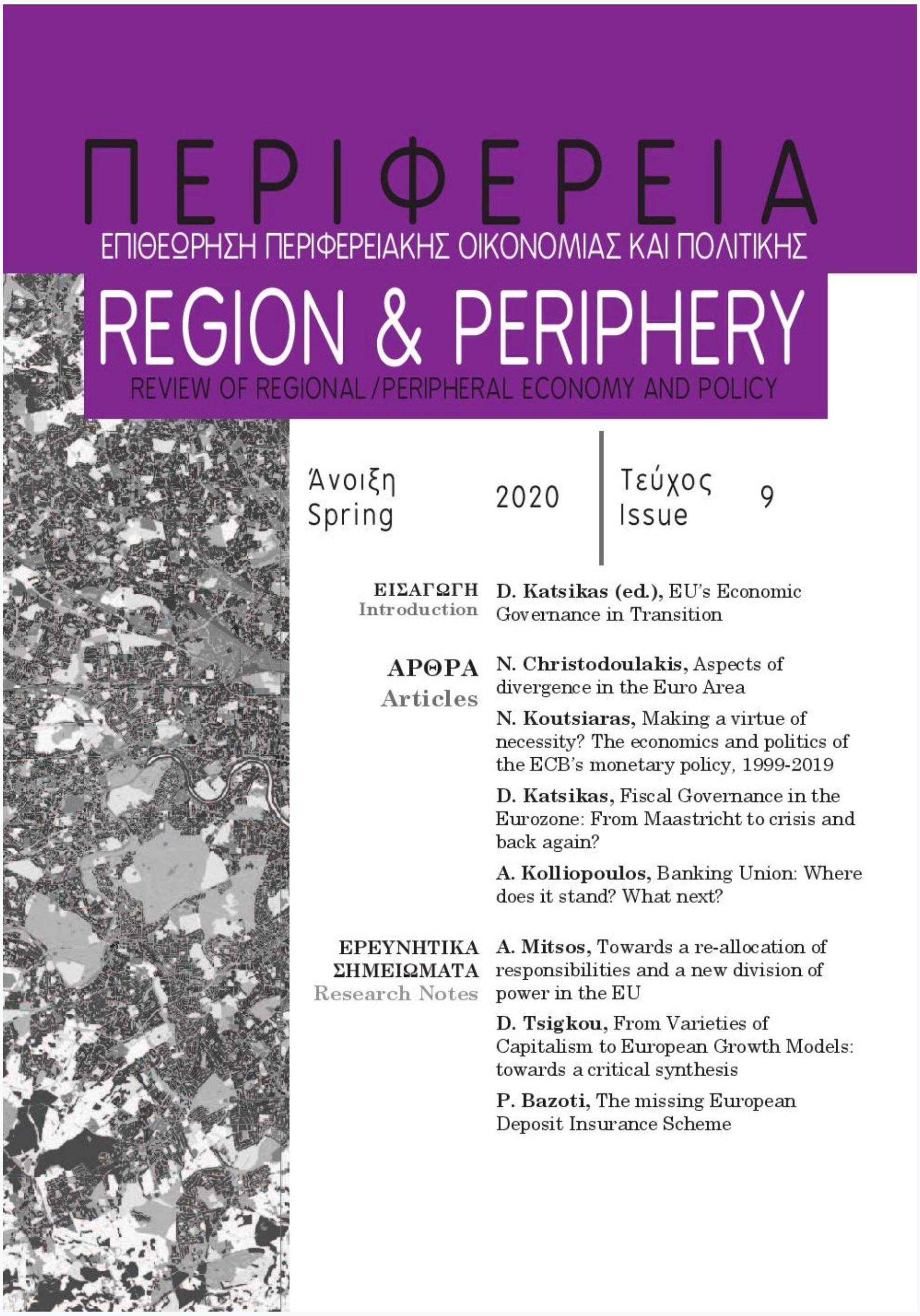
Περιφέρεια

Αρ. 9 (2020)

Περιφέρεια | Region & Periphery



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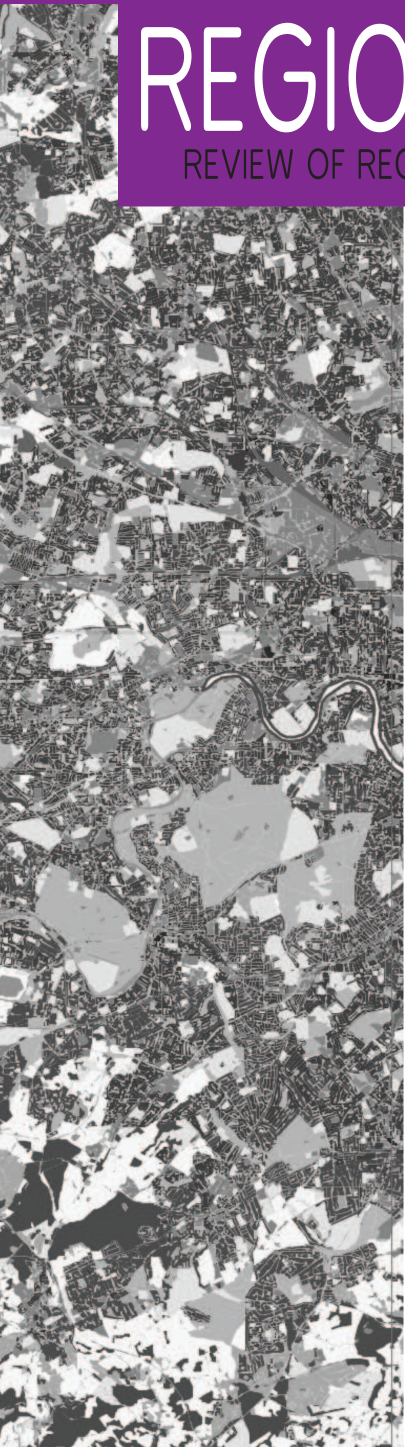
REGION & PERIPHERY

REVIEW OF REGIONAL / PERIPHERAL ECONOMY AND POLICY



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ΠΕΡΙΦΕΡΕΙΑ
REGION & PERIPHERY

**Το παρόν τεύχος εκδίδεται με την ευγενική χορηγία
του Ομίλου Ελληνικά Πετρέλαια Α.Ε.**

Περιφέρεια
Region & Periphery

Η *Περιφέρεια* είναι ένα επιστημονικό περιοδικό το οποίο φιλοδοξεί να καθιερωθεί ως ένας χώρος ανταλλαγής επιστημονικών απόψεων αλλά και πολιτικών παρεμβάσεων, σε θέματα που σχετίζονται με την ανάπτυξη της «περιφέρειας» από ιστορική, νομική, θεσμική, πολιτική, κοινωνική, περιβαλλοντική, πολιτιστική, χωροταξική και οικονομική σκοπιά.

Στο περιοδικό μας, ο όρος «περιφέρεια» ενέχει διττή υπόσταση. Αφενός, ορίζεται ως μια συγκεκριμένη περιοχή, η οποία καθίσταται αντικείμενο μελέτης υπό το πρίσμα διαφορετικών προσεγγίσεων των κοινωνικών επιστημών (region). Αφετέρου, νοείται ως ένας χώρος ο οποίος προσδιορίζεται μέσα από την διαλεκτική του σχέση με ένα «κέντρο», ο οποίος μπορεί να βρίσκεται σε εθνικό, ευρωπαϊκό ή διεθνές επίπεδο (periphery).

Κατά την πρώτη έννοια, η ανάπτυξη της περιφέρειας αναφέρεται στην Ήπειρο, την Αττική ή οποιαδήποτε άλλη χωρική μονάδα, μεμονωμένα και ανεξάρτητα. Κατά τη δεύτερη έννοια, αναφέρεται στην αντιδιαστολή της «περιφερειακής» Ηπείρου με την «κεντρική» Αττική, στην ανάπτυξη της Ελλάδας ως ευρωπαϊκής περιφέρειας σε σχέση με τον πυρήνα της Ευρωπαϊκής Ένωσης, ή στην ανάπτυξη μιας χώρας του τρίτου κόσμου σε σχέση με τον ανεπτυγμένο κόσμο. Η θεώρηση αυτή είναι καθοριστική για την ταυτότητα του περιοδικού.

Η *Περιφέρεια* εκδίδεται ως δίγλωσσο περιοδικό, δύο φορές το χρόνο, δημοσιεύοντας επιστημονικά άρθρα, τόσο στην ελληνική όσο και στην αγγλική γλώσσα, στοχεύοντας στην ευρύτερη δυνατή εξέταση των θεμάτων που σχετίζονται με την ανάπτυξη της περιφέρειας. Ταυτόχρονα, η *Περιφέρεια* δημοσιεύει πολιτικές παρεμβάσεις, περιλήψεις ερευνητικών εργασιών και βιβλιοκριτικές, ενώ προβλέπεται και η περιοδική έκδοση ειδικών τευχών με συγκεκριμένη θεματολογία και κατά το δυνατό εμπεριστατωμένη θεώρηση των σχετικών θεμάτων.

Region & Periphery is an interdisciplinary journal which aims to establish itself as a forum for the exchange of scientific views and political interventions on issues related to regional development from a historical, legal, institutional, political, social, environmental, cultural, spatial and economic point of view.

The English title of the journal comprises two related, but different terms, in order to convey the twofold meaning of the Greek word "*periphereia*" (περιφέρεια). On the one hand, *periphereia* refers to a specific geographical area, which becomes an object of social scientific analysis (region). On the other hand, it is conceptualized as a space defined by its dialectic relationship with a "centre", which can be found at a national, European or international level (periphery).

Thus, under the first conceptualization, regional development refers to an individual and independent analysis of the regions of Calabria or Darmstadt, the federal state of Bavaria, the city of Shanghai or any other spatial unit. According to the second conceptualization, regional development refers to the juxtaposition of the "peripheral" region of Calabria to the "central" region of Darmstadt, the development of Greece as part of the European periphery in relation to the European "core", or the development of a "third world" country in relation to the developed world. This twofold reading of the word περιφέρεια is central to the identity of the journal itself.

Region & Periphery is published bi-annually. It publishes scientific articles in the Greek and English languages, aiming for a wide-ranging coverage of issues related to regional development. At the same time, *Region & Periphery* publishes opinion pieces from policy makers, summaries of postgraduate dissertations and book reviews, as well as periodical special issues dedicated to specific topics of regional development.

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EU's Economic Governance in Transition

The European Union's (EU) economic governance is in a transitional phase. After the outbreak of the global financial crisis, and in the midst of the eurozone debt crisis that followed, the EU embarked on an ambitious reform effort. Reforms ranged from addressing loopholes and updating regulations in all areas of financial activity, to the strengthening of monitoring and coordination processes for fiscal policy and macroeconomic developments, and from establishing unconventional monetary policy facilities to setting up entirely new institutions, including bailout mechanisms.

The progress made notwithstanding, the reform of EU's economic governance remains incomplete. The main cause for this is the way reforms were designed in the first place. Both the handling of the crisis and the EU's economic governance reform were subject to substantial political pressures. The asymmetrical nature of the shock, where some countries in the periphery of the European Economic and Monetary Union (EMU) suffered a deep economic crisis, whereas countries in the European North went largely unscathed, and the lack of institutional preparedness for such an eventuality, turned the policy responses and the reform effort into a highly political process. Negotiations took place in an increasingly intergovernmental framework, where the states contributing the funds for the bailout of crisis-hit economies had a de facto negotiating advantage, which allowed them to determine the terms of both bailouts and reforms.

A key consideration of creditor countries was the issue of moral hazard; i.e. the likelihood that debtor countries would use fiscal solidarity instruments to avoid implementing politically costly, but economically necessary, reforms. The desire to limit moral hazard, itself rooted in underlying ideological and material considerations, dictated the harsh conditionality that accompanied bailout programs, but also the design of reforms, with a view to enhance supervisory and control mechanisms, while minimizing the commitment of resources and the delegation of powers at the supranational level.

The outcome is, unsurprisingly, not satisfactory. Many of the reforms adopted are not considered effective or sufficient, and more ambitious proposals failed to progress. What is more, many of the proposed reforms remain unfinished or incomplete, as economic recovery has weakened the catalytic pressure of the crisis for reform. In view of the widely acknowledged need to complete the reform process, in recent years, the European institutions have put forward a wide array of proposals, often highly ambitious. Unfortunately, the political economy stakes involved remain significant; dealing with the adverse legacy of the crisis for a number of member states, requires further adjustment, which comes at substantial economic and political cost. The distribution of this cost is a highly political issue, which continues to divide the Union, between risk reducing and risk sharing options. In view of this political economy struggle, the potential for substantial further reform of EU's economic governance seems limited.

This is a problem for the EU because the European economy has not yet fully recovered from the crisis and continues to face many challenges, old and new. The crisis casts a dense and long shadow; its legacy includes non-performing loans, high levels of public debt and output gaps. The crisis' legacy also includes the need for a smooth exit from the loose monetary policy regime, whose adverse impact on individual and institutional (e.g. pension funds) savers and distorting effect on asset prices is starting to be increasingly felt. The new challenge of the coronavirus, now in full swing over Europe is going to deepen these legacy problems and add new ones, particularly as the countries that seem most badly hit at the moment, are some of the countries that also suffered during the Eurozone debt crisis.

In addition, the EU is also facing a number of broader challenges; some of them are linked to global economic competition, such as managing the impact of the US trade dispute with both itself and China, improving the productivity of European economies and promoting the policies necessary for the transition to the 4th industrial revolution; others are linked to long-term structural challenges, like its poor demographic dynamics. These issues need to be addressed in an increasingly Eurosceptic political environment, itself a legacy of the debt and refugee crises. Although the recent European elections did not verify fears of a large anti-European wave, the new landscape does not create optimism for the necessary coalition building to move forward with more ambitious reforms.

The objective of this special issue is to elaborate on these issues by critically examining progress in the ongoing effort to reform the EU's economic governance, in the aftermath of the eurozone crisis. The issue includes four research papers and three research notes dealing with different aspects and debates on EU's economic governance.

The first research article by Nicos Christodoulakis provides the background for the rest of the issue, as it offers an overview of the development of the EMU since the 1990s and examines the asymmetries that led to the crisis. Christodoulakis focuses on what is arguably the most important parameter, the convergence of per capita income among member states, which is after all, one of the fundamental objectives of European economic integration. Christodoulakis shows initially a weakening of the convergence process following the launch of the common currency and later, after the outbreak of the crisis, a reversal of convergence, particularly between the core member states and the old member states of the Southern periphery, which were hit by the crisis and were affected adversely by the bailout policies that followed. The article focuses on certain key factors -public indebtedness, institutions and investment activity- to account for the polarization between the North and South of the euro area and proposes an EU investment plan as the most effective policy to foster growth and restore convergence.

The next article by Nikos Koutsiaras, offers a detailed analysis of the 20-year old journey of the European Central Bank (ECB) from a bastion of monetary orthodoxy to a qualified lender and investor of last resort. Koutsiaras shows how, despite the ECB's proclaimed independence from political interference, being a stateless monetary authority, effectively has entailed striking political compromises. The political influence of the dominant member states became particularly evident during the crisis. It delayed and constrained the ECB's policy reaction, and prioritized the provision of liquidity to the banking industry. Mario Draghi's later policy reversal, which according to Koutsiaras was only partial, came with restrictions and was in any case, inevitable, given the critical stage to which the crisis had deteriorated and the stern refusal of creditor countries to consider fiscal responses. As a result, ECB's new facilities and unconventional policy initiatives became, unreluctantly, the 'only game in town'.

The third article by Dimitris Katsikas reviews the reform of EU's fiscal governance. Beginning with an overview of the literature, Katsikas shows that determining the optimal level and instruments of fiscal governance in a monetary union of sovereign states is a complicated task; it needs to balance different national preferences and economic idiosyncrasies, allowing enough flexibility to deal with asymmetric shocks, while discouraging fiscal mismanagement, and minimizing spillover effects when it happens. At the same time, it needs to provide the means for effective fiscal management over the business cycle and build the necessary mechanisms to deal with a common external shock. The political compromise that led to EMU did not meet these requirements. Its weaknesses, revealed by the global financial crisis, contributed to Eurozone's deterioration into a second, debt crisis. Creditor countries dictated the provisions of EU's new fiscal governance. Being essentially a reinforced version of the pre-crisis framework, the new fiscal governance has tried to balance conflicting objectives with little success and it is hardly more effective than its predecessor. As a result, the reformed fiscal governance, needs now to be reformed anew.

The final research article by Athanassios Kolliopoulos reviews the progress of the Banking Union, one of the most important reforms undertaken by the EU after the crisis. Kolliopoulos argues that a 'window of opportunity' was opened in 2012, facilitated by both the acute pressure of the debt crisis and a number of political developments in important countries. Initial progress notwithstanding, the completion of the original design has not been an easy task. Following the establishment of the Single Supervisory Mechanism (SSM) and most of the components of the Single Resolution Mechanism (SRM), progress became difficult as economic recovery eased the pressures for reform, political developments created uncertainty and perhaps most importantly, the remaining reforms and particularly the European Deposit Insurance Scheme (EDIS) came up against the moral hazard issue, as it entails pooling of resources and mutualization of risk. For the moment this obstacle seems insurmountable and further progress seems unlikely.

The first of the research notes, by Achilleas Mitsos reviews the recalibration of policy, institutional and power relations in EU's governance as a result of the crisis. Mitsos describes how new intervening powers have been acquired by 'stealth' in the context of the new governance, as surveillance metrics and policy recommendations have expanded into areas not covered by EU legislation. This trend has been strengthened by the amplified use of conditionality in terms that get increasingly broader. In addition, there has been a major re-balancing in terms of decision-making institutions; the European Council has emerged as the dominant European decision-making organ, marginalizing the European Parliament and transforming the role of the Commission into an implementation service. This 'new intergovernmentalism' may be the most lasting legacy of the crisis.

The next research note, by Dimitra Tsigkou reviews the recent comparative political economy literature and the debate between the Varieties of Capitalism (VoC) and Growth Regimes theories. Tsigkou describes the different arguments, which are particularly relevant for the design of EMU's economic governance, given that the outcome of this debate may provide answers to the quintessential question of how to create a successful monetary union whose member states belong to very different models of capitalism. Tsigkou believes that some form of 'epistemological bridge-building' between the theories could improve our understanding of Eurozone's predicament.

The final research note, by Pery Bazoti examines in more detail the politics of the Banking Union's missing link, the European Deposit Insurance Scheme (EDIS). Bazoti describes the bank-sovereign 'doom-loop' and the moral hazard issues that constitute the justification and obstacle to EDIS' completion respectively. Bazoti goes on to explore different policy proposals on the institutional design of the EDIS, in order to limit the potential of moral hazard abuse. Bazoti concludes with some thoughts on the prospects of completing the EDIS; in her view unless rules are introduced to limit moral hazard to the satisfaction of Germany, further progress should not be expected.

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Aspects of divergence in the Euro Area

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Abstract

The paper examines how the convergence process between the less and the more developed members of the Euro Area weakened significantly after the circulation of the common currency, and subsequently reversed course in the post-crisis recession. The front-loaded consolidation programs that followed the bail-outs in the over-indebted economies caused asymmetric losses in per capita income in the peripheral countries and led to further North-South polarization. The paper identifies public indebtedness, quality of institutions and capital formation as the areas where divergences are more pronounced and suggests that policy initiatives to encourage more investment and a faster institutional assimilation are needed for the convergence process in the Euro Area to take off again.

KEY-WORDS: Euro Area, Growth, Convergence.

Acknowledgement: Useful comments and suggestions from Dimitris Katsikas, and from the participants in a presentation during the Jean Monnet seminars in AUEB, are gratefully acknowledged without implications. Opinions expressed in the article are solely those of the author.

Ζητήματα απόκλισης στην Ευρωζώνη

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Περίληψη

Η εργασία εξετάζει πώς η διαδικασία σύγκλισης μεταξύ των λιγότερο και περισσότερο ανεπτυγμένων οικονομιών της Ευρωζώνης εξασθένισε μετά την κυκλοφορία του κοινού νομίσματος και, εν συνεχεία, αντιστράφηκε σε απόκλιση μετά την κρίση χρέους. Η εμπροσθοβαρής δημοσιονομική προσαρμογή που συνόδευσε τα προγράμματα δανειακής διάσωσης στις υπερχρεωμένες χώρες προκάλεσε ασύμμετρες απώλειες εισοδήματος και μεγέθυνε το χάσμα Βορρά-Νότου στην Ευρωζώνη. Οι αποκλίσεις ανάμεσα στις δύο ομάδες χωρών που είναι έντονες αφορούν το δημόσιο χρέος, τις επενδύσεις και την ποιότητα λειτουργίας των θεσμών, συμπιέζοντας έτσι τη δυναμική της ανάπτυξης και υπονομεύοντας τη σύγκλιση. Για να ξαναπάρει μπροστά η διαδικασία σύγκλισης των χωρών της Ευρωζώνης, χρειάζο-

νται νέες πολιτικές οι οποίες ευνοούν την αύξηση των επενδύσεων και προάγουν την ταχύτερη θεσμική προσαρμογή των κρατών-μελών.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Ευρωζώνη, Ανάπτυξη, Σύγκλιση

1. Introduction

The aspirations of nations vying to join the European Union (EU) over the last half century were social, political and economic, albeit to a different extent for each new member. Mature western democracies, such as those of the United Kingdom or the Scandinavian countries sought to increase their involvement in the post-war European making, though later some of them changed their minds and chose to break away. The countries of European South that lived through military dictatorships until mid-1970s as well as those of Eastern Europe that abolished communist rule in the early 1990s saw their accession to the EU as an anchor of socio-political freedoms, and a helping hand for setting up democratic institutions. After decades of domestic oppression and geopolitical isolation, they hoped of fully participating in the family of Western societies sharing similar values and opportunities.

However, the *Holy Grail* of Governments, pressure groups and opinion makers in forging their people's approval of EU membership was the process of *convergence* towards the living standards of the older and more developed member-states. The expectation was that -sooner rather than later- some kind of mystical dynamics would bring about more efficient markets and macroeconomic stability ushering in to a new era of growth and prosperity for their citizens. The EU authorities embraced these aspirations and since mid-1980s made the financing of regional projects through the Community Support Frameworks (CSF) a central policy priority to foster growth in the less-developed areas.

In mid-1990s, however, most EU economies were in a state of panic after abandoning the Exchange Rate Mechanism (ERM) and the harsh monetary policy they had to follow in order to sustain the exchange rate targets. Naturally, policy priorities shifted toward seeking macroeconomic stability, and the need to create the Economic and Monetary Union (EMU) subsequently attracted most of the political capital and legislative work of that period. Each member-state had to comply with a number of rules and limitations regarding the burden of public debt and deficits, the inflation rate, the exchange rate fluctuations, and the cost of sovereign borrowing in world markets. It was only after achieving all criteria that a country could qualify for participating in the EMU and adopting the common currency.

It was clear that the emphasis given by both the EU authorities and national governments alike was to set up the EMU in time and by then secure the accession of as many member-states as possible. The new policy process was called -somewhat derogatorily- *'nominal'* convergence as opposed to the *'real'* convergence process involving households' incomes. As the latter was no more a prerequisite either for a country to join the common currency or for its smooth functioning afterwards, its urgency started fading away from the policy agenda and was since then considered to be the ultimate (as opposed to imminent) pursuit of the EU. To reassure the signatory member-states that real convergence is not abandoned, the Maastricht Treaty pledged that "*…the Community shall aim at reducing disparities between the levels of development of the various regions*"; see (EC, 1992, Article 130a).

To that effect, the EU responded first by extending the financial resources allocated to the CSF it hoped to speed-up convergence in the least-developed regions, and, second, by announcing the Lisbon Strategy for Growth (LSG for short). With the latter, it hoped to revive market reforms and boost competitiveness and non-inflationary growth. In practice, however, LSG lacked the financial capacity to implement such ambitious policies, and not even enforced a major reallocation of CSF funds to support them. No wonder that finally it became nothing more than a reference framework.

At that time, policy makers could not possibly imagine the different models of economic development that prevailed across member-states according to whether capital flows were mainly allocated to internationally traded (as happened in the northern countries) or non-traded sectors (as in the southern part of the Euro Area). In the former case, competitiveness and external balances greatly improved, while in the latter they deteriorated, thus leading to serious post-EMU divergences within the Euro Area. The dominant theory of the time was that EMU would evolve smoothly to correct any remaining imbalances in the economic behavior of member-states, ranging from business cycles smoothing (e.g. in Christodoulakis et al. 1993) to free factor mobility and equalization of wages (e.g. in Emerson et al. 1992). No doubt, at least the first of the above expectations was duly accomplished: for example, González and Ruscher (2008) confirm the synchronization of fluctuations and imply that it forged the confidence of the viability of the common currency. Similarly, De Grauwe and Ji (2016), and Belke et al. (2016) conclude that business cycles have had become increasingly synchronized across Euro Area economies even after they were severely hit by the global crisis.

But no comparable progress in closing the gap of post-EMU living standards has been noticed even before the global crisis. In fact, the Euro Area was experiencing a slow deterioration of income gaps that became a lot more pronounced in the aftermath of the debt crisis and the bailout programs implemented in the weaker economies. As a result, social dissatisfaction towards the common currency -and the European institutions in general- would reach unprecedented levels before a new policy interest in bridging the asymmetries started to emerge in policy debates.

In the literature, there are two measures of income convergence: one is the so-called β-convergence, which tests whether countries with an initially lower GDP per capita subsequently, grow indeed faster than countries with a higher initial level, thus giving rise to the "catching up" effect. The other is the so-called σ-convergence, which measures the decline in dispersion of GDP per capita among fellow member-countries. In a study for the initial 12-member group of the Euro Area (henceforth EA12), Christodoulakis (2009) employed both convergence indicators to show that the gap had in fact widened, albeit to an extent that at that time seemed to be reversible if certain policies were implemented.

Such corrective action, however, was never implemented at a scale sufficient for the convergence process to appear again. Hence, the catching-up effect ceased and the gap between less and more developed nations further widened after the global financial crisis in 2008. According to Diaz et al. (2017), it is striking that so little convergence has occurred among the early euro adopters, despite their differences in GDP per capita at the beginning of the period. In contrast to some optimistic expectations that the establishment of the euro would itself act as a catalyst for faster real convergence, they find that little convergence, if any at all, has taken place for the whole period 1999-2016. In a more updated study, Cabrillac (2019) examines both measures of convergence and finds that improvement among EU members has slowed down during the recent period if compared to the two prior decades.

It was only after the global crisis and the socio-economic cracks that appeared in recession-hit countries that policy makers started again appreciating convergence of living standards as an important pillar in the EMU foundation and longevity. No less than ECB (2015), openly admitted that 'little real convergence has taken place among the euro area economies since the establishment of the euro, despite initial expectations that the single currency would act as a catalyst for faster real convergence'. Further on, the ECB report suggested that 'sustainable real convergence supports the smooth functioning of Monetary Union over the medium term', and the Commission followed suit by emphasizing that 'progress on economic convergence is of particular relevance for the functioning of the euro area but is equally important for the EU as a whole'; see (EC, 2017).

In the same Report it is found that '[t]]he convergence trends of the single currency's first years have proven partly illusory', the Report calls for swift and effective action to achieve 'strong economic and social re-convergence'. Academic research responded with a strong voice in favour of more real convergence. For example, spirit, Diaz et al. (2017) argue that achieving economic convergence is a crucial condition for sustainability of Euro Area membership. More emphatically, Franks et al. (2018) remind all competent authorities that convergence of per capita income levels is *an important objective of the economic integration process*; (my italics). More recently, Imbs and Pauwels (2019), examined why EMU failed to generate convergence in per capita GDP terms and suggest that the best way to achieve that is by pushing EMU to become an optimal currency area ex post, even though it had not been one ex ante.

The aim of the present paper is to examine the gradual erosion of the convergence process since before the establishment of EMU in the late 1990s to the post-crisis years. In this context, it shows that major external imbalances that characterized the Euro Area economies in the post-EMU period led the most-exposed countries to the sudden-stop crises and necessitated the bailout agreements. The recession that followed exacerbated several inherent weaknesses and further widened the gap in living standards between the most developed countries of the Euro Area and the peripheral economies.

Investigating the areas where post-crisis discrepancies are more pronounced, the paper focuses on the issues of public indebtedness, the fall in investment activity and the delay -if not outright reversal- in improving institutions. In all three areas, the Southern economies of the Euro Area are found to starkly deviate from their Northern peers. The new member-states that joined the EU in 2003 and EMU a few years later appear to follow a more satisfactory process of convergence, though gaps in some critical areas continue to persist.

The rest of the paper is organized as follows: Section 2 describes how the convergence process was set in motion in the run-up to EMU but was then gradually extinguished and replaced by strong disparities after the global crisis. Section 3 discusses the main areas in which divergences appear to be stronger, leading to a further polarization between Northern and Southern members of the Euro Area. Section 4 examines some key aspects of polarization and proposes a number of policies to mitigate discrepancies. Finally, Section 5 concludes with some suggestions for future research.

2. From convergence to divergence

We start by examining a simple measure of dispersion in per capita incomes among member-states. Fig. 1a plots the band of one standard deviation around the mean of per capita GDP in real terms during the period 1986-2018. Calculations involve only the initial group joining the Euro Area to avoid possible idiosyncrasies in the countries that were not full members of the EU for the whole period. By further excluding Luxembourg as a high-income outlier, the group remains with eleven member states, (henceforth EA11). The growing gap in living standards becomes evident by observing that one standard deviation reached €13,538 in 2018, more than twice wider than the amount of €5,775 in the beginning of the EMU in 1986.[2]

In Fig. 1b, another measure of dispersion is depicted by plotting the gap between the maximum and minimum levels of per capita incomes among member-states relative to their mean. Before EMU, relative dispersion had fallen from 56% in 1986 to 49% in 1998, though it slightly rose afterwards to reach 52% in 2009. After the global financial crisis, it sharply widened reaching 76% of the mean in 2018. These findings imply that the convergence process between the less and the more developed initial members of the Euro Area significantly weakened in the post-EMU era and reversed course during the previous decade.

