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The future of the Euro: agreements to disagree and prospective scenarios from the 2014 Vienna debate

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Working paper based on the 2014 Vienna debate on European integration between Fritz Scharpf and Henrik Enderlein

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[1] This paper was prepared on the basis of the 2014 Vienna debate on European integration, which took place on May 22, 2014. It benefited from comments by Fritz Scharpf, Henrik Enderlein and Gerda Falkner as well as from Alina Lengauer, Franz Nauschnigg and Thomas Gehrig, who commented during the debate. All remaining errors are mine.

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***Abstract*:**

The policies of the European Central Bank and a series of reforms have stabilized the Euro area. However, further systematic reforms are necessary for the long-term viability of the Euro. At the same time, the limited legitimacy of many crisis-induced measures and their asymmetric consequences in terms of growth and employment across the Euro area make unanimous agreement on systematic reforms difficult. This keeps the Euro area vulnerable to economic and political shocks that may yet force either its systematic reform or break-up. The 2014 Vienna debate on the future of Euro has revealed some agreement on reforms that could make the heterogeneous Euro area viable over the long-term, as well as two fundamental disagreements on the political feasibility of such reforms and on the consequences of (openly discussing the) reintroduction of differentiated macroeconomic policies within the Euro area. Possibly, these disagreements could be reconciled when formulating a policy recommendation for moving ahead: the Euro area needs to focus on minimizing the reform agenda in order to maximize the political chances of its adoption while also exploring unorthodox strategies and break-up scenarios in such a way that would not trigger a self-fulfilling crisis. This would provide the Euro area with a realistically designed 'Plan A', but also a better idea of a 'Plan Z' that could guide its actions in case joint responses get overwhelmed by the next bout of crisis.

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INTRODUCTION

This paper reviews the current state of the debate on the future of the ***Euro***. It argues that while the policies of the European Central Bank and a series of macroeconomic and financial reforms have ***stabilized*** it, further systematic reforms are indispensable for the long-term viability of the Euro area. At the same time, the limited legitimacy of crisis-induced measures and their asymmetric consequences in terms of growth and employment across the member states make unanimous agreement on reforms difficult. This keeps the Euro area ***vulnerable*** to economic and political shocks that may yet force either its systematic reform or break-up.

The paper is rooted in the ***2014 Vienna debate on European integration***,[2] where professors Fritz Scharpf and Henrik Enderlein debated the future of the Euro area with reference to four scenarios which combined the divisive political legacy of the present crisis with the need for further systematic reform: (i) ***systematic reforms*** pursued on the basis of a consensus that the EU members agree on despite their political differences, (ii) continuation of ***incremental reforms***, whereby the EU responds reactively to the most pressing problems with the most minimalist policy changes, (iii) ***shock-induced systematic reform***, when the return of the acute crisis forces the EU to adopt systematic reform, and (iv) ***shock-induced break-up*** of the Euro area, when the pressure of an acute crisis overwhelms the capacity and willingness of member states to find a common response.

The debate produced two ***'agreements to disagree'*** as well as numerous insights into the op-

[2] The debate took place on May 22 2014 at the University of Vienna. The two main speakers were Fritz W. Scharpf, Emeritus Director at Max Planck Institute for the Study of Societies in Cologne and Henrik Enderlein, Professor of Political Economy at the Hertie School of Governance in Berlin. Comments for the debate were provided by Franz Nauschnigg, head of European Affairs and International Financial Organizations Division, Austrian National Bank, professor Alina Lengauer, deputy head of the Department of European, International and Comparative Law at the University of Vienna, professor Thomas Gehrig, Vice Dean of the Faculty of Business, Economics and Statistics at the University of Vienna, and Zdenek Kudrna from the Institute for European Integration Research, University of Vienna. The Rector of the University of Vienna, professor Heinz W. Engl, provided the opening speech. The event was moderated by professor Gerda Falkner, head of the Institute for European Integration Research at the University of Vienna.

portunities and constraints of various reform ideas.[3] Enderlein outlined a clear path of systematic reforms that could make the Euro area viable and that, in his view, could be implemented within the next five years or so. They centered on complementing the banking union and other reforms implemented to date with a deeper single market and a cyclical adjustment insurance mechanism (see section 8 and Enderlein et al. 2012 and 2013). Scharpf agreed that these measures might be helpful in addressing future imbalances in a heterogeneous monetary union but denied that they would suffice for correcting the deep structural imbalances that presently persist. He was also skeptical about their current political feasibility. He argued that due to divisive legacies of the Euro-crisis management, the member states are unlikely to adopt such reforms, and even if they did, the effectiveness of the new framework would require further structural reforms on the national level (see section 6a and Scharpf 2014). Hence, the first agreement to disagree could be formulated as:

The adoption of common policies and institutions that could

contain the future centrifugal tendencies within the Euro area:

is *vs.* ***is not***

politically feasible *given the current divisions within the Euro area*

The second agreement to disagree derives from the first one. Professor Scharpf argued that given the meager chances for adoption, and the likely limited effectiveness of the systematic reforms, the Euro area needs to reintroduce more differentiation and flexibility to its macroeconomic and financial policies that could compensate for the absence of an independent monetary and exchange-rate policy at the national level. He pointed out that Europe should not be bogged down by Euro area impasse because there are other important challenges in foreign, security or climate change policies that require the EU to act. Hence, the EU should seriously explore unorthodox policies such as the introduction of parallel currencies. In contrast, pro-

[3] The two agreements to disagree were initially formulated by Gerda Falkner in her summary of the debate.

fessor Enderlein argued that any attempt to introduce parallel currencies or other forms of substantive differentiation would require currency controls and the reintroduction of internal borders, which is at odds with the foundational EU freedoms. In his view, any such differentiation is de facto a break-up of the Euro area triggering enormously costly bank failures and endless court cases on redenomination of contracts for which there is no constitutional basis. He also added that ideas for differentiation are underdeveloped and hence there is a high risk of being wrong. In short, the second issue that ended in agreement to disagree was:

Any attempt to substantively differentiate the macroeconomic

policies of Euro area member states:

is *vs.* ***is not***

just ***the first step towards a dismantling*** *of the common currency.*

The disagreements indicate the three core themes of the debate: managing heterogeneous economies within the single currency area, the political feasibility of necessary reforms and preparing for the uncertain future that may favor unorthodox responses. Table 1 provides the schematic summary of the arguments raised by the speakers vis-à-vis these three issues and the rest of this paper summarizes the more detailed insights that arose from the debate and relates them to some of the more prominent proposals. The paper tries to maintain the 'big picture' view by focusing on broader principles rather than delving into technical details of specific proposals. Its leitmotif is that ***there are no perfect reform solutions for the Euro area*** because each proposal involves difficult trade-offs and uncertainties, but ***there are ways*** to ***improve the reform designs*** to ***make them more politically feasible*** as well as to ***prepare for the unexpected*** turn of events.

