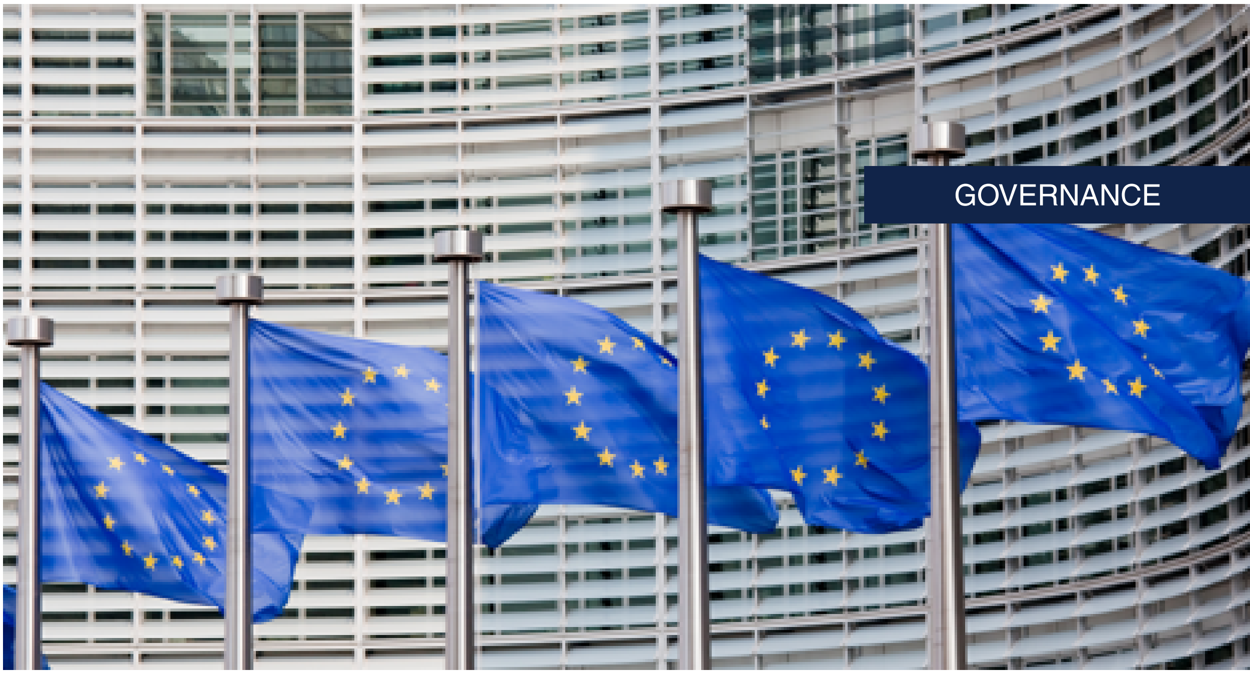

European economic governance reform: Moving past power politics

Analysis of European economic governance reform often focuses primarily on who wins and who loses in the intergovernmental bargaining. Unfortunately, this perspective tends to leave out the ideas, assumptions, and underlying principles that are crucial to making the system work. Successful reform is more than just power politics.

Erik Jones

Abstract: European governments disagree on how to reform their shared institutions for economic governance. Moreover, that disagreement is substantive. It rests on different assumptions about what caused the recent crisis, about who is responsible for crafting a solution, and about what are the most important obstacles standing in the way of success. These competing visions are difficult to reconcile; a compromise solution, borrowing elements from different positions, would lead to contradiction and vulnerability. Hence, the challenge is not to land the negotiations according to some diplomatic calendar, it is to find some way to foster a meaningful consensus on which of the competing visions should be adopted for what should be done and why.

