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The Future of Eurozone Fiscal Governance

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Abstract

This paper discusses various options for reforming fiscal governance in the Eurozone. We focus on two possible reform approaches referred to as the 'Maastricht model' and the 'US model'. The Maastricht model implies that ultimate responsibility for economic and fiscal policy remains at the national level. The US model, by contrast, calls for the development of much stronger European institutions. In both cases some degree of policy coordination, a European Banking Union and insolvency procedures for sovereigns are indispensable. We discuss the challenges and trade-offs involved and argue that certain elements of the two approaches which combine increased risk sharing with increased market discipline and risk reduction could be combined to achieve a more resilient and economically successful Eurozone.

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1 Introduction

If there is one lesson to be learned from the global financial crisis and the European debt crisis, it is that the Eurozone's institutions in their original form are ill-equipped to prevent crises and failed to make the currency union resilient enough to deal with them. The fact that reforms are needed is widely accepted, not only by academics and experts, but also by European institutions. This is reflected by various reports and reform proposals including the 'Five Presidents Report' (Juncker et al. 2015), the 'White Paper about the future of the EU' (European Commission, 2017a), and the 'Reflection paper on the deepening of the Economic and Monetary Union' recently published by the European Commission (2017b). These documents highlight "banking union" and "fiscal union" as two key objectives. Both are challenging and complex. The first steps towards a establishing a banking union have already been taken, despite the still highly controversial nature of elements related to financial risk sharing. Achieving fiscal union is even more challenging. While there is a general consensus that some type of common fiscal policy framework is needed, views on what fiscal union actually means differ wildly.[1]

For various reasons, the year ahead may open a window of opportunity for reforming the EU and the Eurozone. The recent election of a pro-Europe government in France, combined with elections in Germany and possibly in Italy later this year, is reshaping the political landscape. Brexit also approaches, raising the question of how the EU 27 wish to proceed with their integration project. At the same time, the Eurozone is enjoying a cyclical recovery. These favourable macroeconomic conditions are very welcome, but will not last forever. Clearly this opportunity for reform needs to be firmly seized. But doing so requires at least some degree of consensus on a diagnosis of the Eurozone's disease as well as on the therapy. There are at least three different reasons widely claimed to be the cause of its malaise.

The first is that EMU governance has been disappointing, and notably that policy coordination has been weak. The member states, as soon as they are under pressure, do not feel bound to common rules or European recommendations. This is due to the fact that the currency union consists of sovereign member states, where democratic legitimacy is based on national elections and national parliaments (Schuknecht et al. 2011, Eyraud et al. 2017). Its symptoms typically include a persistent deficit bias in fiscal policy, public debt growth and a reluctance to undertake structural reforms.

[1] See e.g. Bénassy-Quéré et al. (2016), Bordo et al. (2013) and Fuest and Peichl (2012).

The second view is that the rules failed as substitute for explicit policy coordination because they were designed to control for the negative spillovers of fiscal profligacy, but not for those of fiscal austerity. This is why the recession has been deeper and longer recession in the EMU than elsewhere.[2]

A third view is that the EMU as a supranational institution lacks "incentive compatibility" with the legitimate role of democratic governments as representatives of societal preferences and interests over policies and their outcomes (Eyraud et al. 2017; also Wickens 2016, Delatte et al. 2016). This view is naturally intertwined with the longstanding question of the "democratic deficit" of Europe (Bastasin 2015, Fabbrini 2015).

Current reform proposals point in at least two directions. The first direction is the deepening and strengthening of the original rule-based conception of the EMU embedded in the Treaties. Sovereignty devolution should preferably be towards, "technocratic", non-political agencies as guardians of the rules (e.g. the European Fiscal Board and national fiscal boards; Villeroy de Galhau and Weidmann 2016, Asatryan et al. 2017). Capital market discipline and credible No-Bailout mechanisms should form the backbone of fiscal governance, not political coordination mechanisms at the European level (nor fiscal rules, according to some: Mody 2013, Wyplosz 2015). In the following, we refer to this direction as the 'Maastricht model'. This approach is based on the idea that the Eurozone member states share a common currency, but ultimately retain sovereignty in economic and fiscal policy.

