A historical black and white photograph of a protest. Several men are standing in a line, holding large signs. The signs contain text such as "THERE ARE THOUSANDS WALKING THE STREETS AT NIGHT WITHOUT SHELTER LODGING HOUSE FOR?", "THE RIGHT TO WORK! SHALL BE GUARANTEED TO ALL CITIZENS REGARDLESS OF CREED, COLOR OR SEX", and "IT'S CO... FOR A... THAT MAN TO... SHALL... AND A...". The men are dressed in early 20th-century attire, including suits and caps. The background shows a city street with buildings.

Shared Unemployment Insurance

Helping refocus the Eurozone on convergence and cohesion

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Prime

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Summary

The divergences developed between core and periphery within the euro area represent the main threat to the existence of the single currency and to the cohesion and stability of the EU as a whole. Without proper automatic stabilizers, a monetary union can only deliver suboptimal results, and may not even be sustainable.

If divergence and asymmetries are not dealt with through substantial EMU reform, continuing stagnation may turn greater shares of the electorate against the euro as well as the EU. Reconstruction will be blocked, and the only choice will be between orderly or disorderly deconstruction.

In recent years, various forms of common unemployment insurance have been examined as one of the possible ways to improve the functioning of the EMU through automatic stabilisation. Among the options, a partial pooling of unemployment benefit schemes stands out as the model with continuous impact and direct connection with the citizens.

The euro can only fulfil its originally articulated unifying mission if the costs and the benefits of EMU are more fairly distributed among the participating states, and if the rules of the game help boost the growth potential of all of them. To deliver this, we need a new momentum for EMU reform, with counter-cyclical fiscal capacity, and an emphasis on convergence and rebuilding social cohesion, in the focus.

1. Core—periphery imbalances in Europe

The European Union, also in its Treaty, is committed to (economic, social and territorial) cohesion, balanced growth and upward convergence. After years of financial, economic and social crises, the gap between these ideals and the reality has to be noted, and taken seriously.

However, the gap is not only a product of the recent crisis, but a longer period of transformation. In the last 25 years, Europe was transformed by two main projects. The first project is the establishment of a Single Market and a Single Currency. The second one is the Eastward enlargement (2004, 2007, and 2013), taking countries of the former Soviet bloc into the European economic integration.

The impact of these two projects on cohesion and convergence is a critical question for academic studies and public policy at the same time. The dual transformation of Europe has resulted in a deeply imbalanced union. Both East-West and South-North imbalances can be analysed through the lens of core—periphery relations.

Core and periphery used to be a conceptual framework to describe the world (economic) system. Western Europe, a community of former colonial powers, formed

part of the core of the world system. Countries of East Central Europe have formed part of a semi-periphery.

Core and periphery have been increasingly used to describe relations within Europe, within the EU, and within the Eurozone. However, the nature of core—periphery relations differ if we look at various layers of the European integration: the single market and the monetary union. The first apply more to the East-West asymmetry, while the second is more relevant for the South-North polarisation.

South-North imbalances are largely connected with the functioning of the monetary union (EMU), despite the fact that the EMU has been built around certain convergence criteria (*ex ante* but also after joining). The discrepancy between nominal and real convergence is the key to understanding these imbalances specific to the Eurozone. According to Regan (2015), the imbalance has its roots in merging different types of capitalism in the single currency.

In reality, South and North only vaguely cover the groups of countries in asymmetric situations in the EMU. The actual, “financial” South also includes Ireland, the three Baltic states, together with Slovenia and Slovakia, which were pioneers among Eastern member states to adopt the euro as their national currencies.

The EU is supposed to create unity out of diversity, but the minimalist (or infantile) monetary union turned diversity into divergence in the last two decades. Divergences between the core and the periphery of the Eurozone (or North-South imbalances) are more dangerous for the sustainability of the EMU and the stability of the EU than East-West imbalances. The latter are linked to the wide income gap between old and new member states, which despite the crisis, continued to diminish in the last five years.

