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Building a European Fiscal Union: Eurobonds, Institutional Reforms, and the Future of the EMU

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Abstract

The aim of this thesis is to analyse the challenges, opportunities and perspectives related to the creation of a central fiscal capacity of the European Union, trying to assess the feasibility of a true fiscal union. Starting from the theoretical analysis of the Optimum Currency Area and the structural deficiencies of the European Monetary Union (EMU), the study highlights how the lack of common fiscal stabilisation mechanisms limits the resilience of the eurozone to asymmetric shocks. The paper examines the main reforms adopted, from the fiscal rules of the Stability and Growth Pact to the innovative experience of the NextGenerationEU and then delves into the debate on the introduction of Eurobonds and the need for integrated fiscal governance. In the final chapter, the proposal for the creation of a European Treasury and an Economic and Finance Minister is explored in depth, assessing its institutional coherence and potential impact on the democratic legitimacy of the EU. The paper argues that, in order to strengthen the internal stability and solidarity of the Union, it is necessary to overcome the current intergovernmental constraints and give the EMU a centralised fiscal structure, capable of reconciling economic efficiency and political legitimacy.

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Introduction

Over the past fifteen years, the European Union has been confronted with a multiplicity of economic and geopolitical crises that have made visible the structural fragilities of its institutional architecture. From the Eurozone sovereign debt crisis to the economic and health trauma caused by the Covid-19 pandemic, to the recent energy crisis provoked by the Russian invasion of Ukraine, each of these adversities has severely tested the EU's capacities to react effectively to exogenous shocks, raising crucial questions about the resilience of the economic and monetary integration project.

In order to counter such emergencies, the European institutions have sometimes taken extraordinary and innovative measures, such as the financial crisis rescue programmes, the NextGenerarionEU plan for post-pandemic recovery and the REPowerEU initiative to reduce energy dependency. Although these actions have shown an adaptive capacity of the Union, they have also highlighted the limits of a fragmented fiscal system lacking structural instruments of macroeconomic stabilisation at supranational level.

In this context, the tension between the need for greater fiscal integration and the Member States' willingness to preserve their national sovereignty has become increasingly prominent. The clash point between these two opposing currents marks a crucial stage for the future of the European Union, namely, to strengthen fiscal cohesion through shared instruments and bodies or to continue to rely on weak and uneven intergovernmental coordination.

This work sets itself within this political and institutional dilemma, proposing to analyse the theoretical and concrete possibility of realising a true European Fiscal Union. To try to achieve this goal, the work is divided into three main chapters. The first delves into the concept of a "Cohesive Fiscal Policy", clarifying its theoretical foundations, the conditions for its effectiveness in the context of monetary union, and the limits of the rules currently in force, such as the Stability and Growth Pact and the Fiscal Compact. The second chapter focuses on the debate on the issuance of common debt instruments, concentrating in particular on the Eurobond proposal and the emblematic case of the NextGenerationEU, delving into its redistributive effects and governance implications. The third and final chapter addresses the structural incompleteness of the Monetary Union, analysing its European democratic deficit and discussing reform proposals aiming at the establishment of a European Treasury and a Eurozone Minister of Economy and Finance.

With a critical analysis of the most relevant academic, institutional and policy proposals, the thesis aims to understand whether and to what extent the European Union is able to make a qualitative leap towards an integrated, sustainable and democratically legitimised fiscal governance. Only with such an evolution will it be possible to overcome the emergency logic that has characterised crisis responses so far, providing the Eurozone with greater systemic resilience and a fairer sharing of the responsibilities and benefits of economic integration.

Methodology

The aim of this thesis is to critically analyse the process of fiscal integration within the European Union, with a focus on the role played by systemic crises and the growing need to equip the European Union with a centralised fiscal capacity. The goal is to assess, in the light of regulatory and institutional developments in recent years, the feasibility and political, economic and democratic implications of the creation of a European Fiscal Union.

The methodological approach chosen and used combines qualitative and legal-institutional analysis tools, integrating the analysis of official EU sources (treaties, regulations, policy documents and commission proposals) with the analysis of academic literature in the field of European fiscal governance, optimum currency area theories and fiscal federalism.

The work is structured in three macro-sections, each of which addresses a specific side of the issue under study. In the first chapter, a theoretical and systemic approach is used to define the conceptual assumptions of a fiscal union. In the second chapter, a comparative and interpretative method is adopted to analyse the emblematic case of Eurobonds, examining theoretical proposals and concrete instruments. In the third, and final, chapter, the analysis shifts to the institutional and political level, through an in-depth examination of the proposals for reforming the European decision-making architecture, specifically in the creation of a European Treasury and the figure of a Eurozone Minister of Economy and Finance. The methodological approach in this chapter is of a constitutional-comparative type, inspired by existing federal models, and makes use of a critical analysis of the main institutional and democratic challenges.

The entire project is guided by a problem-oriented logic, which relates the inadequacy of current instruments to the emergency responses adopted during the most recent crises, in order to ask what the future direction of the European fiscal integration project should be. The thesis seeks not only to describe what exists, but to provide analytical tools to assess whether greater fiscal integration is a necessary, effective and sustainable solution, or rather a political utopia still far from being realised.

Chapter 1: Cohesive Fiscal Policy

1.1 The theory of optimum currency area and the impact of a Cohesive Fiscal policy in the EU

To understand what a cohesive fiscal policy is and why its role is important, we must comprehend what is an optimum currency area.

An optimum currency area (OCA) is defined as a geographical region where it is economically advantageous for multiple countries or regions to share a common currency or maintain fixed exchange rates. According to Mundell, an OCA should have key characteristics, including:

1. Labour Mobility: Workers should be able to move freely across the region to adjust for economic shocks.
2. Capital Mobility and Price/Wage Flexibility: Capital should move freely, and wages/prices should adjust easily to changes in supply and demand.
3. Fiscal Transfers: A central fiscal authority should be able to redistribute resources to stabilize the economy.
4. Similar Economic Cycles: Countries should experience similar economic shocks so that a single monetary policy is effective.[1]

Considering the elements outlined below, the European Monetary Union (EMU) does not fully qualify as an Optimum Currency Area. Specifically, the EMU suffers from limited labour mobility, which is further constrained by language barriers and cultural differences. Additionally, wage-setting mechanisms and regulatory frameworks often prevent wages from adjusting quickly, as would be expected in a true OCA. Moreover, the EMU lacks a centralized fiscal system, whereas a well-functioning OCA should possess a common fiscal authority capable of redistributing resources across regions to moderate economic asymmetries.

Given these structural shortcomings, how can the EMU's trajectory be adjusted to move closer to the characteristics of an Optimum Currency Area, in this manner enhancing its overall effectiveness? The answer lies in the development of a more cohesive and

[1] Mundell, R. A. (1961). *A Theory of Optimum Currency Areas.* The American Economic Review, 51(4), 657–665.

integrated fiscal policy, which would play a decisive role in addressing the EMU's existing limitations.

A fundamental step in analysing the European Union's fiscal architecture is to clarify the concept of a cohesive fiscal policy. This refers to a set of coordinated fiscal measures intended to mitigate economic disparities between regions, promote balanced development, and ensure that all regions benefit equitably from economic growth. The necessity of a more integrated and cohesive fiscal policy becomes evident when studying its role in addressing asymmetric economic shocks within the EU.

To demonstrate this, consider a hypothetical scenario in which the EU establishes a centralized budget. Let's suppose that France experiences a recession while Germany undergoes an economic boom. In this model, EU member states have transferred a significant portion of their national budgets to a central European authority, which is responsible for managing income taxation and social security contributions. As a result, the centralized budget operates as a macroeconomic stabilizer: in France, declining output and rising unemployment lead to a reduction in tax revenues and an increase in social security payments by the European authorities. Conversely, in Germany, where economic activity is expanding, tax revenues rise, and social security expenditures decrease. This dynamic results in an automatic redistribution of income from Germany to France, diminishing the social and economic consequences of the recession in the latter.[2]

[2] De Grauwe, P. (2018). *Economics of Monetary Union*. 12th edn. Oxford: Oxford University Press. (218-221).

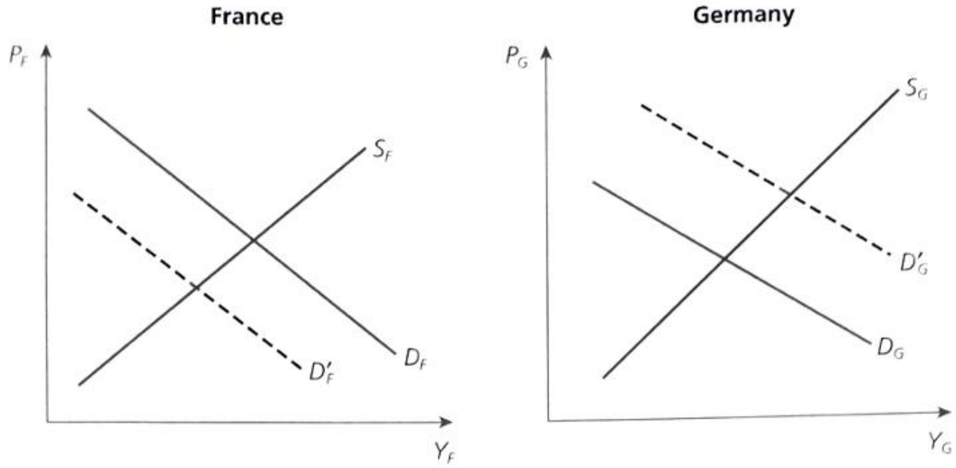

Figure 1, Source: Paul De Grauwe, Economics of Monetary Union, 12ª edizione, Oxford University Press, 2018

Such a mechanism functions as an insurance system, whereby member states experiencing negative economic shocks receive automatic transfers financed by those in more favourable economic conditions. This redistribution is a fundamental characteristic of a centralized fiscal framework and an essential component of a cohesive fiscal policy. Furthermore, the importance of fiscal integration becomes particularly pronounced in cases where a national government faces payment difficulties or defaults. Under a centralized system, the European-level social security framework would remain operational, ensuring the continuity of unemployment benefits, pensions, and healthcare services, therefore protecting essential public services from the fiscal distress of any single member state.

Beyond its role in economic stabilization, a centralized budget also contributes to reducing the fragility of government bond markets within the monetary union. In the case of a symmetric economic shock, automatic fiscal transfers would allow France to access financial support without the need to issue additional sovereign debt. If the fiscal deficit of one country exceeds the surplus of another, the centralized framework would enable the issuance of common European debt instruments, (commonly referred to as Eurobonds). These bonds would enhance the resilience of the monetary union by aligning it more closely with the theoretical framework of an optimal currency area.

This example underscores the critical role that a cohesive fiscal policy would play in strengthening the EMU. A centralized budget facilitates automatic stabilization mechanisms, thereby reducing the social costs associated with economic fluctuations. Additionally, by consolidating government debt issuance, it enhances the financial stability of the union.

These conclusions align with the findings of the MacDougall Report, which emphasized that a successful monetary union in Europe would necessitate a substantial degree of fiscal centralization, particularly in the administration of unemployment benefits. The report cautioned that failure to implement such fiscal integration could lead to severe social and economic strains, ultimately jeopardizing the stability of the monetary union[3].

However, it is important to recognize that a centralized budget must operate within defined limits. Specifically, budgetary transfers should primarily be utilized to address temporary, endogenous shocks, those arising from cyclical fluctuations within the economic system. In cases where shocks are permanent, such transfers should only serve as a short-term instrument to facilitate adjustment rather than a long-term solution.

When a country or region experiences a structural decline in demand for its output, the appropriate response should involve adjustments in wages, prices, or the reallocation of factors of production. Budgetary transfers may temporarily mitigate the adverse effects of such economic adjustments but should not replace necessary structural reforms. Consequently, the extent to which fiscal centralization is required depends on the nature of economic shocks. If asymmetric shocks primarily come from endogenous factors, the justification for a centralized budget to address these fluctuations is strong.

