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The Euro and the 2008 financial crisis: Monetary regime or Eurosystem failure?

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CHAPTER 1

The 2008 crisis

Effects and Causes

On the 15th of September 2008 the American bank Lehman Brothers filed for bankruptcy becoming the largest bankruptcy filing in the US history. When Lehman Brothers failed, the bank was holding more than 600$ billion in assets[1]. Lehman Brothers was not bailed out by the Fed due to the fact that its assets were more fragile than the ones of Bear Sterns, a bank saved by the Fed through JP Morgan which acquired it in order to prevent its failure. The bankruptcy

[1] Mike Adu-Gyamfi (2016), *The Bankruptcy of Lehman Brothers: Causes, Effects and Lessons Learnt.*, Journal of Insurance and Financial Management, Vol. 1, Issue 4 132-149

of Lehman Brothers had major effects in the financial market: Dow Jones lost 500 points in one day, the greatest plunge until that day, while many reserve funds became consistently exposed to Lehman Brothers, with the Reserve Primary Fund which witnessed the Net Asset Value of their market shares go below 1$ due to the holding of 785$ million in Lehman Brothers debt securities[2]. Numerous hedge funds which chose the US failed bank as their prime broker saw their positions blocked after the bankruptcy, slowing down and stopping the growth of these hedge funds, which relied heavily on the trust and confidence they had on Lehman Brothers.

Lehman Brothers bankruptcy uncovered the fallacies which accompanied the mortgage market: indeed, the bank held 3.4$ billion in commercial mortgage backed securities, an amount which had to be filled through an enormous selloff of mortgage securities, resulting in tragic consequences on the prices of these MBSs and bank assets in general. Therefore, since the ratio of mortgage debt on percent of total commercial bank debt has risen from 32% to 42% in less than 20 years, Lehman Brothers bankruptcy stroke every financial institution, from the stock market to money funds, banks and hedge funds[3].

The subprime mortgage crisis affected not only financial institutions but also financial variables, and as some economists state the linkage between macro-financial factors and real shocks is the main cause of economic spillovers and boom-and-bust cycles which characterize the global economy. Indeed, the financial shock of the Lehman Brother bankruptcy rapidly spread its effects all over the global economy: immediately, the plunges visualized in the US most important stock market index influences the performances of European indexes such as the London FTSE or the Paris CAC 40[4]. Eventually, the situation of the major Asian index was not different. Even though some studies assessed that the US financial crisis did not affect the Chinese stock market, the same cannot be said to the other Asian Tigers: Hong Kong, Singapore, South Korea, Taiwan and especially Japan all faced a similar fate, with their respective stock markets losing within 2 and 6 percentage points[5]. The entire world bank system changed, with a clear cut of the bank recapitalization (from 8$ trillions to 4$ trillions). The US stock market slump and the consequent financial disaster affected not only advanced countries but also emerging market which saw their economic growth hampered: countries such as

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[2] Mike Adu-Gyamfi (2016), *The Bankruptcy of Lehman Brothers: Causes, Effects and Lessons Learnt.*, Journal of Insurance and Financial Management, Vol. 1, Issue 4 132-149

[3] Robert L. Hetzel (2012), "*The Great Recession: Market Failure or Policy Failure*?", Cambridge University Press, Cambridge

[4] Dominik Salvatore (2010), *"The Global Financial Crisis: Predictions, Causes, Effects, Policies, Reforms and Prospects.",* The Journal of Economic Asymmetries. 7, pp. 1–20.

[5] *Ibidem*

Mexico and Russia stumbled heavily, while Brazil Indonesia, India and China only witnessed a slow down in their economic development and their real GDP growth[6].

Another major consequence regards the global industrial production. Even if Paul Krugman maintains that, despite the tragic effects of the 2008 crisis, the Great Recession is only "Half a Great Depression"[7], this statement is too optimistic and US centered. Krugman based its reasoning on graphs which took in consideration the US industrial output, whose reaction was far way better than 80 years ago[8]. However, industrial production and international trade in 1929 worked differently; after the Second Industrial Revolution, the majority of the industrial production was based in Europe and North America and the global trade was defined in the exchange of industrial goods produced in the North with raw materials coming from Southern developing countries. The 1929 depression brought the collapse of industrial production, disproportionally harming unemployment and output rates. However, Krugman's vision highlights only one side of the medal by referring only to US industrial production rate. Indeed, even though the output levels of developing countries in Asia and Latin America remained the same, the deterioration of trade caused by the downfall in advanced countries output levels brought to the worsening of the trade terms of the Southern countries, leading to the decrease in the prices of raw materials and the beginning of a process of lowering incomes which produced heavy consequences still evident in developing countries economic paths[9]. In 2008, the industrial production was influenced by globalization processes: industrial production was not US centered or Euro-centered, and the financial plunge heavily influenced various regions of the world. Indeed, the global industrial production fell rapidly in the first year after Lehman Brothers bankruptcy, even faster than during the Great Depression. Furthermore, many economists agree that the real variable highly affected by the 2008 credit crunch was the volume of world trade: from the crisis in the production of manufactured goods which composed the 70% of trade in 2008 (compared to the 44% in 1929) to the recession in imports by advanced countries which obstructed the growth of emerging countries, world trade fell more rapidly in the first year of the 2008 crisis[10]. Finally, the labor market faced a deep crisis, with advanced countries having to deal with double digit unemployment: for example, just the Lehman Brothers bankruptcy left over 25.000 people without a job in one day.

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[6] *Ibidem*

[7] Paul Krugman., (2011) "*The Economic Failure Of The Euro",* Interview with Paul Krugman by NPR

[8] *Ibidem*

[9] Miguel Almunia et al. (2009), "*From Great Depression to Great Credit Crisis: Similarities, Differences and Lessons"*, Historical Patterns of Development and Underdevelopment: Origins and Persistence of the Great Divergence (HI-POD)

[10] *Ibidem*

Economists suggest that the 2008 crisis is not an oil-shock or a technologically-induced recession; the Great Recession was determined by a shortfall in aggregate demand which provoked the beginning of the unwanted accumulation of inventories by enterprises and the subsequent inventory cycle[11]. This process exacerbated economic fluctuations leading to the decrease in real GDP between 2008 and 2009. But which are the causes of this aggregate demand shortfall? The debate over which factors lead to the collapse of an entire economic system characterizes the macroeconomic academic field nowadays. When analyzing the 2008 credit crunch models, economists agree that the housing bubble burst and and consequent housing shock played a major role in the financial crisis. Mathematical models and policies such as the Clinton Housing Ownership policies in the 90s display the increasing amount in home mortgages in the US and in Europe. Housing prices were rising seemingly in an unstoppable way between 2000 and 2005, leading financial institutions to create new financial instruments such as sub-prime home mortgages repackaged into mortgage- backed securities (MBS), structured investment vehicles (SIVs) and the continuous reference to Off Balance Sheet (OBS) which fostered leverage by banks. At the beginning of the 21st century, financial riskiness and exposure of the banks were exacerbated by the enlargement of the financial safety net by central banks and government, and by the enhanced difficulty to monitor the balance sheets and off-balance sheets (fare nota) of various financial institutions, which were mainly composed mortgages divided into tranches, tranches in which cash flooded through structured financing and rated by rating agencies. Initially, the confidence on financial institutions instilled after the Great Moderation period and by rating agencies working together with banks made the housing prices to rise more than 50% after 1995, gave banks the access to funds banks have access to funds whose costs do not rise if the risk rises and convinced investors to become more risk-taking since any damage would be attenuated by the safety net. But when this financial system collapsed due to the burst of the housing price bubble, banks suddenly discovered to be dramatically exposed to the real estate market, while house-owners found out that their mortgage was higher than the actual price of their house, making them to stop payments[12].

In determining the rationale behind the financial system crumble, two visions contrasts each other in the macroeconomic field:

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[11] Directorate General for the Economic and Financial Affairs of the European Commission (2009), "*Economic Crisis in Europe: Causes, Consequences and Responses"* European economy 7.

[12] Assaf Razin, Steven Rosefielde (2011), *'Currency and Financial Crises of the 1990s and 2000s.*', CESifo Economic Studies (57), pp. 499-530.

- The market-disorder view, which follow the principles established by the famous economist John Maynard Keynes, maintain that the lack of regulation on the new financial devices and rating agencies and the greed of businesses to make profits in the unregulated financial market are the main factors behind the crisis. In particular, according to Arnold Kling capital deregulation in the early 2000s (an example is the end of the differentiation between commercial banks and investment banks through the 1933 Glass-Steagall Act) fostered financial institutions to take on "bad bets" and "excessive leverage" with insufficient reserves[13]. Kling explains that in the new financial system, financial institutions are so interconnected that contagion could affect also healthy institutions through a "domino effect", causing what he defines as "21st century bank runs" which is **"**financial stress created when the first creditor that attempts to liquidate its claim has an advantage over creditors that wait"[14]. Keynesians sustain that also the inadequate application of existing rules over investment institutions, together with economic greed and fraud caused by psychological swifts which are intrinsic in human nature (Keynes defines individuals as "animal spirits") compose the main rationale behind the 2008 credit crunch.
- The monetary disorder view believes that the interference of central banks through monetary policy altering the price fixing process of the market system, fooling entrepreneurs through these government-engineered policies and further creating business cycles. Hetzel in his book "*The Great Recession: Market Failure or Policy Failure?*" affirms that the housing shock, energy price increase and the downfall of the exchange rate in some Asian countries could have caused only a moderate recession. Instead Hetzel gives the blame for the major recession witnessed in 2008 to the contractionary monetary policy set up in the US by the FOMC which did not lowered the funds rate during the credit crunch, departing from the period of Great Moderation, Volcker-Greenspan Era and the "Lean Against the Wind" with credibility policy (increase in funds rate when resource utilization increased too). Furthermore, Hetzel maintains that also in Europe a contractionary policy was implemented at the same time, with Jean Claude Trichet focusing on headline inflation rather than on changing then contractionary policy started in July 2008. Both the Fed and ECB focused on the disruption of financial intermediation rather than on implementing an expansionary

[13] Kling, Arnold (2009), *'Not What They Had in Mind: A History of Policies that Produced the Financial Crisis of 2008.'*, MERCATUS CENTER, George Mason University
[14] *Ibidem*

policy and extend the monetary basis which would have introduced disinflation and confidence back in the price system fixing process[15].

The situation in Europe

As said before, the crisis started with the failure of Lehman Brothers spread rapidly from the US to the global financial system, firstly in advanced countries and then in emerging markets. The contagion initiated with the burst of the housing bubble which contaminated the balance sheets of financial institutions around the world. Especially in Europe, rampant optimism was pervasive among investors mindset after the period of low and stable inflation and sustained growth called “Great Moderation” and the introduction of the Eurozone, whose leaders wanted to to appear solid, progressive and irreversible[16].

Based on these optimistic feelings arising from their regional financial system, European banks constituted the largest part of the demand of the financial instruments structured by US banks, due to their greed of returns for long-term, illiquid investments and the cost of short-term funds. Between August 2007 and September 2008, the Fed witnessed an increasing demand for dollars, but instead of initiating open market purchases and let the market allocate liquidity, the US central bank engaged in policies to foster the channelling of money directly to banks with funding difficulties or directly to European central banks. Operations such as the Term Auction facility (TAF) or the swap lines with foreign central banks allocated US dollars in foreign financial institutions which started relying on them. Hence, when the credit crunch dramatically happened in September 2008, European banks found themselves extremely exposed to bank leverage and insolvency. Indeed, bank leverage was 31 for Lehman Brothers at the time it failed in March 2008 and 38 at Citigroup, which was the weakest of the largest U.S. banks, but it was at 42 at UBS, 56 at Deutsche Bank, and 63 at Barclays. On average, bank leverage was 35 for the largest 12 European banks as compared with 12 for the largest 12 U.S. banks[17]. The same can be said regarding the housing market. The housing bubble was greater in some European countries than in the United States. For example, between 2004 and 2007, the peak housing

[15] Robert L. Hetzel (2012), “*The Great Recession: Market Failure or Policy Failure?*”, Cambridge University Press, Cambridge

[16] Barry Eichengreen, Peter Temin (2010), “Fetters of Gold and Paper.” Oxford Review of Economic Policy, 26, pp. 370–384.

[17] Dominik Salvatore (2010), *“The Global Financial Crisis: Predictions, Causes, Effects, Policies, Reforms and Prospects.”,* The Journal of Economic Asymmetries. 7, pp. 1–20.

prices were 2.58 times higher than their long-run trend in Ireland, 2.10 times in the United Kingdom, 1.92 times in Spain, comparing to the 1.76 times in the United States[18].

The global financial crisis resulted in major recession, especially in the EU where there had been a considerable reduction in the rate of increase for GDP in the EU-28 and this was followed by a fall in real GDP of 4.4 % in 2009. Even though in 2010 and 2011 the region recorder a slight recovery, economic contraction came back in 2012 (- 0.5%), despite being followed by larger positive rates of change were recorded in 2013 (0.2 %), 2014 (1.5 %) and 2015 (2.2 %). However, analysing the same data coming from the EA-19, which are those EU members who accepted the common European currency, it is possible to notice that economic records are similar to the ones of the EU-28, but contraction in 2012 was harsher (- 0.9%) and continued in 2013 (- 0.3%). Individually, each member of the EU-28 experienced a halt in their GDP growth in 2008, from advanced countries such as Germany, France, United Kingdom and Italy to emerging markets such as East-European and Baltic states[19]. However, the consequences of the financial crisis did not hit European countries in the same way: indeed, some analysts stated that cultural differences, especially on fiscal policies, altered the effects of the Lehman Brothers bankruptcy and the subsequent credit crunch in Europe. Eichengreen and Temin maintained that "while in Southern Europe deficit spending and government debts were allowed to grow all out of control, in Central Europe there was nothing to prevent the pursuit of a chronic deflationary bias"[20]. The data coming from the Eurostat confirm this trend: countries such as Spain, Italy, Portugal and especially Greece faced deeper decreases in GDP between 2008 and 2013, while Germany and the Netherlands experienced a slight growth in their domestic production[21].

The global recession started in 2008 influenced and struck also the European labour market, where unemployment has been rising sharply since March 2008. As for production, the crisis affected labour market in different ways according to states and social categories: The worst hit countries include Spain and Greece, who both witnessed an increase in unemployment rate until 24% or more. Furthermore, data established that men are clearly affected more than women, young people also appear to be more vulnerable, with youth unemployment rates in the EU 27 reaching the highest level ever registered in July 2014 with 21.8%. The 2008-2013 recession

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[18] *Ibidem.*

[19] Data extracted from Eurostat (2016), *"National accounts and GDP".* http://ec.europa.eu/eurostat/statistics-explained/index.php/National_accounts_and_GDP

[20] Barry Eichengreen, Peter Temin (2010), *"Fetters of Gold and Paper."* Oxford Review of Economic Policy, 26, pp. 370–384.

[21] *Ibidem*

has installed a deflationary spiral in the Eurozone which EU institutions have found difficulties to contrast, which has forced member states with major budget deficits to implement harsh austerity measures and cuts, and which has affected the already fragile EU labour market. Indeed, in 2016 EU unemployment rate was registered at 9.8%, against the 3% registered in Japan and the 4.7 registered in the US and in the UK[22]. EU has been dealing with structural unemployment for over two decades due to rigid labour markets, unemployment benefits which encourage frictional unemployment, geographical immobility by EU workers due to cultural differences such as language differences, and strong labour market regulations which discourages firms from investing and hiring new workers.

Overall, various authors have defined the crisis which stroke Europe as a "sovereign debt crisis", caused by the dry-up of cross-border financial flows, with investors lowering their financial international exposure after the Lehman bankruptcy and the following US financial system break-up. This process asymmetrically affected countries which relied mostly on international short-term debt markets. The crisis started in one of the most isolated European countries: Iceland faced the disruption of its banking system. Immediately, the financial disaster affected Ireland, Portugal and Greece. In particular, the sovereign debt crisis resulted in the collapse of financial institutions, the increase of already high government in some European countries (especially peripheral European countries) debt and rapidly rising bond yield spreads in government securities. More generally, the global financial crisis caused a revision of asset prices and growth prospects, especially for those countries that displayed macroeconomic imbalances. The most relevant consequence of the debt crisis was the lost of confidence witnessed in the firms, businesses and economies in the EU, with rising spreads on sovereign bonds (for example, the annual spread on ten-year sovereign bond yields between Germany and countries such as Greece, Spain and Italy which was close to zero before 2008), rating agencies starting downgrading sovereign debt of several European states and countries which were unable to refinance their government debt or bail out their illiquid and insolvent banks without being helped by third-party financial institutions such as the European Central Bank (ECB) and the International Monetary Fund (IMF).

The European sovereign debt crisis did not come from nowhere: some of the causes are the aforementioned real estate bubble crush and the Great Recession caused by the financial system breakdown. However, other reasons behind this economic process are peculiar of the Eurozone, such as the impossibility for member states of the EA-19 to devaluate their currency, the strange

[22] Data extracted from Eurostat (2009) *"Archive: Impact of the economic crisis on unemployment"*

role played by the ECB as a central bank and the not unified fiscal policy which characterizes the EU and developed this differentiation in the reaction to the crisis started in 2008.