EMU membership for peripheral countries means that in periods of growth they enjoy greater confidence and consequently favourable pricing of finance, for private as well as public actors. At a time of recession, on the other hand, financial fragmentation increases the costs of borrowing and also the risk of insolvency. Capital flight usually aggravates this situation, also in connection with the lack of full confidence in the future of the Eurozone, or in its composition.

All this means that the Eurozone cannot be cured with country level adjustment efforts. The South-North imbalances call for EU-level systemic analysis and consequently for systemic reform as well.

2. Divergences as a key problem for cohesion and sustainability

The EU “five presidents’ report” (FPR), published in June 2015,¹ diagnosed the Eurozone as suffering from “significant divergence” which “creates fragility for the whole Union”.

The divergences developed within the euro area represent indeed the main threat to the existence of the single currency, and to the stability of the EU as a whole. Hence the need to reform the EMU architecture, and in particular to strengthen its real economic performance and its social dimension. This ambition should go beyond securing the short-term survival of the single currency. Without significant improvements in real economic and social outcomes for all citizens, rising dissatisfaction will continue to turn against the EU and European nations will gradually turn against each other. Nicholas Kaldor's fear (1971) that monetary union imposed under inappropriate conditions could backfire and generate political pressures against integration is being proved right.

Rebalancing the Eurozone is a key issue. Various models of rule-based, though limited, mechanisms of solidarity, have already been explored to strengthen people’s and markets’ confidence in the euro, and thus to create a better institutional foundation for the recovery of investment. Hostility around bail-out programs and their conditionality have not created a good atmosphere in which more solidarity could be easily promoted, especially if it involves various forms of fiscal transfers. However, there is virtually no serious assessment of the functioning of the euro that would see a chance of long life without a fiscal capacity and risk sharing (Solow, 2005; De Grauwe, 2013a), ideally in some form of automatic stabilizers that can limit the damage from cyclical downturns.

The EMU was established with an unprecedented divorce between the main monetary and fiscal authorities (Goodhart, 1998), with the idea of progressively moving towards full economic integration. The incompleteness of the EMU, however, was fatally exposed once the financial crisis hit, and has often been pointed out as key determinant of the long recession (Obstfeld, 2013; O'Rourke and Taylor, 2013; Spolaore, 2013).

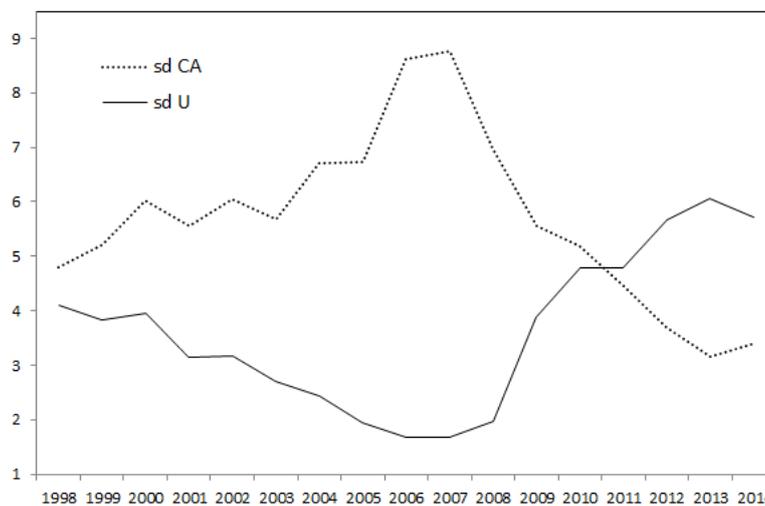
The removal of the exchange rate risk fostered capital flows (Lane, 2013), acting as a system of transfers intermediated by financial markets (Hale and Obstfeld, 2014), rather than through a common fiscal capacity (Pasimeni, 2014). At the same time, the lack of exchange rate excluded an important adjustment mechanism, without creating a new one. The imbalances accumulated during the pre-crisis period were paving the

¹ Their report did not hit the headlines, since it coincided with the Greek storm, but Jean-Claude Juncker, Donald Tusk, Mario Draghi, Jeroen Dijsselbloem and Martin Schulz actually outlined the key arguments for revamping the EU’s economic and monetary architecture.

way for an asymmetric effect of the shock caused by the financial crisis (Regan, 2015). The post-Lehman financial sudden stop and the Great Recession affected countries differently: deficit countries were forced to adjust and suffered greater harm, but surplus countries could choose not to adjust, and did so choose.

