESIF) amount to only 0.4 % of EU GDP.

From the Five Presidents' Report to the white paper process

Five Presidents' Report

In line with the 2014 political guidelines, European Commission President Jean-Claude Juncker and the Presidents of, respectively, the European Council, Donald Tusk, the Eurogroup, Jeroen Dijsselbloem, the European Central Bank, Mario Draghi, and the European Parliament, Martin Schulz, prepared a report on completing Europe's economic and monetary union (the 'Five Presidents' Report'). This report, presented on 22 June 2015, provides a blueprint as to how to deepen European monetary union (EMU), and the successive stages for implementation, beginning from July 2015. It builds on the 2012 'Four Presidents' Report', as well as on a number of Commission documents. The text proposes four building blocks to complete EMU:

- towards economic union (convergence, prosperity and social cohesion);
- towards financial union (integrated finance for an integrated economy);
- towards fiscal union (an integrated framework for sound and integrated fiscal policies); and
- democratic accountability, legitimacy and institutional strengthening ('political union').

The report's first stage, entitled 'deepening by doing' (1 July 2015 – 30 June 2017), prescribes building on existing instruments and treaties to boost competitiveness and structural convergence, complete the financial union, achieve responsible fiscal policies at national and euro-area level, and enhance democratic accountability. The second stage, 'completing EMU', proposes far-reaching measures to make the convergence process more binding, in particular through a set of commonly agreed benchmarks that could be given a legal nature, with the final stage to be reached at the latest by 2025 (see text box below).

Beginning as of 1 July 2017, the report's second stage, the notion of 'completing EMU' would have to include: 'Commonly agreed **benchmarks** for convergence' ... and '**significant progress** towards these standards' ... which 'would be among the conditions for each euro-area Member State to participate in a **shock absorption mechanism** for the euro area'. Such a mechanism 'should not lead to permanent transfers', 'neither undermine the incentives for sound fiscal policy-making', be developed within the European Union framework, and 'should not be an instrument for crisis management'.

European Parliament Resolution on the 2017 Commission work programme (CWP)

On 6 July 2017, Parliament adopted its resolution on the 2017 CWP, including 'completing the economic and monetary union'. It asks the Commission to present a **consistent and well-substantiated set of proposals** on completing economic and monetary union as identified by the Five Presidents' Report and, in addition:

- calls for closer economic policy coordination with a view to addressing the euro area's investment gaps and strengthening reform efforts in order to increase competitiveness and to sustain demand;
- considers that the banking union needs to be completed, with risk-reduction measures

going hand in hand with risk-sharing; and

- notes that the outcomes of the ongoing reflection on developing an economic and monetary union fiscal capacity should be taken into account'.

Commission Work Programme for 2017

The Commission's Work Programme for 2017, presented on 25 October 2016, lists among its priorities creating a 'deeper and fairer economic and monetary union' aiming at 'a Europe that protects our economies and ensures a fair playing field for workers and business'. The document envisages **new initiatives** under two topical headlines as well as **complementary action**.

As part of 'a strong union built on a strong EMU', the Commission planned to take the following action for 2017:

- a 'white paper on EMU stage 2;
- a 'stability oriented review' of the Stability and Growth Pact;
- the incorporation of the Treaty on Stability, Coordination and Governance into the EU framework; and
- the review of the European system of financial supervision (ESFS)'.

Under the heading 'European Pillar of Social Rights', the Commission adopted its proposal on 26 April 2017.

Among 'complementary action', the Commission includes action to 'complete' the banking union, which means finding an agreement on the proposal for a common European deposit insurance scheme. Proposed in November 2015, the EDIS proposal is still being negotiated. The Commission also addresses necessary revisions of substantial parts of EU banking legislation (capital requirements and the resolution framework for banks). Initiated in November 2016, the legislative procedures are still on-going.

As of mid-2017, the European Commission has, benchmarked against its own list of planned initiatives and actions, published the European Social Pillar (new initiatives) and proposed a major review of existing banking legislation (complementary action) only. According to Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA), the revision of ESFS is under way.

Legislative priorities for 2017

On 13 December 2016, the European Commission, the Council and Parliament published a Joint Declaration on the EU's legislative priorities for 2017. Out of those 59 priorities, only two ongoing legislative dossiers are relevant for EMU reform in the strict sense: (i) the European Deposit Insurance Scheme and (ii) the revision of the Single Resolution Mechanism Regulation.

