

Chapter 7

Variation and the Euro



7.1 Introduction

The European Economic and Monetary Union (EMU) and the euro and euro area to which it gave birth have often been presented as the definitive and irreversible outcome of European integration, or even as a historical necessity at a crucial time of major changes in world politics. Today, however, the story of deeper integration and unification through the single currency is being called into question. New facts have intensified doubts; for example, convergence has not lived up to its promise for several years now.¹ During the economic and financial crisis of recent years, the euro severely tested political support for European integration. On the other hand, it could be argued that, in weathering these many storms, the European integration process demonstrated its resilience.

Stabilisation of the euro area is needed, financially, economically and to bolster confidence. That will require more change. It is neither realistic nor desirable to effectuate this change by taking a quantum leap in federalisation. It is equally unrealistic and undesirable to dismantle the existing currency union, however. Drastic overhauls are also difficult² in the current political and social context, despite arguments favouring Treaty revision.³ Allowing for this context, however, there are a number of feasible and desirable options in which the notion of ‘variation’ can be helpful. It should be noted that the euro area itself is already a form of variation within the European Union, as not all Member States participate (while some non-Member States do). This chapter explores and elaborates on such possibilities, bearing in mind the history of the monetary union to date.

Starting in 2010, parties active in the financial markets have engaged in lengthy and spirited speculation about the collapse or break-up of the monetary union, and subsequently about ‘exits’ from the euro area. While fragmentation and departures have so far not occurred, doom scenarios cannot be ruled out as yet, the most recent risk factor being the formation of the Lega-M5S government in Italy. The instability of the euro area has had severe consequences. Examples include disruptive

divergence in interest rates, capital outflows and the bailout of transnational banks using national tax revenues (highlighting the unhealthy interdependence between governments and banks). The debate on how to safeguard the future of the euro is also leading to polarisation in both domestic and European politics. There is constant concern about the currency union's vulnerability.⁴

Contradictions set the tone in the debate about safeguarding the future of the euro. The objectives of financial stability and competitive advantage based on economies of scale and deepening interdependence are at odds with concerns about the loss of national and European control, dissatisfaction with the curtailment of national fiscal discretion and fears that the social dimension will be neglected or that 'free-riding' and 'moral hazard' will become institutionalised (including through the ECB, the European Stability Mechanism or ESM, and any funds that may be established or filled, for example within the framework of the Banking Union).⁵

Ultimately, however, the debate on the future of the euro also revolves around dilemmas related to the production of public goods, as they are defined in this book. Normative considerations are often described in this context as reflections of the general interest ('the logic of appropriateness') and contrasted with considerations based on a cost-benefit analysis ('the logic of consequences'). It is from this perspective that the current chapter looks in greater depth at the specific policy dilemmas that define the debate on the future of the monetary union. The aim is to point out possible directions for strengthening the euro area in line with recent political and economic trends, based on the notion of variation. In doing so, it refrains from making detailed recommendations on the complex issues related to the future of the euro and EMU.

The problem of EMU has several different facets:

- a fiscal dimension (what do we do about out-of-control national debt and associated bailouts, and what does this mean in terms of risk-sharing?);
- an economic dimension (what are the consequences of differences in productivity, economic growth, exports, etc. between Member States?);
- a financial dimension (what do we do to mitigate the potentially destabilising effects of capital flows; what form of organisation is appropriate for the banking system?);
- a monetary dimension (what monetary policy allows for (major) differences between euro-area Member States?);
- and an institutional and political dimension (how can we improve the democratic legitimacy of the monetary union and euro governance?)

In this book, we discuss these dimensions as a whole, but puts greatest emphasis—within the limited scope of this chapter—on the fiscal dimension, because this is at the heart of emu and the euro as they have evolved since the Maastricht Treaty. That said, we also touch on the other four dimensions at various points in this chapter.

In a general sense, exploring the potential for variation in the euro and EMU is a highly complex exercise (more complex than in other policy domains). Readers should therefore regard this chapter as a general survey of how variation can help to

safeguard the future of the euro beyond the crisis. As such, it serves to clarify the main message of this book (and is not a comprehensive, separate study into the causes of, and solutions to, the problems of the euro, or a general economic analysis of those problems). The starting point for this chapter is the (ad hoc) variation in the monetary union that arose at the outset and that has been amplified in many respects during the crises. The main focus, however, is on what variation can do to stabilise the monetary union within the existing Treaty frameworks, both in the medium term and in the steady state.

As we explore the potential to use variation to change and therefore improve the monetary union, it is essential to bear in mind the loss of confidence caused by the euro crisis. In other words, changes and solutions must contribute to restoring mutual trust (between Member States) and to rebuilding support for and the democratic legitimacy of the monetary union (in the Member States).

The critical question that then arises is: how can all euro-area Member States, from Greece to the Netherlands, become and remain credible participants in the euro? Inherent in the design of the monetary union as laid down in the Maastricht Treaty is that the euro-area Member States must take responsibility for themselves. The most visible evidence is the 3% of GDP ceiling (budget deficit) and the 60% of GDP ceiling (public debt) introduced since the Maastricht Treaty and as such fundamental to the monetary union.

Nevertheless, many of the plans proposing changes in the euro area tend to stress the responsibility of the EU's institutions—such as the European Council and the European Central Bank—and that of the Member States.⁶ The question is, however, whether confidence can be restored by transferring more competences to the EU's institutions in an effort to boost the euro. Although proposed solutions to the euro's problems often involve the transfer of even more competences, supported by predominantly technocratic arguments, it is precisely there—in that technocracy and transfer of competences—that the road leading to restored confidence vanishes. How do we find it again? Before we can answer that question, we must go the heart of the current impasse.

Potential solutions within the existing frameworks are delimited by two extremes. At one end of the scale is the effort to boost the Stability and Growth Pact (SGP), the 3 and 60% ceilings mentioned above, with the Member States bearing maximum responsibility. At the other end are proposals to transfer as many euro-related powers as possible to the EC (with accountability to the EP), for example by installing a European 'Minister of Finance'. Both extremes soon lead to a widening gap with the national democracies (maintaining SGP through supra-national mechanisms, institution-building). Both have their fervent proponents and opponents among the Member States. This is at the very heart of the impasse that is gripping the euro area.

Section 7.2 takes the current impasse as its starting point and places it against the backdrop of the history of the euro and the conflict between the 'logic of appropriateness' and the 'logic of consequences' that has coloured the euro's evolution in

recent years. On that basis, it takes a new look at the question: where, given the current situation, are there opportunities for variation in EMU and the euro?

Section 7.3 answers this question by charting three possible routes for variation in EMU and the euro. They are routes in which variation (the co-existence of different arrangements) and unity (as formulated in the existing Treaties) can be recombined and can reinforce each other. We look in particular at the problems associated with the ‘no-bailout clause’—which states that countries do not cover each other’s debts when they are in trouble—owing to its *de facto* annulment in recent years. We also look closely at how IMF involvement might be continued, whether a European Monetary Fund (EMF) could resolve the current impasse, the importance of focusing on macroprudential policy, and whether all these elements can be combined by leaving more room for variation.