CHAPTER 2

The monetary policy in the Eurozone

Differences between ECB and Fed: structure and crisis management

In 1988 the European Council established the objective of the progressive recognition of Economic and Monetary Union (EMU). The project developed in the 1988 Delors Report envisaged 3 stages for the economic and monetary integration of the Eurozone, which included initially the complete freedom for capital transactions and the improvement of economic convergence and which would have ended with the independence of the national central banks, to be completed at the latest by the date of establishment of the European System of Central Banks the introduction of the euro and the conduct of the single monetary policy by the European System of Central Banks. On the 1st of June 1998 the European Central Bank was instituted as a preliminary step for the introduction of the common currency. The main task of the ECB is to maintain price stability[23], considered as fundamental for creating job and fostering economic growth, and control and protect the value of the euro through the supervision of credit institutions within the EA-19 and non-euro member states. These tasks are performed independently under the TFEU which establishes that neither the ECB, nor the national central banks or the members of these bodies shall be influenced or reached by EU bodies or central governments of the member states[24]. The ECB represents the head of the Eurosystem. The Eurosystem consists of the ECB and the national central banks (NCBs) of the Euroland. One

[23] Art. 127 of the Treaty for the Functioning of the European Union (TFEU)
[24] Art. 130 of the Treaty for the Functioning of the European Union (TFEU)

of the governing bodies of the Eurosystem is the Executive Board which is composed of the, the vice – president, and four directors of the ECB[25].

The Executive Board has the task to develop monetary policies following general principles such as the preservation of the transmission process and the readjustment of dysfunctional money markets, a possibility which appeared after the recent financial turmoil. ECB monetary policy is based on 2 pillars: the "economic pillar" is expressed by the quantitative definition of price stability which the General Council must refer to when discussing monetary policies. This definition comprises the Harmonised Index of Consumer Prices (HICP) for the euro area. The HICP is the index that most realistically approximates the alterations over time in the price of a representative basket of consumer expenditures, analysing goods prices and services. The second pillar regards longer-term inflation, which must remain below but close to 2% in the medium-term, excluding deflation. In general, the ECB projects and targets its monetary policies evaluating all the risks to price stability, conveying all the information gained through economic and especially monetary analysis, since the ECB recognizes the role played by monetary growth in the determination of the inflation rates which best fit the region and in the determination of a nominal anchor which provides fundamental data in the development of not only short-term monetary operations but also medium-term and long-term trends and policies[26].

On the other side of the Atlantic, the monetary policy of the United States of America is managed by the Federal Reserve System, founded in 1913 through the Federal Reserve Act after 3 decades in which the US faced several financial panics and bank runs. Even though 50 members constitute the US, the Federal Reserve System is composed by 12 districts supervised by the Board of Governors in Washington and the Board of Directors. The main decisional body regarding funds rate is the Federal Open Market Committee (FOMC), while the Board of Governors guided by the Chairman analyses economic and financial conditions and regulate Reserve Banks, together with proposing the opening or closing "discount windows" (make discount loans at the discount rate). The core objective of the Fed, as for the ECB, is to maintain price stability in the are which it supervises, even though the Fed does not establish the acceptable inflation rate as the ECB (1-2% comfort zone is the target). Furthermore, the Fed aims to reach maximum employment (despite some analysts believe that maximum employment would not result in economic growth, but a certain level of unemployment is needed) and moderate the long-term interest rates.

[25] The entire composition of the ECB can be found at https://europa.eu/european-union/about-eu/institutions-bodies/european-central-bank_en#composition

[26] European Central Bank (2011), *"The Monetary Policy of The ECB"*

As stated in 2009 by Jurgen Stark, member of the Executive Board of the ECB:

In September 2008, conditions in financial markets worsened dramatically. The bankruptcy of Lehman Brothers led to the emergence of a full-fledged financial crisis and this, in turn, was accompanied by a rapid deterioration of economic conditions in most major economies of the world."[27]

The disruption of the financial system and the subsequent consequences on the monetary conditions and on real economy pushed the Fed and the ECB to react immediately. The Fed and the ECB are two politically independent bodies but under supervisors with different nature: for the ECB the Maastricht Treaty, while for the Fed is the Congress. This difference is visible in the types of monetary policy instruments used by the two central banks. Indeed, both engage in open market operations but with different instruments:

The ECB engages in main-refinancing operations (MROs) through standard tenders, long-term refinancing operations (LTROs) with 2 week maturity, fine tuning operations in which maturity is not standardised, and structural operations, initiated by the ECB and performed through reverse operations and issuance of ECB debt certificates.[28]

The Fed sees its short-term objective for open market operations specified by the Federal Open Market Committee (FOMC). Before 2008, Fed used open market operations to follow the target for interest rates set by the FOMC. Fed open market operations consisted in the simple purchase and sale of securities in the open market.

After 2008, some economists maintained that the reaction by the Fed was more aggressive than the one set up by the ECB, which instead was considered sluggish and one of the reasons of the double-dip recession witnessed in the Eurozone. The Fed injected unprecented amounts of liquidity in the market under the direction of Bernanke through credit easing, namely the use of the asset side of Fed's balance sheet to allocate credit to segments of the credit markets deemed dysfunctional. Credit easing is focused on the mix of loans and securities that Fed holds and on how this composition of assets affects credit conditions for households and businesses. The Fed introduced and Congress passed new financial instruments such as the TARP (Troubled Asset Relief Program), which provided funding to purchase the bad mortgage debt of banks and the TALF program, meant to set up special purpose vehicles (SPV's) to buy $200

[27] Jurgen Stark, *"Speech at University Tübingen"*. Tübingen, 9 November 2009.
https://www.ecb.europa.eu/press/key/date/2009/html/sp091109.en.html

[28] European Central Bank (2011), *"The Monetary Policy of The ECB"*

billion in asset-backed securities and consumer and small business loans. Through other new financial tools such as Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) and term auction and securities lending facility, Bernanke, the Treasury and the Fed stopped attempting to limit the moral hazard created by bailouts, made bailouts less limitable, since the necessary funds no longer had to pass through congressional approval, and took the initiative of fiscal policies from the congress.[29]

All these operations by the Federal Reserve System have been effective and fast thanks to the cooperation between the Ministry of Finance and all the other institutions in the US. Cooperation which was not shown among the ECB, national central banks and governments, and the other European institutions. The criticism laid on the ECB's could be justified in a context of the interest rate setting, while the liquidity providing actions have closely followed those conducted by other major central banks[30]. After the explosion of the in financial turmoil in 2008 and the lost of confidence in the financial system by the participants in the market, the ECB answered offering larger amounts through its operations and by narrowing the linkage between the marginal lending facility rate and the deposit facility rate. Furthermore, on 15 October 2008, the ECB also expanded the collateral framework, thus enhancing the provision of liquidity. The ECB has introduced new financial instruments such as liquidity provisions issued in foreign currencies (US dollar, UK pound and Japanese yen) and outright purchases of specific debt securities, demonstrating that despite the political and cultural fragmentation in Europe, the ECB is well organised and able to manage situations with non-standard and unpredictable characteristics[31].

The same well-organised reaction has not been displayed by the ECB when referring to economic analysis, in particular regarding interest rate policies in the Eurozone[32]. Various economists, politicians and policy-makers have criticized the fact that the ECB and the Bank of England have both started to decrease their key interest rates remarkably later than the Federal Reserve. The US Federal Reserve lowered (the Fed Funds rate) of more than 5%, going from 5.25% in September 2007 to -0.25% in December 2008[33] (see Table 1). At that point, "the Fed also initiated quantitative easing made public its intention to keep interest rates low 'for

[29] Robert L. Hetzel (2012), *"The Great Recession: Market Failure or Policy Failure?"*, Cambridge University Press, Cambridge
[30] Yves Mersch, "*The ECB and the Federal Reserve – an ocean apart?",* speech made at Harvard University, 12 October 2016
[31] European Central Bank (2011), "The Monetary Policy of The ECB"
[32] *Ibidem.*
[33] Olli Lethimaki (2009), *"Evaluation of the European Central Bank's Reaction to the Recent Financial Crisis within the Two-Pillar Framework",* Helsinki School of Economics

some time"[34]. The ECB joined the global reduction of interest rates only in September 2008, but its actions remained sluggish and interrupted by two further increases in April and July 2011. But most importantly, the ECB has decreased to near-zero rate the interest rate only in 2013, and has started proper quantitative easing between 2014 and 2015. Two reasons can be given to explain the sluggish reaction by the ECB through interest rate reduction:

- A historical reason: The ECB main priority has always been maintaining price stability. Indeed, the upward pressure on future inflation in the euro area, seen until autumn 2008, has clearly made the ECB less willing to relax its monetary policy. "Statistically speaking, between January 2000 and December 2008 the ECB changed its main refinancing interest rate 25 times, while the Fed funds rate was modified up to 40 times"[35].This analysis demonstrates that the ECN has managed to create a stable and transparent economic situation in Europe in the last decade, with the inflation rate in the EU which was less volatile than in the US. But it shows also that the financial turmoil has hit so heavily the Eurozone that the ECB was not able to deviate rapidly from its consistent interest rate policy.
- A geographical reason: Developing a unique monetary policy for the Eurozone requires the establishment of a common interest rate, which fits the paths of economic growth taken by all countries. Hence, the flaw of the Eurosystem is structural, with this congregation of autonomous countries, big and small ones, which are represented by autonomous parliaments and governments. These factors have brought to internal tensions within less indebted countries (which consider the interest rate reduction as harmful for consumption and investment) and more indebted countries (the target of the policy reduction. Furthermore, the highly differentiated characteristics of the Eurozone make economic predictions hard to collect and vulnerable to mistakes.

Is the ECB a lender-of-last-resort?

The role of lender of last resort in a government bond market is fundamental as much as for the banking system. A central bank can be considered a lender of last resort when it protects depositors and investors from withdrawing their capitals because of shocks caused by the

[34] Dae Woong Kang, Nick Ligthart, Ashoka Mody (2016) *"The ECB and the Fed: A comparative narrative",* VOX, CEPR's Policy Portal

[35] Olli Lethimaki (2009), *"Evaluation of the European Central Bank's Reaction to the Recent Financial Crisis within the Two-Pillar Framework",* Helsinki School of Economics

insolvency or illiquidity of various financial institutions. When solvency problems arise in one bank, depositors start withdrawing cash, setting in motion a liquidity crisis in many sound banks, and degenerating into a solvency crisis as banks try pull down the value of their assets, leading other banks to have solvency problems. The same process is displayed in the government bond market of a monetary union: when a state faces a problem of insolvency, bondholders sell their financial instruments in other markets, causing scarcity of capital and aggravating the situation of the already insolvent original market[36]. Both the banking system and the government bond market require an institution mandated of being lender of last resort since it could solve problems of illiquidity which would deteriorate in lost of confidence by both depositors and governments by injecting capital in the financial institution and re-establishing a good equilibrium in the market. [37]

The way in which Fed and ECB plays the role of lender of last resort represents another discordant point in their comparative analysis. Indeed, The Fed and the U.S. Treasury have been performing the role of lender of last resort since the beginning of the 20th century, with some economists maintaining that the 1929 financial crisis evolved in the Great depression due to the inactivity by the Fed as a lender of last resort.[38] According to its monetary policy, the Fed will help by loaning capital to financial institutions which are experiencing financial difficulties or almost collapsing. Usually, when deposit holders are confident that an institution acting as a lender of last resort exists, this characteristic rarely has to be used[39]. However, the 2008 credit crunch was so destructive that individuals lost confidence in the banking system, causing severe liquidity and solvency problems among commercial banks and depository institutions, which then were not able to fulfil their obligations with other non-financial institutions and dragging the entire economy into recession. In May 2008, the Fed bailed out Bear Stearns through JP Morgan. This financial intervention just a few months before the financial catastrophe is considered to be the reason why the Fed was not able to act in the same way with Lehman Brothers, and so avoiding the Great Recession. However, in order to avoid another Great Depression, the Fed intervened by not only injecting enormous amounts of money in the open market (see 1.1), but also by injecting capital in various banks balance sheets

[36] Paul de Grauwe (2013), *"The European Central Bank as Lender o Last Resort in the Government Bond Market",* CESifo Economic Studies, Oxford Academic
[37] Charles Goodhart, Dirk Schoenmaker (2014), *"The ECB as a Lender of Last Resort?",* VOX, CEPR's Policy Portal
[38] Robert L. Hetzel, "The Great Recession: Market Failure or Policy Failure?", Cambridge University Press, Cambridge
[39] Paul de Grauwe (2013), *"The European Central Bank as Lender o Last Resort in the Government Bond Market",* CESifo Economic Studies, Oxford Academic

(Citigroup, Bank of America, Merrill Lynch) and bailing out other financial institutions (namely two GSEs: Fannie Mae and Freddie Mac)[40].

On the other hand, ECB's lender of last resort role has not been codified in any founding Treaty of the EU yet, and it is up to the national central banks in the Eurosystem to perform this activity[41]. Even though the European banking system did not experience the same devastating effects of the credit crunch as the American one, some criticisms have been moved to the operational framework of the Eurosystem, in particular regarding its supervision and resolution role. Indeed, the aim of European mechanisms such as the Single Resolution Mechanism and Single Supervisory Mechanism was to eliminate the "diabolic loop" between the governments and the banks regarding the LoLR role by allowing not the national central banks, but the ECB to play this part in the monetary union[42]. Under these two programmes, the ECB is responsible for supervising 120 large European banks, while other local banks remain under the jurisdiction of national central banks. However, the institutions acting as a lender of last resort are still the national central banks, thus creating a contradiction between the regional power of supervising and considering a bank solvent or not, and the national power of the central banks to bail out financial institutions which yet have been evaluated by the ECB. This unclear reasoning behind which institutions should become lender of last resort in the Eurosystem could create political tensions between the various apparats of this complicated system, with all the parties blaming the others for any kind of failure, thus hindering the financial failure prevention process of troubled banks.

Additionally, the lender of last resort function of a financial institution should be found also in the government bond market since sovereigns could face problems of liquidity and solvency, requiring the help of a financial institution according to the Bagehot theory. The Fed allows himself to perform this function in the government bond market through US Treasury Bills with different maturities. An example of the strong reaction enacted by the Fed through the performance of the LoLR role is displayed b the acquisition of long-term Treasury Bills and mortgage backed securities for the enormous amount of $3.5 trillion in 5 years from 2009 to 2014[43].

[40] Robert L. Hetzel, "The Great Recession: Market Failure or Policy Failure?", Cambridge University Press, Cambridge

[41] Charles Goodhart, Dirk Schoenmaker (2014), *"The ECB as a Lender of Last Resort?",* VOX, CEPR's Policy Portal

[42] *Ibidem.*

[43] Grègory Claeys (2014), "*The (not so) Unconventional Monetary Policy of the European Central Bank since 2008",* Directorate General of Internal Policies for the European Parliament

In August 2012, the Governing Council of the European Central Bank (ECB) announced that it would start to outright transactions in secondary, sovereign bond markets, aimed "at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy."[44] The technical framework of these operations was formulated on 6 September 2012. The "Outright Monetary Transaction" (OMT) constituts a radical change in the direction of the monetary policies within the Eurosystem, which caused the beginning f a decreasing trend in interest rate spreads between Eurozone countries. But most importantly constitutes the injection of unlimited conditional liquidity by the ECB in the government bond market[45].

However, the OMT is only the last step undertaken by the ECB in its path to become a lender of last resort in the government bond market. Indeed, the sovereign-debt crisis witnessed in Europe convinced the ECB to structure programmes for "common liquidity facility" such as The European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM),as well as the European Financial Stabilisation Mechanism (EFSM)[46], and an initial session of outright purchases of sovereign debt in the secondary markets under the Securities Markets Programme (SMP) in order to help Spanish and Italian sovereigns in 2010, and especially to counter the rise of Greek bond yields and the subsequent debt crisis[47]. However, these operations, together with the Covered Bonds Purchase Programme (CBPP) in 2009 which have been working between 2010 and 2012, have been considered temporary, incomplete and largely influenced by political pressures and restrictions under the Treaties regulating the Euro Area.[48]

Through the SMP, the ECB purchased government bonds, within secondary markets, in order to inject capital to release the pressure from sovereign debt risk on the balance sheet of monetary financial institutions. In order to prevent an inflationary spiral caused by the instalment of the SMP, the ECB annulled the effects of these open market operations by auctioning "Fixed term Deposits" in order foster the lending operation of banks to the general public and increase inflation, in what could be defined as "debt monetisation"[49]. The lack of data about the effectiveness of the SMP and the fact that the government bond market by the end of the programme on 2012 was still financially unstable would suggest that the ECB has failed.

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44 European Central Bank (2012), *"Technical features of Outright Monetary Transactions*", Press Release

45 Paul de Grauwe (2013), *"The European Central Bank as Lender o Last Resort in the Government Bond Market",* CESifo Economic Studies, Oxford Academic

46 Willem H. Buiter, Ebrahim Rahbari*, "The ECB as a lender of last resort for the sovereigns in the Euro area",* Discussion paper, Centre for Economic Policy Research (CEPR)

47 *Ibidem*

48 *Ibidem*

49 Place du Luxembourg (2012), *"ECB Market Intervention: The Securities Market Programme (SMP)",*

However, the only conclusion that can be stated is that, while for Greece, Portugal and Ireland the SMP has not avoided the bailout by the ECB, it has prevented the same finale for Italy and Spain, whose fragmented political systems were driving the sovereigns into a financial collapse. However, it is also possible to maintain that the SMP and CBPP were not as aggressive as the policies set up by the Fed. Indeed, the CBPP brought into the market "only" $76.4 billion through purchases of government bonds[50].

The complicated relation between the ECB and its function as a lender of last resort has several reasons behind:

One reason lies behind the core nature of the Eurozone. Indeed, as explained by Paul De Grauwe "It is useful to start by describing the weakness of government bond markets in a monetary union. National governments in a monetary union issue debt in a 'foreign' currency, that is, one over which they have no control. As a result, they cannot guarantee to the bondholders that they will always have the necessary liquidity to pay out the bond at maturity. This contrasts with 'stand alone' countries that issue sovereign bonds in their own currencies. This feature allows these countries to guarantee that the cash will always be available to pay out the bondholders. Thus, in a stand-alone country, there is an implicit guarantee that the central bank is a lender of last resort in the government bond market"[51].