European Commission White Paper process 2017

On 1 March 2017, the Commission published a white paper on the future of Europe and launched a 'reflection paper' process with several topical reports to be issued by December 2017. The white paper develops five scenarios of differing scope and speed of possible future steps of integration: (i) 'carrying on'; (ii) 'doing less together'; (iii) 'some do more'; (iv) 'radical redesign'; and (v) 'doing much more together'. Deviating from the roadmap sketched out in June 2015 Five Presidents' report, the Commission redrafted the whole process and did not deliver a genuine white paper on EMU reform as had been expected. The institution broadened the topic and applied a scenario approach instead of presenting specific proposals.

Reflection paper on deepening EMU

Key elements

The reflection paper on the deepening of the economic and monetary union of 31 May 2017 assesses progress made so far and outlines the next steps in two phases: 2017 to 2019 and 2020 to 2025. It describes action to be taken up to the next elections in 2019 (mainly completing banking union and capital markets union) and delivers a 'series of options' for the following years. After 2020, the Commission envisages euro-area options for a common issuance of debt ('European safe asset'), without any reference to the no bail-out clause of Article 125 of the Treaty on the Functioning of the European Union (TFEU), as well as a macroeconomic stabilisation function, such as a 'European Investment Protection Scheme'.

Unlike other reflection papers so far, the one on EMU does not apply the five scenario logic of the white paper. Instead, it develops four 'guiding principles', which are in fact functional goals: (i) jobs, growth, social fairness, economic convergence and financial stability; (ii) responsibility and solidarity, risk reduction and risk-sharing going hand in hand; (iii) the need for EMU to remain open to all EU Member States; and (iv) a more transparent and accountable decision-making process.

Assessment

Specified for the fiscal union part, the Commission regards the combination of three further elements to be necessary: (i) sound public finances; (ii) 'complementing common stabilisation tools'; (iii) a combination of market discipline and a shared rulebook. However, the report does not present a clear argument in favour of (ii), such as estimates of potential shock absorption effects of fiscal stabilisers (and contrasting such effects to deeper financial integration). The discussion on different options remains descriptive but, with regards to a possible unemployment variant, clearly opts for a 're-insurance' model.

The paper highlights the importance of steps initiated since 2011, such as the ESM, the overhaul of the European Semester, including a greater focus on the aggregate fiscal stance of the euro area, or the set-up of the European Fiscal Board in 2015. In this view, pre-crisis imbalances, such as real-estate bubbles in some Member States, would be more easily detected under the current framework. However, the Commission admits that 'a strong process of re-convergence is not yet visible' and real GDP per capita in countries like Italy remains as low as in 1999.

Unlike initially expected, the document does not include concrete measures of a legal nature to complete EMU. Preparatory work initially included analytical input from a high-level expert group, to be set up in September 2016 but the Commission decided to produce the document internally.

European Parliament

On 24 June 2015, two days after the Five Presidents' Report, the European Parliament adopted its resolution on a 'review of the economic governance framework: stocktaking and challenges' and, among other things, proposed a fiscal capacity within the euro area. Parliament furthermore demanded that the ESM and the fiscal compact (the fiscal part of the Treaty on Stability, Coordination and Governance), 'be fully integrated into the Community framework' and thus made formally accountable to Parliament.

With regard to the discussion on how to establish such a fiscal capacity, Parliament did not wait for the European Commission to deliver a specific proposal. On 16 February 2017, it adopted a resolution on budgetary capacity for the euro area. Following a lengthy negotiation process, Parliament set out a roadmap for a fiscal capacity with an ESM eventually to be turned into a European monetary fund (EMF), as well as 'additional budgetary capacity for the euro area'. The resolution spells out three pillars of such a potential fiscal capacity: (i) a 'convergence code' to accompany the Stability and Growth Pact, taking into account the country-specific recommendations, which would establish convergence criteria, for a five-year period, 'regarding taxation, labour, market, investment, productivity, social cohesion, and public administration, and good governance capacities'; (ii) the second pillar would absorb asymmetric shocks via automatic shock absorption mechanisms and be administered through a future EMF. Parliament refrained from directly advocating either a European unemployment insurance system or a reinsurance solution but stressed that it would have to be 'budgetary neutral over the longer cycle'; (iii) finally, a third pillar to counter symmetric shocks insofar as these 'are brought about by a lack of internal demand'. The role of the euro-area budget would be to fund 'investment aimed at aggregating demand and full employment in line with Article 3 TEU'.

On 13 June 2017, the European Parliament held a plenary discussion on the Commission reflection paper.

