Euro area macroeconomics, where do we stand twenty years later?

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ABSTRACT

For almost 20 years, euro area countries have been sharing a single currency. The drawbacks of the euro area framework were highlighted by the widening of imbalances prior to the 2007 financial crisis, and thereafter by the huge impact of the financial crisis, the public debt crisis in Southern countries, and the great recession. Prior to and after the crisis, EU institutions and Member States have not been able to implement either a common economic strategy, or satisfactory economic policy coordination.

This did lead neither to a burst of the euro area, nor to a substantial change in its functioning. Euro area institutions were adapted, through the European Stability Mechanism, the fiscal treaty, the “first semester”, the European Central Bank’s support to MS, the banking union. These adaptations were painful.

In mid-2018, the economic situation had clearly improved at the euro area level. However, the following question remains unsolved: can the functioning of the euro area be improved, accounting for divergent situations, interests and views in MS?

Section 2 recalls proposals from EU institutions and from MS. Section 3 presents and discusses several economists’ viewpoints and proposals to improve the euro area policy framework. Some economists rely on financial markets to control domestic economic policies, some are in favour of the introduction of a euro zone budget and minister of finance, some are in favour of moving towards a federal EU with increased democracy, some make original proposals to cut public debts, and last some advocate better economic policy coordination.

KEY WORDS

Fiscal policy, policy coordination, EMU governance

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Euro area macroeconomics, where do we stand 20 years later?

Section 1. Introduction

For almost 20 years, euro area countries have been sharing a single currency. The drawbacks of the euro area framework were highlighted by the widening of imbalances prior to the 2007 financial crisis, and thereafter by the huge impact of the financial crisis, the public debt crisis in Southern countries, and the great recession. Prior to and after the crisis, EU institutions and Member States (MS) have not been able to implement either a common economic strategy, or satisfactory economic policy coordination (see, for instance, Mathieu and Sterdyniak, 2014).

This did lead neither to a burst of the euro area, nor to a substantial change in its functioning. Euro area institutions were adapted, through the European Stability Mechanism (ESM), the fiscal treaty, the "European semester", the European Central Bank's (ECB) support to MS, the banking union. These adaptations were painful: Southern MS public debt remained under the threat of speculation for a long time period; economic recovery was delayed by fiscal austerity, recommended or requested by EU authorities, several MS were placed under surveillance. Greece is still in a difficult situation. This is also the case to a lesser extent for Italy. The UK chose to leave the EU. Political parties highly critical of the current policy orientation of EU institutions gained support in many MS; they came into power in Hungary, Poland, Italy.

In mid-2018, the economic situation has clearly improved at the euro area level: euro area GDP grew by 2.7% in the last quarter of 2017 as compared to the same quarter of 2016, but GDP grew on average by a mere 0.6% per year from 2007 to 2017 (against 2.3% per year in the previous decade). The unemployment rate fell back down to 8.5% (against 7.3% in early 2008, but 12.2% in early 2013). The scars of the crisis remain: unemployment rates remain elevated, especially in Greece (+12 percentage points as compared to 2007), Spain (+7.4 percentage points), and Italy (+4.8 percentage points); public debts have strongly risen; income inequalities have risen in many countries, as did precariousness; many countries (among them especially France and Italy) suffer from de-industrialisation. The following question remains unsolved: can the functioning of the euro area be improved, accounting for divergent situations, interests and views in MS?

Section 2 recalls proposals from EU institutions and from MS. Section 3 presents and discusses several economists' viewpoints and proposals to improve the euro area policy framework. Some economists rely on financial markets to control domestic economic policies, some are in favour of the introduction of a euro zone budget and minister of finance, some are in favour of moving towards a federal EU with increased democracy, some make original proposals to cut public debts, and last some advocate better economic policy coordination.

Section 2. Projects from EU institutions and from member states

EU Treaties and reforms implemented since the crisis have led to a complicated and unsatisfactory euro area architecture. Euro area economic policy is run by the ECB, a federal institution, by the

European Commission (which deals with the whole EU), by the Euro zone council and the Eurogroup (informal intergovernmental bodies), by the European Council, the EU council (intergovernmental bodies involving non-euro area countries), by the European Parliament (democratically elected, but at the EU and not at the euro area level, and with limited power), by the Fiscal Pact and the ESM (which are the outcome of inter-governmental treaties), and when needed to help and supervise MS in difficulty, by the quartet of the European Commission, the ECB, the IMF and the ESM). Main decisions are made through agreements between the EC and MS, without any real democratic debate.

This situation, the financial crisis and the Great recession, followed by the debt crisis in southern economies have initiated numerous project reforms of the EMU, by EU institutions, MS, policy makers and academics. Projects emanating from EU institutions generally tend to increase EU authorities' power. They face reluctance from MS, who wish to keep their power and some autonomy: Northern MS are against EU transfers; smaller countries wish to keep their specificity, and oppose dictatorship from larger MS and from the Commission. EU institutions generally tend to place MS under surveillance, either as concerns macroeconomic management or structural reforms, which comes in contradiction with domestic democratic sovereignty, as could be seen from the Greek crisis or Brexit. Besides, EU institutions do not want to question the Stability and Growth Pact and the Fiscal Compact, which constrain fiscal policy coordination, as they do not wish to undermine the absence of explicit coordination between fiscal and monetary policies.

Towards a deep and genuine monetary and economic and monetary union?

In November 2012, the EC released *A blue print for a deep and genuine monetary and economic and monetary union* (EC, 2012) and the four presidents (European Council, European Commission, Eurogroup, ECB) released '*Towards a Genuine Economic and Monetary Union'***,** suggesting substantial steps towards some federalism:

- "All major economic and fiscal policy choices by a MS should be subject to deeper coordination, endorsement and surveillance process at the EU level". The possibility of different economic or social strategies is not accounted for.

- The need for strengthened fiscal discipline is reasserted, together with the need for *ex ante* fiscal coordination. But, after the fiscal Pact, what remains to be coordinated since all fiscal policies have to be run in autopilot mode?

- The Commission would like to be entitled to oblige a MS to revise its domestic budget plans or to modify budget implementation. The Commission wishes to be allowed to halt EU payments for MS not taking the corrective action required by the Commission. In our view, this would be dangerous as long as the Fiscal Treaty remains a cornerstone.

- The "euro area should have a fiscal capacity to absorb asymmetric shocks". The need for specific discretionary policies should be raised at the EU level. This is an awkward suggestion, once MS have been deprived of their ability to implement discretionary fiscal policies. But MS cannot accept to lose entirely fiscal autonomy

- An insurance mechanism aiming to absorb specific shocks could be settled within euro area MS, based on output gaps or unemployment insurance schemes. However, transfers should be temporary, each MS would from time to time be beneficiaries or contributors. This mechanism should neither introduce moral hazard, nor reduce incentives to implement structural reforms.

- Short-term government borrowing could be mutualised under the auspices of a European Treasury. But MS who have no problem to borrow in the short-term cannot agree to lose this freedom.

- A European Redemption fund could be settled in order to reduce public debts. Each MS would commit to fulfilling the Fiscal Treaty and additionally to reimburse the share of their debt above 60% of GDP (through an automatic process of allocating a share of tax revenues), so as to bring public below 60% of GDP in 25 years. Hence fiscal policies would become even more restrictive, and would be automatic, with the single objective of lowering debt toward an arbitrary target of 60%; there is no analysis of whether this strategy would be consistent with macroeconomic equilibrium.

- A new convergence and competitiveness instrument (CCI) would be introduced in the EMU. MS would sign an agreement with the EU, committing to implement structural reforms, which in return would allow them to benefit from some indulgence in terms of fiscal deficits or from some financial reward. Should countries be subsidised to reform their labour law, for instance?

- The EU should have a single seat at the IMF (which is weird after having requested Greece, Ireland and Portugal to call for IMF support during the crisis).

- The proposals to issue Eurobonds guaranteed by all MS as well as the ECB's guarantee for public debt were not kept, due to the German veto for unlimited and without conditionality commitments. But how to strengthen the euro without such commitments?

On 25 June 2015, a new report was published by the five presidents (including this time the European Parliament President): *Completing Europe's Economic and Monetary Union*. The EU is described as an unfinished house that should be completed with MS economic convergence and a real economic union, financial union, fiscal union and political union. MS should agree that more and more decisions are made in common, which would allow moving away from governance by rules. The real EMU would be done through MS convergence, this *via* structural reforms.

This would be done in three stages: until June 2017, deepening through practice: stimulating competitiveness and convergence. Then, from mid-2017 to 2024, achieving the EMU; the convergence process would become legally binding and would be a necessary condition to be entitled to the shock absorber mechanism. From 2025, the EMU would become an area of stability and prosperity.

According to the report, "[MS] need flexible economies, yet relative price adjustment will never occur as quickly as exchange rate adjustments. Financial markets prevent MS to use the fiscal tool. So, euro area countries need to pool private risks via the banking and financial union. In the medium term, when economic structures have converged, a mechanism of fiscal stabilisation of the euro area as a whole could be established." Thus the report recognises that the euro area framework will remain unstable for a while; many conditions need to be met before setting up a satisfactory stabilisation mechanism. Business cycle convergence would be achieved through financial diversification. Should a country suffer from economic imbalances, this would not be a problem, since households would hold financial assets from other MS. However, empirically the economic impact of this channel is very weak (see for instance Clévenot and Duwicquet 2011). Convergence becomes a *sine qua non* condition for a good functioning of the EMU, the EMU project allowing to manage different countries is abandoned.

The report recognises the inefficiency induced by the accumulation of pacts, reports and procedures, but suggests adding a report by a European fiscal board, in order to coordinate national councils, while remaining in the European rules framework. It advocates the introduction of a new network of independent Competitiveness councils, to coordinate national councils, which is problematic since there are domestic social democracy mechanisms. Nothing is said on how these councils will operate to reduce intra-zone imbalances. Will the German council recommend substantial wage increases in Germany? Or will each Council make recommendations with a view to improve their country's competitiveness?

The macroeconomic imbalance procedure would become more binding, would recommend structural reforms, and would also tackle the case of countries running excessive surpluses. There is a need to account better for the performance in social and employment areas: implementing a social protection pillar, addressing insiders' privileges and their role in persistent unemployment, postponing retirement age, favouring flexi-security, etc. Social indicators would be added in the scoreboard (participation rate, youth unemployment, long-term unemployment).

In a second stage, a stabilisation mechanism could be implemented at the euro area level, but here also it should not allow for permanent transfers, should not reduce incentives to run a sound fiscal policy, and should not support countries in crisis. What impact would it have? The contradiction between the Commission (wishing to expand federalist processes) and Northern countries (wishing to avoid transfers) leads to a vague compromise.

The report suggests strengthening the Eurogroup with a full time president. In stage 2, a euro area Treasury could be introduced (the role of which is not specified). There is no mention of the CCI project or the European unemployment insurance scheme, but the Commission still wishes to be able to cut structural funds for countries not following its recommendations.