The legal structure of the Eurosystem constitutes another limitation to the possibilities of the ECB to develop concrete programmes to stabilise the government bond market. Indeed, "overdrafts or any other type of credit facility with the ECB or with the national central banks in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or national central banks of debt instruments"[52]. Even though it has been stated that the ECB is not allowed to buy government securities under its statutes, this claim is not completely true: indeed, the ECB is allowed to exchange "marketable instruments", and bonds issued by sovereign governments could be considered within this category[53]. In effect, the ECB performed the OMT

[50] Grègory Claeys (2014), "*The (not so) Unconventional Monetary Policy of the European Central Bank since 2008",* Directorate General of Internal Policies for the European Parliament
[51] Paul de Grauwe (2013), *"The European Central Bank as Lender o Last Resort in the Government Bond Market",* CESifo Economic Studies, Oxford Academic
[52] Art. 21 of the Protocol on the Statute of the European System of Central Banks and the European Central Bank,
[53] Art. 18 of the Protocol on the Statute of the European System of Central Banks and the European Central Bank,

and the SMP in the secondary market, providing liquidity not to sovereigns but to the financial institutions, avoiding to finance directly government budget deficits.

The gap between political and economic integration in the EU is shown also when referring to the lender of last resort function. Indeed, the SMP and the CBPP had their lives cut short by economic forecasts but most importantly by political pressure. Indeed, Axel Weber, former head of Bundesbank, and Jurgen Stark, displayed their concerns on the first intervention in the government bond market since it could harm the ECB's independent role as price stabilizer through political pressures and disrupt the boundaries between monetary and fiscal policies, and then left their seats as a manifestation of their negative feelings over ECB engaged in open market purchases[54]. On the other hand, it is undeniable that the interventions of the ECB in bailing out, preventing the bailout and injecting liquidity in various fields of the financial markets of EA peripheral countries have avoided an economic depression.

Furthermore, in explaining why the European policymakers and the member states governments had not decided to give directly the powers to the ECB to supervise and, in extreme cases, buy portions of public debts of various EU countries, instead of creating financial programmes such as the ESM and the EFSF which paly a supportive and not resolute role in the economic framework of the ECB, a "free-rider" assumption pops up. Indeed, traditionally a government debt should not experience a default risk since the central bank can intervene through lending money to the state. However, the European monetary jurisdiction consists in various state governments which refer to one central bank and one common currency. Each state would prefer to borrow as much as possible from the ECB, enlarging in the monetary base of the EMU. The enlargement of the monetary base produces and increase in the inflation rate, which not only would mean an action in contrast with the principles of the ECB of maintain the price stability, but would signify an increase in the level of inflation not only in the country which borrowed the most, but also in the ones belonging to the monetary union.

Despite the ongoing debate on how the ECB should perform the lender of last resort function, the conclusion is that the dichotomy between the lender of last resort in the banking system and government bond market remains one of the greatest challenges the Eurosystem has to face in its evolutionary process. A process made more difficult by the very nature of the monetary regime established by the Eurosystem.

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[54] Axel Weber's speech in New York (2010) quoted in *"Weber-ECB bond buying programme should be scrapped",* Reuters

On the other hand, the blame for the sluggish intervention of the ECB, especially in the government bond market, must not be given entirely to the monetary union structure. The economic framework in which the Eurosystem works is highly influenced by the political fragmentation and the disposition under its regulatory Treaties and protocols which result unclear and ineffective. In addition, the unwillingness shown by European leaders in the years previous the 208 credit crunch to concede some degree of "independence" to the ECB had serious repercussions on the crisis management system among the EMU.

Deflation vs. devaluation the gold standard experience

Despite the change in the economic regime of the Eurosystem after 2008, with the first programmes of quantitative easing and open market purchases of government securities, members of the Eurozone entered in a vicious deflationary spiral, with peripheral countries interest rate such as Spain and Italy going into negative territory between 2008 and 2014. Deflation defines an increase in the value of money and a consequent sharp decrease in prices of goods and services. Erroneously, the public opinion believes that deflationary pressures increase the purchasing power of individuals, and so the level of consumption. In real terms, that is not the case: for example, deflation produces an increase in the real value of debts against the value of the assets. This means that goods and services lose value year by year, producing harsh consequences among the industrial sector such as foreclosures, causing another decrease in the value. Secondly, deflation increases the unemployment rate. The decreasing spiral of prices obligates produces to a further lowering in prices due to increased competition. The decrease in price rates produces subsequent issues such as layoffs. In this sense, the level of income decreases together with consumption, producing a deflationary spiral. The final step is an economic crisis caused by the weakness of aggregate demand, the one witnessed in almost all the advanced countries during the Great Recession.
But why the deflationary spiral affected the Eurozone the most? Paul Krugman maintains that the blame for the impossibility by European countries to counteract deflation must be given to the monetary union. According to Krugman, the best way to drive costs down is to devaluate the currency, cutting wages and prices. This is impossible in a monetary union composed of different points of view and interests. However, price and wage stickiness do not permit costs

cut through direct policies, leading to deflation as the only possible response to increasing costs and further crisis. The difference between the labour markets of the member states of the EA 19 and the tensions over the topic of internal devaluation are deemed crucial to explain the passivity of the ECB over the deflation problem[55]. But the real economic reason behind Europe sluggish reaction to the 2008 financial crisis and to the double-dip recession between 2008 and 2011 is because income fell down while debt continued to rise.

According to Eichengreen and Temin is possible to draw a comparison between the situation in Europe during the Great Recession and the behaviour of the countries constituting the Gold Bloc during the 1929 Great Depression. The gold standard represented the predominant monetary regime among advanced countries until the 20th century, when sovereigns decided to abandon it, despite maintaining enormous amounts of gold reserves. The gold standard regime established that to a unit of currency corresponds a fixed quantity of gold[56]. Due to the fact that every individual could go to the central bank and claim gold for paper money and vice versa, one of the central banks main objective in the 20th century was to maintain a certain amount of gold reserves. In other words, the gold standard constitutes a fixed exchange rate regime which, like other fixed exchange rate regime examples, various economists deem efficient in times of economic growth and stability, since it facilitates business and communication, but it intensifies problems in times of economic crisis due to limitations imposed on the currency and deflationary pressures the economy of the sovereign states adhering to this monetary regime. Indeed, many analysts argue that the principal factor behind the Great Depression was that in 1927 almost all advanced countries have decided to return to the gold standard[57]. The gold standard became so pervasive among 20th century economies and societies that gave life to the so-called "gold standard mentality" and policy makers believed that in order to stimulate the economy the solution was to modify the gold standard, and not abandon it[58]. However, when in 1929 the US stock market crushed, the economic situation became unbearable for countries adhering to the gold standard: indeed, France and especially the US owned over 60% of the gold reserves of the world and were not willing to lend gold anymore in order to avoid domestic bank runs. This produced the spread of deflationary pressures on other countries such as Germany, UK and Italy, which in addition were struggling to pay reparations and debts

[55] Paul Krugman (2011), *"Can Europe Be Saved?"*, Magazine, New York Times
[56] Barry Eichengreen, Peter Temin (2010), "*Fetters of Gold and Paper*" Oxford Review of Economic Policy, 26, pp. 370–384.
[57] Robert L. Hetzel, "*The Great Recession: Market Failure or Policy Failure?*", Cambridge University Press, Cambridge
[58] Ibidem

accumulated after WWI[59]. Consequently, the effects of the deflationary policies by US and France on a nominal variable such as the parity of gold were transferred on real variables, with the unemployment rate increasing violently and the distribution of wealth heavily damaged. Eichengreen and Temin and others sustain that the only solution to stop this vicious economic spiral and to exit the Depression was the abandonment of the gold standard. In particular, they maintain that under the gold standard, countries could not devalue their currencies, allow the demand for exports to determine their exchange rate and could not expand money supply to stimulate domestic demand, since it would push up prices, provoke gold exports and weaken the currency. The only way to reduce production costs, taking in consideration the wage stickiness in the European labour market, was to deflate[60].

Even though the 2008 crisis developed in an economic recession, and not in a depression as in 1929, the similarities between the difficulties experienced by the Gold Bloc countries and the member states of the Eurozone. In their paper "Fetters of Gold and Paper", Barry Eichengreen and Peter Temin consider the euro an extreme fixed exchange rate regime as much as the gold standard. Furthermore, countries could enter and exit the gold standard whenever they wanted, while with the adoption of the euro, countries accepted a monetary union which would eliminate national currencies (while in the gold standard each country retain their single currency and the power to issue money through their central banks) and which would be irreversible, since there is no clause in the Lisbon Treaty on how to abandon the single currency and introduce back the national currency. The analogies with the gold standard continue when referring to the economic symmetry in a monetary regime. The point here is not letting deficit countries "off the hook": both in the crisis of the 20th century and the 21st century, various countries were running budget and current-account deficits and financing them by borrowing abroad, ignoring budget constraints. Their attitude was fostered by the illusive stability created by the pegged exchange rate regimes, namely the gold standard and the euro. As said before, fixed exchange rate regimes result effective in times of economic growth since it encourages foreign investments and the flow of capitals from countries in which the interest rate is low to the ones in which interest rates are high, eliminating the perception of risks. However, when a major crisis erupts, this flow of capital is shut down and deficit countries face enormous problem due

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59 Barry Eichengreen (1992), "*Golden Fetters: The Gold Standard and the Great Depression, 1919-1939*", Oxford University Press.

60 Barry Eichengreen, Peter Temin (2010), "*Fetters of Gold and Paper*" Oxford Review of Economic Policy, 26, pp. 370–384.

to the deflation policies imposed by capital-abundant countries. It happened between Germany and the US in the gold standard, and between Greece and Germany in the euro area[61].

The singularity of the EA-19 is that its structural framework does not contain a provision or a fund to help member states which face financial difficulties to re-adjust their economic situation. While in the 30s, countries heavily harmed by the depression such as Germany had the possibility to abandon the gold standard and devaluate again their currency, starting their economic recovery, the same cannot be said for the euro. Therefore, when the Greek crisis erupted in 2010, the Eurosystem found itself stuck between political differences among member states and its economic structure which did not contemplate direct financial help to countries. Initially, the responsibility for helping Greece was given by the European Institutions to the International Monetary Fund, which according to various economists has always been very lenient to European countries. Others suggested that the Greek crisis was an internal affair and should be solved by Greece itself[62].

The bottom line is that the members of the EA-19 cannot abandon the euro according to the irreversibility of the European Monetary Union and to the economic forecasts according to which abandoning the euro would result in an extreme devaluation of the national currency which would compromise the competitiveness of the entire national economy[63]. On the other hand, as the 2008 financial crisis and the Greek crisis have shown, the monetary regime which operates in the Eurozone has exacerbated the effects of the credit crunch, has propelled the deflationary pressures and has not permitted to the European institution to intervene promptly in order to solve the Greek crisis: By the way, this situation has heavily influenced the modus operandi under which the Eurosystem works nowadays, with the introduction of quantitative easing by the President of the ECB Mario Draghi and new financial instruments directed to the stability of the government bond market (see 2.1).

[61] *Ibidem*
[62] *Ibidem*
[63] *Ibidem*

CHAPTER 3

Not unified fiscal policy

Talk the talk but not walk the walk

The 2008 crisis has demonstrated the weakness and fragility of the European Monetary Union in dealing with a major financial breakdown and the subsequent sovereign debt crisis which hit Greece and other peripheral countries. Most economists suggest that the monetary union reached with the introduction of the common currency is not enough to develop the solid and irreversible European Union as formulated earlier in the 20th century[64]. Indeed, the gap that between economic integration and the political unification has not only been blamed for the chaotic reaction of the European institutions and the economic crisis, but also, in times of Brexit, of incessant flow of immigrants, of the rise of populist movements and of early attempts of economic recovery, has been widening to a point that the situation is unbearable. However, the European institutions had the chance to finally reach political unification and social cohesion between its member states through encouraging the development of a common social model in which both the market and the social programs and institutions. But most importantly, what has characterised the debate over the incompleteness of the project regarding the European Union is the unification of the fiscal dispositions.

The European fiscal union idea could be dated back to 1977, when it was propounded inside the MacDougall Report. The aim of the fiscal union though in the MacDougall Report was different from the one which is discussed now: indeed, in order to launch the monetary union project, the Community budget should have been increased and channeled into regional funds[65]. The objective of the creation of the monetary union could be carried out through the fiscal equalisation of the countries pertaining to the European Community, following the examples

[64] Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", Policy Note, Levy Economics Institute of Bard College. Pp. 1-7

[65] Donald MacDougall et al. (1977), *"Report of the study group on the role pf public finances in European integration"*, General Report for the Commission of European Communities, pp. 1-72

of other monetary unions regimes which have been “powerfully assisted by the largely automatic equalising and stabilizing interregional flows through the channels of federal finance”. [66]

The European institutions and policy-makers moved the dispute over the creation of an internal fiscal union to the background with the introduction of the common currency and the obvious evolution of the single market project especially regarding exchange rate changes which could influence productivity and country competitiveness in the internal market. From the 1992 Maastricht Treaty through the 2002 introduction of euro coins and banknotes, European politicians accelerated the path towards the economic integration of the newly formed European Union, accepting numerous countries in the Eurozone, creating new institutions such as the European Central Bank, developing coordination mechanisms such as the Stability and Growth Pact, the Excessive Deficit Procedure and the Broad Economic Policy Guidelines and believing that extreme economic convergence could have substituted the need of internal adjustments of social, political and fiscal frameworks among member states. Furthermore, during the initial stages of the European Union, the common belief was that the region would have faced mostly country-specific shocks, avoiding strong recessions[67].

But the reality was different. The 2008 crisis has highlighted the enormous structural weaknesses of the European Monetary Union, in particular regarding the the viability of the common currency, as we have seen earlier, and the difficulties faced by member states in repaying the debt. Many economists have suggested that one of the causes of the European sovereign debt crisis regards the insufficient commitment of European institutions and parliaments to fiscal harmonization and efficiency, which could have avoided the major shocks faced by Greece and the spill-over effect witnessed after 2010[68]. According to the International Monetary Fund, fiscal discipline among the EMU is indispensable in order to give to the Eurozone that insurance mechanism which provides an already established system through which the European economic institutions could discipline fiscal frameworks and temporary transfers, providing more certainty regarding the management of financial shocks such as the one in Greece[69]. Furthermore, given the low degree of risk-sharing among the EMU in comparison with other similar federations such as the US and Canada, the European fiscal unification could increase risk-sharing degree, eluding the extension of local shocks into shocks

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66 Quoted in *Ibidem.*
67 Cèline Allard et Al (2013), “Toward a Fiscal Union for the Euro Area”, Staff Discussion Note, International Monetary Fund, pp. 1-27
68 *Ibidem*
69 *Ibidem*

affecting the entire system, against which the European institutions have not developed any mechanism to counteract. The IMF suggests that greater fiscal integration would result in "future crises made less frequent, less severe and less prone to systemic spillovers"[70]. In addition, a common fiscal framework within the Euro area, which requires the introduction of the centralization of fiscal policies in the hands of the European institutions, "would also reduce the risks of idiosyncratic national policies, expand the scope of available counter-cyclical tools, and allow for an improved coordination of fiscal national frameworks, subject to appropriate governance safeguards"[71].

Even though the European Union fastened its process of economic integration and creation of the single market, even though from its beginning the Union has agreed on important matters such as foreign policy and security with the Common Foreign and Security Policy (CFSP), an agreement on a common fiscal framework among European institutions still seems an utopia. Generally speaking, the reason behind this slow path towards fiscal unification in the euro area is because such policy requires a comprehensive and broad political backup to support the project. On the other hand, national visions over a fiscal union differ and do not allow to find a valid compromise yet. The 2008 credit crunch caused by the failure of Lehman Brothers in the US and immediately spread in Europe exacerbated the cultural diversities among European nation states on fiscal matters, with some arguing for a greater solidarity between member states, while others pushed over the reinforcement of national fiscal policies as a priority in order to prevent further stress. Despite this drastically different visions over the nature of a fiscal union, among the European institutions national politicians made speeches highlighting the importance of an increased fiscal soundness in the EMU. But their words were not followed by real actions inside their borders[72]. Some analysts suggested that behind this contradictive behavior undertaken by various national governments lie both political and economic reasons:

- Politically speaking, Eichengreen and Temin describe the attitude displayed over fiscal union inside the buildings in Brussels and Frankfurt as "the euro area […] talked the talked, but didn't also walk the walk, of international cooperation."[73]. The two economists, together with other colleagues, suggest that, even though the awareness over the soundness of national fiscal policies were a matter of common concern, the

[70] Cèline Allard et Al (2013), *"Toward a Fiscal Union for the Euro Area*", Staff Discussion Note, International Monetary Fund, pp. 1-27
[71] Ibidem
[72] Barry Eichengreen, Peter Temin (2010), "Fetters of Gold and Paper" Oxford Review of Economic Policy, 26, pp. 370–384.
[73] *Ibidem*

European institutions are still not designed in a way to develop such general frameworks through which national states could operate. But most importantly, the European Union, and in particular the European Commission, does not have the possibility to enforce its decisions through an army, giving the possibility to the politicians to run their mouths with words of cooperation in Brussels, while preferring the local interests inside their national boundaries. Indeed, when dealing with something as crucial as tax and spending, democratically-elected governments will always follow and according to what their local electorates want, rather than following structures and obligations coming from the regional level. Eichengreen and Temin compare the situation in the EU with the one of the gold bloc countries, claiming that also in the 30s national politicians preferred pursuing permissive policies favorable for their electorates rather than implementing harder actions which could have solved the crisis between the "gold standard mentality" principles, and when they actually implemented those harsh policies they had to face protests and riots[74]. Thus, the difference is that gold bloc countries could have decided to exit the gold standard whenever they want, while the irreversibility of the European union and the consequent monetary union fostered the rise of controversies between member states, for example between Germany and various Southern countries such as Greece and Italy.