Remaining challenges

One side of the coin in the debate about risk sharing and risk reduction relates to Member States' responsibility: implementation of country specific recommendations (CSRs)[17] has been lacking ever since its inception in the current form in 2011 (in 2016, only 2 % were fully implemented). Existing fiscal rules are sometimes bent and have, at times, proven difficult to enforce.[18]

The European Commission's reflection paper offers a roadmap for steps to be undertaken by 2019 and future reforms (under a new Commission and a new Parliament) by 2025. Some of the proposals would require changes to the European Treaties, others would not, but already the status quo of economic governance is struggling with upholding transparency[19] and legitimacy at national level.[20] In addition, current Brexit negotiations and the ongoing migration crisis do not provide a political climate conducive to preparing a debate on Treaty change any time soon. 'The national antagonisms the crisis has exacerbated – or, sometimes, even created from scratch – have made it all the more difficult to give the EU more competences'.[21]

Deepening EMU's fiscal union entails not only difficult technical decisions and trade-offs regarding policy instruments but also two conundrums for policy-makers, a political and an economic one. The **political conundrum** is about sequencing: on the one hand, political support for more euro-area fiscal stabilisation will increase the more Member States actually converge. On the other hand, the Five Presidents' Report and most Commission documents assume that having had such a stabilising system already in place would have made it much easier for crisis-ridden countries to embark on a (cyclical) recovery path, and hence better able to pursue (structural) reforms and to create growth, which ultimately contributes to overall euro-area convergence.

From today's perspective however, the issue of how to sequence risk sharing and risk reduction measures creates an impasse in EU decision-making.[22] Unlike the 'crisis stabilisation' provided so far, such as conditional ESM assistance *after* a balance-of-payments crisis becomes imminent, a euro-area stabilisation function would be aimed at creating fiscal space *ex-ante* and hence contribute to 'crisis prevention'. Critics view this reversal of logic as prone to moral hazard and thus resulting in a 'permanent transfer union'. The latter is explicitly ruled out by the Commission's reflection paper.

The **economic conundrum** may prove even more difficult: most economic accounts of the crisis concede that converging euro-area economies are key to make the centralised monetary policy more effective and the use of fiscal stabilisation instruments less likely. Additionally, the underlying assumption of most studies considers eventual convergence necessary as well as possible, if only the weaknesses of the original institutional EMU set-up were rectified. The streamlining of the economic governance framework since 2011 and especially the macroeconomic imbalance procedure address previously unnoticed potential channels of disintegration, such as major current account imbalances or high levels of private debt.

There are two caveats to this view: first, the present set of surveillance rules, introduced during the crisis as 'lessons learned' to prevent future crises, will be implemented differently the more the Commission views its responsibility to actually enforce them as a 'political' decision. The second is that some of the underlying centrifugal forces inside the monetary union may not be able to be 'hedged' through enhanced surveillance. While it may appear tempting, for instance, to blame Germany for running 'excessive' current-account surpluses at the expense of other Member States,[23] the accommodative monetary policy (and thus low external value of the common currency) of the ECB has had its role too. Current research suggests that so far neglected aspects equally contribute to the euro area's heterogeneity: the size of the non-tradable sector in an economy as well as its labour market institutions and collective bargaining structures may play an important role in individual Member States' shock absorption capacity. If these aspects are not taken into account, the one-size-fits-all monetary policy may well continue to produce diverging tendencies.

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10 C. Dustmann et al (From sick man of Europe to economic superstar: Germany's resurgent economy, Journal of Economic Perspectives, Vol. 28, No 1, 2015, pp. 167-188) consider Germany's labour market governance structures to be the main reason for its recovery, and actually more important than legislated 'Agenda 2010' reforms.

11 This, however, may conflict with different and entrenched welfare state conceptions and its EU equivalent in the Member States, see M. Busemeyer et al, Perspectives on the European economic and social model: distributional and institutional conflicts, in: International Journal of Public Policy, Vol. 3, No 1/2, 2008, pp. 39-57.

12 L. Haffert, P. Mehrtens, From Austerity to Expansion? Consolidation, Budget Surpluses, and the Decline of Fiscal Capacity, Politics & Society, Vol. 43, No 1, 2015, pp. 119-148.

13 See also Bank for International Settlements (BIS), The financial sector – preparing for the future, in: BIS 87th Annual Report, 25 June 2017.

14 A development not corroborated at global scale, see R. McCauley et al, Financial deglobalisation in banking?, Bank for International Settlements, Working paper No 650, June 2017.