2.1 Convergence before the EMU

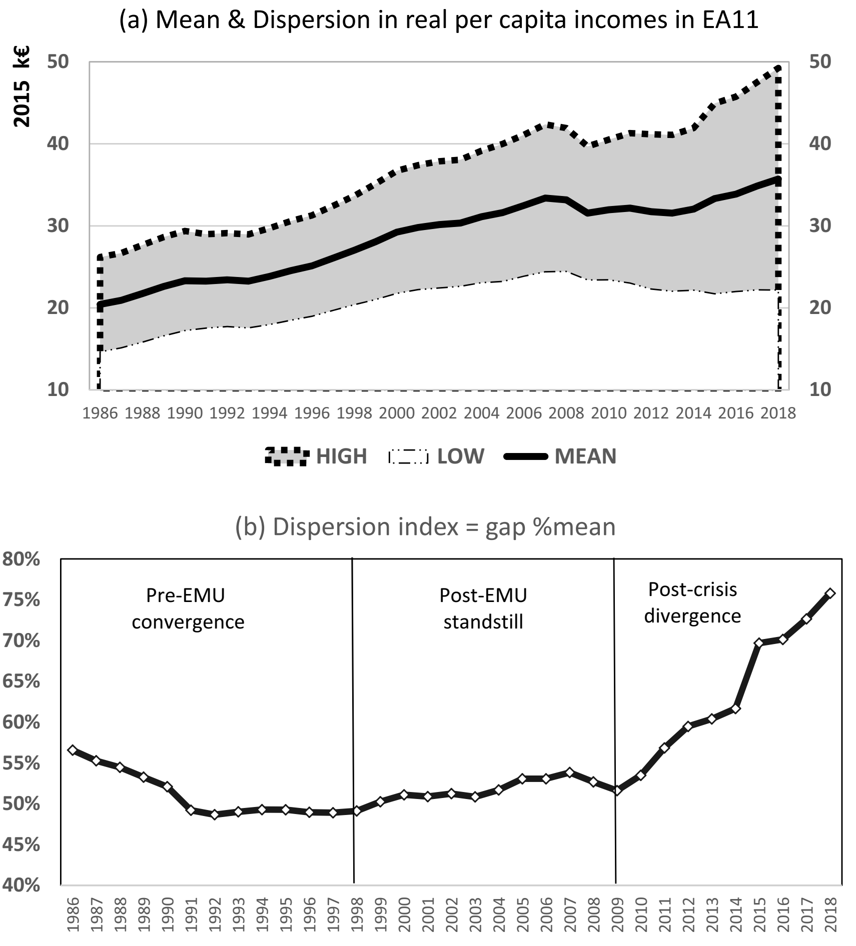
The well-known test for **β**-convergence over a certain period is to look for a strong, significant and negative correlation of cumulative growth versus the per capita GDP in the beginning of the time-span. The result depicted in Fig. 2a for the eleven Euro Area group (i.e. still excluding Luxembourg) in the pre-EMU phase 1986-1997, reveals a negative and statistically significant relationship. The implication is that the gap between poorer and richer members was clearly diminishing during that period, thus generating a strong catching-up effect.

The gap was reduced for both bad and good reasons: In late 1980s and early 1990s, several advanced economies were still trapped in the legacy of stagflation or experiencing painful currency appreciations in their struggle to survive in the Exchange Rate Mechanism (ERM), the EMU's precursor. As some of the less developed countries had remained thus far outside ERM, they enjoyed a more flexible monetary policy and higher growth.

On the positive side, the EU had endorsed a whole set of growth-inducing policies to promote development in the less-advanced regions – from financing new investment to upgrading human skills and supporting renovation and reallocation projects. Under the umbrella of the Community Support Framework (CSF), initiatives to build modern infrastructures, upgrade human capital, and support new productive investment reached such a scale that it finally succeeded in removing pockets of poverty and creating several local champions of competitiveness, exports and employment.

A framework of *ex post* evaluation attached to the CSF funding helped into further expanding the growth momentum. As a way of creating incentives for project efficiency, the eligibility as well as the level and the disbursement of regional funds were made conditional on the actual improvement of living conditions in the specific areas. In case of successful projects, conditionality sparked a virtuous cycle of income growth and project financing. On the other hand, failing to meet the criteria was likely to lead to the discontinuation of project funding, thus causing plenty of political embarrassment to national and local authorities.

Fig. 1. Dispersion of per capita income in EA11



Note: Dispersion in (a) is set to one std around the mean. In (b) the gap is the difference between maximum and minimum levels across EA11 countries relative to the mean. Data source: Ameco

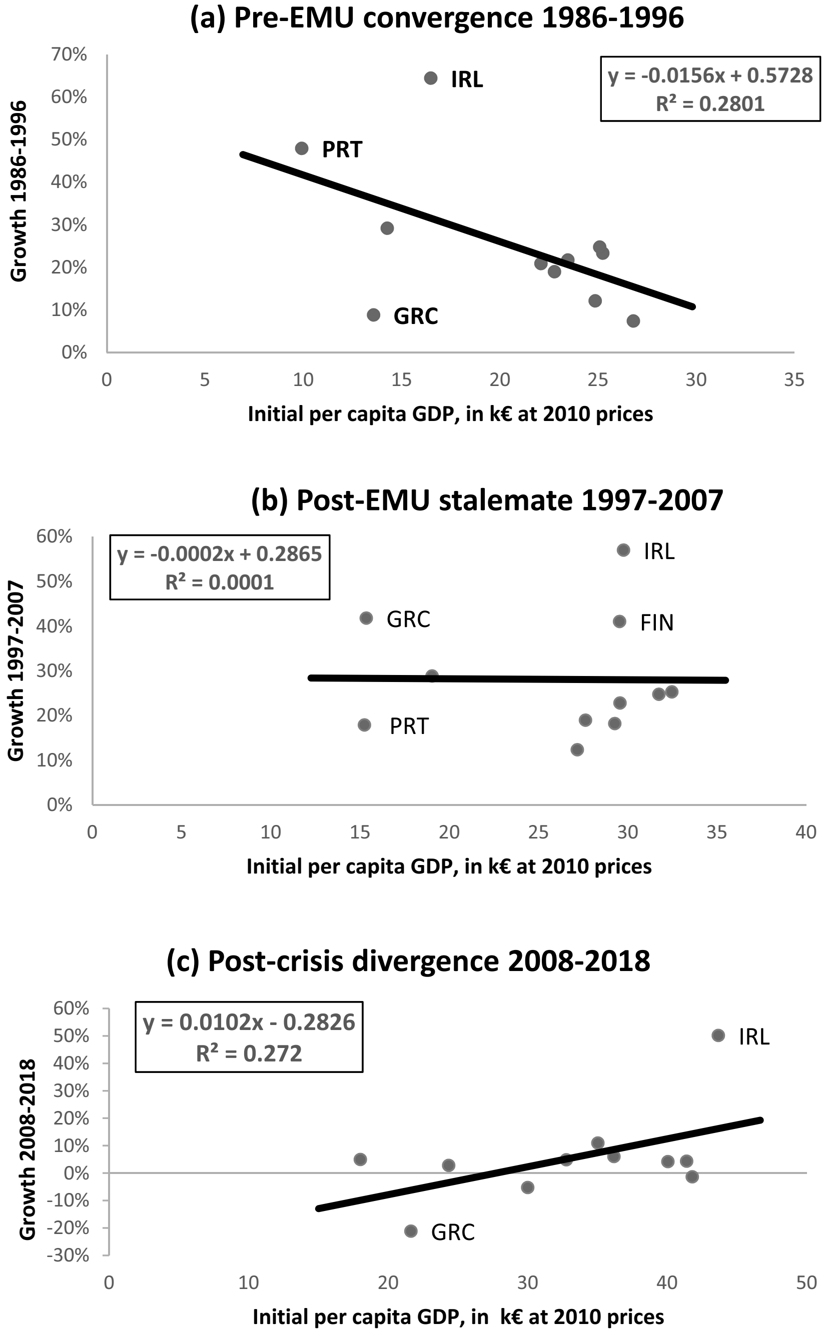
2.2 No convergence post-EMU

The early optimism that prevailed in the 1990s was stretched to the limits by claiming that the establishment of a common currency would automatically catalyze factor mobility between member-states. New investment expected to freely flow to the least-developed economies to exploit higher returns on capital, while labour was likely to move to the most-developed economies to benefit from better wage remuneration and more efficient job markets. Therefore, the gap in per capita living standards would further diminish by the self-correcting process of factor-returns equalization. In practice, however, no worth mentioning correlation is even detected between overall growth during 1997-2007 and per capita levels at the beginning of that period. The relevant test fails to establish any catching-up effect, as clearly shown in Fig. 2b.

The lack of post-EMU convergence should not, however, be attributed to the absence of policy targets. In fact, a long list of actions and reforms known as the Lisbon Strategy for Growth (LSG) had already put in circulation since 2000; see EC (2000). The LSG framework aimed at making the European Union *'the most dynamic and competitive knowledge-based economy in the world'*, by improving competitiveness to achieve sustainable economic growth, more and better jobs, greater social cohesion, respect for the environment, and a leap in educational attainment and technological innovation. All those became catch phrases for all post-EMU policy proclamations, albeit to only a limited practical effect.

The fact that the LSG failed in the post-EMU era was not due to the lack of ambition as to that of political will to confront the new challenges. Soon after its launch, it became evident that the complexity of goals and the lack of strong incentives or clear-cut national obligations in the implementation of LSG would soon make the whole effort to end up in a deadlock. The absence of enforcement mechanisms and the lack of appropriate financing -at least to the scale actually required-, finally made them look as only tentative inspirations rather than rigorously pursued policy targets. A new strategy drafted in 2005 put more focus on the simplification and national ownership via national action plans as the key elements to revitalize the reforms agenda. Nevertheless, as the global crisis was approaching, the Lisbon strategy again stayed below expectations and failed to steer the EU towards more growth and resilience; for a thorough critique see Wyplosz (2010). The LSG finally was declared obsolete and, in March 2010, subsequently superseded by a new framework for *'smart, sustainable and inclusive growth'*; see EC (2010). It was unfortunate that only a month after its launch, the debt-crisis erupted in the Euro Area periphery and its shockwaves hit convergence for yet another time.

Fig. 2: From convergence to divergence in EA11



Data source: Ameco

2.3 Post-crisis divergence

Although all of the EA economies suffered serious losses in households' incomes after the crisis in 2008, some countries were further subjected to the contingencies of bailout programs. The recipient countries agreed on implementing front-loaded fiscal consolidations to restore public balances, and extensive wage-cuts to effectively achieve an internal devaluation and restore competitiveness. In turn, this caused further recession and divergence among the EA11 became even more pronounced, with Greece being the most severe case throughout. According to Estrada et al. (2013), for most of them the result was 'a *reversal of fortunes*', as several economies with better, on average, performance up to 2007 have subsequently experienced deeper recessions and larger increases in unemployment rates.

Figure 2c displays the pattern in the post-crisis period 2008-2018 for the EA11 member-countries. The relationship between cumulative growth in per capital income and its initial level has actually turned positive, suggesting that a process of divergence is clearly under way. An interesting exemption was Ireland, where the economy initially fell but subsequently embarked on a trajectory of superfast growth after 2014.

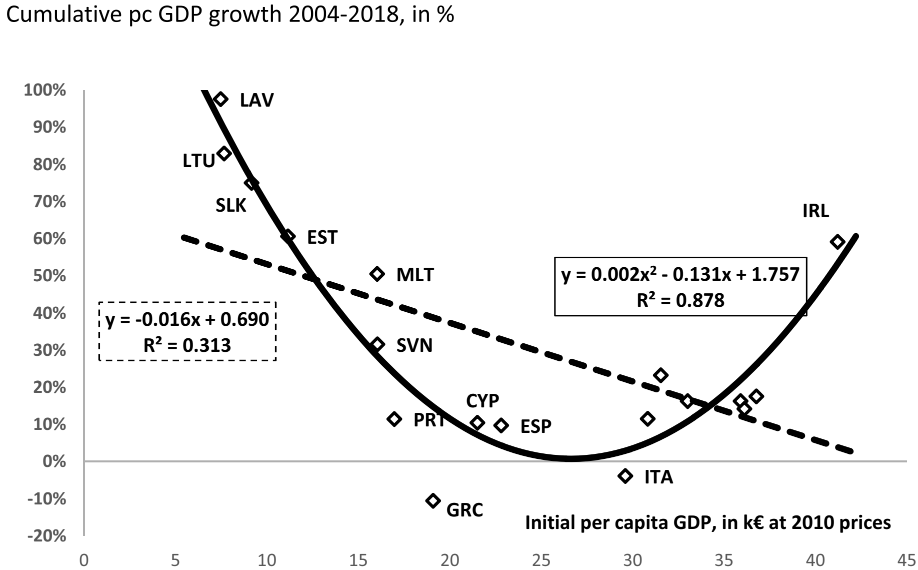
2.4 We are all a family now

The extent of divergence is somewhat mitigated by including the seven new accession countries that joined the EU in 2003 and adopted the common currency a while later. Fig. 3 juxtaposes cumulative growth over the period 2004-2018 with initial per capita GDP for the group EA18, (i.e. again excluding outlier Luxembourg). The straight line is statistically significant and implies that a negative correlation is established. As a matter of fact, the new EA members followed a strong catching-up process, managing to close the huge gap that existed before. Optimism, however, is mitigated by noting that the impressive growth characterizing the new joiners only took place in the years prior to the global crisis. Post-crisis, growth slowed down in them too and their convergence weakened as explained by Franks et al. (2018).

The fact that most of Euro Area convergence is due to Eastern European countries is also confirmed by Cabrillac (2019), who notes that otherwise convergence actually stopped among EU countries and regions after the crisis. This prompts a closer inspection of the scattered plot in Fig. 3. By employing a parabolic relationship, a far better fit is obtained and reveals that there probably exist more than one different growth patterns among the Euro Area economies.

One pattern appears in the rising part of the curve that includes the most-developed countries of the Euro Area. It shows a clear tendency of divergence in per capita incomes, confirming the findings in the previous subsection. The falling part on the left-hand side of the curve includes the new EA members together with those in the European South that experienced very low (or even negative) growth over the period in examination. The only convergence process currently in force in the Euro Area is the one between the less-developed new members with the crisis-stricken and relatively poorer members of the Euro Area. Hardly reminiscent of the aspirations held back in the roaring 1990s.

Fig. 3: Convergence in EA18, (excl. Luxembourg)



Note: All statistics are in favor of the parabolic (versus the linear) fitting and include: DW=1.85 (1.21), F-stat= 54.2 (7.3) and S.E.R.= 11.62 (26.74), Nobs=18. Data source: Ameco

3. New asymmetries

The most diverging performance among the Euro Area economies emerged in their external balances. Several countries saw their current account deficits to go explosive, while at the same time others were building-up surpluses. For the Euro Area as a whole, the current account was virtually in balance without alerting policy makers to the internal gap and the risks associated with it. Initially, European authorities and policy analysts misperceived the asymmetric developments in the external balances as being only a transitional characteristic. As such, it would soon dissipate without any specific action undertaken, although a traditional correction of competitiveness through exchange rate adjustment was no longer possible. Productivity alignments could possibly be carried out by enforcing new reforms in wage setting and labour markets, but that seemed hard to implement in the post-EMU years. A kind of policy fatigue was reigning in after the years of nominal convergence, and thus external asymmetries continued to grow unchecked.

3.1 Grow now, converge later

Furthermore, there was massive capital movement from Europe's core—mainly Germany, but also the Netherlands—to its periphery. According to Krugman (2012), these flows led to an economic boom in the periphery after the creation of the euro and significantly higher inflation rates in Spain, Greece, and other periphery countries, than in Germany. Prior to the crisis, the successful macroeconomic adjustment to the EMU requirements and the lower interest rates that prevailed afterwards had led to a post-EMU optimism in self-enforcing adjustments. Since national governments could borrow at a much lower cost than before, the expectation was that some kind of crowding-in would enable the private sector to finance more investment projects, while the public investment budget could also expand to finance modern infrastructure and, thus, enhance the supply-side capacity of the economy. In several countries, however, the increased availability of funds merely augmented aggregate demand, and soon led to large external imbalances.

According to some authors, the seeds of imbalances were already planted long before the EMU started to take place. For example, Grjebine et al. (2019) note that real divergence increased from the early 1990s as evidenced by low productivity growth in the «periphery» of the Euro area relative to «core» countries. They conclude that the creation of EMU in 1999 was far from being a catalyst for real convergence in Europe, because capital allocations across various sectors followed widely diverging patterns and led to very different developments in their total factor productivity (TFP).

Although capital flows increased all over the Euro Area, there was a strong differentiation in the type and the allocation of investment across different countries. Christodoulakis and Sarantides (2017) developed a theoretical framework predicting that if an economy is relatively capital-intensive in the production of traded-goods, foreign direct investment (FDI) is more likely to flow in greater proportions to the traded sector, thus improving the trade balance of that particular economy. In contrast, economies with relatively dominant service sectors are more likely to attract FDI there, eventually crowding-out production of traded goods and causing deterioration in the external account. By subsequently estimating the model across the Euro area countries over the period 1980-2009, the authors established that a growing divergence was under way in the Euro Area long before the eruption of the global crisis.

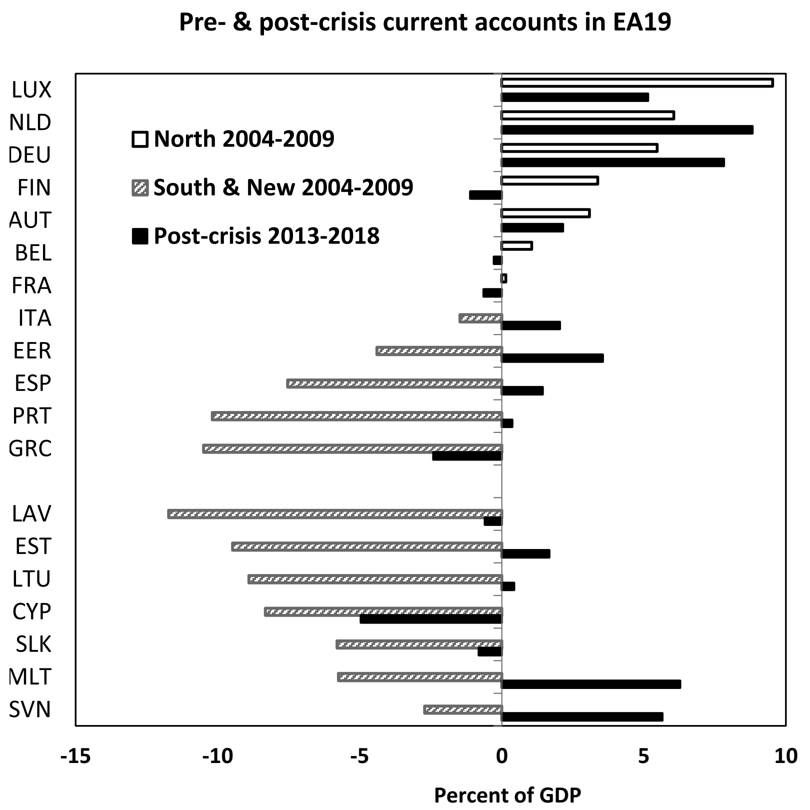
In fact, the majority of new investment in the northern EA countries went to manufacturing and/or other productive sectors, while southern countries became preferred destinations for real-estate development and the service sectors in general. Sooner rather than later, it was evident that northern countries acquired a competitive edge over their southern neighbors and the gap in the respective current accounts further widened. As a result, the northern group of countries managed to have export-oriented growth, while most of the southern economies plunged into real-estate bubbles and vastly increased their dependency on imports. Soon, their fortunes were to change course.

3.2 The reversal of fortunes

In the wake of the global financial crisis, the group of countries most exposed to external deficits were also those, which suffered more hardly from the lack of global liquidity. As described by Krugman (2012), when private capital flows from the core to the periphery came to a sudden stop, leaving the peripheral economies with prices and unit labor costs that were well out of line with those in the core, suddenly, the euro faced a major adjustment problem. Fig. 4 displays the current accounts of the Euro Area, by distinguishing between Northern, Southern and newly joining economies.

It is revealing to see that all countries seeking some kind of bailout agreements after 2010 had already experienced a huge deterioration in their current account deficits. Greece, Portugal and Ireland asked for bailout agreements with the European authorities and the IMF in 2010. Spain had to bail out the financial sector and adopted a similar adjustment program in 2012, albeit excluding IMF's participation. Italy, with a lower external imbalance, pointedly has kept on the verge until today.[3] The eventuality of some of them exiting the Euro was finally avoided, but only after the Euro Area authorities in coordination with the IMF organized massive capital injections. To enhance competitiveness while keeping the common monetary policy intact, each of the bailout countries had to implement extensive austerity programs combined with an internal devaluation process of wage-cutting and the removal of many labour market protections.

Fig. 4: External balances in the EA19



Note: In the vertical axis, country acronyms. Data source: IMF WEO database.

A similar crisis and consolidation pattern took place in the countries that joined the EU after 2003 and became members of the Euro Area a few years later.[4] All those plunged into recession in the event of the global crisis: The Baltic countries with large external deficits were the first to suffer from the global shrinkage of liquidity at the end of 2008. According to Blanchard (2013) the collapse occurred in a sequential pattern with the crisis leading to a sudden stop, a credit crunch, a sharp drop in exports, and finally widespread uncertainty dominating the economy. Estonia experienced a major recession with GDP falling by -14% in 2008 and subsequently underwent a harsh adjustment program. Next was Latvia with a fall in GDP by -18% in 2009 and then following a front-loaded fiscal consolidation to cut aggregate demand, while internal devaluation managed to lower wages and boost exports. Lithuania had a fall in GDP by -17% in 2009 and after following a similar adjustment program became a Euro member in 2015. Cyprus initially had a small reduction in economic activity but the continuing external imbalances and a banking crisis that finally erupted in 2013 drove the economy off the rails and forced the government to seek a bailout too; for details see Clerides (2017)

The other countries with less explosive external imbalances experienced either milder or shorter recessions, thus avoiding harsh consolidation program. Slovakia had just entered the EA when it was hit by recession in 2009-2010 but subsequently recovered; see Biea (2015). Slovenia with a comparatively smaller external deficit suffered a somewhat milder recession with the GDP falling by -8% in 2009. However, a banking crisis later on dragged its economy further down until 2013, before a gradual revival took place. Malta virtually escaped the crisis, by experiencing only a small and short-lived contraction of GDP by -2.5% in 2009, after which it returned to uninterrupted growth. Apart from its tiny size, a reason for the Maltese economy remaining relatively shielded from global recession might have been that it decisively cut the external deficit just before the crisis erupted.

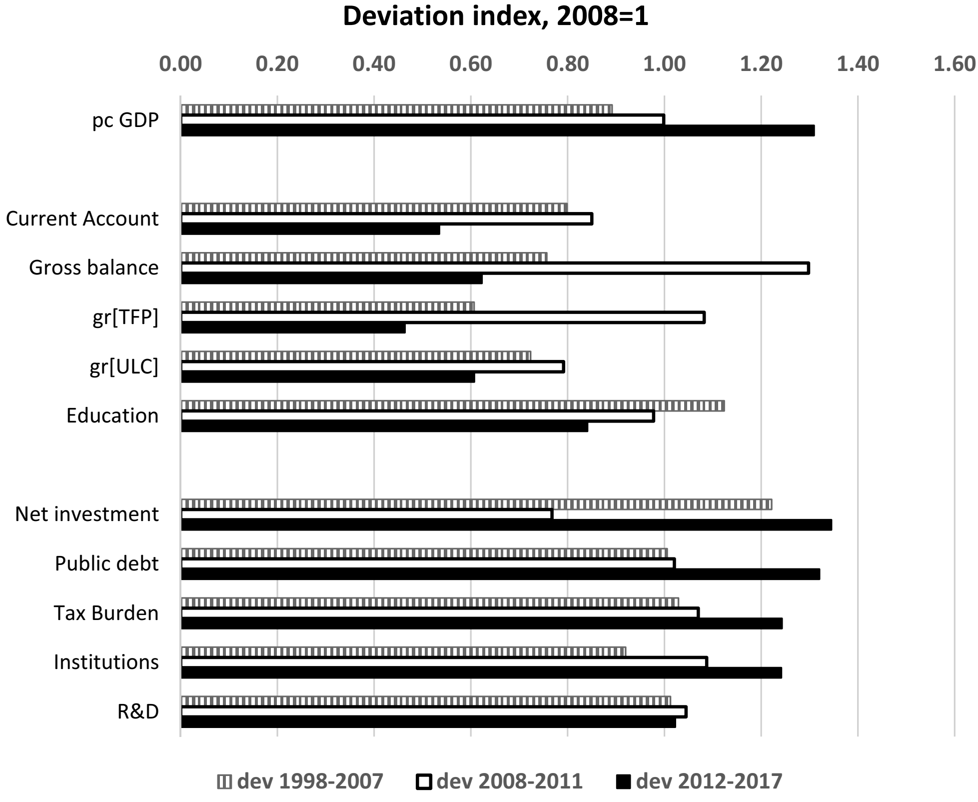
3.3 Spotting the weaker parts

The asymmetric developments in external positions revealed that a clear pattern of a North-South divide was set in motion before the crisis, rekindling the debate on the core-periphery gap and the claim that '*a single currency cannot fit them all'*. However, before jumping to arguments questioning the viability of the Euro, it is useful to check whether and how this pattern differentiated across countries during and after the crisis. Attention again is restricted to the initial 12-member group (including Greece), as the seven new EA countries joined the common currency between 2007 and 2015, either too close or after the global crisis.

The examination takes place by looking at how the dispersion among the Euro Area of some variables that typically are expected to affect growth and convergence. The variables of concern are similar to those included in the standard framework developed by Barro & Sala-i-Martin (1995, Ch. 12), and a comparison is displayed in Fig. 5 for three-time spans to cover the periods before, during and after the crisis. The graph shows that intra-EA deviations in per capita income initially widened only slightly during the crisis as countries suffered more or less symmetrically from the global recession. However, they were wildly exacerbated afterwards due to the different policies that applied to stave off recession and fueled the strong divergence dynamics mentioned in the previous section. The rest of the variables are exhibiting a mixed pattern that reflects the contradictory effects of stabilization measures on income growth as discussed below.

First, it is noticeable that cross-country deviations in the current accounts were seriously contained after the crisis, thus weakening the mechanism through which a troubled economy was suffocated by the international credit crunch. However, most of external balance in the bailout countries were a consequence of the austerity programs, rather than a result of some structural transformation of their economies. As Catao (2017) notes an important segment of structural reforms in southern countries and Ireland has taken the form of public sector streamlining that is expected to harness the external imbalances even if some cyclical correction takes place in the future.

Fig. 5: Comparing EA12 deviations before, during and after the crisis



Note: Standard deviation is calculated on data where per capita (pc) GDP is in levels, flow variables are in percent of GDP; institutions are indexed; education is expressed in population shares of 18-65 years attained secondary schools; and growth rates (gr) are in percent. All 12 members of the initial EA group are included. Data Source: Ameco, World Bank.

In this vein, the curtailment of imports was mainly due to the shrinkage of total demand, brought about by higher taxes and cuts in public expenditures. These are compatible with the reduction of deviations in Government balances and the increase in those of taxation. Moreover, the internal devaluation process of wage-cuts contained the asymmetric rises in unit labour costs as seen by the lower deviation in the post-crisis period. As noted by Fernandes (2019, p 25), real wages had to fall to restore competitiveness and this led to further wage divergence or no convergence between Southern and Northern euro area countries.

But there was a further price to be paid for the bailout adjustments: several banks' recapitalizations had to be financed by issuing new public debt, thus augmenting deviations in indebtedness between EA12 economies. Public investment expenditures were trimmed down by fiscal austerity in bailout countries, while private investment fell dramatically due to lower demand and liquidity shortages. The rise in deviations of net investments after the crisis, underlines the high asymmetries in capital accumulation that may further delay convergence in the future. Adding insult to injury, the intensifying social protests against front-loaded stabilization policies frequently weakened the political system and undermined the overall efficiency of institutions, as indicated by a substantial increase in the intra-EA deviations. Against all the above growth-cutting policies, the slight containment of deviations in education attainment or in TFP were not sufficient to alter the picture.

As deviations between North and South continue to be pronounced in key areas after the crisis, it is likely that new diverging patterns might emerge in the future. Below, the cases of public indebtedness, institutions and investment activity with high post-crisis deviations are further elaborated.

4. Aspects of North-South polarization

In this Section, we examine the developments in public indebtedness, investment activity, and institutional capacity that prevailed in the Northern and Southern members of the Euro Area. To caution for the possibility of Greece driving the Southern average, the graphs are displayed with and without including it. The group of the new seven countries is also displayed. Figure 6 shows the three group-averages.