- Economically speaking, the dispute over the formation of a European fiscal union regards the budgetary position of the government of each member state of the EMU. Among the 19 members of the euro area, it is well known the difference on the attitude undertaken by member states over fiscal policies. Indeed, in the first years of the EMU, in Southern Europe, public expenditures and budget deficits grew gradually but relentlessly. In contrast, Central European countries, worried about the possibility of entering in a deflationary spiral, ran budget surpluses[75]. The two lines of thoughts developed two different vision of fiscal union: Central European countries, led by German, already proposed through the German finance minister Wolfgang Schäuble and by Jean-Claude Trichet, the former president of the European Central Bank (ECB) for a fiscal framework based on shared sovereignty, with more intervention by the EU and discipline over matters of public finance[76]. The plan developed by these countries

[74] *Ibidem*
[75] *Ibidem*
[76] Katharina Gnath, Jörg Haas, *"A Fiscal Union for Europe – Building Block and Not a Magic Bullet"*, Research project, The Bertelsmann Stiftung and the Jacques Delors Institut – Berlin

should avoid what they fear the most: namely, a fiscal union resulting in a "zero-sum proposition", with financial costs systematically falling on those countries with a stronger tradition of fiscal prudence[77]. On the other hand, Southern countries prefer a risk sharing fiscal union, based on mutual support in order to prevent country-specific shocks and the subsequent contagion[78].

Both proposals have pros and cons: if provided with correct safeguards, the risk sharing proposal would not result in permanent transfer of financial capitals from countries in a better economic situation to countries under financial stress. Therefore, if the risk sharing fiscal union is complemented with specific macroeconomic policies, no nation state will remain always on the giving or receiving end and will not depend on the economic size of the countries. On the other hand, the advocates of the common fiscal framework based on sharing sovereignty criticise the fact that the risk sharing proposal will result in the continuous and irreversible transfer of capitals from fiscal prudent countries to irresponsible member states, within the treaties and the institutions already existing in the euro area[79]. The shared sovereignty proposal sponsors higher control over on national budgetary policies and fiscal behaviour by giving back authority and respect to the European fiscal rules, lost after the 2008 crisis, and by setting up new supervisory institutions at the regional level aimed to impose fees and sanctions if European fiscal limits are not respected[80]. However, many critics stated that what Central European countries (especially Germany) propose does not foster economic growth in the Eurozone, but rather would result in a negative impact on income growth, if not supported by policies favouring external competitiveness[81].

The debate on fiscal union is still ongoing and has expanded itself on the very nature of the monetary union, with two factions clashing against each other on themes of monetary policy and mostly fiscal policy.

Economists vs Structuralists

[77] Cèline Allard et Al (2013), *"Toward a Fiscal Union for the Euro Area"*, Staff Discussion Note, International Monetary Fund, pp. 1-27

[78] Katharina Gnath, Jörg Haas, *"A Fiscal Union for Europe – Building Block and Not a Magic Bullet"*, Research project, The Bertelsmann Stiftung and the Jacques Delors Institut – Berlin

[79] Cèline Allard et Al (2013), *"Toward a Fiscal Union for the Euro Area"*, Staff Discussion Note, International Monetary Fund, pp. 1-27

[80] Katharina Gnath, Jörg Haas, *"A Fiscal Union for Europe – Building Block and Not a Magic Bullet"*, Research project, The Bertelsmann Stiftung and the Jacques Delors Institut – Berlin

[81] *Ibidem*

The 2008 crisis ignited one of the main dichotomies which characterized the debate over the economic nature of the European Monetary Union: "Economists" against "Structuralists". Although the first discussions recognized as a common objective the creation of the "United States of Europe" with the introduction of the common currency very similar to the dollar and able to compete with it, the two schools of thought developed contradictory elements and ways of thinking over how to carry out the objective[82].

The American economist Jan Kregel has analysed the core logics behind both economists and structuralist and has observed how these two lines of though have influenced not only the economic view of the countries pertaining to the EU, but also the policies enacted in response to the 2008 credit crunch, which has revealed numerous important flaws of the Eurozone such as the incapability of the institutions to tackle effectively and promptly major financial instability and most importantly the difficulties faced by those institutions to define a common fiscal framework

According to Kregel "economists argued that the operation of market processes would produce real economic convergence, which would eventually create the conditions to allow the introduction of institutions such as a common currency as the "crowning" achievement of the European project". By saying this, Kregel suggests that according to the "economist" trend, the introduction of the common currency should be the result of a simultaneous process pf economic and political integration, in which both the political and the economic field influence each other in order to set up effective and functional institutions and policies. Economists suggest that the completion of the single market market should be managed through policies which foster the synchronization of he business cycles and and through classical market mechanisms.

On the other hand, the "structuralist" view "unification as a process of creating the appropriate institutions on the presumption that the comportment of the member-states would eventually adapt to the desired structure." The structuralist vision of economics was born in the 60s and 70s in Latin America, due to the disappointment of the local economists with orthodox explanations of the economic growth in South America and the Caribbean. The rationale behind the structuralist vision promotes the necessity of a government-guided economic growth through infrastructure and the development of the production sector, "the criticism to

[82] Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", Policy Note, Levy Economics Institute of Bard College. Pp. 1-7

comparative advantage"[83] and the differentiation between advanced and underdeveloped countries through structural rigidities[84]. However, the theories thought by important personalities such as Celso Furtado and W. Arthur Lewis were mostly designed and referred to the economies of Latin America, making the application of those notions difficult on other parts of the world. Hence, after the drafting of the Washington Consensus in the 90s and the appearance in the world of finance of principles such as "stabilization, privatization and liberalization"[85], the structuralist approach was updated in order to analyse the new developmental problems of the South American countries due to processes of globalization and financial liberalization, but also in order to apply the new perspective to other regions such as the Eurozone. The neo-structuralist approach maintains that there is no empirical evidence of the possibility by single markets to optimally allocate goods and services in the economic system[86]. Neo-structuralists believe that changes in the social structure will correspond to the evolution of the institutions composing the economic framework and that the European transition economy needs effective economic and political institutions to promote targeted industrial, financial and mostly fiscal policies[87].

In the wake of the 2008 crisis, both "economists" and "structuralists" struggled to determine the causes of the sovereign debt crisis which characterised the Eurozone between 2008 and 2011 and clashed over the degree of political and economic integration and how it has influenced the fiscal sluggish response by the European institutions to the crisis. In particular, Kregel states that "the debate between the economists and the structuralists is being resumed in the imposition of austerity as the solution to the sovereign debt problems in the EU"[88]. The austerity measures have been implemented in many countries pertaining to the Eurozone (but also in the UK) in order to tackle the major sovereign debt crisis which stroke the region, and majorly influenced the fiscal framework of all the European countries, as we will see in the next chapter. Thus, the development of the austerity measures is the consequence of a series of

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[83] Esteban Pérez Caldentey, Miguel Torres and Romain Zivy (2015), *"Interview on neo-structuralism"*, Newsletter of the World Economic Association.
https://www.worldeconomicsassociation.org/newsletterarticles/neo-structuralism/

[84] Erik Berglof (2015) *"New structural economics meets European transition"*, Journal of Economic Policy Reform, 18:2, 114-130, DOI: 10.1080/17487870.2015.1013543

[85] Esteban Pérez Caldentey, Miguel Torres and Romain Zivy (2015), *"Interview on neo-structuralism"*, Newsletter of the World Economic Association.
https://www.worldeconomicsassociation.org/newsletterarticles/neo-structuralism/

[86] *Ibidem*

[87] Erik Berglof (2015) *"New structural economics meets European transition"*, Journal of Economic Policy Reform, 18:2, 114-130, DOI: 10.1080/17487870.2015.1013543

[88] Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", Policy Note, Levy Economics Institute of Bard College. Pp. 1-7

events, reports and treaties which represent important milestones of the European economic history and highly influenced the mind-set of the European policy makers and analysts. In particular, Kregel affirms that the imposition of financial limitations, spending cuts and tax increases on countries that cannot honour their debt obligations such as Greece represent the result of political pressures exercised on the European policymakers by one country in particular: Germany[89]. The German view resembles in certain aspects the economist view, and in particular after the Maastricht Treaty the German influence permeated the highest offices in Frankfurt and Brussels. As we have seen before, the Maastricht Treaty in 1992 fastened the process of creation of the common currency and the single market, which was introduced in the European economic agenda in the 70s with the Cecchini report. However, the introduction of the euro, "the crowning element of the process of economic integration"[90], was implemented when the European political convergence was not concluded, especially regarding fiscal union. Important members of the Bundesbank and of the ECB stressed the importance of the variable velocity integration among the European Union. In particular, in 1996 Hans Tietmeyer, president of the Bundesbank, explained the situation in this way;

> *"After a certain point, economic integration cannot realistically be expected to advance further without the prospect of further progress in the field of politics. The transfer of an elementary sovereign right such as mon- etary policy to a European Central Bank is likely to mark that point."*[91]

In other words, German economists suggest that political convergence should not come as the consequence the economic integration, but a basic requirement. Some of the reason behind the German position have been analysed earlier in the paper, such as the abandonment of devaluation as an instrumental against negative shocks, which has been substituted by the internal adjustment of wages and prices. However, the harmonization of the safety nets of all the members state of the Eurozone required high levels of political integration, which the European Union has not found yet. But most importantly, the economist view of the German policymakers highlighted the importance of fiscal harmonization in a common currency regime.[92] Kregel stated that "National differences in unemployment and commitment to fiscal

[89] *Ibidem*
[90] Jan Kregel (2012), *"Six lessons from the euro crisis",* Policy Note, Levy Economics Institute of Bard College. Pp. 1-4
[91] Quoted in Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", Policy Note, Levy Economics Institute of Bard College. Pp. 1-7
[92] *Ibidem*

prudence would produce, in the German view, political pressure for compensation in the form of transfers from the wealthier or less indebted to the poorer or more indebted areas and undermine political solidarity, as well as undermine support for a common ECB monetary policy."[93]

Germany underlined that the absence of fiscal coordination could harm the ability of the ECB to perform its principles such as the maintenance of price stability. Furthermore, even before the financial crisis Germany insisted on embedding measures limiting the size of government budgets and pushed to insert these measures in the treaties regulating the monetary union such as the Treaty of the Functioning of the European Union (TFEU) and the Stability and Growth Pact (SGP). On the other hand, the European authorities, realising the difficulties in converging the various cultural and political frameworks, continue ratifying treaties and setting up institutions to which every member states should comply. But without political integration, the measures undertaken by European policy-makers result either incomplete or cannot respected by the sovereigns. As regards fiscal measures, the example regards the SGP and the reform of 2011 with the introduction of the "Six-pack" measures introduced to foster fiscal sustainability as a substitute of strong central control. Even though the requirements for the entrance in the euro are strict, when a state enters the European Union rarely face punishments for not respecting the entry conditions, since imposing sanctions on debt and deficit requirements need intense political integration. The failure of the EU to solve these flaws, and of its members to stick to the entry requirements brought about the pressure that Germany forecasted 20 years ago, and which resulted in the bail out of various peripheral countries by Germany itself. The consequent implementation of the austerity measures and of other budget deficit limitations was provoked also by the refuse by German authorities to "grand debt reductions" and its call upon Greece to introduce a more prudent fiscal behaviour[94].

However, Kregel is critical to both the economists and the structuralists regarding their visions over fiscal union. Kregel maintained that the structuralists "got it wrong" regarding their original vision over the European union, a division made of common structures to which member states should have conformed, as when the Common Agricultural Policy, which introduced the distribution of funds destined to agricultural through fixed rates, was ratified[95]. The introduction of the common currency as the structure which should have completed the

[93] Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", Policy Note, Levy Economics Institute of Bard College. Pp. 1-7

[94] *Ibidem*

[95] Jan Kregel (2012), *"Six lessons from the euro crisis",* Policy Note, Levy Economics Institute of Bard College. Pp. 1-4

process of European economic integration, without the fiscal union and the economic asymmetries present within the Eurozone. The institutions of the EU found themselves in an unprecedented situation when Lehman Brothers failed, the financial market crunched and the sovereigns recognised the fact that they were not able to repay their debts, and the instruments available where not designed to tackle such a critical issue. However, Kregel believes that "the current crisis is not really a crisis of the euro, it is a crisis of the member-states' ability to meet the minimum conditions for refinancing or retiring debt through fiscal policy"[96] and someone still believes that if a stronger institutionalization of the European Union as developed, for example with the creation of a central EU fiscal authority, the recession could have been avoided. On the other hand, the solution suggested by Germany in order to prevent further crisis and to obviate the absence of a fiscal union together with political integration resulted ultimately unsustainable. The austerity measures almost "imposed" on Greece and other financially endangered countries, despite thought by German politicians to be necessary after the debt crisis to maintain the stability of the euro, were deemed by Kregel unbearable and against the definition of financial fragility gave by Minsky, according to which a state under financial stress as Greece n 2010 should borrow to repay its debt instead of committing itself in hedge financing. Indeed, Kregel's final statement affirms that even following the Minskyian point of view and the Ponzi scheme, the alternative path for financial recovery will remain unsustainable with this level of fiscal convergence and political unification[97].

Multi-speed Europe

"Economists" and "Structuralists" clashed over one of the most influential flaws of the European union: the lack of fiscal convergence. Since the formation of the first European Communities, but especially after the Maastricht Treaty, numerous ideas of elements of a fiscal union have flourished among academic and political environments. Furthermore, with the exchange rate and monetary policy no longer being handled domestically after the introduction of the European common currency, a low labour mobility and elevated price and wage stickiness, national fiscal policy has become bound to a more centralistic attitude when it comes to buffer financial shocks such as the one in 2008. However, the formation of a fiscal union

[96] *Ibidem*

[97] Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", Policy Note, Levy Economics Institute of Bard College. Pp. 1-7

requires high levels of political convergence, since the definition of fiscal union is still debated and interpreted in various ways; from the set of common rules which should be accepted by the member states to the creation of a federal government with taxing and spending authorities[98]. A fiscal union requires numerous elements in order to be implemented: from a set of rules and the harmonization of different fiscal systems, a crisis management system to fiscal equalisation and a common debt guarantees[99]. The European institutions attempted to integrate in their economic framework some of this elements: for example, the European Stabilization Mechanism (ESM) functions as a crisis resolution system in the sense that member states which falls under the ESM analysed and provided of a regulation proramme at a macroeconomic level and of financial aid. In addition, Brussels and Frankfurt are discussing the possible creation of Eurobond and a fund based on debt redemptions as a guarantee against the debts of the member states.[100] Despite the attempts made by European policymakers and the effects of the crisis among the European Union, an agreement over the creation of a fiscal union seems implausible, but not only for political reasons. Indeed, the atypical nature of the Eurozone, with monetary policies established at the central level, while fiscal policies are decided at the local national level, derives also by the heterogeneity that characterizes the region, especially regarding fiscal frameworks[101]. Historically speaking, different members of the Eurozone have established different fiscal policies, following the pressures of the public opinion or simply the economical school of their policymakers.

First of all, determining optimal equations for the monetary policy or the fiscal policy of a state is highly subjective. Macroeconomists generally agree that determining a monetary policy

$$r_t = \phi_1^{\pi} E_t \pi_{t+1} + \phi_2^{\pi} \pi_t + \phi_3^{\pi} \pi_{t-1} + \phi_1^{y} E_t \bar{y}_{t+1} + \phi_2^{y} \bar{y}_t + \phi_3^{y} \bar{y}_{t-1}.$$

requires an equation which complies stabilizing output and inflation, as shown in the image below: and the same can be said for the fiscal policy.[102]

[98] Clemens Fuest, Andreas Peichl (2012), "*European Fiscal Union: What Is It? Does It Work? And Are There Really 'No Alternatives'?* ", Policy Paper No. 39, IZA
[99] *Ibidem*
[100] *Ibidem*
[101] Henrik Enderlein et al (2012), *"Completing the Euro: A road map towards fiscal union in Europe"*, Report of the "Tommaso Padoa-Schioppa Group", Notre Europe
[102] António Afonso and Priscilla Toffano (2013), *"Fiscal Regimes in the EU",* Position Paper n. 1529, European Central Bank

In particular, evaluating a fiscal policy equation implies determining whether the government's aim is to stabilize the government debt or not: in the first case, the fiscal policy is regarded as "passive" or Ricardian, with future fiscal revenues which are expected to be devoted to pay for current government liabilities. In other words, in a Ricardian fiscal regime, primary budget balances should react to government debt, in order to avoid fiscal insolvency. On the other hand, an "active" fiscal policy implies that the Treasury does not commit itself to match the future government debt and would determine the level of primary balances not taking in consideration the level of the debt[103]. The paper of the ECB titled *Ricardian Fiscal regimes in the European Union* by Antònio Afonso in 2005 analysed which of these two fiscal regimes were preferred among the countries of the Eurozone, with a strong prevalence of the Ricardian regime both before and after the ratification of the Maastricht Treaty and the SGP[104]. However, António Afonso and Priscilla Toffano in 2013 evaluated the possibility of fiscal regimes shift in three important countries of the European Union: Germany, Italy and UK. Leaving apart the UK due to its recent departure from the European Union, the results found by Afonso and Toffano displayed a shifting attitude between Ricardian and non-Ricardian regimes in Germany and Italy. Specifically, Germany has been found to decrease the primary budget deficits when the level of the indebtedness rose, which is a typical Ricardian regime attitude. Even though there have been more "active" periods in Germany between 1970 and 2010, the tendency of the German fiscal regime has been towards a "passive" and more fiscally sustainable attitude. On the other hand, the data collected on the Italian fiscal behavior slightly contradicted what stated in 2005, since fiscal passivism was maintained until 1997-1998, when Italy reached an acceptable fiscal consolidation. However, after 2000 the primary balances decreased while the debt ratio stabilized at high levels. After the 2008 crunch, the debt ratio increased again to a dangerous threshold, with the fiscal consolidation delivering fiscal relief and saving Italy from worse situations[105].