In instances where asymmetric shocks result from unsynchronized business cycles, flexibility alone is insufficient; rather, a central budget can function as an insurance mechanism, smoothing economic divergences across member states. Conversely, when asymmetric shocks are exogenous, slowing from external factors such as global market disruptions, the focus should be on fostering economic flexibility rather than relying on sustained fiscal transfers. In such cases, fiscal insurance should serve only as a temporary

[3] Commission of the European Communities (1977). *The MacDougall Report — Volume I*. [online] Brussels: Commission of the European Communities. Disponibile su: https://www.cvce.eu/content/publication/2012/5/31/c475e949-ed28-490b-81ae-a33ce9860d09/publishable_en.pdf

measure to alleviate the short-term costs of adjustment rather than as a permanent redistributive tool.[4]

1.2 Existing fiscal rules and regulations

Since the establishment of the Delors Committee for the study of the European Monetary Union (EMU) by the Hannover European Council in 1988, and the subsequent publication of its report, the necessity of a cohesive fiscal policy has been a central concern for EU policymakers. The Delors Report outlined a three-stage process for the introduction of the EMU, emphasizing in the second stage the essential requirement of fiscal rules to impose limits on national budget deficits (European Parliament, 2025, p. 260)[5].

The proposals put forward in the second stage of the Delors Report materialized with the signing of the Maastricht Treaty. This treaty introduced new fiscal regulations, commonly known as the convergence criteria, designed to maintain price stability within the euro area, even as new member states joined the monetary union. These criteria comprehend four key fiscal areas:

1. Inflation**:** "*A country's average inflation rate should not exceed the inflation rate of the three best-performing EU Member States by more than 1.5 percentage points during a one-year observation period*."
2. Public Debt Levels: *"A country's annual fiscal deficit should not exceed 3% of gross domestic product (GDP), and overall government debt should not exceed 60% of GDP*."
3. Interest Rates: "*A country's long-term interest rate should not exceed that of the three best-performing Member States by more than 2 percentage points during a one-year observation period*."

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[4] De Grauwe, P. (2018). *Economics of Monetary Union*. 12th edn. Oxford: Oxford University Press. (221).
[5] European Parliament. (2025). *Fact Sheets on the European Union*. [online] European Parliament, p. 260. Disponibile presso: https://www.europarl.europa.eu/factsheets/en

4. Exchange Rate Stability**:** "*A country must maintain a stable exchange rate, ensuring it remains within the fluctuation margins provided by the Exchange Rate Mechanism (ERM II) for at least the previous two years*".[6]

In the years following the Maastricht Treaty, several measures have been implemented to further the integration of European economies. In 1997, the Stability and Growth Pact (SGP) was introduced to ensure that member states adhered to sound fiscal policies.

Subsequently, In the aftermath of the European sovereign debt crisis (2009–2012), European Union leaders committed to strengthening the Economic and Monetary Union, particularly by enhancing its governance framework. A crucial development in this regard was the amendment of Article 136 of the Treaty on the Functioning of the European Union (TFEU), which enabled the establishment of a permanent support mechanism for Member States experiencing financial distress. This mechanism, conditional upon being based on an intergovernmental treaty, was to be activated only if the stability of the euro area as a whole was at risk and the financial assistance provided was subject to stringent conditionality. Consequently, the European Stability Mechanism (ESM) was created in October 2012, replacing several temporary crisis-response mechanisms.

Concurrently, in a pioneering intervention, European Central Bank (ECB) President Mario Draghi declared that "*within our mandate, the ECB is ready to do whatever it takes to preserve the euro*." This statement laid the foundation for the introduction of the Outright Monetary Transactions (OMT) programme, which allowed the ECB to purchase sovereign bonds of distressed Member States, depending on the beneficiary country signing a memorandum of understanding with the ESM. This arrangement effectively subjected ECB assistance to the same rigid conditionality applied by the ESM, typically involving fiscal consolidation and structural reforms.

Moreover, to prevent the recurrence of sovereign debt crises, the EU undertook a significant reform of EMU's secondary legislation. The European Semester was introduced to reinforce the Stability and Growth Pact, establish the Macroeconomic Imbalance Procedure (MIP), and promote more robust economic policy coordination.

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[6] European Central Bank. (2024, March 24). *Five things you need to know about the Maastricht Treaty*. https://www.ecb.europa.eu/ecb-and-you/explainers/tell-me-more/html/maastricht_treaty.en.html

These institutional innovations were complemented by intergovernmental agreements, notably the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG or Fiscal Compact), and the Euro Plus Pact.

In parallel, the global financial crisis prompted the creation of the Banking Union in 2016, featuring key pillars such as the Single Supervisory Mechanism (SSM) and the Single Resolution Board (SRB). These initiatives aimed to strengthen the resilience and integration of the European banking system, thereby contributing to broader financial stability within the euro area.

However, the economic fallout from the COVID-19 pandemic exerted substantial pressure on public finances across the EU. In March 2020, the Council activated the SGP's general escape clause, granting Member States temporary flexibility to deviate from fiscal rules, including exceeding the 60% debt-to-GDP threshold, without incurring sanctions. Nonetheless, Member States with already elevated debt levels were encouraged to exercise fiscal prudence. Despite the clause's activation, the imposition of sanctions remained legally possible under the SGP framework.

In response to the economic shock induced by the pandemic, the ECB also launched the Pandemic Emergency Purchase Programme (PEPP) in March 2020. Through this programme, the ECB undertook large-scale purchases of sovereign bonds in secondary markets, aiming to provide liquidity and contain excessive yield spreads between German Bunds and the bonds of highly indebted Member States. Although significant in size, PEPP was conceived as a temporary measure.

The ECB conducted a strategic review in the summer of 2021, its first since 2003, which reaffirmed a symmetric 2% inflation target over the medium term. The review also acknowledged the need to accommodate temporary inflation overshoots and integrate climate considerations into Euro system policy decisions.

Years of expansionary monetary policy, intensified by the post-pandemic economic rebound and the inflationary impact of the war in Ukraine, particularly through rising energy prices, culminated in a historic increasement of inflation's level across the euro area beginning in 2022. This inflationary trend caused second-round effects, as diminished purchasing power stimulated widespread wage demands, raising concerns over a potential wage–price spiral. In response, the Euro system decisively reversed its monetary stance by reducing asset purchases and raising interest rates. To address concerns over widening sovereign bond spreads, particularly for high-debt countries, the ECB introduced the Transmission Protection Instrument (TPI) in July 2022 as an anti-fragmentation measure.

Following two years of successive interest rate growth, inflation in the euro area began to moderate in 2023. Simultaneously, discussions intensified within the Euro system and among euro area Member States concerning the reform of the SGP. Despite divergent national positions, a general consensus emerged to grant high-debt countries more time to reduce their debt-to-GDP ratios to below the 60% threshold, while also simplifying the SGP's overly complex enforcement mechanisms. Nevertheless, the numerical benchmarks of 60% for debt and 3% for deficits were maintained. The general escape clause was deactivated at the end of 2023, and in April 2023, the European Commission tabled legislative proposals to revise the SGP. A political agreement on the reform was reached between the European Parliament and the Council on 10 February 2024.[7]

1.2.1 Stability and Growth Pact (SGP)

On 29 April 2024, the European Union adopted a new version of the Stability and Growth Pact, consisting of two regulations and one directive, following approval by the Economic and Financial Affairs Council (ECOFIN), the European Commission, and the European Parliament. The revised Pact, strongly influenced by the German government, particularly the German Finance Minister, reflects a stricter fiscal stance with binding numerical rules aligned with a neoliberal vision. It significantly diverges from earlier drafts proposed by the Commission.

This new framework replaces the original SGP of 1997 as well as, in practice, the 2012 Fiscal Compact, an intergovernmental agreement outside EU law containing the most stringent fiscal constraints to date. While the Fiscal Compact remains legally valid, it is now effectively subordinated to the new SGP. This marks the fourth restatement of the Pact since its establishment. The reference values of 60% for public debt and 3% for

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[7] European Parliament. (2025). *Fact Sheets on the European Union*. [online] European Parliament, p. 261-262. Disponibile presso: https://www.europarl.europa.eu/factsheets/en

budget deficits remain, as these are enshrined in EU treaties and can only be temporarily exceeded under specific conditions outlined in Article 126 TFEU.

Both the preventive and corrective arms of the SGP remain in place, with reforms primarily affecting the preventive component. The most significant operational change is the introduction of a “net expenditure rule,” replacing earlier mechanisms such as structural deficit targets and the Fiscal Compact’s 1/20th rule. Net expenditure is defined as total nominal primary public expenditure, excluding interest payments, cyclical unemployment costs, one-off measures, and Union-financed public investment (including co-financing). Despite this, most public investments are still counted within the expenditure total, aiming to limit the growth of net spending relative to potential GDP when debt or deficits exceed reference thresholds. Although tax increases are not explicitly addressed, they are not precluded.

Member States are required to submit multi-annual "national medium-term fiscal-structural plans" (FSPs) to the Commission, spanning four to five years (or seven years if accompanied by specific reform and investment commitments in areas like climate, digitalization, or defence). These plans must outline strategies to reduce both debt and deficits, applying two separate benchmarks. For countries with debt exceeding 90% of GDP, a minimum annual reduction of 1 percentage point is mandated, and 0.5 percentage points if debt lies between 60% and 90%. Though less strict than the 1/20th rule, this debt reduction must follow a linear path, with annual progress monitored by the Commission. The objective is a sustained and credible reduction toward the 60% debt threshold, albeit over a potentially very long horizon.

FSPs must receive approval from both the Commission and the Council, enhancing their enforceability. For MS exceeding the 60% debt or 3% deficit thresholds, the Commission will conduct a “Debt Sustainability Analysis” (DSA), spanning 10–17 years and based on the S1 and S2 indicators[8] from the Commission’s regular Debt Sustainability Monitor. The DSA methodology remains relatively opaque, allowing for discretion in defining

[8] The new long-term risk classification is based on two complementary fiscal gap indicators that show the fiscal effort required to achieve two specific long-term fiscal goals. The S2 indicator measures the fiscal effort needed to stabilise public debt over the long term. The revised S1 indicator measures the fiscal effort required to bring the government debt-to-GDP ratio to 60% in 2070, hence capturing vulnerabilities due to high debt levels. The methodological approach differs from the Fiscal Sustainability Report 2021, which determined long-term fiscal risks based on the S2 indicator and the DSA results. The revised S1 indicator provides a better long-term complement to the S2 indicator, as based on a similar time horizon.

country-specific “reference trajectories,” which will effectively guide national fiscal strategies.

To maintain deficit control, MS must not only remain below the 3% threshold but also adhere to a safety margin: structural deficits must not exceed 1.5% of GDP starting in 2027. This is more flexible than the Fiscal Compact, which imposed a ceiling of 0.5% (or 1% for low-debt MS). If MS exceed the 1.5% structural deficit cap, they are required to reduce their structural primary deficit annually by 0.4% of GDP (or 0.25% with an extended adjustment period). Low-debt MS thus gain some additional fiscal space, particularly as Germany is approaching the 60% threshold.

For MS within the reference values, continued compliance is required. If only one threshold is breached, relevant procedures apply accordingly. Escape clauses are available for euro area-wide or national crises, subject to Commission and Council approval, and may last up to two years.

Furthermore, there are minimal changes to the corrective arm of the Pact. Sanctions remain limited, with a maximum fine of 0.05% of GDP per six-month period in cases of persistent non-compliance. The emphasis thus lies on preventive mechanisms. To counterbalance the increased powers of the Commission and Council over national fiscal policies, an independent European Fiscal Board composed of five experts will be established. National fiscal boards or independent experts are also expected to play a role in drafting and monitoring FSPs.[9]

1.2.2 The Fiscal Compact

The Fiscal Compact operates as the foundation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), which was officially adopted during the Council of Ministers convening in March 2012 and took effect in January 2013.

All European Union member states, except for the Czech Republic and the United Kingdom, agreed to the Compact, promising to incorporate its provisions into their

[9] Priewe, J. (2024) *The new EU Stability and Growth Pact – new bottle with a lot of old wine*. *European Journal of Economics and Economic Policies: Intervention*, Advance Access, April. doi: 10.4337/ejeep.2024.0143.

national laws and fiscal policies. The primary goal of the Fiscal Compact is to enhance fiscal discipline by improving the oversight and coordination of national budgetary practices. A key provision states that the general government budget must either be balanced or in surplus. Thus, participating countries are obliged to establish a binding medium-term structural deficit limit of 0.5% of GDP within their domestic legal frameworks. This limit can be increased to 1.0% of GDP in instances where the debt-to-GDP ratio is under 60% and fiscal viability is not at risk.