The other direction emphasizes supranational governance, joint fiscal and economic policies and stronger elements of risk sharing. The idea is to build up a fiscal capacity at the European level that can provide fiscal stabilisation in the event of asymmetric shocks. This could be combined with some form of democratic control other than via national parliaments. The introduction of a 'European finance minister' or a 'Eurozone Parliament' were just two of the proposals included in the new French President's election manifesto. In the following, we refer to this approach as the 'US model' because it implies a stronger role for political institutions at the central level, despite the fact the fiscal capacity of these institutions would initially be significantly smaller than that of the US federal budget.

This paper provides an overview of the key issues that are likely to shape the upcoming negotiations over Eurozone reform. We identify those issues by comparing

[2] For different perspectives on this issue, see De Grauwe (2013), Manasse (2015), Corsetti (2012) and Buti and Carnot (2013).

the Maastricht model and the US model as concepts for fiscal governance reform in the Eurozone[3], and by discussing the challenges implied by both approaches.

2 Two options for the Eurozone: Maastricht model versus the US model

2.1 The Maastricht model

The Maastricht model implies that the Eurozone member countries share a common currency, but ultimate responsibility for economic and fiscal policy remains at the national level. If the power to make decisions on economic and fiscal policy is left to individual member states, sound governance requires that liability should also be at the national level. This implies that the Maastricht model requires credible insolvency rules for sovereigns. How would such a setup work?

Four elements are of key importance. The first is fiscal coordination and supervision based on fiscal rules aimed at *preventing* crises by maintaining sound and sustainable public finances.

The second element of the Maastricht model is an institution that deals with cases where individual member states face fiscal crises, despite efforts to prevent them. Currently this task falls to the ESM. The aim of the ESM is to provide liquidity assistance to member states that lose access to capital markets. This liquidity assistance has two purposes: the first is to ensure that governments can continue to provide basic public services; the second is to deal with capital market failures, which may deny countries access to funding, even if they are fundamentally solvent.

The third element is a credible insolvency procedure for sovereigns. The ESM plays an important role here because insolvency procedures will only be credible if governments are able to continue to supply basic public services. The other key issue is that private creditors must be able to absorb losses if public debt restructuring occurs. This implies that banks can no longer hold vast amounts of individual member states' public debt as they do today, and particularly not debt of the state where they reside, without equity underpinning. This means that changes need to be made to banking regulation, forcing banks to diversify investments in government bonds and

[3] In this paper we do not discuss the current and future role of the ECB and the relationship between monetary and fiscal policy including the issue of target balances and the OMT programme, on these points see Baldwin and Giavazzi (2015), Sinn (2011) and Feld et al. (2016).

to finance these debt holdings with more equity than they are currently required to do. Only if that happens the no-bailout rule and sovereign insolvency procedures can be credible. If the stability of the banking system depends on the financial stability of national governments, fiscal crises in individual member states are easily exacerbated by the fiscal sovereign doom loop and can lead to banking crises with detrimental effects on the economy as a whole.

The key role of financial sector resilience underscores the importance of the fourth element: European Banking Union. The role of the banking union goes beyond making sure that the financial sector is sufficiently resilient to absorb fiscal crises in individual member states. Such a union is also supposed to prevent banking crises like those experienced by Spain or Ireland from leading to public debt crises because national governments are forced to bail out their banks. To achieve this, banks need more 'bail-inable' capital on their balance sheets, while bank resolution as well as resolution funding should be shifted to the European level.

2.2 The US model

Adopting the US model for the Eurozone would call for the development of far stronger institutions at the European level. The objective would be to achieve deeper economic and financial integration than today, as well as common economic and fiscal policies. This model would include the following elements.