The banking union should be achieved (since de-nationalisation of banking systems would lower the risks of financial fragility and instability). No financial transaction tax (FTT), or separation between deposit banks and markets and business banks are suggested.

The priority would be to achieve the capital markets union, arguing the need to facilitate SME's access to financing (as if this was not the Banks' role) and risk diversification. The report recognises that eliminating national barriers could create new financial risks. Therefore, it advocates a single supervisor for European capital markets.

In terms of democratisation, the report recommends to increase dialogue between the European Parliament, national parliaments and EU institutions. But the experience has shown that these formal dialogues have little weight.

The project is disappointing in terms of both institutional reforms and policy content. The project is at a standstill with most MS refusing to move towards more federalism, virtuous States refusing to provide greater solidarity, and the inability to propose a convincing supply policy different from regulation. There is no mention of tax harmonization, environmental transition, or of a coordination process targeting the reduction of imbalances between MS.

However, EU institutions try to implement progressively the June 2015 report, without a clear mandate of the MS and of the EU citizens, without launching a democratic debate.

In March 2017, on the occasion of the 60^{th} anniversary of the Treaty of Rome, the Commission published a *White book on the future of the EU*. This paves the way for five scenarios: less but more efficient Europe; Single market only; Continuity; those who want to do more; do more together. The last scenario is the one of the five presidents report of June 2015; it involves in particular the economic, financial and budgetary union, and a fiscal stabilisation mechanism at the euro area level. On 25 March 2017, EU heads of state pretended to choose the fifth scenario, although without mentioning concrete actions.

In May 2017 the Commission published a *Reflection paper on the Deepening of the Economic and Monetary Union.* The text points the disagreements between MS in favour of more solidarity and those wanting MS to be more responsible; the text recognises the persistence of economic and social divergences, and growth weakness in some MS, but does not draw any conclusions in terms of structural reforms. Banking and financial sectors fragilities, excessive private and public debt levels should be corrected by banking union and capital markets union. The drawbacks of the EU fiscal rules are hidden: "The good functioning of the single currency calls for: i) sound public finances and the existence of fiscal buffers which help economies to be more resilient to shocks; ii) complementing common stabilisation tools at the level of the euro area as a whole; iii) the combination of market discipline and of a shared rulebook which would allow these rules to be more effective and simpler to understand and operate". The text recognises that the euro area architecture and governance have become complex and difficult to manage. The reform proposals address mainly three axes:

- The Commission wishes to complete the banking union in setting a common fiscal mechanism to support the single resolution fund and the European insurance deposits scheme. However, some MS refuse any additional solidarity, especially if unlimited; other MS wish to keep the capacity of rescuing domestic banks; it would be costly to set up a sufficiently large fund able to intervene in any event, without 'using public money', it is finally not very useful as these mechanisms could remain at the national level (a country being able to receive the ECB's or ESM support for its banks). These questions arise only because countries lost monetary sovereignty, because there is no clear separation between deposit and credit banks and markets banks; and some MS (Greece, Italy, Spain) still suffer from the crisis, or are condemned to low growth, which weakens their banks. The Commission proposes the capital markets union, with the view that companies will have access to more innovative and diversified funding (but the 2007 crisis has shown the risks entailed by financial innovations and diversification). The Commission suggests the introduction of a single EU supervisor to control capital markets. Last, the Commission wishes to limit domestic government bonds ownership by banks. Government bonds would not be considered anymore as safe in banks' portfolios. Banks would have an incentive to own a safe European asset (this would not be Eurobonds guaranteed by all MS, but a securitized basket of national government bonds). The report admits that the two former measures would however lead banks to reduce government bonds in their balance sheet, which could “disrupt not only the functioning of their home financial systems. It would potentially also impact on financial stability for the euro area as a whole”. Obviously, interest rate spreads would rise strongly in the EU if Italian or Spanish banks were buying huge amounts of Northern countries’ bonds.

- The text advocates MS convergence, but often confuses convergence, coordination and compliance with arbitrary rules. The Commission wishes to set: “a strong link between related reforms, the use of EU funds and access to a potential macroeconomic stabilisation function. The CCI is again envisaged as “a dedicated fund to provide incentives to Member States to carry out reforms”. The text considers a macroeconomic stabilisation mechanism for the euro area, under such conditions that it would have a very limited role: “The function should not lead to permanent transfers, minimise moral hazard, and not duplicate the role of the European Stability Mechanism (ESM) as crisis management tool. Access to the stabilisation function should be strictly conditional on clear criteria and continuous sound policies, in particular those leading to more convergence within the euro area. Compliance with EU fiscal rules and the broader economic surveillance framework should be part of this”. The Commission re-examines, without making conclusions the projects of investment support, unemployment insurance schemes, “rainy day funds”, EU budget funding by own resources or by borrowing. The introduction of a euro zone budget is postponed to a late horizon.

- The EU architecture should be strengthened and more democratic. However, the text does not suggest the introduction of euro area specific institutions, but rather hopes that all MS will join the euro area, which would make the problem disappear. The Eurogroup could become an instance of the Council, with a full-time president. The text still requests a single representation of the euro area at the IMF. The ESM could become an EMF, incorporated in the legislative framework of the Treaties. A euro zone Treasury could be in charge of fiscal and economic surveillance in the euro area and MS, of managing the macroeconomic stabilisation mechanism, coordinating the issuance of the safe European asset. Fiscal rules could be simplified.

The whole package did hardly have any echo in the EU public opinion.

On 26 September 2016, the EU Council agreed on the implementation of National Productivity boards responsible for: diagnosis and analysis of productivity and competitiveness developments; independent analysis of policy challenges in this field. However, the boards are not expected to give a diagnosis and a strategy for the euro area as a whole.

In October 2017, the European fiscal board released its first annual report, dedicated to thoughts on the implementation of the SGP and the Fiscal treaty, especially in 2016. The report does not question the architecture of the scheme; it does recommend the implementation of rules in an imperfect manner, as the absence of rules would be detrimental to public finance sustainability while a strict implementation would be detrimental to economic recovery. According to the report, introducing less binding rules, more in conformity with economic needs, would lead to more complexity and discretionary judgement, possibly in contradiction with the Commission and the Council. The report suggests limited improvement: asking countries to build room for manoeuvre in good times that they would use in bad times; strengthening fiscal rules’ enforcement via the introduction of fiscal sanctions; obliging governments to explain the reasons for deviating from their National fiscal council’s recommendations; making rules stricter and simpler albeit introducing suspension clauses in the event of exceptional circumstances; implementing structural reforms to strengthen domestic economic resilience. Last, the report suggests to implement a fiscal capacity at the euro area level, either via an unemployment benefits reassurance system, or by leaving aside of the fiscal rule some public investment, in times of recession.

In December 2017, the Commission published a set of directives, the principles of which have not been adopted yet by the EU Council. These proposals address:

a) The introduction of a European monetary fund (EMF), as part of the EU legal framework. The EMF would be a safety net of the single resolution mechanism of the banking union. Decisions to support a given country would continue to be made at a strengthened qualified majority (85% of the votes). MS economic and fiscal surveillance would continue to be done by the Council and the Commission. The Fiscal treaty would be incorporated in EU legislative framework, with the structural government balance objective, the convergence trajectory, the convergence towards the 60% limit for public debt and the independent fiscal councils.
b) A European Minister of economy and finance would be created. This minister would chair the Eurogroup and would be vice-president of the Commission. He would coordinate the surveillance of MS fiscal policies. He would strengthen economic policies coordination. He could contribute to the design of an appropriate fiscal policy for the euro area as a whole. But the Commission assigns no additional power to this Minister, such as the right to oblige Member States to modify their fiscal policy.
c) The Commission refuses a separate Eurozone budget, but offers new fiscal instruments to support structural reforms in the context of the National Reform Programmes (especially for countries wanting to join the euro area) and to create a stabilisation mechanism in case of asymmetric shocks of great magnitude. After having refused the unemployment insurance reinsurance proposals, the Commission recommends a mechanism to support public investment through loans or grants. But how this mechanism could play an effective stabilization role when needed is unclear. A country hit by an asymmetric shock needs cyclical and discretionary public deficits, which implies lifting the rules of the SGP and the fiscal compact, accompanied by a guarantee of its public debt.

The Eurozone council of 15 December 2017 was attended by all EU-27 leaders. According to the note by Donald Tusk, EU council president: “Member States differ in their assessment of what needs to be done, as well as in the urgency they attach to this task [completing the EMU]”. There is a broad agreement on three issues: developing the ESM, which would become a EMF, introducing progressively a mechanism to support the Single resolution fund, in the form of a EMF credit line, introducing progressively a European deposit insurance scheme. Conversely, there was no “broad convergence” on rationalising fiscal rules, on controlling more strictly the fulfilment of these rules, on a European minister of economy and finance, on the introduction of a fiscal capacity for the *euro* area, even for stabilisation purposes.

On May 2018, the Commission proposed two new programmes:

- A Reform Support Programme (which is the new name of the CCI), with a total budget of 25 billion euro, to support a Member State implementing agreed reforms, and so a new instrument to exert pressure on MS to implement the liberal reforms advocated by the Commission.
- An Investment Stabilisation Function to help euro area MS to absorb a specific shock. A country having registered a significant increase in unemployment rates would be supported through loans helping to maintain public investment; this fund would be allocated 30 billion euros. As usual, it is stipulated that: "to receive this support, Member States will have to comply with strict eligibility criteria based on sound financial and macroeconomic policies". These loans would have a grant component, since the EU budget will cover interest payments. But, in such situations, MS may need more freedom in the conduct of their fiscal policy and more guarantees for their public debts rather than these conditional loans.

One challenge for any major reform (such as implementing transfer mechanisms between counties in counterpart of increasing EU institutions' control of domestic fiscal policies) is that it would require a change in the Treaties, unanimity, and in several countries a referendum – with no guarantee about the results, as EU construction is not currently popular.

A strengthened project?

Recently, the European project was strengthened by four elements. Since 2015, some economic recovery had been underway in the euro area. Greece refused to leave the euro area. The UK did not succeed to define a clear and dynamic Brexit strategy, which discredits the alternative of leaving the EU. The EU showed unity in both the Greek crisis and Brexit. In both cases, strong positions won. Proponents of softer lines kept silent at the EU Council, and at the Parliament, fearing that they would be accused to breach EU Unity.

Last, Emmanuel Macron's election in 2017 strengthens the EU strategy. His projects of renovating the French economy and taking leadership in the EU, in particular in the Sorbonne's speech (26 September 2017) attracted a lot of interest in Europe: "The time when France proposes is back".

According to Emmanuel Macron, France is today viewed at the 'bad pupil' of the Euro zone class. France should commit to a strict fulfilment of its European commitments, cut its public deficit and implement structural reforms, to show euro zone partners that France is reliable. However, no country in the euro area may accuse France of having run policies with negative external effects for its partners: France did not run an excessive external surplus; it did neither exhibit a too strong competitiveness improvement or deterioration; its public debt was not subject to speculative attacks.