Section 7.4 presents a brief conclusion. In general, this chapter seeks solutions to the current EMU and euro problems in coordination or closer coordination within the existing institutional frameworks, as well as in some of the emergency arrangements rigged up during the euro crisis. This approach would allow the Netherlands to bring the euro and EMU more into line with its own political preferences, but notes at the same time that politicians and the public remain little aware of such opportunities.

7.2 The Two Logics and the Current Impasse

The positions at both the national and European extremes of the debate on the future of the euro are normatively charged. On the one hand, there are the ‘Euroscptics’, who advocate for the primacy of the national state. On the other, there are the ‘Europhiles’, who are fighting for European primacy. The views of both groups are a matter of principle: depending on whether they support the national state or a federation, their arguments are dominated by either a national or a European ‘logic of appropriateness’ (although both groups often use the ‘logic of consequences’ to substantiate their positions). The views, plans and ideas positioned between these two extremes are predominantly pragmatic, *i.e.* aimed at reducing costs and maximising returns.

The tension between the logic of appropriateness and the logic of consequences has intensified in recent years. That tension is disruptive, all the more so because it is growing in a context in which Treaty law and institutions have only limited effect *and* in which the political support for changing the Treaties is inadequate.⁷ In other words, the leeway for unifying solutions that reconcile both logics is limited.⁸ As the current situation shows, moreover, the argument that the single currency is a ‘logical’ consequence of the internal market—the argument that underpinned the run-up to and establishment of EMU (see also Box 7.1)—is no longer conclusive. Powerful evidence can be found in the Greek sovereign debt crisis and the Brexit referendum.

In response to the Union's management of the euro crisis from 2011 onwards, which the United Kingdom (understandably) perceived as a move to border off the euro area, the British government warned that this would jeopardise the 'integrity of the European Single Market' and make its membership of the EU correspondingly more problematic.⁹ British criticism of the euro echoed a broader, swelling chorus of doubt regarding the merits of the single currency.

At the time of its introduction, the euro was seen as an instrument for prosperity, growth and international influence. Progress in all those areas has been inadequate, however. In fact, in view of the euro crisis, the underperformance of the single currency has turned into a serious issue of multilateral coordination and political credibility in virtually every euro-area Member State.¹⁰ At the same time, monetary union has also raised all sorts of problematic side effects, for example unfair tax competition, inadequate capacity for structural reforms, lack of fiscal discipline, the ECB's controversial policy of quantitative easing (QE), and distressing levels of unemployment and impoverishment.¹¹ These developments have put pressure on stability and prosperity growth, the main public tasks that the members of the euro area were attempting to fulfil through the single currency. A further question is whether the crisis management efforts of recent years have in fact strengthened the euro area. For example, the sovereign debt problem remains in many euro-area Member States and there is, as yet, no solution in sight for the broader crisis of confidence that has arisen between governments, EU institutions and citizens.

Even so, much has happened. Several adjustments have been made to EMU. There is closer surveillance of fiscal policy and macroeconomic imbalances, such as potentially harmful imbalances between the current account surpluses and deficits of euro-area members (Six-Pack 2011). Fiscal coordination has also been extended by boosting the budgetary competence of the European Commission (Two-Pack 2013), partly in the context of the 'European Semester' (2010), the cycle of economic and fiscal policy coordination within the EU.¹²

Efforts to set up a banking union are also under way, the ECB supervises system banks, there is a European directive on bank recovery and resolution, and a proposal for a European deposit guarantee scheme. On top of all this, an emergency fund has been set up for euro-area Member States that have experienced acute financial difficulties during the euro crisis, i.e. the European Stability Mechanism (ESM). There are also the Outright Monetary Transactions (OMT) for the Member States that have received ESM support—a programme in which the ECB figures as the de facto 'lender of last resort', even though the OMT mechanism has not been activated to date—as well as the ECB's (ultra-)low-interest-rate policy and its aforementioned programme of quantitative easing.¹³

Many of these EMU adaptations have bolstered the role of the EU's institutions vis-à-vis that of the governments of the Member States. For example, the ESM imposes far-reaching requirements on debtors, while the ECB, the 'daily' saviour of the euro, has gradually assumed a key role as the guardian of euro-area stability, for example by 'Europeanising' (banking) surveillance and expanding its balance sheet. These moves give the ECB much more influence in the governance of the single currency. They have, moreover, been accompanied by a certain 'shifting' of

political responsibilities from the governments of the Member States to the EU's institutions, such as the ECB, the EC and the ESM, which are less subject to democratic control.

The euro's rescue, as it has evolved in recent years, has had far-reaching consequences. Political decisions concerning dilemmas of solidarity, reliability (e.g. with regard to fiscal discipline) and social cohesion are now 'hidden' to a greater or lesser extent in the policy-related techniques employed by the EU's institutions, for example in the ECB's balance sheets (TARGET2), in the ESM,¹⁴ or in the zero risk weighting of government bonds on banks' balance sheets. This is not only increasing the power of the EU's institutions in the EMU, but also raising growing doubts about the independence of, for example, the ECB and concerns about monetary financing through the same ECB (which is prohibited).¹⁵

One of the most drastic crisis measures to stabilise the euro area was the creation of the ESM, an organisation that provides financial assistance to euro-area countries struggling with excessive government debt, subject to their undertaking a programme of reform. Where necessary, moreover, the ECB will buy government bonds from Member States participating in an ESM programme (through the OMT mechanism) to prevent destabilising speculation on sovereign debt. The OMT mechanism has not been activated to date. Measures such as the ESM and OMT are clearly a step towards more risk-sharing in the euro area,¹⁶ and are politically controversial.

The controversies surrounding new moves towards greater risk-sharing reflect the current impasse (mentioned above). In other words, the tendency to shift responsibility in the euro area to the EU's institutions—such as the EC and the ECB—and away from the Member States is seemingly not the way to restore lost confidence. That is precisely why EMU and euro reform is so difficult and regarded with considerable suspicion and mistrust in the Member States.

The impasse has meant that, for the time being, the only progress being made concerns the proposals for completing a banking union. These proposals are meant to contribute to financial stability and to end the 'deadly embrace' between individual governments and 'their' banks. The problem, however, is that the plans establishing the banking union have not advanced far enough to actually navigate the euro into calmer waters.¹⁷ It seems that more is required. This explains France's efforts to further 'deepen' and politicise the euro around the Franco-German axis, but these plans, in turn, have led to the political impasse described above. Whether they will, or will continue to, garner sufficient support and to what extent they serve the interests of the Netherlands is therefore hugely uncertain. In addition, the legitimacy of such plans remains problematic, in any case.

What we can conclude from the above is that there is a need for something else, a prospect that calls for a firmer commitment from euro-area Member States than at present. That prospect might also represent the only opportunity to genuinely reinforce the basis of support for the euro area and its democratic foundations. It must be sought in between the two extremes, i.e. bolstering the Stability and Growth Pact by placing maximum responsibility with the Member States on the one

hand and further centralising euro governance by transferring as many competences as possible on the other.