Firstly, the Eurozone would create a common budget. The main purpose of introducing this common budget would be to provide fiscal stabilisation in the event of asymmetric shocks. A more ambitious approach would be to use the Eurozone budget as an instrument to provide public services of European interest like cross-border investment projects or spending on defence and border protection. The budget would be administered by a 'European Finance Minister', while democratic control would be exercised by a 'Eurozone Parliament'.

A key issue is how the budget would be financed, and what financing the budget would imply for the fiscal sovereignty of member states. An ambitious, but undoubtedly controversial option would be to introduce European taxes. This would imply a fundamental constitutional shift marked by the introduction of an independent power to tax at the Eurozone level. A more limited approach preserving fiscal sovereignty would be to use contributions from the member states. In both cases a key question is whether debt financing should be allowed or not.

The second element would be the development of common economic and fiscal policies. As long as the Eurozone budget is small relative to that of the member states this can only be achieved through the coordination of national economic and fiscal policies. This would require a deepening and broadening of the European Semester to cover wide areas of economic and fiscal policy. In the area of fiscal policy, this would include both the supervision of deficits to prevent member states from accumulating too much debt, as well as coordination of countercyclical fiscal policies to achieve an 'appropriate' fiscal stance for the Eurozone as a whole.

A third element is again an insolvency procedure for sovereigns. In the absence of joint liability for national government debt, it is inevitable that national governments may face insolvency. In the US there is no joint liability for state debt, but there are no explicit rules and procedures for dealing with the insolvencies of individual states either. Instead, states' fiscal crises are addressed on an ad hoc basis, albeit usually without help from other states or the federal government (Henning et al. 2012). Letting state (and local) governments default is possible because banks cannot hold state debt without equity underpinning, and banks do not depend on the financial support of state governments since bank supervision and resolution is a federal responsibility.[4]As a result, as in the case of the Maastricht model, a European Banking Union is a requisite fourth element.

3 Which model is right for the Eurozone?

Which of the two models outlined above is right for the Eurozone? The Maastricht model corresponds to the political reality that democratic control and legitimacy for economic and fiscal policy remains at the national level, and it is very difficult to change this, at least in the short and medium term. At the same time, the Eurozone debt crisis exposed weaknesses in the institutional setup of the currency union. Some of these weaknesses have since been addressed: the process of policy coordination and supervision has been reformed, new fiscal rules have been introduced, notably with the fiscal compact, and new institutions have been created, including the ESM and the European Banking Union. But it is unclear whether these steps are effective. There is a widespread view that more political integration than offered by the Maastricht model is needed to achieve a stable currency union. This would point towards the US model. We will discuss the challenges of both approaches in the following sections.

[4] In addition, the level of debt that has been accumulated at the sub-central level is low, compared to federal debt.

3.1 Can the Maastricht model work?

The idea of addressing the weaknesses of the Eurozone within the framework of the Maastricht model raises various issues: firstly, what we can expect from fiscal rules and fiscal surveillance and how the rules should be designed. Secondly, what is required to complete a banking union, especially with respect to the controversial elements of a fiscal backstop and deposit insurance? The third issue is whether an insolvency regime for sovereigns can be reconciled with economic and financial stability and resilience of the currency union in crises.

3.1.1 Fiscal rules

As illustrated by Optimal Currency Area literature, national fiscal policy in a monetary union is in a critical position (Kenen 1995). On the one hand, the loss of independent monetary policy and an irrevocably fixed exchange rate call for greater fiscal activism in order to stabilise the economy vis-à-vis asymmetric shocks. On the other hand, limits to fiscal sovereignty are needed in order to control for the reciprocal negative spill-overs of fiscal policies exclusively dictated by national preferences or interests that may jeopardise collective goods like the macroeconomic and financial stability of the union as a whole. Against this background, attempts to reign in fiscal sovereignty (in a non-federal system) may take various forms.