In a second stage, renewed trust between France and Germany will allow them to lead a "group for European overhaul", a group of euro area countries who would agree to move towards a rapid convergence in fiscal, taxation and social areas.

In the Sorbonne speech, Emmanuel Macron makes the proposal of a 'sovereign, united and democratic Europe', able to face global challenges and to protect European values of democracy and fairness in face of the US or China. This is ambitious but these values still have to be implemented effectively in projects where MS would be unanimous.

Emmanuel Macron proposes ''to create a budget for the eurozone with three functions (future investments, emergency financial assistance and responses to crisis). Access to this budget will be conditioned to fulfilling common rules in tax and social areas (to avoid dumping in the euro area). A Minister of Economy and Finance of the euro area, which will be responsible for the euro area budget, under the control of a Parliament of the euro area, bringing together European parliamentarians of the Member States". This budget would be funded by taxes on digital activities, on environmental taxes and on a fraction of the CIT. Can France obtain the implementation of a substantial European budget, explicitly having a stabilization target, after agreeing to pass under the European constraints caudine forks? The risk is that in counterpart countries should abandon independent fiscal policies. The euro area Minister, responsible for stabilization, would have a right of inspection on national budgets, could ask for budget correction if he considers them not to comply with the treaties. But EU institutions have always denied the need for and the effectiveness of budget stabilization policies, have always denied fiscal policy effectiveness, need of stimulus (thus, according to them, the euro zone output was in 2017 only 0.4% below its potential level) and claim instead that MS reach full employment by fiscal consolidation policies (i.e. by government spending cuts) and structural reforms. Will this Minister be able to impose expansionary fiscal or wage policies in countries running excessive current surpluses? Emmanuel Macron did not clearly question the fiscal rules of the Maastricht Treaty and of the TSCG. However, he asked Germany to abandon its "fiscal fetishism".

Establishing a Parliament of the euro zone is supposed to democratize the area, but would it be possible and would it be desirable to complicate the EU framework by introducing euro area specific institutions, even more if all euro area MS were not part of it? Emmanuel Macron did not clearly explain what new powers would be devolved to this Parliament compared with the European Parliament powers.

At the same time, Emmanuel Macron still supports the traditional French proposals. A common base and harmonisation of CIT rates is needed to combat tax optimization, but will face opposition from several MS (Ireland, the Netherlands, Belgium). Emmanuel Macron proposes that the European Pillar of social rights defines minimum levels of health coverage, unemployment insurance and minimum wage (taking into account the unequal development of Member States). Considering the current bargaining powers in Europe, the risk is high for tax harmonisation to be obtained by lower taxation of wealthiest people, capital incomes and large companies. France sends a bad signal in removing its wealth tax and reducing its corporate tax rate.

Emmanuel Macron asks for a better control of posted workers to combat social dumping by applying the principle: "At a given place, equal pay for equal work". This is a contentious issue, since Central and Eastern EU countries want to be able to take advantage of having low wage levels. Opening borders for goods and workers necessarily puts in competition workers with different wage requirements. A Romanian worker can compete with a French worker in producing in Romania, or by coming to work in France as well as by using the status of posted worker, such that the issue of posted workers is of second order.

On trade issues, Emmanuel Macron asks for more dissuasive and reactive anti-dumping instruments, a "Buy European Act" allowing to give public market access to companies locating at least 50% of their output in Europe; a control of foreign investment in Europe to protect strategic sectors; the introduction in EU trade agreements of tax, social and environmental binding clauses, a "EU Trade

Prosecutor", to verify the compliance of our partners' commitments; surveillance committees, involving NGOs in the negotiation of trade agreements, to control their implementation and assessing their impacts. But many MS and the Commission are in favour of free trade. Emmanuel Macron proposes the extension of the FTT, but in a softer version, levied only on large companies' equity acquisition and not on speculative transactions.

Emmanuel Macron proposes that the EU takes the leadership in an "efficient environmental transition", *via* a fair carbon price, a carbon tax at EU frontiers, and industrial programmes to support clean cars production. He proposes the introduction of a "European Agency for disruptive innovation"; to support EU champions in digital economy, and besides to raise taxes on digital companies according to their "created added value"[1]

Emmanuel Macron, proposes a reform of institutions, with a European Commission limited to 15 members, but does not say explicitly how this Commission would be set up, on a clear political basis (majority parties in the European Parliament), or national basis, implying the current implicit technocratic-liberal model? The euro area would be split into two, between countries accepting the renovation project, and in particular tax and social convergence and those refusing it, which is difficult to imagine, since Europe would then have three circles, even four if Brexit leads to create around the EU a circle of countries linked by a customs union. But there is currently no agreement among EU people (not even among core countries) to move towards more integration, which would require modalities and a content to be more precisely defined. In the current situation, few People will agree that their budget, taxation systems and reforms of their social systems, be decided by a federal body.

Emmanuel Macron has two contradictory positions. On the one hand he wants to drastically transform France. On the other hand, he asks the other MS to get closer to France, in setting floors in terms of tax rates, social protection, minimum wages, via protectionist measures and industrial policies. But what shall be done if several MS disagree with these proposals? Nothing is said on the fiscal policy framework (rules commitment, piloting by EU instances or via domestic policy coordination?), or on rules in a re-founded Europe (unanimity, MS qualified majority, majority at the EU Parliament).

On 10 October 2017, Wolfgang Schäuble, the then outgoing German finance minister, had given the German position in a paper entitled "Preparing the way for a Union of stability". The ESM would be turned into a European Monetary Fund (EMF), which would have the responsibility to impose MS to fulfil the SGP and the Fiscal Treaty, in an automatic way (i.e., contrary to the EU Council, without political intervention). The EMF's mandate would include a public debt restructuring mechanism, imposed on every country receiving assistance. Thus a MS could go bankrupt, and euro area domestic public debts would become risky assets. Structural funds allocated to MS would depend on the implementation of structural reforms as recommended by the Commission. The paper rejects any deposit guarantee by the EMF, any European unemployment insurance scheme, any debt

[1] This can be justified politically and economically, but is fragile from a taxation viewpoint, since company taxation can bear only on profits generated in the country, while the country of origin for profits may be discussed.

mutualisation, any automatic transfer mechanism between MS, and any common fiscal policy allowed by a new borrowing capacity. Macroeconomic stabilization should be reached through market flexibility, the Banking Union, the Capital markets Union, and free movement of labour in the euro area.

The CDU-SPD coalition programme of 7 February 2018 was moving closer to the French proposals: strengthening French-German cooperation and the role of the European Parliament; introducing a FTT and taxation for big Internet groups (GAFA); increasing the size of the EU budget, in particular through a euro zone budget (devoted to macroeconomic stabilisation, social convergence, structural reforms). Since then, Angela Merkel took some distance with the French proposal. The SPD (and Olaf Scholz, the Minister of finance), ranked in line with the fiscal austerity doctrine. In these conditions, even if Emmanuel Macron asked Germany to abandon its 'fiscal fetishism' it is very unlikely that Germany may be convinced about the need for financial and fiscal mutualisation in the euro area. Germany clearly said that it would veto a transfer union, like a common guarantee for public debts; Germany does not want to make commitments without any strict limit.

In the same vein, on 6 March 2018, the finance ministers of 8 Northern states (the Netherlands, Ireland, Finland, Estonia, Latvia, Lithuania, Denmark, Sweden) requested that all discussions be made at the EU-27 level. For these countries, the priority is to meet existing fiscal rules requirements and to implement structural reforms at country level. The deepening of the EMU should be restricted to what is necessary and not be extended: completion of the single market, of the banking union (but reducing banking risks is a prerequisite before moving towards a common deposit guarantee scheme or towards a common resolution fund for banking failure) developing the capital markets union, transforming the ESM into an EMF (but the EMF should remain inter-governmental) The EU budget should account for budget constraints and give incentives for structural reforms.

Hence, there are still contradictions on many issues. Some stress the need for solidarity between MS, macroeconomic coordination, social and tax harmonisation. Others stress the need to fulfil fiscal rules and financial markets' discipline. A euro area ministry is considered either as a way to impose fiscal discipline and structural reforms, or as a coordination instrument for autonomous economic policies, or as a way to centralise fiscal policies.

The Meseberg declaration, signed by Angela Merkel and Emmanuel Macron on 19 June 2018, is a compromise text. The two leaders accept the Commission's proposal to "develop the links between structural funds and economic policy coordination," which is arguable if coordination means compliance with current fiscal rules. The two leaders accept to strengthen the Banking Union, but, according to German wishes, risk reduction of national banking systems should take place in that view. They clearly reject the Commission's project to set up a synthetic, declared as safe, financial asset from a portfolio of securitized bonds. On the other hand, the text is silent on the other project of the Commission, that discourages banks to hold too much domestic public debt by forcing them to consider it as unsafe. The two leaders plan to review the Treaty on the European stability mechanism (ESM). It could be incorporated into the EU laws, as requested by the Commission, while remaining an inter-governmental agency, as Northern countries wish. The ESM could be renamed, but the often proposed name of a 'European Monetary Fund', seems to be left out. The declaration does not clearly say (contrary to the request from many German economists and politicians) that all countries receiving assistance should also impose a debt restructuring to their private creditors, but it is specified that debt sustainability of a country receiving assistance should be considered; that collective action clauses could be introduced; that the ESM will facilitate the dialogue between helped countries and their private creditors. The declaration stipulates that the ESM should assess the economic situation in the Member States ("without duplicating the role of the Commission and in full respect of the treaties"). How this duplication could be avoided is unclear. A country receiving assistance from the ESM could also ask assistance from the IMF (which implies that the EU abandons the goal of a single representation at the IMF). A precautionary credit line could support a MS having no longer access to financial markets, without being in a full programme. This support would be reserved to economically and budgetary healthy MS.

Germany supported the French proposal to set up a euro area budget to promote “competitiveness, convergence and stability”. However, the size of this budget is not specified (several hundred or a few dozen billion euros?). It would be financed by national contributions, European contributions and specific resources: a financial transactions tax (according to the French model, so only on equity purchases), digital companies’ taxation and part of corporate income tax revenues. Expenditure should come in substitution to national expenditure; public debt reduction remains a priority. It is not said that this budget could be run in deficit. The stabilisation function would not mean permanent transfers: the declaration considers a simple delay for contributions to the euro zone budget or a country hit by a shock (but this implies substantial contributions) or an unemployment stabilisation fund which would lend to the unemployment benefits institution of a MS hit by significant job losses. The advantage of these loans is limited for countries who can borrow without problems on financial markets. Strategic decisions on this budget would be made by euro zone MS, but expenditure would be managed by the Commission.

Twelve countries (the Netherlands, Belgium, Luxembourg, Finland, Ireland, Estonia, Latvia, Lithuania, Austria, Malta, Denmark and Sweden) criticized, in a letter sent to the president of the Eurogroup, the project of a eurozone budget, refusing any increase in EU expenditure and any European taxation.