To ensure adherence, the Compact requires member states to integrate an automatic correction mechanism into their national legislation. This mechanism is designed to ensure prompt progress towards the medium-term objective (MTO) in the event of any deviations.

However, the Compact allows for some flexibility by permitting temporary deviations from fiscal goals in exceptional situations, defined as extraordinary circumstances outside the control of the state that significantly impact public finances, or during periods of major economic downturns, according to the updated Stability and Growth Pact.

Additionally, the implementation of the correction mechanism necessitates those deviations from the MTO or its adjustment path be considered "significant." Furthermore, the Compact requires that the balanced budget rule, aligned with the MTO, be established in national law in a binding and permanent manner, preferably through constitutional provisions or through legal frameworks that guarantee compliance throughout the budgetary process. Enforcement of this rule must be monitored by an independent national fiscal council.

Enhancing the measures of the Compact, the Two-Pack, effective from 2013, improved the European Semester by introducing a supranational evaluation of national draft budgetary plans and reinforcing the oversight systems for member states undergoing the Excessive Deficit Procedure (EDP). Within this arrangement, member states must create an independent fiscal institution to oversee adherence to national fiscal regulations and to supervise the functioning of the automatic correction mechanism.

The significant innovations brought about by the Fiscal Compact and its supplementary measures can be gathered into three main areas. First, it reduces the structural deficit goal to 0.5% of GDP for countries with high debt levels, thereby tightening fiscal restrictions. Second, it mandates a quick return to the MTO, ensuring that deviations are only temporary and that the structural budget balance is central to short-term fiscal planning. Lastly, it requires the institutionalization of the MTO rule through binding national legislation, which is to be overseen by an independent fiscal council.[10]

1.3 Challenges for a EU fiscal union

Over the past two decades, the intention of EU policy makers has been to progressively build a more cohesive fiscal policy. However, the goal of a fully realised fiscal union still seems far off and the path towards this goal is filled with significant obstacles that need to be addressed and overcome. This section of the thesis aims to analyse and highlight the main challenges that currently hamper an acceleration of the EU fiscal integration process.

The difficulties along the path towards a European fiscal union manifest themselves in several areas, including:

1. The fear of moral hazard.
2. The political reluctance of Member States.
3. The institutional rigidity of the European system.
4. The lack of public support.

One of the main structural problems concerns the absence of effective fiscal risk-sharing mechanisms that could help absorb asymmetric shocks within the euro area. Although proposals have been made for the introduction of instruments such as a central EU budget or unemployment insurance schemes, these initiatives are often met with resistance, particularly from countries with stronger economies, such as Germany and the Netherlands, which fear a weakening of fiscal discipline and the emergence of opportunistic behaviour.

In particular, there are two distinct aspects of moral hazard that delay the implementation of a more integrated fiscal policy:

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[10] Kukk, M. and Staehr, K., 2015. *Enhanced fiscal governance in the European Union: The Fiscal Compact*. Baltic Journal of European Studies, 5(1), pp.73–92. doi:10.1515/bjes-2015-0006.

The first concerns the incentives of regional governments, involved in intranational insurance mechanisms, to invest in risk prevention strategies. As shown by Persson and Tabellini[11], the prospect of receiving transfers from other regions in the event of negative shocks reduces the incentive of local governments to increase the tax burden and allocate the resources collected to projects that make such shocks less likely. In a context of decentralised policies geared towards risk prevention, regional governments therefore tend to underestimate such investments. It follows that such strategies should not be left to the initiative of local governments alone but require central coordination. Indeed, a central government providing intranational insurance would have an interest in centralising such policies or, alternatively, in economically incentivising local governments' investments to increase their overall level. In this sense, moral hazard creates a "complementarity of incentives", since the adoption of central fiscal insurance programmes pushes towards a greater centralisation of regional risk policies.[12]

The second moral hazard problem concerns the effectiveness of market adjustment mechanisms in response to transitory and asymmetric shocks. According to Von Hagen[13], since taxes and transfers are generally distortionary, redistributive policies reduce the incentive for individuals to adjust to regional shocks. This is particularly relevant when considering supply-side shocks. Individuals who receive public transfers when their region is adversely affected may have no incentive to accept wage reductions, change sectors or move to other areas. In this sense, centrally provided fiscal insurance may reduce the effectiveness of market adjustments, particularly in the labour market.

Obstfeld and Peri[14] provide a relevant example in this regard by examining labour market adjustment to regional asymmetric shocks. They show how differences in unemployment rates between regions are much more persistent within European states than in the US, and how interregional migration in Europe contributes less to adjustment than in the US context. Considering that within European states there are no language or cultural barriers

[11] Persson, Torsten and Tabellini, Guido, (1996), Federal Fiscal Constitutions: Risk Sharing and Redistribution, *Journal of Political Economy*, 104, issue 5, p. 979-1009, https://EconPapers.repec.org/RePEc:ucp:jpolec:v:104:y:1996:i:5:p:979-1009.

[12] von Hagen, Jürgen (1998) : Fiscal policy and intranational risk-sharing, ZEI Working Paper, No. B 13-1998, Rheinische Friedrich-Wilhelms-Universität Bonn, Zentrum für Europäische Integrationsforschung (ZEI), Bonn

[13] Ibidem

[14] Maurice Obstfeld, Giovanni Peri, Regional non-adjustment and fiscal policy, *Economic Policy*, Volume 13, Issue 26, 1 April 1998, Pages 206–259.

comparable to those between different member states, and that fiscal transfers are generally larger, the authors interpret this phenomenon as evidence that the generosity of European welfare programmes reduces the incentive for workers to migrate in response to economic shocks. Thus, European fiscal transfer systems would reduce the effectiveness of labour market adjustment.

However, while this interpretation is logically convincing, it has to be approached with caution, as reverse causality cannot be ruled out: it is possible that countries in which market adjustments occur more slowly would choose higher levels of fiscal insurance. Nevertheless, theoretical arguments and empirical evidence suggest that full intranational fiscal insurance is hardly desirable. Determining an efficient level of fiscal risk-sharing remains a complex issue, even more if such insurance is an indirect product of the central budget or the national welfare system.

Moreover, another deep structural obstacle to the realisation of a true fiscal union in Europe is the cultural and political divisions between Member States. These divisions manifest themselves in various ways, each of which complicates the building of common institutions necessary for integrated cohesive fiscal policies.

First, language barriers not only delay labour mobility within the EU, but also the construction of a shared public sphere. When citizens do not speak the same language, communication between peoples and the formation of a common political identity is limited. This reduces the possibility of generating consensus around supranational projects, such as tax redistribution between countries.

Secondly, historical memory and mutual distrust between some Member States contribute to a climate of scepticism. Northern European countries, for example, often perceive southern ones as less fiscally disciplined. Conversely, southern countries may perceive the fiscal rules imposed by Brussels as instruments of economic domination, rather than as neutral mechanisms of stability.

These perceptions are connected with very different political systems, reflecting divergent approaches to the role of the state, solidarity and fiscal responsibility. For example, the Scandinavian social model, based on high taxation and generous welfare, differs profoundly from the liberal Anglo-Saxon model or the more fragmented systems of

Southern Europe. This institutional pluralism makes it extremely difficult to harmonise tax policies, as solutions that are acceptable in one national context may be unacceptable in another.

The result is that the willingness of citizens to support cross-border tax transfers remains very low. Fiscal solidarity, which within a nation state is often justified by a common identity affiliation, in Europe clashes with the perception of 'others', e.g. countries that differ in language, culture and political practice. This makes it politically risky for governments to support the idea of debt mutualisation or permanent instruments of fiscal redistribution, such as a European federal budget or shared unemployment insurance.

In addition to cultural and political obstacles, institutional inertia and legal constraints represent equally significant structural barriers to building a genuine tax union in the EU. Even when there is widespread recognition of the need for further tax integration, the legal structure of the EU severely limits the ability to act quickly or ambitiously.

In particular, the current architecture of the European treaties, such as the Treaty on the Functioning of the European Union (TFEU), does not explicitly provide for the possibility of large-scale fiscal transfers between member states or the creation of permanent centralised budgetary instruments. Any step towards a complete fiscal union, for example, the creation of a common Eurozone budget, a European unemployment insurance system, or the issuance of joint debt (Eurobonds) would require significant changes to the existing treaties. Such changes must be unanimously approved by all member states, and in many cases, ratified by the national parliaments or even put to a referendum in some countries, such as Ireland or Denmark. This makes the process not only slow and complex, but also extremely vulnerable to the political veto of individual countries. In a Union of 27 members (and 20 in the eurozone), reaching unanimous consensus on highly sensitive tax issues is politically difficult. As Thirion[15] points out, European legal rigidity means that even partial or experimental solutions, such as limited automatic stabilisation mechanisms or common funds on an intergovernmental basis, are difficult to institutionalise if they find no place in the treaties or general political consensus. Inertia stems not only from written rules, but also from a deficit of institutional flexibility, where

[15] Thirion, Gilles, European Fiscal Union: Economic Rationale and Design Challenges (January 20, 2017). CEPS Working Document.

fiscal competences are historically and constitutionally linked to the sovereignty of member states.

Finally, there is a risk that the absence of a clear legal framework for fiscal union induces policy makers to proceed by “layering”, e.g. by accumulating ad hoc instruments such as the Next Generation EU or the ESM, often on a temporary basis and with uncertain political legitimacy. This can weaken institutional coherence and make the architecture of the Union less transparent.

A further major obstacle to the construction of a true European fiscal union lies in the lack of public consensus. Unlike in nation states, where citizens accept the principle of tax redistribution between more and less developed regions in the name of a shared political identity, in the European context this sense of transnational belonging is still weak and fragmented. Consequently, the idea that common fiscal resources can be permanently transferred from one country to another, e.g. in the form of automatic stabilisation mechanisms or debt mutualisation, meets with strong resistance from the electorate in many areas of the Union.

This phenomenon is particularly visible in the so-called “frugal countries”, such as Germany, the Netherlands, Austria and Finland, where citizens fear having to permanently bear the costs of tax policies perceived as irresponsible in southern European countries. At the same time, in the latter, common fiscal rules imposed at the European level are often seen as technocratic and punitive instruments that limit national economic sovereignty and impose social and economic austerity measures. In this context, the lack of transparency in European tax decision-making processes, coupled with the perceived distance between EU institutions and citizens, contributes to mistrust. Mechanisms such as the European Semester, the Stability and Growth Pact or the Recovery and Resilience Facility, although central to economic and fiscal coordination, are often poorly understood and lack legitimacy in the eyes of the public.

Consequently, the possibility of building a real fiscal union, based on structural and not only emergency solidarity instruments, is strongly conditioned by the absence of a shared political and cultural capital. As long as a common public narrative is not developed, supported by a strengthening of European identity and institutions perceived as representative, popular support for cross-border fiscal transfers will remain limited, constituting a structural political constraint on fiscal integration.

In sum, the realisation of a full European fiscal union is not only hampered by economic divergences or technical governance problems, but by a combination of deeply rooted political, cultural and institutional factors. Reluctance to share risks, lack of mutual trust between Member States, rigid treaties and lack of widespread public support make progress towards fiscal integration a complex and gradual process. Without broad political consensus and stronger democratic legitimacy, any progress will remain fragile and potentially reversible.

Chapter 2: Eurobonds

As analysed in the first chapter, the absence of a central fiscal instrument has highlighted the vulnerability of EMU in terms of management and response against asymmetric shocks and systematic crisis. In this context, the need for mechanism to ensure greater risk-sharing between EU Member States emerges strongly.

Among the proposals made in recent years, the one concerning the introduction of common debt instruments, such as Eurobonds, represents one of the most emblematic responses to the problem of European fiscal fragmentation. This chapter therefore focuses on analysing the concept of Eurobonds, examining their economic rationale, operational mechanisms, critical issues and potential role in strengthening the financial cohesion of the Eurozone.