Between these extremes are modalities of (greater) variation. In essence, they suggest a certain ‘reversion’ to the governments of the Member States, and therefore to their national parliaments. Instead of a stultifying focus on one or the other extreme, the idea would be to mark time so that preferences and expectations in each euro area Member State can become clear. A strategy of this kind would address the urgent need for more democratic legitimacy in the way the euro is managed.¹⁸ The key question then is whether these different preferences can be expressed in (policy) variation between Member States, and, if so, in such a way that each Member State pursues a credible policy that is appropriate to monetary union. In short, can we allow differences between Member States that strengthen the unity behind the single currency at the same time?

There is no simple answer to the question of whether such variation is even possible within the monetary union. The pursuit of a stable monetary union between autonomous states is, by definition, a complex affair owing to the patently large interdependencies and externalities between Member States in the absence of an overarching (political) organisation that has democratic legitimacy and a basis of support among the inhabitants of those Member States. Nevertheless, that is the situation as it now stands, because that is how the single currency was formed (see box below).

Box 7.1 The Franco-German Deal and the Design of EMU and the Euro

Chancellor Helmut Kohl gave a new boost to the EMU project long before the fall of the Berlin Wall on 9 November 1989. The presentation of the Delors Report had made EMU the centre of attention that spring, but there were fears in Paris that events in Central and Eastern Europe would slow its momentum. It was the German Chancellor who took steps to allay French concerns.

Kohl carved out a place for European Political Union (EPU) in his projections of EMU, partly with a view to popular sentiment in his own country (EMU was not a popular topic in German domestic politics). EPU had broad support among West Germans at the time, especially because it implied giving the European Parliament (EP) more power. It also served to pacify the ‘EMU-sceptic’ Bundesbank. Frankfurt conceived of EMU merely as the culmination of a process of peremptory economic convergence, the ‘crowning theory’: first economic convergence and then EMU, and not the other way around. The rationale behind this position was as follows: EMU partners had to adopt German financial and economic best practices before there could be EMU. In terms of financial policy, EMU was to be ‘German’ or not happen at all. EPU fit right into this story. Something like an EPU would, after all, be essential to enforcing the sought-after economic convergence.¹⁹

France, however, looked unfavourably on this. In the eyes of President Francois Mitterrand, France had already made major concessions on two

points. First, the EMU blueprint presented in the Delors Report was already very ‘German’; it proposed an independent central bank, prioritised price stability and imposed strict convergence criteria concerning fiscal discipline and government debt. Second, in the 1980s France had reluctantly consented to the free movement of capital in the European Community, a prerequisite for further discussion of EMU put forward by Germany and the Netherlands.²⁰

Moreover, a Europe that allowed the free movement of capital had to choose between a monetary union or floating exchange rates, but because exchange rate stability was vital for the internal market, the second option was not preferable. The concept of the monetary policy ‘trilemma’ states that it is impossible to have free capital flow, a fixed exchange rate and sovereign monetary policy at the same time. One of these policies always has to give way, and since capital had been liberalised, sovereign monetary policy would have to go.

After Mitterrand had agreed to the starting date of EMU negotiations, an important point in itself, Kohl promised at the Strasbourg Summit that EMU and German unification would be inextricably linked (December 1989). Economic and monetary objections to EMU, which were prevalent in Germany and in the Netherlands, were pushed to the background and German-Dutch concepts failed to prevail in the EMU’s design. The crucial element in that design was the sequence: first monetary union, then economic convergence, and then perhaps EPU. Little or no attention was paid to problems that might accompany a monetary merger between very different national economies and the management of economic and financial interdependence—problems that could grow more serious as EMU expanded.

EMU was launched in 1999. The large group of Member States participating at the outset was contrary to expectations, at least those of the Germans and Dutch.²¹ Prominent economists had also explicitly recommended starting out with a lead group, with Germany as its linchpin. They based their recommendation on Mundell’s theory of ‘optimum currency areas’,²² a system for sizing up the costs and benefits of a monetary union.

The major advantage of monetary union is that it eliminates exchange rate risks and shocks. This is particularly good news for the internal market, which becomes stronger thanks to lower transaction costs. In addition, the single currency also prevents governments from devaluing their currencies to improve the competitiveness of their businesses. Market distortions of this kind may be detrimental to the internal market and can trigger protectionist countermeasures, but a monetary union makes them impossible.

The costs of a monetary union stem from the loss of sovereign monetary policy instruments that can be deployed in response to country-specific shocks. Therein lies a fundamental contradiction between theory and emu practice. In general, the more countries trade with one another, the more benefits they gain by eliminating exchange rates between them and the lower

the cost of abandoning sovereign monetary policy instruments. The latter is not always the case, however, because it depends largely on the production structure.

In the early 1990s, various studies indicated that the group of countries that had pegged their currencies to the German mark resembled an optimum currency area much more closely than the larger group in the single currency zone, which included the southern EU Member States.²³ The outcomes were inconclusive, however, and that is partly why the debate about optimum currency areas increasingly became a question of faith.

The question, ultimately, was whether exchange rates should be regarded as a source of potential distortions in the single market and should therefore be eliminated. Mundell and others were increasingly inclined to say yes, emphasising in particular the aforementioned benefits of monetary union.²⁴

Consequently, Mundell and economists who supported his analysis encouraged a pro-EMU trend, which paved the way to a remarkable phenomenon: the accession criteria for EMU were *not* based on the theory of optimum currency areas.²⁵ Instead, they concerned macroeconomic policy indicators such as low inflation, small government deficits and exchange rate stability. They therefore did not acknowledge the core assumption of optimum currency theory as an argument for EMU, i.e. a sufficient degree of commercial integration. For example, they ignored the trade imbalances of potential Member States. In addition, countries with trade deficits were allowed to cover these with loans that could be raised on the recently liberalised European capital market, and the more likely an EU Member State was to join emu, the better the terms. The financial markets had already factored EMU membership into their interest rates and, for example, furnished countries such as Greece and Italy with generous amounts of capital on that basis.²⁶

If anything became clear after the outbreak of the financial and economic crisis, it was that EMU in its present form and with its current members is not an 'optimum currency area', and that the European policy programme of the 1990s, which was based partly on this erroneous expectation, had diverted attention away from the risks that were taken in setting up EMU.

An imperfect understanding of the 'E' component meant that EMU was ill-equipped to commence with a large group of Member States, in other words a larger group than the core group pegged to Germany. Why, then, did it go ahead?

The Maastricht Treaty did not specify whether the third stage of EMU, the introduction of the single currency, would involve a smaller lead group of Member States or a whole pack. At the very last moment, France and Italy proposed including starting dates in the Treaty. If no majority of countries satisfied the emu criteria in 1997, then the third stage would commence in 1999 with the countries that did. That seemed to leave open the possibility of

starting with a lead group with Germany as its core. That the group ultimately became a pack is due mainly to two factors.

First of all, the recession in 1991–1992 threw public finances in the EMU area off balance. Second, Germany's public finances suffered as a result of the high costs of unification. This made it impossible to launch EMU with a lead group in 1997, giving the southern Member States more time to meet the convergence criteria.

