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EU Assurance & Co.

Social welfare should remain in the hands of member states. But if all goes awry, the EU can help spread the risk

France will be led by a woman, either me or Mrs Merkel, quipped Marine Le Pen. It was one of the best punchlines of her campaign. President Macron indeed promised his first visit to a foreign leader would be to Merkel. He will be the fourth French president she has welcomed in Berlin since becoming Chancellor. But, as Le Pen indicated, such a visit is fraught with risk. Macron's proposed policies on eurozone reform, including joint eurozone bonds, and a common eurozone budget and finance minister, are deeply unpopular in parts of Germany, not least in Merkel's CDU. Social democrat leader Martin Schulz, however, has welcomed these suggestions. Macron does not have a majority in parliament yet. And before the Germans elections in September, there is no room for manoeuvre anyway. So president Macron should plan for the long term.

President Macron can expect a warm welcome in Berlin, which favours his pro-European agenda. His policy chief, Jean Pisany-Ferry, has worked closely with influential German economists such as Hendrik Enderlein of the Hertie School of Governance. Even the SPD all but officially backed his candidacy. And it is in the German interest that Macron succeed so Le Pen doesn't bounce back at the next presidential election. There's a temptation for Macron to cash in quickly on his new popularity by unlocking investment (e.g. through military cooperation), finalising the Banking Union with a deposit guarantee scheme, restructuring Greek debt and pooling competences under a new eurozone minister.

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But Germany and France differ fundamentally in their views on macroeconomic governance. A quick political compromise would lead to instability in the Eurozone. The French model favours direct financial help for struggling member states, short-term responses to crises, political intervention, demand-side management and shuns painful austerity measures and wage cuts. The German view

favours discipline, long-term reform, a rules-based approach, supply-side management and eschews moral hazard. Or as Brunnermeier, James & Landau put it in their book *The Euro and the Battle of Ideas,* 'the French are better at dealing with crises, the Germans are better at preventing them'.

Insurance for the insurers

So what proposal should Macron bring to the Kanzleramt? I would recommend a reinsurance model for the Eurozone. Reinsurance is a concept well understood in Germany, and it runs thus: while most insurance companies can deal with a normal distribution of risk, a major disaster on a large scale could make them go bankrupt. So they themselves purchase insurance from another insurance company, known as the reinsurer, which agrees to pay a percentage of the claims incurred in the event of a catastrophe. The eurozone, too, is vulnerable to large-scale catastrophes. National governments, through the welfare state, act as primary insurers against social and economic risks such as unemployment, ill-health, old age or savings lost when a bank fails. But when the banking system itself collapses, as happened in 2008, and a deep economic crisis sets in, member states are completely exposed. Under current EU rules, the only way countries can make themselves more competitive is through wage devaluation and austerity, which only adds to hardship. And individual countries within the eurozone cannot devalue their own currency as Sweden and Britain have in the past. Equally, the no bail-out clause (Article 125 of the Lisbon treaty) makes it illegal for one member to assume the debts of another. Without some kind of reinsurance mechanism, our European welfare states will no longer function in a disaster, and it will be citizens who bear the losses. The only choice left then is between accepting social hardship and exiting the eurozone. Such a choice would provoke a democratic backlash against the EU. The eurozone cannot survive a repeat of the euro crisis.

A eurozone reinsurance scheme would offer a third choice: direct, targeted and automatic extra funding in the case of a sudden crisis, combined with a responsibility to act prudently at all other times. It would combine the best of both French and German economic policy. It would ensure better crisis management and prevention.

I see three areas where the reinsurance model could deliver a breakthrough: the deposit guarantee scheme, the stability mechanism and the European unemployment insurance scheme, all of which are currently under discussion or negotiation. Each requires a European fund

of last resort. Such a fund could be financed through 'reinsurance premiums' paid by member states, which could vary according to the risk these states represent. Each scheme would also require social and fiscal convergence in order to minimise the risk of having to pay out. These convergence rules would lead to more efficient and effective functioning welfare states.

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I favour a Eurozone reinsurance model instead of a single European welfare state for two reasons. Firstly, the Germans have a point: in normal times, responsible behaviour by national welfare states would be enough to stay out of financial trouble. But we in the eurozone need better management in times of crisis. Secondly, it is inconceivable that any European social welfare scheme will be as comprehensive as our national welfare states. Nor does it need to be. Our welfare states have by and large done a pretty good job of matching social progress with economic growth. They don't need replacement: they need convergence and reinsurance.

A convergence and reinsurance model requires a paradigm shift in the way we think about the European Union. It would mean the national welfare state becomes a tool in preserving peace throughout the union, it would enforce the internal market and stabilise the common currency. It is a fitting supranational answer to the demand for a more social Europe. It would increase solidarity in the EU without the need for permanent transfers. It would encourage national welfare states to provide decent social protection, enhance social investment and harness globalisation. When Macron meets Merkel, the two should agree to bridge their differences and reinvigorate the EU project, starting in 2018 – whoever becomes chancellor.



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