Introduction

The institutions and processes that shape European economic governance need reform. The reasons are well known. The fiscal rules are complicated. The 'imbalances' procedures are asymmetrical. The banking union is incomplete. So is the monetary union. And the various national welfare state regimes have complex pathologies of their own. As a result, European leaders cannot manage their economies comfortably and stably within a single market; European-level economic governance remains largely aspirational. This problem will not disappear as a function of political compromise or power politics. European political leaders can agree on what to do, but that agreement will not ensure the new institutions will function to plan (Jones, Kelemen, and Meunier, 2016). On the contrary, any agreement may still mask lasting contradictions in how policymakers understand European economic performance and what they require to achieve their domestic objectives.

Too pessimistic?

It is too pessimistic to simply say that a compromise solution cannot work either politically or economically. A more optimistic, 'constructive approach' would be to focus on the points of complementarity. The raft of proposals made on December 6th by European Commission President Jean-Claude Juncker and his team might be a good starting point. The Juncker team has called for a wide array of reform measures – both large and small – to improve the process of macroeconomic policy coordination while at the same time strengthening response to crisis and clarifying lines of accountability and control. These proposals include:

- Naming a European Finance Minister who would be Vice President of the European Commission and chair of the Eurogroup;
- Incorporating the 'fiscal compact' treaty into European Union law;
- Transforming the European Stability Mechanism into a European Monetary Fund that could be brought into the Treaty-based framework of Institutions;
- Allocating specific financial resources as a budget line for the European Union that could be used to incentivize reforms at the member state level (European Commission, 2017).

The Commission's approach focuses on institutions. An alternative approach might focus on specific goals. Recently, fourteen French and German economists put forward a comprehensive proposal along those lines (Bénassy-Quéré *et al.,* 2018). Throughout that proposal, they argue that 'market discipline and risk-sharing should be viewed as complementary pillars of the euro-area financial architecture' (p. 2), that '[a] choice between crisis mitigation and crisis prevention is generally a false alternative' (p. 3), that it is possible to 'improve discipline and risk sharing in the euro area' simultaneously (p. 4), and that 'the key to success is to ensure that risk reduction, market discipline, and risk sharing go hand in hand' (p.5). Moreover, these are laudable ambitions and they frame a concrete set of six proposals. These proposals are worth enumerating both because they have been debated for a long time in various forms and because – as a package – they provide a good summary of the many dimensions of policy debate. In summary form, Bénassy-Quéré *et al.* (2018: 20-21) argue that:

- Banks across the euro area need to be given very strong incentives to reduce the risks on their balance sheets before they can be plugged into pan-European deposit and resolution schemes.
- Governments need to be given simple instructions for stabilizing their fiscal accounts and strong incentives to ensure that takes place.
- Investors need to be locked into a transparent framework for absorbing losses

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both on their exposure to banks and on their exposure to sovereign debt instruments in case of need.

- New financial instruments need to be created to help stabilize national economic performance with clear conditions being placed on governments both to participate in the scheme and should they ever need to benefit from it.

- New financial instruments also need to be created to offer a common safe-haven for European investors and to minimize the distortions that arise in the regulation of sovereign debt holdings by bans and other financial institutions.

- Enforcement of the rules regarding fiscal policy, financial stabilization, and macroeconomic stabilization should be better insulated from political interference.

Bénassy-Quéré *et al.* (2018) back each of these points with specific initiatives that they have been developing over the past several years and flank them with new and often very subtle suggestions for how these reforms might be designed or implemented to ensure that they arrive at a balanced outcome. As such comprehensive reform packages go, this is about as good as it gets. Hence the only question is whether it will be adopted. The authors have a clear perspective in their last sentence: 'Our leaders should not settle for less' (p. 21).

We have been here before

That conclusion is hopeful but challenging. Although it is possible for European policymakers to arrive at consensus around a specific view of how macroeconomic policy coordination should function (McNamara, 1998), it has not been possible to construct a compromise of competing visions that has survived the test of time. This bitter observation is the fruit of long experience. The difficulty in governing Europe's economies is not a new problem. Its origins stretch at least as far back as the period of eurosclerosis in the 1970s and arguably to the currency crises of the mid-to-late 1960s. At different points in the intervening decades, European leaders have leapt forward in terms of institution-building. That process started with the first plan to form an economic and monetary union as part of the 'Spirit of The Hague' and culminated most recently in the raft of measures introduced during the recent economic and financial crisis, including the two-pack, the six pack, and the single supervisory mechanism.