Italy's Amato government (1992–1993) did everything possible to exploit this opportunity, helped by the convergence game in the financial markets described above. Interest rates on public debt fell significantly across the whole area identified by the markets as the future euro area, which included Italy. The steady deterioration of Germany's public finances, which had to bear the costs of unification with the GDR, also meant that Berlin had to use every trick in the book to keep its budget deficit below 3% of GDP, although gross government debt rose above the 60% ceiling. This prevented Germany from playing any role in deciding which Member States would or would not advance to the third stage. In the end, both the Treaty *and* the markets forced EMU into a broad start in 1999. To understand 'the way of further strengthening EMU',²⁷ we need to know which strategic vision gained the upper hand in constructing the monetary union.

After the Maastricht Treaty (1992), it was mainly the German Bundesbank that stressed the importance of building a political union.²⁸ Its argument was inspired by the 'crowning theory', which held that EMU would ultimately be unsustainable without political union. In fact, monetary union could only be the 'crowning glory' of an existing political union. The 'crowning theory' is diametrically opposed to its reverse, the 'sequence' described above, which eventually gained the upper hand under pressure of the events in 1989–1991 and the momentum created by the Maastricht Treaty.^{29,30}

Nevertheless, the ambiguous concept of 'an EPU' continues to hover over the market as a possible, but very controversial, panacea for the problems of the euro area. There has recently been a fundamental shift in the thinking about EPU, including viewing it as a possible solution to the current problems in the euro area. The origin of this shift can be traced back to 28 February 2013, when the then President of the European Council, Herman Van Rompuy, gave a speech in the City of London on the future of EMU and the euro area.

Van Rompuy was responding to the notorious speech by British Prime Minister David Cameron earlier that year, in which he openly expressed his doubts as to whether the United Kingdom should remain a member of the EU. Van Rompuy was clear about the way forward: 'We are not witnessing the birth pangs of a federal "Euroland". Changing the EU treaties is therefore not the priority.' Van Rompuy had a different 'top priority' in mind, i.e. 'deepening economic coordination', and in his view that meant '[e]volution, not revolution' in the subsequent development of the EMU.

Nevertheless, Van Rompuy *was* preaching ‘revolution’ because, despite his pragmatic modesty, he did nothing less than to write off the idea of an EPU as a realistic prospect or a solution to the acute crisis in which the euro area found itself at the time. The concept of political union that Van Rompuy described in London was an elaboration of the ‘blueprint’ for an integrated policy framework in the euro area and EMU that he had presented in the autumn of 2012 and that has been developed step by step ever since. That occurred in the following succession of documents: the Commission’s 2012 blueprint for a ‘deep and genuine’ EMU, the aforementioned proposal by the President of the European Council in the same year, the 2015 *Five Presidents’ Report*, and the proposals in the Commission’s 2017 reflection paper referred to above. All these proposals recommend strengthening ‘Europeanisation’ in EMU and the euro area in the long run and greater solidarity between the Member States in the monetary union—including hints about debt mutualisation, with risks on public debt being shared.³¹ This would not be on the basis of an EPU, but rather on the basis of Community policy coordination.

What is crucial to all these proposals is that they take shape within the existing Treaties. This is in line with Van Rompuy’s implicit obstruction of the ‘all-out EPU route’ (by means of federalisation) in 2013, as described above. The point in all these proposals is to improve the existing mechanisms of policy coordination and their democratic legitimacy, not to change the Treaties or come up with new treaties and institutions.

7.3 Variation as a Possible Solution to Coordination Problems in the Euro Area: An Initial Exploration

Where, given the current situation, are there opportunities for variation in EMU and the euro? Opportunities in which variation (the co-existence of different arrangements) and unity (as formulated in the existing Treaties) can be combined and can reinforce each other? That is the question that we must answer if we are to break the current deadlock. This section explores specific variation options; it focuses on how to deal with situations in the euro area in which the members’ fiscal policies have negative effects. Our discussion takes into account the three dimensions of variation described in Chap. 6.

A monetary union requires the advanced coordination of economic policies. The purpose of the single currency policy is to cushion the adverse impact of ‘symmetrical shocks’, for example a change in the global economy. ‘Asymmetrical shocks’ (which are country-specific) must be absorbed by labour market policies and national fiscal policies, but these are constrained by the conditions imposed on the size of the government’s debt and budget deficit.³² In the end, it is mainly

adjustments in the labour market—including social security schemes—that must compensate for the absence of the exchange rate mechanism in this set-up.³³ This is, in short, the logic behind the emu's design, as laid down in the Maastricht Treaty. The 'no-bailout clause' was essential in this respect.

The logic behind the EMU's design as laid down in the Maastricht Treaty is that countries must have their own fiscal policies in proper order. The 'no-bailout' clause was critical in that countries would not come to one another's aid in the event of problems, making it pointless for the financial markets to speculate on a bailout. The purpose was to enforce sufficient fiscal discipline among the emu members. There was a good reason for this: large budget deficits and the ensuing public debt could jeopardise the value of the euro (and deposits in that currency).³⁴ By now, it has become clear that the no-bailout clause did not survive the euro area's collective response to the crisis. In that respect, the 'Maastricht order' has so far proved illusory (Box 7.2).

Box 7.2 The Problems of 'No Bailout' and SGP

If the dilemmas related to the production of such public goods as stability and prosperity growth have become apparent anywhere in recent years, it is in the no-bailout clause of the Maastricht Treaty. During the euro crisis, the basic principles underpinning the prescribed fiscal discipline of the euro area Member States and the ECB's mandate proved politically untenable, even though these principles were referred to explicitly in the Maastricht Treaty. They were also of huge importance in the Netherlands' decision to join EMU and the euro.

Much of what has happened in recent years, however, was already pre-ordained in the Maastricht Treaty. While the Treaty's 'excessive deficit procedure' (Article 104c, now Article 126 TFEU) was based on quantified reference values for Member States' budget deficits and debt quotas (3% and 60% of GDP respectively), these reference values were made 'dynamic' during the final phase of the Treaty negotiations. This means, for example, that budget deficits that exceed 3% of GDP are regarded as acceptable if they can be defined as 'temporary' or 'exceptional' deviations. It also means that it is the ECOFIN (Council of Finance Ministers) that determines this on a case-by-case basis, by qualified majority. Member States therefore do not have the right of veto. The Commission's role is limited to measuring the Member States' performance against the quantified criteria, and to monitoring the procedure. From the outset, then, the excessive deficit procedure, including the imposition of sanctions, was the subject of political decision-making between the Member States in ECOFIN. It has remained so, even though the Stability and Growth Pact (SGP) was added during the run-up to the Treaty of Amsterdam (1997) as extra inducement.