The crisis of the European Union has had numerous consequences both at the structural and in the debate levels on European integration. In some cases, these crises have brought concrete changes, in others, they have simply opened a debate on issues that are still being discussed today. An emblematic example is the European sovereign debt crisis of 2010-2012. During this phase, several southern European countries, known by the acronym *"PIGS"*[16], due to the intense financial pressure they were suffering, began to propose the introduction of shared public debt securities, guaranteed by the entire Union, capable of redistributing risk among the Member States and easing the individual economic burden.

In response to these demands, the European Commission presented a Green Paper on so-called "Stability Bonds" in 2011[17], proposing a debt mutualisation mechanism. However, the proposal encountered strong political opposition from the "*frugal*"[18] countries, which considered such risk-sharing to be excessively dangerous and contrary to principles of fiscal prudence.

[16] PIGS is a derogatory acronym that has been used to designate the economies of the Southern European countries of Portugal, Italy, Greece and Spain during the European sovereign debt crisis.

[17] European Commission, *Green Paper on the Feasibility of Introducing Stability Bonds*, Directorate-General for Economic and Financial Affairs, November 23, 2011, https://ec.europa.eu/economy_finance/articles/governance/2011-11-23-green-paper-stability-bonds_en.htm.

[18] The Frugal is the nickname of an informal cooperation among like-minded fiscally conservative European countries, including Austria, Germany, Denmark, the Netherlands and Sweden.

Nevertheless, the debate did not end with the sovereign debt crisis, but continued to resurface, particularly during the economic crisis caused by the COVID-19 pandemic. On that occasion new exogenous financial pressure were challenging the EU Member states' economies and countries like Italy and France relaunched the proposal of common debt securities. But then again, even at that juncture, Neatherlands and other Northern European countries firmly opposed the introduction of similar instruments.

An important turning point came with the adoption of the NextGenerationEU programme, a €750 billion plan financed, for the first time in EU history, through the issuance of common debt by the European Commission. Although these bonds were not formally named "Eurobonds"[19], they share the underlying logic of debt mutualisation, representing a significant step towards greater fiscal integration.

A further sign of change came on 21 March 2025, when the Bundestag approved, with 513 votes in favour, a vast debt investment plan for infrastructure and defence, derogating from the historical "*debt brake*"[20] rule that has always characterised German fiscal policy[21].

This development could open up new scenarios, in which even countries traditionally associated with an austeritarian mentality in fiscal matters begin to recognise that, in crisis situations, it is possible to reconsider certain economic dogmas. This could lead to a political climate more favourable to the negotiation of evolved forms of shared debt securities at the European level.

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[19] "*A Eurobond is a bond issued by the European Central Bank. By offering bonds, debt securities that public or private investors (such as insurance companies, banks or investment funds) can subscribe to, the ECB enables European countries in the euro zone to finance their deficits. These securities are denominated in euro. Instead of the national guarantee that characterises a national bond, Eurobonds benefit from the European guarantee. They are bonds issued jointly by Euro zone countries on the international market*" ((CIFE), 2025)

[20] Erika Solomon, *"Germany Votes to Suspend Debt Brake, Opening Door to Major Investments," The New York Times*, March 18, 2025, https://www.nytimes.com/2025/03/18/world/europe/germany-debt-brake.html.

[21] "*Paragraph 3 of Article 109 of the Basic Law states that "the budgets of the Federation and the Länder shall, in principle, be balanced without revenue from credits." This means that the government may only spend as much money as it takes in, primarily from taxes and levies. This requirement is known as the "Debt Brake."*

2.1 Mechanisms and rationale behind Eurobonds in the EU context

Over the years, the discussion over the Eurobonds has been enriched with several valid proposals, however not all of them have succeeded in making the Eurobonds attractive for both fiscal disciplined and less fiscal disciplined countries. In this section, the proposal of De Grauwe and Monsen has been selected for the analysis, as it prioritises the economic attractiveness of the instrument and aim to make the creation of Eurobonds more feasible and appealing for all EU Member States.

The joint issuance of Eurobonds would imply a joint and several liability among the participating countries for the debt issued, constituting a highly visible and binding commitment. Such a mechanism can send a credible signal to the markets about the determination of member states to sustain the stability of the euro in the long run[22]. Furthermore, the mutualisation of sovereign debt would help protect member states from potentially destabilising liquidity crises caused by their inability to issue debt in a currency they do not control. Common issuance would overcome this limitation, offering greater security and stability to the system as a whole.

However, the introduction of common Eurobonds raises a number of critical issues that require careful consideration. The main one concerns moral hazard, as the responsibility for debt becomes collective, some states could be incentivised to issue more debt, leveraging the implicit insurance provided by the common mechanism. This behaviour risks generating strong resistance from the more fiscally disciplined countries, which would be unlikely to agree to participate without appropriate correctives to discourage opportunistic behaviour[23].

A second problem concerns the distributional implications. Countries such as Germany or the Netherlands, which currently benefit from a triple-A rating and very favourable financing conditions, might have to bear higher interest rates if the Eurobond also includes states with lower creditworthiness. The question therefore arises: what concrete benefits would these countries have from joining a debt-sharing mechanism?

[22] De Grauwe, P., & Moesen, W. (2009). *Gains for all: A proposal for a common Eurobond*. CEPS Commentary.
[23] Delpla, J., & von Weizsäcker, J. (2010). *The Blue Bond proposal*. Bruegel Policy Brief, 2010/03

A particularly influential compromise proposal is the one formulated by De Grauwe and Moesen[24] and later developed by the Bruegel think tank[25]. It envisages the adoption of a dual-tranche system: countries could issue Eurobonds up to 60 per cent of their GDP in the form of *"Blue Bonds*", thus enjoying common guarantees and presumably a high rating, debt exceeding this threshold, on the other hand, would have to be issued individually in the national bond as "*Red Bonds*", exposed to a higher risk and thus a higher risk premium. This scheme would produce a virtuous incentive for debt reduction, as governments would be disincentivised to accumulate debt above the common threshold due to the higher financing cost associated with the subordinated tranche[26].

However, there is no absence of criticism for this proposal. Gros and Mayer[27], recalling the Modigliani and Miller theorem, argue that simply restructuring debt into tranches does not change the underlying risk. In other words, if the overall risk remains unchanged, any reduction in the rate on the senior tranche will be offset by an increase on the junior tranche, keeping the average funding cost unchanged.

This objection is valid to the extent that the actual risk does not change. However, the main objective of joint issuance is precisely to prevent states from being trapped in negative equilibria, where rising rates further exacerbate debt sustainability[28]. If the Eurobond succeeds in breaking this dynamic, the perceived risk may actually decrease, leading to a fall in the average rate. At the same time, the marginal rate, i.e. the rate applied to excess debt, may increase. This dual effect is desirable, on the one hand, it facilitates the servicing of existing debt, on the other, it strengthens the incentive for fiscal discipline, helping to mitigate the risk of moral hazard.

A further crucial element concerns the rate structure within the common tranche. De Grauwe and Moesen propose the introduction of a differentiated rate system, in which

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[24] De Grauwe, P., & Moesen, W. (2009). *Gains for all: A proposal for a common Eurobond*. CEPS Commentary.

[25] Delpla, J., & von Weizsäcker, J. (2010). *The Blue Bond proposal*. Bruegel Policy Brief, 2010/03.

[26] Gros, D. (2010). *How to deal with sovereign default in Europe: Towards a Euro(pean) Monetary Fund*. CEPS Policy Brief No. 202.

[27] Gros, D., & Mayer, T. (2011). Refinancing the EFSF via the ECB. CEPS Commentary.

[28] De Grauwe, P. (2018). *Economics of Monetary Union*. 12th edn. Oxford: Oxford University Press. (240-241).

countries participating in the Blue Bond would pay a modulated rate based on their fiscal position. In practice, more virtuous states would bear a lower cost, while those with higher debt levels would pay a higher rate. This approach would have the merit of keeping participation attractive for highly rated countries, while reducing potentially unfair redistributive effects[29].

Finally, if effectively implemented, the common issuance of Eurobonds could contribute to the creation of a large, highly liquid European bond market, capable of attracting global investors. This would strengthen the international role of the euro and consolidate its function as a reserve currency. According to estimates by Gourinchas and Rey[30], the dollar currently enjoys a premium of about 50 basis points due to its function as a reserve currency and the high liquidity of its markets. A similar premium could also be obtained by the euro, further reducing the average cost of debt for the euro area as a whole, as is currently the case for the US[31].

2.2 Exploring Eurobonds: Economic solution or political Illusion?

The proposal formulated by De Grauwe and Moesen to issue collectively guaranteed Eurobonds with differentiated interest rates among participating countries is part of the debate on debt mutualisation as a possible instrument to strengthen the economic and financial stability of the Eurozone. According to Pobrić's [32]analysis, the implementation of a proposal with similar characteristics could generate several relevant economic consequences, both positive and potentially problematic.

An expected effect is the improvement of financial stability in the euro area. The possibility of accessing funding through jointly guaranteed instruments would allow the most vulnerable Member States to obtain liquidity even in crisis contexts, avoiding self-

[29] De Grauwe, P., & Moesen, W. (2009). *Gains for all: A proposal for a common Eurobond*. CEPS Commentary.

[30] Gourinchas, P.-O., & Rey, H. (2007). From World Banker to World Venture Capitalist: US External Adjustment and the Exorbitant Privilege. In R. Clarida (Ed.), G7 Current Account Imbalances: Sustainability and Adjustment (pp. 11–66). University of Chicago Press.

[31] De Grauwe, P. (2018). *Economics of Monetary Union*. 12th edn. Oxford: Oxford University Press. (240-241).

[32] Pobrić, N. (2019). *Is the idea of the common Eurobonds issuance in the Eurozone sustainable?* InterEULawEast: Journal for International and European Law, Economics and Market Integrations, 6(2), 1–30.

fuelled dynamics of rising interest rates and investor distrust. This mechanism would act as a market "stabiliser", containing the risk of financial contagion between countries.

Moreover, the creation of a critical mass of safe and liquid securities, the so-called "*Blue Bonds*", would contribute to the formation of a genuine European bond market, deeper and less fragmented than the current national markets. Such a development would enhance the overall liquidity of the system, reducing liquidity premiums and financing costs for many states, particularly small ones.

A further advantage would concern the transmission of monetary policy. In a context where the bond market is highly integrated, the instruments of the European Central Bank (ECB) would be more effective, allowing a more uniform response to macroeconomic shocks and a more consistent management of interest rates in the euro area.

However, the introduction of Eurobonds, even according to the De Grauwe-Moesen model, is not without risks. One of the main ones is related to the possible emergence of opportunistic behaviour: if sufficiently stringent supervisory and conditionality mechanisms are not in place, some countries might be incentivised to reduce their fiscal effort by leveraging the collective guarantee. This phenomenon, known as moral hazard, is considered a threat to the sustainability of the system in the long run.

Furthermore, the proposal could have significant distributional implications. Highly rated states could experience an increase in the average cost of financing, although in the De Grauwe model this effect should be limited through the application of risk-adjusted rates. Nevertheless, the political issue of the perceived implicit transfer of resources from stronger to weaker countries remains and without a strong support from the public opinion of every EU Member state, it becomes almost impossible to realise.

Additionally, another aspect to consider is debt management. The introduction of common instruments could reduce the flexibility of individual states in defining their issuance strategy, especially in terms of maturities, volumes and debt structure. However, in the specific case of the De Grauwe proposal, this rigidity is partly offset by the distinction between mutualised debt (*Blue Bonds*) and residual national debt (*Red Bonds*), which retains margins of autonomy beyond the 60 per cent of GDP threshold.

According to Pobric's analysis, the implementation of the model proposed by De Grauwe and Moesen could yield significant benefits in terms of macro-financial stability, market integration and reduced financing costs for the most exposed countries. Conversely, these benefits must be balanced with appropriate instruments of fiscal control and economic governance, so that redistributive effects and risks of distorted incentives do not undermine the overall effectiveness of the mechanism.