In the absence of self-correction mechanisms, the first decade of the EMU made some countries more vulnerable through accumulating financial imbalances in the private sector. Some noticed that the whole EMU existence has been characterised by symmetric divergences in the current account balances and unemployment rates of the participating countries (Pasimeni, 2015): up to the crisis, unemployment rates were converging while the external balances were diverging.

Figure 1: Divergences in current accounts and unemployment rates



Source: Pasimeni (2015).

Some saw in this dynamic a positive sign of integration (Blanchard and Giavazzi, 2002). Once the sudden stop occurred and the external imbalances had to be adjusted, however, unemployment rates started diverging dramatically. The problem of divergences seems intrinsically entrenched within the Maastricht model of the EMU architecture.

3. The Maastricht model and its contradictions

The Maastricht model of the EMU did not foresee any adjustment mechanism to prevent or correct imbalances and divergences. It did not take full account of unemployment as a key indicator and “an all-out threat to monetary stability” (Dornbusch, 1996), but focused on fiscal discipline, neglecting the financial one (Dornbusch, 1997). Thus it has serious limitations in its capability to handle economic cycles and asymmetric shocks; as a result, dangerous divergences have developed in the years of the crisis (Andor, 2013).

The accumulation of imbalances in the external positions of member states needed permanent transfers to be sustained. These transfers have been operated through the financial markets, but suddenly stopped after the Lehman shock (Constancio, 2014). At that point these imbalances could not be sustained anymore, and the pressure to correct them has naturally been stronger on deficit countries than on surplus ones: the "secular international problem that throws the main burden of adjustment on the country which is in the debtor position on the international balance of payments", as Keynes (1942) clearly explained.

Without the exchange rate mechanism, and in the absence of a lender of last resort, a central budget able to provide fiscal stimulus, or at least coordinated policies aiming to uphold aggregate demand across Europe through a revaluation in 'surplus' countries, those economies experiencing balance of payments problems inevitably have to undertake an internal devaluation to regain cost competitiveness. This has clearly adverse effects on employment and the social situation, because it leads to unnecessary economic losses and has a devastating social impact (Feldstein 1992).

Moreover, if several countries simultaneously try to pursue this strategy, the whole area is trapped into a deflationary spiral (Arestis and Sawyer, 2012). The contemporary strategies of fiscal consolidation have weakened the effectiveness of automatic fiscal stabilisers at the national level, i.e. the ability of a state to immediately act in a countercyclical way as tax revenues drop and social expenditure increases.

As a consequence of this mechanism, between end-2011 and end-2013, all components of domestic demand in the Eurozone shrank and for seven consecutive quarters the only positive contribution to GDP growth came from net exports. No wonder, then, that the period was characterised by a longer recession than in the post-Lehman worldwide financial crisis.

This vicious circle suggests that there is a need for a mechanism to help maintaining aggregate demand in countries having to adjust at the time of economic downturns, and to directly support the innocent victims of this adjustment, who are the unemployed. In the absence of such counter-cyclical mechanism, divergence becomes manifest between the recovery capacities of the Eurozone core and periphery, and even more between their powers to tackle high unemployment.

4. Beginnings of EMU reconstruction

The reform of the EMU began in 2012, when the Presidents of the European Council, the European Commission, the ECB and the Eurogroup came forward with a long-term plan about its reconstruction. Monetary reform became a key component of the EU recovery strategy.

As a first step in EMU reform, a banking union is in the process of being implemented, which will hopefully relieve pressure on government bailouts of major banks. To the extent that the banking union can be trusted to perform equally for all its Member States and their banks during financial crises, it would reduce financial fragmentation in the Single Market already today.