Table: The schematic structure of the debate[4]

Key issue	**One view …** Prospects for systematic reforms are good and pondering unorthodox alternatives is too risky.	**… and the other.** Prospects for systematic reforms are bad and pondering unorthodox alternatives is necessary.
Making the heterogeneous currency union work	Systematic reforms that make the Euro area viable require completion of the banking union, deepening the single market in services and the introduction of some cyclical adjustment financing mechanism.	Some of these reforms would be useful but insufficient. Member states and national societies are too divided by the asymmetric impacts of the crisis to agree on policies that would effectively deal with present imbalances.
Making reforms politically feasible	Political demands of the reform agenda can be minimized by smart reform design and adopted as a mini-constitution on the basis of the existing Treaty within the term of the Juncker's Commission because both creditor and debtor countries share common interests and will be prepared to compromise.	While debtor countries carry the burden of austerity, the creditor countries benefit from the current stability and do not rush to support debtor states through financing and sharing the risks of effective stabilizing mechanisms; some kind of crisis is likely to strike before reforms are agreed on and implemented.
Getting ready for the uncer-	Exploring unorthodox options that may reintroduce differentiat-	There must be alternatives in case systematic reforms are not implemented

[4] Whereas the view in the middle column corresponds closely to arguments presented by Henrik Enderlein and the one presented in the right column to Fritz W. Scharpf, both are the author's interpretations of their arguments.

tain and un-expected	ed, decentralized and more flexible macroeconomic policies is not advisable because the risk of being wrong about their adverse consequences is too high.	on time or do not work well; unorthodox options such as parallel currencies have to be researched to allow for a 'partial' break-up in case of crisis.

The paper consists of two parts. The first provides a brief overview of the crisis origins, the crisis management measures implemented to date and their divisive political consequences. It also contrasts reforms implemented so far with several blueprints that outline systematic reforms deemed necessary for the long-term viability of the Euro. The second part focuses on the path ahead. It starts with an outline of the alternative reform scenarios of how the Euro area may (or may not) implement the necessary systematic reforms. The subsequent sections discuss plausible responses to the triple challenge of heterogeneity, political feasibility and uncertainty. The conclusion summarizes these observations.

Part I: Crisis origins and responses to date

1. Origins of the Euro crisis

Two causes of the Euro crisis stand out from the multitude of explanations: the global financial crisis and the ***incomplete institutional architecture of the Euro area***. The Euro crisis was triggered by the external shock that originated in the US, but the build up of vulnerabilities and the difficulties of its resolution are homegrown. The single currency encompassed economically, politically and institutionally ***heterogeneous countries that did not fulfill the prerequisites of the optimal currency area*** (see Scharpf 2014, Enderlein et al. 2012). Under the single monetary policy, such heterogeneities create a risk of bank and/or debt crisis, which can either be prevented by the coordination of economic policies or resolved by robust crisis management tools. The Euro area, however, lacked both.

The ECB ***monetary policy proved to be one-size-fits-none*** (Enderlein 2006a). The common interest rate was too low for the 'Southern'/debtor member states with higher inflation and too high for 'Northern'/creditor countries with inflation rates below the Euro area average (De Grauwe 2013, Scharpf 2014). Too low interest rates fuelled investments, consumption and real estate bubbles in the 'South' while too high interest rates depressed investment and consumption in the 'North'. The resulting imbalances were observable through large current account deficits in the 'South' that were financed by massive financial inflows from the 'Northern' banks via global financial markets (Gros 2012).

The ***policy coordination proved too weak to prevent imbalances***. The Stability and Growth Pact was supposed to act preventively, but it only focused on state deficits and ignored the rise of macroeconomic imbalances (Enderlein 2004). It was watered down after France and Germany found it too rigid in their 2003 recession. The national authorities of 'Southern' member states failed to address the growing imbalance with adequate fiscal and regulatory policies (Scharpf 2014). Moreover, the financial sector - and 'Northern' banks in particular - mispriced the risks involved in lending to 'Southern' states and banks (Gros 2012), which were thus provided with an excessive amount of credits at excessively low interest rates.

The combination of macroeconomic imbalances and leveraged finance made the ***Euro area vulnerable***. The 2008 collapse of Lehman Brothers provided the trigger that revealed the economic and political consequences of accumulated vulnerabilities. As interbank lending came to a stop, 'Southern' banks first turned to the ECB for refinancing (Mabbett and Schelkle 2014). When that became doubtful, the threat of failures forced states to bail out numerous banks, which increased public debts, and in the cases of Greece, Ireland, Italy, Portugal and Spain, threatened state solvency. This situation ***escalated into the Euro crisis*** during spring 2010.

The ***crisis consequences*** have been felt ever since. The economic growth across the Euro area has yet to recover, living standards in many countries are below pre-crisis levels, ***unemployment*** in the 'South' is generally three times higher than in the 'North' and has reached catastrophic levels in some countries; at the same time, the debt-to-GDP ratio is almost 50 percentage points higher (Pisani-Ferry 2014). Moreover, crisis management measures resulted in deep ***economic and political divisions*** and growing distrust between and within member states (Scharpf 2014).

2. Crisis management and reforms to date

The most important crisis management measures were introduced by the European Central Bank (ECB), which expanded its role to the limits of its legal mandate. In May 2010, it introduced the ***Securities Market Programme*** to purchase the debt of member states on the secondary markets. In December 2011, the ECB drastically expanded its ***Long-Term Refinancing Operations*** (LTROs), providing troubled banks with liquidity for up to 3 years and effectively assuming the lender of last resort function for banks. In August 2012, it added the ***Outright***

Monetary Transactions (OMTs) to its toolkit, which allow it to purchase unlimited amounts of national debt on the secondary markets as long as the country in question agrees to a reform programme. The ECB also participated in the '***Troika***' - along with the Commission and International Monetary Fund - that defined the conditionalities imposed on Greece, Ireland, Portugal and Cyprus as part of their official bail-out programmes. Last but not least, the ECB President Mario Draghi made a commitment to "***do whatever it takes to save the Euro***" in July 2012, which financial markets perceived as an important signal for stabilization.

The ECB measures were complemented by expanded and novel mechanisms for the funding of crisis resolution programmes. The ***European Financial Stability Facility*** (EFSF) and the ***European Financial Stabilisation Mechanism*** (EFSM) were temporary arrangements backed by Euro area governments and the EU budget respectively. They were created in May 2010 with a joint capacity of up to EUR 0.5 trillion. In February 2012, the EFSF was replaced by the permanent ***European Stability Mechanism*** (ESM) with a total capacity of EUR 0.5 trillion. The ESM is guaranteed by Euro area states and financed by issuing bonds on financial markets. Any ESM loan comes with strict reform conditionalities.

The ***ECB crisis management*** measures ***stabilized the Euro area*** after the summer of 2012. However, these measures ***only bought time for the systematic reforms*** necessary for the long-term viability and resilience of Euro area. Some of these reforms are already approved, while others are yet to come.

The EU has adopted four major reforms of its macroeconomic governance designed to prevent a repeated failure of policy coordination. In November 2011, the ***Six-pack*** recasted the Stability and Growth Pact and (re)defined procedures such as the European Semester, Medium-Term Budgetary Objectives, the Commission run warning system, the Excessive Deficit Procedure (that now covers both deficits and debts), the Excessive Imbalance Procedure and the

Alert Mechanism Report for macroeconomic surveillance. These measures extend controls over the full range of economically relevant domestic policies of Euro area states and aim at tightening the discipline on public finances and curbing the reemergence of macroeconomic imbalances. The ***Two-pack*** introduced in May 2013 further tightened oversight of the public finances. The ***Euro-plus pact*** was an early measure trying to promote better economic policy, while the ***Fiscal Compact***[5] reinforced the governance of fiscal and economic policies.