Different actors have played crucial roles in this institutional development. Many of these did not come from national governments or large member states. Nevertheless, the conventional narratives focus on the Franco-German partnership (Brunnermeier, James, and Landau, 2016). Only these two countries were strong enough to push Europe forward, so the argument runs. Hence, most of the great innovation occurred when France and Germany worked together under likeminded leaders who were willing and able to cooperate. Famous pairings run from Georges Pompidou and Willy Brandt to Nicolas Sarkozy and Angela Merkel. Each of these couples, in their own way, followed in the footsteps of Charles De Gaulle and Konrad Adenauer (McCarthy, 2001).

This Franco-German partnership was not always harmonious. French and German perspectives often differed. At the start of the monetary integration process in the early 1970s, the French were 'monetarist' and believed that currency union would lead to economic convergence while the Germans were 'economist' and so believed that economic convergence should be prerequisite for monetary union (Tsoukalis, 1977). Their joint initiatives therefore built on compromise. In the conventional narrative, the French 'won' concessions from the Germans that only the Germans have the power to give. The running theme in this narrative is that whichever of the two was more powerful at the time was also more likely to have a greater influence on the design of common rules and institutions (Brunnermeier, James, and Landau 2016). The reference value for an 'excessive' deficit written into the protocols of the 1992 Maastricht Treaty is an iconic illustration: the Germans wanted something close to two percent of gross domestic product while the French wanted something closer to four percent; they agreed on three percent, which the French believed meant 'declining towards' and the Germans insisted was three percent or less.

With this background, it is unsurprising that prominent journalists like Wolfgang Munchau have concentrated on the current political leadership of France and Germany to anticipate the next step in the economic governance reform process. European Commission President Jean-Claude Juncker has launched and sustained a comprehensive agenda, but ultimately the heads of state or government will decide. During the summer and early autumn of 2017, French President Emmanuel Macron played into that narrative with a raft of bold proposals. Now all eyes are focused on German Chancellor Angela Merkel to see whether and how she will respond. Much will depend upon the coalition she brings together. Power politics, conventional wisdom concedes, is a game played on many different levels.

Power without purpose?

This conventional narrative misses a critical dimension in the reform process. Power without purpose lacks direction; only by understanding the goals of the reforms can we anticipate where that process will go. Such goals are hard to read from the ups and downs in the Franco-German relationship. They are also hard to decipher from the proposals made by various actors. Too often the names, rules and procedures sound interchangeable. A European Finance Minister, a European Monetary Fund, or a budget line for the euro zone are all good examples. The name says very little about the content of the proposal, which could come as easily from the Germans as the French. Such fungibility would be welcome from a power-political perspective. Interchangeable components are easy to mix and match depending upon the balance of influence. Purposive goals are more constraining. They imply fixed assumptions about what is wrong, who can fix it, and how competing proposals might work at cross-purposes.

Once the purpose behind the reform agenda is considered, compromise becomes more difficult and less effective. That is why the fourteen French and German economists are at such pains to insist that their six-point plan strikes a substantive balance (Bénassy-Quéré *et al.,* 2018). Policymakers can still mix and match institutions, but that does not mean those institutions will achieve the goals for which they were created. Worse, they may contradict each other or leave important vulnerabilities unaddressed. The current reform process is particularly prone to such limitations. The goals and understandings of the various participants are mutually exclusive both in terms of what they think lies at the heart of the economic governance problem and in terms of what Europeans should do about it. Denying this fundamental tension will not make it disappear; looking for subtle engineering solutions is likely to make the conflict worse. One way for European leaders to move forward would be to agree on a coherent vision of what a completed monetary union should offer and then to assemble those institutions and facilities best suited to achieve that common goal. Hence the way forward leads not through a collection of piecemeal compromises on specific institutional arrangements, but rather through a more fundamental consensus around what a single currency entails.