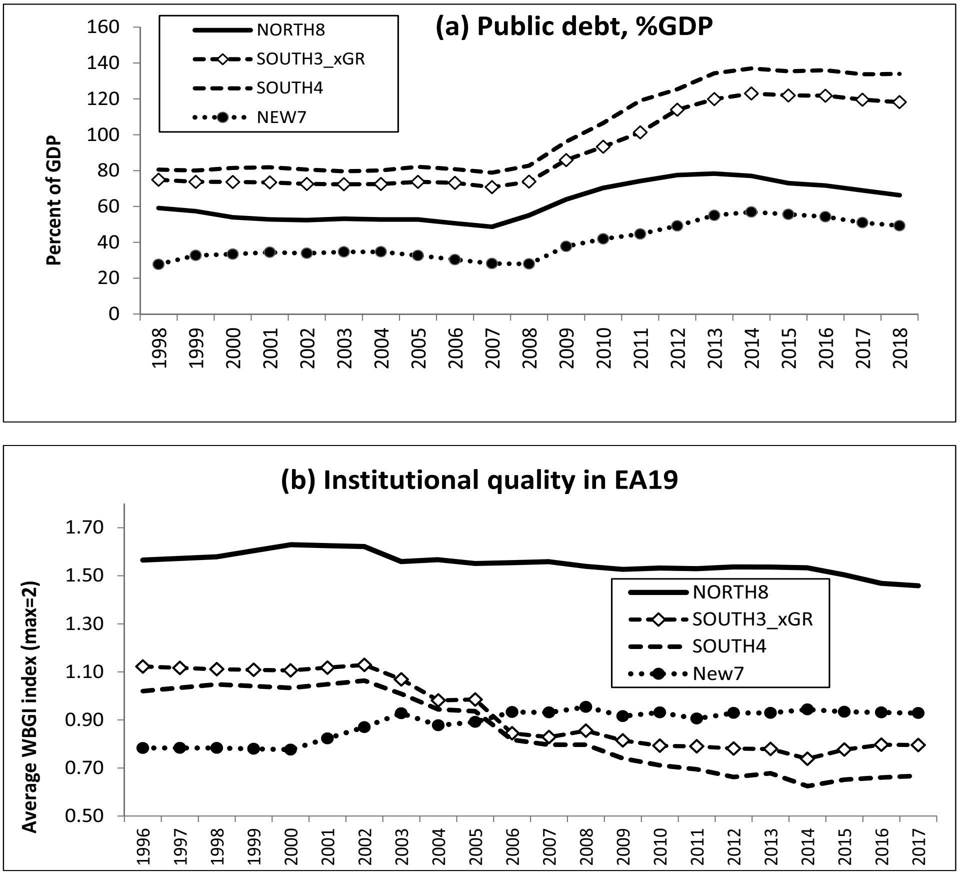
4.1 Public indebtedness

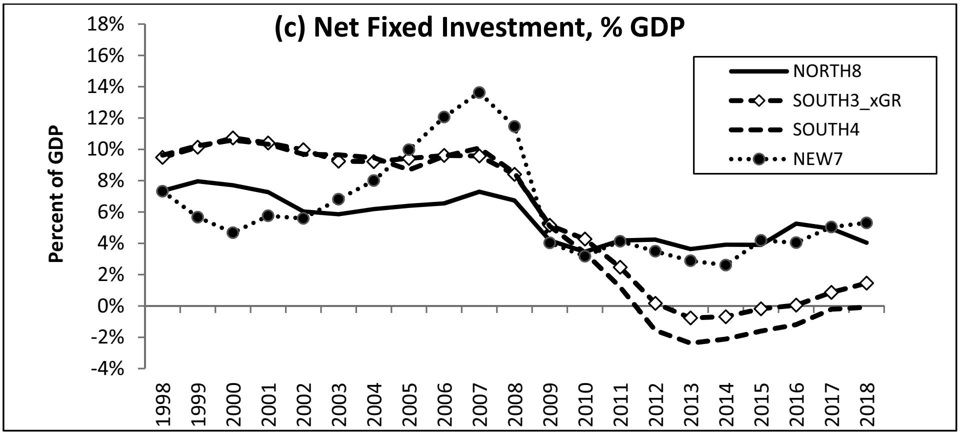
In the aftermath of the global crisis, public debt rose in most economies of the Euro Area for a variety of reasons: in the first phase, governments were engaged in Keynesian expansionary policies to support aggregate demand in the face of the incoming recession. With tax revenues falling due to slack economic activity and borrowing costs going up as a result of financial collapse worldwide, public deficits widened at a scale hitherto unseen for the Euro Area.

The second phase included a wave of banks' capitalizations by issuing public debt in order to compensate for the losses in their balance sheets due to investing in toxic assets overseas. As some governments in the Euro Area periphery were at the same time facing enormous borrowing requirements, they sought bailout agreements with European authorities and the IMF.

As bailout agreements imposed austerity programs to control deficits, they subsequently caused further recession and public debts spiraled as a proportion to GDP. Finally, the stock of debt expanded to cover the needs of banks' recapitalizations. Overall, all of the southern countries are characterized by a degree of indebtedness considerably higher than ever before; see Fig. 6a.

Fig. 6: New divergences in the Euro Area





Note: WBGI is in levels. Country-group averages. Dotted lines include Greece with the other three southern countries. Data source: Ameco, World Bank.

4.2 Public institutions

The most surprising finding, however, regards the growing discrepancies in the efficacy of institutions in the member states. Although institutional assimilation is by no means a process with specific targets and convergence requirements, it was natural to assume that increasing factor mobility and policy coordination during the run-up to EMU would rather smooth down idiosyncratic differences than amplifying them.

To visualize the process, we use the six governance indicators published by the World Bank (WBGI, for short) at an annual frequency and including the following:

1. Voice and accountability – capturing perceptions of the extent to which a country's citizens are able to participate in selecting and assessing their government, as well as freedom of expression, association, and press media.
2. Political stability and absence of violence/terrorism – capturing perceptions of the likelihood that the political system will survive in the face of fragile governments, partisan challenges, an eventual power vacuum or extensive protests, including politically motivated violence and terrorism.
3. Government effectiveness – capturing perceptions about the quality of public goods and services, the readiness of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of government's commitment to such policies.
4. Regulatory quality – capturing perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector activities and developments.

5. Rule of law – capturing perceptions of the extent to which agents have confidence in, and abide by, the rules of society and, in particular, the quality of contract enforcement, property rights, the police, the functioning of courts, as well as the frequency and intensity of crime and violence.
6. Control of corruption – capturing perceptions of how effectively malpractices including both petty and grand forms of corruption are checked, as well as avoiding the 'capturing' of the state by elites and private interests.

According to Kaufmann et al. (2011), the first two indicators qualify the process by which governments are selected and monitored; the next two, measure the capacity of governments to effectively formulate and implement sound policies; the final two show the respect of citizens and the state for the institutions that govern economic and social interactions.

To simplify the analysis, a principal components analysis is performed in order to obtain a weighted average of the above WBGI indicators for each country; see Christodoulakis (2019) for more econometric details. Subsequently, Fig. 6b displays how the country-group average evolved over the last twenty years. It is remarkable that the newly joined group improved institutions in accordance with stronger performance in GDP growth, thus speeding up convergence to the Euro Area peers. In contrast, the Southern countries suffered a pronounced deterioration in institutional capacity right after the circulation of the common currency, and continued unabated after the crisis.

The discrepancy in the institutional performance might -at least partly- explain the divergence in income growth, as has been debated in the economic literature for a long time (for a survey on the subject see Acemoglou et al. (2005), and Algan & Cahuc (2014), among many others. For the effect on European growth, see MacFarlan et al. (2013), Masuch et al. (2016), and Christodoulakis (2019), among many others).

As noted by Loon (2018), the importance of the structural/institutional aspect in the convergence process is often either neglected or purposefully avoided. To overcome the present impasse in convergence, a refocusing on structural and institutional indicators would aid in furthering the debate and, thus, strengthen the resilience of the EMU. The finding is in agreement with Eichengreen (2019), who notes that the change in the dynamics of convergence of TFP and per capita GDP before and after the global financial crisis underscores the fact that the problem is not just a legacy of the global financial crisis but, as he puts it, is fundamentally a crisis of institutions.

4.3 Investment activity

Investment activity appears to be strongly diverging in the Euro Area both before and after the global crisis, albeit for different reasons. Before the crisis, the

Southern Euro Area economies were investing in aggregate new fixed capital formation at an intensity consistently higher than that of their northern peers, as shown in Fig. 6c.

Obviously, this resulted to higher growth in per capita incomes and contributed to somewhat closing the gap with the most affluent countries as examined in section 2.2. Investments in the European South were predominantly channeled to real-estate and the non-tradable sectors in general, in contrast with the mostly productive investment in tradable sectors that was taking place in the Northern countries. An unpleasant consequence of these developments was that exports were boosted only in the North leading to a more robust growth, while external balances in the South hugely deteriorated leading to the bailouts and the prolonged austerity programs.

In the aftermath of the crisis, fixed investment declined in all countries with adverse consequences everywhere. The growth prospects of the Euro Area were starkly diminished by under-investment as described by Kolev et al. (2013), Bardi et al. (2014), Gornig and Schiersch (2014), among many others. Christodoulakis and Axioglou (2017) note that the overall response in the EA was sluggish and lagging behind the competitor economies, like the US or even Japan, where aggregate investment -after an initial slump- started quickly recovering. By estimating a neoclassical economic model, they show that underinvestment is the main factor behind unemployment and slow growth witnessed in the Euro Area ever since.

Even more alarming, however, has been the vast disinvestment that has taken place over the recent years in the peripheral economies. For example, investment in the real-estate sector plunged everywhere though its impact on overall investment was greater in the South, due to the higher share it had before the crisis. Further on, private sector savings in those countries were severely hit by direct wage cuts and increased taxation, as conditioned by the austerity programs. Moreover, governments were cutting back public investments as a politically easier way to trim deficits than by further raising taxes. These policies generated new post-crisis asymmetries in net fixed investment profiles, wider and more threatening than before. The northern Euro Area countries managed, after an initial drop in 2009-2010, to keep an average of 4% of GDP, while those in the South experienced a devastating fall. The intensity is so low after the crisis that it practically amounts to abstaining from new investment activity. Some marginal rekindling of investment appeared in 2017, though it again disappears if Greece is taken into account.

Regarding the newly joined economies, they naturally experienced a much more volatile pattern before the crisis in their way to remove the rigidities of state-planning and make room for modern dynamic market economies. In the prospect of becoming full members of the European Union in 2003, gross investment peaked and continued at even higher rates afterwards approaching 14% of their GDP in average in 2007. Post-crisis, however, investment activity also collapsed by more than 10% of GDP per year in average before reaching levels close to those followed in the northern Euro Area group.

4.4 Resolving the puzzle

The aforementioned analysis invites a debate on how each one of the three aspects characterizing the North-South divide could improve by specific actions. The situation, however, is more perplexing since the three characteristics are not autonomous but seem to affect -or being affected by- the other. For example, a deterioration in the efficacy of institutions deters new investment, thus halting growth and finally augmenting public debt as a proportion to GDP. High indebtedness is by itself a deterrent to new investment, while the positive feedback loop of underinvestment, recession and unemployment strains social coherence and undermines the institutional capacity of the country. Pierluigi and Sondermann (2018) argue that high levels of debt make economies more vulnerable to adverse shocks. For that reason, they suggest a higher GDP growth that would also help debt sustainability, which can be achieved by fostering the implementation of structural reforms.

The question then is how all the above aspects could start simultaneously moving in the right direction. Currently, there are some public debates to ease the burden of indebtedness in the most stressed countries of the Euro Area, either by reducing and further reprofiling debt repayments as in the case of Greece and possibly Italy in the near future, or by designing some kind of debt mutualization at the Euro Area level. As all such measures will eventually materialize - either directly or indirectly - at the expense of other member-states with currently lower debt burdens, it seems unlikely that they become popular issues to be easily adopted in the near future.

On the other hand, improving institutions by enacting market reforms and applying best practices seems to be promising for catalyzing new investment and fostering growth without burdening other member states. However, policy lags are important and it may take some time before the private sector reacts to an improved institutional framework. Especially for the countries exiting the long tunnel of consolidation programs, enacting radical market reforms may face a wave of socio-political resistance reminiscing of the post-EMU fatigue as mentioned earlier.

This leaves the option of enhancing investment activity as the most realistic in political terms and promptly delivering in economic terms. Describing the multiple effects that investment could have had on the Euro Area, Della Posta et al. (2019) underline the fact that in some peripheral Eurozone countries, aggregate demand and investment (especially public investment) are far from having recovered, thus explaining why they continue to have sluggish growth and fall away from their peers. To overcome this, they suggest a grand investment plan capable to stimulate both current and medium-term GDP growth. Moreover, it will definitely contribute to the stabilization of public debt as a ratio of GDP and might even help in the restoration of a pro-European sentiment in those countries.

However, underinvestment has been so vast in the recent past that even such an ambitious plan may not be enough. Barkbu et al. (2015) found that the shortfall in investment not explained by recession amounts to 3-6% of GDP, and suggest that to overcome the problem a *'complementary policy action at both the national and the euro area levels'* is needed in order to speed up investment in the non-residential sectors.

Arguments for raising, innovating and transforming productive capital and infrastructures in the Euro Area are becoming overwhelming. The investment initiative known as the 'Juncker Plan' helped to launch a number of major investment projects in post-crisis economies, though the amount of funds were clearly far below the critical mass needed to make them change course and embark on a sustained growth path. To strengthen the process, Fernandes (2019, p. 21) suggests to adopt the recommendation made by the European Trade Union Confederation for the establishment of a European Treasury for public investment.

Even the central bank's *zeitgeist* seemed to be more radical nowadays, as the new president of ECB took the unparalleled step to invite Germany and the Netherlands to use their fiscal surpluses in order to spur investment and boost growth both at home and in the rest of the Euro Area.[5] Striking a rare resonance with public sentiment and positive aspirations, both the outgoing and the incoming presidents of the ECB stressed the need for more investment as the single most important action to boost the economies in the Euro Area and avoid a new recession. In one of his last public lectures as ECB president, Draghi emphasized that "*the most effective response [...] would be an investment-led stimulus at the euro area level*".[6] Adopting a similar tone in her inauguration speech a few weeks later, the new ECB president went further to argue in favour of increasing public spending on investment. Drawing a distinction between general government spending and "productive expenditure — which, in addition to infrastructure, includes R&D and education", the new ECB Chief admitted that productive investment had fallen as a share of overall public spending in most

Eurozone countries, urging that "new investment needs are emerging" Lagarde (2019). It remains to be seen whether such wording opens up a new era of policy action to restore growth or is another chapter of high moral lecturing without practical consequences.

5. Conclusions

Using a simple framework of analysis, the paper demonstrated that the process of convergence in per capita GDP first weakened, after the commencement of the single currency, and then reversed in the event of the global financial crisis. The only evidence of convergence is obtained after including the countries that joined the Euro Area during the last decade. Taking into account, however, that their leap onto high-growth paths is mostly explained by the policies of removing soviet-style rigidities and boldly adopting a series of market reforms, makes a repetition difficult to imagine. A similar opportunity is hardly realistic to appear again, either for the same or any other group of countries in the Euro Area, at least anytime soon and at the same pace and enthusiasm. A crucial finding among the older members of the Euro Area was that convergence dynamics were completely reversed leading to a polarization in the economic circumstances of the southern countries versus those of their northern most-developed peers.

Investment differentiation was a crucial factor in generating the North-South dichotomy before as well as after the crisis, albeit for different reasons. In the post-EMU era, it was the composition effect of investment toward tradeable and non-tradeable sectors in the Northern and Southern countries respectively. The different patterns quickly led to asymmetric and hugely diverging current accounts that subsequently necessitated the bailouts and fiscal consolidation programs. In the aftermath of the crisis, however, divergences appear to be sizable in other areas as well, such as public indebtedness, the efficiency of institutions and the intensity of investment activity as a whole.

Therefore, an investment plan across all the economies of the Euro Area seems to be the most effective policy approach in fostering growth and restoring convergence dynamics. The access to cheap borrowing in world markets creates new opportunities for financing EU-wide and country-specific investment projects implemented by either the private or the public sector.

Future research will further investigate the links between public indebtedness, institutional quality and investment activity in order to establish how all currently diverging areas follow a more integrated pattern. To make their implementation more effective, policy priorities should be placed in the new framework of economic governance that is under preparation for the Euro Area.

Notes

1. Athens University of Economics & Business, and Hellenic Observatory, LSE. Email address: nchris@aueb.gr and N.Christodoulakis@lse.ac.uk
2. To facilitate comparison, both values expressed in constant 2015 prices.
3. As noted by Barrios et al. (2009) the explosion of sovereign spreads that sparked the crises of the European periphery occurred in countries with large external deficits even if their fiscal position looked healthy. For a relevant discussion, see Christodoulakis (2016).
4. Slovenia was the first to join in 2007, followed by Cyprus and Malta in 2008, and Slovakia in 2009. After the global crisis, Estonia joined in 2011, Latvia in 2014 and Lithuania in 2015.
5. Financial Times, October 20, 2019.
6. Reuters, October 1, 2019.

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Making a virtue of necessity? The economics and politics of the ECB's monetary policy, 1999-2019

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Abstract

The ECB could hardly afford political neutrality, even in the monetary union's "honeymoon phase". Being a stateless central bank entailed striking compromises between conflicting (national) monetary policy preferences. However, such compromises would often be reached at the expense of theoretical consistency and to the detriment of coherence in the ECB's monetary policy strategy. And, perhaps inevitably, they would also bear the mark of the dominant partner in the European Monetary System, that is prior to the establishment of the monetary union, now also being the biggest subscriber to the ECB's capital. Political neutrality and, for that matter, monetary activism on the part of the ECB -as well as liquidity in the euro-area- were largely inadequate during the euro area crisis, especially in its early phase. They were subsequently increased, but at a slow pace and in a preferential fashion, that is, largely to the benefit of the banking industry. Eventually, the ECB did try to make a virtue of necessity; yet, this could only go so far. Thus, the ECB has reluctantly become the only game in town, its reluctance being mostly associated with the overriding concerns of certain national central banks of the Eurosystem, most notably the Bundesbank; namely, ensuring monetary dominance, averting (at that time illusory) inflationary dangers, preventing moral hazard, enforcing structural reforms and, not least, fending off any, indirectly emerging, type of transfer union. Therefore, the ECB could have no great ambitions; its lonely game was unlikely to produce a medal-winning policy maker in the world championship of central banking.

KEY-WORDS: ECB, central bank independence, monetary policy, monetary policy strategy, transmission mechanism, zero lower bound, lender of last resort, investor of last resort.

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Την ανάγκην φιλοτιμίαν ποιούμενη; Η πολιτική οικονομία της νομισματικής πολιτικής της ΕΚΤ, 1999-2019

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Περίληψη

Η ΕΚΤ δεν θα ήταν δυνατόν να παραμένει πολιτικώς ουδέτερη – ούτε καν στην διάρκεια της πρώτης και σχετικώς ανέφελης περιόδου της νομισματικής ένωσης. Είναι μια κεντρική τράπεζα χωρίς πατρίδα και τούτο συνεπάγεται την ανάγκη συμβιβασμών μεταξύ αποκλινουσών εθνικών προτιμήσεων νομισματικής πολιτικής. Τέτοιοι συμβιβασμοί επιτυγχάνονται, όμως, εις βάρος της θεωρητικής συνέπειας και της συνοχής της στρατηγικής νομισματικής πολιτικής. Και, αναπόφευκτα, αντανακλούν την επιρροή του κυριάρχου εταίρου στο Ευρωπαϊκό Νομισματικό Σύστημα, τουτέστιν πριν από την εγκατάσταση της νομισματικής ένωσης· αυτού που σήμερα καταβάλλει την μεγαλύτερη (εθνική) εισφορά στο κεφάλαιο της ΕΚΤ. Η πολιτική ουδετερότητα και, κατά την ίδια λογική, η προενεργός νομισματική πολιτική -όπως και η ρευστότητα- ήσαν ανεπαρκείς στην κρίση της ευρωζώνης, ιδίως κατά την αρχική φάση της. Ενισχύθηκαν κατόπιν, ωστόσο με βραδύ ρυθμό και τρόπο προτιμησιακό, δηλαδή, εν πολλοίς προς όφελος των τραπεζών. Η ΕΚΤ κάποια στιγμή, πράγματι, προσπάθησε να κάνει ό,τι μπορούσε -να κάνει την ανάγκη φιλοτιμία- όμως η δράση της δεν ήταν δυνατόν να παραγάγει μεγάλα αποτελέσματα. Η ΕΚΤ έγινε, διστακτικώς, ο μοναδικός πρωταγωνιστής. Οι δισταγμοί της απηχούσαν της ανησυχίες ορισμένων εθνικών κεντρικών τραπεζών, κυρίως της γερμανικής κεντρικής τράπεζας – και συνδέονταν με την επιβεβαίωση της νομισματικής κυριαρχίας, την παρεμπόδιση του (φαντασιακού) ενδεχόμενου πρόκλησης πληθωριστικών πιέσεων, την αποσόβηση του ηθικού κινδύνου, την προώθηση των διαρθρωτικών μεταρρυθμίσεων και, ασφαλώς, με την αποτροπή του ενδεχόμενου σχηματισμού, εμμέσως, μιας ένωσης μεταβιβάσεων. Η ΕΚΤ δεν θα μπορούσε να έχει μεγάλες φιλοδοξίες. Μπορεί να υπήρξε ο μοναδικός πρωταγωνιστής στη διαχείριση της κρίσης, όμως υπολειπόταν των άλλων μεγάλων κεντρικών τραπεζών.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: ΕΚΤ, ανεξαρτησία κεντρικών τραπεζών, νομισματική πολιτική, στρατηγική νομισματικής πολιτικής, μηχανισμός μετάδοσης, κατώτατο μηδενικό όριο, δανειστής ύστατης καταφυγής, επενδυτής ύστατης καταφυγής.

1. Aspiring to be boring?

"Successful monetary policy should be boring. Successful central bankers should be seen as neither heroes nor villains, but simply as competent referees, allowing the game to flow."

(The Economist, 1999:36)

Twenty years ago, Mervyn King, former governor of the Bank of England, said that successful central banking is boring – being boring should be the aspiration of the Bank of England, he proclaimed in front of a delighted audience in Plymouth. Ten years ago, Eric Leeper, now at the University of Virginia, made a sharp contrast between monetary and fiscal policy: the former has achieved the status of science, whilst fiscal policy is still alchemy, its use (and misuse) being grounded mostly in politics, not economics (Leeper, 2010); the monetary policy-as-science view had earlier been articulated in Clarida, Gali and Gertler, 1999; however, a humbler perception is suggested in Blinder, 1997, esp. p. 17; and a strictly critical argument is made in White, 2013).

Surely, the financial crisis and the Great Recession have put such proclamations to rest. Instead of boredom, Sir Mervyn and his colleagues have felt both the anxiety and the excitement which are likely to arise when navigating uncharted waters. And they have found themselves very often criticised and accused of various sorts of things, apart from being boring. At the same time, the scientific authority of monetary policy has been seriously challenged as central banks have broadened their operational framework employing non-standard policy instruments which might have worked in practice, despite their being theoretically disputed.[1]

Yet, for the ECB, the second most powerful central bank in the world, boredom has mostly been akin to an "inaccessible ideal". The phrase was coined by Gerard Debreu in order to denote what theoretical physics had actually been for early economic theory and to describe how striving for that ideal grew into a strong stimulus in the mathematisation of economic theory and its scientific advancement (Debreu, 1991). Which brings us to the monetary policy-as-science issue, but only to question the relevance of that argument in the case of the ECB, regardless of the time and stage of the European monetary unification process. As a matter of fact, the monetary policy strategy of the ECB has seldom been free of controversies, obviously not during the negotiations on making the European monetary union and designing its central bank (James, 2012, esp. pp. 304-317), nor following realisation of the single monetary policy for the euro area. Although such controversies are technical in character and content, they fundamentally reflect clashes of ideas (James, 2012; Brunnermeier et al., 2016). Yet, ideas about money and monetary policy are often demarcated along national lines and, thus, aligned to national interests and policy preferences. Notwithstanding the role of technocrats in resolving monetary policy disputes, a role that was prominent during the negotiations and has formally been exclusive -that is, institutionally independent- following the establishment of the single monetary policy, politics has implicitly, at least, thrown its weight around.

Feelings of anxiety and excitement had in all likelihood been prevalent amongst policymakers of the newly established ECB. Besides maintaining price stability *per se*, affirming their anti-inflationary credibility and upholding their reputation for effectively minimising the ECB's loss function had certainly been daunting tasks, albeit crucial in order to keep inflation expectations firmly anchored. Thus, during the first decade of the economic and monetary union -its nice decade, to borrow again a metaphor from one of Mervyn King's speeches-[2] a lot of ECB intellectual capital and institutional resources were spent in forging, calibrating and reforming its monetary policy strategy. Putting in place and adjusting its decision-making procedures and rules of conduct, whilst reinforcing the microeconomic foundations of the monetary union, had also loomed large in the ECB agenda.

In spite of the self-congratulatory and optimistic tone of official reports published on the occasion (for example, Commission EC, 2008), the tenth anniversary of the European monetary union marked the beginning of a nasty second decade -to make use of another metaphor-[3] associated with the global financial crisis and, in particular, the euro area crisis. The ECB has since, reluctantly is often said, been the only game in town;[4] or, so the argument goes. Yet, fending off the (twice) heightened risk of currency redenomination, ensuring financial stability and providing for macroeconomic stabilisation have called for the introduction of new -so-called unconventional, or non-standard- policy instruments as well as making intensive use of the existing -conventional, or standard- ones. Discretion has, for all intents and purposes, outweighed rules in monetary policy-making, whilst policy choices and realisation of trade-offs have inevitably involved an element of experimentation, thereby often producing unforeseen direct or side effects and giving rise to unintended consequences. Furthermore, the ECB has assumed hitherto untried, if controversial roles.

Therefore, the powers and capabilities of the ECB have been stretched to their limit and that has caused fierce disputes pertaining to the economic soundness and legal legitimacy of ECB policies. In case there had ever been a doubt, resignations of three German members of the ECB's Governing Council -two of them being also members of its Executive Board- have clearly made evident that clashes of ideas and divergence of preferences as to the monetary (and the fiscal, for that matter) order in the euro area have been running deeper, much to the detriment of market and people's perceptions of the authority of the ECB. Thus, politics has, perhaps unsurprisingly, been making inroads into the politically independent realm of European central banking. Not only have leading politicians in some euro area countries been furiously critical of ECB policies, but they also have, somehow paradoxically, been alleging that the ECB has effectively compromised its independence. Perhaps again, for all its achievements and shortcomings the ECB should invariably -that is, on both positive and normative grounds- be treated as the manager of a stateless currency, a technocrat on paper but a politician of sorts in the real world, especially when things turn sour. However, such an arrangement may be destined to fail.

This paper elaborates on the aforementioned arguments, thereby developing a political economy perspective on the ECB's monetary policy and practice. Thus, in the next section an attempt is made to assess the role and appraise the performance of the ECB during the ten years following the introduction of the single currency. The third section deals with the response of the ECB to the global financial crisis and to the euro area crisis and its aftermath; it focuses on the functions undertaken, the instruments employed and the reforms put into effect, but also delves into the controversies surrounding the ECB's activist stance. The final section concludes; and it also touches upon the main issues relating to the ECB's monetary policy at the zero lower bound and the questions and dilemmas raised in redrafting the central bank's monetary policy strategy.

To that effect, the ECB and its monetary policy are placed, albeit cursorily, within the broader institutional context of the European monetary and economic union. Besides, neither assessing the role and the performance of the ECB thus far, nor advising on its monetary policy strategy henceforth could accurately and fairly be accomplished, unless attention was duly paid to the constraints built into the institutional set-up of the monetary union – but also, to the second-order incentives which might be likely to ensue.

2. Going by the book, with strings attached

"Some observers have criticised the strategy as 'asymmetric'. In other words, they argue that the Eurosystem is more concerned about inflation than it is about deflation… I reject this criticism. The use of the word 'increases' in the definition imposes a floor of at least zero for the lower bound… Let me state categorically, as I have often done in the past, that neither prolonged inflation nor prolonged deflation in the euro area would be deemed by the Governing Council to be consistent with the maintenance of price stability… Others criticise the 'prominent role of money' in our strategy… I do not agree with these criticisms of the role of money in our strategy. There is little doubt that monetary aggregates in the euro area exhibit a close relationship with inflation…"

(Willem F. Duisenberg, 1999)

The statutory objectives of the ECB are clearly prescribed in the Treaty on European Union – and the Treaty on the Functioning of the European Union. The ECB's primary objective is to maintain price stability. And provided that the objective of price stability is fulfilled -without prejudice to the objective of price stability, in Treaty language- the ECB can take into account growth and full employment – the ECB supports the general economic policies in the European Union with a view to contributing to the achievement of the objectives of the European Union, in Treaty language. Accordingly, the ECB is mandated to define and implement monetary policy for the euro area. Yet, in relation to other tasks, most notably safeguarding financial stability and prudential supervision of credit institutions, the ECB is only assigned a contributing role – but since 2014 the ECB has been entrusted with the role of banking supervision in the European Banking Union, thereby having been brought into line with several central banks' institutional and policy acquis.

The monetary policy strategy of the ECB was first announced by its Governing Council in October 1998, three months before the introduction of the euro. It entailed two interrelated aspects, namely definition of price stability and the framework for the analysis of price developments and risks to price stability; and thus, it also provided the skeleton for communicating the policy actions of the ECB, whilst allowing for the ECB being held publicly accountable in a comprehensive way. Specifically, the Governing Council adopted a quantitative definition of price stability as a year-on-year increase of below 2% in the Harmonised Index of Consumer Prices for the euro area as a whole, at the same time placing emphasis on the medium-term orientation of the monetary policy of the ECB – however, precluding intentions to depict the medium-term orientation as a fixed term horizon.