15 On the recent debate of (contested) state aid for two failing Italian bank, see Reuters and 'Why Italy's €17bn bank rescue deal is making waves across Europe', Financial Times, 26 June 2017 as well as the Commission's fact sheet.

16 A. D'Alfonso, A. Delivorias, M. Sapała, A. Stuchlik, Economic and budgetary outlook for the European Union 2017, EPRS, European Parliament, January 2017 – see chapter on investment.

17 A. Zoppè, Member States with Excessive Macroeconomic Imbalances, Economic Governance Support Unit, European Parliament, June 2017.

18 See I. Begg, Fiscal and other rules in EU economic governance: helpful, largely irrelevant or unenforceable?, FIRSTRUN – Fiscal Rules and Strategies under Externalities and Uncertainties, H2020, November 2016.

19 See P. Leino, T. Saarenheimo, 'Sovereignty and subordination: on the limits of EU economic policy coordination', *European Law Review*, Vol. 42, No 2, 2017, pp. 166-189 (working paper version).

20 C. Lord, How can Parliaments Contribute to the Legitimacy of the European Semester?, in: Parliamentary Affairs, Vol. 70, No 3, pp. 1-18.

21 J.-W. Müller, Constitutional fantasy, London review of books, Vol. 39, No 11, 1 June 2017, pp. 9-12.

22 See also Scharpf 2016, p. 6. The controversy over the creation (and sequencing) of EDIS is one example of this debate. The issue of how to sequence risk sharing and reduction concerns economists too: a liberal approach views a low-interest environment as conducive to fiscal consolidation, including the Fiscal Compact (see Buti et al 2016, Becker, Fuest 2017, etc.) while for a progressive, this is a 'policy error' and governments should boost public

investment by allowing bond financing instead (e.g. P. De Grauwe, EMU Governance and Eurozone Fiscal Stance, presentation at CEPS-Intereconomics conference, Brussels, 20 April 2017).

[23] The problem is, of course, more nuanced: extra-EU trade as well as trade with central and eastern European Member States have predominantly contributed to Germany's large current account surplus. Insofar these increases do not completely reflect intra-EU gain of competitiveness. See e.g. J. Becker, C. Fuest, Profitiert Deutschland wirklich vom Euro?, in: Frankfurter Allgemeine Zeitung, 13 February 2017.

Appendix – Key economic indicators for the euro area, forecast 2017

2017	Budget balance	Structural budget balance	Debt	Real GDP growth	Unemployment rate	Non-performing loans ratio
BE	-1.9	-1.6	105.6	1.5	7.6	3.38
DE	0.5	0.6	65.8	1.6	4.0	2.46
EE	-0.3	-0.3	9.5	2.3	7.7	confidential
IE	-0.5	-0.3	73.5	4.0	6.4	15.90
EL	-1.2	2.5	178.8	2.1	22.8	45.86
ES	-3.2	-3.4	99.2	2.8	17.6	5.71
FR	-3.0	-2.3	96.4	1.4	9.9	3.65
IT	-2.2	-2.0	133.1	0.9	11.5	15.16
CY	0.2	-0.2	103.4	2.5	11.7	37.78
LV	-0.8	-1.4	38.5	3.2	9.2	3.18
LT	-0.4	-0.9	42.4	2.9	7.6	3.78
LU	0.2	0.4	22.0	4.3	6.1	1.83
MT	0.5	0.4	55.8	4.6	4.9	4.39
NL	0.5	0.2	59.8	2.1	4.9	2.43
AT	-1.3	-1.1	82.8	1.7	5.9	5.72
PT	-1.8	-2.2	128.5	1.8	9.9	19.48
SI	-1.4	-1.8	77.8	3.3	7.2	15.38
SKǂ	-1.3	-1.4	51.5	3.0	8.6	-
FI	-2.2	-1.3	65.5	1.3	8.6	1.60
EA	-1.4	-1.1	90.3	1.7	9.4	6.17

Source: all data in percentages. European Commission, European economic forecast, 11 May 2017. The structural budget balance is the cyclically adjusted budget balance net of one-off and other temporary measures. Greece does not take part in the EU's macroeconomic surveillance programme but in a 'stability support programme'. For the latest data on Greece see Angerer, J. et al. June 2017. NPL data from Q4/2016, ECB Supervisory Banking Statistics, April 2017, p. 71). ǂThere are no significant institutions at the highest level of consolidation in Slovakia. The total euro area NPL ratio of 6.17 % results from €14 251.28 billion in 'loans and advances' of which €879.79 billion are 'non-performing loans and advances'.

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