Dichotomies and diagnoses

To recognize the distinctions, it helps to start with two dichotomies framing the recent economic and financial crisis. Depending upon the perspective, the crisis had very different origins. For example, it is possible to argue that the crisis emerged out of aberrant behavior or poorly designed institutions; similarly, the crisis was a problem of finance or of real economic performance (Jones, 2015). In combination these dichotomies result in four different scenarios, each of which has been prominent in crisis narratives: excessive risk-taking, weak government accounts, competitiveness, and 'sudden stops' (Table 1).

The excessive risk-taking story focuses on bad behavior in finance. Both banks and bank regulators ignored the build-up of leverage and failed to provide sufficient loss absorbing capital. The crisis emerged when these failings became apparent. Iceland, Ireland and Cyprus are good examples of relatively small national economies that were jeopardized by disproportionately large banks.

The government accounts story is where bad behavior meets the real economy. The problem is that public indebtedness increases no matter what the level of economic performance. Governments tax too little and spend beyond their means. This problem can be hidden in a low interest rate environment but will resurface once the cost of borrowing increases. Belgium, Greece and Italy are good examples of countries that would struggle if they faced a sudden spike in government borrowing costs.

The competitiveness story is about the structure of real economic performance. The problem has less to do with banks or governments, than with the more general notion of external indebtedness. Total factor productivity must increase to pay back money from abroad. Alternatively, foreign investors will lose confidence and provoke a balance of payments crisis. Here the putative examples are Portugal and Spain, but just about any country that accumulated a current account deficit could be accused of misallocating capital.

Finally, the 'sudden stop' account is about the structure of financial markets. What matters is not so much the behavior of financial market participants as the fact that they are interdependent. It also matters that financial institutions transform short-term savings into longer-term investments. Should everyone try to liquidate their assets at once in a 'flight to liquidity', the financial economy could disintegrate in ways that would bring one or more of the member-state economies to a sudden stop. Any of the countries that suffered from the crisis could illustrate this potential. The challenge is to distinguish between capital flight that takes place because of general fear in the markets from a more justifiable concern for the solvency or liquidity of the national economy that is abandoned.

Overdetermination

These stories are not mutually exclusive. As is often the case in public policymaking, the economic crisis is overdetermined. European economies can suffer from any mix of bad institutions and behavior. The different crisis narratives do, however, suggest different solutions — many of which can be found in the economic reform proposals currently under discussion. The problem of excessive financial risks can be tackled, at least in

Table 1 **Two dimensions of the recent crisis**

	Behavioral	*Structural*
Real	Fiscal profligacy	Loss of competitiveness
Financial	Excessive risk-taking	Sudden stops

Source: Authors' own elaboration.

part, through dynamic provisioning against losses on risky assets and through ceilings on exposure to home-country sovereign debt instruments. Excessive government spending can be addressed through close supervision by a European Finance Minister and binding conditions on financial assistance from a European Monetary Fund.

On the surface, some solutions could encompass different problems. Closer European supervision of national policymakers and tighter regulations on financial institutions could drive the process of market-structural reform as well. Other proposals could buy time for problems to be addressed. The re-insurance of national unemployment compensation could smooth over any temporary losses in national competitiveness as could a euro-area budget line for fiscal stabilization. Finally, the solution to sudden-stop dynamics is to complete the European banking union with common resolution funding and a European deposit system. If possible such a solution would also include a common European safe asset.

The proposals emerging from the Juncker Commission sketch out this kind of comprehensive agenda. The reflection papers published in spring 2017 echo the many factors that were taken into consideration from a range of different perspectives. The state of the union address Juncker delivered in September announces the priorities for action and the order of operations; meanwhile, the documents accompanying that speech show how even those policies not prioritized by the European Commission President will not be left behind. Finally, the specific proposals delivered on December 6th confirm the European Commission's formal right to initiate European legislation by providing precise legal texts to be considered in the reform process. In other words, the fourteen French and German economists are hardly alone in looking for a compromise that meets the goals of the major stakeholders.

