

The utopia of fiscal union Premium

FT [ft.com/content/1f8dd500-7768-11e7-90c0-90a9d1bc9691](https://www.ft.com/content/1f8dd500-7768-11e7-90c0-90a9d1bc9691)

Martin Sandbu, Financial Times, August 2nd, 2017

02/08/2017

Despite the strong recovery in the eurozone, the consensus view remains that the architecture of Europe's monetary union remains broken and needs to be fixed through some form of deeper fiscal integration. Politically, the most important impetus at the moment is the French presidency of Emmanuel Macron, who stood on a programme including a eurozone budget. The latest [intellectual contribution to the push for fiscal union](#), well worth reading, comes from Pierpaolo Barbieri and Shahin Vallée in *Foreign Affairs*.

The piece revisits the “Hamiltonian moment” many think should inspire the eurozone, when the fledgling federal US government assumed the debts of the individual states. Barbieri and Vallée point out that this was about much more than economic policy; it was part of a deep political bargain to settle the balance of power between Washington and the states. They argue persuasively that a eurozone fiscal union would be a similar moment of federalist construction.

But while that is correct as a matter of historical description, it hardly amounts to a reason why the eurozone should make the same leap. Here Barbieri and Vallée, like so many others, have to fall back on economic arguments. And these fail to persuade.

What, exactly, is a fiscal union — something it would take huge political capital and determination to realise — supposed to achieve? Above all, to make impossible a self-fulfilling debt crisis of the sort we saw in 2010-12. But why should we expect a fiscal union to bring this about? Joint borrowing (or “eurobonds”) will not rule out capital flight from sovereigns unless you also ban countries from doing any borrowing on their own account. So long as a country can continue to borrow on its own account, investors could herd themselves into a self-fulfilling flight from those bonds in a downturn that threatens the issuers' creditworthiness.

Second, the idea is to use temporary fiscal transfers to help countries “adjust” to “asymmetric shocks” — changes in their particular economic conditions that they would have adapted to by devaluing their currency were they not in the euro. But the 2010-12 debt crisis happened as part of *synchronised* downturns or slowdowns that afflicted all eurozone member states. And in the face of asymmetric downturns, a government can normally borrow to fund countercyclical budget deficits. If the rules prohibit this, it makes more sense to [relax the rules](#) than to circumvent them through government-to-government lending.

The bigger problem in the eurozone was, in any case, lost access to financial markets — but as we just pointed out, it is not clear why fiscal union would prevent this. Even if there had been a transfer mechanism to the most crisis-hit countries, [what difference](#) would this have made? In the US, smoothing of local economic shocks through the federal budget [amounts only to about 20 per cent](#) of the swing in a state's GDP reduction. If the Greek depression (or the Irish, Spanish or Portuguese recessions) had only been four-fifths as deep, would that really have made a debt panic impossible?

Third, federal-level, or transfers financed by joint borrowing, give rise to a pool of safe assets and this is thought to be good for financial stability. But this can and should be achieved without fiscal union. There is good reason for the eurozone to [pursue packaged securities proposed under the name of ESBies](#), which would bundle the bonds of individual sovereigns, tranche them by safety, and thereby provide a large pool of safe and homogenous assets. The ECB should give its blessing by making such bundled securities eligible for its purchase programmes or as collateral for central bank liquidity. But this has nothing to do with fiscal union.

Fourth, many argue a common “fiscal backstop” for banks is necessary to complete Europe's banking union. But the idea that European banks need a fiscal backstop is a legacy of a past in which applying capitalism to banks — by letting their investors pay for losses incurred — was seen as anathema. EU law now provides (despite large loopholes) for writing down banks' debt, which makes restructuring a substitute for bailouts with public money. That is as it should be — but most of those who support “bail-in” do not realise that [it obviates the need for a fiscal backstop](#) for bailouts.

That leaves one final reason for joint borrowing and a common budget, which is to finance projects in the common interest (those that are public goods for all the countries concerned or involve spillover effects from one country to another). This, unlike the others, is a good reason. But it is hard to see why it applies specifically to the eurozone. It is more an argument for beefing up the size and the effectiveness of the EU budget, and enhancing the EU's own borrowing and taxation capacity.

None of this is to say that fiscal stabilisation of idiosyncratic shocks — or put differently, insuring national economies against particularly large shocks — is not important. But it is not clear that fiscal union is either necessary or sufficient to improve the degree of fiscal stabilisation for eurozone countries or the monetary union as a whole. A [smarter interpretation of the fiscal rules](#) — to allow properly countercyclical fiscal policy at both the national and the federal level, and allow insurance or risk-sharing through private markets — is much more promising.

Meanwhile, to prevent a future market run that closes a sovereign borrower off from financing, public debt can be issued at much longer maturities, so that the amount of refinancing required in any one year would never be unsurmountable. And in extremis, [sovereign debt can and should be](#) rescheduled, reprofiled or written down.

Fiscal union has acquired an almost religious reverence because it is seen as the salvation of the eurozone. But while the functioning of the monetary union clearly leaves something to be desired, the sublimation of that desire into fiscal union worship is unwarranted. A solution that has lost contact with the problems it is supposed to solve, it would be a terrible waste of political energies better applied to policies that would make a bigger difference.

To receive Martin Sandbu's [Free Lunch](#) by email every workday, [sign up here](#).