On 29 June 2018, the eurozone Summit brought together all EU27 leaders. The principle of strengthening the Banking Union was enacted, but to meet the German request, the risks of current national banking systems will have to be reduced before they are shared. The ESM should establish a credit line, as a safety net to the single resolution Fund, with the same size as the Fund itself. Any contribution from the ESM to banks should be reimbursed by the banking sector in three (or possibly five) years. Its introduction, before 2024, will depend on the evolution of risks in national banking sectors. The political negotiation on the European deposit guarantee scheme could begin as early as June 2018; its implementation will also depend on risk reduction. The plan to limit government bonds in banks’ assets and to encourage banks to hold a securitized asset was not mentioned. The ESM reform and eurozone budget issues have been postponed to December 2018.

Section 3. The debate among economists

Economists have diverging views on European issues. Shall the SGP and the Fiscal Treaty be kept unchanged, although they are hardly consistent with macroeconomic stabilisation needs? Can structural reforms and increased economic flexibility offset the loss of ability to implement a precise macroeconomic stabilisation? Should we live with high public debts or should we try to reduce them? There are also diverging views on the reliability of national governments, EU institutions or financial markets. Should the objective be to avoid non-cooperative policies inducing negative externalities, to facilitate economic policy coordination possibly generating positive externalities or to place MS under surveillance to compel them to implement structural reforms? There are also divergences on the political project: should the EU move towards a federal union or a Nation-States union?

Financial markets supervision?

Public debts in advanced economies have strongly risen before, during and since the crisis. The rise was smaller for the euro area as whole than in other economies (the US, the UK, Japan, table 1). The rise in public debts was due to the expansion of financial capitalism and to the deepness of the crisis, and not because of over expansionary fiscal policies run before and since the beginning of the crisis (Greece being the only exception). Public deficits and low interest rates offset insufficient private demand, weakened by decreasing wage share in value added, by the fall (in relative value) of needed investment, by a rise in income inequalities. The rise in public debts was implicitly desired by households (who wish to own safe assets, and do not want to buy risky assets), while companies want to reduce their debt levels. In view of low interest rates and inflation, current public debt levels do not generate higher interest rates and there is no crowding out effect for private investment. It would be detrimental for output growth to cut public debts as long as the reasons why debts rose remain, as long as public debt cuts cannot be offset by significantly lower interest rates. The euro area already runs a large current account surplus and cannot expect to be able to offset a fall in domestic demand by a higher external surplus, unless destabilising the world economy.

Table 1. Public debts and deficits

% of GDP	Public debt, Maastricht criteria		Public balance		
	2007	2017 (and max.)	2007	Highest deficit 2007-17	2017
Germany	64	65 (81)	0.2	-4.2	0.9
France	64	97	-2.5	-7.2	-2.6
Italy	100	132	-1.5	-5.3	-2.1
Spain	36	98 (100)	1.9	-10.5	-3.1
The Netherlands	42	58 (68)	0.2	-5.4	0.7
Belgium	87	104 (108)	0.1	-5.4	-1.5
Austria	65	79 (84)	-1.4	-5.3	-1.0
Greece	103	180	-6.7	-15.1	-1.2
Portugal	68	126 (131)	-3.0	-11.2	-1.4
Finland	34	63	5.1	-3.2	-1.4
Ireland	24	70 (120)	0.3	-32.1	-0.4
Euro area	*65*	*89 (94)*	*-0.6*	*-6.3*	*-1.1*
UK	44	87	-2.6	-10.1	-2.1
USA	64	108	-3.5	-12.7	-5.0
Japan	183	240	-2.8	-9.8	-4.3

Source: Ameco.

Some economists and policy makers (especially in Germany) rely on financial markets to ensure fiscal discipline in Europe. The high public debt levels, like the memory of the Greek partial default make it more likely that public finances remain under financial markets supervision in the coming years. But this surveillance is unsatisfactory: financial markets have no macroeconomic perspective, they request efforts in bad times (in times of recession, when deficits are rising); their views are self-fulfilling and they are aware of it; they do not try to account for all information available, but only of elements which are 'in the mood of time'; they are schizophrenic, requesting at the same time economic growth strategies and fiscal consolidation. They have their own judgement on appropriate economic policies, with a liberal bias. Should economic policy choices be submitted to financial markets' threat? MS ability to run fiscal policies would be even more reduced. Can financial markets be the judges of public debt sustainability and of public deficits appropriateness? What would have occurred if governments had refused to rescue banks in 2008, to avoid them to borrow on financial markets? Financial market regulation is necessarily imperfect. A country may run an over expansionary policy for a while but markets will react only when they estimate that the debt level is excessive, i.e. too late. Macroeconomic regulation cannot be limited to fiscal discipline: markets cannot oblige countries running too restrictive policies to borrow. The experience has shown that markets cannot impose countries to run needed policies: markets were blind in the case of Greece before 2007, and have been too strict for Italy or Spain since 2011.

Letting markets set freely public debt interest rates, according to their default fears, would have a major drawback: it would maintain arbitrary interest rates spreads in the EU, it would restrain fiscal policy (a country may be obliged not to run the policy needed, fearing this would worry markets), it would reduce monetary policy efficiency and let financial markets play a too large role. On the one hand, the EU would claim that the Greek case was an exception, and that from now on no euro area country will default. On the other hand, the EU would rely on markets to assess how serious its commitments are. Interest rate spreads would be arbitrary, costly (should Italy pay each year 1.2% of GDP to financial markets to offset a supposed default risk?) and may become self-fulfilling. Conversely, the weight of financial markets is considered today by leading classes, by Northern countries, by the EU technocracy as a guarantee against deviating policies, and hence they will refuse the markets' power to be reduced.

A country having kept monetary sovereignty, and issuing bonds in its domestic currency, is of course subject to financial markets' judgement, but this is a different type of constraint. Markets do not fear government default, hence do not anticipate a crisis, but may anticipate currency depreciation, which is a normal phenomenon. This will not raise interest rates (which would lower growth) but will entail exchange rate depreciation (which may be expansionary).

Numerous proposals aim to strengthen financial markets surveillance. German economists and policy makers demand that principles of no-solidarity between MS and no-guarantee by the ECB be re-asserted, that the possibility for a country to default (and even, to exit the euro area) be explicitly written in EU Treaties, that a MS supported by the ESM be automatically obliged to restructure its public debt, and so a strong signal would be sent to financial markets to be more vigilant.

In May 2018, 154 Germans economists (including Hans-Werner Sinn and Jürgen Stark), refuse a Europe of liabilities or a Europe of transfers. Under the principle of responsibility of each country, they refuse an EMF where non euro zone MS would be entitled to vote, which would help countries that did not undertake the necessary structural reforms; they refuse a Single Resolution Fund for bank failures, like a European deposits insurance fund, which would relieve bankers and national supervisory bodies from their responsibilities. They propose to promote structural reforms, to consider the possibility that a country leaves the euro area, to declare that public debts are risky. The ECB should end its programme of buying government securities: voting rights of largest MS should be increased, Target2 balances should be regulated. Asymmetric shocks would be offset by portfolios diversification allowed by the capital markets union.

The EU Commission suggests to lower the share of public debt hold by domestic banks, to consider this debt as risky, which should have a counterpart in banks' capital. EU banks would thus have the incentive to reduce and diversify their public debts portfolios. Thus, in theory, a country could restructure its debt without putting its banks in trouble.

Simultaneously, one or several synthetic and supposed safe assets would be introduced, from public debts securitized portfolios. These assets could (or should) be owned by banks or EU financial institutions. Financial engineering would be relied upon to build and assess such safe portfolios, with senior tranches containing necessarily a lot of German, Finnish, Dutch bonds, and few Italian, Portuguese or Spanish bonds.

These proposals would contribute to fragmenting the euro area between countries considered as safe or unsafe. It would undermine the financing of MS, which would be deprived of a more or less guaranteed funding by domestic banks and financial institutions. This fragility could only raise speculation. Fiscal discipline would rely on financial markets surveillance and on financial engineering, although the crisis showed their failures. How to assess the probability of events such as a sovereign default of France, Spain, Slovenia, which depend not only on the country's situation but also on the ECB's and other MS responses? The objective of the Commission is clear, cutting the link between national Treasuries and domestic financial intermediaries, so as to restrict their ability to issue bonds.

Delpla and von Weisäcker (2010) or De Grauwe (2012) had suggested that public debts be split into two categories: a 'blue' debt, collectively issued and guaranteed, with a 60% of GDP ceiling for each country, and a 'red' debt. Each MS would also be allowed to issue a red debt under its own responsibility. Since such a red debt would bear a high interest rate, which would be a strong disincentive to issue public debt above 60% of GDP. But the 60% limit remains arbitrary. It was breached since 2007 by almost all euro area countries, for legitimate reasons. It would be a source of tensions between MS to see the ability of a country to issue guaranteed bonds conditional to a Parliament vote in other MS. Should speculators be offered new possibilities to bet against different kinds of public debt?

Fourteen German and French economists (Bénassy-Quéré *et al.*, 2018) published a text on 17 January 2018: "Reconciling risk sharing with market discipline: A constructive approach to euro area reform" which recognizes "the persistent financial fragilities" of the euro area, but which in fact proposes to accentuate their causes by weakening even more States and by increasing the influence of financial markets and European Institutions. Pretending to account for the German view point, these economists accept the strengthening of a so-called 'market discipline' as if it was not markets which, due to their exuberance and their blindness, would need to be disciplined. They pretend to believe that the rise in public debts since the crisis is due to MS fiscal indiscipline, albeit forgetting that the rise was even more pronounced in Japan and the United States, that imbalances induced by financial capitalism led public debts to rise. They forget that the risk comes from one of the original sins of the euro area: public debt is not guaranteed by the Central Bank. These economists make six proposals, often taking the Commission's view:

1) *Penalise banks who have too much debt of their origin country.*
2) *Provide a device for an orderly restructuring of public debt*

Like the Commission, the 14 economists propose to proclaim that euro zone MS public debts are risky, that they can be restructured, that banks holding them take risks that should be assessed according to the country in question. Such a declaration would have three consequences: public debts would effectively be more fragile, MS would not be ensured anymore to issue safe bonds, speculation on public debts would be encouraged. Bank deposits would be guaranteed at the EU level, but the insurance premium paid by banks would vary depending on the "specific risks of the country", so one would point to financial markets which countries to speculate against.

3) *Replace the current fiscal rules by a new simple one: nominal public spending should not grow faster than nominal income, defined as the sum of potential output growth and expected inflation; they show grow less rapidly in countries where the debt ratio is too high* (see below).

4) *Set up a Fund to help Euro area MS to absorb the most serious economic crises.*

Countries could benefit from this Fund if they followed a fiscal rule defined as in point 3) and the European semester recommendations. As the latter cover all economic policies areas, no country can really comply. None of the Southern countries would have been helped by this Fund. To avoid permanent transfers (the big fear of German leaders), this Fund would be supported by national contributions which would rise with previous help received from the Fund. Thus, countries having previously experienced difficulties would finance countries currently in difficulty. A country having requested support from the Fund would always pay higher contributions for a long time, and so it would hardly be helped.