Reaffirming the evident tendency of European governments to follow the Ricardian fiscal regime, and acknowledging that the switch from a passive fiscal policy to a less focused on fiscal solvency coincided with election periods, the different cultural visions developed by the members of the Eurozone over fiscal matters represented the central topic of the debate on why the Eurozone has not complied to a common fiscal regime. Furthermore, as seen earlier in the

[103] *Ibidem*
[104] Antonio Afonso (2005*), "Ricardian fiscal regimes in the EU"*, Position Paper n. 558, European Central Bank
[105] António Afonso and Priscilla Toffano (2013), *"Fiscal Regimes in the EU",* Position Paper n. 1529, European Central Bank

previous chapters, the 2008 credit crunch, the subsequent sovereign debt crisis and the tensions in between European institutions over how to fiscally and financially manage unbearable situations such as the one in Greece and Ireland, brought many analysts to believe that if Brussels does not take steps towards major fiscal convergence, the European Union as it is could not continue to exist. The concern over the dismantling of the European Union has penetrated also among the most important European institutions and personalities. Indeed, on the occasion of the celebrations for the 60 years of the Treaty of Rome on March 2017, the European Commission chaired by Jean-Claude Juncker, presented a white paper title "*White paper on the future of Europe: Reflections and scenarios for the EU27 by 2025".* In the introduction to the white paper, Juncker supports the importance that the European Union and its values had in this modern multipolar world, but stresses the need to revalue the role of the EU, and reform the challenges, the opportunities and the vision which European institutions and policy makers must follow. In order to do this, the European Commission sets up five possible scenarios which the EU could undergo and which could determine the potential state of the EU27 in 2025. Among the possibility to carry on with the contemporary Europe and the possibility to share more power and resources inside the European institutions, scenario number 3 represents the more controversial one since it denotes the openness of the European Commission to the "multi-velocity Europe"[106].
Scenario 3 titled "Those who want more do more" proceeds to introduce "coalitions of the willing" which are meant to work together in specific policy areas such as defence, migration and social matters. Among the others, one policy area which has stimulated the minds of various economists and analysts was the one over economic and monetary integration, with a limited array of EU member states decide to deepen their cooperation on taxation and social matters. According to the European Commission and its white paper,

> *"Greater harmonisation of tax rules and rates reduces compliance costs and limits tax evasion. Agreed social standards provide certainty for business and* contribute *to improved working conditions. Industrial cooperation is strengthened in a number of cutting edge technologies, products and services, and rules on their usage are developed collectively"*[107]

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[106] European Commission (2017), "*White paper on the future of Europe: Reflections and scenarios for the EU27 by 2025",* White Paper
[107] *Ibidem.*

In addition, these member states which decide to participate in a stronger way in the European Union will benefit from additional EU budget allocated to specific areas which are selected jointly.
The "multispeed Europe", as it is generally defined does not represent a new concept, since it was introduced in the European debate immediately after the Cold War, and especially the integration of EU members at different pace is already witnessed in various areas: in particular, examples of the multispeed Europe are the Schengen area and the Eurozone itself, which is composed by 19 out of 28 EU members. The white paper drafted by the European Commission is not an obligation towards the Member States and the other European institutions to set their differences and comply to one of the scenarios, but it only furnishes glimpses to the protagonists of the European political and economic agenda on how the EU27 could appear in 2025. In reality, the European Commission recognised that after the Great Recession, the Union found itself in a "polycrisis", that is serious difficulties in finding agreements over important social, political and especially economic matters. Hence, the European Commission delivered possible future projects which could shape the original European vision, considered outdated and detached from reality nowadays, and "pass the ball" to Member States and EU policymakers. The European Commission also displayed some pros and cons for each of the five scenarios. As regards the "multispeed Europe", the Commission chaired by Juncker recognised the unity of the EU27 "is preserved while further cooperation is made possible for those who want", while some doubts arise regarding the transparency of the process of decision-making with different levels of integration. However, the pros and cons detailed in the white paper seem simplistic and not convincing, especially when the fiscal convergence is touched. Despite this, the leaders of the four most powerful European countries (Germany, France, Italy and Spain) spoke in favour of it. Indeed, by increasing economic convergence through common political actions, and by introducing a fiscal common framework (some economists suggested to introduce the so-called "European taxes"[108]), European institutions could settle the doubts of German politicians after the bailout of peripheral fiscally solvent countries and their claims over the passage of wealth from more fiscal prudent countries to countries with riskier financial frameworks such as the newcomers from Eastern Europe. Furthermore, Italy, Spain and France could finally re-establish as the core of the European Union, could benefit from the financial, social and political advantages of "doing more" among the European institutions and from the

[108] Clemens Fuest, Andreas Peichl (2012), "*European Fiscal Union: What Is It? Does It Work? And Are There Really 'No Alternatives'?* ", Policy Paper No. 39, IZA

restriction of the single market under which each state could pursue advanced economic projects.
On the other hand, the third scenario was highly criticised by political leaders and economists. As stated before, the scenarios offered by Juncker could be considered possibilities under which Member States should think through. For this reason, they are not presented in a detailed way and are supported only by small outlines, eclectic examples and "snapshots"[109]. The main criticism regards the absence of legal and institutional developments that should be processed and approved by the institutions to introduce one of the scenarios. This objection was made in particular regarding the third scenario, since all the attempts of creating a fiscal union have been contrasted or have been deemed as incomplete, such as the missed incorporation of the Fiscal Compact in EU law[110]. While Treaty changes in the medium term are allowed and effectively possible, the problem arises when a scenario such as the one regarding the multispeed Europe affects the general principles and the institutional set-up of the EU, which are more "rigid" and impose restrictions on the purposed scenario. In addition, political criticisms were expressed during various sessions of the European Parliament. In particular, a Bulgarian EP member compared the multiple velocity scenario to the apartheid, in which the juxtaposition is between Western European countries and Eastern European countries. Indeed, Eastern European countries leaders expressed their dissent over the possibility for a multispeed Europe, since as the latest entrants in the Union, their position will not be at the core of the organization. Polish and Hungarian EP members strongly affirmed their vision of a European Union as a "singular organization" which could focus on their core economic and social principles. Even though the idea of a EU with different levels of integration started when the number of EU member states increased, and even though the multi-speed EU represents a democratic tool under which each state can pursue their own interests on a different scale and on different matters, the Eastern European countries believe that with the introduction of the third scenario and the subsequent developments on the fiscal union, their national sovereignty will be harmed[111].
Finally, the idea of a multi-speed Europe remains far from being developed, in particular on the topic of a fiscal convergence. How European institutions will implement the fiscal union in a

[109] Koji Shiromoto (2017), *"For A Multi-Speed Europe",* The MCGILL International Review, http://mironline.ca/multi-speed-europe/
[110] Federico Fabbrini, *"The Enhanced Cooperation Procedure: A study in Multispeed Integration"*, Research Paper, Centro Studi del Federalismo
[111] 111 Koji Shiromoto (2017), *"For A Multi-Speed Europe",* The MCGILL International Review, http://mironline.ca/multi-speed-europe/

two-velocity Europe? Are they going to elect a European financial minister? Are the Member States going to release their taxing powers towards the supranational institutions? These questions are still unanswered, while the consequences of the 2008 crisis are still affecting the financial and labour market of both Western and Eastern European states. By the way, one effect of the Recession was the recognition by European institutions, in particular by Juncker and the European Commission, that the cooperation which has characterised the fiscal policies at the EU level provoked the sluggish reaction which exacerbated the fiscal instability and led to the EU sovereign crisis. The willingness showed by Juncker and other European leaders to discuss and eventually introduce multi-speed Europe represents a step forward towards increased integration and expresses the failure of the cooperative attitude on fiscal matters which produced treaties honoured in breach and measures politically influenced. All these criticisms on the cooperative nature of the EU fiscal and monetary policy after the 2008 crisis will be discussed in the next chapter.

CHAPTER 4

Cooperation on fiscal and monetary policies

The gap between economic and political integration

The current crisis, as the Great Depression, is recognized as the burst of an asset bubble created by a period of optimism initiated by easy money, which expands the presence of credit over the real demand in the market resulting in an inflationary trend, and in increased speculation and leverage[112]. When the crisis erupted, the financial sector was devastated and the effects spread across the world, harming the global trade rate and consequently national GDPs and labour markets. Analaysing the data, economists agree that the US reacted with an aggressive monetary policy made of bail-out of national banks and enormous quantitative easing. The same cannot be said for the EU, which, despite engaging for the first time in a quantitative easing programme, answered in a sluggish and sketchy way, resulting in a double-dip recession with the sovereign debt crisis in 2010[113]. Indeed, in a report of the "Tommaso Padoa-Schioppa Group", various economists under the patronage of Jacques Delors and Helmut Schmidt explained that within the common causes of the 2008 Recession such as fiscal irresponsibility due to the absence of a fiscal union, or the carelessness showed over banking regulation and supervision, the core cause of the crisis in Europe lies in "the contradiction between a single, supra-national currency and the continuation of nation-state-based economic policies"[114].
What stated by the Padoa-Schioppa Group is present also in the thought of Kregel and the "Economists": indeed, the process which led to the introduction of the euro, starting from the Maastricht treaty, fastened the economic integration of the Eurozone, leaving apart the political convergence between Member States which is deemed as fundamental for the stability of the new common currency area. Furthermore, the rationale behind the creation of a single common

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[112] Robert L. Hetzel, "The Great Recession: Market Failure or Policy Failure?", Cambridge University Press, Cambridge
[113] Eichengreen B., Temin P. (2010), "Fetters of Gold and Paper." Oxford Review of Economic Policy, 26, pp. 370–384.
[114] Henrik Enderlein et al (2012), *"Completing the Euro: A road map towards fiscal union in Europe"*, Report of the "Tommaso Padoa-Schioppa Group", Notre Europe

currency was the assessment of the single market and the custom union[115]. And at the origin of the single market lie the political vision of a continent dominated by peace and stability. Indeed, the Treaty on the Function of the European Union (TFEU) recognizes the fundamental role played by political convergence, in particular when referring to national economic policies. Article 121 of the TFEU states:

> "*Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council...*"[116]

This statement was followed by other political measures in order to provide the legal basis for this process of coordination on economic matters between EU member states such as the Broad Economic Policy Guidelines (BEPG). But this measures were used by the Council only to make recommendations, and not obligations to change financial and fiscal policies deemed irresponsible. For example, the Council send a specific recommendation to Ireland for the violation of the BEPG, Ireland completely ignored it. Then, when the European Union experienced an acceleration in terms of it economic structures and projects, the gap created with the degree of political integration enlarged even more, becoming the origin of various structural flaws of the Union such as the absence of a common fiscal framework and the atypical and ineffective nature of the ECB as regards its role as lender-of-last-resort[117].

The gap between harmonization on economic and political matters derived from 30 years of attempts, initiatives and reports estimating the introduction of the single market as the jumpstart for an integration process which stalled on trade between the 70s and the 80s. Documents such as the 1970 Werner Report and the 1988 Cecchini Report described both the advantages of implementing a single market (eventual increase of the Community GDP by 5%)[118], but also the limitation which the introduction of the common currency would have faced. The Werner Report specified that the single currency could have not been developed among the brackets of the Bretton Woods system, which was removed after the delusion of the Smithsonian Agreement[119]. But while the obstacle represented by the Bretton Woods system was removed,

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115 Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", Policy Note, Levy Economics Institute of Bard College. Pp. 1-7

116 Art. 121 of the Treaty for the Functioning of the Euro

117 Henrik Enderlein et al (2012), *"Completing the Euro: A road map towards fiscal union in Europe"*, Report of the "Tommaso Padoa-Schioppa Group", Notre Europe

118 In Jan Kregel (2015), "Europe at the crossroad: financial fragility and the survival of the single currency", the author explains also that these forecasts proved wrong, since the GDP increased of 2% in the 90s.

119 *Ibidem*

other economic and political reasons hampering the project of the euro remained strong and difficult to get rid of.
As stated earlier, the Eurozone is an economically heterogeneous region: in particular, the Padoa-Schioppa Group recognizes two types of heterogeneities which characterize the EMU:

- "Structural divergences" describe the different paths undertaken by each member states regarding economic specializations. Furthermore, the definition comprehends the relative situations in terms of GDP per capita and wealth in comparison to the EMU average. Structural divergences have always existed and does not represent an insurmountable barrier for the political and economic convergence process which the EMU should experience, since other federations under a single currency regime face the same situation.
- "Cyclical divergences" define a characteristic which is peculiar to the EMU. Among the countries which accepted the euro as the European common currency, there are differences regarding business cycles, which affect important economic variables such as imbalances in current account positions and national inflation rates[120].

This two types of heterogeneities are not correlated, and these differences makes difficult for regional institutions to develop monetary and fiscal policies capable of being effective for all the member states. Indeed, among the EMU, some countries weak structural position but with great cyclical performances (Portugal and Spain), countries with strong structural positions but with average cyclical performances (Germany), and countries with both cyclical and structural positions which are either strong (Scandinavian countries) or weak (Greece)[121].
Despite the high degree of economic and structural divergence witnessed in the EMU, the 2008 crisis has shown that the monetary union can effectively deal with a symmetric shock such as the Lehman Brothers bankruptcy, which prompted a joint monetary-fiscal policy by the ECB in a way never seen before in the EMU. Furthermore, economists deem unrealistic that an exogenous shock, such as a financial crisis of a national banking system, could be solved at the domestic level or through emergency measures already foresaw in the Maastricht Treaty[122],

[120] Henrik Enderlein et al (2012), *"Completing the Euro: A road map towards fiscal union in Europe"*, Report of the "Tommaso Padoa-Schioppa Group", Notre Europe
[121] *Ibidem*
[122] Thomas Fazi (2015), *"Why Fiscal Policy In The Eurozone Should Be Fully Renationalised"*, Social Europe https://www.socialeurope.eu/2015/11/why-fiscal-policy-in-the-eurozone-should-be-fully-renationalised/

avoiding the contagion of other member states and the formation of negative externalities in the region[123].

What instead should be tackled by the policymakers governing the EMU are the endogeneous shocks, that is shocks affecting the real interest rate and subsequently the real exchange rate of the euro and the inflation rate deriving from policies developed inside the offices in Brussels and Frankfurt. Endogenous shocks are intrinsic in single currency monetary regimes, should be considered temporary and could be solved by stimulating the competition on price alignment among the EMU. However, the process was hampered by the discussions and disagreements met during the encounters in the European institutions and the sovereign debt crisis exacerbated once again the need for structural reforms in the EMU in order to fill the gap between political and economic integration. Indeed, to ensure the proper functioning of the monetary union, adjustments and reforms of the core structures of the EMU are necessary and require higher degrees of cooperation[124].

The crisis showed that the exchange rate channel as thought before was weak and did not foster external competitiveness and the realignment of the prices through imports and exports. The solution mostly appreciated various economists and professors is the strengthening of the Single Internal Market for goods and services. In 2011, the Commission, basing its assumptions on a paper by Mario Monti titled "*A new strategy for the single market*", suggested the deepening of the Single Market should be performed through measures such as the reduction of tax-related administrative burden in order to discourage the tax competition within the EU which mostly affected the labour market. In other words, according to Monti's report the corporate tax rate in the EU-15 fell from 50% in 1985 to 30% nowadays. Scared for losing their revenue raising capacity, but willing to maintain their attractiveness towards international companies and businesses, member states broadened their fiscal framework taxing less mobile categories such as labour and social contributions. However, this attitude compromises the workings of the Single Market regarding regional tax sovereignty and tax cooperation, which are fundamental fundaments for the fiscal consolidation of the EU after the sovereign debt crisis, for tackling tax avoidance and especially limit tax fragmentation and furtherly introduce a fiscal union. In addition to this, tax competition is also blamed for harming the labour mobility of EU citizens crushing the possibility for member states to fully exploit the single market[125]. Furthermore,

[123] Henrik Enderlein et al (2012), *"Completing the Euro: A road map towards fiscal union in Europe"*, Report of the "Tommaso Padoa-Schioppa Group", Notre Europe

[124] *Ibidem*

[125] Mario Monti (2010), *"A new strategy for the single market: At the service of Europe's economy and society"*, Report to the President of the European Commission

the labour market within the monetary union topic came forward after the 2008 crisis since it was recognized as negatively influenced by the approssimative cooperation inbetween the Eurozone and the low political integration. Apart from tax competition, the mobility of the European workers is hampered by other factors which are more social and political rather than economic: indeed, the OECD Economic Survey regarding the European Union in 2012 recognises 5 areas which should be reformed after the debt crisis:

I) the lack of portability of supplemen-tary pension rights;
II) scarce cross-country information about job vacancies,
III) the difficult recognition of professional qualifications,
IV) housing market policies that raise the costs of moving,
V) the difficulty in accessing public sector jobs as non-nationals.[126]

The implementation solutions to solve these problematic areas and develop the Single Market requires a broad socio-political support, apart from appropriate economic institutions and policies and the use of "enhanced cooperation" to foster the passage of the required legislations[127]. Specifically, the EMU needs to accelerates its process of political integration in order to catch up the level of economic convergence, in order to avoid the appearance of new issues as the ones which developed "within the gap", and in order to finally introduce those measures needed to enhance the effective power of the European institutions over economic and social policies.

Treaties honored in breach

Despite the lack of economic and political convergence which characterized the EU since its origins, various treaties were drafted and ratified by the majority of the member states. From the Treaty of Rome signed in 1957 which proclaimed the formation of the European Economic Community, Europe signed 25 treaties of various nature: from the Schengen Convention which removed border checks between EU members to the Lisbon Treaty which explicitly describes

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[126] Quoted in Henrik Enderlein et al (2012), *"Completing the Euro: A road map towards fiscal union in Europe"*, Report of the "Tommaso Padoa-Schioppa Group", Notre Europe
[127] Federico Fabbrini, *"The Enhanced Cooperation Procedure: A study in Multispeed Integration"*, Research Paper, Centro Studi del Federalismo

the competences of the various organs of the EU, almost all these 25 treaties represent amendments of the two core functional Treaties of the Union: the Treaty on European Union signed in Maastricht in 1992 and the Treaty on the Functioning of the European Union, which is the evolution of the Treaty of Rome signed in 1957. The TEU and the TFEU touch various aspects of the framework under which European institutions, national governments and citizens should live and work: from the core principles of the Union, the free movement of persons, goods and services, human rights to the structure and functions of the European institutions and the economic requirements of the member states in order to enter the EU. But while important files and measures found in the Schengen Treaty or the Charter of the Fundamental Right of the European Union among the Treaty of Lisbon were implemented easily and largely respected, the same cannot be said for various measures introduced in "economic treaties" such as the Maastricht Treaty and the Treaty Establishing the European Stability Mechanism, apart from important economic agreements such as the Stability and Growth Pact.