However a Single Resolution Mechanism is not yet in force, nor the Common Deposit Insurance Scheme. The absence of these two pillars does not allow to break the sovereign-bank nexus, as recently noted by Padoan (2015). This incomplete, minimalist banking union could not be sufficient to avoid future banking crises (De Grauwe, 2013b) and will do little to mitigate the EMU's bias towards internal devaluation as the predominant adjustment mechanism during balance-of-payments crises. Moreover, governments may still find themselves forced towards pro-cyclical fiscal consolidation in times of a downturn.

Coordination of fiscal and structural policies within the EU was strengthened through a series of legislative acts² in order to reassure financial markets of the Member States' commitment to the EMU. Many other elements of economic and political union remained lacking though. These new instruments have been proposed to protect one defined group of innocent victims of financial crises, which are the taxpayers. But they are not the only ones affected.

It is also a matter of fairness to ensure that economic downturns and the malfunctioning of the financial system do not undermine aggregate demand, economic growth potential and the viability of welfare states in the Eurozone periphery. A second specific group of innocent victims, those who became unemployed, have borne the full burden of the adjustment.

A European safety net for the national safety nets is needed, for the sake of economic, social and political cohesion. In particular, the EMU needs to become able to cope with economic shocks in a way that would be acceptable from the viewpoint of the EU's Treaty objectives such as balanced economic growth, full employment and social progress.

Despite stabilisation efforts and some elements of monetary reform in place, Europe today is more imbalanced than before, in terms of the growth potential of its various parts. The core and periphery of the Eurozone have become more divided, and the employment and social situation perfectly exemplifies this polarization.

² The European Semester, the Six-Pack, the Two-Pack and the Treaty on Stability, Coordination and Governance.

5. The social dimension of the EMU

In parallel with the establishment of the Banking Union, the social dimension of the EMU was looked at, driven by the understanding that the sovereign debt crisis since 2010 and the fiscal consolidation strategies implemented in response to it have substantially weakened the welfare state. In particular, they have weakened the effectiveness of so-called automatic fiscal stabilisers at the national level, which means the ability of a state to immediately act in a countercyclical way as tax revenues drop and social expenditure increases.

Unemployment increased over 11% in the EU and 12% in the euro area in 2013, but it became twice as high in those countries going through a painful process of internal devaluation. In these countries, poverty has also risen significantly, demand for the services of food banks has grown and many young people lacking opportunities had to emigrate, and often to other continents. This results in a worrying loss of human capital for the whole EU.

This social crisis cannot be considered as a matter of subsidiarity. Social policy alone, even if national welfare systems are reformed, cannot handle the social consequences of the Eurozone crisis. Given the constraints which membership in a monetary union implies, it is fundamental to re-create possibilities of macroeconomic adjustment inside the euro zone whereby aggregate demand and economic growth can be maintained. When the Commission introduced a scoreboard in October 2013 of key employment and social indicators, it demonstrated that key indicators³ showed significant and dangerous divergence during the crisis, especially inside the euro area.

Diverging trends in economic and social outcomes cannot be explained without linking them to the design of the EMU, in which monetary policy being centralised at the European Central Bank, but fiscal and structural policies being predominantly under the responsibility of national governments, without any eurozone budget in place. This means that instruments that were historically used to limit the social impact of crises were not available any more, while there has been nothing newly introduced to replace them. This also means that the Europe 2020 targets⁴ to increase employment and reduce poverty in the EU cannot be expected to be achieved, not even with big delay.

The social dimension of the EMU is crucial for the legitimacy of the European project but also – given the deep integration of our policies – for the legitimacy of national policies. However, it cannot be pursued in the same way as the social dimension of the single market. The latter is mainly a matter of legislation, while strengthening the

³ The five indicators included were: overall unemployment, youth unemployment and inactivity, gross household disposable income (GDHI), income inequality and the share of population at risk of poverty.