Changing perspectives

The difficulty for the Juncker Commission and for Bénassy-Quéré *et al.* (2018) is that the solutions do not fit well together even if the diagnoses of the underlying problems are compatible (or at least not mutually exclusive). To understand why, it is useful to look at the fundamental dichotomies from a different perspective. For example, it is possible to characterize the distinction between real economies and financial economies as more a matter of scale than substance. Real economies tend to be framed by national regulations and market institutions; this makes them somewhat idiosyncratic. It is possible to imagine sharing best practices and trying to improve national performance, but it is unlikely that national institutional arrangements will ever be the same. Indeed, that assumption is baked into the European market-structural reform processes that constituted the Lisbon Strategy and the various attempts to coordinate market-structural reforms that have flowed from that, up to and including the macroeconomic imbalances procedure that prevails at the moment.

By contrast, financial markets tend to operate at a European level. This is by choice and not by accident. European policymakers made a series of decisions over the previous half century to make it possible for capital to flow across national boundaries (Helleiner, 1996). They also made decisions to encourage financial institutions to take advantage of the opportunities created by this capital market liberalization and to adapt to the competitive environment it generates. Almost immediately, European policymakers realized that capital market liberalization would change their financial institutions fundamentally – giving them a scale and complexity beyond the national level. Given the deep ties across the Atlantic, however, they did not turn initially to a European solution. Instead they enlisted the support of global institutions to manage the interdependence between national regulatory authorities (Story and Walter, 1997). European institutions only came to prominence as those more global arrangements for managing interdependence proved ineffective at stabilizing integrated financial markets (Mügge, 2010).

This change in perspective to focus on idiosyncrasy and interdependence does not offer a clean dichotomy like the theoretical division between the real economy and financial markets. Real economies are deeply inter-connected and so also interdependent even as financial institutions retain the influence of their national regulators and countries of origin and so remain somewhat idiosyncratic. Nevertheless, the two sides of the economy sit at different ends of the spectrum that runs from idiosyncrasy to interdependence and the crisis narratives that focus on these differences between finance and the real economy share that tendency. That is why explanations that focus on government accounts or national competitiveness tend to emphasize the cultural dimension of individual cases (think of Greece) while explanations that focus on risk-taking or sudden stops tend to look for more common factors (think of Iceland).

It is possible to change perspectives on the dichotomy between behavior and structure as well. The behavioral problem is essentially a matter of moral hazard, with the emphasis on the word 'moral'. People will take advantage of any system or institutional arrangement. The only way to stop that prospect is through clear rules backed by the political will to enforce them. Sometimes the rules proscribe certain behavior and sometimes they proscribe specific consequences for transgression. What matters is that the rules are followed. This perspective places the emphasis on 'moral' because it infuses rule-abiding with an ethical dimension: following the rules is 'right'; breaking the rules is 'wrong'. When breaking the rules imposes a cost on others, the 'wrongness' of the act is compounded. Hence the moral hazard here is not so much taking on risks that are incommensurate with potential losses, because it is possible to do that while following the prevailing rules. Problematic behavior is taking on risks that are incommensurate with potential losses only in ways that are not allowed.

The problem of structure is different. Structure is about technical engineering and the incentives that flow from institutional design. This notion of engineering is complicated by the fact that institutions do not exist in isolation (Ostrom, 2005). On the contrary, they are nested in complex systems and overlapping incentives (Meadows 2008). Worse, these systems are constantly evolving with changes in technology and social norms. Hence, the challenge is to design institutions that are fit for purpose but also resilient enough to absorb unforeseen shocks and flexible enough to adapt to changes over time.