Since the banking failures and excessive risk-taking were among the most important causes of the Euro crisis, the EU reformed its financial regulation and governance as well. Reforms included the introduction of the ***European Systemic Risk Board*** (ESRB) charged with oversight of 'macro-prudential supervision' and an upgrade of existing regulatory agencies to ***European Supervisory Authorities*** (ESAs) responsible for 'micro-prudential' regulation in banking, insurance and securities. The EU also introduced ***30 packages of new and amended financial regulations*** (Commission 2014a), such as the CRD IV reform that introduced new global banking standards (so-called Basel III).

The most significant achievement in terms of long-term reforms is the ***banking union***. Whereas the above reforms essentially represented 'more of the same' response by providing ever more commitments to coordination, ever closer surveillance and ever more sanctions for non-compliance, the banking union includes a substantive ***shift of authority to the supranational level*** - primarily to the ECB.

The banking union is intended to cut the vicious link between the solvency of banks and solvency of member states. It creates the ***Single Resolution Mechanism*** that includes a joint resolution fund which, along with other measures, can be used to stabilize collapsing banks. Hence, if a national bank needs to be bailed out, it can be done with Euro area-level funding

[5] Specified in the Treaty on Stability, Coordination and Governance.

that does not count as national debt. The member state in question can thus avoid over-indebtness and insolvency due to a major bank bailout. However, in order to prevent moral hazard of states and banks, the banking union also includes joint regulation and supervision: The former in the form of the ***Single Rulebook*** overseen by the European Banking Authority and the latter in the ***Single Supervisory Mechanism*** operated by the European Central Bank.

3. Proposals for further systematic reforms

The macroeconomic and financial reforms implemented so far do not address all sources of instability within the Euro area formed by heterogeneous countries. A comparison of reforms to date with the EU's official reform blueprint (Commission 2012a, EP 2014a) or with independent reports such as that of 'Padoa-Schioppa Group' (Enderlein et al. 2012) reveals ***there are further measures deemed necessary for long-term viability***. Which of the systematic reform proposals are necessary and sufficient to achieve this goal is debated, but a somewhat deeper banking union, some elements of fiscal union, a deepening of the single market to compensate for various rigidities, and measures to improve democratic legitimacy and oversight of new policies are on all blueprints.

The banking union as currently implemented remains minimalist and incomplete. The original Commission (2012c) proposal included an additional pillar - the ***Single Deposit Insurance Mechanism***. This would pool deposit insurance and prevent a repetition of the Icelandic situation, when EU depositors were not compensated due to insolvency of the national deposit insurance scheme.[6] Although deposit insurance rules were harmonized, they remained national as a further reform was postponed indefinitely (House of Lords 2014). The ***Single Resolution Fund*** that is to be phased in till 2023 also delays the completion of the banking union.

[6] Iceland is part of the European Economic Area and therefore subject to the same single market rules as any EU member state.

There are numerous proposals for setting up the various ***elements of a fiscal union*** that could deal with asymmetric economic shocks, i.e. providing financial support to a few Euro area economies that are in recession while the rest of the member economies are doing well. These proposals range from minimalist to federalist, although the latter are usually only used to demonstrate the unlikely feasibility of systematic reforms of the Euro area (see section 7). The Commission (2012a) blueprint based on the 'Four Presidents' report (Council 2012) proposes an ***integrated budgetary framework*** that would build on the reforms to date and strengthen the fiscal discipline of indebted countries. It would be a precondition for some form of ***Euro area budget*** that could assist the member states in dealing with asymmetric economic shocks and implementing reforms. Less ambitious proposals for dealing with asymmetric shocks include ***common unemployment insurance*** (Dullien 2013, Claeys, Darvas and Wolff 2014), a ***cyclical shock adjustment fund*** (Enderlein et al. 2013, 2012) or various kinds of ***investment schemes*** (see Marty 2014). If implemented quickly, these limited cyclical measures would allow creditor countries to help ease the effects of austerity in debtor countries, although they might also reduce the pressure on the implementation of structural reforms.

A ***debt mutualization*** is the next step towards a fiscal union. Various proposals try to balance responsibility and solidarity associated with any form of ***Eurobonds***. Delpla and von Weizsäcker (2010) propose two sets of bonds – mutualized blue bonds for countries within the Maastricht debt limits and red for those above it. The Commission (2011) proposes stability bonds with varying degrees of joint liability and there are also proposals for various forms of ***Eurobills*** (Tumpel-Gugerell et al. 2014). These proposals also include the formation of the ***European Debt Agency*** (Enderlein et al. 2012, IMF 2010) or a similar body that would administer any combination of tasks on the scale between a limited 'European Monetary Fund' (Enderlein in Vienna debate) and some form of the Euro area ministry of finance (Soros 2012).

Systematic reforms also need to foster ***competitiveness and labor mobility*** in order to approximate the prerequisites of the ***optimum currency area*** (see also section 6a). This can be achieved by deepening the single market as proposed by the ***Single Market Act*** (Commission 2012b). In particular, the implementation of the ***Services Directive*** and a removal of barriers to labor mobility are frequently proposed measures (Enderlein et al. 2012).[7] In addition, the Commission (2012a) also suggests greater tax harmonization and greater ***coordination of supply-side reforms*** as complementary measures. The implementation of such commitments could include setting up a formal ***contract on convergence and competitiveness strategies*** between any member state and the Commission, which would make them both accountable to the European and national parliaments (Commission 2012a).

The above proposals impose various forms of constraints on democratically elected actors and empower technocrats on the European level of policy-making. Therefore, a crucial aspect of further systematic reforms is greater ***democratic oversight of reformed policies*** (Commission 2012a). However, the enhancement of legitimacy of Euro area decision-making is by no means certain, not least because the political and economic consequences of Euro area reforms to date make agreements on further changes more difficult.

4. The political consequences of the crisis management

The Euro area ***crisis management policies lack the legitimacy*** of both input- and output-oriented type (Scharpf 2014). This is particularly important for the stabilization programs imposed on debtor countries by the Troika. These programs' input legitimacy was undermined by the fact that the Troika consists of technocratic actors from the Commission, ECB and IMF (EP 2014b). These are accountable only to the Council, where the crisis shifted the bargaining power in favor of creditor countries, especially Germany as the largest contributor to stabilization. Scharpf (2014:3) argues that this has resulted in "non-democratic expertocracy and an extremely asymmetric intergovernmental bargaining system" that can hardly be regarded as

[7] There is a debate, however, on the effects of 'brain drain' on macroeconomic imbalances as 'Northern' economies overcome skill shortages by encouraging the emigration of the most productive 'Southern' workers (as pointed out by Scharpf).

legitimate in debtor countries. Although this is a common problem of monetary and financial policies that tend to be delegated to actors with indirect accountability in most democratic societies (Bertoncini 2013, Enderlein and Verdun 2009, Enderlein 2006, Moravcsik 2002), it is also the case that independent actors on the European level are less connected to politically potent public debates and controversies in an effective political community than their national counterparts (Grimm 2014).

Output-oriented legitimacy is undermined by the extremely ***unequal distributional effects*** of Euro area crisis management. The imposed "austerity policies have deepened the decline of economic activity, while severe cutbacks of social benefits, public services and public-sector wages combined with labor market deregulation have greatly increased mass unemployment, poverty and social inequality" (Scharpf 2014:12). Furthermore, employment has declined in all 'Southern' states and youth unemployment increased in some regions to over 50 percent.