The solution embedded in the Maastricht Treaty, and further specified by the Stability and Growth Pact[5] and subsequent modifications, is essentially a sovereignty + rules mix. The idea of fiscal governance based on a sovereignty + rules mix is controversial. In modern constitutional democracies fiscal policy choices are firmly under the "input" and "output" responsibility of governments to whom citizens confer the legitimate power to tax and spend by force of the law (Scharpf 2015). From this fundamental point of view, rules "are in permanent contradiction with budgetary sovereignty" (Wyplosz 2015, p. 3). A tension has often surfaced between the status of the EMU fiscal rules and national constitutional courts (Giuriato 2016). Accordingly, "de-politicising" fiscal institutions may sound like an intrinsic contradiction. According to some authors, the tension between sovereignty and rules is easily resolved by removing rules since all that is needed in a monetary union is "market discipline and scrupulous application of the no-bail out clause" (Wyplosz 2015; also Mody 2013).

[5] When the euro was introduced the Stability and Growth Pact required Eurozone member states to have balanced budgets. The deficit limit of three percent was to provide room and flexibility for expansionary fiscal policy in the case of downturns. Compliance with these rules, however, was poor. The balance budget was replaced by the three percent deficit as a point of reference for sound public finances, and when countries considered themselves as being caught in a downturn they complained that there was no room for countercyclical policies.

Still, credibility of the no-bail out clause would have to be supported by the institutional setup, in particular a resilient financial sector.

From the perspective of the Maastricht model of Eurozone reform, effective fiscal rules alone cannot safeguard fiscal prudence. Any such rules must be embedded in a system that also provides market incentives for responsible budgetary policies. However, well-defined rules are a potentially helpful element of the euro area set-up. Today, the system of fiscal governance in the euro area suffers both from increasing complexity and a politicised interpretation of rules. With each individual reform of the Stability and Growth Pact, albeit well-founded, the rule book has grown. It is now so complex that the whole approach seems opaque and difficult to follow. In principle, if European citizens punished politicians for overstepping fiscal rules at the polling booth, the rules could serve as a complement to market discipline. But complexity is likely to reduce popular support for such rules.

Moreover, some of the recent reforms have yielded disappointing results. The new voting mechanism for the Excessive Deficit Procedure introduced by the Six Pack, for instance, strengthens the Commission in its enforcing role. Sanctions initiated by the Commission can only be blocked by a qualified majority in the Council (reverse majority voting). Unfortunately, the hope that this will make any sanction threat more credible has proven unfounded. The Commission does not present itself as an impartial guardian of the rules, but rather as a political body. In its application of the rules it extensively refers to political arguments like the threat of populist election successes. Hence, reforms that had been designed to make the rules more easily enforceable have effectively led to a further politicization of fiscal governance. It is certainly possible to make a case for a more political Commission. However, this development questions the institution’s current function as a guardian of the European treaties and as a referee of fiscal rules. If a neutral guardian of rules turns into a political institution, the rules lose their reputation.

From this perspective, it is questionable whether further refinements of the rules are a viable way forward. According to the Maastricht model of Eurozone reform, the existing rules do not suffer from a lack of flexibility, but from the lack of a neutral and non-political use of flexibility clauses. This raises the question of how a less politicized application of fiscal surveillance can be achieved. At the national level, there is a strong tendency towards setting up independent fiscal boards (Debrun et al., 2017). Typically, these boards do not take decisions and or directly enforce fiscal rules. Instead, they advise parliaments and governments and inform the public of their assessment. Their function is to overcome a problem of asymmetric information between decision-making politicians on the one hand, and the general public and the media on the other hand. The latter often lack the capacity to evaluate their governments' fiscal performance. Here, neutral fiscal boards can send out valuable signals that offer information on the quality and efforts made by governments. This should limit the leeway of political decision makers to abuse their discretionary power in favour of a myopic agenda.