Here again the dichotomy is not as clean as that between behavior and structure. The rules that define appropriate behavior are institutions, for example, and so is the norm that the rules should be enforced. Similarly, only people can give institutions 'purpose' or make them function. Even the best institutional engineering requires commitment from those who staff, use, or interact with institutions to make them work as intended. The tendencies are nevertheless distinctive, with those who worry about aberrant behavior more likely to look for ways to constrain moral hazard and those who worry about dysfunctional institutions looking for ways to engineer a solution to the problem.

Contrasting implications

This change in perspectives reveals contrasting implications that arise from the various crisis narratives. By combining notions of idiosyncrasy and interdependence with moral hazard and institutional engineering, the principal themes that have emerged in the economic governance reform debate become apparent. Specifically, these new perspectives highlight the role of risk reduction and conditionality, but also national ownership and risk sharing (Table 2).

> "The challenge is to design institutions that are fit for purpose but also resilient enough to absorb unforeseen shocks and flexible enough to adapt to changes over time."

Table 2

Competing soultions for future crises

	Moral Hazard	Technical Engineering
Idiosyncrasy	Conditionality	National Ownership
Interdependence	Risk Reduction	Risk Sharing

Source: Authors' own elaboration.

The emphasis on 'risk reduction' comes at the interface between moral hazard and interdependence. Hence the goal is not to reduce risks per se. Some risk is inescapable and risk-seeking behavior is important for innovation. Rather the goal is to ensure that the consequences of risk taking can be contained either within that group which engaged in risk-seeking in the first place or, in extremis, within the national community responsible for ensuring that the rules for engaging in risk-seeking behavior are obeyed. The structure of loss-absorption flows from the view that the worst kind of rule-breaking is that which imposes costs on others. That structure is also contained by the logic of collective action (Olson, 1965): as the groups grow larger, the incentives for any individual to abide by the rules decrease which raises the prospect not only of free-riding on the system but also of encouraging moral hazard. For many advocates of this view, national boundaries constitute a convenient – and politically justifiable – stopping point for aggregation, even at the expense of market integration.

The emphasis on 'conditionality' arises where moral hazard overlaps with idiosyncrasy. There is no denying that different countries have different institutional environments. According to this view, however, such idiosyncrasies are no excuse for putting the costs of bad practices onto others. Hence, wherever it is clear that moral hazard is at work – meaning whenever a national government cannot absorb risks through its own resources – then it is necessary to take remedial action. That action can be tailored to suit national idiosyncrasies, yet it cannot be avoided. Ideally, such action should be adopted prophylactically, meaning once the prospect of future losses become apparent. In this way, conditions could be attached to the threat of sanctions before crisis unfolds rather than only to assistance offered after things have turned out badly. In the best-case scenario, assistance would never be required because moral hazard could be avoided.

The overlap between technical engineering and idiosyncrasy is very different. The reason is the importance of getting 'buy-in' from the national population. It is not enough to propose a well-designed institutional arrangement or even to tailor that institution to local circumstances. The real challenge is to get people to integrate any reforms into the many other things that make up their social and economic existence (Ostrom, 2005). Part of this challenge can be addressed through local political leadership, but that leadership needs to stay in office long enough for the reforms to take effect. Hence the goal is to encourage national ownership of the reform process so that both political leaders and

> "If the goal is to support market integration – and accept the interdependence that comes with it – there has to be some mechanism for risk-sharing."

the rest of society lay the foundations for a long-term commitment to change. Often this means adapting both the process and the priorities for the reform effort to meet national circumstances. This is true particularly where governments expect to face entrenched opposition from one or more powerful interest groups opposed to change.