In addition to the economic aspects related to the introduction of Eurobonds, it is crucial to analyse the degree of fulfilment of the legal and political conditions necessary for their effective implementation. The discussion on the legal feasibility and political desirability of the joint issuance of common debt securities in the euro area is central, since such an instrument, although supported by some proposals made in academic and institutional circles, would currently encounter significant regulatory obstacles and strong political opposition.

From a legal point of view, the central issue concerns the interpretation of the Treaty on the Functioning of the European Union (TFEU) and the compatibility of the proposal with its provisions. Indeed, the TFEU does not expressly regulate the issuance of debt securities, neither by the Union nor by the member states. In this sense, there are no direct obstacles to defining the legal model according to which Eurobonds could be introduced. However, a relevant constraint is the "no-bailout clause" contained in Article 125 TFEU, which states that "*No Member State shall be liable for the debts of another Member State*".[33]

Whether this clause constitutes an effective impediment to the issuance of Eurobonds depends on the nature of the guarantees underlying the proposed instruments. While, on the one hand, the issuance of Eurobonds in which each participant is exclusively liable for its share would not face any legal obstacles (as such issuance would also be possible outside the EU legal framework), on the other hand, models involving cross-guarantees between states or the issuance of securities by European institutions would entail the need for amendments to the TFEU or secondary EU legislation.

[33] Tielens, J. et al.: Effects of Eurobonds: a stochastic sovereign debt sustainability analysis for Portugal, Ireland and Greece, Journal of Macroeconomics, 42, 2014, p. 156-173. DOI: https://doi.org/10.1016/j.jmacro.2014.06.004, p. 157.

In particular, the cross-default nature of joint guarantees violates Article 125 TFEU, necessitating a revision of the Treaty to make the issuance of Eurobonds with joint and several liability legally feasible. Although such a change is not legally impossible, it would require a long lead time and a broad political consensus. In addition, the political-philosophical dilemma remains as to whether the no-bailout principle should be weakened or even eliminated, while it acts as a brake on irresponsible fiscal behaviour, it represents a structural obstacle to fiscal and financial integration of the Eurozone.

Even if the issuance were entrusted to an EU institution, the cross-guarantees would remain, although not explicit, implicit in the European legal order. Therefore, the legal obstacles would not be removed but would take a different form. Substantial changes to the TFEU would still be required to overcome these problems, and to allow an EU institution to issue securities to support the needs of states. A further problem would arise if non-participating states would in fact have to bear the financial risks associated with common indebtedness, creating tensions as to the fairness of intervention.

Politically, the idea of Eurobonds continues to meet with strong resistance, especially from those member state governments with solid fiscal foundations. The reasons for the opposition are mainly based on the fear that joint issuance could incentivise opportunistic behaviour on the part of less virtuous states and on the perceived unfair distribution of the costs and benefits of the programme.

Sometimes, political objections are disguised as legal arguments, but in essence they reflect the absence of a concrete interest in participating in a mechanism that entails burdens without proportionate returns. In other words, no state will be willing to pay a higher interest rate or guarantee the debt of others unless it receives tangible and proportionate benefits.

Considering this, the lack of political will is one of the most significant obstacles to the realisation of Eurobonds. Several proposals, as the one of De Grauwe and Mosen, have tried to provide technical solutions to alleviate these critical issues and facilitate the accession of member states. However, full political acceptance of the idea is only likely to come about when a qualitative leap towards true fiscal and political integration of the

Eurozone is made. Only then can Eurobonds be perceived as instruments of high credit quality, acceptable even by the most financially prudent states.[34]

2.3 Case studies: Next Generation EU

The introduction of the Next Generation EU (NGEU) programme represents a turning point in EU fiscal and financial policy and one of the most ambitious and coordinated responses to a systemic crisis in the history of European integration. Decided in July 2020 as a reaction to the COVID-19 pandemic, the programme gave the European Commission extraordinary access to the financial markets to raise up to €750 billion in 2018 prices (corresponding to around €807 billion in current prices), assigned to support economic recovery and the structural transformation of the member states' economies. The real innovation introduced by the NGEU lies not only in the size of the operation, but in the nature of the financing mechanism: for the first time, the Union issued large-scale debt not only to offer loans, but also to grant non-reimbursable subsidies, thus marking a significant evolution from the previous limits of European fiscal action.

The financial set-up of the NGEU was made possible by the temporary extension of the guarantees provided by the Member States to the EU budget, through an increase of the headroom[35] to 0.6 per cent of the total Gross National Income (GNI) of the EU. This margin serves as a guarantee for creditors and allows the Commission to raise funds safely, reassuring the markets about the Union's solvency even in adverse scenarios. In parallel, Member States have agreed to introduce new EU own resources in the future, including a digital tax, a levy on financial transactions and mechanisms related to environmental taxation.

These resources, if introduced, would contribute to the repayment of the debt, scheduled to start in 2028 and to be completed by 2058.

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[34] Pobrić, N. (2019). *Is the idea of the common Eurobonds issuance in the Eurozone sustainable?* InterEULawEast: Journal for International and European Law, Economics and Market Integrations, 6(2), 1–30.

[35] In finance, "headroom" refers to the unused portion of a borrowing facility, financial covenant, or a trading limit, essentially the available space for future actions or growth. It represents the leeway or buffer an entity has to increase spending, cut taxes, or undertake other financial activities without breaching predetermined limits.

The financing strategy put in place by the Commission envisages the issuance of securities of up to €150 billion per year until 2026, through a diversified portfolio of instruments: long-term bonds (up to 30 years), short-term securities (bills), and a significant commitment to the issuance of green bonds, which are expected to account for around 30% of the total. This reflects not only the objective of supporting green and digital transitions, but also the will to establish the EU as a credible player in sustainable finance markets. Moreover, the adoption of a regular programme of auctions and syndications has transformed the EU into a debt issuer similar in volume and complexity to major member states such as Germany, France and Italy.

From an operational point of view, the Commission has created an autonomous debt management structure, which oversees planning, executing and monitoring financing operations. Each year, a debt decision is published that defines the ceiling for annual issuances, while half-yearly financing plans provide detailed forecasts of issuance dates, expected amounts and the distribution of instruments used. Transparency, predictability and accountability have been identified as essential conditions for the long-term success of the debt strategy, especially in a context in which debt issued by the EU continues to be considered a quasi-sovereign issue. Although the EU is not a state, NGEU debt enjoys a high credit quality, with AAA ratings from Fitch and Moody's and AA from Standard & Poor's[36], thanks to the shared guaranteed mechanism among the Member States, which entails an implicit form of joint and several liability.

Another relevant aspect concerns the investor profile. The EU has predominantly turned to long-term (buy-and-hold) investors in order to stabilise prices and strengthen confidence in European bonds, while maintaining a certain balance with the need to ensure sufficient liquidity in the secondary market. At the technical level, the Union introduced multi-priced auctions through the TELSAT[37] system operated by the Banque

[36] European Commission. (n.d.). *EU credit strength*. Retrieved April 22, 2025, from https://commission.europa.eu/strategy-and-policy/eu-budget/eu-borrower-investor-relations/eu-credit-strength_en

[37] *The Commission uses the TELSAT auction system, administrated by the Banque de France but separate from its central-banking operations. This system uses a 'multi-price auction,' in which securities are supplied at the bid price with the highest bids served first and then going down until the volume is exhausted.*

de France, and favoured syndications for new issues, while auctions were mainly used to reopen existing maturities.

Overall, the NGEU experience marked a structural change in the EU's role in international capital markets. In addition to providing tangible support to the post-pandemic recovery, the programme has strengthened cohesion among Member States, improved the strategic autonomy of the Union, and opened new prospects for institutional evolution towards a truly common fiscal capacity. The effectiveness of this innovation will be measured not only by its short-term economic impact, but above all by the Union's ability to consolidate this new function over time and with new economic instruments, possibly making permanent part of the mechanism tested with NGEU[38].

2.4 The permanent establishment of NGEU's mechanism and the three trilemmas

The new key features of common debt introduced by the NGEU have paved the way to a fresh discussion within the EU: could these innovations become permanent, setting a precedent in which common debt instruments become a central pillar of EU's economic system?

To better understand the huge change and the possible forthcoming outcomes of the innovations that the NGEU has introduced in the economic governance of the EU, is crucial to analyse the latter structure trough three fundamental strains, that the authors Buti and Fabbrini have conceptualised as three trilemmas.[39] These three Trilemmas analyse different section of the EU' economic governance, namely: the Institutional one, the economic policy coordination and the democratic support for reforms. They describe the impossibility of simultaneously pursuing three desirable goals, thus placing structural constraints on the evolution of the European integration model. Overcoming these restrictions and finding a balance between the dimensions involved is, according to the authors, a necessary condition for the NGEU to represent a lasting paradigm shift and

[38] Christie, R., Claeys, G., & Weil, P. (2021). *Next Generation EU borrowing: A first assessment* (Policy Contribution No. 22/2021). Bruegel.
https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/699811/IPOL_IDA(2021)699811_EN.pdf

[39] Marco Buti & Sergio Fabbrini (2022): Next generation EU and the future of economic governance: towards a paradigm change or just a big one-off?, Journal of European Public Policy, DOI: 10.1080/13501763.2022.2141303

overcome the so-called Monnet Compatibility Test (MCT)[40], which requires institutional, economic and political coherence.

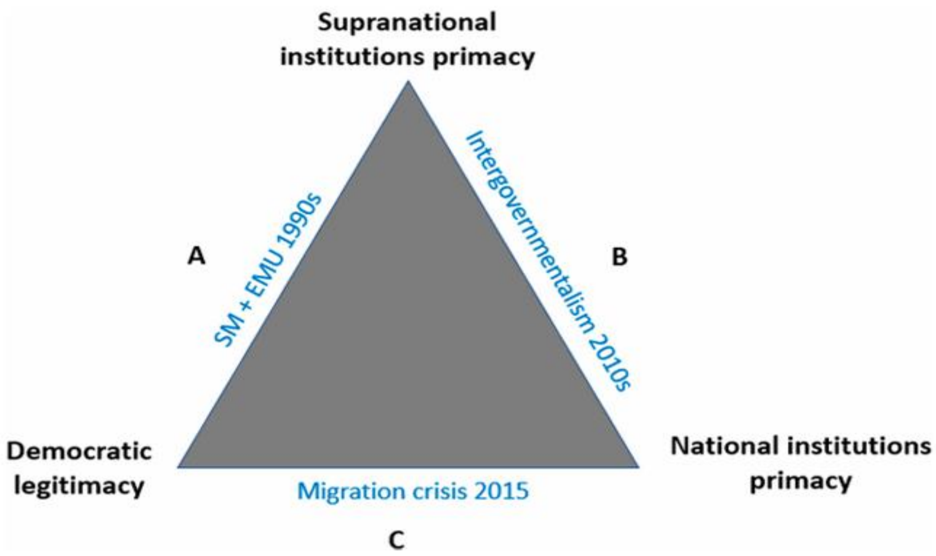

Figure 2, Source: Marco Buti & Sergio Fabbrini (2022)

The first trilemma concerns institutional integration and is based on Dani Rodrik's[41] formulation that full supranational integration, the primacy of national institutions and effective democratic legitimacy cannot be achieved simultaneously. As shown in Figure 1, the Union has historically oscillated between these options: during the 1990s, the response to "Euro sclerosis" favoured option A, with the construction of the Single Market and EMU, strengthening the Community method and the role of the Commission and the European Parliament. In the 2010s, in response to the sovereign debt crisis, Option B instead emerged, focused on strengthening the intergovernmental method, in which the European Council and national governments assumed a predominant role, often to the disadvantage of effectiveness and supranational integration. Finally, during the migration crisis of 2015, option C developed, characterised by a tension between common decisions

[40] "*A governance/policy response would meet the MCT criteria when there is the leveraging of supranational governance while respecting the role of national institutions (hence respecting subsidiary) and the logic of the EU Treaties (institutional coherence), and an effective economic policy response at the EU and national level (economic coherence). Finally, the strategy should maintain national citizens' support (political coherence)".* (Fabbrini M. B., Next generation EU and the future of economic governance: towards a paradigm change or just a big-one off, 2022)

[41] Rodrik, D. (2000). How Far will international economic integration Go? Journal of Economic Perspectives, 14(1), 177–186. https://doi.org/10.1257/jep.14.1.177

and the prevalence of national interests, resulting in a weakening of the effectiveness and democratic legitimacy of the system. The NGEU breaks with these dynamics, being a response to an exogenous crisis and not to irresponsible behaviour of individual member states, it rebalanced the role of European institutions, strengthening the Commission's function not only as a controller, but also as a promoter and supporter of national policies through the disbursement of funds and the approval of National Recovery and Resilience Plans.