The conclusions of the Dublin European Council of 14 December 1996 were the prelude to the SGP: they announced that the excessive deficit procedure would be laid down in two directives and not in a supplementary

treaty. In essence, Article 104C remained unchanged. At the Amsterdam Summit on 16 and 17 June 1997, the European Council adopted a Resolution establishing the SGP. In it, the EC pointed out the obligation under the Treaty to avoid excessive government deficits, but also noted that the 'Member States remain responsible' for meeting this obligation. The role of the Commission and ECOFIN remained as defined in the Maastricht Treaty. It was therefore still up to the Council of Ministers to take a final decision in accordance with the procedure laid down in the Treaty and to decide whether or not to impose the associated sanctions. ECOFIN may deviate from the procedure if a qualified majority in the Council determines that 'special circumstances' exist in the Member State that has exceeded the reference value, or if ECOFIN determines that the Member State has made sufficient efforts to address the deficit—although a decision 'not to act' on the Commission's recommendation must be supported by sound arguments.

At best, the SGP was a 'gentlemen's agreement' between euro area Finance ministers, based on the realisation that free riding at the expense of the single currency project—by taking advantage of the single currency's stability without linking it to national fiscal discipline—was unwise. There was, however, great confidence in the unifying power of the market as the foundation for monetary union.

The credibility of the SGP's quantitative reference values ultimately depended on a qualified majority. That changed dramatically in November 2003 when the German government under Chancellor Gerhard Schröder invoked the 'special circumstances' clause, referencing the ongoing costs of German unification (which had caused Germany's budget deficit to exceed the 3% of GDP ceiling). Germany managed to drum up a qualified majority in ECOFIN, partly thanks to the support of France, which had also exceeded the 3% threshold. The SGP was suspended temporarily and would later be made more flexible.³⁵ In euro area Member States such as the Netherlands, this turn of events was a blow to the credibility of the single currency as the key to long-term stability and prosperity growth, and to the credibility of the crucial no-bailout guarantee in the Maastricht Treaty. Doubts were further raised by the manner in which the euro had taken shape since the signing of the Maastricht Treaty, and in part by the large number of Member States that appeared to qualify for admission at the euro's introduction.

All these doubts were intensified by the course of events during the euro crisis. It turned out that it was impossible to adhere strictly to the no-bailout clause, that the rules for budgetary discipline were unfeasible, that the governance of the monetary union had less-than-perfect democratic legitimacy, and that yawning differences remained between the Member States. It became clear that the monetary union's design had certain consequences and involved certain responsibilities and budgetary risks, and that change and adaptation would be unavoidable. That is where we are today. The general view is that the measures taken in recent years have considerably strengthened the

institutional structure of EMU. At the same time, there is a widely shared awareness that the monetary union in its present form is ‘unfinished’ and a ‘lack of consensus about how the EMU should develop further’.³⁶

The problems surrounding the no-bailout clause clearly illustrate the dilemmas of collective action, for example the problem of ‘moral hazard’. In essence, this means that when Member States can rely on assistance in the case of excessive debt, they may incur more debt. Another question is how to deal with debts incurred in the past. In other words, introducing debt sharing as a stabilisation measure could very well undermine the whole point of the single currency, namely (price) stability. This analysis helps us understand why euro-area Member States such as the Netherlands find using European debt mutualisation to prop up the euro area problematic.³⁷ Germany, the Netherlands and other Member States greatly prefer to bolster the single currency by restoring the credibility of the no-bailout clause in the Maastricht Treaty. This may not be impossible if the Union manages to make better use of its existing variation options.

The potential for more variation is inherent in the current set-up of the euro. It is, as it were, the ‘flip side’ of the Member States’ own responsibility for fiscal discipline and structural reform. Variation in this sense requires different, co-existing arrangements. In exploring the actual potential for variation, we must briefly indicate which elements in the current governance of the euro might be included. There are at least three factors that need to be considered:

- a. the extent to which euro-area Member States exercise market discipline;
- b. whether the Member States want mutual insurance, and the status of a common monetary fund;
- c. whether the IMF should be involved.

Using the terminology of the dimensions of variation introduced in Chap. 6, this list logically begins with variation in policy content, but it also considers variation in membership and decision-making.

What are the options that arise working with the above elements (on the understanding that we do not immediately assess their feasibility)? Below, we discuss potential routes to variation, by which we mean different arrangements that can co-exist. They are:

1. variation by means of market discipline and IMF involvement going forward;
2. variation by means of a European Monetary Fund (EMF).

Both forms of variation are geared primarily towards variation in policy content, i.e. the type of variation appropriate in situations in which the Member States concerned have the same motivation for collective action (in this case, reciprocity). However, they may have differing interpretations of the situation that drives this

action, i.e. socio-economic goals versus price stability and structural reforms (see the concluding section of Chap. 4).

After surveying variation in policy content, i.e. creating leeway for national discretion based on framework or minimum agreements, we can then consider variation in decision-making and/or (sub)membership, for example with regard to the development of existing or the establishment of new institutions, such as the ESM or an EMF. What is the decision-making procedure on the appropriation of loans (supranational, Community, intergovernmental)? Who are the members of such funds and what does their membership consist of? In other words, is variation in membership possible?

This approach—variation in policy content first and then variation in decision-making and (sub)membership—forms the basis for our exploration of variation in the EMU and the euro by means of the two arrangements identified above.

There are, additionally, euro-related policy domains in which variation in policy content is already facilitated. One current and evolving example is macroprudential policy. We discuss this existing form of variation in more detail at the end of this section. We also identify ways of making this policy integral to efforts to strengthen EMU and the euro in the light of the arrangements that we will discuss first. The aim at all times is to consider the budgetary, economic, financial, monetary and institutional-political dimensions as a whole when taking further steps to strengthen EMU and the euro (see the introduction to this chapter).

1. Variation by means of market discipline and IMF involvement going forward

One option is for some Member States to exercise market discipline and submit to the IMF's recovery programmes in the event of difficulties while other Member States establish a common fund providing mutual insurance. In both cases, rules will be necessary, including the option of variation in decision-making and membership (of certain arrangements), the details of which are beyond the scope of this (exploratory) chapter. The existing euro architecture provides the necessary leeway for tightening up checks and balances through the exercise of market discipline and for reducing the technocratic complexion of policy-making. This is feasible without far-reaching politicisation at European level or Treaty amendments. Such leeway is the starting point for our discussion of this first route of variation.

The market discipline/IMF arrangement is appropriate for countries that are committed to taking responsibility for their own affairs. The fund arrangement, in turn, requires a large measure of trust between the Member States that choose to participate. In the toolkit of solutions for the dilemmas associated with bolstering the single currency, one element has garnered considerable attention recently: the creation of a European Monetary Fund (EMF), which is not provided for in the Treaty but is possible within its framework. An EMF may be of particular value as an emergency fund in the event of exceptional asymmetrical shocks and as an additional instrument alongside automatic stabilisers and temporary budget

deficits.³⁸ In such cases, however, Article 122(2) TFEU already provides for the possibility of furnishing aid to Member States. As an interpretation of this clause, an EMF could take the form of an ex ante fund and/or (mutual) borrowing capacity.