In contrast, the ***creditor banks and countries benefited*** from the crisis management policies. The collapse of the Euro and the default of the periphery have been avoided, sparing the ‘Northern’ creditors massive losses on investments of their banks and firms in the 'Southern' periphery. Moreover, their export sectors were reoriented to international markets and have experienced growth in profits and employment, supported by the Euro exchange rate depreciation caused by the crisis uncertainty. To be sure, the creditor countries are exposed to debtor countries’ risks through the stabilization measures – via the ECB balance sheet, TARGET2 payment system and ESM. However, there were no write-offs or losses on these funds to date.

Benefits accrued by the creditor countries provide them with strong ***vested interests in the continuation of the current status quo***, which delivered stability without any obvious losses. They have no immediate economic interest in supporting further systematic reforms that would redistribute more risks and costs to them. Since systematic reforms require unanimous consensus among member states - and possibly also Treaty change - their adoption under current preference constellations would be difficult, if not impossible.

The ***European Parliament elections*** in May 2014 ***confirmed the deepening opposition to the Euro*** and further integration as Eurosceptic parties gained 28 percent of the seats (Treib 2014:5). Although the results allow the renewed formation of a comfortable pro-European majority, they also signal fundamental concerns of voters about EU policies and general dissatisfaction with mainstream politics. Moreover, the current exclusion of Eurosceptics from power provides ideal breeding ground for even stronger backlash in 2019 (Treib 2014), which suggests that systematic reforms ought to be completed within this term as the next parliament might be even less supportive.

PART II: CONTROVERSIES, TRADE-OFFS AND MOVING FORWARD

5. Alternative scenarios for the future of the Euro

The undisputed need for systematic reforms combined with the high likelihood of political stalemate creates an impasse. At the same time, the current status quo does not preclude the possibility of either economic or political shock. Foreseen and unforeseen events may trigger the next bout of Euro crisis that may force either rapid agreement on systematic reforms or a drastic dismantling of the Euro area. The economic requirements combined with political stalemate generate ***four principal scenarios*** for the way out of the impasse.[8]

a) Systematic reforms

The Eurozone reforms will advance towards a 'Genuine Economic and Monetary Union' or some similar blueprint.[9] This scenario assumes a good understanding of the systematic reforms necessary for a robust long-term functioning of the heterogeneous currency area and that political agreement between the debtor and creditor countries can be reached, perhaps even in the form of some 'grand bargain' that would facilitate Treaty change and improvements in the input legitimacy.

This is the alternative officially promoted by the EU Commission and European Parliament. However, the required political agreement is a tall order for the politically divided EU, especially when most of the systematic reforms focus on long-term stability while not necessarily addressing the social catastrophe in some of the debtor countries (Scharpf in Vienna debate). Political agreement is likely to require measures that create some immediate and observable improvements for the debtor countries that bear the full burden of austerity and experience political mobilization against it.

[8] There might be further options arising from splitting the Euro area into various subsets of countries that would respond differently (see Dirksen et al. 2013).

[9] Whereas the goal of the systematic reform is clear - making the heterogeneous Euro area stable and viable for the long term - there are many proposals of specific instruments to achieve this goal. The paper notes a number of them without endorsing any single technical specification.

Enderlein argued (in Vienna debate) that Germany and other creditors are well aware that the Euro area cannot survive in the current set-up. They will trigger some negotiation process at the onset of the Junker's Commission after the May 2015 elections in the UK. Between mid-2015 and 2016 there will be a period without any pre-scheduled election campaign in any major EU country so political leaders may be able to focus on Euro area reforms. The negotiations could be finished after the 2017 elections in Germany and France and adopted by the end of the Commission's mandate in 2020. The political feasibility of systematic reforms could be enhanced by their smart design (see section 7) and we can expect that debtor and creditor governments will be prepared to compromise, although the negotiations may start with seemingly irreconcilable positions. One option for keeping the Treaty change demands reasonable is to formulate the systematic reforms as a Euro area 'mini-constitution' based on Article 137 of the Treaty on the Functioning of the European Union.[10]

b) Incremental reforms

The Eurozone will become complacent with the current stabilization and will avoid further systematic reform due to conflicting interests among its members. The debtor states will have to continue internal devaluation - reducing wages, public budgets and implementing structural reforms - as dictated by the Troika and accepted within the European Semester without any relief from the asymmetric crisis. The creditor states will bear risks though the ESM, ECB and TARGET2, but will otherwise benefit from an undervalued exchange rate that supports growth and employment in their export sectors. Reforms will be limited to the smallest increments responding to the most urgent threats.

This scenario is essentially a continuation of the current approach. However, the absence of systematic reforms leaves the Eurozone vulnerable to political and economic shocks for a pro-

[10] Article 137 refers to the protocol number 14 on the Euro Group. Although from the legal point of view protocols are part and parcel of the Treaty, their amendments tend to be easier to agree upon, as long as the change remains broadly within the intended purpose. The change of a protocol is thus not perceived as a reopening of the Treaty negotiations.

tracted period of time. This scenario assumes that systematic reforms can be eventually implemented in small increments over a long period of time without any major political or economic disruption that could derail this process.

The principal difference between the systematic and incremental scenarios is in timing.[11] The former expects systematic reforms to be completed within five years or so, whereas the latter is open-ended and essentially reactive, as each successive increment of reform is likely to follow a next crisis scare.

It is of course impossible to predict what kind of social, political or economic shock may cut the incremental scenario short. However, political risks seem to be the most likely source. The asymmetric distributional consequences of the Euro crisis management destroy the future prospects of a generation in some debtor countries (as noted by both Scharpf and Enderlein in the Vienna debate). The recent national and European elections confirmed the increasing tendency of a protest vote in both creditor and debtor countries (see Treib 2014). Although it proved possible to form coalitions that are permissive to ongoing incremental reforms on national and European levels, this can change in any of the next elections. A single anti-Euro government in any Euro area country or any other shock may end the incremental reform process and shift the Euro's future to one of the crisis-induced scenarios.

c) Shock-induced systematic reform

Unforeseen events may destabilize the current status quo and force in the postponed systematic reforms. Such an event may be one of the many 'known unknowns', including the election of an anti-Euro national coalition, massive banking losses revealed by the ECB stress test, finan-

[11] An additional difference might be that the systematic scenario makes stronger assumptions about our understanding of the necessary reforms. The incremental scenario allows for gradual adaptation of reforms as policymakers begin to better understand the inner workings of the Euro area in crisis. It is akin to the "crossing the river by feeling for the stones", i.e. the gradualist reform strategy, whereas the systematic reforms scenario has a stronger element of blueprint-based shock therapy.

cial losses due to the escalation of sanctions on Russia or any unexpected instability in the global economy perhaps due to the end of the US quantitative easing. Any such event may disrupt the current stability and restart the full-blown Euro crisis as the incomplete stabilization mechanisms may be overwhelmed again.