Obviously, information problems are particularly acute with respect to a responsible use of discretion in the Stability and Growth Pact given its complexity problem. Hence, the 'European public' is hardly able to judge whether or not the Commission and the Council apply the rules in a responsible way. An independent board may potentially improve European public debates on the Stability and Growth Pact and its application.

It was exactly this kind of reasoning that made the Five Presidents' Report suggest the "European Fiscal Board" (EFB), which was established at the end of 2016 and has become operational since then. However, compared to most national boards, this first European variant has many shortcomings, which render it a rather weak institution (for details, see Asatryan et al., 2017). The EFB lacks effective independence from the Commission with its secretariat's staff exclusively recruited from Commission Services. Its mandate encompasses both the search for an appropriate fiscal stance and ensuring fiscal sustainability – two concepts in strong tension with each other. The EFB also suffers from a lack of resources and communication option. Nevertheless, it is a promising starting point, which can be seen as a first stage in a longer-run strategy.

3.1.2 The European Banking Union: fiscal backstop and deposit insurance

While there is broad support for the idea that a European Banking Union is an important element of the institutional setup of the Eurozone, views are divided over what exactly is needed to make the banking union work. There is a consensus that a common framework for banking regulation, supervision and banking resolution is essential. The more critical question relates to financial risk sharing. Risk sharing to date has been restricted to the common resolution fund, which is of limited size. But it is clear that this fund would be insufficient to deal with a major banking crisis either in one country, or in the Eurozone as a whole. In such a scenario financial support for the banking system would still be provided by the member states. Along the same lines deposit insurance is still national. There are common rules regarding the standards for deposit insurance, but risk sharing is limited to individual member states.

The main reason for the reluctance of some member states to agree to a common fiscal backstop for the banking system, or to common deposit insurance, is that the economic situation of the member states and, by extension, the economic situation of the banks - and particularly the incidence of non-performing loans - is highly asymmetric. Progress in these areas would require measures to write down non-performing loans and recapitalize the banks. At the same time, greater trust would be needed in bail-in rules, which protect taxpayers against being forced to bear losses generated by failing banks.

3.1.3 An insolvency regime for sovereigns?

The question of who bears the costs of financial crises of individual member states is of key importance to the institutional setup of the Eurozone. The No-Bailout-Clause was a cornerstone of the Treaty of Maastricht, and it was a prerequisite for making monetary union acceptable to many citizens in Europe. During the Eurozone debt crisis the No-Bailout-Clause was called into question. Several proposals have been made to introduce various forms of joint liability for government debt via Eurobonds or similar instruments. But joint liability for government debt would require member states to relinquish their sovereignty in fiscal policy; in other words national parliaments would have to give up the right to issue debt. Again, this would require a fundamental constitutional change in the Eurozone, something which is not part of the Maastricht model.

This implies that a credible procedure for sovereign insolvencies is necessary. Some elements of such a procedure already exist, notably collective action clauses for government bonds. The key policy question is whether additional and explicit procedures for sovereign insolvencies are needed, or whether it is more appropriate to rely on an ad hoc management of fiscal crises. This is a question that has been intensively discussed both within the Eurozone and at an international level, in the debate over the sovereign insolvency mechanism proposed by the IMF.[6] Irrespective of whether or not an explicit insolvency procedure for sovereigns is created, a number of steps should be taken to facilitate and reduce the economic costs of sovereign debt restructurings when they are needed.

[6] For a discussion of proposals developed before the Eurozone debt crisis, see Behrensmann and Herzberg (2009).