⁴ The Europe 2020 strategy was launched in 2010 in order to achieve smart, sustainable and inclusive growth. Through the strategy, EU member states committed to five headline targets, including reaching a 75 % employment rate, and lifting at least 20 million people out of poverty and social exclusion by 2020 (as compared to 2008).

social dimension of the EMU is fundamentally a matter of financial and monetary instruments.

The social dimension, however, is not simply about social outcome, but also about economic performance. In a deflationary environment, a protracted period of low or negative growth will cause the decline of both human and fixed capital, which will in turn undermine growth potential. Without adequate macroeconomic intervention capacity, only limited temporary results will be achieved. Better governance and a stronger coordination of social policies is possible, but insufficient to restore the potential of convergence.

6. The case for EMU level automatic fiscal stabilisers

The main rationale for setting up such a stabilisation function for EMU is that national fiscal stabilisers might not be sufficient to smooth the cycle within individual countries, maintain economic convergence and deliver the optimal fiscal stance for the euro area as a whole. This was the case during recent years when national budgets, even in countries with a sound underlying fiscal position, were overwhelmed in a very severe crisis, and the lack of national fiscal stabilisation in turn harmed the whole euro area.

An automatic stabiliser at the EMU level would help uphold aggregate demand at the right time, and it would prevent short-term crises from unleashing longer-lasting divergence within the monetary union. At the same time, a fiscal stabiliser would not represent ‘more Europe’ for its own sake, and certainly not more intrusion of Brussels into national policy-making. It would constitute a mechanism that strengthens the autonomy of each Member State precisely by stabilising the EMU, on the basis of transparent rules.

Focusing fiscal transfers on mitigation of asymmetrically distributed cyclical shocks means that over the long term all participating Member States are likely to be both contributors and beneficiaries of the scheme. But even if the balance is not exactly zero after a certain period of time, the capacity of the system to reduce the duration and deepness of economic crises would provide a more stable macroeconomic environment for all, sustain aggregate demand and therefore improve growth perspectives for the whole area.

If short-term shocks and private sector deleveraging cannot be mitigated by autonomous monetary policy, they have to be absorbed by fiscal policy. Contrary to “Maastricht orthodoxy”, structural reforms cannot be the main answer to cyclical developments. Fiscal instruments are needed not to replace but to supplement other adjustment mechanisms, like structural reforms and labour mobility.

Structural reforms can play an important role to respond to crisis, but they primarily provide a boost to long-term growth potential (Rodrik 2015), without a short-term

capacity to stimulate the economy. In the history of financial crises in emerging economies they always functioned in combination with currency devaluation.

Labour mobility in principle (in textbooks) offers a solution to imbalances, but in reality it can only play a minor role, especially in such a fragmented labour market as the EU (Draghi, 2014; Beyer and Smets, 2015). The euro zone crisis has triggered new migration of workforce, but often towards other continents, causing a long-term human capital loss to the EU.

There is evidence that unemployment caused by the cyclical downturn is becoming structural in the euro area (European Commission, 2015). Given the very limited chances of overcoming such imbalances through increased labour mobility in the EU (Draghi, 2014) a rule-based stabiliser mechanism becomes an appropriate and very desirable solution.

The importance of unemployment as a driving indicator should be emphasised. A major advantage of basing an EMU-level shock absorber on short-term unemployment is that this indicator very closely follows developments in the economic cycle. It is easily understandable and it is easily and promptly measurable (as compared, for instance, to the output gap). People know very well that if periods of adjustment result in withdrawing support from the unemployed, the chances of new employment will diminish and the resulting human capital loss will just get greater, causing further damage to the growth potential of a country.

Common unemployment insurance in the EMU can be one of the possible instruments to improve the functioning of the single currency, and at the same time to address the social divergences produced by the crisis. The idea and the concept of unemployment insurance is not new: in 1975 the European Commission put it forward in the Marjolin Report (European Commission, 1975), arguing that such a mechanism for stabilisation and redistribution was needed if the project of a monetary union, proposed in the Werner Report (Werner, 1970), was to be realised. While in the early 1990s, at the time of creation, political imperatives overruled much of the economic arguments, some already argued that such a scheme was necessary in view of the forthcoming monetary union, simulating its effects (Italianer and Vanheukelen, 1993).