5) Offer investors a synthetic risk-free financial asset alternative to national public debt (see above)

6) Reform the institutional architecture of the eurozone

The 14 economists propose to establish a Court to judge governments' policy, with a supervisor (*attorney)* who would be a Commissioner, independent of the rest of the Commission and a *judge*, who would be the president of the Eurogroup. But what power would have this Court? On what grounds could they judge a MS, who implements a fiscal policy that it considers appropriate to its situation?

The paper makes no recommendation to improve euro area economic policies coordination, to reduce imbalances between MS, to launch a large investment programme required by ecological transition, to reduce the instability induced by financialisation, to refocus the banking and finance sectors activity towards lending to public and productive investment rather than speculation on public debt.

The 14 economists' proposal was criticized by Messori and Micossi (2018), two Italian economists, with arguments close to ours: "their proposals heighten the risk of financial instability and weaken euro area defences against financial shocks".

Public debt centralisation?

A simple solution would be to introduce a European debt agency (EDA), which would issue a common debt for all euro area countries. This debt would be guaranteed by all MS and would be considered as safe by financial markets; its market would be broad and very liquid, hence it could be issued at very low interest rates. The tricky point is that the EDA would supervise domestic fiscal policies and would be entitled to deny financing *over-lax* countries, leading the latter to have to sell bonds to markets. The EDA would raise the same problems as the SGP, even more strongly. What would be the EDA's democratic and economic legitimacy? What would be its assessment criteria? How would the EDA decide that a country runs an excessive deficit, if the country considers that such a deficit is necessary to support domestic output or to rescue domestic banks? Would it implement rigid automatic rules (a country would be entitled to loans from the EDA up to 60% of its GDP) or softer ones (a country would be entitled to loans from the EDA, except in exceptional circumstances)? The EDA would benefit neither virtuous countries (the latter have no difficulty to borrow) nor countries in difficulty, which the EDA would refuse to lend to, leading these countries to issue domestic bonds, without any European guarantee, without any possible ECB's financing, in other words risky assets, at a high interest rate. The EDA makes sense only if it accepts to consider all public debts, but what shall be done then against lax countries? Northern countries refuse such a system on moral hazard grounds: 'sinner' MS would have no more incentives to cut their public debts. The EDA's proposal may thus be seen from two different perspectives: either as a way to impose EU fiscal rules on MS or as a way to ensure MS autonomy in fully protecting them from financial markets.

Schulmeister (2013) suggested the introduction of a European Monetary fund (EMF), which would finance MS though issuing euro-bonds guaranteed by the MS and the ECB. The EMF would maintain long-term interest rates slightly below GDP growth. Individual MS financing would not be subject to a numerical constraint, but would be agreed within the EMF by MS Finance ministers. This proposal hands over to finance ministers the responsibility of agreeing on public deficit targets for each country, which is problematic (what should be done in case of divergent macroeconomic strategies?), and undemocratic (each finance minister would impose in its national Parliament the fulfilment of the target set at the European level), difficult to implement (what to do in case of specific or global shocks?).

Palley (2017) suggests the introduction of a European public finance authority, which would issue a certain amount of euro-bonds and redistribute it to governments, according to their GDP weight. Beyond that level, MS would have to issue a domestic junior debt. This is also a proposal with 2 types of debts. The guaranteed debt would amount to an arbitrary percentage of GDP; this would not be very helpful for MS with higher public debt, who would have to sell unguaranteed junior bonds.

Bibow (2015) suggests the introduction of a European Treasury, which would issue euro-bonds to finance public investment in the euro area. In return, MS should bring to and then maintain their structural current budgets in balance. Thus, a substantial share of public debts would progressively be settled at the European level. In addition, Bibow proposes to enlarge the definition of investment to education spending, such that the European Treasury lends automatically each MS 3% of their GDP each year, and the euro area debt will converge towards 60% of euro area GDP if nominal GDP grows by 5% (but if nominal GDP grows by 3.5% only, the euro area debt/GDP ratio will converge towards 85.7%). The proposal has the advantage of being based on the golden rule of public finances: the structural deficit should be equal to public investment (but without strictly applying it). Conversely it prohibits discretionary fiscal policies, it relies on the unobservable measure of the 'structural balance', and on a postulate for which no evidence can be given: the macroeconomic equilibrium is associated with a 3% of GDP structural deficit. It is a sleight of hand, which Germany and other *virtuous* States are unlikely not to see. MS public debts would be hidden in the European Treasury balance sheets. In fact, according to the Treaties, the European Treasury debt would be allocated among member States and counted within the envelope of the 60% limit for public debt. This would be the case if the European Treasury lends to Member States rather finance directly investment projects. Besides, the proposal raises institutional issues: most public investments are made by local authorities; other investment concern large infrastructure; other concern military defence. MS will not accept decisions in these fields to be made by a European Treasury.

The German Council of Economic Experts (Doluca *et al.,* 2012) had suggested the introduction of a European Redemption Pact, i.e. a fund to guarantee the repayment of the share of public debts above 60% of GDP. Countries with debt exceeding 60% of GDP, would place the share of their debt over 60% of GDP in a Redemption Fund (RF) and, in counterpart, would transfer irremediably tax revenues allowing for debt repayment over 25 years. Countries would transfer guarantees to the fund, such as part of their gold reserves. Moreover, they would commit to implement structural reforms programmes and would fulfil the Fiscal Pact in bringing rapidly their structural deficit at 0.5% of GDP. With these guarantees, the fund could borrow at interest rates without risk premium. The debt-to-GDP ratio would thus fall rapidly. But the proposal does not address the impacts of these restrictive policies on output, making the implicit assumption that fiscal multiplier is nil (Mathieu and Sterdyniak, 2014). Similarly, the proposal does not consider the possibility that the euro area economies go through slowdown episodes in the next 25 years, which may require to soften the restrictive stance of fiscal policies. What would then happen with the redemption pact? The proposal does not address either the reasons why public debts rose. Are these sins that MS have to pay for? Or was the rise in public debts necessary because of the economic crisis? The proposal lies on a postulate: optimal fiscal policy consists in stabilising the structural deficit at 0.5% of GDP (and hence government debt at 14.3% of GDP under a nominal GDP growth at 3.5%) and to refuse any discretionary fiscal policy.

The ESM was introduced through an inter-governmental agreement. It could be enshrined in the EU Treaties and transformed into an EMF (European monetary fund). However, according to some authors, the challenge would be for the EMF to exert surveillance (and to impose) that fiscal policies fulfil the SGP, the fiscal pact, and the national reform programmes. This surveillance would be done via an automatic process, i.e. without accounting for the economic situation, without any political vote from MS. MS would entirely lose their fiscal autonomy.

Many authors suggest to introduce a minister of economics for the euro area, who would chair the euro group and be a vice-president of the Commission. The minister would chair a euro Treasury, the budget of which would be widened to finance collective spending of the area, macroeconomic stabilisation spending, transfers within countries. This raises first a question of democracy: how would this minister be appointed? On the basis of a democratic political choice or on the basis of the illusion of a technocratic consensus? For some authors, this should facilitate domestic economic policy coordination. For some others, the euro area ministry should have the capacity to oblige countries to modify their budget plans if they are not in conformity with EU rules. Last, for some other authors, the euro area ministry would allow to centralise fiscal policies, such that automatic rules would not be necessary anymore: this ministry would define the policy needed at the euro area level, and then policies needed at the level of each country, which the latter would have to apply.

Changing the fiscal rules?

Fiscal rules in the SGP and TSCG are arbitrary. They can oblige countries with insufficient demand to run restrictive fiscal policies, although the latter cannot be offset by lower interest rates. Fiscal policy should target employment (keeping it at or bringing it back to a satisfactory level), while allowing inflation and interest rates to remain at satisfactory levels. According to the functional theory of public finance, public debt and deficit should be derived from this target (see Box 1 and Mathieu and Sterdyniak, 2012), and not from arbitrary rules.

Some economists have proposed accounting tricks to turn SGP rules and the Fiscal Treaty. For instance, not to account for unemployment-related expenditure or public investment in the 3% rule, setting up temporary funds in good times to allow for higher deficits in bad times, or on the contrary, to introduce a temporary debt in bad times to be redeemed in good times, etc. According to us, it would be better to write simply: a public deficit is acceptable if the inflation rate is below the target, when the interest rate is below the normal level (i.e. according to the golden rule, potential growth plus the inflation target), when the external deficit is below the target.

Box 1. Functional theory of public finances

A certain level of government debt and deficit may be necessary to ensure a satisfactory demand level. If one writes: $y = a + d + cy - \sigma(r - g) + k(h - l) \quad \dot{p} = \pi y \quad \dot{h} = d$, with *y*, GDP level (in deviation from potential level), *d,* public deficit, *a*, private demand, *r*, the interest rate, g, nominal growth trend, *h*, public debt as a % of GDP, *l* the public debt desired by the private sector (when *r=g*).

Two situations should be distinguished:

The country controls its interest rate. Then full stabilisation can be obtained without the fiscal tool, with the interest rate: $r = g + (a + k(h - l))/\sigma$. A negative demand shock or an increase in the desired public debt allows for an interest rate cut (which can increase investment, and then growth). A positive demand shock can be offset by a rise in the interest rate (which is detrimental to investment) or by a restrictive fiscal policy (which is more relevant). The rule is: fiscal policy must allow to maintain unemployment at its natural level of and an optimal interest rate.

In the long run, the debt ratio is stable so: $d=0 \quad r=g+k(h-l)/\sigma$ The country has a trade-off between interest rate and public debt levels. A restrictive fiscal policy may be implemented if it allows for the interest rate to decrease.

The country does not control its interest rate, because the interest rate is already at 0 or because the country belongs to the Euro zone) , the short term fiscal policy is : $d = -a + \sigma(r - g)$

If this policy is implemented and if stabilisation is perfect. there is no link *ex post* between the deficit and the output gap, which remains nil. Let us note also that. in this case. d. government borrowing. is considered as structural according to the OECD or the EC' methods, which make no sense.

In the long run, g = 0 and $h = l + \sigma(r - g)/k$. The long-term public debt level is not arbitrary, but depends on private agents' wishes: debt must equal desired debt at the optimal interest rate, i.e. the rate equal to the growth rate. This simple model shows that a fiscal rule like: $d = \bar{d} - \lambda y - \mu\,(h - \bar{h})$ cannot be proposed, since it would not allow for full stabilisation and since the government cannot set a debt target independently of private agents' saving behaviour. The public debt level desired by private agents is likely to have increased during the crisis, since households wish to hold fewer risky financial assets and companies wish to deleverage. In structural terms, population ageing implies that the demand for safe public assets increases.

Box 2: A Keynesian fiscal rule?