Firstly, as mentioned above, the exposure of banks to individual Eurozone member states should be reduced.[7] Secondly, the ESM should be reformed to reduce the risk that the ESM bails out member states in cases where debt restructuring is needed. One proposal put forward is that all outstanding government bonds should automatically extend their maturity if the issuer starts an ESM programme (Wendorf and Mahle 2015). Thirdly, legal provisions must be made to prevent holdouts (Zettelmeyer 2017). If these reforms are carried out, they will make the existence of explicit and rule based procedures for sovereign insolvencies less important, since the political pressure to delay restructurings will be weaker than it is at present. It would nevertheless still be useful to introduce more explicit procedures for sovereign insolvencies. More specifically, there should be an institution that would deliver expertise and provide a forum for negotiations over debt restructurings. The ESM would be a natural candidate.

3.2 Is the US model a feasible alternative?

As mentioned in section 2, the US and Maastricht models have some features in common, notably the European Banking Union and the need for a credible sovereign insolvency mechanism. This implies that the obstacles to the introduction of these reforms discussed in the preceding section also need to be overcome if the Eurozone is reformed along the lines of the US model. However, the US model raises other issues that will be discussed in turn, including the nature and the size of the Eurozone fiscal capacity and the process of fiscal and economic policy coordination.

3.2.1 The Eurozone budget: focus on large shocks or nucleus for a federal budget?

One of the many differences between the US and the Eurozone is that the US federal government's share of overall public spending is roughly 54 percent, whereas public spending at the EU level is just two percent of overall public spending. The Eurozone as such has no central budget at all. This implies that fiscal stabilisation has to come mainly through national budgets. This is perfectly possible in the case of normal fluctuations over the business cycle. But in the presence of large shocks, countries may run into financial difficulties that limit the effectiveness of automatic stabilisers

[7] Various authors have argued that this is feasible only if a new 'safe asset' is created in the Eurozone, for instance bonds issued to finance a new Eurozone budget or 'Esbies' (Brunnermeier et al., 2011). Others have rejected the concept of introducing regulatory privileges for sovereign bond backed securities in the Eurozone, see Scientific Advisory Board of the Federal Ministry of Finance (2017).

or their ability to engage in active countercyclical policy. This is where fiscal stabilisation through a fiscal capacity at the Eurozone level could be useful (Gros, 2014).To maximize its impact with a limited financial volume, such a fiscal capacity should only be active in the event of large shocks. This implies that the fiscal capacity of the Eurozone would resemble more of an emergency fund, rather than an annual budget.

How would the emergency fund be used and how would it be financed? As far as use of the fund is concerned, there are two options: the first being support for national unemployment insurance systems. Countries experiencing a large increase in unemployment would be 'reinsured' through the Eurozone fiscal capacity. The second option would be to use the fund for public investment. The European Commission (2017b, p.26) puts this as follows: "A European Investment Protection Scheme would protect investment in the event of a downturn, by supporting well-identified priorities and already planned projects or activities at national level, such as infrastructure or skills development. In an economic downturn, public investment is usually the first item to be cut in the national budget."

How would the fund be financed? It seems clear that an emergency budget to be activated only under exceptional circumstances would be funded via contributions by the member states. It has also been suggested that the fund could be financed through debt, so that it makes a contribution to the fiscal stabilisation of the Eurozone as a whole. A similar effect would be achieved if the member states contributed and accumulated funds in 'good times'.

Clearly, the governance of such a fiscal capacity would be of crucial importance. There would be strong political pressure to activate the fund in cases of chronically low growth, rather than true economic shocks. At the same time, it might be activated too late or not at all in the event of true asymmetric shocks if countries unaffected by the shock resist. This again suggests that clear and simple rules for activating the fund would be needed. At the same time, for this type of Eurozone fiscal capacity, it is unnecessary to introduce institutions like a Eurozone Parliament or a Eurozone Finance Minister.

There are proposals, however, which suggest a different role for a Eurozone fiscal capacity, which is closer to that of a traditional budget with permanent expenditure. One option is to create a budget that focuses on the provision of European public goods like defence, border protection or development aid. Such a budget could be seen as a nucleus for the development of a federal, more substantial fiscal role at the European level. An open question here is how the Eurozone budget would be related to the EU budget. Clearly, if core areas of national sovereignty like defence spending were to be shifted to the European level, the case for a fundamental reform of governance and democratic control would be much stronger.