The return of the 'hot' crisis could break the stalemate and enable postponed systematic reforms. Under the extreme pressure of crisis political actors may be prepared to accept solutions they were not (yet) accepting during the negotiations on systematic or incremental reforms, perhaps in the hope that such a solution would gain output legitimacy by virtue of stabilizing the crisis situation. This requires the systematic reform agenda to be well-defined and capable of resolving the issues that induced the crisis, so that it can be adopted and implemented without delay. However, the obvious risk of the shock-induced systematic reform is that under potentially extreme time pressure, some minor mishap can transform this scenario into a shock-induced break-up.

d) Shock-induced break-up

Much of the debate on the Euro's future rests on the assumption that social, political and economic costs of its dismantling are prohibitive. Hence, any way of keeping the Euro together - save for those that breach the fundamental democratic values - is expected to be better than a break-up. However, if any of the reform scenarios fail to materialize, the Euro area might be unable to contain the next major shock and still be forced to break up, either in parts or altogether.[12]

The Euro was deliberately designed as irrevocable and its legal framework thus provides no mechanism for organized dismantling (Athanassiou 2009). There is no procedure for re-

[12] There is no accepted definition of 'the break-up'. Most often it refers to either a multilateral split of the Euro area into two or more currencies or the unilateral exit of one or more countries (see Athanassiou 2009). However, it is less clear whether measures that differentiate among Euro area countries by imposing capital controls or limits on cross-border deposit withdrawals or parallel currencies amount to a de facto Euro break-up or not.

denomination of all existing contracts into successor currencies, no legal option for the Eurozone exit without exiting the EU, no procedure for handling consequent bank runs or failures and no way for the inevitable suspension of the four freedoms.[13] Any break-up or unilateral exit would thus trigger drastic costs, extreme legal uncertainty and the potential for intense political conflicts, overshadowing Europe's future for generations.

In principle, developing a pre-agreed break-up procedure could reduce these risks, but doing so is difficult. Any official debate to this end could trigger a self-fulfilling dynamic in financial markets - as more actors take the break-up scenario seriously, more of them panic and try to 'cut and run', resulting in a spiral of increasing likelihood of a break-up. Any such debate within official institutions also undermines the ECB President's pledge to “do whatever it takes to save the Euro" that is one of the essential pillars of the current stabilization. However, that does not preclude academic and think-tank research.[14]

The public debate on break-up scenarios is limited to negotiated scenarios (see Bootle 2012, Kawalec and Pytlarczyk 2013) that are underdeveloped and offer no solution to the self-fulfilling conundrum - they assume actors will postpone panicking until a negotiated break-up procedure can be agreed upon. Apart from this research, there are only contingency plans developed by private actors addressing individual aspects of a break-up (see Deo et al. 2011, Buiter 2011). Nothing approaching a systematic blueprint had appeared in the public domain by the time the break-up fears subsided after ECB's interventions in summer 2012.[15]

However, there are still reasons to explore various unorthodox ideas for a 'non-total' break-up

[13] There are rules for temporary limitations of the freedom of movement of people and capital. The latter have been used as part of the Cypriot crisis management package (see IMF 2014).

[14] The EU and IMF officials admitted to having a "Plan Z" - a detailed script for the event of collapse of Greece's banks in mid-June 2012, when there was a distinct possibility of an anti-Euro coalition arising from repeated elections (Spiegel 2014). However, the insiders stressed that the plan did not extend beyond the banking sector; they did not address the possibility of Greek exit from the single currency (Spiegel 2014).

[15] The subsequent debate ventured into the question of whether the creditor member states, not the debtors, might be better positioned to exit the Eurozone (see Soros 2012, Sinn 2013).

that may reintroduce some degree of macroeconomic diversification and flexibility, even if at the cost of restrictions on the four fundamental freedoms. The stabilizations of Cyprus and Iceland included the introduction of capital controls while these countries remained within the Euro area and the single market, respectively.[16] Similarly, temporary capital controls might facilitate the introduction of parallel currencies in the debtor countries (Scharpf in the Vienna debate; Meyer et al. 2011).

The Euro area reforms to date have introduced a possibility for differentiation in the form of macroprudential supervision overseen by the European Systemic Risk Board. However, this is a tool designed to support financial stability.[17] It is unlikely to generate macroeconomic effects comparable to independent regulatory policy. Hence, the Euro area still lacks tools for macroeconomic differentiation other than austerity, internal devaluation and structural reforms that fuel political backlash against it (Scharpf in Vienna debate).

In short, the break-up option may not be excluded entirely, as long as the cumulative costs of the current asymmetric stability are increasing and systematic reforms are marred by political stalemate. This may alter the perception of the break-up's costs and benefits in debtor and creditor countries alike, inducing some important actors to reconsider their support for crisis management policies (Scharpf 2014:17).[18] All the more reasons for having a more refined understanding of break-up alternatives.

The probabilities of the occurrence of any of the above four scenarios are anybody's guess because the future of the Euro remains fundamentally uncertain. However, it is possible to im-

[16] Iceland is part of the European Economic Area and hence part of the EU's single market.

[17] Available macroprudential tools rely primarily on more restrictive financial regulation for overheating markets. However, within the single market, such differences will be 'arbitraged away' (Enderlein in Vienna debate), for example, by banks offering cross-border loans and transnational firms borrowing through subsidiaries in other countries where the more restrictive rules do not apply.

[18] For example, securities issued by debtor countries have moved from the private sector balance sheets to the ECB that accepts them as collateral (see Merler and Pisani-Ferry 2012 for discussion). This is a difference compared to 2012 that may marginally reduce banks' fear of a break-up.

prove the chances of systematic reforms by identifying the necessary minimum of changes and maximizing their political acceptability across the divided Euro area while also cautiously preparing for the event of their failure. In short, the thinking about the Euro's future needs to address the three distinct challenges of heterogeneity, political feasibility and uncertainty that are discussed in the next three sections.

6. Accommodating heterogeneous economies within a single currency

The ***Economic and Monetary Union*** was widely expected to make its member countries more homogeneous (Scharpf in Vienna debate). However, during its first decade, structural characteristics of member economies did not converge and their ***macroeconomic and financial parameters diverged.*** This increased ***heterogeneity*** prevents the EMU from meeting the optimal currency area requirements that facilitate a smooth functioning of multiple economies using the single currency. If there was an opportunity to reconstruct the Euro area from the ground up, the ideal solution would be to only include the more homogenous core countries (Scharpf and Enderlein in the Vienna debate). However, since there is no easy way to dismantle the Euro, ***defining*** precisely which ***macroeconomic and financial institutions*** need to complement implemented reforms remains the key challenge.

Throughout the crisis, the dominant approach to problems caused by heterogeneity was increasing ***centralization of macroeconomic and financial policies***. This has brought the current level of stability, imposed a set of objectives on debtor countries and created numerous new tools for the prevention and management of future crises (see section 2). However, the centralized policy framework still lacks clear answers to several important issues including a) the effectiveness of the real exchange rate channel as a mechanism preventing macroeconomic imbalances among structurally heterogeneous countries, b) the kind of cyclical adjustment mechanism that could support faster adjustment to shocks than the real exchange rate channel, and c) the functioning of the new policies and instruments in the creditor/surplus countries, given that were designed primarily with debtor/deficit countries in mind.

a) Real exchange rate channel: slow and for integrated sectors only

Countries with their own currencies and monetary policies adapt to asymmetric shocks primarily through changes in interest and exchange rates. However, the Eurozone members need to accept the one-size-fits-none rates set by the ECB; therefore, ***the most straightforward way of adapting to cyclical divergences is the real exchange rate channel*** (see Enderlein et al. 2012).[19] This means that in those economies where the ECB's rate of interest is too low, prices increase faster, thus motivating economic actors to shift to the other Eurozone economies for which the ECB's rates are too high (thus keeping the prices at a relatively lower level). Consequently, investment and financial flows motivated by price differentials between the two sets of countries should prevent the build up of excessive imbalances and thus improve the stability of the Eurozone.