Pan-European solutions emerge where technical engineering combines with interdependence. Some of these solutions revolve around rules and enforcement. In that sense, the engineering solution tends to look a lot like to solution to moral hazard. The difference is the emphasis in the logic of interdependence. The presumption is that some risks simply cannot be eliminated or contained within national boundaries in integrated markets. Therefore, if the goal is to support market integration – and accept the interdependence that comes along with it – there has to be some mechanism for risk-sharing. Moreover, this mechanism has to be extensive enough to underwrite market integration in the face of unforeseen shocks. This is true particularly given that European markets are not self-contained and so remain subject to external influences. Alternatively, there is a danger that a common external shock will have different implications for different participants in the European marketplace and so expose them to losses that they can neither absorb nor contain.

Institutional progress

This change in perspectives is not meant to deny that significant institutional progress has been made. The creation of a Single Supervisory Mechanism was a major step forward in the construction of a banking union, for example. So was the elaboration of the mechanisms through which banking resolution decisions are made. This framework is not perfect, and the recent banking resolution programs undertaken in Italy show that there is still work to be done in building out the new system. Nevertheless, they are a step in the right direction.

Moreover, we can use the experience of national financial market integration to map out roughly where this progress should be headed. Through an analysis of the completion of domestic financial market integration in the United Kingdom, the United States, and Canada (Jones and Underhill, 2014), we discover that all three countries experimented with institutional reforms in different domains until they came up with a framework that included six different elements as a sort of greatest common factor:

(i) a common risk-free asset (currency and debt instruments) to use as collateral for liquidity access and clearing as well as a refuge for capital 'fleeing to quality' in times of distress; (ii) a central system of sovereign debt management; (iii) centralized counterparties such as exchanges, clearing agents, and depositories; (iv) a common framework for prudential oversight; (v) emergency liquidity provision that includes lender-of-last-resort facilities for the financial system and the sovereign; and, (vi) common procedures and orderly resolution mechanisms for financial institutions and public entities (Jones and Underhill, 2014: 5).

There are good reasons why Europe has not moved forward with the common risk free asset, although it is clear that there is a strong desire to bring that item back onto the agenda (Jones, 2017a). Recent efforts to reform the stability and growth pact and to strengthen the European semester address the centralized debt management issue to some extent. The capital markets union agenda tackles some of the issues related to centralized counterparties, although there are lender-of-last-resort or backstop questions that have gained prominence during the British negotiations to exit the European Union and that remain to be addressed. The single supervisory mechanism and resolution authorities touch on some of the remaining agenda, as does the European Stability Mechanism – whether or not that gets transformed into a European Monetary Fund.

European leaders have made significant progress and yet they remain at an impasse. The reason is not for want of an appropriate institutional blueprint or engineering solution. Rather it is due to a more basic disagreement as to whether the problem Europeans face is a matter of engineering or ethics.

Fundamental conflicts

The implications of this change in perspectives are hard to reconcile with each other. This is particularly true across the divide between moral hazard and technical engineering. Conditionality is more likely to foster a backlash against European institutions than to create a sense of national ownership. The more enforcement of conditionality is separated from political accountability, the greater that sense of powerlessness will be. That is why the sixth proposal made by (Bénassy-Quéré *et al.,* 2018) is going to be very hard for many member state governments to accept. The tension between conditionality and national ownership also explains why the details framing the constitution of a European Monetary Fund or the allocation of a eurozone budget line will take on exaggerated significance. A slight tweak in one direction or the other will make the difference between a carrot and a stick.

Of course, that tension between conditionality and political accountability is not always predominant. Italy is a classic example of a country that sought external constraints as a means of driving its domestic reform process. Nevertheless, it is worth considering what goals made it worthwhile for Italians to accept the imposition of those European constraints. Joining the single currency was a powerful motivation; now Italians lack that kind of overriding objective. Moreover, 'becoming a better Italy' is hard to use as a substitute when non-Italians appear to be dictating both the content of the reforms and the pace of change. The point is not to criticize well-intentioned and carefully considered reform proposals for the Italian economy; rather it is simply that an external constraint is not always welcome and may prove counter-productive. Indeed, that is the problem in Italy today and it explains why popular attitudes toward Europe in Italy have diverged so significantly from those in other countries (Jones, 2017b). It is also (at least partly) why the only unashamedly pro-European Union and pro-reform political party is losing popularity in public opinion polling.

