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EMU Reform – Still Far From the Right Solutions

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President Monti in his Asian roadshow has declared that the Euro zone crisis is over. This statement, which is unwarranted for the real economy according to all major forecasts, is overly optimistic with reference to the sovereign debt crisis. The so-called "Treaty (!) on Stability, Coordination and Governance in the economic and monetary Union" released with fanfare in December, is juridically precarious, quantitatively insufficient, and qualitatively disappointing.

Speculative attacks against euro sovereign debts have taken a moment of rest only thanks to local backstops to the Greek contagion, which, if anything, have unveiled that coordinated actions and ammunitions are still below necessity. The latest negotiation round about the endowment of the ESM has not resolved the problem. At the moment, there is no guarantee that the severe budgetary measures taken in Rome will not be self-defeating in a recession spiral as is happening in Athens. The dramatic reopening of spreads against Spanish and Portuguese bonds witnesses that markets are still quite nervous and far from being reassured by the would-be Reform.

Qualitatively and politically, it is hard to see any substantial step towards true fiscal policy coordination, not to mention creation of a *political* fiscal authority or fiscal federalism. The backbone of the so-called Fiscal Compact (FC) remains the deleterious country-by-country "rules+sanctions" philosophy of the old Stability and Growth Pact. That is Germany's standpoint, and no real progress has been made beyond rhetorical concessions.

The FC, like the SGP, deceitfully vehiculates the idea that "policy coordination" is in place. A centralized system of rules, monitoring, recommendations and sanctions is not policy coordination; nobody would say that the highway police is the means whereby drivers coordinate themselves. Policy coordination is first of all a voluntary device whereby members identify common policy objectives, and coordinate instruments and actions in order minimize reciprocal spillovers. As a matter of fact, the notions that the EMU as a whole may have common macro-objectives, and that national fiscal policies may have spillovers onto other members, were banned from the SGP philosophy from the very beginning. The FC follows in the same line; for example, you cannot find a word about Union-wide effects of un-coordinated fiscal restrictions, and how these effects can be minimized by way of true policy coordination. The fancy idea of "macro-surveillance" focusing on current account imbalances and one-sided correction of deficits is the blatant negation of policy coordination.

The Reform delivers nothing with regard to the true Gordian Knot of the EMU, namely a new (North-South?) pact of "rules + risk-sharing". Obviously, only risk-sharing without rules is unacceptable. But it is now clear that “only rules” packages like the old SGP did not, and will not, work. Yet the clear German message behind the FC is more rules now, risk-sharing instruments and institutions maybe in the future.

So, in the end, the so-called Reform is not much more than the chart of a “fiscal police” system (and it may be instructive to read that for some authoritative officials of the ECB it is not yet enough; see L. Schuknecht, P. Moutot, P. Rother, J. Stark, ECB Occasional Papers, n. 129). The fact that such a system is centralized and operated by a supernational entity cannot be sold as a step towards a common fiscal policy. True enough, the FC entails a limitation of fiscal sovereignty, exactly like drivers with the highway police, which is quite a different arrangement than creating a new political institution entitled to manage a common fiscal policy.

It is often argued, with more than a grain of truth, that European peoples and their governments are not yet ready for the big jump into a true federal system. Yet, ironically, we do have a unique fiscal federal system, one which is totally decentralized without central fiscal authority. Hence, many intermediate stages would be possible and feasible. One important progress would consist of transferring some selected taxing or spending competences to the centre. Usual examples are those with the largest spillovers, such as military expenditures, large infrastructures, V.A.T., etc., and in general those competences for which coordination is better obtained by centralizing decisions rather than by painful harmonization of national legislations. This would be an important progress also for another reason: national budgets of most EMU countries are too large (as extension of competences) to be manageable in a monetary union with rigid fiscal rules. As some scholars have shown, the larger the budget, the more rigid. National governments should be nudged to give up the more onerous competences, and keep with themselves only those that are really crucial for national differences in identity, tastes and values. More slender budgets would also entail smaller debts and risks. Hence they would also be the right complement to the much awaited introduction of risk sharing devices, such as Euro bonds. Sorry, President Monti, but we are still very far from the right solutions.