The effectiveness of the real exchange rate as a main balancing mechanism for heterogeneous regions of the Euro area is undermined by its slowness and limited by its concentration on export sectors. The destabilizing effect of the one-size-fits-none interest rates propagates through the economy very quickly, in a matter of weeks or months, while it takes two to three years before investors and consumers respond to price differentials signaled through the real exchange rate (Enderlein et al. 2012). Moreover, only sectors that are fully integrated within the European economy are sufficiently sensitive to price differentials (Scharpf and Enderlein in Vienna debate). These are primarily the export sectors that represent a rather small proportion of the economy in some of the debtor countries.[20] In contrast, the large, less integrated sectors that rely on country-fixed endowments such as real estate or nation-specific skills of

[19] The real exchange rate (RER) compares prices of the same product in two regions. A famous example is the Big Mac index that compares prices of sandwiches in different countries. If a Big Mac costs 3 Euros in Spain and 4 Euros in Germany, then the Spanish/German real exchange rate is 3/4 (0.75), suggesting than one can get more of the product for one Euro in Spain than in Germany. This is an opportunity for arbitrage, i.e. producing more of a product in Spain and selling it in Germany until the RER becomes 1 (the simple example ignores transport and other transaction costs). The RER illustrates the logic that lower production prices in one EMU region should attract more investments and thus stimulate the economy of this region.

[20] In fact, in some of the crisis countries (e.g., Spain and Ireland), the rise of unit labor costs in the export sector was significantly below the national averages – with the effect that export performance did not really suffer. Thus credit-financed demand affected mainly wages and prices in the sheltered sectors – and of course imports (Scharpf in Vienna debate).

professions such as teachers, doctors and civil servants, are not sensitive to price differentials (Scharpf in Vienna debate, Enderlein et al. 2012). Hence, the structural differences among Eurozone economies are likely to reduce the effectiveness of the real exchange rate channel, especially in countries that export primarily low-tech products to mature markets (see Wiertz et al. 2013).

Structural reforms could make all sectors more responsive to the price differentials signaled by the real exchange rate fluctuations, but these are politically difficult and take a lot of time to implement. Deepening the single market in services, removing barriers to professional mobility and other supply-side policies could improve the effectiveness of this channel (Enderlein et al. 2012). Similarly, reforms of industrial relations regimes that relate wage developments in sheltered sectors to those of export sectors would also be useful. However, the need for structural reform on the national level does not make systematic reforms of the Euro area more politically feasible (Gros et al. 2014). Making all sectors responsive either through supply-side reforms or through developing an Austria-like social partnership regime requires heavy political investments and a lot of time.[21] Indeed, the former 'soft currency' economies, today's debtor countries, progress very slowly with the structural reform imposed by the Troika. Hence, the deep-rooted structural and institutional heterogeneities make large and speedy adjustments through the real-exchange rate channel unrealistic in most countries (Scharpf in Vienna debate). Ireland with its export-focused economic model may be the possible exception.

b) Automatic cyclical adjustment supporting the real exchange rate channel

Due to the above limitations, the real exchange rate channel can never be the only adjustment mechanism to asymmetric shocks within the heterogeneous Euro area (Enderlein et al. 2012). It needs to be complemented by other policy tools that generate a faster response (Enderlein in

[21] Moreover, preconditions for the development of social partnership arrangements have been undermined by the union-busting conditionalities imposed by the Troika on debtor countries (as pointed out by Scharpf).

the Vienna debate, Furceri and Zdzienicka 2014).[22]

The new European Stability Mechanism can serve this function to a limited extent, as it is a discretionary arrangement reserved for crisis situations only. A long-term systematic solution requires a more preventive and automatic mechanism that would not require an extraordinary summit of EU leaders any time it is about to be used. The more discretionary proposals for such a mechanism include the ***European Monetary Fund*** or the ***European Debt Agency*** overseeing some financing mechanisms such as Euro bills or Eurobonds (see section 6). More automatic mechanisms include the ***cyclical shock adjustment funds*** or ***common Euro area unemployment insurance***. The common aspect of any such a scheme is the requirement for the joint fiscal backstop, which is the single most politically contested issue in the Euro reform debate. Hence, good criteria for selecting among these proposals might be their political feasibility (see section 7).

If any of the proposals for Euro area-wide automatic stabilizers had been adopted in 1999, they might indeed have prevented the crisis. If they are adopted now as tools intended to deal with the structural consequences of the crisis, they will still have a number of advantages but also notable risks. They would provide the single currency with a more agile tool to prevent and manage asymmetric economic shocks and, if based on some kind of Euro bond, also a new safe asset capable of improving the transmission of monetary policy, liquidity and stability of financial markets (Enderlein in the Vienna debate). However, there would always be a risk that the temporary adjustment funding becomes a permanent subsidy from the stable creditor countries to the struggling debtors.[23] If the recipient countries fail to return to a growth path, the cyclical problems become structural and it may always be the same countries on the receiv-

[22] Ideally, such tools would have prevented the build-up of imbalances during the first decade of the Monetary union by stopping the credit-financed overheating of domestic demand and imports in Southern economies as well as the decline of domestic demand and the rise of export surpluses in Northern economies (Scharpf 2013).

[23] The US unemployment insurance, for example, is designed as a balanced-budget trust fund, but often receives permanent 'emergency benefits' from Congress that are financed through the federal budget but practically amount to permanent grants financed by the wealthier states (Dullien 2013). This illustrates that even a scheme designed as temporary and balanced exposes creditor states to the political risk of permanent grants.

ing end. The creditor countries are aware of the risk; hence, the political feasibility of any proposal for the automatic cyclical adjustment mechanism depends on its capacity to avoid creating some kind of 'European Mezzogiorno' – states permanently dependent on European subsidies. This may be difficult, if not impossible, as there is no fail proof way of committing the future political representations to the past commitments (Scharpf in the Vienna debate).

c) Application of the new policies in the creditor countries

The ***new centralized framework*** implemented to date (see section 2) imposes clear expectations on the debtor countries. However, its ***impacts on the economic policies of creditor countries are much less discernible***. The six- and two-pacts focus on deficits much more than on surpluses, be they on the balance of payments or government accounts (Gros and Busse 2014). The Commission (2014b) asked Germany to reflate its economy, but the response was negative, not least because there was no obvious way of increasing the domestic demand under the circumstances (Scharpf in Vienna debate). Consequently, while the centralized rules impose a system of competitive internal devaluations on debtor countries, there are no corresponding measures imposed on creditor countries that could stimulate external demand for debtors' exports (Scharpf in Vienna debate). This asymmetry only strengthens the case for the cyclical stabilization mechanism.

Overall, there are apparently workable policy proposals for systematic reforms, which could ensure the stability of the heterogeneous Euro area. Their implementation in 1999 could have prevented the Euro crisis and their timely adoption in the near future could support the Euro area's long-term stability. A deepened single market might prevent a build up of macroeconomic imbalances through the real exchange rate channel, while the short-term stabilization could be achieved by a cyclical adjustment mechanism backed by common fiscal resources. However, as remedies for the present crisis, these mechanisms are not free of risks.

The debate also raised serious criticisms suggesting that such measures do not adequately respond to the depth of the economic and social crises on Southern societies. In the political process, however, they have the advantage of building on the centralizing reforms implemented to date and being reasonably well-specified, which makes them more likely blueprints for the Euro's future than underdeveloped proposals for federalization or differentiation. Nonetheless, whether these systematic reforms can be implemented given the current political divides remains the crucial question.