In the case of mutual borrowing capacity, variation is possible in policy design (and possibly also in decision-making and degrees of participation). That would certainly be true if such organised borrowing capacity can be applied in tandem with pre-existing IMF funds (formed by euro-area countries). Moreover, the IMF has traditionally extended funds to ease pressure on the balance of payments caused by a policy of fixed exchange rates (of which the single currency is essentially a—specifically European—version).³⁹

Specifically, this could mean, for example, that euro-area Member States whose government deficits regularly test the boundaries of the rules and agreements would be more likely to request assistance from an EMF and/or the IMF, or do so more frequently, than other euro-area Member States. This makes it possible to build variation into the architecture of an EMF for example pegging risk premiums to such fiscal behaviour by applying SGP criteria (as proposed on several occasions; see, for example, CEPR 2018).⁴⁰

Another option is to make the establishment of the emergency fund optional for Member States. Those that want to arrange joint coverage contribute to the fund (and can rely on it in crisis situations). Those that do not want such an arrangement do not contribute and must rely on themselves (and the IMF) in crisis situations. As a result, the basic fund, in which everyone participates, may be limited or very limited. The Member States that do not participate in the fund will no longer receive assistance if they get into financial difficulties but will instead be forced to restructure their debt, with the expense then being borne by the private sector.

Variation in this sense implies less integration, for example with regard to fiscal rules.⁴¹ In the latter case, that would mean a reshuffle of the responsibilities in the monetary union by devolving responsibility (to the national parliaments), a move that so far has seldom been considered. This could provide a more effective way of addressing a key dilemma of policy coordination within EMU: on the one hand, there seems to be a need for more coordinated action (to better guarantee resilience, balance and growth, including bridging the investment gap⁴²), while on the other such action is at odds with the decentralised nature of EMU, as structured in the Maastricht Treaty, and with the aim of minimising pressure on national and European budgets on account of the euro.

The Dutch Council of State [*Raad van State*] has examined this approach in information furnished at the request of the Dutch House of Representatives in November 2017⁴³ and noted that if this more ‘decentralised’ trend were to be continued, three elements would be important: (1) completion of the banking union, (2) certain financial safety nets, (3) European enforcement of fiscal and economic rules in special circumstances.⁴⁴ This corresponds with the main outlines of our examination in this section and the rest of the chapter in this book.

2. Variation by means of an EMF

An EMF is another way to deal with the dilemma of stabilisation versus decentralisation. It differs from the ‘variation by means of market discipline’ discussed above (particularly in terms of (fund) membership), in which an EMF can be combined with existing IMF instruments. As discussed in this section, ‘variation by means of an EMF’ primarily involves creating a fund that could act as an additional stability mechanism for the single currency, alongside market discipline. This approach fits in with the history of European integration, which features an array of ‘fund structures’ meant to compensate for market frictions and to act as a buffer in crises.⁴⁵ It is driven by the ongoing quest to strike the right balance between European intergovernmental or supranational buffers on the one hand and market incentives that are deployed optimally to induce national responsibility on the other. That quest requires a certain amount of institutional agility.

Institutional agility can be achieved by allowing variation in policy content and (fund) membership. The single currency as it now stands offers starting points for a move in that direction. For example, the European Stability Mechanism could form the basis for a permanent stabilisation fund. The set-up of the fund can remain intergovernmental in nature. At least as important, however, is that an EMF offers certain advantages: (1) it would take some of the pressure off the debate about the need for an EPU, and (2) it would create new scope for a stricter interpretation of the ECB’s mandate (because the fund could serve as a ‘lender of last resort’) Moreover, both of these would be consistent with the Dutch position on the future of the euro in recent years.

There have already been various suggestions as to the form that such a fund might take, some involving the installation of a ‘European Minister of Finance’. Other suggestions include a European system of investment protection, a European system of national unemployment insurance, or a ‘rainy day fund’ for euro-area Member States in the event of major economic shocks.⁴⁶ In the case of the latter two options, all sorts of alternatives are certainly conceivable (variation in policy content).⁴⁷ In addition, they carve out more scope for democratic control and/or economic ‘conditionality’ as prerequisites for such a fund. This can be intergovernmental in nature or involve a hybrid blend of intergovernmental and Community elements (variation in decision-making). It is also important to decide between ex ante funding or the institutionalisation of ex post borrowing capacity.

An EMF can chart an alternative route to strengthening monetary union, namely through variation in short, medium and long-term measures, as well as in overarching conditions of democratic control and economic robustness. In particular, the existing European Semester (which is essentially a policy dialogue between EU institutions and Member States) could be used to achieve temporal variation in policy content and variation in the overarching conditions of economic robustness (and their application). The European Semester already involves a dialogue with *individual* Member States, a country-specific approach (shown, for example, by the country-specific recommendations that are central to this cycle). There is therefore already considerable potential for (further) variation here.

We can elaborate on this reality in relation to an EMF. For example, the set-up of an EMF could be patterned on whether or not certain Member States implement economic reforms. The EMF can thus assist the IMF by customising the IMF's instruments for the euro. It would exploit what is already a visible pattern of variation between Member States by permitting those that are facing major structural economic reforms to derogate from the reference values.

It could also mean that euro-area Member States whose government deficits regularly test the boundaries of the rules and agreements would be more likely to request assistance from an EMF or the IMF, whereas others would not have to. It then becomes possible to build variation into the architecture of an EMF, for example by charging different premiums on high-risk fiscal behaviour. This could also be reflected in the risk weighting of government-issued securities on banks' balance sheets (to loosen the galling bonds between government debt and national banks).

In addition, an EMF also clears a path to addressing the problem of the no-bailout requirement. That path has already been described, in tentative terms, by the Dutch Council of State in information that it provided at the request of the Dutch House of Representatives in November 2017.⁴⁸ The path mapped out by the Council of State and the routes described in this chapter (in particular the first two), which have the potential to co-exist, are very similar:

One possible way of further strengthening the emu is to place responsibility for policy and for complying with agreements more firmly at the level of the Member States, along with greater market discipline through the credible reinstatement of the no-bailout clause. This would allow more scope for policy competition based on national preferences, placing accountability for their performance within the emu squarely with the Member States.⁴⁹

This is in line with the variation in policy content that occupies a central place in the present report.

Like the present report, the Council of State also describes a variation route involving an EMF:

At the same time, however, it would be necessary to increase a number of European responsibilities so that it becomes possible to transfer more responsibilities to the national level in other domains without jeopardising the survival of EMU... First of all, a new division of responsibilities requires that Member States be goaded into complying with agreements by other means than centralised enforcement (alone). This would require greater market discipline through strict application of the no-bailout clause. That will only be credible if financial markets are convinced that there are mechanisms in place that affect them directly and that will be applied as soon as a Member State encounters difficulties. Otherwise, financial markets will continue to speculate in the belief that other Member States will eventually help out.

This could be a 'European mechanism' for 'orderly debt restructuring',⁵⁰ in which the Council of State notes that 'one obvious option is to transfer this mechanism to the ESM (by means of an amendment to the ESM Treaty) and transform it into an EMF'.⁵¹ An important advantage of variation through an EMF is that it could serve as a unifying factor in the euro area.