As stated before, the Maastricht Treaty represents a milestone for the economic convergence and harmonization of the European Union, since it is considered the actual starting point for the process of introduction of the European common currency. In particular, the Euro Convergence Criteria, known also as "Maastricht Criteria", stand for the requirements which countries should comply if they want to enter the third stage of the EMU and authorize the adoption of the euro. The criteria are described in Art. 140 of the TFEU, which refers to the Protocol on the Convergence Criteria and Protocol on the Excessive Deficit Procedure[128]. Art. 140 comprehends 5 criteria which can be summarized as:

1. **The Harmonised Index of Consumer Prices (HICP)** (see 2.1 above) shall not exceed its reference value which is established at the end of each month through the evaluation of data such as "the unweighted arithmetic average of the similar HICP inflation rates in the 3 EU member states with the lowest HICP inflation plus 1.5 percentage points".[129] Though, during the evaluation, external shocks which provoke significant changes in the price rates are taken in consideration, and countries with exceptionally low levels of HICP inflation are deemed outliers and cast away from the evaluation procedures.
2. **Government budget deficit:** the ratio of the annual government deficit to the GDP at market prices shall not overcome 3% for the precedent fiscal year and for the subsequent

[128] Art. 140 of the Treaty for the Functioning of the European Union
[129] European Central Bank (2010), *"Convergence Report May 2010"*, http://www.ecb.europa.eu/pub/pdf/conrep/cr201005en.pdf

two years (the evaluations are made through notified data and forecasts). If a state breaches this criterion, European Council should start an Excessive Deficit Procedure against the state referring to Art. 126(6) of the TFEU[130]

3. **Government debt-to-GDP ratio:** the ratio of the nominal value of the gross domestic debt to the value of the GDP shall not be over 60%. If the criterion is not respected, the state shall demonstrate that the ratio has been "sufficiently diminished and must be approaching the reference value at a satisfactory pace". After the sovereign debt crisis, the "new debt reduction benchmark rule" was passed, under which each state over the 60% debt-to-GDP ratio shall provide an annual reduction of 5% of the excess referring to the criterion for the next 3 years. The procedure for the non-compliant states is equal as the one for the budget deficit criterion[131].
4. **Exchange rate stability:** the states applying to enter the EMU should not have promoted a devaluation of their pegged to the euro currency in the previous two years, and should have complied for two consecutive years to the exchange-rate mechanism (ERM / ERM II) under the European Monetary System (EMS).
5. **Long-term interest rates:** the interest rate for the 10yr government bonds should not exceed of two percentage point the average of the long-term interest rate of the 3 members state with lowest HICP inflation decided in the first criterion[132].

The Maastricht criteria has been repeatedly amended, but it has also been highly criticised especially after the 2008 crisis. In particular, the second and the third criteria are the rationale of harsh debates among the European policymakers and the national governments. Indeed, while the entry requirements for entering the EMU are strict, various charts demonstrate that the Eurozone as a whole is in a serious breach of the Maastricht Treaty since 1995, with a steady increase in the debt-to-GDP ratio after 2007. In 2016, the debt-to-GDP ratio of the EA-19 was recorded at 90.1%, sharply over the 60% required under the Euro Convergence Criteria[133] (see Table 2). Despite the fact that no sanctions are considered for those countries already entered the Eurozone which do not comply to the entry requirements, the data after the 2008 crisis made economists state that the founding Treaty of the single European currency is dead. Furthermore,

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[130] European Monetary Institute (EMI) (1995), "*EMI Annual Report 1994*", Retrieved 22 November 2012.
[131] European Commission (2012), "*Specifications on the implementation of the Stability and Growth Pact, and Guidelines on the format and content of Stability and Convergence Programmes*", Retrieved 13 August 2014.
[132] " European Commission (2014), "European Economy: Convergence Report 2014"
[133] Eurostat (2016), "*Government debt fell to 90.1% of GDP in euro area*", News Release Euro Indicators, http://ec.europa.eu/eurostat/documents/2995521/7826125/2-23012017-AP-EN.pdf/2c7f83e4-7db7-42e0-b6f8-bee8d10f6fa2

the European policymakers, in order to reinforce their vision of a EU harmonization under a single currency and not under political convergence, became very lenient on the entry requirements and the growing membership became one of the main causes of the sovereign debt crisis due to the entrance of weaker economies able to borrow at the same interest rate of the stronger and fiscally prudent Germany, enlarging their debt-to-GDP ratio[134].

Another important example of a fundamental document resulted from the cooperation reigning among EU states on economic and fiscal matters is the Stability and Growth Pact. In order to impose and supervise the fiscal discipline among the EMU, between 1997 and 1998 an agreement between 28 members of the European Union was signed and entered into force finally in 1999. The Stability and Growth Pact is not considered a formal treaty, but represents a strengthening of the Maastricht Treaty based on articles 121 and 126 of the TFEU. The SGP gives permission to the European Commission and the the Council of Ministers of monitoring the fiscal performances of the signatories of the agreement, to issue EDP basing their analysis of the Euro convergence criteria and finally issue economic sanctions if the countries do not answer the recommendations through economic policies.

The SGP is composed of 2 "arms":

1. **Preventive arm:** it ensures "sound budgetary policies over the medium term by setting parameters for Member States' fiscal planning and policies during normal economic times". Each state must submit a SGP compliance file to the Commission and the Council of Ministers, which will present the states with their expected fiscal performances for the next three years, which are defined as "stability programmes" for the members of the EA-19 and "convergence programmes" for non-Eurozone members. After the 2005 Reform, the SGP was included with the Medium-Term budgetary Objectives (MTO's), which are objectives developed to guarantee the fiscal health of a state and take into account business cycles and shocks referring the evaluations to budget deficit in structural terms[135].
2. **The corrective arm:** it consists in the launching, continuation and closing of Excessive Deficit Procedures. The countries under EDP are given 6 months to conform their economic situation to the recommendations made at the European level. If the EA19

[134] Mary Elise Salotte, "*Eurozone Crisis as Historical Legacy*", International Institutions and Global Governance Program, Council on Foreign Relations

[135] Council of the European Union (1997), "*Council Regulation (EC) 1466/97: on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies*", http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1997R1466:20111213:EN:PDF

country failed to comply, the state will be fined up to a 0.2% of its GDP. Otherwise, if the state manages to conform to the recommendations, the EDP will be abrogated[136].

Already before the 2005 reform, some criticisms were moved towards the SGP, both by the states of the Eurozone and within the European institutions. For example, the Commission was reluctantly backing up the agreement, since the President Romano Prodi defined the provisions contained in the SGP as "stupid"[137]. Furthermore, the efficiency of the Pact was questioned when EcoFin decided to move punishing measures against France and Germany, which have violated repeatedly the 3% limit. The enormous political influence of these two European giants, their role as promoters of the SGP and the numbers of vote they are endowed with among the Council of Ministers made the first draft of the SGP unenforceable to them[138].
Undeniably the Great Recession and the resulting EU sovereign debt crisis, together with the generally agreed increase in public debts and the financial aid provided by the EU, affected heavily the fiscal soundness of the Eurozone and demonstrate that the SGP as laid down in 1999 and after the 2005 Reform had disappeared or at least suspended. The EU introduced EU Treaty on Stability, Coordination and Governance, also know as the "EU Sixpack", which describes a set of six legislative measures set up to reform the SGP tackling fiscal policy and macroeconomic imbalances. The 2011 Reform of the SGP put the basis of the new European economic governance, whose goals regard intervening in 4 + 1 economic fields: fostering competitiveness, fostering employment, contributing to the sustainability of public finances, reinforcing financial stability, and tax policy coordination[139]. Despite the enthusiasm envisaged in the first period after the 2011 Reform of the SGP, the degree of political cooperation needed to fully enforce the newly structured measures is burdensome to reach. The treaties compounding the new EU economic governance require the strengthening of both the preventive and corrective arms and stronger financial and non-financial sanctions against non-compliant countries. Furthermore, the 2011 Reform was criticised of being too much attemptive on fiscal soundness and national fiscal policies, not taking in consideration whether these fiscal

[136] Council of the European Union (2009), "*Council Regulation (EC) 479/2009: on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community*", http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2009R0479:20100819:EN:PDF
[137] Andrew Osborne (2002), "*Prodi disowns 'stupid' stability pact*", The Guardian
[138] Philip Baguse (2012), *"The Tragedy of the Euro"*, Second Edition, MISES Institute, pp. 29-43
[139] European Council (2011), *"25 March 2011 Council decisions"*, Cover Note, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf

measures will be sufficient and especially, the expenditure side of economic policies, which play an important role in the financial framework of a state.[140]

In conclusion, up to 2015 only 6 countries are respecting their MTOs, with important countries such as Italy, Spain, Portugal and France which have never been compliant to their MTOs since after 2011. Furthermore, for the year 2016, 5 countries were issued and Excessive Deficit Procedure (France, Ireland, Slovenia, Spain and Portugal), while other 12 countries were put under the "preventive arm", with states such as Italy and Austria at serious risk of non-compliance to the SGP.[141]

These data, together with the analysis made upon the Maastricht criteria, demonstrate that the cooperation which characterised the Eurozone since its beginnings have brought to the creation of treaties mainly honoured in breach, and measures which are difficult to put effectively in action and which take the form of compulsory recommendations rather than mandatory obligations. The 2008 crisis and its consequences on the European public debts gave the EU economic governance the possibility to substantially reform the monetary and fiscal framework in which it performs its duties. Today, various radical changes from the original European economic view can be witnessed, such as the removal of the "no-bailout clause" from the Maastricht Treaty, thanks to the formation of the EFSF and the "indirect" possibility for the ECB to bailout national banks[142]. However, the absence of political convergence and the actual cooperation which is restricted within the boundaries of the European institutions brought to the incomplete efficacy of the treaties, pacts and agreements coming from the regional level once again and the reiterative non-compliance of Eurozone countries to the limitations imposed by Brussels. Indeed, the final remark is that the crisis paradoxically affected the most those countries which behaved according to the SGP requirements (Spain and Ireland), while countries such as Germany, which did not respect the limitations imposed through the SGP did not run into a deep recession.

When politics and economics influence each other: the austerity measures

Political compromises have characterised the first decades of the process of construction of the EMU. Some economists argue that this continuous reliance on partial cooperation on financial

[140] Ludger Schuknecht et al (2011), "*Stability and Growth Pact: crisis and reform*", Occasional Paper Series n. 129, European Central Bank, pp. 4-20

[141] European Commission (2017), "*Communication from the Commission 2017 draft budgetary plans: overall assessment*", http://eur-lex.europa.eu/resource.html?uri=cellar:de0e8f8c-b18d-11e6-871e-01aa75ed71a1.0017.02/DOC_1&format=PDF

[142] Tim Congdon (2012), "*The Eurozone is in breach of the Maastricht Treaty*", News Archive, International Monetray Research Limited, http://mv-pt.co.uk/the-eurozone-is-in-breach-of-the-maastricht-treaty/

and fiscal matters at different formation stages have brought to an incomplete monetary union, which at the first global external shock, namely the 2008 financial crisis demonstrated its structural weaknesses. Furthermore, the credit expansion witnessed in the EMU, especially in peripheral countries such as Portugal, Ireland and Greece, brought national states to intervene by enlarging public expenditures. As we know, the side effect of these intervention was the 2010 sovereign debt crisis, with sovereigns unable to make revenues due to the sharp reduction of corporate taxes but increasing their public debt in order to subsidize sectors which were financially in danger. In a common single-currency monetary regime, the state would have had the possibility to devaluate its currency through the central bank and refinance its debt. In an atypical monetary union such as the EMU, the single governments do not own the sovereign power over their currency and, as seen earlier, their solution is the consolidation of their finances and the reduction of budget deficits, avoiding excessive deflation which could alter the price stability maintenance process.

After the 2008-2009 Great Recession and the aggressive pumping from capital in the market by central banks worldwide through direct quantitative easing (the Fed in the United States) or structured policies (European Economic Recovery Programme in the EU), the situation in the Eurozone seemed to be aimed to a period of financial stabilization, with the Commission approving a stimulus package of €200 billion destined both to the Member states and the EU institutions, in order to "kick-start" the economy after the credit crunch. The EERP had also long-term objectives of enhancing competitiveness and counter-react against the social costs of the crisis[143]. The economic data obtained over the period of the stimulus plan showed unexpected rates which presumed a period of recovery: for example, the International Monetary Fund recorded an expansion of the real GDP in the Eurozone of 2% between 2009 and 2010. However, the situation changed drastically when the spreads for long-term government bonds started increasing dangerously, together with the exacerbation of the government debts crisis[144]. The subsequent decision was to revise the stimulus package and to concentrate the efforts on correcting national fiscal orders through what had become famous as the "austerity measures". In macroeconomic terms, the austerity measures represent a set of policies aimed to curtail the government spending through wage and spending cuts, tax increases and polices which could improve investment expectations. Austerity measures are implemented when a government

[143] Commission of the European Communities (2008), "*A European Recovery Plan*", Communication from the Commission to the European Council, http://ec.europa.eu/economy_finance/publications/pages/publication13504_en.pdf

[144] Martin Wolf (2013), "*How the austerity measures have failed*", The New York Review of Books

approaches the impossibility of repaying its debt and when s in jeopardy of defaulting on its bonds, but the implementation is complicated on a social and political point of view since these measures are usually directed to popular targets and vulnerable sectors of the society such as pensions, health care and in general low-income workers, and because of the disagreements arose on the way of implementing these measures between Germany and other Eurozone countries and the UK. Furthermore, the effectiveness of such polices is sharply debated; Martin Wolf wrote in his blog published on *the Financial Times* that in all, there is no evidence "large fiscal contractions bring benefits to confidence and growth that offset the direct effects of the contractions"[145]. However, the debt situation among the EA17 countries between 2008 and 2011 became increasingly dangerous and alarming: Eurostat has registered a growth in the overall debt-to-GDP ratio from 68.4% in 2007 to 87.3 in 2012.

For the reasons stated before, the implementation of these austerity measures was complicated both politically and economically speaking. The austerity measures were introduced through the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union signed on the 2nd of March 2012. In particular, the measures could be found in one chapter of the intergovernmental treaty (Title III), known also as the "Fiscal Compact"[146]. Initially, the Fiscal Compact was thought as a revision of both the TEU and the TFEU, but the opposition of the United Kingdom and, later on, of the Czech Republic made this path unfeasible. Indeed, the TSCG presents itself as a treaty "outside" the two founding treaties of the Union and as a strengthening of the SGP. The Fiscal Compact represents an example of differentiated integration, since it has created several groups of countries among the Eurozone: states which have ratified the treaty (16 countries, with Finland being the twelfth and resulting in the entry into force of the Treaty in 2013), non-Eurozone countries bound to all the fiscal and economic clauses of the treaty (Romania and Denmark), non-Eurozone states bound only to fiscal and not economic provisions (Bulgaria), non-Eurozone states not bound to any fiscal or economic clauses of the Treaty (Hungary, Poland and Sweden) and states which opposed the TSCG (Czech Republic and the UK)[147]. Initially, the division was thought to be through concentric circles and comprehended another category: Eurozone countries refusing to adopt the fiscal and economic provisions in the Fiscal Compact. The differentiated integration caused by the Fiscal Compact could have been considered the first attempt the first stage of the project of a "multi-

[145] Martin Wolf (2012), "*The impact of fiscal austerity in the Eurozone*", "Martin Wolf's Exchange" Blog, The Financial Times
[146] Gianni Bonvicini e Flavio Brugnoli et al (2012), "*Il Fiscal Compact*", Edizioni Nuova Cultura, Istituto Affari Internazionali
[147] *Ibidem*

speed Europe" (see above), but because this multi-level integration was structured outside the the TEU and the TFEU, the aims and functionalities of the TSCG have been reformed. Indeed, even though the Fiscal Compact was directed to the members of the Eurozone in order to solve the sovereign debt crisis by enhancing fiscal cooperation and harmonization, and even though the provisions contained in Title III were strongly coupled with the SGP and the norms on the euro contained in the Treaties, the "external" nature of the TSCG has not assured the deepening of fiscal synergy in the Eurozone and the introduction of norms defending the single currency. The procedure under which the austerity measures were implemented[148]. Furthermore, art. 16 of the TSCG established that after 5 years after the entry into force, the parties jointly agree in integrating the treaty in the juridical order of the EU. The procedure is described under art. 48.6, which states that a member state's government, the European Parliament and the Commission can present the project of integration to the European Council, which should deliberate unanimously on it. The unanimous decision of the EC could paralyse the system and jeopardise the efforts made by the European institutions to implement rules and norms advocated insistently after the 2008 Recession and during the sovereign debt crisis. Furthermore, the reliance on the simplifies revision procedure of the Treaties could have been avoided from the beginning, if the UK and the Czech Republic had been more cooperative and accepted the modifications of the TEU and TFEU and the structuration of *opting-out* protocols for those countries which were opposing such measures[149].