Could a Keynesian fiscal rule be suggested? Net Public investment (NPI) should be financed through borrowing: the public balance should be corrected from debt depreciation induced by inflation; fiscal policy should play a countercyclical role: with a negative output gap of 1%, a deficit of 0.75% of GDP is justified, i.e. slightly more than the automatic effect; fiscal policy should be restrictive when monetary policy is restrictive (when the ECB's interest rate is higher than the rate of 'the golden rule of growth', set out by Phelps, i.e. the inflation target plus potential growth. With an inflation target at 1.75% and GDP growth at 1.5%, this gives:

s=-Ipn- πD% + 0.75 output gap +0.5 (i-3.25)

If one considers the output gap estimated by the EC at -0.7% in Spring 2018, the French public deficit should have been in 2017: 0-0.9-0.75*0.7-1.625 =-3.05% of GDP. The official recorded figure was -2.7%. But this rule does not allow for full stabilisation; it does not account well from the link between fiscal policy and the output gap; it depends on the output gap and potential growth estimates.

Claeys *et al*. (2016) propose that public expenditure (excluding interest payments, unemployment insurance benefits, exceptional expenditure, public investment, but including fixed public capital consumption) may not rise more rapidly than the ECB's inflation target (2%) plus the medium term potential growth less a correcting term of 0.02 times the share of the debt above the 60% target. However, a country could choose to raise its public expenditure if it raises tax revenues at the same time, or to cut tax revenues if public spending is cut at the same time. Hence this rule is in fact a structural balance rule. A country, such as France, where debt stands at 100 % of GDP, should set a target for public expenditure growth 0.8 percentage point below potential output growth, i.e. improve by 0.4 percentage point each year its primary structural government balance, until its debt comes down to 60% of GDP. This rule may seem relatively satisfactory, since it lets automatic stabilisers play, since it becomes less binding if inflation is below 2% (1 percentage point of inflation below the target allows to increase public spending by 1%, i.e. an additional 0.5 percentage point for the structural deficit). But in this proposal, the arbitrary 60% of GDP target for public debt remains. Should the main objective of French fiscal policy be to bring debt down to 60% of GDP within 20 years, i.e. to run average primary fiscal surplus of 2 points of GDP, when the 60% figure is arbitrary and lower than debt in countries outside the euro-zone? These 2 points could be better used (for example, for ecological transition). The impact of permanent fiscal consolidation on output is not assessed. Discretionary fiscal policies remain forbidden. The rule does not set an equilibrium level for the primary fiscal balance and so does not bring debt to a long-term equilibrium. A country with a 100% debt and a primary structural deficit of 1% of GDP will have to increase each year its primary structural balance. After 18 years (under the assumption that the interest rate is equal to output growth), its debt will fall below 60 % of GDP (at 58.4%) and the primary structural surplus will reach 4.5% of GDP. The rule gives no indication on what should be done once the debt reaches 60% of GDP: staying at that level, which would allow to bring rapidly the structural surplus to balance or maintain a substantial structural surplus.

Bénassy-Quéré *et al.* (2018) suggest to replace existing fiscal rules by a new *simple* rule: « nominal [public] expenditures should not grow faster than long term nominal income (that is, the sum of potential output growth and expected inflation), and they should grow at a slower pace in countries that need to pay down their debts." But the authors also say that countries would be entitled to raise their expenditure more rapidly, if this is financed by higher structural tax revenues. The rule is thus equivalent to: “the structural deficit should remain stable, and even diminish in countries where the public debt level is too high”. But will a country be entitled to increase public expenditure or cut taxes to support output in terms of economic slowdown? The rule should clearly state that discretionary, and defined as temporary measures, are allowed. Let us assume that a country wishes to promote pension funds instead of pay-as-you-go retirement systems. In the short and medium term this may lead households’ savings to rise, and, at fixed interest rates and exchange rates, this may require a rise in the equilibrium structural public deficit. This is not taken into consideration in the proposed rule. How to define excessive debt ratios, knowing that the rise in public debts since the crisis is due to the needs of macroeconomic regulation? Then the text says: “If a country passes a budget with spending above the target, all excessive spending must be financed by junior sovereign bonds [..] first to be restructured in case a debt reduction is deemed necessary”. But the so-called excessive expenditure should be financed by a guaranteed public debt, if they reflect the need for output stabilisation. Should markets be asked to fine countries who would raise public expenditure even if the latter are needed for macroeconomic stabilisation or for rescuing banks or companies in a difficult situation? The proposal relies on a weird and irrelevant financial innovation: advanced economies would issue sovereign bonds announcing there are unsafe assets. No advanced economy outside the euro area ever did such a thing. How to imagine that a large economy, such as France, may default, even partially? According to which criteria? The enforcement of the rule would be done under the control of an independent fiscal committee, itself supervised by an independent committee at the area level. Will this authority have to comply with the Commission's estimates and to blindly stick to the prescriptions of the rule or will it be able to have its own estimates and to evaluate policy on macroeconomic relevance? Besides, like the previous one, this rule does not have any stable long-term. It simply tells us: once a satisfactory debt ratio has been reached, the structural balance may be stable. But at what level? We have seen that this level depends on the path from the public balance and does not stabilize debt. Any fiscal rule should lead to stable debt and deficit levels consistent with the macroeconomic equilibrium.

A euro area fiscal capacity?

Some economists consider that the euro area could implement stabilisation mechanisms at the euro area level, managed by a euro area minister, but this is an illusion, knowing that the size of output gaps is minimised by the European Commission’s estimates, denies the implementation of discretionary policies but sticks to automatic fiscal rules. But many shocks or imbalances are country-specific. Implementing stabilisation tools at the euro area level would be dangerous if as a counterpart, countries have to abandon stabilisation policies, have to bring their structural budget (as measured by the EC) in balance and should wait for the Commission’s green light to stabilise their economy.

A two-step procedure is often proposed: The Commission would set the broad fiscal stance of the euro area, and would then verify the compliance of all MS budgets. But this does make sense only if the SGP and the Fiscal Treaty are abandoned, and the full-employment target in the euro area re-affirmed. However, this proposal makes little sense if euro area cyclical developments and objectives differ too much. Why saying that fiscal efforts should be neutral in the euro area if countries with fiscal room of manoeuvre refuse to run expansionary policies, while countries in depression have to fulfil EU constraints? It is hardly relevant today to design procedures which could work only with countries having already converged.

Some propose to implement a system of transfers between MS to ensure that countries in good economic situation finance countries in depression. Accounting for the reluctance in Northern countries, this system should avoid permanent transfers, each country should alternately be a net contributor or receiver. Can a system on average neutral have a visible macroeconomic impact?

Some propose to base these transfers on output gap differentials, since, for a given country, the output gap is by construction nil over a long-time period. But they forget that the output gap is a vague and unobservable concept, a measure which can be criticized, and fluctuates over time (Mathieu and Sterdyniak, 2015). As could be seen after the 2008 crisis, when a crisis occurs at year N, potential output growth estimates are reduced for year N-1, N-2, … Should there be re-payments each time the Commission's estimates are revised? Should a country in depression wait for European funds to support its economy, and meanwhile implement a pro-cyclical restrictive policy? Last, potential output growth fluctuates very closely with observed output growth, according to Commission's estimates, and hence transfers would necessarily be small.

Some propose the unification of unemployment insurance systems, unemployment spending being the most pro-cyclical category public expenditure. But national systems differ widely from one MS to another (allowance levels and duration; accounting or not for the family situation), and are run by social partners in many MS. Social partners would not agree on a unification done under the leadership of the Commission. The unemployment concept would have to be standardized (what about recipients of vocational training, disability pensions, early retirement schemes, or part-time unemployment schemes?). A country having made efforts to reduce its unemployment rate would refuse to pay for countries with high unemployment, blaming these countries for not having undertaken the necessary reforms.

Some propose transfers between countries based on the differences between the observed and the structural unemployment rates. But how to assess the structural unemployment rate, which according to the Commission's estimates also varies like the observed unemployment rate? Transfers based on differences in unemployment rates would entail permanent transfers between countries. To avoid this, proposals restrict transfers to unemployment regimes applying them only to newly unemployed and for a limited time period (Dullien, 2017). Transfers are generally small and become nil if the depression lasts and hits all euro area MS. Transfers are expected to be nil for each country in the long term, and thus may have only a limited impact. Others suggest a reinsurance unemployment system, based on short-term unemployment developments, normalized according to their past volatility, MS contributions depending on the extent to which they previously resorted to the fund (Dolls and Lewney, 2017, Aparisi de Lannoy and Ragot, 2017). But can social transfers be based on complicated mechanisms? Re-insurance may have an impact only *ex post*. They would have no direct impact on unemployment benefits, but only on the financial equilibrium of unemployment regimes.

Those in favour of the proposal argue that it would have had stabilisation properties in the past. In particular, Germany would have been a net beneficiary in the beginning of the 2000's, as if the other MS would have agreed to pay for the German internal devaluation strategy. Also, this system would have softened the recession in Southern economies after 2010, as if the EU, requesting fiscal austerity, would have offset it at the same time by unemployment benefits transfers. Even more, proponents of this proposal assume that these transfers would be entirely consumed by households (Dolls and Lewney, 2017). Let us consider the case of France. Unemployment benefits were not cut after the crisis, despite the rise in the public deficit; they would not have been larger if the EU mechanism had been in place. At best, the mechanism would have reduced the UNEDIC's financing needs. So its impact on activity would have been weak, if not nil.

Some economists (CAE, 2016) admit that the implementation of this mechanism requires the convergence of domestic labour markets, to be implemented by a European minister of labour. But a convergence towards which model and decided by whom? Should the flexible labour market model be promoted (labour contracts revised in permanence, precarious jobs, flexible wages) or a stable labour market (companies and employees linked with long term contracts, companies caring for maintaining their workers' skills and investing in specific skills). Should wage flexibility be promoted through bargaining at the company level, or on the contrary through sector agreements or national agreements based on the 'golden rule' of wage growth, i.e. the inflation target plus average productivity growth in the economy, as the European Confederation of trade unions recommend?

The debate on euro area's future

Many economists recommend a move toward a more and more federal EU (or euro area). They admit that technocracy currently prevails in the EU, that there is a lack of democracy and a liberal bias, but they consider that a more democratic federalism could be introduced. The euro area would have a substantial budget and own resources; it could finance EU common goods (military defence, research, infrastructure, migration policy), transfers between countries, both structural and cyclical, and to deal with all or part of macroeconomic stabilisation.