A European Monetary Fund would be an outgrowth of the European Stability Mechanism that is already in place. It would align with the institutional paths trodden in response to the euro crisis: excluding Treaty amendments but including the structural involvement of the IMF. After all, the ESM was created to support vulnerable euro-area Member States and as such replaced the European Financial Stability Facility (EFSF). It functions as a permanent defensive wall of euro 700 billion to fund bailout loans to euro-area Member States in the event of a solvency crisis, provided that the Member State in question implements a programme of economic reforms. It is important that the creation of an EMF complements the IMF (which is often already the case when IMF support is supplemented by additional support, e.g. from neighbouring countries); duplication of funds through the IMF and an EMF must be avoided.

Facilitating long-term stability through the ESM could take the form of an EMF. In certain respects, this would also fit in with the next phase of the programme to strengthen the euro area—following the acute crisis management of recent years—which will have to focus on reassessing national and European responsibilities for the single currency going forward.

Macprudential policy as an example of variation in policy content

For some time now, blueprints of what is known as the ‘fourfold union’ have circulated in the French Ministry of Finance and various Brussels think tanks, for example. This depiction elaborates on the path taken since the introduction of Van Rompuy’s blueprint (see Box 7.1) by proposing four pillars that would shape the monetary union going forward⁵²:

1. financial integration (banking union, capital market union);
2. fiscal integration (funds, euro-area budget);
3. economic integration (macroeconomic balance, structural reforms);
4. political integration (European Minister of Finance, euro-area parliament, Eurogroup as co-legislator).

These plans call for coherence between the four pillars, implying that they must be created jointly. The components of the different pillars vary in terms of scope, feasibility and degree of change, however. On the one hand, there are the ‘no regret’ measures identified by the Council of State,⁵³ which mainly involve completing what has begun, such as the banking union. On the other, there are measures so far-reaching—for example setting up a euro-area parliament—that they in any case imply a Treaty change. In between these two extremes are suggestions for reforms within the current institutional frameworks, such as the creation of an EMF.

In the light of the above, it is important to consider the dimension of timing with regard to the ‘fourfold union’. In other words, which suggestions can be prepared now and which should be planned for the future? This makes it possible to size up the various elements and, possibly, decide on their sequencing and conditions.

One option that merits further discussion in this book is to continue refining the existing ‘macprudential policy’, which is largely decentralised.⁵⁴ In its current

form, this is already a policy area in which a conscious choice has been made to allow national authorities to chart their own course (variation in policy content), given that financial cycles can vary widely between Member States, making a one-size-fits-all policy undesirable. It would be better, however, to position this policy alongside the existing macroeconomic imbalances procedure and the enforcement of price stability, a task entrusted to the ECB. In addition, a clearer distinction could be made between country-specific macroprudential policy (designed to address country-specific shocks when monetary policy is ineffective) and Union-wide macroprudential policy. The first has been elaborated in all sorts of ways, the second much less so.

Neither the Maastricht Treaty nor the theory of optimum currency areas gave much thought to this. The forces of global financial development and integration have made them much more important, however. In addition, the greater importance of financial markets in the monetary union is creating new problems with regard to managing the deeper financial and economic interdependencies. All these factors have indisputable consequences for the ways in which the single currency can be strengthened in the future⁵⁵—ways that require further examination.

7.4 Conclusion: Ways Forward for Variations in Policy

It is already complicated enough to coordinate monetary, fiscal, financial and labour market policies in a single country, let alone between different countries. In reality, the quest to boost prosperity through common measures has proved to be very difficult and has resulted in lengthy negotiations about how to distribute prosperity gains, especially since some Member States ‘lose’ and others ‘win’, for example in terms of trade surpluses or (emergency) loans. Matters are further complicated by the fact that the shocks to emu only become apparent after the fact.⁵⁶

At the same time, however, it is clear that the euro area needs to be strengthened. How this should happen, however, remains far from clear (see also the information provided by the Council of State on 7 November 2017). Some potential solutions, such as far-reaching debt mutualisation or major leaps forward in centralisation and federalisation, also entail consequences that will be interpreted as unfeasible or contrary to Dutch interests. Nevertheless, it must be said that the euro’s current situation leaves plenty of room for improvement.

The existing euro architecture and EMU offer scope for tightening up the system of checks and balances without resorting to a Treaty change. That requires us to view the conflicting short- and long-term considerations associated with the ‘logic of appropriateness’ and the ‘logic of consequences’, but also with individual, national and European interests, from a longer-term perspective: beyond the crisis, even, if possible, including the dismantling of a crisis policy that has stretched EMU to the limit, in particular with regard to the no-bailout rule and the ban on

monetary financing through the ECB.⁵⁷ The basis for this approach could well be the aforementioned ‘no regret measures’ meant to strengthen the monetary union.⁵⁸

The institutional and political framework for a more gradual path of this kind took shape following the introduction of initiatives based on Van Rompuy’s ‘blueprint’ (2012), which ruled out any ‘quantum leap’ in federalisation. This framework creates leeway both for more centralisation and for more decentralisation (by enhancing the role of the national parliaments), as well as for refining existing instruments, policy coordination and democratic accountability, including through variation. The present report offers a frame of reference for constructing such scenarios, including possible sub-variations in membership/members (of which the euro area itself offers the most detailed example). Such scenarios can give the Netherlands a better understanding of the opportunities and risks intrinsic to the future of the euro area and allow it to anticipate them.

In the approach sketched above, an EMF (with the ESM as its possible basis) merits more study (with regard to the scope for variation), for example by comparing it with alternatives such as continuing the current regime of ongoing IMF involvement. There may be an additional advantage for the Netherlands in that setting up an EMF would create scope for enforcing a stricter interpretation of both the ECB’s mandate and the no-bailout rule (if the fund can be linked to market discipline in varying arrangements that allow for the differing preferences of the Member States).

We can conceive of all sorts of variations on an EMF, including mechanisms for reallocating funds between Member States based on prearranged formulas, more discretionary powers of assessment—which may imply more politicisation—and linking disbursements from the fund to criteria, for example macroeconomic ‘conditionality’. All this implies seeking to strengthen the single currency along a route which may not have been provided for in the Treaty, but which appears to be possible under the Treaty in the current situation.

This route also offers new variation options, for example by establishing framework conditions for democratic control per country and for financial, economic and macroeconomic robustness and convergence (e.g. through variation in risk premiums). One potential advantage is that this route may well create new opportunities to use variation as a means of building closer ties to the national democracies.

The euro and EMU need to change, but effectuating such change by making a quantum leap in federalisation or by shattering the existing monetary union seems neither realistic nor desirable. In other words, neither the straitjacket of federation nor the straitjacket of the national state can drive the necessary change in the euro area and EMU. There is another way, however, which involves making use of the opportunities for variation offered by the current Treaty frameworks. This chapter has outlined a few of these opportunities.