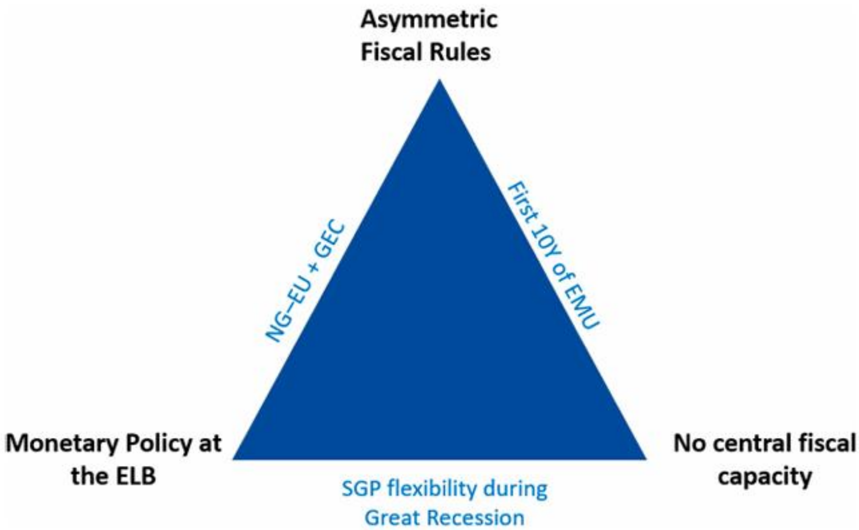

Figure 3, Source: Marco Buti & Sergio Fabbrini (2022)

The second trilemma addresses the issue of economic policy coordination within a monetary union. The authors show how it is not possible to simultaneously maintain asymmetric fiscal rules, such as those of the SGP, a monetary policy constrained by the lower bound on interest rates (Effective Lower Bound) and the absence of a central fiscal capacity. As shown in Figure 2, in the early stages of EMU, the absence of a central fiscal capacity was partially compensated for by the so-called "*convergence bonus*"[42]. However, with the 2008 crisis, and even more during the sovereign debt crisis, fiscal policies became pro-cyclical, and the burden of macroeconomic stabilisation fell entirely on the

[42] "*the "convergence bonus" arising from the fall in interest rates made it possible to maintain public support and enact policies geared to short-term purposes, but at the cost of not achieving the structural transformation necessary for countries to thrive in a currency union and a deeply integrated single market"* (Fabbrini M. B., Next generation EU and the future of economic governance: towards a paradigm change or just a big-one off, 2022).

European Central Bank. The pandemic forced a change, the activation of the general escape clause, the introduction of European fiscal instruments such as SURE[43] and NGEU, and the adoption of expansive monetary policies made it possible to temporarily resolve the trilemma, offsetting monetary rigidity with a robust fiscal response at supranational level.

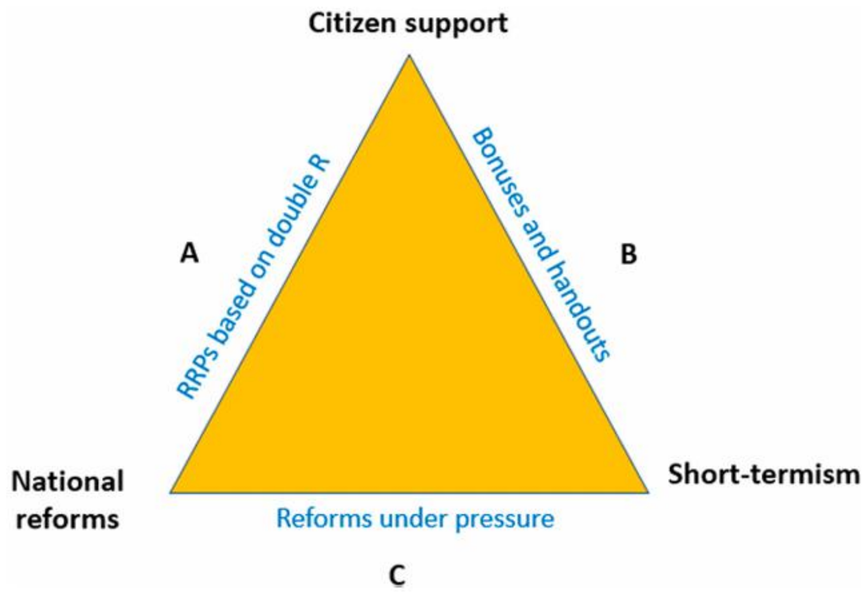

Figure 4, Source: Marco Buti & Sergio Fabbrini (2022)

The third trilemma, called the reform support trilemma, revolves around the tension between implementing structural reforms, maintaining public support and the short-term logic that often guides government action. The history of EMU shows that, during its first phase, governments managed to reconcile electoral consensus and short-term policies thanks to the benefits of monetary integration but failed to tackle necessary structural reforms. In subsequent years, such reforms were imposed in response to market pressure, but at the price of a sharp erosion of public consensus. The NGEU proposes a different model, through grants and not just loans, it incentivises reforms in exchange for resources, focusing on green and digital investments. The main challenge, as Figure 3 shows, is to reconcile the political timing with the timing of reforms, if governments manage to "stretch the political horizon" and ensure continuity in the implementation of projects, it

[43] The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency

will be possible to overcome what Buti calls the "Juncker curse", according to which those who initiate structural reforms are destined to lose the next election.

Taken together, these three trilemmas define the structural conditions for the NGEU to evolve from a temporary response to a permanent instrument of European economic governance. If the tensions between integration and sovereignty, between fiscal discipline and stabilisation capacity, and between reforms and democratic consensus are resolved in a manner consistent with the common goals of the Union, then the NGEU could indeed represent a new paradigm for dealing with future crises.

In this perspective, the NGEU's ability to establish itself as a stable architecture of economic governance will necessarily have to be assessed in the light of the Monnet Compatibility Test, ideated by Buti. The NGEU represents a significant step towards overcoming the limits of the uncontrolled intergovernmentalism that emerged in the management of the eurozone crisis by introducing a form of "*constrained supranationalism*" capable of combining European initiative and national responsibility. However, the ultimate success of this new architecture will depend on the ability to consolidate the progress made over time, by strengthening the role of the Commission, stabilising a European fiscal capacity, and stimulating lasting national reforms that, while respecting the Community method, succeed in promoting growth, cohesion and trust among the Member States.

At last, if the conditions identified by the three trilemmas are successfully addressed, the NGEU will not only pass the Monnet Compatibility Test but may also offer an effective model for the management of future systemic crises, bringing the Union closer to a true capacity for autonomous and solidarity-based response to global challenges.

2.5 The Germany's fiscal turning point and its implication for EU's governance

After several years of severe fiscal Austerity, the German's government is now facing a radical changing in its fiscal policy and this conversion of the economic paradigm could produce a spillover effect on the entire EU's economic governance. Indeed, on 21 March 2025, the Bundestag[44] has amended its constitutional debt brake, with this new disposition

[44] The parliament of Germany.

the precedent constraint on the federal structural deficit, traditionally fixed to a max of -0,35% of the GDP, is loosened to allow an increase of public spending in two strategic sectors, the national security and infrastructural investment. More precisely, the expenditures for the security that exceed the 1% of the GDP (including the defence, the civil protection, the intelligence services and cybersecurity) are excluded from limit calculations, and an extra-budgetary fund of €500 billion is created to finance infrastructure projects considered "additional" to ordinary expenditure.[45]

To understand the implications of the changes introduced by the Bundestag in economic terms, it is useful to consider the new reference formula that the German federal government is now obliged to comply with.

"Following the constitutional amendment, Germany's federal structural balance (including the use of extrabudgetary funds) must observe:

$$b_{Fed} \geq -0.35 - (s - 1) - f = 0.65 - (s + f)$$

where f denotes annual spending from the extrabudgetary infrastructure fund, and s spending on security – including from an extrabudgetary fund for defence created in 2022. Security spending s is defined as defence spending plus "federal spending on civil protection, the intelligence services, cybersecurity and support for countries attacked in violation of international law." Hence, under the amended debt brake, the balance of revenues and budgetary non-security spending – including interest spending – cannot be lower than 0.65 percent of GDP. But the debt brake does not restrict security spending or infrastructure fund spending". (Zettelmeyer, 2025)

These innovations are answering concrete contemporary challenges of modernisation and strategic reinforcement, but they push Germany in a tension with the actual EU fiscal rules, in fact, the latter imposed a progressive reduction of the public debt below the threshold of 60% of the GDP. According to the Bruegel estimates[46], a full use of the headroom of the public spending foreseen by the new German's discipline, could lead the

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[45] Steinbach, A., & Zettelmeyer, J. (2025, April 24). *Germany's fiscal rules dilemma*. Bruegel. https://www.bruegel.org

[46] Ibidem

national debt to level above the 100% of the GDP in the long term, configuring a clear deviation from the constraints establish with the Maastricht Treaties.

Even with the activation of the "National escape clause"[47] granted by the European Commission, which allows temporary derogations for defence spending above 2021 levels, the margins of manoeuvre are insufficient to finance the ambitions announced by the new German executive, which has promised to mobilise around 0.9% of GDP per year in infrastructure investments until 2029. In a realistic scenario, Berlin would be forced to generate primary surpluses significantly higher than those envisaged by the new debt brake, or alternatively to give up a significant part of its strategic goals. This is combined by a further political element, while other member states, such as Italy and France, are complying with the consolidation plans negotiated with Brussels, differential treatment for Germany would be difficult to sustain in terms of fairness and institutional legitimacy.

In this context, the German case becomes emblematic of the growing incompatibility between the European fiscal architecture and the structural public investment needs of the Member States. Faced with this dilemma, two solutions appear on the horizon according to the Bruegel analysis[48]. On one hand, a reform of the fiscal rules that explicitly excludes, within certain limits, strategic infrastructure expenditure from the calculation of deficits. On the other, a more ambitious step towards a truly common European fiscal capacity, through the permanent adoption of shared debt instruments such as Eurobonds. The latter would represent a structural response to the tension between austerity and investment, allowing member states to finance common projects, in the climate, digital, and military spheres, without burdening national budgets and without fragmenting the debt market.

Furthermore, the crisis of coherence generated by the German reform is not an isolated anomaly, but the symptom of a system struggling to adapt to a new geopolitical and economic context. If Germany itself, traditionally the guardian of fiscal orthodoxy, finds itself forced to revise its paradigms, then it is legitimate and necessary for the European

[47] *"A national escape clause, in the context of the European Union's Stability and Growth Pact, allows a Member State to deviate from its medium-term fiscal structural plan due to exceptional circumstances outside its control, with a major impact on public finances. These circumstances must be severe and not caused by the Member State itself. The clause allows for temporary flexibility in fiscal rules but must not endanger medium-term fiscal sustainability".* (European Commission, 2025)

[48] Ibidem

Union to consider long-term solutions. Eurobonds, in this scenario, stop being an exceptional hypothesis and become a potentially stable instrument for making common investments sustainable, strengthening European economic sovereignty and ensuring cohesion among member states. The transition to a more solidary and integrated Union will require political courage and a review of current constraints, but the German case shows that this transition is now a contemporary challenge for the EU.

Chapter 3: Towards a European treasury? Institutional perspectives on a common fiscal capacity

In the first two chapters, the methods, benefits and critical issues related to the implementation of a fiscal union in Europe were examined, with particular attention paid to instruments such as Eurobonds and their economic-financial implications. This third and final chapter aims to investigate the structural and institutional obstacles that still hinder the creation of a central fiscal capacity at the European level.