Yet, the most distinguished aspect of the monetary policy strategy of the ECB was its so-called two-pillar framework for the analysis of price developments and risks to price stability. The first pillar attributed a prominent role to money, thus echoing the fundamental conception of the quantity theory of money: in the long term, inflation and, for that matter, deflation are monetary phenomena. In that vein, a guideline for the growth of a broad monetary aggregate -in particular 4.5% annual growth of M3- was also endorsed by the Governing Council. In parallel to the monetary pillar -but not quite on a par, at least by way of nominal ordering- a second pillar was inserted within the analytical framework. Thus, price developments and risks to price stability were (also) appraised on the basis of (other than monetary, but not preset) economic and financial indicators, that is, measures of causally relevant economic and financial variables. In that sense, the second pillar reflected the New Keynesian approach to monetary theory and macroeconomics.[5]

The monetary policy strategy of the ECB was carefully explained. The quantitative definition of price stability was thought to strengthen the ECB's accountability since it implied that the ECB would have to explain contingent deviations of inflation from its own benchmark. And that was also deemed to provide for better anchoring of medium and long-term expectations (Issing et al., 2003). Furthermore, the medium-term orientation of the ECB's monetary policy was highlighted for its properly taking into account the variable and at times protracted lags in the transmission of monetary policy shocks, thereby ditching excessive policy activism and motivating the ECB to act in a forward-looking fashion (Hartmann and Smets, 2018). Besides, focusing on the medium term would enable the ECB to appropriately respond to supply shocks, especially oil price increases, as it effectively directs attention to the second-round (wage and price) effects of such price increases, whilst averting virtually unwarranted policy actions which might also induce volatility and threaten employment and output stabilisation. As a matter of fact, it had already been shown that, regardless of the specification of the objective of price stability -whether it is a price level target or an inflation target- a prolonged policy horizon amounts to a higher weight on output stabilisation (in the reaction function or the loss function of a central bank), (Smets, 2003; also Svensson, 1997).[6]

Turning to the two-pillar analytical framework, it was maintained that, by giving prominence to the role of money and on account of money's medium to long-term neutrality, the medium-term orientation of the monetary policy of the ECB was practically ascertained. Furthermore, monitoring the growth of money -maybe, alongside other monetary indicators- was thought to provide timely indication of risks to financial stability; besides, asset price inflation and, in particular, asset price bubbles can destabilise economic activity and threaten price stability (Issing et al., 2003). Hence, focusing on monetary developments could, in theory, prompt the ECB to adopt a leaning-against-the-wind policy stance – yet, there has been no evidence that the monetary policy of the ECB has ever taken that course of action (Hartmann and Smets, 2018).

The two-pillar analytical framework allowed for harnessing information on both long-term price movements -propelled by money growth- and high frequency movements of inflation -driven by supply and demand developments and, thus, being the subject of analysis within the economic pillar. In other words, the two-pillar framework allowed for cross-checking of long and short-term determinants of inflation, thereby advancing on the conventional practice -including the time horizon- of projection, and possibly ensuring that the monetary policy of the ECB is on the right track (Issing et al., 2003). Lest it be understated, the two-pillar framework and, in particular, the prominent role of money should, perhaps primarily, be conceived as a form of collateral pledged in order for the ECB to borrow the Bundesbank's credibility for price stability (more on that later) – and/or as evidence of the unrivalled influence of German and other like-minded central bankers.

For all its rationalization, the monetary policy strategy of the ECB was not indubitably justified. Mainstream academic criticism -not least from macroeconomists attesting to the New Keynesian "divine coincidence" conception of inflation targeting (Blanchard and Gali, 2007)- drew attention to various shortcomings in the ECB's quantitative definition of price stability. Thus, reliance on the Harmonised Index of Consumer Prices was found to impart an upward bias in the (so measured) headline rate of inflation – although the actual rate of inflation might well be lower. On top of that, the core (or underlying) rate of inflation was thought to (more) accurately reflect medium to long-term price developments, by filtering out of headline inflation volatile food and energy prices, computational misgivings notwithstanding. More importantly, the 2% ceiling in the definition of price stability -associated with the lack of a lower bound- was said to be inherently asymmetric, thereby giving rise to the risk of undesirably low inflation, if not outright deflation (see *inter alia* Wyplosz, 2003; De Grauwe, 2005, esp. chapter 8).[7]

Besides asymmetry as such, the 2% ceiling was deemed to be very low, or for that matter, excessively aggressive owing to various considerations. Thus, downward nominal wage rigidities, perhaps related to both employees' and employers' distaste of nominal wage cuts, imply that some inflation -maybe higher than the ECB's 2% ceiling- is conducive to easier reduction of real wages, thereby providing for a speedier adjustment of the economy to shocks (Akerlof et al., 1996). Moreover, inflation differentials within the euro area are wide and persistent. Therefore, in countries inhabiting the low end of the distribution of inflation rates the unpleasant effects of downward nominal rigidities -mainly unemployment- could be magnified, whereas in countries residing in the upper end of the distribution there is a substantial risk of inflationary dynamics becoming entrenched. What is more, asymmetries across the countries of the euro area exist both with regard to the macroeconomic shocks to which countries are exposed and in respect of the transmission of monetary policies. Thus, reliance of interest-rate setting decisions on monetary union-wide data only -that is, lack of accounting for national inflation and output gap projections- could result in sub-optimal monetary policies (De Grauwe and Sénégas, 2003) – thereby, also reinforcing the growth of inflation differentials (more on that later). Last but not least, the 2% ceiling may fall short of safeguarding against the event of interest rates hitting the zero-lower bound.

Criticism was directed towards the prominent role attributed to money, monetary analysis and, ergo, the two-pillar analytical framework of the ECB's strategy too. Fundamentally -that is, at the level of theoretical foundations and empirical observation and largely echoing Keynesian ideas- doubts were raised with regard to the definition of money and the M3 approximation, the (assumed) stability of money demand and the predictability of price developments on the basis of broad monetary aggregates, to mention but a few – arguably, the main points at issue. Additionally, the two-pillar framework, in particular the monetary pillar, was said to function poorly when it comes to communicating the ECB's stance. That was ascribed to misinterpretations being given rise to (for example, concerning the exact meaning and scope of the reference value for the rate of growth of M3). And it consequently was pinned on noise being effectively imported, thereby distorting the public's understanding and markets' perception of ECB's signals.

In their detailed analysis of the ECB's monetary policy during its first twenty years, senior ECB officials Philipp Hartmann and Frank Smets (2018, esp. pp. 14-17) explain *inter alia* the central bank's reactions to macroeconomic and monetary developments and risks in the course of the ECB's first interest cycle or, the first business cycle managed by the ECB – to borrow the two co-authors' dual characterisation of the period January 1999-June 2003. The main factors driving business cycle fluctuations in the euro area -and main issues of concern for the ECB- consisted in volatility in global financial markets, variations in oil and import prices, movements in the euro exchange rate, and (uncertainty inciting) geopolitical tensions. Thus, in response to changing macroeconomic conditions -in essence, inflation and output forecasts- the ECB's monetary policy moved through phases of loosening and tightening. More concretely, the interest rate on the main refinancing operations (the ECB's main policy rate) was reduced from 3% to 2.5% in April 1999,[8] whilst a series of interest rate increases were engineered between November 1999 and October 2000, by that time bringing the main policy rate to 4.75%. Yet, those interest rate increases were later more than offset. Indeed, between September 2001 and June 2003 the ECB cut its policy rates by a total of 275 basis points; as a result, in June 2003 the main policy rate was brought to a then historic low level of 2%.

During those first four and a half years of the ECB, price stability -at least in the ECB's own definition- was mostly maintained. As a matter of fact, in early 1999 inflation rates were very low, even reaching levels lower than 1%. That was largely accounted for by the earlier disinflationary policies which, alongside fiscal consolidation, were earnestly pursued by member states' authorities in order to meet the convergence criteria, thereby becoming eligible to adopt the single currency (Praet et al., 2019). Subsequently, though, average annual inflation rose and peaked at 3% in early 2001, on the back of strong output growth and, also, reinforced by a rapidly depreciating euro exchange rate. Following concerted foreign exchange interventions by the ECB, the Fed and the Bank of Japan in September 2000, the euro exchange rate appreciated considerably, whilst the growth outlook took a turn for the worse. Thus, although average annual inflation hovered slightly above 2% from 2000 to mid-2003, no inflationary pressures were seriously contemplated. As a matter of fact, long-term inflation expectations were evidently drifting down and, with interest rates having fallen to a historically low level, the risk of nominal interest rates hitting the zero-lower bound was unlikely to be dismissed in academic and policy debates (Praet et al., 2019; for an early identification and analysis of that risk in the then prevailing economic circumstances, see Krugman, 1998).

The first business cycle managed by the ECB was thought to contain enough evidence that the ECB did acquire (the much sought after) anti-inflation credibility (Hartmann and Smets, 2018). Leaving aside the definitional nuances and the theoretical, empirical and policy-focused controversies surrounding the issue of anti-inflation credibility (see Forder, 2004 and references therein; for a closely related argument see Posen, 1995), one might, yet, question such an unqualified verdict. Not only was the emerging risk of a liquidity trap likely to turn the objective of anti-inflation credibility on its head -at least, to foster perceptions of that being the case- but the intellectual integrity and persuasiveness of the ECB's claim of anti-inflation credibility might also be cast in doubt in view of the inconsistencies pertaining to the central bank's implementation of monetary policy. What was primarily at issue was the real role attributed to money -and the actual relevance of monetary analysis- in the ECB's practice. For instance, money growth (M3) in excess of the reference value was no deterrent to the

ECB's lowering of policy rates in April 1999, whereas it was argued to dispel the case for further interest rate cuts in 2003. But, if the coherence of the ECB's monetary policy was disputed, one might also wonder whether the achievement of price stability reflected the competence and, for that matter, the credibility of the central bank. One might, instead, consider that the job of the ECB -admittedly, of other central banks too- was being made much easier with increasing globalisation (on the disinflationary effects of globalisation, see Pain et al., 2008; also Rogoff, 2003); or, that luck had simply not been scanty.

The 2003 review of the monetary policy strategy of the ECB was an attempt to address such criticisms. It led to two main changes. First, the objective of price stability was redefined – clarified, in the ECB's jargon. Thus, the Governing Council would aim at a yearly inflation rate of below but close to 2% over the medium term. Second, the (prominent) role of money -the monetary pillar- would be downgraded. That was reflected in the decisions to end the annual review of the reference value for M3 and restructure the introductory statements of the President at the monthly press conferences on the ECB's monetary policy, thereby putting economic analysis ahead of the monetary analysis. Those changes were mostly welcome by academic economists advocating inflation targeting. By redefining the objective of price stability, it was reckoned, the risk of undesirably low inflation was curtailed and the probability of the nominal interest rates hitting the zero-lower bound much lowered. Downgrading the role of money growth was also consistent with empirical evidence on instability in the demand for money; also, fluctuations in M3 growth were evidently not linked to medium-term price developments (Hartmann and Smets, 2018, p. 18).

Besides, borrowing the Bundesbank's anti-inflation credibility was likely to be no longer needed. If "credibility is won through systematic, coherent action" (Issing, 2005, p. 71), the ECB had probably done its bit. After all, the establishment of the monetary union was no less than a major regime change associated with almost pure (Knightian) uncertainty in regard to the structural properties and the statistical regularities describing the euro area and fed into the ECB's economic model (Rostagno et al., 2019). And the 2003 review was precisely an attempt to remove remaining contradictions. Yet, downgrading the role of money growth also meant that a formal excuse for opting for a leaning-against-the-wind approach, in case there was a risk to financial stability, was effectively relinquished. What is more, the 2003 review did little to address inflation differentials across the euro area countries. One could thus argue that, at that time, it mostly catered to the preferences of the low-inflation countries of the core of the euro area. Alas, the 2003 review also marked the beginning of a period of growing financial and macroeconomic imbalances (2003-2007).

Indeed, the thorniest issue -arguably, those espousing the theory of endogenous optimal currency areas would not use that or any synonymous adjective- was that of sizable and persistent inflation differentials between euro area economies (Darvas and Wolff, 2014).[9] Such differentials may be caused by temporary factors, primarily including divergent cyclical developments and dissimilar fiscal policies, as well as structural factors, in particular the so-called Balassa-Samuelson effect. The latter attributes inflation differentials to diverse productivity trends between the tradable and the non-tradable sectors; and it relates such productivity trends to economic convergence across euro area countries. Hence, the Balassa-Samuelson effect describes an equilibrium process. Regardless of their underlying cause, inflation differentials and the associated current-account disruptions are mitigated via adjustments in the real exchange rate (Koutsiaras, 2005, esp. pp. 44-5). Yet, structural imbalances are ultimately remedied as a result of investment capital flowing into the (higher-productivity) tradable sectors in lower-income euro area countries (Koutsiaras and Manouzas, 2016).

As previously mentioned, not only inflation differentials *per se*, but broader and deeper asymmetries across the euro area countries imply that the ECB should not exclusively rely on monetary union aggregates when setting its policy rates; it should also pay sufficient attention to the relevant national (macro-)economic indicators. In a similar vein, discussion is often made on the appropriate, yet implicit, country weighting scheme in the ECB's reaction function -that is, the weighting scheme for national policy-rate preferences- in order for the loss of monetary autonomy to be less costly and national business and inflation cycles to be better synchronised. This is an empirical matter; still, the literature remains inconclusive (an attempt at estimating implicit country weights in the ECB's reaction function is made in Sturm and Wollmershäuser, 2008; see also Pereira and Tavares, 2019). It is no less a political question, pitting the preferences of the high-income, low-inflation, surplus countries -in effect, the core countries- against the preferences of the low-income, high-inflation, deficit ones – in effect, the peripheral countries. That being the case, the ECB's monetary policy could neither be optimal for all, nor actually depoliticised.

No doubt, redressing inflation differentials and current-account imbalances depends, to no small extent, on (national) fiscal policies. Thus, it hinges on fiscal stability, including compliance with the numerical rules of the Stability and Growth Pact and countercyclical fiscal policy;[10] and, in general, it bears on the quality of public finances (for a conceptual and empirical analysis of the quality of public finances in EU member states, see Barrios and Schaechter, 2008). Yet, redressing inflation differentials and current-account imbalances crucially relies upon market processes and qualities, comprising responsiveness to demand and supply shocks and efficient resource allocation. The former refers to domestic product and labour market flexibility. The latter relates *inter alia* to European market integration, in particular, financial integration coupled with -rather uncoupled from in practice- effective regulation and supervision of financial markets and banks. There is a twofold question at this point: does the ECB have any, mostly auxiliary or indirect, role to play in those policy areas and, accordingly, how has it actually fared?

As a matter of fact, communication on fiscal policy and structural reforms has evidently been a standard practice in central banking – although the literature has largely dealt with communication of monetary policy to financial markets and the public (Blinder et al., 2008). That should cause no big surprise, once account is taken of the, often, positive thrust of central banks' statements on fiscal and structural policy. Indeed, the stance of monetary policy is partially shaped by fiscal policy and market adjustability – and economic agents and the public need to be informed to that effect. However, the ECB's communication on fiscal policy and structural reforms has been more frequent -and heavier- than that of the other major central banks; and, perhaps unsurprisingly, the ECB's pronouncements on fiscal policy have largely been normative in nature – preaching the benefits of cutting deficits (Allard et al., 2012).

Yet, the ECB has never contemplated the option of providing (monetary) stimulus for coordinating national governments' policies to enrich the quality of public finances and implement structural reforms, thereby giving teeth to so-called soft -and rather ineffectual- methods of coordination being then in place. More precisely, the ECB has never signaled any intentions to accommodate reforms, on the condition of their being credibly implemented; or, in today's parlance, it has never committed itself to future reform-accommodative actions, in the way of state-contingent forward guidance (on the latter, see Samarina and Apokoritis, 2020). In fact, the ECB has explicitly ruled out such a case.[11] Yet, in so doing it has ignored both economic theory and political economy thoroughly pointing to the contrary – and that, without prejudice to the objective of price stability (Koutsiaras, 2001).

On the other hand, the ECB has been instrumental in fostering financial integration, and with good reason. Financial fragmentation would preclude the convergence of prices of same-risk assets across euro area countries, thereby perpetuating the divergence in nominal interest rates for similar firms and, given inflation differentials, exacerbating differences in real interest rates (Darvas and Wolff, 2014). Not only would the transmission of monetary policy be impaired, but, much worse, asymmetries across euro area countries would be growing further, thus making costlier the loss of (national) monetary autonomy and further driving apart business and inflation cycles. On top of that, resource (especially capital) allocation across euro area countries would seriously be distorted, thereby undermining convergence dynamics.

Fostering financial integration was, in principle, justified and desirable. However, the ECB was overly optimistic that higher and deeper, yet poorly regulated, financialisation would both provide for the efficient allocation of capital across euro area countries and economic industries and allow for the monetary policy getting optimal and better transmitted. Underlying that optimism was the ECB's -and many other central banks'- attesting to the efficient market theory and subscribing to its policy implications. Hence, the risks of irrational exuberance and asset-price inflation were practically discounted and the perils of financial dominance neglected (on the latter, see Dietsch et al., 2018, pp. 63-71). Thus, one can partly explain why, as time went by, the ECB virtually turned a blind eye to money-growth trends when setting its policy rates,[12] the formally advanced reasons notwithstanding. Furthermore, the ECB's actual distaste for a leaning-against-the-wind policy can accordingly be interpreted. This very argument might also go some way towards explaining why the ECB was, in the first place, assigned a secondary role only in matters of financial stability and prudential supervision of credit institutions. Besides, the ECB was eagerly promoting the cause of financial markets' self-regulation (Fontan, 2018, p. 166).

In fact, the ECB threw its weight alongside the European Commission in pushing for the liberalisation and unification of national repo markets, as a remedy for financial fragmentation. And, pursuant to that end, the ECB adapted its own collateral framework in accordance to -and in a sense complementing- the provisions of Directive 2002/47/EC on financial collateral arrangements (for a detailed account, see Koutsiaras and Manouzas, 2016). That led to government bonds being treated as risk-free, regardless of national origin, in repo transactions with the ECB, thereby encouraging investment in peripheral euro area bonds. As a result, the prices of peripheral euro area bonds increased and their yields went down; nominal interest rates across euro area countries converged, interbank lending expanded and euro area banks' balance sheets grew exponentially; besides, substantial capital flows took place from core euro area banks to peripheral economies.

However, not only were such capital flows sizeable -and the balance sheets of banks oversized- but they were largely used in funding the peripheral economies' non-tradable sectors, be they governments or construction industries. Thus, peripheral euro area countries were afflicted with the so-called Dutch disease, whereby the equilibrium process described by the Balassa-Samuelson effect was virtually reversed (Koutsiaras and Manouzas, 2016). Private and/or public debt in peripheral countries reached unsustainable levels and economic and financial imbalances, including asset-price bubbles and too-big (and interconnected)-to-fail banks, were built-up. In the words of Dietsch et al. (2018, p. 61), "[t]he combination of those factors set the Eurozone up for the perfect storm when the financial crisis hit", resulting *inter alia* in interbank lending being frozen and government bonds of peripheral countries being dumped – and their yields sharply increasing.

3. Turning unconventional: Meanings and labours, gains and losses

"I proposed an analogy, to associate the "standard" measures with the ethic of conviction and the "non-standard" measures with the ethic of responsibility. It is equally important to preserve integrity between intention and action, and between action and consequences. Our 'separation principle' proposes a way to preserve both."

(Jean-Claude Trichet, 2011)

"The concept of "monetary policy transmission" is fundamental to the activities of a central bank, i.e. the process by which changes in the benchmark rate of interest of a central bank are transmitted through the financial system to the real economy."

(Mario Draghi, 2012)

The period of so-called Great Moderation -and unhidden, but largely unappreciated global and European imbalances- came to an abrupt end. Mainstream macroeconomic theory was evidently found wanting. Thus, central banking had to find its own way through a global credit crunch, huge financial landslides and the greatest recession since the Great Depression of the 1930s. Sooner or later, monetary policymakers needed to improvise; but whether it was sooner rather than later did surely make a difference. Doubtless, the challenge for the ECB was even tougher. In Europe, the financial crisis developed into an economic, political and institutional crisis when financial investors betted on the creditworthiness -or lack thereof- of several euro area sovereigns, thereby threatening the integrity of the monetary union. And the ECB is the manager of a stateless currency. Monetary dominance in the euro area is realised over decentralised fiscal policies which are institutionally (cf. the Stability and Growth Pact) Ricardian in character, but often manage to escape the scripture.

During the early phases of the crisis, the ECB's monetary policy was guided by the so-called separation principle: interest rates were set in order to boost demand and bring the rapidly falling level of prices back to its (below but close to 2%) objective; and provision of liquidity aimed at addressing severe tensions in the interbank and other short-term money markets. Thus, from October 2008 to May 2009 the ECB lowered its policy rate by 325 basis points (from 4.25% in July 2008 to 1% in May 2009); it provided credit to (even creditworthy) banks which failed to secure funding in financial markets at (market) rates close to zero from early 2009. Provision of liquidity was

Initially realised via the main refinancing operations (cf. fixed-rate full allotment policy); and following the collapse of Lehman Brothers, longer-term refinancing operations (LTROs) were also introduced – and later re-introduced. Most importantly, the collateral requirements were substantially eased (and/or the range of eligible assets that could be pledged as collateral expanded). Furthermore, a covered bond purchase programme (CBPP) was implemented in July 2009 -and repeated twice, in 2011 and 2014- aiming at stabilising markets for those securities, thereby easing banks' refinancing problems. Thus, demand for liquidity on the part of sound credit institutions was virtually met in full, thereby allowing for the restoration of longer-term interbank lending commitments (Honohan, 2019, pp. 90-91).

It is true that the ECB was bold enough in those lending-of-last-resort actions, whilst the Bank of England and the Fed were initially hesitant and/or effectively constrained in their liquidity- management initiatives (Brunnermeier et al., 2016, p. 326). And, probably as a result, tensions in financial markets eased and spreads -capturing risk differentials across maturities of interbank unsecured lending commitments- stabilised, albeit at levels higher than before the crisis (Praet et al., 2019, pp. 97-98). However, that can only go so far in proclaiming the glory of the ECB during the early phase of the crisis (as argued in Brunnermeier et al., 2016, pp. 325-326). In fact, the Fed reduced its policy rate earlier than the ECB and in a more aggressive manner; from October 2007 to December 2008 the policy rate was reduced by 450 basis points (from 4.75 in September 2007 to 0,25% in December 2008). Also, in December 2008, the Fed launched its forward-guidance policy and asset-purchases programme, thereby embracing a much proactive approach.

Furthermore, it has been argued that the beneficial effect of the ECB's supply of liquidity was mostly related to the provision of dollars procured via swap operations with the Fed and channeled towards European banks struggling to refinance their short-term unsecured dollar debt (Mody and Nedeljkovic, 2018). What is more, whereas the ECB's euro liquidity operations helped to allay distress in financial markets, they fell short of reviving the bank-lending activity – and economic activity at large. As a matter of fact, demand for loans remained weak, whilst banks were also not eager to supply, which is a typical manifestation of a (corporate and household) balance-sheet recession (the concept is analytically founded in Koo, 2011). Thus, seeking to maintain their profitability, European banks used the ECB liquidity to embark on carry-trade operations. In the peripheral euro area countries, especially, banks used the ECB-supplied liquidity to buy their own government bonds, which paid a relatively high interest rate. Bond spreads were slightly reduced, but the banks-sovereign (lethal) nexus was at the same time deepened: not only were banks increasingly exposed to sovereign risk, but sovereign default premia were also pushed up (Mody and Nedeljkovic, 2018). Such carry-trade operations on the part of European banks were unsurprisingly reinforced as new (very) long-term liquidity-provision measures were put into effect (Fontan, 2018, p. 175).

By May 2010 sovereign bond markets in peripheral euro area countries were becoming increasingly distressed. Thus, in parallel to its lending-of-last-resort operations in support of the banking system, the ECB took up an investor-of-last-resort role in virtually illiquid secondary sovereign-bond markets via its securities markets programme (SMP), (the investor-of-last-resort concept is introduced in Caballero et al., 2019). Henceforth, the (national) central banks of the Eurosystem were enabled to make large-scale purchases of sovereign bonds in secondary markets. Yet, the fact that the SMP was formally claimed to repair the monetary-policy transmission mechanism did little to appease those concerned about the programme's legal, financial and political-economic implications (for a description of the various channels through which the transmission mechanism was likely to be impaired, see González-Páramo, 2011). German central bankers, in particular, were seriously worried that the SMP was practically equivalent to (legally prohibited) monetary financing and/or a transfer-union-through-the-back-door device;[13] and that, in general, it was prone to inducing moral hazard (Honohan, 2019, p. 87). Such arguments were also raised regardless of the (stipulated) weekly sterilisation of the liquidity injected via SMP purchases, the sole purpose of which was to ensure the ECB's commitment to price stability. Those very arguments were going to resurface forcefully when the investor-of-last-resort actions of the ECB were advanced in size and scope.

Inflation nutters -alternatively hawks- would soon realise that they had very little, if any, reason to worry. Notwithstanding the transmission-mechanism justification of the SMP programme, the ECB was still holding fast to the separation principle. Thus, in April 2011, the policy rates were increased by 25 basis points and, contrary to what could prudently be expected, a further 25 basis points increase was introduced three months later. Perhaps, those inclined to side with the ECB, for intellectual, institutional or other reasons, would offer some justification for the first policy-rate increase. Inflation was at that time likely to reach 3%, by virtue of potential second-round effects of a recent surge in energy prices. Nevertheless, economic recovery was very weak and, for a large part of the euro area, hardly in sight. Thus, one may probably reflect that the April 2011 rate increase was rather premature (Honohan, 2019, pp. 91-92).[14] The July 2011 increase, though, was totally incomprehensible. The financial crisis in the periphery of the euro area was escalating, economic growth prospects were downgraded and fiscal consolidation was fully in force. The euro area was surely in need of monetary easing. Yet, the ECB's diagnosis was that monetary policy was too accommodative; and that inflation expectations had to be kept firmly anchored, thereby entailing an increase in policy rates (Mody, 2018, p. 296).[15]

Mainstream monetary theorists would find it almost inconceivable – and modern monetarist theorists simply beside the point; still, students of the political economy of central banking would plausibly argue that the SMP initiative was traded for forestalling the slightest risk to price stability. The politics of the ECB's monetary policy were thus made evident; for all its sophistication, financial and economic analysis, by itself, could seldom win the race. What is more, though, the ECB stepped into the politics of the euro area at large, whereby the interests of creditors were pitted against the interests of debtors, across and within euro area countries; and it clearly chose sides.

Martin Sandbu, an economics leader writer for the *Financial Times,* has eloquently narrated the euro area's self-inflicted damage. The latter was caused by universal fiscal austerity, ill-advised monetary policy and zombie banks exacerbating the credit crunch. And it resulted in a double-dip recession (2011-2013) and an exit from the single currency -and the threat coming thereof- being no-longer incredible (Sandbu, 2015, pp. 106-138). As Sandbu bluntly writes, "[a]t the root of all this lies the refusal to accept that debts that cannot be paid, will not, and it is worse to pretend they will -even from the point of view of collecting as much as can be had- than it is to try to manage their restructuring in an orderly manner. From that error flawed the colossal mistakes that the eurozone would go on to make, ranging from Greece and Ireland early on to the damaging stand-off with Greece in the spring of 2015" (p. 137).

Since the beginning of the euro area crisis, the ECB was adamant that debts, be they government or private, should be fully honoured. Regardless of authoritative academic opinion and International Monetary Fund (IMF) advice, Jean-Claude Trichet, at that time president of the ECB, was fiercely opposing the idea of a partial default on Greek debt in order to make the Greek economic adjustment programme sustainable and socially less costly. And he persistently demanded that the Irish banks' solvency be restored with taxpayers' money, instead of asking creditors (bondholders) to bear losses. Part of the explanation is surely ideational: the ECB wanted to uphold (policy and institutional) credibility, safeguard investors' confidence and avert moral hazard. The ECB was almost fully in principle, and quite often in practice, aligned with German policy preferences – but that was about to change to some extent as the time went by. Interestingly though, Jean-Claude Trichet did his best to kill off a plan for "orderly insolvency" sponsored by German Chancellor Merkel and French President Sarkozy (the so-called Deauville agreement, October 18th, 2010). At the same time, he championed the idea of automatic sanctions being imposed on fiscal sinners, although the German government had already abandoned its earlier demands to that effect (Mody, 2018, pp. 273-276).[16]

What was primarily at issue was the ECB's concern to preserve the stability of mostly French and German banks at that time exposed to Greek sovereign bonds; and, generally, to alleviate the losses incurred by private financial institutions exposed to risky assets – alas, via socialising such losses. At issue was also the ECB's aversion to the risk of its balance-sheet incurring losses, thereby putting its independence at risk too (on the subject of a central bank's loss of capital and the financial, economic and policy implications, with emphasis to the Eurosystem, see Buiter, 2008). The ECB's worries about the health of its balance sheet were mostly incited by its SMP purchases rather than its open market operations.[17]

Thus, it may cause little surprise that the ECB kept on opposing the restructuring of Greek government debt, regardless of the euro area governments' unanimously agreeing, in May 2011, on the partial write-down of Greek sovereign debt. Private sector involvement (PSI) -as was euphemistically called- entailing the voluntary, in name, participation of private sector creditors, was part and parcel of a second rescue programme; and it was only agreed upon when it became evident that the Greek government could no longer service its debt. However, Jean-Claude Trichet threatened that the ECB would stop accepting Greek bonds as collateral in the central bank's open market operations. It took time to specify the details of the Greek PSI and, finally, in March 2012, it was decided that the face value of bonds held by private creditors (in total, 200 billion euros amounting at that time to 60% of the Greek sovereign debt) were to be cut by half. Meanwhile, the

ECB had given its assent, but only after it was made whole via a separate debt exchange exclusively held for the central bank – a choice that would later prove unwise (Sandbu, 2015, pp. 140-144).