7. Increasing the political feasibility of systematic reforms

In principle, there is a good ***potential for political agreement on systematic reforms***. The debtor countries wish to share the burden of adjustment while the creditor countries want to ensure the long-term viability of the Euro area (Enderlein et al. 2012, Belke 2013). This opens the opportunity for agreement on cyclical adjustment funding in exchange for systematic reforms on the EU and national level (Enderlein in Vienna debate, see also section 5a). The negotiations of the minimalist banking union have also demonstrated that functional compromises can be adopted despite the political divisions.

However, an overly ambitious reform agenda can prevent adoption and implementation of necessary reforms. The 'Four Presidents' report (Council 2012) on the path towards the genuine economic and monetary union and the associated Commission blueprint (2012c) present a very ambitious vision for the integrated budgetary, economic and legitimacy frameworks. It would eventually require a major overhaul of economic and political institutions, some form of a common budget and a Treaty change (Belken 2013, House of Lords 2014). This is a very tall order given the extent of political divisions (see section 4). At the same time, these blueprints were focused primarily on the last two years of the Barroso Commission and the long-term goals were outlined expansively but without any specific details (see Commission 2012c). This task is left to the upcoming Junker's Commission, who has so far only reaffirmed the commitment to the 'Four Presidents' blueprint (Juncker 2014, Council 2014).

The new Commission may base a specific design for the adjustment mechanism on any of the existing proposals. However, these differ in their scope and ambition, which is likely to influence their political feasibility. The blue/red bond proposal (Delpla and von Weizsäcker 2010)[24] mutualizes Euro area debt at about 30 percent of its GDP, whereas the similar proposal from the French ministry of finance proposes 10 percent (ADD SOURCE), while the proposal for the cyclical adjustment insurance (Enderlein et al. 2013) or common unemployment insurance (Claeys, Darvas and Wolff 2014) suggest a fiscal backup of about 2 percent of Euro area GDP. The more ambitious proposals might be plausible if there is some opportunity for a 'grand bargain' on systematic reforms, but the continued incrementalism favors the smaller-scale proposals.

Related to the political feasibility of reforms is the legitimacy of the decision-making regarding the use of the new stabilization instruments. This is an important concern after the experience when the Troika, composed of experts from the Commission, ECB and IMF, imposed strict austerity policies on five member states without much democratic accountability (see section 4). The experience motivated calls for a political union or even the 'United States of Europe' that were quickly seized by Eurosceptics, who exaggerate the extent of necessary reforms in order to illustrate the futility of even trying (as pointed out by both Scharpf and Enderlein in Vienna debate). However, rather than a federation, the Euro area needs a multi-level governance arrangement that handles those aspects of economic policies that need to be centralized on the supranational level while keeping all other aspects on the local level close to the primary sources of political legitimacy (Enderlein in Vienna debate). The Euro area needs a ***sui generis federalism*** that is built in response to functional necessities (Scharpf and Enderlein in Vienna debate) and is not necessarily modeled on existing federations that tend to redistribute much more than necessary within the Euro area (Enderlein in Vienna debate).

[24] The Commission (2012a) blueprint notes this proposal under the heading of a redemption fund, which mutualizes all debts above the 60 percent of national GDP.

Some of the adjustment mechanisms, such as cyclical or unemployment insurance, can function as automatic stabilizers without any discretionary decision-making. Their legitimacy is then derived from the Treaty and ordinary legislative procedure used to adopt these rules. These schemes may, at least in principle, be designed to balance their budget every year and, over the long-term, balance the contributions with withdrawals.[25] For example, Enderlein, Guttenberg and Spiess (2013) calculate that, for the 1999 to 2014 period, the cyclical adjustment insurance fund that they propose would have been close to a net-zero financial position for almost all Euro area countries.[26] A well-designed common unemployment insurance could share some of these properties that allow for short-term solidarity while limiting long-term redistribution that would not be acceptable without robust input-oriented legitimacy.

Nonetheless, policy instruments that involve discretionary decisions require an ongoing source of democratic accountability and legitimacy. These include the European Monetary Fund that could replace the Troika in managing adjustment programs or the European Debt Agency that could manage any mutualized debts - in whichever form of redemption fund bonds, stability bonds, Euro bills or any other type of Euro bonds. The degree of democratic legitimacy of such bodies could be improved by a dedicated subcommittee of the European Parliament that could also include some national parliamentarians (Enderlein in the Vienna debate). This would be formally consistent with the practices of most member states that tend to delegate such matters to (independent) regulatory authorities accountable to the governments or parliaments (see section 4).

Inevitably, there is a trade-off between the speed of the functional response to the Euro crisis

[25] Enderlein refers to this scheme as 'federalism by exception', because as long as the economic cycle is symmetric in all Euro countries, there is no sharing of resources to balance cyclical asymmetries (Enderlein in Vienna debate).

[26] The fiscal neutrality over time assumes that the distribution of asymmetric shocks - departures from Euro area average trends - is approximately random. That may be the case over the long-term counted in decades. At shorter time horizons, a subset of countries consistently underperforming the rest would be always on the receiving end, which would undoubtedly invoke the 'Mezzogiorno' arguments and undermine the political sustainability of the scheme.

and the input-oriented legitimacy of reforms and the new policy instruments. However, postponing systematic reforms until the EU makes major progress towards the political union also means prolonging the period of vulnerability when the Euro area still lacks policy instruments to respond to political and economic shocks. Developing federal-like democratic structures, including some kernel of a Euro area ministry of finance, will be a long process that is more likely to succeed during the period of stability and prosperity than amongst the divisive legacies of the crisis.[27]

In summary, minimizing the reform agenda by relying on relatively small-scale, automatic stabilizers can improve the chances of systematic reforms being adopted. Similarly, submitting new bodies and instruments to the European Parliament's oversight also improves the chances of timely adoption of reforms that are fundamentally in mutual interests of all Euro members. The reforms should include clear commitments to further political reforms, but conditioning them on the progress of the political union could unduly prolong the period of vulnerability when the Euro area is exposed to shocks without adequate response tools.

8. Preparing for the uncertain and unexpected

The bold decisions from the June 2012 summit that took place at the peak of the crisis paid off. The Euro area is stabilized, the banking union is largely in place and the debate moved from break-up scenarios to technical details of various reform proposals. However, the economic legacies of the crisis in terms of unemployment, poor growth, and bad assets in banks still linger. So do their political consequences in terms of conflicts between creditor and debtor states as well as undermined legitimacy and trust within the European Union. The systematic reforms are far from over and may yet prove too little too late in the face of the next bout of crisis. Fundamentally, the future of the Euro still remains shrouded in the high degree of uncer-

[27] The potential divisiveness of attempts on increased politicization of the EU institutions was demonstrated by the case of 'Spitzenkandidaten' for the EP groups. They very largely ignored in national campaigns (Treib 2014), but became a source of bitter dispute regarding the new Commission President, which in the end deepened the divide between the UK and the rest of the EU.

tainty and it is premature to abandon any thinking about the adverse scenarios.[28]

In principle, the Euro's future could be decided by a simple empirical criteria that compares the expected costs and benefits of a break-up with the expected costs and benefits of systematic reform (Enderlein in the Vienna debate). The extent of uncertainty over the outcomes of alternative actions and scenarios and the unresolvable conflicts over the relative valuation of these outcomes certainly prevents any meaningful estimation of such costs and benefits. The Euro area is too unique, with hardly any historical or contemporary parallels which could help with such estimation. However, the comparison of costs and benefits is still a useful thought experiment and also a reminder that as uncertainty recedes in time, the perceptions and valuations of cost-benefits may change.