After the establishment of the single currency, little attention was devoted to the need for fiscal risk sharing and shock-absorption capacity, until the euro crisis revealed the need for them⁵. The European Commission included reference to unemployment insurance as one form of automatic stabilisers in two key documents: first, in the Blueprint on the deep and genuine EMU (2012), and ten months later in the Communication on strengthening the social dimension of the EMU.

⁵ The debate has been developed through two Commission documents, two expert conferences, two Council debates, and several independent studies – all in between two Presidents' Reports.

It is important to note that the idea emerged primarily not from the social agenda of the EU, but from the need to reform the EMU, in the wake of a Eurozone crisis which produced dire social consequences in large areas of the Eurozone periphery, which however cannot be tackled through social policy alone.

On the other hand, the involvement of social partners in the governance of the fiscal capacity would provide a concrete meaning for the strengthening of the social dimension and the participatory principle within the EU, also addressing concerns about the democratic deficit and technocratic economic governance in Europe.

7. Exploring options for automatic stabilisers

Once the systemic nature of the crisis of the single currency was recognised in the 2011-2 period, a number of options for Eurozone level automatic fiscal stabilisers have been proposed in the literature and in policy debates. The idea of a basic European unemployment benefit scheme has been pioneered and most clearly advocated by Sebastian Dullien of HTW Berlin, and it also has been analysed by the European Commission's DG EMPL, including joint conferences with the Bertelsmann Foundation.

Dullien (2013) suggested a scheme based on the payroll tax, insuring directly the unemployed across Europe, and giving rise to a specific European fund which could run surpluses and deficits, according to the needs, therefore including the possibility of issuing debt. This would enhance the stabilisation effects of the system. The annual cost would range between 0.3% and 0.6% of GDP.

Dolls et al (2014) analysed different alternatives for an EMU unemployment insurance system, quantifying the trade-off between stabilisation effects and degree of cross-country transfers. Beblavy and Maselli (2014) proposed a scheme open to all EU countries, not restricted to the euro area, of a maximum duration of 12 months. The political feasibility of various options has been investigated by Hess (2015).

In 2014, the debate on automatic stabilisers entered the political arena⁶ feeding into the considerations of EMU reconstruction. The French Ministries of Finance and Economy published a brief in June 2014 (Trésor Economis, 2014) supporting the establishment of common basic unemployment insurance, to consolidate euro area integration, improve the macroeconomic and financial stabilisation and move towards enhanced coordination of labour market policies. They suggested that such a scheme would need to be implemented in stages.

⁶ Under the Italian presidency, an informal EPSCO (i.e. meeting of ministers of employment, social policy etc.) discussed automatic stabilisers in July 2014 as did an informal ECOFIN in 2014. The first called for a Green Paper on EMU unemployment insurance.

In November 2014, the Bank of Italy published a paper identifying the broad characteristics that a shock absorber based on unemployment should have in order to be incentive-compatible and politically feasible (Brandolini et al, 2014). At the same time, Deutsche Bank also published a research briefing on this topic (Vetter, 2014), stressing the alleged problems of "moral hazard" among participating countries.

In 2015, the European Commission has launched a major study to examine details and explore possible implications of EMU unemployment insurance. And in September 2015, the National Bank of Austria (OeNB) hosted a two-day conference⁷ on EMU reform, in which one of the panels discussed the need for unemployment insurance and various alternatives.

In October 2015 the Italian Minister of Finance has stressed the need for "a European mechanism to mitigate the cyclical unemployment and its consequences" (Padoan, 2015) and specifically proposed an unemployment insurance scheme. Such a scheme would increase convergence in labour market regulation, consolidate medium term growth and prevent hysteresis effects. The key point of the Italian proposal is its sense of urgency accompanied by the argument that "such an instrument could be established without treaty changes".