Collateral policy and, especially, conditionality were the main means employed by the ECB in order to ensure that its liquidity-providing (last-resort) interventions would reinforce -rather than weaken- governments' policies to lower default risk. Yet, they were also the means for the ECB's blurring the boundaries between monetary and fiscal policy and even posing a challenge to (national) democratic politics. Thus, the eligibility of Greek bonds -issued or fully guaranteed by the Greek government- used as collateral in the ECB's refinancing operations was made conditional on the government's implementing fiscal austerity and structural reforms, in exchange for a rescue loan and the purchasing of Greek government bonds on the part of the ECB (cf. SMP). To put it precisely, a waiver of minimum credit requirements for Greek bonds was put into effect in April 2010, lifted in February 2015, following the newly elected leftwing government's rift with its creditors over the pace and the size of fiscal austerity measures, and reinstated in June 2016, following the government's capitulation.[18]

As a matter of fact, the ECB's conditionality policy -and politics- took different forms. Firstly, being a member of the Troika supervising the implementation of the economic adjustment programmes for Greece, Ireland, Portugal and Cyprus, the ECB put itself into an awkward position, at least to the informed observer's eyes. It both provided liquidity support and took part in assessing the conformity of governments' fiscal and structural reforms to the prescribed benchmarks, thereby also authorising the disbursement of rescue loans. The legality and legitimacy of the ECB's role in the Troika were questioned (Fontan, 2018, p. 171), yet the Troika would survive such challenges.

Secondly, conditionality was applied unofficially -and intensely for that matter- via the SMP operations. The governments of Portugal (prior to its May 2011 economic adjustment programme), Italy and Spain (with no programmes) were evidently pressed hard to put fiscal and structural reforms in place. Letters were sent to that effect by the ECB to the governments, the pressure being severe on the government of Italy. It took the form of making Italian sovereign bond purchases strictly conditional on the implementation of reforms, regardless of the alarming increase in yield spreads on Italian sovereign bonds. Yet, the ECB made vast purchases of Italian sovereign bonds only after the recalcitrant prime minister Silvio Berlusconi resigned – so much for the unintended consequences of the ECB's actions (Brunnermeier et al., 2016, pp. 334-336; Fontan, 2018, p. 172).

Perhaps, from a technical point of view, emergency liquidity assistance (ELA) could -indeed, should- only carry little political weight. ELA is provided at the discretion of national central banks to credit institutions pledging collateral that fails to meet the eligibility requirements in open market operations; and provision of ELA often comes at a high rate of interest. What is more, ELA implies no risk-sharing. Risk is solely undertaken by national central banks -and potential losses are accordingly borne- whereas in open market operations risk is inherently shared across the Eurosystem – and potential losses are thus mutualised. Nevertheless, the ECB's Governing Council can veto, with a two-thirds majority, a national central bank's provisioning of ELA. That was initially justified on the grounds of maintaining a well-functioning transmission mechanism of monetary policy. Following the establishment of the single supervisory mechanism (SSM), the Governing Council's role could also be directly justified on the grounds of upholding the criterion of solvency of banks receiving liquidity assistance.

The ECB's Governing Council made use of its veto power in the cases of Ireland (November 2010), Cyprus (March 2013) and Greece (July 2015). Yet, in all three cases technical justification was in short supply – to say the least, it was contradictory. The Irish government was threatened that ELA would no longer be available, unless plans for a policy of "burning the bondholders" were totally abandoned and, what is more, an economic adjustment programme for Ireland was promptly negotiated and, then, fully implemented. Legitimate or not, the ECB's concerns for its balance sheet were clearly far-fetched; what mattered most was capital adequacy of European private banks exposed to Irish banks' debt (Sandbu, 2015, p. 100). Yet, dictating policy to the government -the letter sent by Jean-Claude Trichet to Finance Minister Brian Lenihan was testament to that purpose- went far beyond the ECB's mandate (Honohan, 2019, p. 245).

Whereas in Ireland the ECB's threat aimed at forcing the government to bail out banks, in the case of Cyprus the ELA weapon was used in order to force the government to bail in creditors and restructure Cypriot banks – and only on that condition could an economic adjustment programme be concluded. Indeed, this was a "stunning trajectory" for the ECB (Sandbu, 2015, p. 151). It was shocking, though, that the ECB -along with the IMF and the European Commission- approved, by way of concession to the Cypriot government, that resolution and restructuring of the two Cypriot banks be virtually put aside and that, instead, a one-off levy be charged, albeit differentiated, on both big and small deposits. In doing so, the ECB acquiesced in a choice that would in all likelihood dent the credibility of deposit insurance across the euro area, technical excuses notwithstanding (p. 152). The plan was rejected by the Cypriot parliament and a new plan, going in the right direction, was finally put in place – but that is beside the point.

The ECB's use of ELA in Greece was different in form; and it was profoundly political. The ECB, at that time headed by Mario Draghi,[19] did not cut off banks' access to ELA, nor did it lower the amount of emergency liquidity potentially provided by the Bank of Greece. Yet, it refused to increase the amount of ELA, which at that time stood at 90 billion euros, following the newly elected Greek government's announcement, in June 2015, of a referendum on the terms of a third adjustment programme. The ECB did so regardless of massive deposit withdrawals from Greek banks – whilst in May 2012, when withdrawals were lower, the amount of Greek ELA had reached 125 billion euros. However, such a decision was hard to justify. In October 2014, the ECB, acting in its new capacity as bank supervisor, had considered Greek banks to be solvent. On the other hand, had the ECB now reasons to reconsider that verdict -for example, because the banks-government nexus was getting deeper and, especially, more worrisome-[20] it should have called for resolution of insolvent banks and restructuring of the banking system (Koutsiaras and Manouzas, 2016). Yet, the ECB shied away from that dilemma. It virtually had no other purpose than forcing the government to agree on the terms of a third adjustment programme. In July 2015, the government gave in to the demands of its creditors, alas overring the outcome of the referendum – but, again, that is beside the point.

Back in November 2011, while the euro area's self-inflicted damage was unfolding, Mario Draghi succeeded Jean-Claude Trichet to the presidency of the ECB.[21] A revision of monetary policy was largely justified, at least on the grounds of empirical evidence and other central banks' successful practice; and on political grounds too. Thus, the interest rate increases of April and July 2011 were reversed, by cutting policy rates by a total of 50 basis points in November and December 2011. Furthermore, in December 2011 and February 2012, two very long-term refinancing operations (VLTROs), with a maturity of three years and the option of early repayment, were conducted, grossly amounting to 1 trillion euros. Funding constraints were thus relaxed for banks, but that did not -and could not- have substantial effects on the non-financial sector's activity. Besides, in the absence of conditionality, banks could use the ECB's money just to repair their balance sheets, potentially transferring risk to the balance sheet of the central bank, as well as engage in carry-trade. Last, the range of eligible collateral was further expanded and the minimum reserve ratio reduced.

Safe prediction: Mario Draghi's "whatever it takes" speech and his announcement in September 2012 of the Outright Monetary Transactions (OMT) "emergency facility" will always find a place in financial historians' narratives of European money. OMT did not literally constitute an open-ended commitment on the part of the ECB; no lender-of-last-resort-to-governments role was thereby assumed by the central bank. Only shortly maturing -up to three years- sovereign bonds of crisis countries could be purchased in the secondary market, provided the country in question had access to private funding or embarked on an economic adjustment programme sponsored by the European Stability Mechanism (ESM) – and, for that matter, unanimously agreed. Formally, OMT was justified on the grounds of enhancing transmission of the stance of monetary policy. And it was made explicit that potential risks to price stability would be taken care of. Thus, amongst others, the liquidity created via OMT would be fully sterilised (ECB, 2012; for a skeptical view about the impact of OMT sterilisation, in itself, on inflation, see McMahon et al., 2012).

For all the ECB's promise to deploy its balance sheet heavily, the separation principle was not eliminated (for a different view, albeit qualified, see Rostagno et al. 2019, p. 15); and revision of monetary policy was still devoid of vigour. Part of the reason might be hostility to OMT on the part of the Bundesbank's president Jens Weidmann; his testimony to the German constitutional court, which was asked by a group of professors to rule OMT illegal, provided solid evidence to that effect.[22] Perhaps, slowing down the pace of cutting policy rates -from December 2011 to November 2013, the main policy rate was cut by 75 basis points in total- was an attempt to assuage Bundesbank's (falsely prompted) fears of inflation expectations being de-anchored.

This argument is mostly political rather than technical in nature. The other German member of the ECB's Governing Council (and former advisor of Wolfgang Schäuble), Jörg Asmussen, was one of President Draghi's allies in pushing for OMT. And he had the German government's backing to that effect. Granted, the German government had firmly endorsed Mario Draghi's initiative implied in his "whatever it takes" speech – subject, of course, to strict conditions being applied therein (Brunnermeier et al., 2016, pp. 354-337, p. 355; also, Sandbu, 2015, p. 160). The German government's support to the OMT programme was obviously endogenous to two major institutional reforms pursued at the same time; namely, the establishment of ESM in October 2012 and the decision by euro area governments in June 2012 to put SSM in place, in order to break the nexus between sovereigns and banks.[23,24]

It is widely believed that OMT was perceived as a credible ECB commitment – a credible threat to rentiers, if you wish. As a result, bond markets calmed and panic was arrested. However, OMT did not provide any stimulus to the euro area economy; sliding into another recession was at that time pointed to in macroeconomic forecasts (Tooze, 2018, pp. 442-443; Honohan, 2019, p. 94). Revision of monetary policy and, for that matter, abandoning the separation principle and making active use of the ECB's balance sheet could no longer be postponed. Besides, the ECB was confronted with three contingencies: receding excess liquidity and exchange-rate movements had effectively tightened the stance of monetary policy; the latter's transmission through the banking channel had evidently been impaired; and disinflation had been entrenched in the euro area economy, because of a weakening aggregate demand and lower inflation expectations (Rostagno et al. 2019, p. 17).

What is probably more, monetary policy was the only stabilisation instrument on offer. Although the ECB's main policy rate had virtually reached the zero-lower bound -by November 2013 the interest rate on the ECB's main refinancing operations had been cut to 0.25%- fiscal stabilisation in the euro area was politically and institutionally restrained; and that will hardly change substantially in the foreseeable future. Yet, mainstream macroeconomic theory -in the form of workhorse New Keynesian models of the business cycle- and analysis show that, when an economy enters a liquidity trap, fiscal policy aiming at directly stimulating demand will in all likelihood be effective (for example, Eggertsson, 2009; DeLong and Summers, 2012).

Following the experience of a number of smaller countries' central banks outside the euro (Denmark, Sweden, Switzerland), the ECB introduced in June 2014 a negative interest rate of -0,10% on its deposit facility. Henceforth the rate on the deposit facility would effectively become the ECB's main policy rate – the rate on its main refinancing operations having been lowered to 0.05% in September 2014 and 0.00% in March 2016. A series of 10 basis points cuts were subsequently introduced -in September 2014, December 2015, March 2016 and September 2019- bringing the rate on deposit facility to -0.50%. Designed to dissuade households and businesses from saving, thereby making borrowing and spending on consumption and investment more attractive, negative rates are nonetheless controversial.

Obviously, the effectiveness of negative rates in stimulating demand depends much upon the response of banks, whether that be related to lowering rates on the deposits of households and firms, or lending; and it also depends on the response of savers and borrowers to banks' interest-rate policies (for an optimistic view, see Alatavilla et al., 2019). Yet, the transmission of the ECB's negative rates, especially their effect on the lending policies of banks and business investment, may differ across banks, depending upon their funding base -that is, upon their relative reliance on deposits or market funding- and on their taking of risk in lending or investing in securities issued by the private sector (Heider et al. 2019). And the same may go a long way towards putting the issue of bank profitability in perspective.[25]

How far can the negative-policy-rates policy go? Kenneth Rogoff (2016) has eloquently argued the case for making negative rates "central banking business as usual" (p. 127), while fully acknowledging the legal, institutional, political economy and even moral questions pertaining to phasing out paper currency. Indeed, paper currency is the major obstacle to introducing negative rates on a large scale; there is virtually no impediment to charging negative rates on electronic currency (p. 5-6). Yet, regardless of the impressive technological developments (from credit and debit cards to blockchain technology) allowing for an ever-expanding use of electronic money, love for cash remains strong. As a matter of fact, 79% of all transactions by euro area consumers in 2016 were made in cash, such a preference being stronger in southern euro area countries, as well as in Germany, Austria and Slovenia (Esselink and Hernández, 2017). Yet, demand for cash is very likely to be endogenous to a central bank's policy rates (Shirai and Sugandi, 2019).

The limits to the ECB's policy of negative interest rates are virtually set at the level of a "political lower bound". In other words, they are determined by the implications of negative rates for income redistribution across and within euro area countries, redistributive cleavages being shaped by financial, institutional and demographic factors. Hence, savers are pitted against borrowers, deposits-funded banks against market-funded credit institutions and young or even middle-aged households against elderly ones. Therefore, it causes little surprise that opposition to the ECB's policy of negative interest rates was so furious in Germany. The media made use of the (German) term "Strafzins" or "punishment rates" to refer to below-zero interest rates; *Bild* portrayed Mario Draghi as "Count Draghila", a vampire sucking dry the deposit accounts of savers. And Finance Minister Wolfgang Schäuble went so far as to say that the effects of the ECB's monetary policy were fuelling German Euroscepticism, thereby boosting the popularity of the Alternative für *Deutschland* (AfD) so party.[26]

Forward guidance (FwG) was effectively introduced in July 2013, aiming to anchor inflation expectations and preserve an accommodative level of long-term interest rates in the face of tensions in global bond markets and a still timid euro area recovery (Hartmann and Smets, 2018, p. 36). FwG was also intended to inform market agents and the public at large about the ECB's reaction function (Praet, 2013), thereby implying the central bank's commitment to bring inflation (lower but) close to 2%. FwG has subsequently evolved and a framework for that policy has formally been defined. Thus, FwG took up a time and state-contingent form and even linked guidance on policy rates to that on the ECB's net asset purchases (about which more later), thereby allowing for policy interactions to be realised and enabling coordination of investor expectations in asset markets (Rostagno et al., 2019, p. 18). Adjustments to FwG were later made in order to take account of changes in other monetary policy instruments.

Rationalisating FwG has given monetary theorists a hard time. A "forward guidance puzzle" has thus emerged: standard New Keynesian models predict that a credible FwG commitment to keep policy rates low for a long time has an immediate effect on output and inflation, although such a prediction is evidently unrealistic – and theoretically challenged too (Eberly and Woodford, 2020, esp.

pp. 233-234). Alan Blinder (2018) has bluntly argued that there is nothing reasonable in our belief that FwG works in practice, that is, in the belief that central banks can influence long-term interest rates by influencing expectations of future short-term rates. Such a belief is conceptually relied on the rational expectations theory which is no less than an "abysmal empirical failure" (p. 568). Indeed, the effectiveness of FwG is theoretically doubted in models featuring bounded rationality and heterogenous agents (Farhi and Werning, 2019). Importantly, Blinder (2018) has also argued that FwG is about prediction, not commitment, the main purpose of a central bank's communication about monetary policy being to "influence market expectations by forecasting its own behaviour" (p. 569). Obviously then, the effectiveness of FwG, however little, depends a lot upon the quality of a central bank's macroeconomic forecasts. Alas, ECB forecasts in the years 2013-2018 have been found to be systematically incorrect, thereby rendering the central bank's FwG inadequate and prompting market participants to ignore it (Darvas, 2018).

Using the ECB's balance sheet as a monetary policy instrument came to be considered inevitable. The easing of policy rates -from September 2011 to June 2014 the rate on the main refinancing operations was cut by 125 basis points- had little effect on economic activity in weak euro area countries and the outlook for inflation had worsened (Hartmann and Smets, 2018, p. 34). Credit growth was still negative, largely reflecting continuing private sector deleveraging. Banks, in particular, were making use of the early repayment option they were afforded in VLTROs to pay back a large amount of liquidity they had borrowed in times of liquidity shortages; and the ECB's balance sheet was consequently receding, but for no good reason from a macroeconomic point of view (Praet et al., 2019, p. 104).

Thus, in June 2014 the ECB introduced targeted longer-term refinancing operations (TLTROs) with a four-year maturity. Lending of last resort to credit institutions would now be made conditional on the latter's use of borrowed liquidity. That is, banks had to lend the borrowed liquidity to non-financial firms and households and if they failed to do so, they would have to pay back idle liquidity before the maturity date of the relevant TLTRO;[27] moreover, they could no longer take part in further longer-term refinancing operations (Fontan, 2018, pp. 176-177). However, reluctance on the part of banks to borrow on such conditions led the ECB to soften sticks and strengthen carrots – to relax conditionality and enhance incentives. Thus, in March 2016 a second TLTRO programme was introduced whereby banks were no longer required to repay the liquidity they had borrowed prior to its maturity date, whilst borrowing rates were linked to the participating banks' amount of lending (with the exception of lending to households for house purchases); borrowing rates could even be as low as the interest rate on the deposit facility. The latter provision was made more attractive in the third TLTRO programme which was introduced in March 2019; namely, borrowing rates could now be as low as the average interest rate on the deposit facility prevailing over the life of TLTRO.[28]

Using the ECB's balance sheet became at last the main monetary policy instrument. This entailed both increases in size and changes in the composition of the central bank's balance sheet (on the asset side); to that effect, the ECB played (nearly) in full the role of an investor of last resort. In September 2014 an asset-backed security programme and a third covered bond purchase programme were introduced. Yet, the biggest -and most controversial- part of the ECB's asset purchase programme (APP) was announced in January 2015, amidst persistent deflationary pressures and long-term inflation expectations trending quite lower than 2% (Brunnermeier et al., 2016, pp. 360-361); and a corporate sector purchase programme (CSPP) and, far more importantly, a public sector purchase programme (PSPP) were to start in March 2015. The ECB was thereby taking not so much a brave -the other major central banks having been there before- as a bold step toward the age of quantitative easing (QE). What was bold, however, might have been braver had it been prompter; and, perhaps, bravery would also have been more rewarding.

Thus, during the 2015-2018 period, monthly purchases averaged: 60 billion euros from March 2015 to March 2016; 80 billion euros from April 2016 to March 2017; 60 billion euros from April 2017 to December 2017; 30 billion euros from January 2018 to September 2018; and 15 billion euros from October 2018 to December 2018. Furthermore, between January 2019 and October 2019 the ECB fully reinvested the principal payments from maturing securities, in order to maintain the cumulative net purchases at the level obtained in December 2018. In September 2019 the ECB Governing Council decided that APP purchases be restarted in November 2019 and end only shortly before it starts raising the policy rates; and reinvesting the principal payments from maturing securities be fully continued for "as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation", that is, "for an extended period of time past the date on which the Governing Council begins to raise the key ECB interest rates". At the end of January 2020 Eurosystem holdings under the APP amounted to about 2.600 billion euros in total, of which about 2.115 billion euros were accounted for by holdings accumulated under the PSPP.[29]

No wonder the ECB's QE -its PSPP dimension, in particular- was politically controversial and economically doubtful. A great deal of criticism came from the German side and focused on familiar concerns; the boundaries separating monetary and fiscal policy would effectively be blurred and a transfer union, mostly in the form of a Eurobond, would be introduced through the backdoor. In response to such criticisms, and by way of concession to German demands, ECB purchases were to be made in proportion to the capital contributed to the ECB by each national central bank and a limit of 33% was placed on the share of a country's outstanding debt held by the Eurosystem.[30] What is more, national central banks were to make 80% of bond purchases and take on their own balance sheets the sovereign risk implied; risk sharing was thus limited to 20%.

However, such arrangements revealed a paradox inherent in the ECB's QE; namely, bond purchases were to be made regardless of the size of sovereign debt markets, their allocation being instead determined by the size of the economy and the population of the euro area member states.[31] Those arrangements also implied that the pace of QE would inevitably be slowed down -actually it did- because of bond purchases reaching their 33% limit. And they also reflected a fundamental flaw built into the Eurosystem, as argued by Willem Buiter (2019). In spite of their holding significant amounts of assets at their own risk, national central banks have almost no control over their issuance of central bank money -this is decided by the ECB Governing Council- thereby running the risk to go bankrupt. In this sense, all euro-denominated assets held by national central banks are effectively foreign-currency-denominated assets (p.4).

Mainstream monetary theory, in the form of general equilibrium models with representative agents, had virtually offered no support to QE. This (pessimistic) view of QE has recently been questioned in models with heterogenous households – economically unequal households holding assets with different liquidity properties (for a discussion, see Cui and Sterk, 2018). Yet, theoretical ambivalence may partly explain why the effects of QE are still poorly understood, let alone safely predicted. Robert Skidelsky (2018) has rightly argued that, in effect, central banks had to take a chance with the (long rebutted) Fischer-Friedman version of monetarism -at that time embraced by the Fed chairman Ben Bernanke- thereby turning themselves into quantity theorists of sorts (p. 256).

QE was meant to work through various channels; namely, the portfolio rebalancing channel, inducing holders of sovereign bonds to switch to equities and corporate bonds, thus encouraging firms to raise funds in capital markets; the bank lending channel, offsetting the vast increase in liquidity preference of banks, firms and households; the exchange rate channel, entailing an increase in the demand for foreign assets, a fall in the euro exchange rate and an increase in exports; and the signaling channel, revealing the central bank's commitment to reflation, thereby allowing for the long-term inflation expectations to be re-anchored (Brunnermeier et al., 2016, p. 362-363; Skidelsky, 2018, pp. 263-268).

Yet, the scope and the effectiveness of QE were empirically challenged. Granted, critical arguments were deployed in the deliberations of the ECB Governing Council – and in political debates too. Deflation, to start with, was said to pose no threat to economic growth; historical evidence has made clear that deflation may often reflect improvements in productivity and cause no harm to consumption expenditure and aggregate demand (Bordo et al., 2004). Furthermore, experience with QE, in both the US and Japan, was thought to have made evident that not all QE operations were equally successful, nor were all channels of transmission equally powerful. Thus, in the US purchases of mortgage-backed securities helped the balance-sheet debilitated housing sector to recover, whilst purchases of government bonds had no obvious success; and in Japan implementation of QE in 2013 led to large movements in the stock market and the exchange rate, implying that the exchange rate channel was the most powerful one (Brunnermeier et al., 2016, p. 364). Admittedly, the more QE works through the exchange rate channel, the less palatable are its repercussions for the world's political economy.

Furthermore, it was maintained that portfolio rebalancing may result in the formation of asset price bubbles. It was also argued that, by reducing funding costs and allowing for lower interest rates on bank loans, QE may facilitate the emergence of so-called "zombie companies", thereby causing deceleration in productivity growth, albeit indirectly (for a discussion of the negative reallocation effects of easier credit constraints, see Aghion et al., 2019). Finally, from a wholly different point of view, it was alleged that QE has a "substitution effect", namely that it discourages alternative policy strategies with less inegalitarian effects, such as "helicopter money" or fiscal stabilisation (Fontan, 2018, pp. 176-177) – but this is a far-fetched allegation so far as the euro area's political economy is concerned.

Assessing the effects of the ECB's QE is a daunting task. It is an exercise in counterfactual reasoning, thus being fraught with (huge) uncertainty about paths that would have been taken, had QE been implemented in a different way or/and earlier – or simply in its absence. Likewise, disentangling the impact of QE from that of the other, yet in parallel pursued, ECB's (non-standard) policies is hard to attain. Nevertheless, there is a widespread belief that monetary easing -and QE in particular- was less successful in the euro area than in the US and the UK. In the US coordination of fiscal and monetary policy provided for more stimulus being injected, whereas in the UK the stimulus from monetary policy was bigger than in the euro area (Skidelsky, 2018, pp. 273-274). One may plausibly speculate that had the ECB's monetary policy been less hesitantly activated, the euro area would probably have escaped, perhaps in part, the ills of double-dip recession, stubbornly low inflation and lower drifting long-term inflation expectations, subdued investment and declining Wicksellian (natural) interest rates and weak GDP growth prospects. That echoes Paul Krugman's diagnosis of the Bank of Japan's (BoJ) failure, in 2014, to stimulate aggregate demand and bring about a sustained increase in inflation; namely that the BoJ had lost credibility having being stuck in a "timidity trap" (cited in Mody, 2018, pp. 382-383).

What is maybe more important, the effects of the ECB's QE have not been distributionally neutral. Asset owners have clearly benefitted and, given that wealth tends to be concentrated in richer households, a further increase in the concentration of private wealth has in all likelihood occurred (Fontan, 2018, p. 176). Furthermore, it is maintained that savers holding interest-bearing assets have suffered an income loss, whilst net-borrowing younger households have enjoyed increases in their purchasing power (Dobbs et al., 2013). On the other hand, research by a group of ECB economists has focused on the impact of monetary policy on wages and income, while accounting for differences amongst households in employment and ownership of liquid assets; their findings point to favourable income effects for households holding few or no liquid assets, implying a reduction in inequality (Ampudia et al., 2018). However, evaluating the impact of non-standard monetary policy on financial variables, such as stock market prices, bond yields and interest rates, is relatively straightforward, whereas assessing its effects on real economic variables -which is much more important- depends a lot upon counterfactual reasoning, thus being controversial (Skidelsky, 2018, p. 263).

Of course, the distributional effects of the ECB's monetary policy have a bearing on the bigger questions of the central bank's independence and accountability. Granting independence to central banks was premised on the distributional neutrality of monetary policy (Tucker, 2018). Politically neutral central banks could solely focus on safeguarding price stability (and, in broader terms, providing for macroeconomic stabilisation) by making uncompromised use of their technocratic expertise. Transparency and accountability -or, in a narrowly technical form, accountability as transparency- were among other meant to enhance the legitimacy of central banks. However, one may fairly suggest that central banks, the ECB being virtually on the forefront, have increasingly been accountable to those people who are able to fully grasp the highly technical issues pertaining to monetary policy, or are well aware of their practical implications, that is, to large-scale asset owners and, by way of aggregation, the financial sector (for a theoretical treatment of central bank accountability along these lines, see Best, 2016).

4. Back to the drawing board

"If central bankers are the only game in town, I'm getting out of town!"

(Mervyn King, 2013)[32]

"But monetary policy does not exist in a vacuum. The situation of central banks is better described as independence in interdependence, since other policies matter a great deal. They can buttress or dilute the effects of our policy. They can slow down or speed up the return to stability. And they can determine whether stability is accompanied by prosperity…"

(Mario Draghi, 2016)

"[M]onetary policy cannot, and should not, be the only game in town. The longer our accommodative measures remain in place, the greater the risk that side effects will become more pronounced… Other policy areas –notably fiscal and structural polices– also have to play their part… Indeed, when interest rates are low, fiscal policy can be highly effective… We also have to gear up on climate change… Like digitalization, climate change affects the context in which central banks operate…"

(Lagarde, 2020)

The ECB could hardly afford political neutrality, even in the monetary union's "honeymoon phase". Being a stateless central bank entailed striking compromises between conflicting (national) monetary policy preferences. However, such compromises would often be reached at the expense of theoretical consistency and to the detriment of coherence in the ECB's monetary policy strategy. And, perhaps inevitably, they would also bear the mark of the dominant partner in the European Monetary System, that is prior to the establishment of the monetary union (Giavazzi and Giovannini, 1989), now also being the biggest subscriber to the ECB's capital. Political neutrality and, for that matter, monetary activism on the part of the ECB -as well as liquidity in the euro-area- were largely inadequate during the euro area crisis, especially in its early phase. They were subsequently increased, but at a slow pace and in a preferential fashion, that is, largely to the benefit of the banking industry. Eventually, the ECB did try to make a virtue of necessity; yet, this could only go so far. Thus, the ECB has reluctantly become the only game in town, its reluctance being mostly associated with the overriding concerns of certain national central banks of the Eurosystem, most notably the Bundesbank; namely, ensuring monetary dominance, averting (at that time illusory) inflationary dangers, preventing moral hazard, enforcing structural reforms and, not least, fending off any, indirectly emerging, type of transfer union. Therefore, the ECB could have no great ambitions; its lonely game was unlikely to produce a medal-winning policy maker in the world championship of central banking.

In November 2019 Christine Lagarde succeeded Mario Draghi to the presidency of the ECB.[33] In January 2020 the ECB's Governing Council launched a review of the central bank's monetary policy strategy, encompassing the quantitative definition of price stability, the ECB's monetary policy, the analytical framework and the central bank's communication practices. Other issues will also be considered, such as financial stability, employment and climate change.[34] No doubt, the quantitative formulation of price stability is of the utmost importance. But it is also surrounded by theoretical controversies regarding: a. specification of the target – nominal GDP (Hughhes Hallet et al., 2015), the price level, inflation, Taylor rule; b. symmetry of the target – downward and/or upward; c. flexibility of the target – for example, flexible inflation averaging (Mertens and Williams, 2019); d. the numerical value of the target, especially in the case of inflation targeting (a higher inflation target at around 4% is advocated in Blanchard et al., 2010). Taking into account inflation differentials amongst the euro area economies is an equally important element of the ECB's monetary regime – and should accordingly be dealt with in the upcoming deliberations.

