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MONETARY UNION DANGEROUSLY INCOMPLETE WITHOUT SOME FISCAL UNION: "DELORS 2" NEEDED

The crisis revealed the Monetary Union to be dangerously incomplete, jeopardizing global economic stability. As Jean-Claude Trichet has said, EMU always needed the E as well as the M. That wasn't so surprising given research on previous currency unions, but that earlier literature and the pre-EMU debates did not focus on the vital importance of banking union. While much has been done to unify supervision and resolution, a vital lacuna of strategic significance remains. The monetary union employs two kinds of money: central bank money and private-bank money, ie deposits. Both need to be homogenous. The former is: by definition, the ECB issues the euro area's central bank money. But the private deposit money, comprising most of the money used in the euro area, is *not* homogenous. That is because the deposit-insurance regime in one member country is not the same as in another, so that a retail deposit in one country is not the same as in another. This is fundamentally inadequate for a sustainable monetary (and banking) union. Without a collective deposit-insurance scheme, the monetary union will remain fragile: an incipient fracture in the credit system will persist, even when the current crisis has finally passed. As the Bank for International Settlements 2012 annual report suggested, banks domiciled in euro area countries need to be euro-area banks. A euro area deposit-insurance scheme should be funded by the banks themselves, in order to ensure that defaulters contribute something. A funded scheme can also shield the taxpayer somewhat, but I recognize that this would be a step towards some kind of a fiscal union.

That is why this apparently technical issue is truly strategic, substantively and in what it signals.

In the US, the deposit-insurance regime is part and parcel of the fiscal union. The euro area needs to debate what *kind* of fiscal union it should have, and through what staged-process it could move there. The issues are profound, requiring thorough technical and public exploration before political decisions could be taken. A decent first step would be an expert commission, completing the work of the 1980s'Delors group on EMU.

Fiscal unions come in lots of varieties. On possible route would be a union of rules, where control over fiscal policy in a euro-area member country was transferred to 'the centre' if certain debt or deficit thresholds were breached. That seems to me likely to create political resentment at tension in the event of a country suffering a crisis that's not of its own making.

Another possible route would involve some kind of collective insurance against the costs of *cyclical* unemployment. This has the key feature of the *people* of the euro area helping each other out, but with discipline on member-country governments. That discipline comes in two forms. First, there would be no subsidy for structural unemployment, underlining the incentive for necessary supply-side reforms.

Second, there would be no bailout for insolvent states. The US established in the mid-19th century that the people of America would not bail out bankrupt State governments; the Federal government would not stand behind the government of, say, California. The euro area needs to establish the same. But a ‘no bail-out’ rule means nothing unless it is clear how a member state government could go bankrupt in a reasonably orderly way. As with bank resolution, that too needs some technical ground clearing. It was absurd that government insolvency threatened euro area membership, threatening EU membership.

I offer these thoughts as a citizen outside the euro area. But the whole of the EU, indeed the whole of the world economy, badly needs the euro area to have firm foundations.