3.2.2 Developing a common economic and fiscal policy through an intensified European Semester?

The second challenging element of the US model would be to achieve a common economic and fiscal policy in the Eurozone. While this is straightforward in a currency union with a full-fledged federal government with a large budget and far-reaching regulatory powers, it is more difficult to achieve in the far more decentralised setting of the Eurozone. Currently economic and fiscal policy coordination takes place in the framework of the European Semester. Essentially, the European Semester is a process of dialogue and voluntary policy coordination, whereby the European Commission analyses economic and fiscal policy plans submitted by national governments and proposes recommendations which may or may not be adopted by the European Council. National governments may follow these recommendations if they wish to do so.

There is no doubt that this process of consultation and discussion can be very useful, but its impact is limited, particularly in situations where national governments face pressures to deviate from recommendations. In addition, it is questionable whether the judgement of the European Commission or the Council about which policies and reforms are appropriate in the different member states with their very specific issues is better than the judgement of the national governments and other institutions in the member states.

A related issue is that too much European involvement in national economic and fiscal policy decisions easily blurs responsibility and sometime encourages national politicians to blame the EU for economic problems created at home. This undermines political support for European integration and for the enforcement of rules.

For these reasons it is worth considering giving *national* fiscal boards and other advisory institutions greater weight in the context of the European Semester. As recently pointed out by Pisani-Ferry (2016), these institutions would be able to provide more granular advice and would be in a better position to adjust European recommendations and requirements to the specific conditions of national economic policy debates.

4 Can elements of the Maastricht and the US model be combined?

It is natural to ask whether progress could be made by combining elements of the Maastricht model and the US model. The US model is more ambitious when it comes to reforms of democratic control and legitimacy. While the Maastricht model sticks to the principle that democratic control of fiscal policy takes place at the national level, the US model would seek to establish some form of more direct democratic control through a Eurozone Parliament (which could, but would not have to be related to the European Parliament). This would require a fundamental reform of the European treaties, a step that may be necessary in the long term, but faces considerable obstacles in the short and medium term. [8]

An alternative approach may be to ask whether the Maastricht model can integrate some aspects of the US model, particularly those related to providing fiscal stabilisation
at the European level. It would mean focusing on a reform agenda that includes the following points:

- Completion of European Banking Union (Recapitalise banks with high NPLs, ESM as a fiscal backstop)

- Increasing the credibility of the No-Bailout-Clause by reducing the costs of sovereign insolvencies (equity underpinning of government bond holdings, greater diversification, tightening of capital requirements for banks)

- Creating a Eurozone fiscal capacity that supports public investment and unemployment insurance in the event of strong asymmetric shocks

- Separating fiscal surveillance from the European semester and giving independent fiscal boards (or the ESM) the task of making countries comply with fiscal rules

- Reforming the European Semester to integrate independent expertise at the national level to achieve recommendations that are more adjusted to specific circumstances of the individual member states

It is important to note that this is a reform package that combines elements of increased risk sharing with elements of increased market discipline and risk reduction.

[8] Piketty et al. (2017) propose to create a Euro-zone parliament composed of national MPs without changing the treaties.

5 Conclusions

Reforming the Eurozone with the objective of achieving sound fiscal governance and economic stability is a considerable challenge. Against the backdrop of the current economic recovery, the temptation exists to postpone the debate over the necessary reforms. But this would be unwise. The conditions for making progress towards a more resilient and economically successful European Monetary Union are favourable at the moment precisely because the current situation is less fragile than it has been in recent years. At the same time, views – at least when it comes to the trade-offs to be considered when it comes to reforming the institutions of the Eurozone – seem to be converging, even if persisting differences in opinion still need to be bridged.

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