In principle, a higher inflation target and/or a more flexible regime, including specification of an inherently flexible target, allow for the ECB's monetary policy providing more support to the fulfillment of other (general) economic policy objectives, primarily (full) employment. Yet, there is no absence of trade-offs and policy dilemmas. For example, safeguarding financial stability may, sometimes, imply the need for a less accommodative monetary policy stance than otherwise justified, implementation of macroprudential measures notwithstanding. Furthermore, "greening" the ECB's monetary policy, for example by tilting the Eurosystem's assets and collateral towards low-carbon industries and firms (as suggested in Schoenmaker, 2019), may be associated with substantial side-effects of an allocative and redistributive nature, regardless of the potential (maybe positive) overall impact of a "green" monetary policy on productivity and growth; concerns relating to the ECB's independence and accountability may thus arise.

Questions about the conduct of monetary policy, and normative theoretical controversies for that matter, are founded on analytical grounds. The ECB's analytical framework as well as the methods and models deployed therein will, therefore, be subjects of intense debates, theoretical controversies still being empirically unresolved. Amongst the numerous issues that need to be dealt with the following are only indicative. What has the relative impact of money and credit been on prices and economic activity both in normal and disinflationary conditions, compared to the effects of policy rates? And how and to what extent has monetary analysis informed the ECB's reaction function respectively? What is, thus, likely to be the added value of monetary analysis to the ECB's policy framework, regardless of its formal acknowledgement, or lack thereof (for a favourable view, see Rostagno et al., 2019)? What drives inflation and how can the episodes of "missing disinflation", after the onset of the Great Recession, and "missing inflation", in the period of economic recovery, be explained (for example, see Ehrmann et al., 2020 and references therein; Arrigoni et al., 2020)? Is the Phillips curve still alive and useful in macroeconomic analysis (for example, see Ball and Mazumder, 2020; for a deeply skeptical, yet thoroughly argued view on the Phillips curve, Forder, 2014)? What is -and should be- the place of (still evolving) general equilibrium models with heterogenous agents in the ECB's macroeconomic analysis, especially in regard to the analysis and prediction of the effects of unconventional monetary policies on prices, economic activity and income distribution?

Historical experience, however little by other central banks' standards, provides enough evidence to suggest that the 2020 review of the ECB's monetary policy strategy is most likely to be yet another instance of both conflicting policy preferences being in full force and the conservative preferences of policy makers from core euro area countries weighing heavier. The outcome of the review process is, therefore, likely to cause little excitement, at least as far as the theoretical consistency of the monetary policy framework and the coherence of the ECB's strategy are concerned.

Be that as it may, the ECB's monetary policy can no longer be the only game in town. Monetary easing has been facing increasing constraints; its stabilization potential has been receding, whilst its side-effects have been reinforced. And criticism has, therefore, been getting harsher.[35] Regardless of its potency -which is nonetheless disputed- "helicopter money" is a form of fiscal policy, also raising issues of coordination between monetary and fiscal authorities, thereby jeopardising the principle of central bank independence (Reichlin et al. 2019; Davies, 2020). One may thus plausibly allege that this policy option is simply out of the ECB's reach.

Thus, an active fiscal policy is much needed, primarily in countries with fiscal space. What is more, so long as interest rates are lower than rates of economic growth -as they will in all likelihood be in the foreseeable future- a reasonable increase in public debt is both desirable and feasible, that is, fiscally not costly (Blanchard, 2019). Not only are pressures for debt monetization literally non-existent but, as Marco Buti (2020) has brilliantly argued, a monetary-fiscal paradox is thereby thwarted; namely, when monetary policy is at the zero lower bound, excessive fiscal prudence is tantamount to a form of fiscal dominance, in the sense that fiscal sluggishness impedes the ECB's monetary policy to fulfill its primary objective (p. 8). As a matter of fact, Mario Draghi had long made the case for a more balanced stabilization policy, entailing fiscal expansion (and/or accelerating structural reforms), but to no avail. Adequate fiscal expansion is currently not on offer – and, in general, credibly countercyclical fiscal policies are institutionally circumscribed.

What is more, achieving an appropriate euro area fiscal stance -allowing for short-term stabilisation and ensuring long-tern sustainability, the trade-offs notwithstanding- while paying little regard to national fiscal positions and little attention to structural asymmetries in spending and saving patterns makes little sense. In fact, it only tends to perpetuate "the paradox of thrift", which stems from the (institutionally required) excess saving in countries with no fiscal space and results in growth fragility (Lagarde, 2019), while reinforcing asymmetries amongst euro area countries. An appropriate euro area fiscal stance could thus be attained if only a central fiscal capacity was established. However, such a prospect is hardly acceptable by core euro area countries; it entails risk-sharing, encourages moral hazard and activates transfers to peripheral euro area countries, as their arguments go. Yet, the European monetary union has been a "transfer union from the start" (Perotti and Soons, 2020; Wolf, 2019); trade and financial integration resulted in implicit flows from the periphery to the core, such flows having been not resisted. Herein lies the fundamental asymmetry in the political economy of the euro – a deep flaw, which cannot be rectified by the ECB on its own. The truism remains: monetary policy can only go so far.

Notes

1. Ben Bernanke had famously quipped, while being chairman of the Federal Reserve, that "the problem with quantitative easing is that it works in practice, but it doesn't work in theory" (Bernanke, 2014; an opposing argument is developed in Farmer and Zabczyk, 2016).
2. Drawing a comparison between the US, the UK and continental Europe's economic performance in the 1990s, Mervyn King had argued thus: "In the United States growth was so rapid that at least two authors wrote books entitled 'The Roaring Nineties' and another chose the title 'The Fabulous Decade'. In contrast, continental Europe experienced slow growth and heart-searching over structural reforms. As with much else, our economic performance lay somewhere between the excited exuberance of the United States and the relative disappointment of continental Europe. So the UK experienced a non-inflationary consistently expansionary - or ***"nice"*** - decade; a decade in which

growth was a little above trend, unemployment fell steadily, and, supported by the improved terms of trade, real take-home pay rose without adding to employers' costs, thus allowing consumption to grow at above trend rates without putting upward pressure on inflation." (King, 2003).

3. Following the worsening of the medium-term outlook for the UK economy, as evidenced in the inflation forecasts released by the Bank of England in May 2008, an article titled "The start of the nasty decade?" appeared in the opinion page of the *Financial Times,* May 16, 2008.
4. In June 2013, Raghuram Rajan, who had recently been appointed governor of the Reserve Bank of India, gave the first Andrew Crockett Memorial Lecture. In his closing remarks he asserted that central banks had "offered [themselves] as the only game in town" (in Tucker, 2018, p. 535). = was later adopted by Mohamed El-Erian as the title of his much-cited book (El-Erian, 2016).
5. Although it deserves a place in the main text, a brief reference to the operational framework and the monetary policy measures of the ECB, as there were initially set up, is made in this footnote, only for reasons of economy. Thus, the operational framework for implementing the monetary policy preferences of the ECB consisted of the following sets of instruments: open market operations, standing facilities and minimum reserve requirements. The monetary policy preferences of the ECB are revealed via its setting of three key interest rates, namely the rate on the main refinancing operations, the rate on the deposit facility and the rate on the marginal lending facility. Furthermore, pursuant to Article 14.4 of the Statute of the European System of Central Banks and of the European Central Bank (Protocol No 4, OJ C 326/230, 26.10.2012), which sets the broad rules and the procedures governing national central banks' functions outside of normal monetary policy operations, an Emergency Liquidity Assistance (ELA) facility was established – and the relevant rules and procedures were operationally specified by the Governing Council. Following the global financial crisis and the crisis in the euro area, the ECB has at various stages added new instruments and introduced several non-standard monetary policy measures, discussion on which is made in the next section (for a detailed description of the operational instruments and the monetary policy measures of the ECB, see https://www.ecb.europa.eu/ home /html /index.en.html).
6. However, a higher weight on interest rate smoothing compared to output stabilisation requires an even longer policy horizon. Generally, though, the optimal horizon is longer when the objective of price stability is specified as a price level target than when its quantification takes the form of an inflation target (Smets, 2003).

7. As a matter of fact, ECB President Wim Duisenberg was at pains to explain that there would be no tolerance of (prolonged) deflation on the part of the Governing Council – as recalled in the introductory quotation to this section.
8. Following a coordinated step by national central banks in the euro area, policy rates were reduced to 3% in December 1998; and that had effectively been the short-term interest rate bequeathed to the ECB, in other words the policy rate at which the ECB started its monetary policy operations when the third stage of the European economic and monetary union was launched, in January 1999 (Hartmann and Smets, 2018, p. 14).
9. Persistent Inflation differentials across regions are surely observed in other monetary unions too, although their size is (much) smaller than that within the euro area (Darvas and Wolff, 2014). What is more, inflation differentials matter less in fully-fledged economic and monetary unions -in effect, political unions- featuring inter alia centralised fiscal capacity.
10. Of course, raising the issue of compliance with the Stability and Growth Pact does not in any way imply -and is not meant to imply herein- that the Stability and Growth Pact is economically sound. In other words, the argument made here, relating fiscal stability to observance of the Stability and Growth Pact, has no normative relevance other than legalistic.
11. ECB President Wim Duisenberg could hardly make it more explicit. As he argued in one of his public speeches "… political pressures on monetary policy to facilitate or 'reward' developments on the fiscal and structural side would raise uncertainty about the objectives of monetary policy, thereby endangering credibility and reducing the benefits associated with the maintenance of price stability." (Duisenberg, 2001).
12. Note that, during the period 2000-2007, the average annual rate of growth of M3 was 7.2%, the benchmark being 4.5% (Koutsiaras and Manouzas, 2016, pp. 12, 43).
13. Leaving aside legal controversies, one should acknowledge that, although both refinancing operations and sovereign bond purchases provide liquidity to the banking system directly, sovereign bond purchases provide liquidity to governments too, albeit indirectly. Moreover, if the market value of collateralised bonds is adequately haircut, as can reasonably be assumed, refinancing operations are relatively risk-free, whereas sovereign bond purchases are inherently risky; governments may default on their debts (Brunnermeier et al., 2016, p. 344).
14. Patrick Honohan, who was at that time Governor of the Central Bank of Ireland (and member of the ECB's Governing Council), takes the view that the "more obvious policy would have been to wait" (Honohan, 2019, p. 92). Yet, as

he acknowledges, custom -"[a] degree of deference to the views of the president is inevitable in such matters"(p. 92)- and, perhaps mostly, a successful negotiation on his part to avert a technical change in ECB bank lending rules that would have hurt Irish interests, did not allow Governor Honohan to make his opposition to the rate increase explicit. Who says that the ECB's monetary policy is politics-proof?

15. Interestingly, presenting himself to the European Parliament, in June 2011, Mario Draghi argued the case against monetary easing (Mody, 2018, pp. 295-96). Not much later, though, he was going to change course.
16. Ashoka Mody has forcefully argued that, contrary to widespread beliefs (for example, see Buti, 2020), the Deauville agreement did not cause panic in bond markets; the agreement was misinterpreted by analysts, not markets (Mody, 2018, pp. 276-278).
17. See footnote 13.
18. One should bear in mind that the price -and yield- of government bonds is not impervious to central banks' collateral policy and investor-of-last-resort interventions; indeed, it is endogenous to such central banks' policies. And this implies that the central banks' balance-sheet risk is lower than often thought.
19. Old habits die hard.
20 In order to lessen that risk, the ECB had put a cap on the amount of Bank of Greece's purchases of Greek treasury bills via ELA; the cap had been set at the level of 3.5 billion euros.
21. In an interesting study of the central bank elite, Mikael Wendschlag (2018, p. 183) maintains that, in general, the economic and political context "seems to pick" its distinct type of central bank governors. Yet, somehow paradoxically, he also observes that changes in central bank practices "appear to be" closely related to changes in leadership. One might wish to approach the remaining part of this section as an evidence-based discussion of Mario Draghi's attestation to either of the two interpretations. This paper does not have such an explicit intention; yet, it implicitly sides with the first interpretation.
22. In 2015, the European Court of Justice ruled OMT legal; yet, it also ruled that there are limits to the ECB's discretion in that respect.
23. See, https://www.bankingsupervision.europa.eu/about/milestones/shared/pdf /2012-06 29_euro_area_summit_statement_en.pdf.
24. A word of caution is in order here: this nexus could well be less dismal than commonly thought. It is argued that self-fulfilling pessimism about a country's solvency is mostly sourced in foreign banks' lack of soft information on the local economy and the capacity of the issuing government. The nexus could thus allow a country to resist the dismal implications of foreign banks'

panicked sales of domestic assets; that is, domestic banks, enjoying soft informational advantages, could act as byers of last resort (Saka, 2020).

25. Responding to concerns about profitability raised by European banks -but officially sticking to the transmission argument- the ECB's Governing Council decided in September 2019 to introduce a two-tier system for reserve remuneration. Thus, part of the excess liquidity of banks held with the Eurosystem, amounting to a multiple of a bank's minimum reserve requirements, will be exempted from the -0.50% deposit rate. The size of the multiplier -currently at the level of 6- is subject to adjustments (https://www.ecb.europa.eu/mopo/two-tier/html/index.en.html.). Clearly, the two-tier system is more in favour of credit institutions in countries where deposits exceed loans (for example, in Germany or France), rather than where banks are market-funded.
26. "There's a German word for negative rates", https://ftalphaville.ft.com/2019/09/13/1568375752000/ There-s-a-German-word-for-negative-rates/. Also, "ECB boosting Euroscepticism in Germany?", https://www.eurotopics.net/en/152285/ecb-boosting-euroscepticism-in-germany#.
   It is important to note that by 2019, 60% of German banks were charging negative rates on corporate savings accounts and more than 20% were doing the same for retail deposit accounts; "Most German banks are imposing negative rates on corporate clients", *Financial Times*, November 18, 2019. See also footnote 25.
27. To put it precisely, the maturity of borrowed liquidity was conditional on banks achieving certain lending thresholds. Calculation of lending thresholds was based on the amount of past bank lending. Given that past lending was low at that time, thresholds were not hard to achieve. However, banks were dissatisfied (Fontan, 2018, p. 176).
28. https://www.ecb.europa.eu/mopo/implement/omo/tltro/html/index.en.html.
29. This paragraph, including quoted phrases, draws fully on https://www.ecb.europa.eu/mopo/implement/ omt/html/index.en.html.
30. That limit had initially been set at 25%; it was raised to 33% in September 2015.
31. With the exception of Greece which did not have access to the QE programme owing to its failure to satisfy certain technical requirements.
32. That is how Mervyn King responded to Raghuram Rajan's suggestion that central banks had become the only game in town (cited in Tucker, 2018, p. 535). See also footnote 4.
33. Mikael Wendschlag (2018, p. 207) argues that, following the crisis, the "academically founded 'credibility'" of central bankers has been questioned and that a transformation of central bank elites is currently in the making. And

he observes that, as calls for more democratic accountability of the central banks and policy makers have gained force, a "return of the politically vested central banker of the post-Second World War decades" is underway. Partly at least, the appointment of Christine Lagarde to the presidency of the ECB seems to confirm Wendschlag's observations; and the same applies -perhaps to an even larger extent, for obvious institutional and political reasons- to the case of Jerome Powell, who was appointed to the Fed Chair in February 2018. Both Lagarde and Powell are lawyers by training, specialising in finance, and have spent some time in government posts. See also footnote 21.

34. https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200123~3b8d9fc08d.en.html.

35. Following the announcement in September 2019 of a new round of monetary easing measures, six former central bankers -two amongst them being also former members of the ECB's executive board- signed a memorandum in which the ECB was severely criticised for its monetary policy being ultra-loose and potentially undermining the central bank's independence; "Memorandum on ECB Monetary Policy by Issing, Stark, Schlesinger", https://www.bloomberg.com/news/articles/2019-10-04/memorandum-on-ecb-monetary-policy-by-issing-stark-schlesinger.

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Fiscal Governance in the Eurozone: From Maastricht to crisis and back again?*

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Abstract

Determining the optimal level and instruments of fiscal governance in a monetary union of sovereign states is not an easy task. A monetary union needs to have in place a comprehensive framework of fiscal governance, which allows enough flexibility to deal with asymmetric shocks in different member states; discourage fiscal mismanagement, and minimize spillover effects when it happens; provide the means for effective fiscal management over the business cycle; and build the necessary mechanisms to deal with a common external shock. The fiscal governance designed at Maastricht was imbalanced and incomplete. It instituted a decentralized 'individual responsibility' approach, with no effective compliance mechanism and no support facilities for times of economic turbulence. Its weaknesses, revealed by the global financial crisis, contributed to Eurozone's deterioration into a second, debt crisis and a double dip recession. The lack of institutional provisions for dealing with the crisis, turned its handling into a de facto political, and therefore, intergovernmental process where creditor countries, enjoying a highly asymmetrical negotiating advantage, dictated both the terms of the bailout agreements and the provisions of the new fiscal governance. Being essentially a reinforced version of the pre-crisis framework, the 'reformed' fiscal governance has tried to balance conflicting objectives with little success; it is simultaneously more constraining and more prone to political maneuvering, increasingly complex while leaving more room for variable interpretations, and ultimately it is not more effective than its predecessor. As a result, a short few years after its implementation, the calls for a new reform are multiplying.

KEY-WORDS: Fiscal governance, fiscal rules, moral hazard, risk reduction, risk sharing.

Δημοσιονομική Διακυβέρνηση στην Ευρωζώνη: Από το Μάαστριχτ στην κρίση και πάλι πίσω;

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Περίληψη

Ο καθορισμός του βέλτιστου επιπέδου και των μέσων δημοσιονομικής διακυβέρνησης σε μια νομισματική ένωση κυρίαρχων κρατών δεν είναι εύκολο έργο. Μια νομισματική ένωση πρέπει να διαθέτει ένα ολοκληρωμένο πλαίσιο δημοσιονομικής διακυβέρνησης, το οποίο θα επιτρέπει ευελιξία για την αντιμετώπιση ασύμμετρων σοκ στα διάφορα κράτη μέλη· θα αποθαρρύνει τη δημοσιονομική κακοδιαχείριση και θα ελαχιστοποιεί τις δευτερογενείς επιπτώσεις όταν αυτή συμβαίνει· θα παρέχει τα μέσα για αποτελεσματική δημοσιονομική διαχείριση κατά τη διάρκεια του οικονομικού κύκλου και θα δημιουργεί τους απαραίτητους μηχανισμούς για την αντιμετώπιση ενός κοινού εξωτερικού σοκ. Η δημοσιονομική διακυβέρνηση που σχεδιάστηκε στο Μάαστριχτ ήταν ασύμμετρη και ελλιπής. Καθιέρωσε μια αποκεντρωμένη προσέγγιση «ατομικής ευθύνης», χωρίς αποτελεσματικό μηχανισμό συμμόρφωσης και χωρίς μηχανισμούς στήριξης για περιόδους οικονομικών αναταράξεων. Οι αδυναμίες της, αποκαλύφθηκαν από την παγκόσμια χρηματοπιστωτική κρίση και συνέβαλαν στην επιδείνωση της κρίσης στην Ευρωζώνη οδηγώντας σε μια δεύτερη κρίση χρέους και σε διπλή ύφεση. Η έλλειψη θεσμικών δικλείδων για την αντιμετώπιση της κρίσης μετέτρεψε τον χειρισμό της σε μια de facto πολιτική, και ως εκ τούτου, διακυβερνητική διαδικασία όπου οι πιστώτριες χώρες, βρισκόμενες σε μια εξαιρετικά πλεονεκτική διαπραγματευτική θέση, υπαγόρευσαν τόσο τους όρους των συμφωνιών διάσωσης όσο και αυτούς της μεταρρύθμισης της δημοσιονομικής διακυβέρνησης. Όντας ουσιαστικά μια ενισχυμένη έκδοση του πλαισίου που προϋπήρχε της κρίσης, η νέα δημοσιονομική διακυβέρνηση στέφθηκε με περιορισμένη επιτυχία στην προσπάθειά της να εξισορροπήσει αντικρουόμενους στόχους· είναι ταυτόχρονα πιο περιοριστική και πιο επιρρεπής σε πολιτικούς ελιγμούς· ολοένα και πιο πολύπλοκη, αφήνοντας παράλληλα περισσότερο περιθώριο για διαφορετικές ερμηνείες, χωρίς να είναι τελικά πιο αποτελεσματική. Ως αποτέλεσμα, λίγα μόλις χρόνια μετά την εφαρμογή της, οι εκκλήσεις για μια νέα μεταρρύθμιση πολλαπλασιάζονται.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Δημοσιονομική διακυβέρνηση, δημοσιονομικοί κανόνες, ηθικός κίνδυνος, μείωση του κινδύνου, επιμερισμός του κινδύνου.

1. Introduction

Determining the optimal level and instruments of fiscal governance in a monetary union of sovereign states is not an easy task. A monetary union needs to have in place a comprehensive framework of fiscal governance, which allows enough flexibility to deal with asymmetric shocks in different member states; discourage fiscal mismanagement, and minimize spillover effects when it happens; provide the means for effective fiscal management over the business cycle; and build the necessary mechanisms to deal with a common external shock.

The fiscal governance of the European Economic and Monetary Union (EMU) was the result of a political compromise. This led to an imbalanced and unsustainable fiscal framework, which along with other shortcomings of EMU's broader economic governance contributed to the outbreak of the eurozone debt crisis. Eurozone's lack of institutional preparedness forced European leaders and policy makers to embark on a reform effort at the same time that they were trying to bring the crisis under control. The adverse economic and political environment put pressure for prompt decisions, often based on last minute compromises and more often than not, on the imposition of the will of member states enjoying an asymmetrical power advantage in an increasingly intergovernmental negotiation setting. The resulting governance framework raises significant political economy concerns, and it is doubtful whether it is effective and indeed, whether it signifies a substantial departure from the previous governance's failed philosophy.

The aim of this chapter is to explore these questions by reviewing the fiscal governance of the Eurozone and its evolution after the crisis, against lessons derived from the theoretical and empirical literature on fiscal governance in a monetary union. The first part of the article engages with the theoretical and empirical literature on fiscal governance in a monetary union, employing insights from the Fiscal Federalism and Optimum Currency Area (OCA) theories, as well as from the literature on fiscal rules and coordination. The second part, focuses on the design and evolution of Eurozone's fiscal governance, particularly following the crisis. The aim is to provide a critical examination of the reforms under the analytical lens of political economy, in order to evaluate their contribution to a more effective economic and monetary union.

2. Fiscal policy in a monetary union

According to classic public finance theory, a government can use the state budget to perform three basic functions: (a) the efficient allocation of the resources of an economy (for example by providing public goods in case of market failure), (b) the redistribution of income and (c) the stabilization of economic activity in fluctuations of the economic cycle or in case of an exogenous shock (Musgrave 1959). Although the justification of these functions is based on economic criteria, their adoption as objectives of government policy depends to a large extent also on non-economic factors, such as political and social institutions and traditions, which shape the prevailing perception of the role of the state in a society, and thus affect the priority given to different functions, as well as the intensity with which these are pursued.

In the case of member states of the EMU, achieving a desirable but also fiscally sustainable balance between these objectives, should also take into account the budgetary constraints and opportunities arising from their participation in such a union. In this context, a key question to be answered concerns the level of governance (national/supranational) on which the different budgetary functions should be exercised.

One way to answer this question is by recourse to the literature on 'fiscal federalism'. The theory of fiscal federalism refers to the operation of a central fiscal system, which includes all members of a federal state, both the federal administration, as well as the Länder or states (Whyman and Baimbridge 2004, 1). In its classical form, the theory puts forward arguments about the appropriate level (local/federal) of exercise of the different fiscal functions and what financial tools should be used in each case (Oates 2004). More specifically, restrictions on the operation of the fiscal multiplier and the risk of external debt growth make stabilization operations less effective at the local level (Oates 1968). The effectiveness of the redistributive function is also hampered at the local level, due to the mobility of individuals and other productive factors, while finally, the effective production of public goods can be implemented at both local and central level, depending on the nature of these goods (Oates 1968).

The above analysis shows that despite the normative predilection of fiscal federalism for fiscal decentralization,[1] the centralization of fiscal functions is often necessary. This conclusion is of interest in the study of fiscal policy in the EMU, which has several of the characteristics of a federation, such as a multilevel governance structure, freedom of movement of goods, services and people and a common monetary policy. On the other hand, however, several of the assumptions of the theory of fiscal federalism are not met in the case of the EMU. Thus, for example, the hypothesis of high labour mobility, which is central to the theory of federalism (Ribstein and Kobayashi 2006), does not apply in the EMU, as the existence of different institutions, languages and cultural traditions restrict the mobility of individuals. Also, an important hypothesis for the stabilization function, that cycle fluctuations or exogenous economic shocks occur primarily at the national (central) rather than at the local level, does not apply in the EMU, where different member states often face asymmetric economic shocks. Finally, unlike a federation, in the EMU there is no fiscal union where a budgetary authority can pursue fiscal policy at a central level.

It is clear therefore, that the EMU's sui generis nature, where increased levels of economic integration and multi-level governance structures co-exist with sovereign nation-states, complicates the determination of its optimal fiscal governance. The absence of basic characteristics of a typical federation, such as the high degree of human mobility and economic symmetry, is a problem for the functioning of the EMU, as according to the OCA theory (Mundell 1961, McKinnon 1963, Kenen 1969), these conditions are considered to be particularly important for the successful operation and stability of a monetary union.[2]

Economic symmetry ensures that the macroeconomic fluctuations experienced by members of a monetary union are closely correlated with each other. Otherwise, asymmetric economic shocks lead to very different macroeconomic developments in each country, which cannot be effectively addressed by the union's single monetary policy (De Grauwe 2009). In these circumstances, flexibility in the member states' labour markets can be an important stabilizing mechanism. Labour market flexibility refers both to the mobility of the labour force within the monetary union and the flexibility of wages according to economic conditions (Mundell 1961). Labour factor mobility allows workers to leave member states in the downside of the economic cycle, which experience high unemployment rates, and move to member states on a high growth trajectory, where there is strong demand for labour. Wage elasticity, respectively, allows wages to be adjusted downwards (upwards) in member states facing high (low) unemployment, thereby reducing (increasing) production costs and making their products more (less) competitive. This simultaneous adjustment helps to restore the balance between the member states of the union.

From the preceding analysis, it follows that when economic symmetry and labour mobility among member states of a monetary union are low, and wages in their labour markets do not adjust easily downwards, dealing with asymmetric economic shocks is a major challenge. In these circumstances, and since the single monetary policy is not capable of effectively addressing the different asymmetric shocks, fiscal policy becomes necessary for stabilizing the economy. The budgetary stabilization function can be exercised both at the supranational and the national level.

The OCA theory supports the creation, at supranational level, of a central, common budget, which can automatically use the (increased) revenues from the countries on the upward phase of the economic cycle, in order to support the countries in recession, thus facilitating the adaptation of member states to asymmetric economic shocks (Kenen 1969). The creation of a common budget also has the advantage of removing pressure from national governments to use their national budgets to stimulate the economy in the event of a recession, avoiding the risk of running high budget deficits, which, as experience has shown, are not easy to reduce, at least in the short-term.

However, the creation of a common budget has its own risks, and more specifically, the so-called 'moral hazard'. Moral hazard arises from the alteration of the incentives of the governments of the countries receiving the cash flows from the central budget. Access to centralized funding relaxes incentives to promote and implement reforms, which may be necessary, particularly when the economic shock proves to be long-term, suggesting structural problems. For this reason, centralized budgetary transfers should have a limited duration and be used in short-term fluctuations of the economic cycle and not in crises having structural causes, by substituting for necessary reforms (De Grauwe 2009).

3. The limitations of national fiscal policy in a monetary union

At the national level, the functioning of automatic fiscal stabilizers can contribute to the smoothing of consumption and limit the negative effects of an economic shock. On the other hand, the use of discretionary fiscal policy to stabilize the economy is a much more complex issue, which presents significant technical difficulties (Tanzi 2005), poses the risk of further destabilization (Kamps et al. 2017) and could lead to high fiscal deficits and the accumulation of public debt. If this happens, the cost of adjustment will be transferred to future generations, who will have to repay it through a restrictive fiscal policy, thereby limiting the degrees of freedom of future policy makers (De Grauwe 2009). This problem is magnified when public debt reaches a level where its viability is questioned; in this case, the use of fiscal policy for stabilization purposes in the event of an economic shock will not available, worsening the potential effects of the shock.

On a second level, high budget deficits and increased levels of government debt may create indirect negative effects in other member states of the monetary union (cross-border spill-over effects). According to the literature, these effects may stem either from the possible bankruptcy of a member state with increased levels of debt, or from the existence of high budget deficits in a member state, even if there is no danger of bankruptcy (Buiter 2006).

In the first case, the bankruptcy of one member state may lead to significant problems in the financial sector of other member states, in so far as part of the first state's debt is held by investors in the other states (which is expected in a monetary union with increased levels of financial integration). The possibility of a bankruptcy is increased in a monetary union, as in the event of a liquidity crisis, the inability to devalue the currency and exercise an autonomous national monetary policy create conditions for its conversion into a solvency crisis (De Grauwe 2011).

This creates an incentive for the other member states, to rescue the state facing a debt crisis, either directly or through a central (supranational) mechanism, even when there are explicit rules (no-bailout clauses) that prohibit such action. Although historical experience from federal states has shown that no-bailout rules have contributed to a more prudent financial management on the part of local governments (Bordo et al. 2011), the case of a monetary union of sovereign states is different; the presence of no-bailout rules is not credible, as a possible bankruptcy would not only damage the economy and thus burden the budget of the other member states, but would also call into question the continued participation of the member state in crisis in the monetary union, risking an irreparable damage to the latter's credibility.[3]

In the second case, the policy of increased budget deficits by one member state may lead to an increase in inflation and interest rates at the union level, thereby affecting both the economic policy of the other member states (e.g. through the adoption of restrictive budgetary measures to curb inflation), and the exercise of monetary policy by the single monetary authority (Beetsma and Giuliodori 2010).