Nonetheless, the Euro area reform debate presently assumes that the costs of break-up are so catastrophic that stabilization and reforms should be done at practically any costs (Scharpf in Vienna debate). Indeed, as far as it can be estimated, the costs of the Euro area break-up would be drastic, including bankruptcy of banking sectors, reintroduction of capital controls and beggar-thy-neighbor policies, conflicts over redenomination of an astronomic number of contracts (Deo et al. 2011, Buiter 2011) and a possible collapse of the basic EU infrastructure developed over the last six decades. However, living with the asymmetric consequences of crisis management and reforms to date may also turn very costly, thus making more and more actors in debtor countries less and less scared of the break-up scenario. This can undermine the coalitions backing Euro survival and related reforms in each member state.

Moreover, the future of the Euro is going to be influenced by many other 'known unknowns'

[28] Uncertainty in this context is understood as incalculable risk that is difficult to manage and prepare for. Nelson and Katzenstein (2014) show how market actors and economic policy-makers rely on social conventions when uncertainty prevents rational calculations. However, the EU actors have not developed any conventions and experiences with differentiation and disintegration of economic policies, which makes research on an unorthodox alternative even more important.

that can derail its stabilization and systematic reforms: election of an anti-Euro government, shifting perceptions of the break-up costs as risks move from the private to the public sector, increasing secession and geopolitical risks, and withdrawal of unorthodox central bank policies are just a few examples. These are the low-probability high-cost events, so-called 'black swans' that may quickly exhaust the capacity or willingness of some Euro area actors to support ongoing policies. Moreover, there may be some 'unknown unknowns', events that can alter the course of European history by forcing the Euro's break-up. All these call for exploration of unorthodox responses.

A high degree of uncertainty also exposes the Euro debate to arguments based on ideological claims and subjective beliefs (Scharpf in Vienna debate). On the one hand, the uncertainty over the costs and benefits of Euro reforms can be used for scaremongering about the consequences of the Euro break-up, thus justifying any measures that preserve the Euro area practically at all costs. On the other hand, the uncertainty can be employed to promote break-up scenarios by claiming without any evidence that the resulting chaos will be short-lived and not so costly and disruptive as is at times assumed. The most likely consequence of such unfounded claims is the indecisiveness that postpones reforms and keeps the Euro area vulnerable to shocks.

At the same time, the uncertainty should be taken seriously as the probability of something going horribly wrong will never be zero. It therefore may seem prudent to think about unorthodox alternatives to the systematic reforms, as they can provide novel adaptation mechanisms, or, as the last line of defense, help to prevent the Euro break-up from tearing down the rest of the EU architecture. The list of unorthodox policy ideas that may deserve further research includes parallel currencies (Scharpf in Vienna debate, Melitz 2014, van Suntum 2013, Mayer 2012, Meyer et al. 2011; James 2011), electronic currencies with negative interest rates (Rogoff 2014, Buiter 2009), extensive use of macroprudential policies to differentiate country-specific bank deposits (following the Cypriot case), or various scenarios for negotiated dismantling (Bootle 2012). Measures implied by these ideas are likely to be incompatible with free movement of capital, at odds with the single market and outright illegal under the Treaty (as argued by Enderlein in Vienna debate), but ignoring them altogether may amount to excessive complacency.

An important counter-argument is that the exploration of unorthodox differentiation measures and 'non-total' break-ups by the official EU institutions would not be perceived as a signal of confidence in Euro (Enderlein in Vienna debate). However, unaffiliated research institutions can do this research so it is unlikely to trigger some self-fulfilling crisis dynamics in financial markets or public opinion. Various aspects of differentiation policies are discussed anyway, albeit not systematically, and academic theories of differentiation within non-optimal currency areas are not so easy to hijack by Eurosceptic politicians, tabloid press, market actors or whoever may wish to stir some panic.

CONCLUSION

The fundamental choice in the debate on the Euro area's future appears to be simple: for or against the Euro. However, hardly anyone is willing to argue against the Euro, because of the obviously drastic costs of its break-up.[29] Hence, all the attention is focused on the reforms of the Euro area that would make it stable and viable. Yet this does not mean that the failure of reforms can be completely disregarded. Whether the Euro area should prepare for such a possibility by ***studying unorthodox measures*** like parallel currencies is one of the two '***agreements to disagree***' yielded by the 2014 Vienna debate on the future of Euro. The advantage could be more policy options for macroeconomic differentiation and potential for damage control (Scharpf in Vienna debate), while the disadvantage is the potential danger of triggering some self-fulfilling panic in media and financial markets (Enderlein in Vienna debate).

[29] One reason is that the question for or against Euro often gets conflated with the separate question of for or against a prosperous, peaceful and democratic Europe (as pointed out by Scharpf).

The ***second disagreement*** is rooted in a consensus that there are reforms that might have prevented the Euro crisis and could help to make the Euro viable in the long-term. Whether they could also resolve the present social and economic crises and whether they can by implemented at all is disputed. Their ***timely implementation may be impossible***, due to deep structural and political divides between the debtor countries that bear the brunt of crisis adjustment costs and the creditor countries that benefit from the current stabilization. The unemployment and stagnation are destroying the prospects of the young generation in debtor countries and the key question is whether proposed reforms can improve the situation before some kind of political or economic upheaval pushes the Euro area towards the crisis-induced break-up. In the 2014 Vienna debate, Henrik Enderlein argued that necessary reforms have good prospects while Fritz W. Scharpf remained skeptical.

The two agreements to disagree might possibly be reconciled on the level of ***policy prescription***. The vulnerability of the Euro area to economic and political shocks can be reduced by ***minimizing the systematic reform agenda*** in order to ***increase the political chances*** of its timely adoption, while also ***exploring unorthodox differentiation*** and break-up scenarios. These three steps can be done at the same time (as long as the study of the latter does not undermine the current stability) and history will tell whether systematic reforms will preempt any use of unorthodox ideas.

The policy blueprints for the systematic reforms range in their ambitions from federal Europe, through 'genuine economic and monetary union', to the minimalist proposals of 'federalism by exception'. While overly ambitious proposals serve more as Eurosceptic straw men illustrating the impossibility of Euro reforms, the ***minimalist proposals come closer to meeting the criteria of political feasibility***. The latter outline pragmatic solutions comprising a now nearly complete banking union and deeper market integration complemented with some jointly-financed cyclical adjustment mechanism in the form of common unemployment insurance or cyclical adjustment fund. Such measures are in the common interest of both the creditor and debtor states that can equally benefit from them over the long-term. This opens a possibility for the agreement on systematic reforms either in one 'grand bargain' or in small increments over time or perhaps even under extreme pressure of the next bout of crisis.

However, any reforms will follow in the steps of technocratic crisis management that brought austerity and unemployment. The legitimacy of Troika policies is questioned in debtor and creditor states alike and there is a ***strong demand for increased democratic accountability*** of those who decide on and implement the new policy instruments. Their output-generated legitimacy is likely to remain limited, since the return to prosperity seems to be gradual at best. Hence, the semblance of input-oriented legitimacy needs to be improved at least by ***increased oversight of the European Parliament***.

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