Despite this structural flaws regarding the political implementation of the austerity measures, the greatest criticisms over the Fiscal Compact appeared over the economic advantages of those provisions. In order to understand the criticisms and the first consequences of these economic interventions, it is useful to understand what austerity measures are contained in the Fiscal Compact:

- **Balance budget rule:** integrated with the SGP, the government budgets should be balanced, with the general deficit not exceeding 3%, and the structural deficit complying with the MTO of the specific country. The novelty introduced by the Fiscal Compact is that the upper limit for exceeding the MTO depends on the debt situation of the country: if it is within the limits of the 60% debt-to-GDP ratio, the upper limit is established at 1%, while if the debt-to-GDP ratio is not respected, the limit is reduced at 0.5%.

[148] *Ibidem*
[149] *Ibidem*

- **Debt brake rule:** states not respecting the debt-to-GDP rule should diminish of at least 5% percent their ratio according to the calculated average of the latest three fiscal years. The Fiscal Compact introduced a more complicated and complete benchmark rule to calculate the cyclically adjusted debt-to-GDP ratio.
- **Automatic correction mechanism:** these process is triggered when a "significant deviation" from the MTO or for a non-compliance to the "balance budget rule". The procedure for the correction of the breach is jurisdiction of the Member State; however, the governments should follow basic principles established in a directive of the Commission published on June 2012.[150]

In addition, the most controversial statement made in the Fiscal Compact is the "Balance budget rule" and the "Automatic correction mechanism" shall be implemented in the domestic law framework of the Member States which are signatories within 12 months from the entry into force of the treaty. The criticism here is that rules developed by a group of economists at the regional level should be implemented without any claim in the domestic economic and judicial field if the state does not want to be judged by the Court of Justice of Strasbourg[151]. Furthermore, the consequences of the austerity measures did not coincide with the expectations and forecasts made by the European institutions. Austerity measures were thought in order to foster fiscal consolidation after the sovereign debt crisis and the extremely high level of expenditures by some governments in the Eurozone. Furthermore, economists suggested the introduction of such provisions also to stimulate the confidence of private investors in putting capital in the EU market, lowering bond yields and the cost of refinancing the deficit.[152] All these statements influenced and encouraged not only policymakers, but also the public opinion to accept to make sacrifices, and in the elections after 2010, most of the parties promoting austerity won. The data collected between 2009 and 2013 proved them wrong: the table below shows a negative relation between the change in primary balance and the real GDP growth, and the data over the economic growth of the Eurozone displays that the EA-19 economically performed better between 2009 and 2011 (when the EERP was active) than between 2011 and 2013.

[150]European Commission (2013), *"Vade mecum on the Stability and Growth Pact*", European Economy Occasional Papers, http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp151_en.pdf
[151] Gianni Bonvicini, Flavio Brugnoli et al (2012), "*Il Fiscal Compact*", Edizioni Nuova Cultura, Istituto Affari Internazionali
[152] European Union Center of North Carolina, "*The politics of Austerity*", EU Briefings, Network of European Union Centers of Excellence, pp. 1-8

The reasons behind the what have been defined by Wolf and Krugman respectively as "failure and "delusion" of the austerity measures in the Eurozone refers to the misunderstanding of the economists suggesting the implementations of restrictive fiscal provisions such as Alberto Alesina of when such limitations could actually work, but most importantly the degree of influence acquired by the economic academy on the political world and the policies after the 2008 crisis. Alesina found out from his study on fiscal policies in advanced economies between 1970 and 2007 that cutting expenditures coincided with periods of economic expansions[153]. However, the IMF proved him wrong by stating that austerity measures have negative effects on economic variables, in particular rate of GDP growth and unemployment. Paul Krugman also maintained that examples of austerity regimes which brought recovery in a state are totally different from the situation in Europe after the crisis. He maintains that "When Canada began a major fiscal retrenchment in the mid-1990s, interest rates were high, so the Bank of Canada could offset fiscal austerity with sharp rate cuts – not a useful model of the likely results of austerity in economies where interest rates were already very low."[154]

The negative effects of austerity in the Eurozone were envisaged also by the IMF, which deemed them within the historical average though. Instead, the consequences were 3 times greater than the expectations made before the sovereign debt crisis, leading the economic community to consider the entry into force of the Fiscal Compact and its provisions as "ill-timed and unnecessary". [155]

The experience of the austerity measures in the Eurozone after the 2008 crisis displays how strictly connected are economics and politics and how a mere cooperation between all the parties in the European economic and political framework enhances the negative aspects of analysis, forecasts, expectations and lastly real policies. The implementation of the fiscal retrenchment through the Fiscal Compact was highly suggested by European economists and was implemented after the political pressure of what has been defined as the "Austerity Dictator": Germany[156]. There are rationales and causes for the attitude undertaken: Angela Merkel pressured countries in clear financial instability such as Portugal, Spain, Italy and especially Greece to cut expenditures and reform their fiscal regime, rather than continuing

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[153] Alberto Alesina, Silvia Ardagna (2010), "*Large Changes in Fiscal Policy: Taxes versus Spending*", University of Chicago Press, pp. 36-64

[154] Paul Krugman (2015), *The case for cuts was a lie. "Why does Britain still believe it? The austerity delusion*", The Long Read, The Guardian

[155] Martin Wolf (2013), "*How the austerity measures have failed*", The New York Review of Books

[156] European Union Center of North Carolina, "*The politics of Austerity*", EU Briefings, Network of European Union Centers of Excellence, pp. 1-8

with a Keynesian stimulus programme such as the EERP, after witnessing an internal increase in debt of about 25% and taking advantage of the fundings needed by peripheral countries which only Germany could provide at a time in which the ECB was not a lender-of-last-resort yet.
On the other side, not all the countries were reluctant over the introduction of harsher fiscal regimes and cut of government expenditures: that is because several economists had expressed their approval over such measures and managed to enter in the offices of both the EU and the single Member States. Furthermore, the poorly integrated cooperation over monetary and fiscal matters which characterised the monetary union in the years before and after the crisis helped both economists and politicians to intervene on policies affecting the EU citizenry, and in many cases provoking a deepening of the tragic situations on social and economic issues.

CHAPTER 5

Conclusion

Ben Bernanke, the former head of the Federal Reserve, made this statement nearly after the 2008 credit crunch:

> *"September and October of 2008 was the worst financial crisis in global history, including the Great Depression."*[157]

Even though the data suggest that the Great Depression has more long-lasting consequences on the global economy, the first two months after the bankruptcy of Lehman Brothers represent one of the most critic moments of modern financial history, with the global stock market and the world trade declining faster than in 1929-1930 and unemployment rising at dangerous rates bot in the US and in the UK.

Despite the financial shock spread immediately worldwide, hampering also the economic growth of developing countries in Asia and in South America, the prompt and aggressive recovery plan developed globally by numerous central banks through extremely evident rate cuts, enormous quantitative easing programmes and the possibility to intervene directly thanks to the flexible exchange rate regimes characterizing modern economies, made the crisis less severe and stopped its evolution in a depression such as in 1929, when output fell on average for three consecutive years.

The financial crisis erupted in the US represented the first important challenge for the "newborn" European Union and its economic framework. Despite the fact that the EU was constituted in a period of financial stability, the situation after the introduction of the single currency worsened, with European banks leveraging more than the US ones and with budget deficits in a critical state more in 2008 than in 1929. The subprime mortgage market, the financial deregulation due to the excessive economic greed by financial institutions and the

[157] Tim Worstal (2014), "*Ben Bernanke: The 2008 Financial Crisis Was Worse Than The Great Depression*", Forbes Economics & Finance

enlargement of the financial safety net all over the world are considered some of the causes of the Great Recession, which obliged the Eurozone to deal with process of crisis management for the first time in its brief history. This experience in dealing with a financial shock displayed the numerous core flaws and deficiencies of the Eurosystem, its treaties, its policies and its institutions.

When in 1992 the Maastrich Treaty was signed by twelve members of the European Community, the steps to introduce the single European currency, and the passage to a new monetary regime were set and the conclusion arrived on the 1st of January 2002, when the euro entered into service. The single currency monetary regime was thought to produce positive externalities, with the elimination of converting currencies costs, the increased efficiency and competitiveness with the elimination of customs and the creation of a single market and the disappearance of the exchange rate uncertainty. However, the Eurozone monetary regime emerged in a region characterized by social, cultural and political differences and which experienced a period of solid economic growth, with impressive GDP growth rates and increasing internal trade levels. When the crisis struck the Eurozone, the European institutions attempted a reaction which resulted sluggish, disorganised and finally incomplete, leading to a double-dip recession visible only in Europe and which affected directly the sovereign states and their public debts.

The first consideration made in this paper regards the monetary policies undertaken in Europe in order to answer the Great Recession and the role of the European Central Bank in the crisis management process. The post-crisis period provoked drastic changes in the mindset of European policymakers and in the structure of the Union itself. While the Fed intervened aggressively to stabilize the market through the pumping of enormous amounts of capital, when the recession started the ECB had not the power to intervene in such a drastic way, due to its linkages with European political institutions highly divided internally, the differences between Member states on the monetary solutions to be chosen in order to solve the crisis and the actual instruments which are endowed to the ECB. These issues partly compromised the possibility for the central bank to stick to its principles, in particular in maintaining the price stability in the European region. Furthermore, the Maastricht Treaty did not envisage any clause regarding bailing out financial institutions or giving the role of lender-of-last-resort to the ECB. When the worst period seemed gone after one year and the interest rates started rising again, problems of insolvency within financial institutions, and especially the situation regarding governments' budget deficits became extremely serious, the Eurozone found itself without any institution allowed to intervene, leading Germany to bail out peripheral countries, with Greece in the first row. The new European economic governance was set up, and with the advent of Mario Draghi as the governor of the ECB, new instruments, mechanisms and funds were developed, which changed heavily the economic vision and modus operandi. However, issues such as the impossibility to devaluate for the members of the EA-19, resembling the gold bloc during the gold standard era, or the formation of special mechanisms such as the ESM of the EFSF which still do not permit the ECB to fully perform its lender-of-last-resort power suggest that some steps forward should be done in the future, despite the many novelties witnessed in these years such as the introduction of quantitative easing in the Eurozone or the creation of funds in order to aid Member states under financial difficulties.

Another important consequence left by the 2008 crisis regards the disputes over the differences between the fiscal systems of each member states and how these diversities have exacerbated the recession and impeded a more concrete reaction by the European economic institutions leading to the sovereign debt crisis and ferocious social reactions through riots and demonstrations in those countries affected by spending cuts and increases in the unemployment rate. The solution which dominated the debate within the European community is the formation of a fiscal union, which promotes the integration of all the fiscal systems of the members of the EMU. Nowadays, while the EA-19 works under a single currency regime, the decisions over fiscal matters remain at he national level, and European policy-makers are experiencing difficulties in transporting it to the regional level. Indeed, while among the EU institutions, European leaders suggest higher degrees of cooperation over the harmonization of their countries' fiscal frameworks, the actions undertaken within their national boundaries follow the pressures of their public opinion rather than the recommendations coming from Brussels.

The dispute over the development of a fiscal union in the Eurozone divided not only sovereign governments, but also academics, who harshly debated whether the formation of the European Monetary Union without fiscal synchronization represented a false step in the process of political and economic integration or whether the economic harmonization of the EMU member states should be treated separately from the political integration, which could stem autonomously from the increased affinity over economic matters. The EU followed the "structuralist" approach, with the creation of multiple economic institutions, the ECB and the common currency in just one decade from the Maastricht Treaty. However, the absence of political convergence, especially over the integration of fiscal frameworks and the release by sovereign states of their powers over fiscal matters, brought to an economic framework which results poorly cooperative, integrated and heavily incomplete, especially in dealing with uncommon external shocks such as the Lehman Brothers bankruptcy. Hence, recalling that political diversities in Europe are innate and endogenous, the decision to accelerate the process of economic convergence through the introduction of the euro was dictated by the need to move forward in the evolution of the Union and to benefit from t the period of “Great Moderation”, but has buried aspects which are fundamental in monetary system such as the Eurozone, which are high levels of cooperation and solidarity on fiscal matters and the creation of a fiscal union in order to contrast business cycles.

Even though the fiscal union of the Eurozone remains crucial in the discussions in the European institutions, some alternatives start to pop up and to rise through the ranks of European policymakers. The appearance of the “multispeed Europe” in a white paper by the European Commission and signed by Juncker over the possible scenarios in which the EU could found itself in 2025 shows that differentiated integration, already used in different areas such as during the creation of the Schengen Area, could become an alternative in order to create a European fiscal framework able to maintain fiscal and financial stability in the area and allowed to perform important supervision and resolution roles without being pressured by sovereign states or constricted by political decisions taken by other organs of the EU.

What has characterized the approach of the Eurozone in dealing with the 2008 financial crisis was not a structured shared sense of purpose envisaged in the Treaties of the Union, but rather an enhanced cooperation within the institutions and the single member states. A cooperation aroused from the gap that has formed after the Maastricht Treaty in 1992 between political and economic integration, which brought to the development of treaties, agreements, protocols and many other measures which either are honored in breach or are completely ignored by those affected by provisions at the regional level. Furthermore, this enhanced cooperation built on low levels of integration has allowed politicians and economists to influence and intervene directly on provisions and measures which do not pertain to their “jurisdiction”. Some of these measures such as the austerity which has distinguished the period immediately after the sovereign debt crisis have not fulfilled their objectives and have exacerbated the consequences of the crisis.

In conclusion, the introduction of the euro in the European Union and the passage to the single currency monetary regime has given numerous benefits to the region, with many economic variables sustaining this assessment. The single currency monetary regime has attracted many foreign capitals and investors, and has cut many expenses within the region. However, when an external shock hit the European Union, the single currency demonstrated that works better in period of financial stability rather than in low periods of business cycles. Though, other federations following the same regime as the Eurozone managed to confront the crisis more decisively and avoiding double-dip recessions or a complete depression. On the other hand, the atypical nature of the European Central Bank, the lack of political integration between the states pertaining to the EA-19, the indecisiveness of institution and policymakers over the creation of a fiscal union or the adoption of the multispeed Union, and the unstructured cooperation which characterized the economic governance of the Eurozone for the first decade of the 21st century have hampered the possibility for the EU to solve fundamental issues which showed up in these years such as the increase in public expenditures or in bank leverage, avoiding to make European citizens to experience the greatest financial and economic crisis in 80 years.

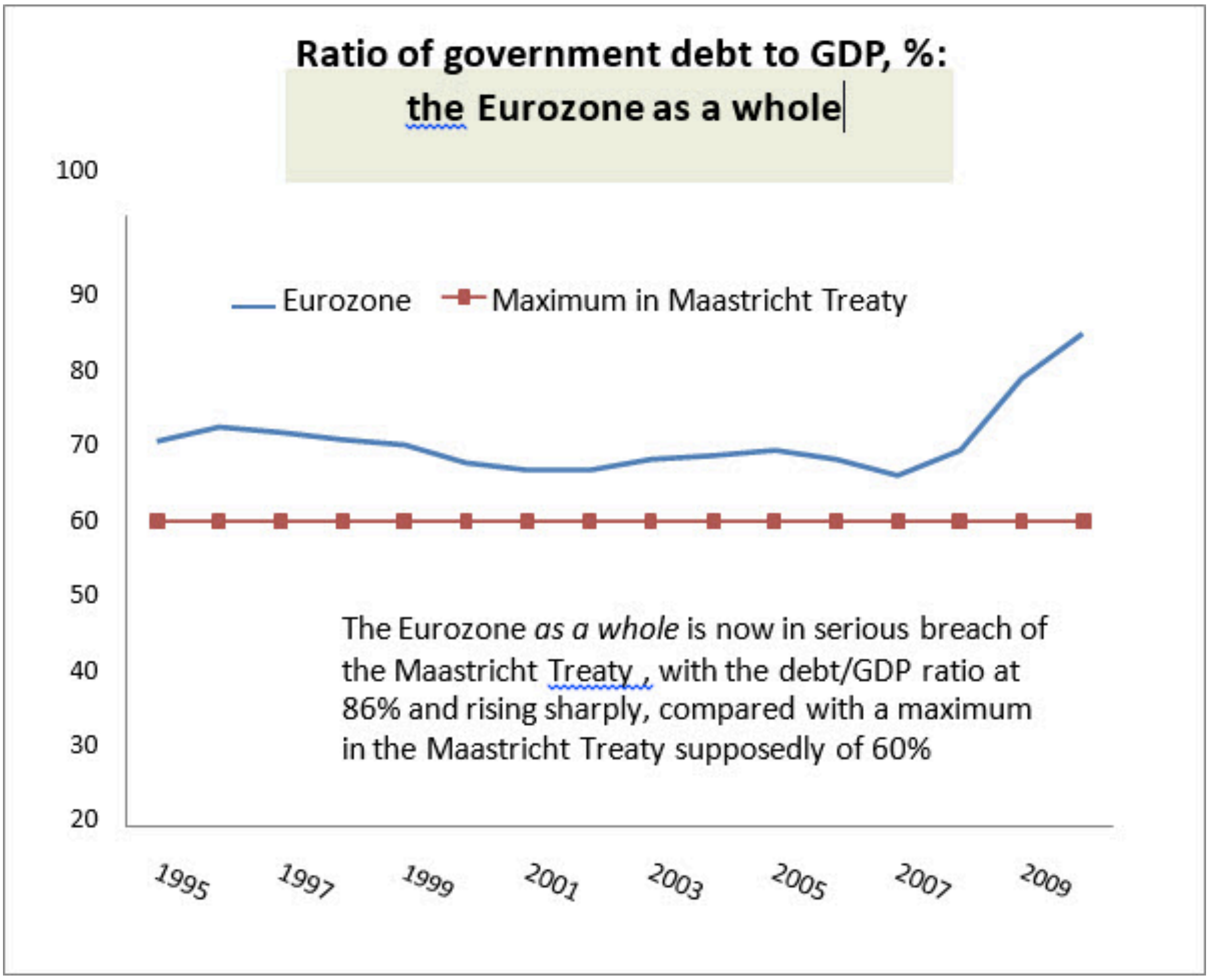
Tables

Table 1

Date of transaction	ECB	Main Refinanc. Int.Rate	DoT	Fed	Fed Funds Rate	DoT	Bank of England	Official Bank Rate
1.1.07		3.50	1.1.07		5.25	1.1.07		5.00
14.3.07	I-0.25	3.75	18.9.07	D-0.50	4.75	11.1.07	I-0.25	5.25
13.6.07	I-0.25	4.00	31.10.07	D-0.25	4.50	10.5.07	I-0.25	5.50
		4.00	11.12.07	D-0.25	4.25	5.7.07	I-0.25	5.75
		4.00			4.25	6.12.07	D-0.25	5.50
		4.00	22.1.08	D-0.75	3.50			5.50
		4.00	30.1.08	D-0.50	3.00	7.2.08	D-0.25	5.25
		4.00	18.3.08	D-0.75	2.25			5.25
		4.00	30.4.08	D-0.25	2.00	10.4.08	D-0.25	5.00
		4.00			2.00			5.00
8.7.08	I-0.25	4.25			2.00			5.00
8.10.08	D-0.50	3.75	8.10.08	D-0.50	1.50	8.10.08	D-0.50	4.50
11.11.08	D-0.50	3.25	29.10.08	D-0.50	1.00	6.11.08	D-1.50	3.00
9.12.08	D-0.75	2.50	16.12.08	D-0.75	0.25	4.12.08	D-1.00	2.00
10.1.09	D-0.50	2.00			0.25	8.1.09	D-0.50	1.50
		2.00			0.25	5.2.09	D-0.50	1.00
10.3.09	D-0.50	1.50			0.25	5.3.09	D-0.50	0.50 [158]