4. Fiscal Governance in a monetary union

The mechanisms typically chosen to overcome the limits of supranational fiscal governance and address the risks of discretionary national fiscal policy within a monetary union are two: (a) fiscal rules and (b) coordination of national fiscal policies. The aim of fiscal rules is to place restrictions on the exercise of national fiscal policy to avoid excessive budget deficits and the accumulation of public debt. The debate on fiscal rules in a monetary union revolves mainly around two issues: (a) their necessity and (b) their effectiveness.

On the first issue, arguments have been made challenging the necessity of fiscal rules, particularly at the central (supranational) level. The inherent weakness of fiscal rules emanates from their very nature, as they set predefined targets without taking into account the prevailing conditions, which creates a problem of time inconsistency for fiscal policy (Wyplosz 2012). The problem lies in the fact that the 'rigidity' of fiscal rules restricts the ability to exercise the stabilization function at a time when it is most needed. The imposition of supranational rules restricting the ability of national governments to react to adverse economic conditions inevitably leads to a clash between member states and monetary union institutions with negative results for the credibility of the rules and therefore for the functioning and reliability of the monetary union itself (De Grauwe 2009).[4] Furthermore, it is argued that the participation in a monetary union tends to improve the budgetary discipline of the member states, as they lose the ability to 'print' money to finance their budget deficits, thus making fiscal rules unnecessary (De Grauwe 2009).[5] Finally, in so far as the spill-over effects of an expansive fiscal policy in other member states are not significant, the need to establish budgetary rules at the supranational level is called into question (Buiter 2006).

As regards the effectiveness of fiscal rules, recent empirical research seems to suggest a positive impact on the fiscal deficit (e.g. Debrun et al. 2008, Holm-Hadulla et al. 2012, Badiger and Reuter 2017). On the other hand, other studies report lack of impact when all available instruments of debt (Von Hagen 1991), or levels of government (Kiewiet and Szakalay 1996, Von Hagen and Eichengreen 1996) are taken into account, or mixed results, depending on the effectiveness of the rules' design (Kennedy and Robbins 2003, Tapp 2013, Caselli and Reynaud 2019). A recent meta-regression analysis of 30 studies performed by Heinemann et al. 2018, points to overall positive results, which however are significantly reduced when methodological approaches become more sophisticated to account for factors of endogeneity. The experience of EMU, as described in more detail in the next section, also gives a mixed picture, as the budgetary rules introduced by the Maastricht Treaty for entry into the EMU appear to have had a positive effect on the restriction of budget deficits, while the Stability and Growth Pact (SGP) does not appear to have had an equally effective impact on the fiscal management of the member states once they were inside the Eurozone (Ioannou and Stracca 2011). This provides support for the view that fiscal rules are effective when they are compatible with the preferences of governments, i.e. when they act as mechanisms for signaling their incentives (Debrun and Kumar 2007), and not when they are used as 'suppression' mechanisms, since in this case policymakers find ways to bypass the rules (Koen and Van Den Noord 2005).

The ambiguity about fiscal rules' effectiveness, has led in recent years to a debate on the role of fiscal institutions and more specifically, the usefulness of independent fiscal councils (Calmfors and Wren-Lewis 2011, Wyplosz 2012, Debrun et al. 2013, OECD 2014, Calmfors 2015, Beetsma et al. 2018). Although fiscal councils had initially been considered as an alternative to fiscal rules (e.g. Wyplosz 2005), in recent years it seems that the use of fiscal councils is increasingly considered as a complementary institution in an existing framework of fiscal rules (Calmfors and Wren-Lewis 2011, Wyplosz 2019). In particular, it is considered that a fiscal council independent of political influence and increased technical competence can help both in designing and monitoring the implementation of more complex (non-rigid and counter-cyclical) fiscal rules.

On the other hand, fiscal councils should not be considered a panacea. Although they can potentially play an important role in reducing the trend towards excessive budget deficits, their effectiveness depends to a large extent on the root causes of deficits and on their own institutional characteristics, which are shaped by the preferences of the political system, making them therefore subject to some of the same restrictions facing fiscal rules (Calmfors 2015). Although initial empirical studies show positive results from the functioning of the fiscal councils on budgetary discipline (Debrun and Kinda 2017), as well as on the quality of forecasts and the application of fiscal rules (Beetsma et al. 2018), it is probably still too early to draw definitive conclusions, particularly as there is a wide variety of institutional designs in place across countries.

A second mechanism to address the potential negative consequences of unilateral fiscal policies by the member states of a monetary union refers to the coordination of national fiscal policies. Although the adoption of common fiscal rules at the supranational level can be seen as a kind of coordination mechanism, it is not the same. In the case of common fiscal rules, member states act independently and without taking into account the fiscal policies of the other member states; on the other hand, coordination requires cooperation between member states with a view to formulating a common fiscal stance at the union level.

Fiscal coordination has the potential to overcome the relative rigidity of fiscal rules, and its benefits are magnified during a crisis when the potential negative effects of unilateral discretionary fiscal policy increase (Frankel 2014, Alcidi and Gros 2014). Having said that, fiscal coordination is not easy to achieve given the different cyclical positions of different member states in a monetary union; in this context, the stabilization needs of individual states and the union as a whole may be different (Kamps et al. 2017), which could lead to a clash between the sustainability and stabilization objectives between different states. Implementation difficulties aside, there is also some uncertainty about the desirability of fiscal coordination, given the possibility of member states in a monetary union working in a coordinated manner to pressure the single monetary authority to ease monetary policy (Beetsma and Giuliodori 2010).

The latter possibility also highlights a second dimension of fiscal policy coordination in a monetary union, that between national fiscal policies and the single monetary policy. The coexistence of a single monetary and multiple fiscal authorities creates a conflict of policy priorities and objectives resulting in an inefficient overall policy mix for the union. This inefficiency is likely to be magnified in the event of a crisis, when interest rates fall to very low levels and the monetary authority is forced to enlist non-conventional monetary policy tools, as has been the case in recent years in the EMU; in this case, the coordinated use of monetary and fiscal policy is necessary in order to restore macroeconomic balance (Corsetti et al. 2016).

The previous analysis shows that fiscal policy at both the national and supranational levels faces significant constraints. A common, and perhaps most important, limitation for both levels of governance is the duration of its use. Although the definition of a predetermined period of time is not desirable, as the duration of its use for stabilization purposes should be judged individually according to the type and intensity of the economic disorder that is called upon to address, it is obvious that its use for a long time can cause significant problems.

This assumption highlights the importance of structural reforms in a monetary union. More specifically, the preceding discussion of the OCA theory shows that reforms which increase the flexibility of member states' labour markets, so that the latter can act as a mechanism for restoring imbalances in the wake of asymmetric economic shocks, can improve the stability of the monetary union. The need to increase economic symmetry between member states of a monetary union also suggests the need to coordinate a range of national macroeconomic and other policies, often linked to broader political, social and institutional characteristics of an economy. Different traditions, institutional characteristics of the labour and product markets, but also political and social preferences on the level of wages, inflation and unemployment can create economic divergences with significant consequences (Calmfors and Driffill 1988, Maclennan, Muellbauer and Stephens 1999).

In conclusion, the theoretical debate, the findings of empirical research and historical experience seem to imply that the use of fiscal policy for stabilization purposes is necessary in a monetary union consisting of sovereign nation-states. However, given the political incentives for its abuse and the risks it entails both for the states exercising it and for the other members of the monetary union, it is equally necessary to create institutions to monitor and control its use. The views on the design and the level (national/ supranational) of fiscal governance are divided, as some analysts consider it necessary to exercise centralized fiscal stabilization, while others consider that a more flexible central framework of fiscal rules, combined with the creation of national institutions such as fiscal councils, could be a satisfactory solution. In any case, promoting reforms for the convergence of economies and increasing flexibility in the labour market should be considered necessary both to prevent the asymmetric economic shocks affecting the member states of a monetary union, and their more effective management when they arise.

5. The development of fiscal governance in the EU

From EMU to the crisis

The idea of creating a supranational governance framework for fiscal policy in the EU is inextricably linked to the prospect of a European economic and monetary union. Although its implementation had to wait for the signature of the Maastricht Treaty in 1992, the idea was first suggested a long time before that. In particular, in 1970 the Werner Report argued for the need to coordinate the fiscal policies of the member states of an economic and monetary union,[6] while the Marjolin Interim Report (1975), which examined progress towards economic and monetary integration, went much further, stating that all fiscal functions should also be exercised at the supranational level and proposed the creation of a Community unemployment fund as a kind of supranational stabilization mechanism. The MacDougall report (1977), which followed, was the first attempt to systematically study the fiscal dimension of European economic integration; the report adopted the previous proposals, which it analyzed more systematically, and proposed the possibility of grants and lending at the Community level for the stabilization of the economy and the management of the economic cycle both in different member states and for the European Economic Community as a whole. On the last point, the report refers to the need to coordinate fiscal and single monetary policy in the context of a monetary union.

The first attempt to create a European economic and monetary union failed. The adverse economic conditions of the 1970s and the sharp exchange rate fluctuations following the collapse of Bretton Woods led member states to adopt independent and often divergent economic policies, which did not allow further progress. The EMU would have to wait for the revival of the European project in the mid-1980s, as the common currency was presented as a logical but also necessary complement to the single market.

The Maastricht Treaty provided for three stages on the road to the EMU. Fiscal policy was at the heart of this process from the second stage, which began on the 1st of January 1994 and introduced, inter alia, the fiscal rules (convergence criteria) laid down in the Maastricht Treaty. These appeared to work effectively, at least in part, since all the countries wishing to enter the EMU satisfied the criterion for a budget deficit of less than 3% by the end of the decade. On the other hand, the criterion for public debt (less than 60% of GDP) was clearly not met by three countries, Italy, Belgium and Greece.[7] These countries were burdened with high levels of public debt (more than 100% of GDP) which could not be reduced to levels that met the sovereign debt criterion in the foreseeable future. To overcome this problem, the criterion included an 'override clause', which allowed higher levels of public debt, provided that the latter was on a downward trend.

The decision to override the debt criterion, illustrates the political nature of the EMU, which was clear from the outset (see Sadeh and Verdun 2009 for a review of the relevant literature); when the decision to create the EMU was taken, it was obvious that the conditions for an optimal currency area were not met (e.g. Eichengreen 1990, De Grauwe and Heens 1993). Against this background, the design of EMU's governance framework was bound to be shaped by political factors. EMU's governance reflected more the preferences of certain member states and the balance of power in the EU at the time, rather than the dictates of economic theory. In particular, the pillar of monetary policy was, from the start, institutionally strong. The European Central Bank (ECB) had a clear mandate to maintain price stability, was equipped with all the necessary policy instruments and authority and was protected from political interference. The strong institutional guarantee of ECB's independence, but also its strict commitment to the objective of price stability, were modelled after the German central bank and reflected Germany's preferences in this field.

On the other hand, the fiscal governance of the EMU was based on the Stability and Growth Pact (SGP), which set a balanced or surplus budget as a medium-term target for the member states of the euro area, establishing also a threshold (3% of GDP) for the start of an excessive deficit procedure. This procedure could lead, on a proposal from the European Commission to be adopted by the Council of Ministers, to recommendations to the member states violating the deficit threshold; if these were not adhered to within a specified timetable, sanctions could be triggered. The objective of the SGP was to ensure that member states adhered to budgetary discipline after entering the EMU (Pisani-Ferry 2006).

This institutional set-up soon proved to be ineffective; ironically, in 2003 it was Germany, which had pushed for the SGP framework, but also France, that refused to implement the Commission's recommendations on budgetary discipline in the midst of a recession, and led a coalition of states in the Council which blocked the continuation of the excessive deficit process against them. In the wake of this conflict, the renegotiation of the SGP in 2005 introduced more flexibility, which was interpreted in many quarters as a weakening of the fiscal rules' framework (Buiter 2006). In any case, the significance of the reform is questionable, since data on member states' fiscal management reveals that the SGP was equally ineffective both before and after the reform. For the EU-15, there were 14 cases of excessive deficit (over 3% of GDP) between 1999-2003 and another 16 cases between 2004-2007 (Begg 2011). In addition to these violations, there were another 50 cases of deficit in the 0-3% range (Ibid), which while below the excessive deficit threshold, were obviously not in compliance with the SGP's target of balanced or surplus budget. It appears then that, after entering the EMU, governments relaxed their fiscal efforts and the fiscal rules did not provide a credible external constraint, particularly since the political nature of the procedure ensured the impunity of the offenders.

Given this data, it is evident that there was no EMU-wide fiscal stance and accordingly no coordination between fiscal and monetary policy before the crisis. Against a background of differential growth rates, driven by different institutional and economic dynamics (e.g. non-tradables in the periphery vs exports in the core) and divergent fiscal policies, the one-size-fits-all monetary policy, became a one-size-fits-none policy (Schmidt 2015), which ended up magnifying macroeconomic imbalances between the member states. Thus, for example, the combination of substantial inflation differentials and common official rates, led to widely divergent levels of real interest rates. In countries like Ireland and Spain real interest rates were on average below one percent for the period 2000-2007, which in turn contributed to the creation of asset bubbles; during the period 2002-2007, dwellings' prices increased by 70% in Ireland and doubled in Spain (Financial Crisis Inquiry Commission 2011). The development of significant fiscal and macroeconomic imbalances in several countries,[8] resulted in increased divergence among euro area economies instead of the much-anticipated convergence.

Once the bubbles collapsed, these countries were forced into an abrupt adjustment, as access to funding was quickly restricted. Things were even worse for countries like Greece, which had entered the global financial crisis with little fiscal space and a high public debt. There was no central instrument which could deal with the shock and ensure funding for the governments dealing with a meltdown of their financial systems, the slowdown of their economies and/or the sustainability of their public debt. The EU's budget, close to one percent of GDP was clearly insufficient to deal with the crisis -not that employing funds from the common budget for stabilization purposes was ever seriously considered- while the ECB was unable, due to its mandate, to act as a traditional lender of last resort, although it did employ various instruments designed to enhance access to credit and liquidity to the European banking system.

In hindsight, it could be argued that the rationale of the pre-crisis fiscal (and more generally economic) governance in the EMU, rested on a political deal, which at the same time, employed and defied economic rationale. Against a background of low labour mobility and highly asymmetrical and diverse national economies, EU's political leaders based the monetary union on institutionally weak fiscal and macroeconomic pillars and resisted the creation of supranational fiscal capacity, which could perform a stabilization function and coordinate an EMU-wide fiscal stance. By completely defying the tenets of OCA theory they effectively made sure that the growth of macroeconomic imbalances could not be monitored and controlled, allowing thus the development of conditions that would lead to a crisis, and that once a crisis erupted, there would be no procedure or mechanism to address it effectively. In combination with the monetary authority's institutional constraints to act as lender of last resort, the institutional outcome 'ensured' that the consequences would be magnified in the event of a crisis.

Why did they opt for such an obviously imbalanced and ineffective framework? The answer lies in a combination of national preferences, selective economic argumentation and political short-sightedness. The stronger EU members acknowledged the differences in the institutional organization and potential of different economies, but they opted to ignore them -a decision necessary to achieve the political agreement of weaker members- resting their hopes on a much anticipated 'catching-up' process, while also limiting their liability in case things did not develop as planned. This political compromise, was justified by a selective use of economic theory, whereby OCA theory's dismal predictions were replaced by the more optimistic projections of the so-called endogenous theory of optimal currency areas, which stipulated that economic integration and symmetry could follow monetary unification (Frankel and Rose 1998, 2002), and by the belief that 'market discipline' would prohibit the emergence of large imbalances, particularly when a no-bailout clause, was in place.

Unfortunately, markets dismissed the no-bailout clause alleging instead the existence of an implicit bailout clause. On this assumption, increased financial integration instead of disciplining member states, relaxed the funding constraints of weaker states, allowing the emergence of large fiscal deviations (e.g. Greece), or hiding weak fiscal foundations (as was the case with the fiscal windfalls related to real estate bubbles in countries like Spain, Ireland and Cyprus).[9] When the crisis hit, the decentralized 'individual responsibility' governance of the EMU, had no institutional tools to handle it, forcing member states to engage in a major reform effort, amid economic difficulties and political recriminations.

Crisis and the first wave of fiscal reforms

The global financial crisis unfolded gradually from 2007 in the US housing market, and then expanded to the rest of the world and Europe at a rapid pace, particularly since the collapse of Lehman Brothers in September 2008. In this context, the outbreak of the Greek crisis in autumn 2009 exacerbated an already negative European and international economic environment and served as a catalyst for the wider eurozone debt crisis that followed. The crisis revealed the limitations of the Maastricht compromise -dealing with fiscal spillover effects became a necessity when sovereign default turned into a likely scenario. The danger of default in the periphery threatened the solvency of European financial institutions at the core, while the scenario of a default-induced exit of a member state from the Eurozone threatened the credibility and therefore survival of the entire monetary union. In this context, 'bailing out' countries under distress became necessary. The reluctant acknowledgement of this necessity did not alter creditor countries' previous attitude on fiscal transfers and common fiscal capacity; on the contrary, it incentivized them to reduce their fiscal exposure as much as possible. The approach was justified by invoking the moral hazard that would result from the creation of stabilization or other 'fiscal solidarity' mechanisms at the supranational level; countries in trouble needed to have the proper incentives to reform.

The handling of the crisis through national adjustment programmes with a view to ensure fiscal sustainability at the national level with the minimum pooling of fiscal resources at the supranational level, led to a prioritization of austerity over all other policies, including structural reforms (Pisani-Ferry et.al. 2013, Petralias et al. 2018). The policy recipe was based on a diagnosis of fiscal mismanagement and irresponsibility, obviously not true for most cases aside Greece. The coincidence of the Greek crisis' outbreak being the first, erroneously shaped the view of policy-makers' response to the other countries, whose problems did not originate from fiscal mismanagement (Buti 2020); the most likely explanation for this misdiagnosis is that the Greek case served as an excuse to promote a policy which satisfied creditor countries' aversion to fiscal risk sharing. Irrespective of one's interpretation of decision makers' motives, the result was an unnecessary and prolonged economic and social suffering in crisis-hit countries, which undermined further the economic and political cohesion of the euro area, and ultimately threatened its very survival.[10] What is more, the endorsement of austerity policies, even in countries like Germany, which did not face fiscal constraints, led to a de facto EMU-wide deflationary fiscal stance, which led the euro area in a double deep recession in 2012/13. The asymmetry of the response was evident at both national and euro area levels; fiscal sustainability took precedence over stabilization in the midst of a recession.

At the same time the EU was forced to reform its economic governance (see Appendix I for a brief review of the most significant reforms). A cursory review of the reforms is enough to acknowledge that a significant reform effort was made; existing rules and procedures were updated and entirely new institutions and mechanisms were introduced, making this the most comprehensive institutional reform initiative since Maastricht. Such progress notwithstanding, the design of the new economic governance echoed the approach that dominated the handling of the crisis. Given the narrative of fiscal irresponsibility, the emphasis of the reforms lay in the fiscal dimension of economic policy (Pisani-Ferry

2015). Their aim was to ensure fiscal sustainability in member states, in order to minimize negative fiscal spillovers and therefore the need for the pooling of fiscal resources at the supranational level. The creditor countries, which enjoyed a highly asymmetrical negotiating advantage, came to dictate the terms of the new fiscal governance according to their national preferences (Schimmelfenning 2015). In order to ensure the desired outcome, reforms were often negotiated outside the EU's legal framework; both of EU's new funding mechanisms, the emergency European Financial Stability Facility (EFSF) and the ESM, and one of the most important fiscal reforms, the Fiscal Compact, were negotiated as international agreements.

Accordingly, the main reforms in the area of fiscal governance comprised mechanisms of enhanced national fiscal discipline and surveillance, while EMU-wide fiscal coordination and/or supranational fiscal instruments and funding mechanisms were absent. The requirement of the Fiscal Compact for the incorporation of budgetary rules into national law, 'two-pack's' requirement for the screening of national budgets by the European Commission before submission to national parliaments, the principle of a negative majority for the obstruction of sanctions on member states which do not apply the Commission's directives within the framework of the excessive deficit procedure, the obligation to create independent fiscal councils to supervise national fiscal policy and the enhanced surveillance procedures of the European Semester, have created a strong fiscal framework, which limits the budgetary discretion of national governments.

At the same time, the stabilization function remained at the national level, with the main changes relating to the recognition of the need for greater flexibility in order to cope with fluctuations in the economic cycle. There was no move to create a stabilization mechanism at the supranational level, nor was the use of the EU budget discussed for macroeconomic stabilization purposes. Moreover, proposals for the creation of a European safe asset did not progress, despite the fact that it could provide an effective mechanism for restoring access to funding for countries undergoing a crisis and prevent uncertainty-induced contagion to other member states (Gilbert et.al. 2013).[11] Furthermore, the coordination of fiscal policies remained an institutionally unrealized objective; nonetheless coordination as previously noted, did take place, by member states' voluntary or imposed adherence to austerity. The creation of the European Fiscal Council, which could assist in formulating a common fiscal stance, took place in 2017, several years after the first wave of reforms; in any case its role is advisory, and its proposals do not have binding force.

On the other hand, there were two important reforms with implications for fiscal policy. The first was the establishment of last resort funding mechanisms like the European Stability Mechanism (ESM).[12] The ESM provides funding to countries which lose access to the international markets and thus functions as a lender of last resort. The problem however, is that it operates on the basis of strict policy conditionality, aimed at restoring imbalances at the national level. Conditionality tends to work in a procyclical manner, intensifying in the short-term the negative effects of the economic shock. Beyond economic inefficiency, these features reduce the bailout programmes' political appeal for member states in difficulty and can produce frictions between national governments and EU institutions, undermining the credibility of the union. As already noted, these problems were observed during the crisis. A second significant development relates to the promotion of an EU Banking Union, intended to limit the close links between sovereigns and banks, which can prove detrimental in times of crisis for both sides. Although progress has been satisfactory regarding the establishment of a common supervisory mechanism and restructuring procedures in case of a banking crisis,[13] agreement on the common deposit guarantee system has proved elusive thus far, which is hardly surprising, in view of the shared liability it entails.

6. Completing the EMU's fiscal governance

Trying to balance conflicting priorities and objectives, has unsurprisingly led to unsatisfactory outcomes; the framework of fiscal governance has proven complex, technically difficult to implement and ineffective (Alcidi and Gros 2014, Pisani-Ferry 2015). Trying to ensure adequate flexibility to deal with asymmetric shocks, without committing supranational resources has led to an ever-increasing number of overlapping rules and exceptions, which undermine both their operability, and their credibility, by allowing room for political maneuvering, not only by national governments, but increasingly by the European Commission as well (Claeys et al. 2016, Beetsma and Larch 2019). Indeed, the experience from the first few years of the new fiscal framework's operation casts doubt on its credibility as the application of fiscal rules has been characterized by discontinuity and inconsistency (Begg 2017).[14] Paradoxically, the result is a fiscal governance framework, which while relying more than ever before on rules, at the same time allows more discretion in their interpretation and implementation (Begg 2017). In the end, and in spite of all the reforms efforts, it seems that once again, as was shown before the crisis, fiscal performance responds more to domestic political preferences and constraints, rather that adjust to externally imposed fiscal rules. This is nowhere demonstrated as vividly as in the system's inability to enforce fiscal targets symmetrically, that is, not only for the deficit but also for the surplus countries, like Germany, which in recent years as noted above, tightened its fiscal policy well above its SGP medium-term objective (Claeys et al. 2016). Beyond the economic inefficiency that such an asymmetry entails, it also undermines the ability to coordinate an EMU-wide fiscal stance, and has significant distributional implications for the other euro area member states.

Given these problems, there seems to be wide agreement that, so soon after its reform, the EMU's fiscal governance needs to be reformed again (Beetsma and Larch 2019). In this context, the European Commission proposed new measures and a roadmap for the completion of EU's economic governance (European Commission 2017). In addition, to amendments in order to streamline existing institutions, the Commission proposed new and ambitious initiatives, including among other things, turning the ESM into a European Monetary Fund and founding the position of a European finance minister. The European Commission's proposals and the proposals of the French President Emmanuel Macron in September 2017, for a broader EU reform, triggered a public debate on the issue of EU's economic governance.[15]

Although the terminology has slightly changed, the stakes in the discussion have remained the same; the distribution of costs to restore balance in the European economy. The debate is now taking place in terms of actions necessary to reduce or share the risk, that is, the cost for dealing with the crisis' legacy problems. The position on risk reduction essentially represents the position of the creditor countries, that restoring the balance should be the result of an adjustment process undertaken by the member states that face problems, which, of course, would alone bear the cost of this adjustment. Only when the imbalances faced by these states are addressed and therefore the risk of fiscal and other economic spillovers has been reduced, can the discussion on more ambitious risk-sharing initiatives proceed. This sequence of political choices illustrates the basic argument on which this view is based, which is none other than moral hazard. The concern is that the introduction of risk-sharing mechanisms prior to the completion of the adjustment process will create distorted incentives for the political elites of countries in trouble, thereby loosening their reform efforts. This will lead to a perpetuation of problems in these economies, which will be able to survive thanks to transfers and guarantees of solidarity mechanisms at the supranational level. The permanent nature of these transfers essentially entails the establishment of a transfer union.

On the other hand, those who argue that emphasis should be placed on risk-sharing mechanisms are essentially calling for greater solidarity. The economic rationale behind the immediate creation of risk-sharing mechanisms lies in the belief that the creation of such mechanisms will contribute to reducing risk, thus facilitating and accelerating the adjustment process. A particularly important element of this argument has to do with the fact that many problems that seem to be theoretically manageable can develop into uncontrolled situations due to the behaviour of financial markets (De Grauwe 2011). To the extent that part of the problem is the way financial markets operate, insisting on the adoption of tough national adjustment policies at significant economic and social cost is not only unfair but also unlikely to be economically effective. So, for example, without the completion of the banking union (in particular the common deposit guarantee system), the credibility of banks, particularly in countries whose banking sector still experiences difficulties, will continue to be low. This in turn will have a negative impact on banks' ability to fulfil their intermediary role, thereby delaying the consolidation of a sustainable recovery. In other words, the lack of supranational risk-sharing mechanisms prolongs market uncertainty, making their adjustment more difficult and painful than necessary.

For this reason, a number of voices have been arguing that the two options should be treated not as alternatives but as complementary: supranational solidarity mechanisms facilitate adjustment at national level, which makes it less likely that they will actually be used. This interpretation is evident in the Commission's 2017 proposals and has also been adopted by officials of all EU institutions, like the ECB (Draghi 2018), the European Fiscal Council (Beetsma and Larch 2019) and the European Commission (Buti 2020). In addition, in order to address the concern about the moral hazard of the creditor countries, many of the proposals include a series of measures to discourage their possible abuse.

Alas, progress is not probable in the foreseeable future as the two sides in the political economy contest seem immovable; the negative attitude maintained by both Germany and a number of other countries in Northern Europe has already been recorded on many of the Commission's proposals. The resistance of these countries is not only a matter of definition of their national interests, on the basis of the question of moral hazard described earlier, but also stem from internal politics, as the crisis has shaped trends of Euroscepticism not only in the countries that have implemented hard adjustment programmes, but also in the creditor countries.

The Joint Communication between France and Germany in Mesenberg on 19 June 2018, largely confirmed the political difficulties of the project. The most ambitious and rather unexpected proposal in the joint declaration was to create a budget for the euro area. Despite the initial surprise, the proposal, was actually not what many people thought; the proposed budget was linked to EU's multiannual financial framework, which diminished expectations regarding its size, particularly in a post-Brexit context. Moreover, the proposed budget was meant to promote competitiveness and convergence and not function as a stabilization mechanism. On the other hand, the declaration also contained a proposal for part of the budget to finance a European Unemployment Fund, on the basis of budgetary neutrality between the countries. With regard to the Banking Union, it was proposed that the fiscal backstop should be in the competence of the ESM, but start operating only if significant progress is made in reducing risks to member states' banking systems, in particular those arising from the issue of non-performing loans.

The Eurozone Summit of 14 December 2018 fully adopted the priorities and proposals of the French-German cooperation. In addition to decisions taken about the fiscal backstop of the Banking Union's resolution fund, and other technical modifications of ESM's institutional features, in the direction of the proposals of the French-German declaration, the Summit also approved the integration into the Multiannual Financial Framework of a fiscal tool specifically for the Eurozone. This tool will be used to promote the competitiveness and convergence of European economies, while no reference is made to the possibility of financing a European Unemployment Fund. The June and December 2019 Euro Summits recognized the technical progress made in implementing the above decisions without deciding on any major new reforms.

7. Conclusions

National preferences and economic idiosyncrasies dictate different fiscal policy priorities and attitudes towards deficit spending in different countries. Such differences affect the frequency, intensity and duration of discretionary fiscal policy, leading to different fiscal stances. This is problem in a monetary union is necessary because uncoordinated fiscal policies do not allow the adoption of a union-wide fiscal stance, and consequently the coordination between fiscal and monetary policy. In addition, discretionary fiscal policy faces serious technical difficulties and holds an irresistible political appeal for incumbent governments leading to a deficit bias in public finances. This is also a problem in a monetary union, because the fiscal derailment of a member state can have adverse spillover effects for the other members of the union. On the other hand, economic theory argues in favor of central, 'federal' mechanisms for the exercise of fiscal functions, particularly for stabilization purposes. As a result, in a monetary union of sovereign states, there is a need to monitor and control national fiscal policy, but also to support it in times of need.