And most recently, in early November 2015 experts of the European trades unions⁸ explored options, together with arguments for and against.

8. Basic European unemployment insurance – main features

An automatic fiscal stabiliser in the form of basic European unemployment insurance would have a meaningful macroeconomic effect in counteracting a cyclical downturn. It would be based on a few basic parameters agreed in advance, and its functioning would be entirely predictable and calculable on the basis of these clear rules. This means helping EMU countries to share part of the financial risk associated with cyclical unemployment caused by a drop in aggregate demand, and not compensating for structural differences caused by skills mismatches, less efficient labour market institutions and the like⁹.

The European scheme would not completely replace national ones, being an additional, complementary tool. The levels of the contribution and of the benefit should represent a relatively low common denominator between the rules of national schemes, to ensure a fairly basic standard of support during short-term

⁷ See conference documents on the OeNB website: <https://www.oenb.at/en/Monetary-Policy/Research/workshops/toward-a-genuine-economic-and-monetary-union.html>

⁸ See conference documents on the ETUI website: <http://www.etui.org/News/Towards-a-desirable-and-feasible-European-unemployment-benefit-scheme>

⁹ It is important not to exclude workers in short-term or part-time jobs from contributing and qualifying for the support, with the attached conditionality in terms of job-search and training effort.

unemployment. Each Member State should be free to levy an additional contribution and pay out a higher or longer unemployment benefit on top of this European unemployment insurance.

The jobseekers would continue to interact with national authorities (public employment services). However, every month these national authorities would send to the European fund the basic contribution from all their employed workers. Likewise, every month the European fund would pay to the national authorities an amount corresponding to the sum of all the basic European unemployment benefit payments to be made that month in the country. However, for it to be effective, a minimum degree of harmonisation will be necessary. Citizens would directly benefit from EU solidarity at times of hardship, and Member States would be required to upgrade their employment services and labour market institutions to the best EU standards.

The issue of convergence in regulation is an important one, and should be addressed in the design phase of the scheme. If the Member States agree to pool more financial, budget and economic sovereignty, this inevitably calls for a clear framework for social coordination and convergence. Otherwise, it will only lead to more fierce competition between the Member States, lowering of social standards and jeopardizing of the social model.

The parameters of the scheme could be adjusted in response to actual experience. At the same time, governments, citizens as well as financial markets would be able to rely on the principle that an EMU country undergoing a cyclical downturn receives a limited fiscal transfer to support the cost of short-term unemployment.

The fact that the scheme would trigger countercyclical transfers automatically and immediately is a major advantage compared to bailout programmes or bank rescues. These are always surrounded by uncertainty, which pushes up their cost. The basic European unemployment insurance would be relatively cheap precisely because of its automaticity.

It is important to have a clear view of the potential costs and benefits associated with such a scheme. All simulations suggest that it would absorb less than 1% of countries' GDP. At the same time, it would provide an answer to the simple question of a disillusioned European voter: 'Where is Europe when we need it most?'

The size, predictability and automaticity also make the basic European unemployment insurance scheme a better alternative compared to discretionary fiscal instruments, where a fiscal transfer would be provided in exchange for structural reforms. The 'catalogue' of reforms and corresponding financial support under such discretionary instruments would be very hard to define and the decision-making process would be rather unpredictable, not to mention the political tensions arising around the approval of discretionary cross-country transfers.

The predictability, limited volume and limited duration of fiscal transfers would also make a basic European unemployment insurance scheme a much (politically) safer option than various scenarios for mutualisation of euro zone countries' sovereign debt. This feature is particularly important when Member States consider themselves in the role of a contributor rather than a beneficiary. Altogether, a basic European unemployment insurance scheme would strengthen the EMU institutionally, economically, politically and in terms of social cohesion.

9. The broader perspective of EMU reform

The single currency never was a purely financial or economic project. It was launched two decades ago with a strong political mandate to keep Europe united. However, the incomplete EMU proved to be – at best – a structure for fair weather, but not for a financial and economic crisis.

