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The euro crisis
A delicate proposal

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HOW TO resolve the euro's woes? Angela Merkel says Germany will not agree to pool sovereign debt or share banking liabilities with other countries until there is greater political union. François Hollande says France cannot accept the loss of sovereignty without greater solidarity. So today Herman Van Rompuy, the president of the European Council (who chairs European summits), issued a report (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf that tries to split the difference: there should be both joint liabilities and more European-level control of national policies.

Drafted with three others—José Manuel Barroso, president of the European Commission, Mario Draghi, president of the European Central Bank, and Jean-Claude Juncker, president of the Eurogroup (made up of finance ministers of the euro zone)—the report is thus a delicate piece of diplomacy at a time of sharp differences between Germany and France; indeed between Germany and many of the euro zone's biggest countries.

It sets out four "building blocks" for deeper euro-zone integration: a European system to guarantee bank deposits and manage troubled banks; fiscal integration to exert greater control on national budgets and steps towards issuing joint debt; more integration in economic policy-making to boost competitiveness; and more democratic accountability in European-level decisions. Precisely what these building blocks consist of, how the steps should be sequenced and how much can be done within existing treaties is all left a bit vague. The paper is peppered with words like "appropriate" and "commensurate" without attempting to define them.

On what many in Brussels call "banking union", it proposes creating a fund, "primarily funded" through contributions from banks, to help guarantee deposits and wind up failed banks. To be credible the fund should be backstopped by the euro zone’s permanent rescue fund, the European Stability Mechanism (ESM), expected to be activated in the coming weeks.

On fiscal union, the report goes beyond the current system of euro-zone controls on national budget. It suggests jointly setting the ceiling for each country’s debt and deficit. Governments would have to seek permission to break these limits, and Brussels could demand changes. Greater budget controls could, later on, lead to some form of Eurobonds (or “Eurobills” for short-dated debt). This is how the report puts the delicate issue:

> “ *In a medium term perspective, the issuance of common debt could be explored as an element of such a fiscal union and subject to progress on fiscal integration. Steps towards the introduction of joint and several sovereign liabilities could be considered as long as a robust framework for budgetary discipline and competitiveness is in place to avoid moral hazard and foster responsibility and compliance. The process towards the issuance of common debt should be criteria-based and phased, whereby progress in the pooling of decisions on budgets would be accompanied with commensurate steps towards the pooling of risks. Several options for partial common debt issuance have been proposed, such as the pooling of some short-term funding instruments on a limited and conditional basis, or the gradual roll-over into a redemption fund. Different forms of fiscal solidarity could also be envisaged.* ”

Even further in the future, the euro zone could create a common treasury with some kind of central budget.

The report has been toned down in drafting, and some contentious ideas have been dropped. Gone is the call, made in an earlier version, for an “immediate and permanent” mutualisation of risk to backstop the banking sector. Ditto for the idea that the ESM could recapitalise banks directly (so relieving some troubled sovereigns like Spain from having to take on a big additional debt burden). The report is also silent on the question of a financial-transactions tax, no doubt to avoid upsetting a British government that is wary of stronger European bank supervision.

It is worth comparing the wooliness of Mr Van Rompuy’s paper with the detail of the more convincingly worked-out proposal (here (http://www.notre-europe.eu/uploads/tx_publication/CompletingTheEuro_ReportPadoa-SchioppaGroup_NE_June2012.pdf)) issued on the same day by a group of prominent economists under the aegis of Jacques Delors, the former commission president, and Helmut Schmidt, the former German chancellor. It calls, for instance, for the creation of a special fund to help countries weather cyclical downturns. It also proposes a European debt agency to oversee the issuance of limited amounts of joint Eurobonds (typically up to 10% of GDP, with more possible if a country is willing to cede ever more budgetary decision-making powers).

Mr Van Rompuy’s report does not pretend to be a “roadmap” to greater fiscal federalism. It is, instead, a proposal to talk about one. European officials argue that just getting Mrs Merkel to agree in principle to discuss things like the mutualisation of debt would be a big achievement, as would getting the French to talk about surrendering the powers of the Fifth Republic. Yet talking is one thing, agreeing quite another—and there is still no sign of accord among leaders.

Mr Van Rompuy says a detailed plan for integration could be presented in December, with perhaps an interim version issued in October. But will the markets be ready to wait that long? After all, this is the week that Cyprus asked for a bail-out, and Spain confirmed it would seek up to €100 billion to recapitalise its banks.

The likelihood is that this week's European summit will disappoint, and that could set off another round of panic in the markets. If the euro is to survive, Mr Van Rompuy may have to draft his roadmap rather sooner than he expects.