The tension between risk-reduction and risk-sharing is less obvious but still important. What is at issue is whether the threat of irreducible risks from external shocks or hidden features of market integration are more dangerous than the threat that market participants will use common institutions to take on risks that will result in losses they can neither absorb nor contain. As an empirical matter, this issue is almost impossible to resolve. Irreducible risks are largely unquantifiable and hidden features are, by definition, hidden until they are found. These are the domains of Knightian uncertainty. As Frank Knight (1921) argued, such uncertainty can only be mitigated through experience and insurance. They cannot be accommodated before the fact. By contrast with this empirical ambiguity, the moral calculation is clear. Moral hazard is wrong and so should be addressed; anything that threatens to increase moral hazard should be avoided. That is why the fourth and fifth proposals – to have a macroeconomic stabilization fund and to introduce a common safe asset – made by Bénassy-Quéré *et al.* (2018) are problematic. They treat moral rectitude as an engineering problem; for those who worry about moral hazard, it is not.

Reconciliation of the division between idiosyncrasy and interdependence is less complicated but still challenging. The process of European integration has long wrestled with the combination of unity with diversity and that tension is still unresolved. Moreover, it continues to have familiar political implications. The European Commission's proposal of a supranational European Finance Minister did not find warm

> "The process of European integration has long wrestled with the combination of unity with diversity and that tension is still unresolved."

reception in the finance ministries of the member states; the initial German proposal to reconstitute the European Stability Mechanism as a European Monetary Fund with an apolitical, intergovernmental mandate did not find much support at the European Commission or the European Central Bank. It would be easy to put these conflicts down as a matter of institutional self-interest. In fact, they rest on serious arguments about what are the vulnerabilities in the economic governance framework and how they should be addressed.

The first three proposals made by Bénassy-Quéré *et al.* (2018) fall under this rubric as well. The authors take great pains to show how the adjustment costs to a common regime can be mitigated for those member states who face the greatest challenges in moving toward less holdings of home-country sovereign debt in their national banking system and more rapid disposal of non-performing loans, large-scale fiscal consolidation, and higher charges to float new sovereign debt (or bank bonds) with private investors. Moreover, there are sound reasons to make those adjustments. Nevertheless, there is no way to guarantee that governments who take these steps and pay the high adjustment costs will be rewarded with pan-European deposit insurance, resolution funding, or direct recapitalization of their banks. That trade-off was made already once in June 2012 at the start of the first serious banking union discussions when the introduction of a single supervisory mechanism was required as a precondition for the direct recapitalization of distressed banks. It took less than a year for the President of the Eurogroup to make it clear that the goal was to ensure that such 'direct recapitalization' would never happen (Jones, 2013). The argument he made was on principled grounds. That argument has found a constant refrain – most recently in the October 2017 German 'non-paper' on macroeconomic governance reform.

Europe's heads of state or government are unlikely to forge a consensus around a single vision for design of the EU's economic governance. The reason is not power politics, or even a failure to reach agreement between the French and German governments. There are deep, principled divisions between the different stakeholders across the member states and in each of the main institutions. Those divisions must be acknowledged and addressed. Compromise is not an option. The only option is choice. Europeans must come to some kind of meaningful consensus around the substance of economic governance reforms. That means choosing among the coherent visions that are on offer. More specifically, it means choosing between the belief that macroeconomic governance is an ethical matter that pivots around the threat of moral hazard or an engineering problem that can be solved with appropriately-designed fiscal and financial institutions. Recognizing the different perspectives and their implications is only the first step in making such a selection. Addressing those divisions and forging that consensus will be the hard part. Bénassy-Quéré *et al.* (2018) have made a detailed and very constructive proposal. The Juncker Commission's proposals are even more substantive. But the real conversation about what a completed monetary union should accomplish and how it should be structured has yet to take place.

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