The analysis will begin with a reflection on the functioning of the current architecture of the Eurozone, conceived as an incomplete monetary union, highlighting the limits of a system that has centralised monetary policy without accompanying it with a corresponding common fiscal capacity. In this context, the costs and benefits of the current institutional set-up will be discussed, highlighting how the absence of a common budget and shared redistributive instruments contributes to generating economic asymmetries and political tensions among member states.

A key point of the chapter will be dedicated to the analysis of the democratic deficit that characterises the European Union, understood as the inability of community institutions to guarantee effective mechanisms of political responsibility and democratic representation in fiscal and redistributive choices. Starting from this reflection, hypotheses for reforming the European decision-making architecture will be discussed, with particular reference to the proposal to create a European Treasury as the political and technical body in charge of managing common resources and macroeconomic stabilisation.

Finally, the chapter will end by outlining the main institutional reforms supposed to be necessary to strengthen the legitimacy, effectiveness and resilience of the European Monetary Union, with a sight to a more solid and democratically sustainable integration.

3.1 The absence of a European treasury: benefits and costs of an incomplete monetary union

The Eurozone is characterised by a profoundly asymmetric institutional structure, that makes it as a perfect example of incomplete monetary union, on one hand there is a centralised monetary policy, entrusted to the ECB, and on the other hand there remains a multiplicity of national fiscal authorities operating autonomously. Member states issue debt in a common currency over which they exercise no direct control. This configuration can generate serious tensions in the event of adverse shocks, especially when governments face a significant drop in tax revenues. Such circumstances, named "*solvency shocks*" (Grauwe, 2018), can result from a recession, loss of competitiveness or other factors that reduce a state's ability to service its debt.

In these situations, the possibility of a sovereign default may arise, the default is the decision by a state not to repay part or all of its debt on time and in the agreed manner [49]. This can occur through a "haircut", a cut in the nominal value of the debt (e.g. repayment of only 50%), or through a restructuring of payment terms. Although on the surface a default is a negative event, in certain contexts it can have economic and political benefits for the debtor government. By reducing the amount of debt to be repaid, the government can ease the pressure on the public budget, avoiding or mitigating painful, on a political level, austerity measures such as public spending cuts and tax increases. In this sense, default can be seen as a strategy to preserve domestic political consensus and minimise the social costs of the fiscal crisis.

As shown in Figure 4, as the intensity of the shock to solvency increases, so does the potential benefit of default, represented by two ascending curves. The first (BU) describes the government's perceived benefit if the default is not expected by the markets, the second (BE), on the other hand, reflects the higher benefit in the event of an expected default, as anticipation by investors leads to higher interest rates, worsening the fiscal position and making default even more beneficial than austerity.

[49] De Grauwe, P. (2018). *Economics of Monetary Union*. 12th edn. Oxford: Oxford University Press.

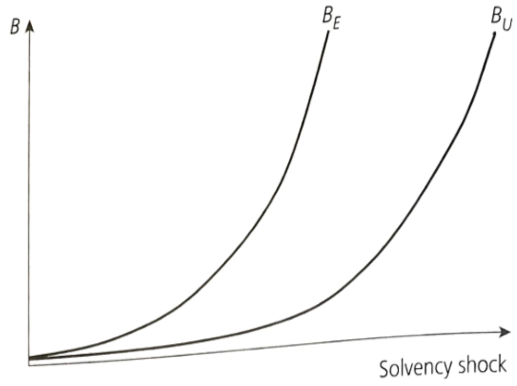

Figure 5: The benefits of default after a solvency shock.

Source: (Grauwe, 2018), Economics of Monetary Union, 12ª edizione, Oxford University Press, 2018

However, default also entails significant reputational costs, especially in terms of future access to financial markets. After a default, investors may refuse to buy government bonds or demand much higher interest rates to compensate for the risk. Figure 5 depicts this cost as a fixed threshold (C), to be compared with the benefits illustrated above. When the shock is small (below S1), cost C remains higher than the benefits, the government therefore has no incentive to default. In contrast, for severe shocks (above S2), the benefits systematically outweigh the cost, making default the rational choice.

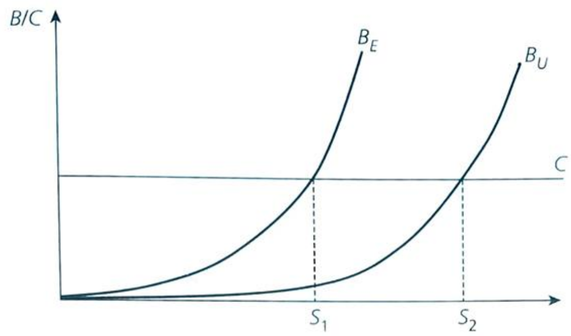

Figure 6: Cost and benefits of default after a solvency shock.

Source: Paul De Grauwe, Economics of Monetary Union, 12ª edizione, Oxford University Press, 2018

In the intermediate case between S1 and S2, the system can generate an indeterminacy, as illustrated in Figure 6, two equilibria can coexist. If markets do not expect a default (point N), the benefits remain lower than the cost, and the crisis is avoided. But if, on the contrary, investors fear a default and start selling government bonds (point D), the rise in interest rates increases the benefit of default, inducing the government to choose it. The negative expectation alone, therefore, can turn into reality, in this case become real the self-fulfilling equilibrium

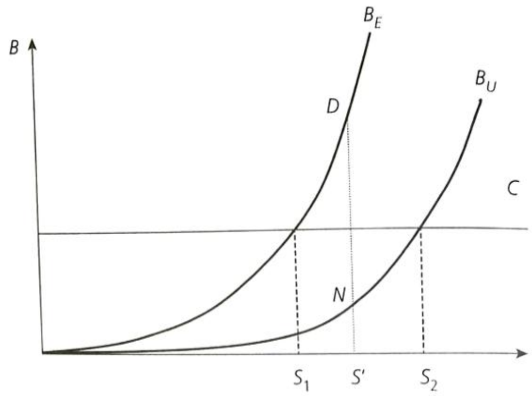

Figure 7: Good and bad equilibria.

Source: Paul De Grauwe, Economics of Monetary Union, 12ª edizione, Oxford University Press, 2018

This mechanism highlights the inherent fragility of a monetary union without an appropriate fiscal union. In the absence of a common fiscal guarantee, even states with relatively strong fundamentals can fall victim to crises of confidence. The creation of a European Treasury, equipped with fiscal power and common debt issuance instruments, would be a structural response to this vulnerability, filling one of the major gaps in the Economic and Monetary Union.[50]

3.2 Is the EMU's Democratic deficit a fundamental obstacle to a central fiscal capacity?

The project to create a central fiscal capacity within the Economic and Monetary Union comes up against a fundamental obstacle, the persistent democratic deficit of the European institutions. This concept, already raised in the 1990s, refers to the fact that, although there is a European Parliament elected by universal suffrage and provided with increased powers over time, the European Union still lacks those instruments that would

[50] De Grauwe, P. (2018). *Economics of Monetary Union*. 12th edn. Oxford: Oxford University Press.107-115

make the democratic process truly effective.[51] What is lacking is an integrated European party system, capable of coherently connecting the national and European levels. The political groups in Brussels do not represent real European political forces, but rather loosely structured groups, often lacking clear and recognisable programmes that could guide the debate and guide the voters.

In addition to this weakness, there is the absence of a European political opposition capable of proposing concrete alternatives to existing policies, a central element in any democracy. Moreover, there is no real European public space, most citizens receive information about the Union only through national sources, often fragmented and filtered by internal logic. All this makes it difficult for the average voter to understand what happens at European level, who makes the decisions, what the political alternatives are and how their vote can affect EU policies. In practice, citizens do not have adequate tools to exercise effective democratic control.

This institutional deficiency becomes particularly challenging when it comes to fiscal and redistributive policies, such as those that would be involved in the creation of a central fiscal capacity. Unlike technical policies, such as internal market regulation or banking supervision, which can be managed by independent authorities and do not necessarily require direct popular legitimisation, fiscal choices involve the management and redistribution of public resources, directly affecting the lives of citizens. This is why, in a democracy, such decisions must be taken by elected institutions accountable to the electorate. Thinking of managing them as if they were mere administrative matters, through automatic rules or technocratic agencies, risks being not only unrealistic, but also dangerous.

In the absence of proper democratic legitimacy, decisions taken at the European level become battlegrounds in national political debates. Governments can blame Brussels for unpopular choices, despite having participated in them, and voters end up losing confidence in both European and national institutions. To prevent the future of a true European fiscal union from being built on fragile foundations, the issue of democratic accountability must be explicitly addressed. Common fiscal choices must be

[51] Saarenheimo, T. (2020). *Democratic constraints on EMU.* In M. Buti, G. Giudice, & J. Leandro (Eds.), *Strengthening the institutional architecture of the Economic and Monetary Union* (pp. 21–24). CEPR Press.

accompanied by a political system that is capable of being accountable for decisions taken, clearly defining who decides what, and offering citizens real power to influence. Only in this way will it be possible to build fiscal integration that is not only economically effective, but also democratically complete and legitimate.[52]

3.3 The rational and Institutional design behind the Euro Treasury

With the analysis made in the first two paragraphs of the incompleteness of the European monetary union and its democratic deficit, the ground has been prepared to go deeper and propose a solution to these two serious shortcomings of the European monetary union.

The answer to these difficulties lies in the creation and institutionalisation of a common European treasury. The institutionalization of this institution, moreover, would not simply solve these two difficulties but would be part of a broader context on the actual completion of the European monetary union. This would outline a very ambitious institutional vision, but one that could lead to the overcoming of the constant fragilities that torment European fiscal governance.

In the past, through the "five resident's report"[53], the European treasury had already been presented in the discussions in Brussels and seen as a key part of maintaining an effective EMU in the long term, but in recent years the diminishing political interest, also driven by sovereigntist propaganda, and the lack of public support has meant that the discussion has faded to the point of almost disappearing, except in a few cases such as the commission's communication on the possible role of a European Minister for Economic Affairs and Finance.

However, this political disinterest collides with the real needs of the EMU, as seen in the preceding paragraphs, the lack of a strong and coherent institutional structure risks making the architecture of the euro area increasingly chaotic, dispersed among complex rules, with partial supranational authorities and opaque intergovernmental decision-making processes. All this would only make the EMU weaker, with less and less

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[52] Saarenheimo, T. (2020). *Democratic constraints on EMU*. In M. Buti, G. Giudice, & J. Leandro (Eds.), *Strengthening the institutional architecture of the Economic and Monetary Union* (pp. 21–24). CEPR Press.

[53] Juncker, J.-C., Tusk, D., Dijsselbloem, J., Draghi, M., & Schulz, M. (2015). *Completing Europe's Economic and Monetary Union*. Brussels: European Commission.

transparency and ambiguity in terms of political accountability. Moreover, these dynamics could also affect the capabilities of the ECB, leading the European central bank to be less effective in the implementation of unitary monetary policies.

Starting from these circumstances, in this section we will analyse the proposal made by two ECB's economists, Hans-Joachim Klöckers and Sander Tordoir[54].

In the analysis carried out by the two economists, the comparison with other federal treasuries, specifically that of the US and Germany, is essential for the establishment and realisation of the common European treasury. Indeed, these models differ in crucial characteristics and functions: they manage federal finances and debt, prepare tax legislation, have a key role in managing economic and fiscal crises, and have unified external representation.

Clearly, not having a common European treasury, the EU has no institution that brings all these functions together under one management. In fact, the euro area is divided into 19 national treasuries, followed by a limited fiscal capacity at the supranational level that, while formally extending to all 27 member states, does not allow for effective shared fiscal governance. Thus, national fiscal policies, despite being subject to common constraints and rules, continue to be designed and implemented on a purely national basis, thus creating imbalances, inefficiencies and coordination failures that can jeopardise the stability of the entire area. Structural weaknesses in the governance of the European monetary union do not only manifest themselves in the inefficiency of coordination, but manifest themselves in different ways, these are some of them:

- *"Lack of steering of euro area fiscal stance/stabilisation function*
- *No common safe asset*
- *Distortion through insufficient coordination of tax policies*
- *National economic and fiscal policy often insufficiently support smooth functioning of EMU*
- *Fragmented financial markets*
- *Not exploiting the full weight of the euro area in global fora"* (Marco Buti, 2020).