From the perspective of economic performance, the current model of the EMU represents a competitive disadvantage for Europe *vis a vis* the US and Japan. The excessive burden of adjustment on deficit countries erodes political support for the single currency, and the eventual break-down will only be a matter of time. If divergence and asymmetries are not dealt with, continuing stagnation may turn even greater shares of the electorate against the euro as well as the EU. Reconstruction will be blocked, and the only choice will be between orderly or disorderly deconstruction.

Legitimacy partly comes from the process, and partly from the outcomes. It is about institutions, but also about politics and values. National governments and the EU as a whole are losing legitimacy in the eyes of many workers and other citizens by failing to deliver what is expected from them, i.e. broadly shared prosperity and equal opportunity to improve one's situation. This may even translate into political instability at national but also at EU level, where economic and social divergences can eventually destroy the project.

The EU is in a race against time, if it is to make the single currency sustainable and legitimate. If the single currency is to be kept, the original Maastricht design has to be replaced with one with a much stronger social dimension, supported by a stabilisation and recovery capacity. For that we need automatic fiscal stabilizers at the euro area level. A scheme of fiscal transfers that helps mitigate asymmetric shocks in the short term can allow every country to grow, even if exogenous factors or endogenous pressures happen to put it at a momentary disadvantage.

Discussion of automatic stabilisers and EMU reform in general should therefore be seen as urgent, even if the necessary political momentum isn't there. The dogma of 'no fiscal transfers' in the EMU has to be dropped. In a system of single market, high income countries have to support low income countries or regions. In a system of monetary union, surplus countries have to support deficit countries, otherwise the

different problems of moral hazard, on both sides, will inevitably undermine the union.

We need less muddling through and more systemic reform for a proper European recovery. A somewhat reformed “Minimalist Monetary Union” will not be sustainable (Enderlein et al, 2015), and the EU cannot live together for too long with the risk of monetary breakdown. With the *status quo* more and more unsustainable economically and politically, the EU has to choose between monetary deconstruction and reconstruction. The first would compromise some of the key principles of the EU. The second means sorting out the fundamental problems that have caused losses to our economies and frustration to our societies in recent years. Choosing this alternative means going to the root causes of our economic, social, and now also political troubles.

Either the EMU allows each country to be better off inside than outside it, or it will not be sustainable (Draghi, 2014). If the EMU is really meant to be irreversible, it must also be fair and based on solidarity. We must pay attention to the employment and social outcomes, and try to prevent lasting divergences. There are solutions capable of sorting out the macroeconomic bias against full employment in the EU, even though the political complexity of implementing these solutions should not be underestimated. Nevertheless, at some point, the ECB should be explicitly empowered to act as a lender of last resort, become a true European institution and consider employment as much among its goals as price stability. The “Europeanisation” of the ESM is an equally important step to be made.

All this requires a stronger sense of solidarity in Europe, and especially inside the euro area. Jürgen Habermas (2012) has issued passionate calls for solidarity in the period of the EMU crisis. He has repeatedly reminded us that solidarity is not charity; it is support provided to a fellow in difficulty, based on confidence that it may be reciprocated in the future. Indeed, all models of EMU unemployment insurance suggest that in a sufficiently long time period (two-three decades) all countries would be net beneficiaries at least once. The idea of basic European unemployment insurance represents an example of forward-looking solidarity. It is much better to help each other out in times of crisis than to put the fate of the Union and of its individual members at stake whenever a financial crisis occurs.

Without concrete initiatives towards a better functioning model, de-construction will present itself as the more appealing option towards the end of this decade. The consequences would be much more unpredictable than limited fiscal risk-sharing in a system of shared European unemployment insurance.

The euro can only fulfil its unifying mission if the costs and the benefits of the EMU are more fairly distributed among the participating states, and if the rules of the game help boosting the growth potential of all of them. To deliver this, we need a new momentum for EMU reform, with counter-cyclical fiscal capacity in the focus.

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