[158] Olli Lethimaki (2009), *"Evaluation of the European Central Bank's Reaction to the Recent Financial Crisis within the Two-Pillar Framework",* Helsinki School of Economics

Table 2



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Riassunto in italiano

L' elaborato "The 2008 crisis and the Euro: Monetary regime failure or Eurosystem failure?" intende analizzare le cause, le conseguenze e i motivi per i quali la crisi finanziaria iniziata a settembre del 2008 ha visto i suoi effetti esacerbati vistosamente all'interno dell'Eurozona e se la colpa deve essere attribuita al regime monetario in sé o alla struttura dell'Eurosistema.
Il primo capitolo introduce la crisi del 2008, concentrandosi inizialmente sulle cause originarie, per poi focalizzarsi sulla situazione finanziaria ed economica in Europa nel 2008. Quella che viene definita "La Grande Recessione" vede come suo evento scatenante il fallimento di Lehman Brothers, importante banca d'investimento americana, il 15 settembre del 2008. Alla notifica della bancarotta, i mercati finanziari statunitensi hanno reagito drasticamente, con Dow Jones che perde numerosi punti percentuale, e numerose altre banche ritrovatesi con problemi di insolvenza ed illiquidità. L'origine di questo tracollo finanziario viene attribuito allo scoppio della bolla immobiliare e del mercato dei titoli garantiti da mutui ipotecari, strumenti finanziari meno controllabili dalle istituzioni, portando all'aumento del livello di leverage nelle banche. In più, il mercato dei titoli garantiti da mutui ipotecari ha connesso numerose istituzioni finanziari globali, portando all'immediata propagazione del tracollo finanziario. Le analisi riguardo la crisi del 2008 hanno portato nuovamente allo scontro tra i Keynesiani, ossia coloro che ritengono necessario l'intervento di governi ed istituzioni politiche per un maggiore controllo e regolamentazione del mercato finanziario, ed i monetaristi, i quali ritengono le politiche monetarie di matrice governativa inopportune ed alla base della recessione, e sostengono l'indipendenza del mercato finanziario nello stabilire le sue variabili.
Concentrandosi sulla situazione in Europa al momento del crush di Lehman Brothers, si può notare come gli istituti finanziari del vecchio continente erano color che facevano più riferimento al mercato degli MBS americani e, benchè la crisi sia iniziata negli US, le banche europee registravano un livello di leverage molto più alto rispetto a quelle americane. Con queste premesse, il risultato è stata una vera e propria catastrofe finanziaria all'interno dei confini europei, in particolare dentro l'Unione Europea e l'EMU. Le ripercussioni maggiori sono state rilevate nel mercato del lavoro, dove paesi come Spagna, Grecia ed Italia hanno dovuto fronteggiare livelli di disoccupazione oltre il 20%. Inoltre, la crisi del mercato finanziario ha causato una perdita di fiducia da parte degli investitori finanziari e dei businesses nel mercato, con una decrescita delle transazioni tra i paesi dell'Unione, una perdita enorme di liquidità da parte delle banche e delle istituzioni ed una spirale deflazionaria difficile da

fermare. Questo ha comportato l'impossibilità per molti paesi europei di ripagare il proprio debito pubblico, e l'aumento del budget deficit, causando una "double-dip recession" che non è stata registrata in nessun'altra regione del mondo. Il motivo dietro questa peculiarità della crisi europea è da attribuire non solo alla natura del tracollo finanziario, ma anche alla struttura dell'Eurosistema stesso, non in grado né di affrontare né di evitare un tale shock.

Il secondo capitolo dell'elaborato analizza le politiche monetarie vigenti in Europa ai tempi della crisi finanziaria, facendo un paragone con il ruolo e gli strumenti utilizzati nello stesso periodo tra la Federal Reserve e la Banca Centrale Europea, discutendo la natura atipica della stessa BCE, specialmente riguardo il suo ruolo da lender-of-last-resort sia per le banche che per gli stati, e riflettendo sull'impossibilità da parte degli stati membri dell'Unione Monetaria di svalutare la propria moneta, facendo un riferimento ai paesi del Blocco Aureo durante la Grande Depressione.

In primis, la Fed e la BCE sono organi indipendenti le cui politiche monetarie vengono sancite da Executive Boards e Consigli e seguono obiettivi simili quali il mantenimento della stabilità dei prezzi ed un certo livello di inflazione. Le differenze sorgono riguardo gli strumenti a disposizione di queste due istituzione: mentre la Fed ha il permesso di iniziare procedimenti di bailout di banche o altre istituzioni finanziarie, lo stesso non vale per la BCE, in quanto nessuna clausola del Trattato di Maastricht lo prevede. In più, la Fed ha immediatamente provveduto a disporre un piano aggressivo di quantitative easing tramite l'acquisto per miliardi di dollari di US Treasury Bills. La BCE, non avendo uno strumento simile ai Treasury Bills americani, ha iniziato un programma di QE solamente dopo la crisi del debito sovrano con l'avvento di Draghi. Nonostante queste mancanze strutturali, la BCE ha introdotto numerosi nuovi strumenti finanziari per stabilizzare il mercato, dimostrandosi ben organizzata in caso di crisi finanziarie. Lo stesso non può essere detto per le decisioni riguardo i tassi d'interesse: mentre la Fed ha tagliato subito gli interest rate, la BCE ha impiegato quasi 4 anni per abbassarli fino allo 0, portando molti economisti a dire che questa lenta reazione alla crisi sia la causa della doppia recessione. Questa diversità di vedute è causata da ragioni storiche, con la BCE che ha cambiato i tassi d'interesse molto meno spesso rispetto alla Fed negli anni precedenti al 2008, sintomo di un periodo di stabilità economica e finanziaria della regione, e geografiche, in quanto le differenze culturali, linguistiche e politiche tra gli stati europei sono obiettivamente maggiori rispetto ai corrispettivi statunitensi o di qualsiasi altra federazione simile alla UE, e determinare un tasso d'interesse che combaci perfettamente con le necessita di ogni singolo stato sovrano diventa complicato.

Per quanto riguarda il ruolo da lender-of-last-resort, nel 2008 la BCE non era abilitata dai Trattati dell'Unione Europea ad attuare programmi di bailout né di banche né di stati, al contrario della Fed, in quanto sotto la giurisdizione delle banche centrali dei singoli stati aderenti. Si è venuto a creare un sistema dove le banche centrali locali, non avendo più la possibilità di stampare moneta, hanno visto le loro possibilità di salvare istituzioni finanziarie limitate. Per ovviare a questa falla, e per fornire l'Eurosistema di un'istituzione in grande di essere lender-of-last-resort, fondamentale per il funzionamento corretto del regime monetario, la BCE ha da prima istituito meccanismi di supervisione e risoluzione all'interno del sistema bancario (ma solo per 120 banche "importanti"), per poi introdurre programmi di acquisto di bond governativi per stabilizzare il mercato dopo la crisi del debito del 2010, all'interno della quale la Germania ha provveduto al bailout di stati periferici quali Irlanda e Portogallo. Nonostante ciò, alla BCE non è stato concesso di essere lender-of-last-resort ufficialmente in quanto bloccata dalla struttura legale della UE, dalla possibilità di "free-riding" da parte degli stati nel chiedere prestiti alla BCE, e dalle dispute politiche interne tra i paesi aderenti, che hanno reso i programmi stabiliti dalla BCE inefficaci ed incompleti.
L'altra critica mossa all'Unione monetaria in Europa riguarda l'impossibilità da parte degli stati sovrani di svalutare la moneta, costringendo all'abbattimento dei costi tramite deflazione. Una simile situazione si è verificata durante la crisi del '29, con i paesi aderenti al Sistema Aureo entrati in una spirale deflazionaria dopo che il tracollo di Wall Street aveva bloccato le riserve di oro in America, portando alla propagazione di pressioni deflazionarie in tutta Europa, portando in particolare la Germania ad un periodo di grave crisi economica e che molti ritengono abbia generato il fenomeno del regime nazista e non solo. Qualche economista sostiene che sia impossibile paragonare le due crisi in quanto nel 2008 non si è verificata una "depressione", ossia un periodo prolungato di almeno tre anni di decrescita economica, ma bensì una semplice recessione contrastata da politiche monetarie immediate ed efficaci. In realtà per i paesi europei è stato molto più difficile uscire dalla spirale deflazionaria nel 2008 che negli anni '30. Infatti, mentre per ottenere nuovamente il potere di svaluta della moneta, i paesi del Blocco Aureo potevano prendere la decisione di uscire dal Sistema, l'irreversibilità dell'Unione Europea e di quella monetaria hanno portato ad una recessione importante, insieme alle dispute interne tra paesi in budget surplus e paesi in budget deficit che hanno bloccato le istituzioni monetarie europee.
Il secondo capitale sposta il focus dell'elaborato sull'unione fiscale che non esiste nell'Eurozona e che, secondo molti, ha comportato un aggravamento delle conseguenze della crisi del 2008. Un'unione fiscale prestabilita porterebbe a crisi meno frequenti ed allo sviluppo

di sistemi di assicurazione contro tracolli finanziari che eviterebbe effetti di spill-over all'interno del Unione. Ma una tale armonizzazione fiscale richiede un livello di convergenza politica che non esiste al momento nella UE, e che ha portato gli stati membri ad esprimere parole di cooperazione durante gli incontri a Bruxelles, per poi attuare politiche fiscali che non rispecchiano le raccomandazioni da parte delle istituzioni regionali, ma la volontà dell'opinione pubblica. Inoltre, tra i paesi dell'Eurozona c'è disparità di vedute sulla natura dell'unione fiscale, con la Germania che spinge per una centralizzazione dei poteri fiscali al livello regionale, mentre i paesi più colpiti dalla crisi del debito pubblico che richiedono una maggiore condivisione dei rischi finanziari ed una maggiore solidarietà per evitare altri shock.
Anche il mondo accademico si è diviso riguardo all'unione fiscale e alla natura dell'Eurosistema stesso: partendo dal presupposto che il trattato di Maastricht ha accelerato il processo di convergenza economica, gli "strutturalisti" sostengono che creare istituzioni economiche sovranazionali porta all'armonizzazione delle politiche monetarie e fiscali, e ad una maggiore convergenza politica. Dall'altra parte, gli "economisti" ritengono che l'istituzione di entità come la moneta unica o altre strutture economiche sono lo step finale di un processo di convergenza politica ed economica che comprende anche l'istituzione di una unione fiscale. Entrambe le posizioni hanno i loro pro e contro: quello che è certo è che gli strutturalisti hanno visto la loro visione esacerbare la crisi finanziaria in Europe, con istituzioni bloccate da divergenze politiche e con contraddizioni interne che hanno portato all'incompletezza ed all'inefficacia del sistema economico europeo. Nonostante ciò, la visione degli economisti risulta un'utopia all'interno dell'Eurozona, e l'introduzione di misure come quelle del Fiscal Compact sono l'esempio lampante di come il livello di convergenza politica sia bel lontana da poter istituzionalizzare una sincronizzazione fiscale efficace.
Per ovviare a questa mancanza, ultimamente tra i leader nazionali e i dirigenti di Bruxelles è comparsa la possibilità dell'"Europa a più velocità", con l'introduzione dell'integrazione differenziata anche per quanto riguarda le politiche fiscali. Molti paper della BCE evidenziano le differenze tra i regimi fiscali dei singoli stati, in particolare riguardo l'introduzione di sistemi Ricardiani passivi o attivi. Un'Europa a più velocità potrebbe risolvere i contrasti interni tra paesi come la Germania che richiedono vivamente un'armonizzazione ed una riforma di quei regimi fiscali imprudenti che aumentato gli effetti della crisi del debito sovrano, e quei paesi come l'Italia ai quali è stata attribuita l'esplosione della crisi del debito sovrano, i quali impegnandosi nell'attuazione di tali rivisitazioni acquisirebbero enormi vantaggi grazie all'integrazione differenziata. Le critiche piovono da parte dei nuovi stati appartenenti alla UE (ad esempio gli stati dell'est Europa e dei Balcani) e che vorrebbero entrare nell'EMU, in

quanto vedrebbero la loro posizione ridimensionata, ritenendo la soluzione proposta non-democratica. Altre critiche riguardano l'attuazione effettiva di tale proposta, conoscendo i tempi di riforma dei Trattati della UE e l'introduzione di essi nei sistemi giuridici locali che non è sempre stata implementata correttamente e completamente, specialmente in materia di misure economiche e fiscali.

Il quarto capitolo si concentra non sulle soluzioni, ma su il sistema vigente nell'Eurozona durante la crisi: le istituzioni europee si sono basate su una cooperazione tra le varie strutture basata su un alto livello di convergenza economica (sulla carta) ed un basso livello di sincronizzazione politica. In questo gap, si sono formate istituzione, accordi o trattati che sono risultati incompleti o poco efficaci. Il motivo di questo gap è spiegato da divergenze strutturali tra i paesi membri (le quali però sono facilmente riscontrabili anche in altre federazioni) e cicliche (differenze di business cycles tra paesi che non permettono la determinazione di tassi favorevoli per tutti). Queste divergenze portano l'EMU ad avere difficoltà a gestire shock di carattere endogeno, ossia proveniente da politiche economiche interne a Bruxelles. Per ovviare a tutto ciò, servirebbe un innalzamento del livello di convergenza riguardo il mercato unico e le politiche economiche in modo da poter sviluppare misure efficace per tutti i paesi membri. Questo processo è reso estremamente complicato da fattori che caratterizzano i sistemi sociali, fiscali e lavorativi degli stati europei e i quali sono difficilmente sincronizzabili.

Un'altra conseguenza di questa cooperazione europea sugli aspetti economici riguarda la stipulazione di trattati o accordi che puntualmente o non vengono rispettati, o vengono concepiti pur sapendo che i paesi ratificatori non sono in grado di onorarli. L'esempio più lampante è sicuramente il trattato di Maastricht e i suoi criteri: sebbene per entrare vengano richiesti rapporti tra debito e Pil e deficit e GDP molto stretti, i paesi già all'interno dell'Unione Monetaria possono essere sanzionati tramite misure minime e che vengono sospese o palesemente ignorate dai paesi stessi. Un altro esempio è il Patto di Stabilità, il quale introduce il rispetto di obiettivi economici nel medio termine stabiliti da Bruxelles secondo criteri unici per ogni paese, ma che solamente 6 paesi tra i 19 dell'Unione Monetaria Europea stanno rispettando. Le procedure di sanzione contro chi non rispetta i dettami di Bruxelles sono poco efficaci a causa della scarsa convergenza politica, in quanto vengono determinati all'interno di organi politici che difficilmente approverebbero misure contro paesi che vengono rappresentati al loro interno, come capitato nel 2003 a Francia e Germania, importanti fautori dei trattati europei e che hanno visto le loro sanzioni mai implementate.

Ultimo argomento trattato riguardo la politica della cooperazione in seno all'UE è l'influenza vicendevole tra politici ed economisti in materia di politiche monetarie e fiscali regionali. Tra il 2008 ed il 2010, il restringimento del credito nei paesi europei ha portato ad un aumento delle spese pubbliche da parte dei governi, i quali però hanno portato alla deflazione ed alla crisi del debito pubblico. In questo periodo, numerosi economisti hanno portato avanti le loro teorie per risollevarsi dalla crisi e sono riusciti a convincere sia l'opinione pubblica che Bruxelles. Le politiche di austerità che sono derivate da questo processo non solo sono state basate su dati economici rilevati in condizioni totalmente diversi da quelle nelle quali si trovava l'Europa nel 2010, ma hanno vanificato l'effetto del piano di recovery introdotto dalla BCE e che aveva portato buoni risultati tra il 2009 ed il 2010 sul piano del Pil dell'Eurozona.

Le politiche di austerità ed il Fiscal Compact sono il risultato evidente delle carenze strutturali dell'Eurosistema e del suo continuo appellarsi alla cooperazione, in modo tale da non intaccare quelle strutture sancite anni fa in un periodo di moderazione e stabilità fiscale, ma che risultano obsolete ed inadatte a contrastare una crisi economica. Sebbene sia vero il fatto che il regime della moneta unica funzioni meglio in periodi di pace finanziaria, questo elaborato ritiene che una strutturazione più chiara e flessibile dell'Eurosistema, un incremento della convergenza politica all'interno dell'Eurozona ed un più alto grado di indipendenza della BCE su temi monetari e fiscali avrebbe potuto evitare una recessione così imponente come quella del 2008.