[54] Klöckers, H.-J., & Tordoir, S. (2020). *Designing a euro area treasury*. In M. Buti, G. Giudice, & J. Leandro (Eds.), *Strengthening the Institutional Architecture of the Economic and Monetary Union* (pp. 33–41). CEPR Press.

All these problems are rooted in the same problem, the excessive decentralisation of economic and fiscal competences, which continuously generates coordination failures. Not only do the European institutions, first and foremost the Commission, lack the necessary legal and political powers to steer the fiscal policies of the member countries in an integrated direction, but the very structure of the decision-making process, slowed down by the logic of vetoes and intergovernmental compromises, hampers effective and expedient governance, while simultaneously amplifying the citizens' perceived feeling of disconnection and opacity.

The establishment of a euro area treasury, according to economists Hans-Joachim Klöckers and Sander Tordoir, would intervene precisely in this framework. In fact, the new institution would represent a structural shift towards a more robust, transparent and legitimate economic governance. The body should have a mandate exclusively geared towards the interests of the euro area as a whole, following a logic similar to that guiding the ECB's mandate, and only intervene in areas where national treasuries are structurally unsuitable. Its competences should extend from the management of common fiscal instruments, including possible European taxes and the issuance of shared debt, to the supervision of the quality of national economic and fiscal policies, from the preparation of financial regulations to crisis management and unified external representation. To be effective and fully functional, the treasury should be equipped with real operational tools, clear enforcement mechanisms and appropriate decision-making capacity, as well as being fully accountable to the European Parliament and subject to judicial review by the Court of Justice.

Moreover, the institutional design of the euro area treasury should respect six fundamental principles:

1. *"A euro area mandate*
2. *Respect for the principle of subsidiarity*
3. *The effectiveness of its functions*
4. *The efficiency of decision-making*
5. *The clarity of competences*
6. *Solid democratic legitimacy"* (Marco Buti, 2020)

This switch, from a system based mainly on rigid and often static rules to an institutional system guided by democratically controlled objectives and processes, would make it possible to overcome the critical aspects of the current model. Indeed, institutions can react more flexibly to emerging challenges without losing credibility. Conversely, rules that fail or cannot be updated in a timely manner and applied consistently tend to lose effectiveness and confidence.

Obviously, the creation and establishment of a euro area treasury would involve a gradual and articulated path, requiring a well-planned transition phase. First, it would be essential to facilitate a process of economic, fiscal and financial convergence among member states, in order to create the political and economic foundations for shared governance. Next, operational cooperation between national treasuries could be progressively strengthened, overcoming the current intergovernmental logic and promoting an integration like the one that led to the birth of the ECB from the European Monetary Institute. Finally, the dilemma between the Community method and the intergovernmental approach will have to be tackled realistically, although the latter may speed up certain steps, the legitimacy and sustainability of the project in the long term require the full involvement of the European institutions and national parliaments.

Thus, according to the analysis of the ECB economists, the establishment of a euro area treasury would strengthen the EMU's capacity to respond to crises and would represent a very important step towards a true fiscal and political union, capable of ensuring economic stability, internal cohesion and a greater European weight in the global scenario. Therefore, even though the creation of such a project may seem difficult to achieve in the short term, it is crucial to start outlining the institutional and functional features now, so that the transition can be guided in a coherent and shared manner.

3.4 Is the commission's proposal for a European Minister of economy and finance a viable solution for EMU reform?

Following the analysis carried out in the previous section concerning the idea of the creation and institutionalisation of a common European treasury, it is essential for the success and completeness of the study to delve not only into the possible ideas but also into the concrete proposals made. In this section, we will analyse the proposal made by the European Commission for the creation of a European minister of economy and finance[55] and whether its creation could play a crucial role in the current European institutional context.

In fact, as seen above and as highlighted by former ECB President Mario Draghi in 2019[56], the EMU is characterised by a structural incompleteness. The main difficulty lies not so much in the policies adopted as in the institutional design itself, The EMU has taken important steps on the monetary policy side but continues to remain without a real common decision-making framework in fiscal and economic terms. Against this backdrop, the proposal made by the European Commission in December 2017 for the creation of a European Minister of Economy and Finance is proposed as a potential solution to the need to strengthen the EMU's political and institutional dimension.

On the other hand, as several European scholars and constitutionalists have found, proposals for institutional reform cannot be established solely based on economic or functional considerations. They must be designed and aligned in accordance with the fundamental principles of the union, which include good governance, democratic legitimacy and respect for the rule of law. Therefore, it goes without saying that the creation of a new executive figure with a politically significant title, such as "minister", only makes sense if this person is endowed with real powers of intervention and management. Failing this, there would be a risk of stumbling into a merely symbolic, if not at times counterproductive creation.

Indeed, if the European Minister of Economy and Finance was not entrusted with the management of a real fiscal capacity, to be used for macroeconomic stabilisation purposes, as is the case in all developed federal unions, the entire proposal would be ineffective. A mere nominal centralisation of competences already exercised by the commission (according to Art. 126 TFEU), the Council (according to Art. 5 TFEU) or the

[55] European Commission (2017a), "A European Minister of Economy and Finance", Communication from the Commission to the European Parliament, the European Council, the Council and the European Central Bank, COM (2017) 823 final.

[56] Draghi, M (2019), Introductory Statement at the European Parliament Economic and Monetary Affairs Committee, Brussels, 28 January.

euro group (Protocol No. 14) would not produce any additional value[57]. On the contrary, the conferring of the title "Minister" could generate high and unfounded expectations on the part of European citizens, thus increasing the possibility of further fuelling disillusionment with the European institutions. Therefore, given the current European political context, in which Euroscepticism is gaining more and more vehemence, it becomes crucial that this is avoided in order not to throw fuel on the fire of propaganda that aims to go against European integration.

A further criticism of the commission's proposal lies in its ambiguous institutional configuration. The concept of a "*double-hatted authority"* (Marco Buti, 2020), operating both within the commission and as chairman of the Eurogroup, follows a hybrid logic already tried and tested in foreign policy with the High Representative for the Common Foreign and Security Policy. However, this configuration poses the risk of undermining the principle of separation of powers and making the chains of political legitimation opaque. The commission, a supranational body with growing European elective legitimacy, and the Eurogroup, an intergovernmental structure composed of nationally appointed ministers, are based on profoundly different sources of legitimacy. An authority that attempts to represent both runs the risk of being neither sufficiently independent nor sufficiently accountable, exacerbating confusion about competences and responsibilities in economic matters.

In contrast, the Commission's 2018 evaluation of the European Investment Stabilisation function (EISF)[58] pointed in a more encouraging direction. While not explicitly referring to the figure of the European minister, the Commission proposed to equip itself with decision-making power over the distribution of stabilisation funds to support member states affected by sudden labour market shocks. In this case, a clear separation was defined between the executive function entrusted to the Commission and the control function assigned to the council, outlining the frameworks of an autonomous supranational treasury of the EMU, differentiated from national interests. This institutional paradigm, more constitutionally aligned, would have avoided disorder

[57] Fabbrini, F. (2020). *Strengthening EMU through institutional reforms: Constitutional engineering done right*. In M. Buti, G. Giudice, & J. Leandro (Eds.), *Strengthening the institutional architecture of the Economic and Monetary Union* (pp. 59–62). CEPR Press.

[58] European Commission (2018), "Proposal for a Regulation of the European Parliament and of the Council on the establishment of a European Investment Stabilisation Function", COM (2018) 387 final.

between levels of governance and would have strengthened transparency and political accountability.

In view of the considerations just analysed, the proposal made by the European Commission for a European Minister for Economic Affairs and Finance may represent a significant step towards a more accomplished and politically balanced architecture of the EMU, but only if it is supported by a clear redefinition of powers and responsibilities. In particular, this subject should be institutionally rooted in the Commission, endowed with autonomous instruments of fiscal intervention, and not entrusted with the presidency of the Eurogroup, which would only produce overlaps and conflicts of legitimacy.

Thus, the proposal is of great symbolic and political value, but its implementation requires a clear and coherent institutional vision. In line with what Alexander Hamilton wrote in Federalist Paper No. 1, "*good government and political constitutions should be established from reflection and choice*, *rather than depending on accident and force"* (Marco Buti, 2020). For this reason, an effective and lasting EMU reform cannot result from overnight intergovernmental compromises or technocratic agreements, but needs an organic design based on sound democratic principles. Only in this way will it be possible to close the EMU's structural gaps, strengthening its legitimacy and building a more stable, accountable and citizen-friendly European economic governance.

Conclusion

The study carried out in this thesis has highlighted how the incompleteness of the European Monetary Union (EMU), particularly the absence of a centralised fiscal capacity, represents one of the main structural fragilities of the European Union's economic architecture. Although it has made the single market stronger and ensured greater macroeconomic stability, the asymmetry between a centralised monetary policy and fiscal policies anchored at national levels has shown obvious limitations, especially in the times of systematic crises that have hit the Union over the last fifteen years.

Through the examination of the most relevant economic theories, first and foremost that of the optimum currency area (OCA), of the institutional responses provided by the EU, from the stability and growth pacts to the innovative experience of the NextGenerationEU, a framework of reactivity but poor planning approach has emerged. The Union has shown that it can respond with extraordinary and innovative instruments to emergencies, but this has not led to a structural and permanent consolidation of its fiscal capacity. The introduction of common debt instruments, such as Eurobonds, and the proposal to establish a European Treasury or a European Minister of Economy and Finance have emerged as essential elements to strengthen the resilience of the euro area and to ensure a fairer, more efficient and transparent management of common economic policies. However, these proposals collide with several political, cultural and institutional criticalities, the most relevant difficulties that have been pointed out in the analysis are: the fear of moral hazard, the aversion of member states to ceding fiscal sovereignty, the lack of a European public sphere and the persistent lack of democratic legitimacy of EU institutions.

An important aspect that emerged from the study concerns the nature of European fiscal rules, such as the Stability and Growth Pact (SGP), in fact, it appeared that these rules possess a certain rigidity in adapting to changes and reform processes. The long and complex European intergovernmental process hampers the adaptation of the rules to new economic and geopolitical challenges, generating institutional inertia and an accumulation of ad hoc instruments that make the regulatory framework even more fragmented.

These observations have led to a broader reflection on the nature and consequences of economic governance based predominantly on rules, rather than on institutions endowed with flexibility and democratic legitimacy. Rules may work well in stable contexts but tend to lose effectiveness and credibility when they fail to respond to unforeseen shocks or when they are not quickly updated to reflect new political and economic realities. In the absence of a centralised institutional body capable of interpreting and adapting fiscal policy to macroeconomic conditions, the Union remains hampered by mechanisms that create deadlocks and hinder its evolution.

The thesis also emphasised that the development of European fiscal integration cannot be separated from a contextual reform of the governance of the union, capable of ensuring accountability, transparency and democratic representation. In this context, the proposed creation of a European Minister of Economy and Finance or a Euro Area Treasury may be a step in the right direction, but only if these bodies are endowed with real decision-making powers and fully integrated into the European institutional framework. Indeed, it has become clear that the mere creation of new institutional bodies without giving them the necessary powers would risk becoming a purely symbolic exercise, with potentially counterproductive consequences for citizens' confidence in the European institutions.

Thus, the transition from a governance based on rigid adaptation rules and emergency solutions to a true fiscal union based on permanent and democratically legitimised instruments is not only desirable today, but necessary to ensure economic stability, solidarity among member states and the political credibility of the European Union in the global context. The path is undoubtedly tortuous, as it requires not only technical reforms but also a qualitative leap in the European public debate, aimed at strengthening the common identity and consensus of citizens.

However, recent experience has shown that crises can act as catalysts for profound structural changes. The hope is that we will finally succeed in breaking away from the logic of emergency response and embark on a logic of lasting and sustainable institution-building, capable of pushing the European Union towards a new, more efficient and effective phase of its political and economic integration. Only in this way the EU will be able not only to overcome its internal challenges, but also to establish itself as a credible and influential actor on the international stage, actively contributing to the construction of a more stable and multilateral international system.

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