Notes

1. Bara et al. (2017: 6), AIV (2017: 15–21).
2. Boot and van Riel (2014).
3. Fabbrini et al. (2015).
4. For a good and complete overview see: Boot and van Riel (2014).
5. The resulting tensions can be detected in several key documents that form part of the ongoing debate on the future of the euro, such as the European Commission's reflection paper, the German Federal Constitutional Court's referral to the ECJ of a case against the Expanded Asset Purchase Programme (EAPP), and in particular the Public Sector Purchase Programme (PSPP), but also the ECB's motivations for its existing interest rate and quantitative easing policies.
6. Schmidt (2016: 5).
7. Leonard (2017: 46–48).
8. See Raad van State (2017a: 54).
9. In the run-up to the referendum and during negotiations on the 'Better deal for Britain' (the Cameron Government's 'Bremain' campaign before the referendum), the British Government made it crystal clear why it considered EU membership to be increasingly problematic. The main reason was that in the UK's eyes, the euro area was becoming a locked fortress at the heart of the single market (particularly with respect to financial services and economic and financial policy). That put non-euro members at a disadvantage, according to the British Government (George Osborne, *Speech to the BDI conference in Berlin*, 3 November 2015).
10. See Enderlein et al. (2016).
11. Fabbrini et al. (2015: VI).
12. The macroeconomic imbalance procedure (IMP) is one of the Six-Pack measures aimed at broadening economic policy coordination in an attempt to correct existing differences in the euro-area members' balance of payments.
13. Centraal Planbureau (2017), Bara et al. (2017).
14. Armbruster (2017: 16).
15. See Press release No. 17/2017 of 15 August 2017, 'Proceedings on the European Central Bank's Expanded Asset Purchase Programme are stayed—Referral to the Court of Justice of the European Union', which states, among other things, that: '... significant reasons indicate that the ECB decisions governing the asset purchase programme violate the prohibition of monetary financing and exceed the monetary policy mandate of the European Central Bank, thus encroaching upon the competences of the Member States'; available at <https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/EN/2017/bvg17-070.html>.
16. Centraal Planbureau (2017).
17. While it is clearly useful to improve the supervision of banking and make it more objective (and while this has reasonable support; i.e. it is less controversial an issue in the Member States themselves), the financial system remains

intertwined with the individual Member States and a systematic separation between their financial systems and their socio-economic systems is unlikely. That is in part why initiatives such as the Capital Market Union (CMU) may be useful, for example because it can reduce the dependence on bank financing.

18. Boot and van Riel (2014: 742–745).
19. Segers and van Esch (2007: 1101).
20. Dokumente zur Deutschlandpolitik (1998: 475, 565–567 and 597), Bakker (1996: 187 and 253), Delors (2004: 385).
21. Metten et al. (2000: 27), Janssen (2012).
22. Mundell (1961).
23. See de Grauwe (2003: 82–85).
24. Mundell (1997: 214–216).
25. See Raad van State (2017a: 53).
26. Jones (2012).
27. Raad van State (2017a: 51).
28. Deutsche Bundesbank (1992).
29. Segers and van Esch (2007: 1096–1098).
30. The agreements reached between Mitterrand and Kohl in Evian in June 1988 are what drove the EMU momentum. Mitterrand had conceded the free movement of capital to the Germans in exchange for their support for an ambitious EMU agenda (which had led to the Delors Report) and Delors' reappointment as President of the Commission. As a result, they could no longer keep EMU at bay by arguing that political union was a necessary prerequisite (Segers 2013, 234–41).
31. See Raad van State (2017a: 52).
32. See, for example, Bayoumi and Eichengreen (1992), Verhoef (2003).
33. A good example is the Wassenaar Agreement of 1982, in which unions and employers agreed to wage restraint to help restore the competitiveness of the Dutch economy. Wage restraint is sometimes referred to as internal devaluation, because production becomes cheaper than in the rest of the world without an exchange rate adjustment.
34. However, the Maastricht Treaty's rules on the excessive deficit procedure (Article 104, now Article 126 TFEU) are not strictly quantitative and binding, and are highly intergovernmental in nature (Metten et al. 2000, p. 59).
35. Tietmeyer (1994), Segers and van Esch (2007: 1102).
36. Raad van State (2017a: 51).
37. See Centraal Planbureau (2017: 3)
38. See Wyplosz (2017).
39. This policy route—mutual borrowing capacity in the event of an emergency paired with IMF assistance—could even render ex ante funding superfluous, or limit it to ad hoc contributions by neighbouring Member States in the event of IMF support. Such an arrangement involves maintaining a permanent (borrowing) capacity so that Member States can quickly borrow money made available (in part) through the IMF (which also avoids an unwanted replication of funds).

40. This assumes that the base situation is sustainable (and healthy). One could think in terms of packages—some countries purchase more insurance to give themselves more budgetary leeway. And the higher the level of (necessary) insurance, the higher the premium.
41. Raad van State (2017b: 53, 68–69, 92–93), Sandbu (2015).
42. See also the Report of 31 October 2017 on combating inequalities as a lever to boost job creation and growth (2016/2269(INI)), published by the European Parliament’s Committee on Employment and Social Affairs.
43. Kamerstuk 34 387, nr. 6; here: Raad van State (2017b).
44. Raad van State (2017b: 93).
45. One of the first detailed examples of this is the ‘readaptation fund’ that the Dutch Minister of Foreign Affairs Johan-Willem Beyen included in his influential 1952 plan for a stable common market of ‘the Six’ (Segers 2013).
46. See Raad van State (2017a: 54).
47. By way of illustration, in its recent advisory report *De staat van de euro*, the Council of State mentions three versions of a rainy day fund: ‘funds could automatically be redistributed between member states on the basis of pre-arranged formulas (e.g. via fixed ex ante formulas based on economic indicators), but more discretionary powers of assessment are also conceivable, as well as the possibility of linking disbursements to other criteria such as [for example] certain reforms’ (Raad van State 2017a: 54).
48. See Raad van State (2017b).
49. Raad van State (2017b: 68).
50. See Raad van State (2017b: 69).
51. See Raad van State (2017b: 69–73); here too, the Council of State provides a clarifying and detailed assessment of the socio-economic, political, institutional and legal aspects of this route, although its conclusions are largely tentative.
52. See Trésor-Economics (2017: No. 190).
53. Raad van State (2017a: 85–89).
54. A European macroprudential policy framework is already in place. The Capital Requirements Directive (CRD) IV and the Capital Requirements Regulation (CRR) provide for explicit macroprudential instruments that can be activated. These are policy instruments in the banking sector: macroprudential authorities may activate them to address systemic risks. In the Netherlands, for example, they have been used to impose additional capital requirements on the ing, Rabo and ABN AMRO banks. The European Systemic Risk Board (ESRB)—formally part of the ECB—is authorised to issue warnings on systemic risks and to advise macroprudential authorities in this area. Article 5 of the SSM Framework Regulation (Banking Union) gives the ECB certain powers in the domain of macroprudential policy, allowing it to ‘top-up’ national macroprudential policy measures. If the ECB believes that systemic risk is accruing in certain countries, it may impose additional requirements on institutions in those countries.

- 55. *ESB* (2017: 41).
- 56. See de Grauwe and Costa Storti (2005), Beetsma and Bovenberg (2001).
- 57. See Schmidt (2016: 5).
- 58. See also Raad van State (2017a: 85–89).

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