In '*Pour un traité de démocratisation de l'Europe',* S. Hennette, T. Piketty, G. Sacriste and A. Vauchez (2017) propose a new Treaty. It would introduce a Parliamentary Assembly of the euro area, involving members of the national parliaments and of the European Parliament. This Assembly would supervise the euro area summit and the Eurogroup. Contrary to what the authors suggest, this Treaty would need to be ratified by European citizens. Besides, there is already a European Parliament. Why introduce a new structure and duplicate all EU institutions with euro area institutions? This assembly would vote the various documents of the European Semester (the Report on Mechanism Alert, country reports on Stability Programmes and on National reform programmes, on the EDP), the directives, the ESM assistance programmes and the Memoranda of Understanding. This would represent on the one hand many elements which are dealt with at the EU level, and so the process would duplicate European Parliament activities; on the other hand, dispositions which are currently domestic prerogatives: should EU parliament members be asked to vote on each MS Stability programme and national reform programme? The proposal for a New Treaty does not clearly set out the powers that would be attributed to the euro area, as compared to the EU and to countries. It does not say if the SGP and the fiscal Treaty would continue to apply. What would be the assessment criteria for national budgets: sound in view of the economic context, or in view of the Fiscal Treaty? Strangely, the proposal says that the euro area budget will be funded only by CIT, which would become a EU tax, with a minimum rate. But it is difficult to bring CIT at the EU level, because the tax base differs from one country to another (for instance, depending on the income tax rates, individual entrepreneurs may choose to pay the income tax or company taxation), and domestic tax collecting administration should be able to control companies settled in the country. Corporate tax revenues fluctuate with business cycle conditions. The proposal does not clearly say if the euro area budget expenditure may be financed by borrowing. It plans to put in common public debt above 60% of GDP, which may seem to be solidarity, but implies necessarily that countries with debts higher than 60% of GDP need to launch a redemption process, without any economic justification. Should unmanageable constraints be accepted to ensure Germany's agreement? The risk is that the democratisation concept hides new constraints for MS.

In a *New deal for Europe* (2013), Aglietta and Brand explain that a political union is needed for the euro to become a full currency. They propose to create a European Financial Institute (EFI) which would coordinate fiscal policies "according to a criterion of long term public debt consolidation", since "fiscal consolidation will require two decades". At the national level, independent experts' committees would assess the sustainability of the Government strategy, under macroeconomic assumptions provided by the EFI. But the notion of sustainability is unclear: public debt may rise in a country for a short or longer time period, which may not signify an unsustainable policy, if the rise in public debt matches households' desire to own more public debt, or companies' deleveraging if interest rates are very low. A European Debt Agency would issue Eurobonds with an insurance premium to give incentives to high-risk countries to run a consolidation strategy and to reward low-risk countries from the protection they bring to others (but what if they are responsible for imbalances resulting from too restrictive policies?)

Along the same lines as an ETUC proposal, Heyer *et al.* (2016) make a proposal for a huge investment plan of an annual 2% of euro area GDP to renovate public infrastructure (transportation systems, digital networks) and boost ecological transition (urban renovation, renewable energies, housing renovation). This investment plan could be financed by bonds issued by the EIB or by new tax revenues (FTT, carbon tax, if the latter is not used to help poorer households and developing countries to adapt, to offset partly companies' costs). This could be an opportunity to introduce a European tax on households' assets (but it would be difficult to get the agreement of a majority of MS). They suggest transfers between countries to offset interest rates spreads between countries resulting from the crisis (but the latter are difficult to assess) and vocational training expenditure for workers trained in a country A who would work in a country B (which may be problematic if unemployment in country B is such that there is no need for workers from country A).

Aglietta and Leron (2017), in *La Double démocratie* (The twin democracy), make a proposal for a European budget amounting to 3.5% of GDP. This budget which would finance public investment and more generally European common goods (such as fighting against climate change), would have own resources (such as a carbon tax and a financial transaction tax), and could issue euro-bonds. A European fiscal Agency would assess the economic and fiscal situations of MS, would make recommendations for necessary adjustment, determined by a fiscal commission (bringing together elected national parliament representatives), adopted by the Council and implemented by MS governments. This will allow to change the fiscal treaty. But what principles would guide this process: debt or deficit criteria, full-employment targets and what scope (how to handle differences in competitiveness)? Although the second element of the proposal is problematic, the first element is interesting – setting up a specific field for EU action, with dedicated funding.

Fourteen European economists published a call for a "democratic renewal of the euro zone".[2] They are in favour of a jump to democratic federalism, to a "real European executive that is democratically accountable before a parliament of the eurozone and leads economic policy with expertise and a larger degree of political autonomy". The call however does not have a reflection on the meaning of democracy in a federal EU: can a People be constrained by decisions made in a Parliament where its representatives are a minority? How to account for different interests, situations and institutions in MS? Should the subsidiarity principle be forgotten? The call suggests the appointment of a EU Commissioner, in charge of fiscal and monetary affairs for the area, who would chair the euro group and make executive decisions. But the extent of his/her powers is not defined: would he/she be able to amend budgets voted by National Parliaments? Certainly, the Commissioner would be accountable to the Eurozone Parliament, but how can one imagine that peoples agree to entrust to a foreign Commissioner and such a Parliament powers over their budget, public expenditure and their taxation? Moreover, it is unclear if the current budget rules would be maintained. Will the Commissioner be a watchdog verifying that budgets are consistent with the European rules or a conductor who will coordinate all countries economic policies? For the rest, the project is unrealistic. The euro area budget should start with a small size, of the order of 1% of GDP, but it should secure the financial system; finance a new cohesion policy for countries facing structural competitiveness problems (education, university, training, justice), this without duplicating European structural funds; it should encourage surplus countries to run social policies; it should finance defence, innovation, the environment, be open to non-euro area members. "While under the control of the Commission, this budget should, however, sit outside the EU budget". This budget would basically duplicate the budget of the Union, to do what it does not currently do. But why would governments, reluctant to increase the budget of the Union create a parallel budget? This budget would be financed by taxes and by issuing debt, that the text says strangely that it will be a risk-free asset, "complementing the constrained capacity of MS to issue safe assets. This will be crucial if member countries were to default on their national sovereign debt": the non-guaranteed of national public debts is not questioned. The financial sector is expected to "perform its stabilizing and risk-sharing function", this is hardly what it has done in the past. Finally, the text includes the project of a small unemployment insurance scheme at the euro area level. On the whole, the text offers little reflection on economic policies coordination, on the linkage between national and European democracy, in a delicate situation, a union restricted in his fields between different countries.

[2] https://www.politico.eu/article/opinion-blueprint-for-a-democratic-renewal-of-the-eurozone, 28 février 2018.

According to Bofinger (2018), "The monetary union is an unfinished building with a supranational monetary policy and 19 independent national fiscal policies. Thus, the only way to make it stable is to go ahead with political integration. With the transfer of fiscal policy responsibilities to the supranational level, fiscal discipline of the member states would be enforced by a democratically legitimised euro area finance minister and not by myopic financial investors". But the text does not say according to what principles the Minister would decide MS fiscal policy and what would be his democratic legitimacy to intervene to impose this fiscal policy on MS.

A Europe with more solidarity?

Should more solidarity, more transfers be promoted in Europe? According to us, the euro area functioning cannot durably rely on transfers between Northern countries (in good economic situation and with large current account surpluses), and Southern countries (with high unemployment rates). Northern countries' populations would not accept it. Southern countries cannot offset hard economic situations with transfers which would place them under the diktat of Northern countries and of the European Commission. Transfers between countries should take place only in exceptional circumstances or in the framework of production development policies. Each country should find a satisfactory economic model, which requires today differentiated strategies.

The EU is not a country. There is no EU solidarity, contrary to national sovereignty. Domestic specificities remain and people are attached to it, although not all of them can be viewed as respectful (for instance, low female employment rates in Southern countries, tax competition strategies in Ireland or Luxembourg). There is no agreement today between MS citizens to move toward a social Europe, a taxation Europe, insofar as this would imply to undermine national institutions.

Accounting for current disparities in the EU and from the willingness to cut public expenditure, it may not be obvious to raise common EU expenditure. Many countries are reluctant, either because they do not want to pay for the others, or because they want to keep their domestic specificities. In military defence, for instance, France and Central and Eastern countries may not have the same priorities. Migration policies differ, due to demographic and labour market prospects. In higher education and research, there is a contradiction between spending EU funds where they are the most efficient and countries' desire to develop these sectors.

At the word level, the EU is a leader in terms of economic governance and fight against climate change. But the EU did not succeed to set a common view on financial and banking sectors during the crisis. There is no agreement within the EU on the combat against tax evasion and tax competition. The EU seems to hesitate between a federal model, which the Commission and the Parliament tend to promote, and an intergovernmental functioning.

Can we imagine that major economic and social decisions be made at the EU level, by the Commission, the Council or even the Parliament without accounting for national votes and debates? Can we image a federal power able to account for domestic specificities in a EU made of heterogeneous countries?

In our view, accounting for current disparities in the EU, economic policies should be coordinated between MS and not decided by a central authority. EU institutions should first show that they are able to implement an efficient strategy, before the Peoples accept to increase powers at the EU level.

A Europe with several circles?

Brexit, the deviations of some Central and Eastern countries (Poland, Hungary), Denmark and Sweden's reluctances could be incentives to move towards a EU in several circles[3]. The first circle would include euro area countries agreeing new transfers of sovereignty, and would build a political, social, taxation, and fiscal union. This would be a step toward a democratic progress: Euro area Parliament, EU Commission accountable to the Parliament. The second circle would include EU countries who would not wish or would not be able to join the first circle. Last, a third circle would include countries linked to the EU with a free-trade agreement: Norway, Iceland, Liechtenstein, Switzerland, as of today, the UK and other countries (Turkey, Morocco, Ukraine) tomorrow[4].

This project raises many problems. The Commission is against, because it would undermine the EU move towards "an ever closer union". Non-euro area countries are hostile to such a project where they would be marginalised as 'second class' members. EU institutions would have to be split between euro area institutions functioning in a federal mode, and EU institutions continuing to function on Union of Member States mode, with a EU Parliament and a euro area Parliament, EU and euro area commissioners, EU and euro area budget and financial transfers, etc. There is no certainty that all euro area MS would wish to be in a first circle where tax and social harmonisation would be imposed; one would have to choose between accepting compromises so that Ireland, the Netherlands, Luxembourg, the Baltic countries agree to join or have a euro zone itself with two circles. Many issues would have to be tackled four times (at the restricted euro area, euro-area, EU, free-trade agreement levels). Depending on the issue, a member state could choose its circle and it would rapidly become a "à la carte" Europe. This is hardly compatible with European democratisation, which would rapidly require a different Parliament depending on questions. The members of the third circle would be in an even more difficult situation, as they would have to comply with regulation over which they would have no say. Besides, there is probably no agreement among EU People, even in the euro area to move towards a federal Europe, with all convergences and loss of democratic control that this would entail. In the current situation, few People will accept that their budget, tax systems, reforms of their social systems are decided by a federal body.

Unconventional proposals

QE for people proponents suggest that the ECB should support economic output, via giving a given amount of money to each euro area citizen each month. This project does not make much sense. The ECB cannot distribute money without counterpart. This is not the Central Bank's role; this is the fiscal policy's role. Banks must have assets equal to their liabilities. The ECB's balance sheet would be in deficit, i.e. a debt which would be affected to MS, the ECB's shareholders, and would come on top of

[3] This is what Emmanuel Macron advocates in his speech at the Sorbonne.
[4] See proposals by Pisani-Ferry *et al*. (2016) or Demertzis *et al*. (2018).

government debt. Such a policy would have to be agreed between MS, and be a transfer payment from domestic budgets.

