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Blueprint for a democratic renewal of the eurozone

Strengthening the monetary union requires a significant leap in governance.

In the last few months, the European Commission as well as a group of 14 French and German economists have issued new blueprints for strengthening the architecture of the eurozone. These proposals are all guided by a spirit of compromise but limited by perceived political constraints. By focusing on gradualist solutions, they allow for an economic compromise to emerge but ignore the deep institutional, political and democratic underpinnings of the euro crisis.

In other words, they neglect the fact that if the monetary union doesn't rapidly succeed economically rather than merely survive, it will eventually become politically unsustainable.

A bolder, more sweeping approach is thus needed.

Since the eurozone crisis, the intellectual consensus has gradually solidified around the hope that once the financial system is repaired, the creation of a banking union, extended with a capital markets union, would allow for enough risk sharing as in an insurance system to stabilize the currency union. If properly designed, this might convincingly redress the worst flaws of the initial architecture, but it is not enough to ensure its success.

Classical economists believe that financial markets, price signals and economic incentives can be the unique source of both discipline and private-sector risk-sharing. But a functional monetary union cannot operate only on the basis of mutual insurance that inevitably pits creditors against debtors.

Institutional and political issues, rather than the economic solutions, should be at the heart of the reform debate. The last few years have shown that the institutions governing the eurozone are not fit for purpose in preventing crises and even less so in managing them. Economic policy orchestrated by an ineffective combination of complex rules, erratic market discipline and loose inter-governmental cooperation arrangements cannot continue to be the way forward for the eurozone.

Instead, a new political approach would include a real European executive that is democratically accountable before a parliament of the eurozone and leads economic policy with expertise and a larger degree of political autonomy.

A mere credit line from the EU budget or rainy day fund for difficult times would be far from adequate to fund such an adjustment mechanism. It would be only possible with a real and sizeable eurozone budget, which would perform five critical functions.

First, it should credibly backstop the financial system so that it can perform its stabilizing and risk-sharing function. Beyond using the current resolution fund for banks when necessary, this means agreeing to an effective backstop for a common deposit insurance scheme, as well as for a common and strengthened resolution authority.

Second, it should enable stronger macroeconomic stabilization in the event of shocks, for example by way of a small unemployment insurance scheme at the eurozone level. Funded through taxation, it could for instance cover a part of the salary for the first 12 months of unemployment, which would be small but meaningful.

Back-testing this proposal suggests that in the early 2000s, Germany would have been a net recipient of such a system and Spain a net contributor. It would also alleviate the European Central Bank from being the sole bearer of cyclical-shock adjustment — a politically divisive situation.

Third, unlike the current EU budget, this eurozone budget should entail the ability to raise taxes, decide on expenditures and issue debt. The last point means it would be a supplier of eurozone risk-free assets in times of crisis, thereby complementing the constrained capacity of member states to supply safe assets. This would be crucial if member countries were to default on their national sovereign debt.

Fourth, it should help create a new form of cohesion and convergence policy for members that have structural competitiveness and institutional challenges. It should help make the sort of investments — in universities, schools, legal systems, training and infrastructure — that boost productivity and support relevant reforms. But it should also encourage investment and social policies in countries that have structural surpluses.

The current set of economic reforms pushed to achieve rebalancing was exclusively based on internal devaluations. This has proven to be not only politically and socially destructive, but also economically destabilizing given the large external surpluses of the eurozone.

Finally, while the boundary between public goods for the EU and those for the eurozone can be blurry, there is a strong case for an investment agenda that includes defense, innovation and the environment and improves both the aggregate output of the eurozone and helps those economies that have high potential in renewable energy. This function of the eurozone budget could complement the EU budget and, as such, be open to non-eurozone member countries.

All these functions would require new revenues, which could be raised from a portion of value-added tax, corporate tax, or even a new carbon tax. The budget of the eurozone could start at a modest size of at least 1 percent of the eurozone GDP. Without prejudice to the EU and its finances and while under the control of the Commission, this budget should, however, sit outside the EU budget so as to provide the eurozone with enough financial and institutional independence and flexibility.

These technical solutions on the monetary and fiscal front would also have far-reaching political consequences that would require a significant leap in the governance of the eurozone.

A European commissioner should be in charge of monetary and fiscal affairs of the eurozone, chair the Eurogroup, take executive decisions on its behalf, and be democratically accountable to a eurozone parliament formed by a subset of the European Parliament that would be empowered to remove him or her from office in a no-confidence vote.

Such bold steps would establish the foundation of a European economic sovereign body and acknowledge that economic policy decisions require executive powers and democratic accountability. A modern vision of the eurozone needs to advance, rather than avoid, Europe's political union.

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