For the same reason, the proposal asking the Central bank to buy a substantial amount of public debt, before cancelling MS credit line (or keeping them at 0 forever) should be rejected. In counterpart the ECB would issue bonds, hence transforming government debts in ECB's debt (see for instance the PADRE proposal, by Pâris and Wyplosz, 2014). Here also, the ECB's balance sheet would show a deficit, which would be added to government debts. The ECB would not pay dividends to MS, but would be subsidized by them. The savings in terms of interest payments for MS would be offset by the loss of dividends received from the ECB and from the amount of the subsidy that would be paid to the ECB. This would be a mere accounting trick.

Similarly, Watt (2015) tries to find a way to get around the SGP and the Fiscal Treaty. He proposes to finance a large public investment programme of 7.5% of GDP in 5 years by ECB's money creation. In fact, the investment projects would be financed by EIB credits to MS; the EIB would issue bonds, which would be purchased by the ECB on the secondary market. According to Watt, the advantage of such funding is that the public debt is not increased and so there are no costs in terms of interest payments. Certainly, its objective is totally relevant: a strong revival of public investment in Europe focused on ecological transition. The funding should have a counterpart, not in the form of banknotes with zero interest rate, but in the form of interest-bearing deposits or bonds. The ECB will have to reduce banks refinancing, which represent a cost for it, which will affect public finances. Above all, the ECB would be at risk of losing control of the money market. The monetary theory has shown that there is no difference between debt financing and monetary financing, when the Central Bank sets interest rates (with a Taylor rule or in a zero lower bound). Debt and monetary financings have the same macroeconomic impacts and the same costs in terms of public finances. The impacts on output and inflation are the same. As non-financial private agents will not hold more central bank banknotes, the money supply will not increase. If the central bank holds more bonds issued by the State or by a public bank (such as the EIB), the State (or the EIB) will issue less bonds on financial markets. So, financial investors will hold more firms' bonds, and firms will need less credit. For the Central bank, the increase in government bonds holdings will be offset by a decrease in commercial banks refinancing. Moreover, EIB loans would be counted in the public debts figures so that the operation does not allow to circumvent the TSCG constraint for public debts. Once the EIB has granted the loans it can finance without difficulty by issuing bonds, the purchase of its bonds by the ECB has no macroeconomic impact.

Tober (2015) rightly criticizes the proposals made by Watt, and Pâris and Wyplosz. She raises the issue of the respective roles of fiscal and monetary policy. In fact, both must manage the growth/inflation trade-off. In the short term, a given level of output can be achieved with a high public deficit and a high interest rate or with a balanced budget and a low interest rate. Coordination between fiscal and monetary policy is therefore necessary. In the euro area, the rule cannot currently be: "public budgets must always be in equilibrium and monetary policy manages the economic situation" as monetary policy is constrained by the zero lower limit for nominal interest rates and as national economic situations differ. Therefore, the only possible rule is: "monetary policy maintains a near-zero interest rate as long as inflation does not converge towards the 2% target, increases the interest rate towards the GDP nominal growth rate in normal times, fiscal policies support the activity as long as national inflation is not excessive”.

Some consider the launch of a fiscal money issued by the government, and accepted for tax payments (Bossone *et al.*, 2015, Kalinowski *et al.,* 2017[5]). The government could thus support output, by paying civil servants, social benefits and suppliers, with this money. However, contrary to what the proponents of this proposal claim, this money would be part of the public deficit and debt. The authors do not specify if this money would be a full currency; if retailers would be obliged to accept it even for imported products. There is no guarantee that economic agents would be ready to own it. Either it would be fully convertible (agents would quickly exchange it in euros as it would not yield any interest rate); or it would not be convertible, which would mean that two currencies would circulate, with parallel exchange rates, black market, instability risks, complications for transactions. This is only a way to turn the deficit and debt criteria. But who would be fooled?

Some authors propose that MS cut their public debts in a discretionary manner by an arbitrary percentage at the expense of their creditors. This would have no economic or legal justification. It would be done at the expense of economic agents who trusted European countries and often lent to them without risk premium. It would destroy market confidence in euro zone MS, whose public debt would be, for a very long time, considered as risky. MS would then have difficulties to borrow on financial markets, which is not currently the case. One cannot argue that MS debts are *illegitimate,* because they are issued by democratically elected governments. Even if some tax cuts and some public spending made by countries are questionable, creditors should not pay for it, as it would legitimate financial markets’ right to be the judge of national fiscal policy. One cannot argue that public debt is *unsustainable* when EU countries could borrow at 1% interest rates for 10 years, for a higher than 3 % trend nominal growth, and so the primary balance required for the stability of the debt-to-GDP ratio is negative.

However, in some countries, a fraction of the public debt comes from debts contracted by private banks. If rich depositors benefited from exorbitant interest rates and helped some banks to induce financial and real estate bubbles (like in Iceland, Ireland, Spain, Greece, Cyprus), it is not legitimate that their assets become public debt. It is legitimate that banks’ shareholders and large creditors bear losses (like in Iceland).

Moreover, public debts result partly from the excessive interest rates of the 1980-2005 period, partly from tax competition and tax evasion, partly from banks debts, partly from the great recession, and so from the functioning of neo-liberalism. It is socially unfair and it is an economic nonsense to ask austerity efforts to peoples to reduce public debts. The only possible strategies for public debt reduction are on the one hand to increase taxation on wealthy households and large multinational companies, to combat tax evasion and to avoid tax competition, and on the other hand to maintain interest rates below the rate of growth, which should be accompanied by a robust macro-prudential framework to avoid financial bubbles.

The note by *France Stratégie* (Aussilloux *et al*., 2017) recognizes the large costs implied by cutting public debt via fiscal consolidation policies. It makes three proposals: countries implementing debt-

[5] The project is part of the programme of the new Italian Government under the name of "mini-bots".

reduction programmes (for example, down to 60% of their GDP) would benefit from a guarantee of the ESM, which would finance the difference between the interest rates on their debt and their growth rate (but the benefit would be of second order and would play if the country's growth is low, which one wants to avoid; moreover, the country would *benefit* from a monitoring of the ESM, which is not acceptable). The State would nationalize a certain proportion of all lands (but it is hardly credible politically; it may be justified to expropriate those who have benefited from real capital estate gains, but many owners are indebted after buying real estate whose price already incorporated these gains). The ECB would buy a part of the public debts that it would indefinitely retain (but we already saw that it is fictional).

Coordinating policies in the EU

In advanced economies, the system which worked until 1999 and still works in the US, UK and Japan, lied on unity between the government, the central bank and commercial banks. The central bank is the lender of last resort for the government and banks. The government can issue unlimited public debt. This public debt is considered as safe and benefits from as low as possible market interest rates. This system allows to guarantee the banking system. Besides, countries chose taxation, social protection and possible reforms, according to democratic processes.

The introduction of the euro area had led to a hardly manageable structure. On the one hand, countries need to run more active fiscal policies because they have lost control over their interest rates and exchange rates. In addition, since 1973 and even more since 2007, the macroeconomic equilibrium requires a certain level of public deficit and debt. On the other hand, in a single currency union, current imbalances in one country affect the other MS. Therefore, excessive deficits (or surpluses) should be avoided, but how to define them? Rules lacking economic rationale have been enshrined in the Treaties. Last, financial markets' functioning makes it necessary for public debts to become safe assets again, while at the same time Northern countries deny to give unlimited guarantee to their partners. The treaties provide procedures for economic policies coordination, but they have not delivered. The Commission tries to impulse many reforms, without democratic debates.

Ideally, euro area countries should become able again to issue safe public debts, at an interest rate controlled by the ECB. They should be able to run a government deficit in line with their macroeconomic stabilisation needs. The mutual guarantee of public debts should be entire for countries agreeable to submit their economic policy to a coordination process.

This coordination cannot consist in fulfilling arbitrary rules. It should be done through a negotiation process between countries. Coordination should target GDP growth and full employment; it should account for all economic variables; countries should follow an economic policy strategy allowing to meet the inflation target (at least to remain within a target of around 2%, which may be increased in time periods when a strong recovery is needed), to meet an objective in terms of wage developments (in the medium-run real wages should grow in line with labour productivity), in the short-run adjustment processes should be implemented by countries where wages have risen too rapidly, or not sufficiently[6]. A strategy of internal devaluation (such as a cut in employers' social contributions) offset by an increase in VAT should only be implemented by countries with a competitiveness problem. Countries should announce and negotiate their current account balance targets; countries running high external surpluses should agree to lower them or to finance explicitly industrial projects in Southern economies. The process should always reach unanimous agreement on a coordinated but differentiated strategy.

The Treaty should maintain an effective process in the event where no agreement is reached. In that case, the new debt issued by countries outside the agreement would not be guaranteed, but such a case should never occur. This is the only way to ensure countries not to be under the financial markets diktat. Besides, the ECB should keep interest rates below the GDP growth rate, to reduce the public debt burden. Simultaneously, the ECB should provide incentives to banks not to develop speculative activities (in particular by a financial transactions tax and the separation of deposit banks from markets activities), to finance productive activities (especially re-industrialisation and environmental transition).

National fiscal policies would be facilitated if a European budget financed public investment and more generally European common goods (such as fighting against climate change) by common resources (such as a carbon tax and a financial transactions tax), and by issuing euro-bonds. But this cannot be a pretext for additional constraints on national budgets.

Economic policy coordination should not raise difficulties after negative demand shocks (global or specific); it should not target objectives with no economic rationale (such as a structural government balance or a debt at below 60% of GDP). Coordination may be harmful for a country having to implement a supply side policy after a negative supply shock. On the contrary, coordination will be impossible if a group of countries set non-cooperative targets, such as large gains in competitiveness or a large current account surplus.

It would be difficult, if not impossible, to reach such an agreement, based on an intelligent and precise cooperation and not on rigid rules. It would require negotiations with uncertain outcomes. But this is the only way for a currency area to work properly. If open economic policies cooperation cannot be run within the euro area, the single currency will not survive.

It should however be recognised that our proposal cannot currently politically be implemented, since Germany and many Northern countries refuse to depart from the European Treaties, the SGP or the TSCG; they request that financial markets exert control on MS, and that EU authorities can impose structural reforms to MS. If one adds the refusal of a EU of transfers and the refusal of tax harmonisation, it seems unlikely that ambitious projects, such as Emmanuel Macron's projects, for instance, may be implemented.

Besides, three political choices need to be made. Does the EU want to maintain and develop its social model, with its specificity in terms of social and fiscal systems and labour rights or is its objective to oblige reluctant countries to accept the constraints of a liberal globalization? Should EU MS keep

[6] But the adjustment should not be done through the introduction of an automatic link between the minimum wage and the current account, as proposed by IAGS (2014). If a country runs of current account deficit due to a financial or housing bubble, the effort should not bear first on lower paid workers.

different national social and tax systems, or is the objective to make them converge? Or does the EU want national systems to converge? Which share of public spending should be done at the EU level? Can the EU make progresses without any precise agreement on these three issues?

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