The fiscal governance decided at Maastricht was imbalanced and inadequate in both respects. Being the result of a political compromise, it instituted a decentralized 'individual responsibility' approach, with no effective compliance mechanism and no support facilities for times of economic turbulence. Its weaknesses, revealed by the global financial crisis, contributed to Eurozone's deterioration into a second, debt crisis and a double dip recession. The lack of institutional provisions for dealing with the crisis, turned its handling into a de facto political and therefore intergovernmental process where creditor countries, enjoying a highly asymmetrical negotiating advantage, dictated both the terms of the bailout agreements and the provisions of the new fiscal governance. Being essentially a reinforced version of the pre-crisis framework, the 'reformed' fiscal governance has tried to balance conflicting objectives with little success; it is simultaneously more constraining and more prone to political maneuvering, increasingly complex while leaving more room for variable interpretations, and ultimately it is not more effective than its predecessor.

As a result, a short few years after the new fiscal governance has been implemented, the calls for a new reform are multiplying. Unfortunately, substantial progress does not seem likely in the near future; the central issue, which is the management of the problems inherited by the crisis in a number of countries and banking institutions, continues to divide the member states. The question is whether countries should be left to manage them on their own, taking on the costs involved and then going ahead with the most ambitious reforms, or whether risk-sharing mechanisms should be created now, facilitating the adjustment and reducing its cost. This question has obvious distributional and therefore political implications. Given the rise of Eurosceptic parties in both crisis-hit and creditor countries, the political resolution of EMU's fiscal predicament any time soon seems very difficult.

Notes

* The article is based on work done for a research project on EU's fiscal policy, assigned by the Bank of Greece to ELIAMEP.

1. According to the theory, each fiscal function should be exercised at the lowest possible level of governance where it is most effective (Oates 1972).
2. The coincidence of these criteria in the two theories should not come as a surprise given that typically federal states are also monetary unions.
3. Empirically, this argument is supported by the extremely low level of interest rate spreads for the public debt of different member states of the Eurozone in the early years of its operation. This has been attributed to the markets' conviction of the existence of an implicit bail-out clause, despite the Treaty no-bailout provision.
4. Again, this was seen in the EMU already from the first years of its operation with the refusal of Germany and France to abide by the rules, in conditions of economic recession (see next section).

5. On the other hand, as already noted, the markets' conviction about an implicit bailout clause in a monetary union of sovereign states, may relax their discipline and allow governments to borrow more than it is economically justified.
6. In 1969, the Heads of State of the European Economic Community (EEC) instructed a committee under Pierre Werner, Prime Minister of Luxembourg, to formulate a plan for the implementation, in stages, of the economic and monetary union of their countries.
7. There were other countries that did not meet the debt criterion but were close to it, which allowed the Commission to declare that provided fiscal consolidation efforts continued, these countries' debt would soon fall below the 60% threshold (European Commission 1998).
8. If fiscal governance proved ineffective, macroeconomic coordination was almost entirely absent; it was based on the Broad Economic Policy Guidelines, which were rather generic and essentially non-binding. In this context, the development of significant imbalances in productivity, wage policies and the current account were not surprising.
9. The adverse effects of large capital inflows were not exhausted on the fiscal front but led to broader macroeconomic imbalances, which weakened further the position of the periphery economies once the crisis hit.
10. There is a large literature on the design of the bailout programmes and their consequences, which is outside the scope of this paper.
11. The debate on a European safe asset continues. In recent years, experts (e.g. Brunnermeier et al. 2016) have suggested European Safe Bonds (ESBies), which are now referred to as Sovereign Bond-Backed Securities (SBBS), i.e. securities backed by a diversified portfolio of euro area government bonds. The European Commission has endorsed this proposal and on May 2018 released a proposal for a Regulation on SBBS.
12. The ESM was preceded by the European Financial Stability Facility (EFSF) and the European Financial Stability Mechanism (EFSM) established in 2010.
13. Despite the establishment of a new resolution process, the link between sovereigns and banks is not as easy to break as thought, as demonstrated by the banking crisis in Italy in 2017.
14. A similar picture emerges in the field of macroeconomic coordination, where stipulations produced by both the European Semester and the macroeconomic imbalance process do not appear to be taken seriously by the Member States (Alcidi and Gros 2014, Begg 2017).
15. A particularly influential paper in this context was the so-called policy paper 'No 91' of the prestigious Centre for Economic Policy Research (CEPR), in which 14 prominent economists from Germany and France put forward a

series of proposals for reform (Bénassy-Quéré et al. 2018). These proposals received praise but also critique, from many quarters, primarily for their lack of ambition and their affinity to the official German position. See for example the *Blueprint for a democratic renewal of the eurozone*, Politico, 28.2.2018 (the counter-proposals of another 14 economists and politicians), *Merler (2018) and Messori and Micossi (2018*).

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Appendix I

Fiscal Reforms

European Semester

Framework for the coordination of budgetary and economic policies to achieve the objectives of the Europe 2020 strategy. It takes place in the first half of each year before the preparation of national budgets. It was first implemented in November 2010.

'Six-Pack'

A package of six legislative measures that revised the Stability and Growth Pact. It was adopted in December 2011 by all EU Member States and aims to strengthen member states' fiscal compliance by reforming provisions for the imposition of financial fines in the event of a fiscal derailment and of excessive macroeconomic imbalances. In the revised Stability and Growth Pact, the Commission's proposals for sanctions against Member States which do not take satisfactory measures to correct their budgetary imbalances are taken on the basis of the negative majority rule, i.e. the Commission's proposals are adopted automatically, unless a qualified majority of Member States disagree.

Fiscal Compact

International agreement of EU Member States. The aim of the pact is to strengthen budgetary discipline. The most important provision of the Pact is that Member States should incorporate into national law the rule of the balanced budget. This rule provides for a structural deficit of up to 1% of GDP if public debt is less than 60% of GDP and 0.5% of GDP if debt is more than 60% of GDP, in which case it should be reduced (by a rate of $1/20^{\text{th}}$ of the above-threshold debt). An automatic correction mechanism should be put in place if deviation from the objectives is observed. It entered into force on 1 January 2013.

'Two-Pack'

Package of two European Regulations to strengthen the supervision and control of the budgetary policy of the Member States. Increased supervisory and accountability obligations are provided for by states facing or likely to face financial stability problems. The screening of the draft national budgets by the Commission before their adoption by the national parliaments is also established. The Commission can examine the draft plans and submit recommendations in the event that they lead to budgetary and macroeconomic derogations; the Commission does not have veto power, in the event of non-compliance with its instructions. It is also envisaged to set up independent financial councils in each Member State with a view to monitor more effectively the implementation of fiscal planning and the compliance with the rules set out in both the Stability and Growth Pact and the Fiscal Compact. The Regulations are in place since May 2013.

European Fiscal Board

In the wake of the proposals of the Five Presidents' Report, the European Commission set up the European Fiscal Board. The Board's objective is to ensure transparency and coordination of fiscal policy at the European level. In this context, the Board supervises the implementation of fiscal planning at both national and European levels, formulates proposals for the overall fiscal position of the EU, as well as for the Member States, and proposals for the reform of the EU's fiscal governance, and cooperates with the independent national fiscal councils. The Council began its work in October 2016 and in November 2017 published its first report.

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Banking Union: Where does it stand? What next?

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Abstract

In response to the financial crisis, the Eurozone pursued a number of initiatives to create a safer financial sector for the single market. However, the divergent preferences between core and periphery countries and the negative legacy of the crisis have watered down ambitious reform plans for substantial risk-sharing arrangements. In this context, the Eurozone cannot strike a balance between solidarity and crisis prevention. Compared to mid-2012, the "window of opportunity" for strengthening the banking union seems closed for the moment. Paradoxically, doing reforms in fair weather is much more difficult, while the immediate reason for the sudden move to Banking Union was the intensifying euro sovereign crisis. As a consequence, the implemented reforms have limited scope and they leave room to financial markets for a disciplining role over states.

KEY-WORDS: Eurozone, banking union, reforms, risk-sharing, market discipline.

Τραπεζική Ένωση: Πού βρίσκεται; Τι επακολουθεί;

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Περίληψη

Την επαύριον της παγκόσμιας χρηματοπιστωτικής κρίσης, η Ευρωζώνη έλαβε σημαντικές πρωτοβουλίες για τη διαμόρφωση ενός ασφαλέστερου χρηματοπιστωτικού συστήματος και την εμπέδωση μιας πραγματικά ενιαίας χρηματοπιστωτικής αγοράς. Παρά ταύτα, οι αποκλίνουσες προτιμήσεις μεταξύ των χωρών του πυρήνα και αυτών της περιφέρειας, όπως επίσης και η αρνητική κληρονομιά της κρίσης (π.χ. μη εξυπηρετούμενα δάνεια), έχουν αποδυναμώσει τα πιο φιλόδοξα μεταρρυθμιστικά σχέδια, σχετικά με τον αποτελεσματικότερο επιμερισμό των κινδύνων μεταξύ των κρατών-μελών. Επιπρόσθετα, η πολιτική σταθερότητα και η σταδιακή οικονομική ανάκαμψη των τελευταίων ετών έχουν -παραδόξως- περιορίσει σημαντικά το «παράθυρο ευκαιρίας» για την ολοκλήρωση της τραπεζικής ένωσης, σε σχέση με το αντίστοιχο «παράθυρο» για την υλοποίηση σημαντικών μεταρρυθμίσεων που δημιουργήθηκε το 2012. Το γεγονός, λοιπόν, ότι τα μέτρα

που έχουν -έως σήμερα- παρθεί από την πολιτική ηγεσία της Ευρωζώνης είναι περιορισμένου βεληνεκούς, ενισχύει τον ρόλο της «πειθαρχίας της αγοράς» στον τομέα της προληπτικής τραπεζικής εποπτείας, με ό,τι αυτό συνεπάγεται για την πολιτική αυτονομία των κρατών-μελών και της ζώνης του ευρώ συνολικά.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Ευρωζώνη, τραπεζική ένωση, μεταρρυθμίσεις, επιμερισμός των κινδύνων, «πειθαρχία της αγοράς».

1. Introduction

The sovereign debt and banking crises of 2010-12 have led to significant changes in the institutions of the Eurozone. More specifically, the decision of heads of state or government of euro area countries on 28-29 June 2012 to establish the banking union was the hallmark of an important reform process. The three pillars of the banking union -the Single Supervisory Mechanism, the Single Resolution Mechanism and the European Deposit Insurance Scheme- ensure stronger prudential requirements for banks and common rules for managing troubled financial institutions. However, a common system for deposit protection has yet to be established and further measures are needed to tackle the remaining risks of the banking sector. During the past few years, many ambitious reforms have been watered down due to the political disagreement on the extent of solidarity required for a deeper banking and economic integration. A truly Eurozone budget does not currently exist; banking integration and the common deposit insurance scheme are proceeding at glacial speed; a decision on a common "safe asset" is in deep freeze (Pagoulatos 2020). What are the reasons which reduced the "window of opportunity" for implementing more ambitious initiatives after 2012? What is the content of the current debate on strengthening the banking union? How will the banking union be affected from the recent reforms of the Eurozone? Has the sovereign-bank doom loop been sufficiently severed? Is it possible to reconcile risk sharing with market discipline? We explore these questions looking at: (a) the role of a complete banking union and the surrounding political conflicts, (b) the possibility of opening a new "window of opportunity", as it was the case in 2012, and (c) the content of the current reform proposals and the following political initiatives which have taken place.

2. The role of a complete banking union in the euro area

In the aftermath of the global financial crisis, a strong heterogeneity in macroeconomic variables remains in the EMU. For example, there is significant heterogeneity in unemployment rates across the euro area countries. In this regard, the low degree of risk sharing through banking systems, capital markets, savings, and, to a lesser extent, fiscal policy within the EMU made things worse and delayed recovery (Gopinath 2019: 244). On the contrary, in the US, it is estimated that around 70% of local crises are absorbed through the integrated financial markets with the capital markets absorbing about 45% and the remaining 25% absorbed by the banking market. In the euro zone, however, the overall absorption rate is only 25% (Draghi 2018). Indeed, risk-concentration is significantly high in the economies of the Eurozone. European banks have been criticized for holding too much domestic government debt, before and during the crisis, intensifying the doom loop between sovereign and bank credit risks. Banks and sovereigns are linked by three interacting channels: (a) banks hold large amounts of sovereign debt; (b) banks are protected by government guarantees; (c) and the health of banks and governments both affects and is affected by economic activity (Dell'Ariccia et al. 2018: 6). There are "bad" and "good" reasons for that. The "bad" reason for increasing sovereign home bias is the excessive exposure to high-yielding risky sovereigns (Acharya and Steffen 2013), in combination with the long history of banking nationalism in Europe (Veron 2017). Basel bank regulations also treated sovereign debt essentially as risk-free, implicitly assuming that there would always be a bailout. On the other hand, the bank-sovereign nexus may be considered as a stabilizing force for home economies during market downturns when sovereign risk rises. Informational advantage might lead domestic banks to act as buyers of last resort, absorbing the local assets while foreign banks may rid themselves of their exposures (Saka 2016).

In this context, the role of a fully operational banking union in the euro area is two-fold: (a) to manage the flow of credit risk emanating from weak banks to the balance sheet of their sovereigns and (b) to manage the flow of credit risk emanating from sovereigns to the banking system holding sovereign debt (Acharya 2012, Goodhart and Schoenmaker 2009). In the same vein, an integrated architecture for financial stability would reduce financial fragmentation and weaken the vicious loop in many countries of rising sovereign and bank borrowing costs. Moreover, a single regulatory and supervisory framework would contain systemic risks and limit the moral hazard related to common safety nets; a single resolution mechanism with adequate financial backstop would isolate and minimize areas of weakness; and a common safety net would help prevent massive deposit runs (Goyal et al. 2013: 6,7). In addition, another group of safe asset proposals consider that a European-level safe asset could emerge as part of a borrowing capacity for a European budget or for European institutions (Best 2018: 11).

In the light of the above, the current debate on banking union is over whether to put risk sharing or risk reduction first. Solidarity means, by definition, a kind of risk sharing and debt mutualization but, on the other hand, moral hazard always exists in such a process. Nordic countries are in favour of the banking union ultimately being completed although they believe that the first priority should be risk reduction (Smid et al. 2018). For example, the idea of a full common safe asset to manage the flow of credit risk emanating from sovereigns to the banking system holding sovereign debt was rejected by the fiscal conservatives (Issing 2009). A common European safe asset tends to improve Euro area financial stability by limiting destabilizing capital flows as well as break the bank-sovereign nexus by limiting domestic bias in bank portfolios. For this reason, several proposals have been put forward, ranging from full to partial or common issuance, some based on mutualisation and others entailing no joint liabilities (Monti 2010, European Commission 2011, van Riet 2017, Leandro and Zettelmeyer 2018). Nevertheless, breaking the doom loop requires the adoption of a common safe asset, since "all regulatory designs are constrained by the incompleteness of euro area sovereign debt markets, which make it impossible to assemble a portfolio that has sufficiently low concentration and credit risk" (Alogoskoufis and Langfield 2019).

Consequently, beyond the technical aspect of risk-sharing, there are two different strategies that are unfolding on the future of the banking and economic union in general: on the one hand, there are those proposals that seek to create a large and robust bond market in the Eurozone in order to deepen the single financial market and, on the other hand, proposals with far more political content that tend towards fiscal union by promoting the creation of a mechanism to help troubled economies to maintain a stable source of funding, even in times of crisis (Claeys 2018). The divergent interests of core and periphery economies are explained by the different variables that affect fluctuations of growth rates. More specifically, institutional integration plays a positive role for growth, overall and for the periphery in particular. Looking into the variables which are linked to differences in growth rates the findings affirm a positive association of the EU institutional and political integration with long-run growth, for periphery countries particularly (Comunale and Mongelli 2019a). In the opposite direction, deeper financial integration seems to have beneficial effects on the core economies, but it is not significant in the periphery (Comunale and Mongelli 2019b).

3. The lost opportunity for deepening the banking union

A) The "window of opportunity" in 2012

In the recent literature on explaining the response to the sovereign debt crisis in the euro area there is a trend detected towards a new type of intergovernmentalism that includes to some degree a neofunctionalist perspective (Bickerton et al. 2015, Schimmelfennig 2015, Schmitter and Lefkofridi 2016, Epstein and Rhodes 2016, Schimmelfennig 2017). On the one hand, liberal intergovernmentalism explains the politics to cope with the euro area crisis by the influence of national preferences and bargaining power. On the other, the core assumption of the neofunctionalist approach connects the degree of integration progress with the realization of mutual gains from cooperation in policy arenas characterized by high levels of functional interdependence. In this context, divergent national preferences on distributional consequences of fiscal consolidation were accompanied by a common willingness of member states to preserve the euro. This led, in turn, to incomplete solutions based on minimal supranationalism, which deepened integration in an asymmetric way. Asymmetric effects took place to prevent complete collapse, but the core development is that financially powerful member states imposed limited risk-sharing on weaker economies (Jones et al. 2016, Donnelly 2014). If that is the case, competing coalitions of member states that shared any similar economic interests by saving the common currency resulted in an incomplete banking union (Howarth and Quaglia 2016, Quaglia 2017): banking supervision was supranationalised; resolution was supranationalised although there is still room for intergovernmental bargaining and a relatively high degree of discretion exercised by national resolution authorities; and a single deposit guarantee scheme was not established.

Nevertheless, recent literature has not yet scrutinized the timing of the setting up of the European Banking Union. The banking union as a term was first introduced in the European public debate at the end of 2011 and was widely used by European officials in the spring of 2012 (Veron 2015). Until then, the EU followed the recommendations of the Jacques de Larosière report, which rejected the introduction of a single surveillance mechanism as unrealistic and recommended the creation of the European Banking Authority (EBA) to organize a more formal coordination of national supervisory authorities. So, what explains this policy change? Our analysis for examining the "window of opportunity"[1] in mid-2012 is based on the "multiple streams" theory of policy formation. This theory is concerned with three categories of independent variables that interact to create "windows of opportunity": (a) the "problem stream" is filled with perceptions of problems that are seen as "public"; (b) the "policy stream" is filled with the output of experts and analysts who examine problems and propose solutions; and (c) the "political stream" comprises factors such as changes in national mood, executive or legislative turnover (Béland and Howlett 2016). The "window of opportunity" in mid-2012 turned up as a result of the coupling of two main streams: the political stream and the problem stream. These developments, in turn, brought about a significant policy change. First, Spain's request for financial assistance altered the "framing contest" of the Eurozone crisis, accelerating the creation of the banking union. Framing contests refer broadly to "the way in which political elites, such as the news media, politicians, interest groups, and other political players, define the political space and erect the boundaries within which a public policy issue will be considered" (Callaghan and Schnell 2005: xi). In this regard, it is important to underline that "if Spain had agreed to an adjustment program before the spring of 2012, the window of opportunity for the banking union would not open because the bank recapitalizations would have been negotiated bilaterally with the Troika" (De Rynk 2014). Consequently, European leaders, and Angela Merkel in particular, recognized the increased systemic risk and the contagion risk against the backdrop of the problematic Eurozone architecture. Since then, the need for accelerating the creation of a permanent crisis resolution mechanism and the establishment of the banking union were considered top priorities (ESM 2019b:132). The European Stability Mechanism (ESM), a permanent solution for the lack of a backstop for euro area countries which no longer maintain access to external finance, was established in October 2012. The ESM is the successor to the European Financial Stability Facility (EFSF), which was set up as a temporary solution in June 2010 and provided financial assistance to Ireland, Portugal and Greece.

Furthermore, the change in the conceptual framework of the crisis encountered the political developments ("political stream") that took place in some politically important countries, i.e. Italy, Spain and France, during November 2011-May 2012. The first political change took place in Italy, in November 2011. The technocratic government of Mario Monti replaced the government of Silvio Berlusconi, who resigned on 12 November 2011, under the pressure of financial markets. Mario Monti, on the other hand, was welcomed with great satisfaction by the financial markets. At the same time, the Spanish government's bond yields approached the levels of Portugal and Greece in their time of need, and socialist Prime Minister Zapatero called early elections in December 2011. The conservative leader Mariano Rajoy emerged as a winner with a very rigorous financial agenda supporting an adjustment programme of €65 billion in the next two years, the largest ever in the Spanish history. Subsequently, in May 2012, François Hollande won the presidency of France, promising a "new start" and an end to the austerity measures imposed by Germany. Despite their ideological differences, all the new leaders signaled a new era of political stability in Southern Europe. Moreover, the political changes marked the creation of a robust coalition against Germany's restrictive fiscal policies. For example, the change of government in Spain in November 2011 brought "a significant change in crisis management: the style became more adversarial, less predictable". In February 2012, the prime minister Rajoy announced that "Spain would not meet its fiscal targets and hinted he was not prepared to agree on binding new restrictions" (Brunnermeier et al. 2016: 353). The effects of the above political changes were shown at the European Council of 28-29 June 2012, which confirmed the decision to support the European Banking Union. At this Council, the President of the European Council was invited to develop, in close collaboration with the President of the Commission, the President of the Eurogroup and the President of the ECB, a specific and time-bound road map for the achievement of a genuine Economic and Monetary Union. The report "Towards a Genuine Economic and Monetary Union" including "four essential building blocks" for the future EMU: an integrated financial framework, an integrated budgetary framework, an integrated economic policy framework and strengthened democratic legitimacy and accountability (European Council 2012). It was upon these "building blocks" that European leaders decided to take on significant political initiatives for the strengthening of banking and economic integration.

The European Commission proposed a regulation for the establishment of the Single Supervisory Mechanism (SSM) in September 2012. The initiative to create the first pillar of the banking union was formalized on 15 October 2013, when the Council of the European Union approved Regulation (EU) 1024/2013. The SSM came into force on 4 November 2014, thereby the ECB assumed the supervisory tasks assigned in accordance with the SSM Regulation. Thereafter, the SSM supervises directly the systemically important banks of the participating countries.[2] In addition, the ECB may at any time demand and take over the direct supervision of smaller banks. Furthermore, all euro area member states participate automatically in the SSM and other EU countries that do not yet have the euro as their currency can choose to participate in "close cooperation" with the ECB. It is worth noting that the establishment of the SRM took place despite the strong resistance from key local interests, mainly the dissatisfaction of small/medium public saving banks (Sparkassen and Ländesbanken) and cooperative banks, which are the central pillar of liquidity for the regional development in Germany. Given the vital role of saving banks in the economy, the German government favored a limited scope of single supervision, focusing exclusively on systemically important banks, in order to maintain saving banks under domestic control (EUobserver 2013). In this direction, the German saving banks association supported that "banks that are too big to fail -not savings banks- should remain the regulatory priority". Additionally, the German saving banks underlined that the new supervisory mechanism should "take into account the different circumstances" (Financial Times 2012) and the specific characteristics of each individual economy.

Regarding the second pillar of the banking union, resolution is the orderly restructuring of a bank when the bank is failing or likely to fail. This procedure ensures that a bank failure does not harm the broader economy or cause financial instability. In July 2013, the Commission issued a proposal for the establishment of the Single Resolution Mechanism (SRM). The final agreement was accomplished at a meeting of the Economic and Financial Affairs Council in December 2013. The SRM applies to all the banks being subject to the SSM. The organization of the SRM mirrors that of the SSM, as far as the division of responsibilities between the supranational authority and the national authorities is concerned (Baglioni 2016: 95). The tasks of resolution are assigned to the Single Resolution Board (SRB), in collaboration with national authorities, which retain responsibility for executing the resolution actions. The SRB consists of representatives from the ECB, the Commission and the national resolution authorities; also, it covers all the banks headquartered in Banking Union member states. Additionally, the SRB holds broad powers in cases of bank resolution upon notification by the European Central Bank, which decides when a bank is failing or likely to fail. Otherwise, the Board on its own initiative would adopt a resolution scheme placing the bank into resolution. The Board would also determine the application of resolution tools and the use of the Single Resolution Fund (SRF). Decisions by the Board would come into force within 24 hours of their adoption, unless the Council, acting by simple majority on a proposal by the Commission, objected or called for changes (Council of the European Union 2013). It is worth noting that the German government with their allies (Holland, Finland) opposed the Commission's decision-making power on the approval of a resolution plan and they pushed to assign this responsibility to the Council (El Mundo 2013a).

The banking union also allows the SRF to support financially the restructuring process. The SRF is composed of contributions from credit institutions through the pooling of financial resources of national funds of participating countries. Furthermore, it is important to underline the ability of the SRF to borrow from the markets. In 2012, the then Internal Market Commissioner Michel Barnier proposed alternatively that the ESM should assume the permanent rescue backstop facility task. On the other hand, the German government opposed strongly these proposals. Wolfgang Schäuble, the then German Finance

Minister, challenged the legal basis of Barnier's proposal (El Mundo 2013b) and insisted that a resolution process "could only be the responsibility of the national resolution authorities" (DW 2013). Five years later, a wider package of measures to complete the Banking Union, which was approved in December 2018, included the introduction of the common backstop for the Single Resolution Fund (SRF). The common backstop will be in place by 1 January 2024 at the latest. The size of the credit lines will be aligned with the target level of the SRF, which is 1% of covered deposits in the Banking Union (currently estimated at around €55 billion) (SRF 2019: 1). If the credit line is used, the SRF will pay back the ESM loan with money from bank contributions within three years, although this period can be extended by up to another two years. As a result, it will be fiscally neutral over the medium term (ESM 2019a). Additionally, a contribution from the SRF to recapitalisation may be made only under two key requirements included in the Bank Recovery and Resolution Directive (BRRD): the bail-in of at least 8% of total liabilities including own funds (TLOF), and a contribution of a maximum of 5% of TLOF. Furthermore, the use of the SRF would be assessed by the Commission to ensure it complies with State aid rules. Nevertheless, some national authorities have resisted in several cases a complete implementation of the BRRD. For example, the Italian authorities lobbied the Commission for leeway and looked into the intricacies of the BRRD to find the extent of discretion allowed for policy makers, just as was the case with the treatment of three failing Italian banks -Monte de Paschi, Veneto and Vicenza- that were resolved in 2016/2017 (Donnelly and Asimakopoulos 2019).

As regards the third pillar of the European Banking Union, the insurance deposit scheme remains merely a system of national deposit guarantee schemes. More specifically, the Directive 2014/49/EU provides that all deposits up to €100.000 are protected all over the EU. Despite the pressure from the European Commission for a single insurance deposit scheme, the German government "has long opposed it, fearing a political backlash to the idea that its funds could be used to guarantee the deposits of savers in other European countries" (Reuters 2015). In addition, the fear of moral hazard has resulted in the rejection, by the German authorities, of any form of debt mutualization, like a single European liability – proposed by the Commission in October 2017 (European Commission 2017). From the point of view of the Germans, "entrepreneurial and political responsibility and liability must not be separated", while a single European liability "leads to the opposite outcome" (Handelsblatt 2018).

B) This time is -actually- different…

In the mid of 2015, the so called "Five Presidents' report", authored by Jean-Claude Juncker, Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, and Martin Schulz, was published outlining plans for strengthening the economic and monetary union by 2025 at the latest. Since then, a lot has been done towards completing the EMU. However, the banking union's architecture is not yet complete. Compared to mid-2012, there are strong differences resulting in minimizing the "window of opportunity" for significant reforms. First, as regards the problem stream, the economic situation over the last three years is clearly more stable, less pressing and the spreads of the periphery countries remain under control. The European Commission in an update ahead of the Euro Summit of December 2018 underlined that the global financial crisis that hit Europe "laid bare some of its institutional weaknesses. Thanks to determined efforts, Europe is now experiencing a robust economic recovery with growth in all Member States. This provides a window of opportunity to take the next steps towards deepening Europe's Economic and Monetary Union. It is essential for its members as well as for the EU as a whole" (European Commission 2018: 2). But doing reforms in fair weather paradoxically is much more difficult, while the immediate reason for the sudden move to Banking Union was the intensifying euro sovereign crisis (Schoenmaker 2016). At the political level, apart from President Macron, the leaders of two other politically important countries, namely of Italy and Spain, have just taken office and their prospects are not yet clear. In Italy, the new coalition government is based on two parties (the Democratic Party and the Five Stars Movement), and it is doubtful whether they have the power to handle the tedious and demanding negotiations at a European level. In Spain, the coalition government includes the anti- systemic Podemos, under the socialist Prime Minister Pedro Sánchez, and it is doubtful whether it can overcome internal divisions among the heterogeneous members that make up the parliamentary majority. In addition, Chancellor Merkel's self-declared last term in office reduces the possibility for important steps towards reforming the Eurozone at a bare minimum.

The political reluctance to complete the banking union manifested, for example, at the end of March 2018, even though the Eurozone's heads decided that "in the next six months, the work of finance ministers should focus on areas where the convergence of views is greatest. Gradual progress on issues such as the completion of the Banking Union […] should significantly strengthen the resilience of EMU" (Euro Summit 2018). More specifically, the French President supported the creation of a pan-European bank deposit guarantee fund, as well as the completion of the Single Resolution Fund, funded by the ESM. A few weeks before the Summit, Emmanuel Macron believed that together with the

German Chancellor Angela Merkel they would present a common line for the planned Eurozone reform ahead of the Summit of March but that was not confirmed. As a result, President Macron appeared at the Summit along with Mariano Rajoy and Antonio Costa. This alliance emphasized the formation of a pole against the reluctance of Berlin and its allies, which did not support any form of mutualization (Euractiv 2018). In this direction, the Danish, Estonian, Finnish, Irish and Latvian Ministers for Finance in a joint communiqué in March 2018 referred to their objections to the reform plans, and they put the issue of budgetary discipline on top of the agenda (Reuters 2018). One and a half years later, a common deposit insurance scheme is still proceeding at glacial speed. However, German Finance Minister Olaf Scholz offered a ray of hope in November 2019. The SPD politician said that the European Union needs to increase its pace regarding the banking union and signaled a willingness to compromise on the EU-wide bank deposit reinsurance, in an op-ed for the Financial Times. In this context, he proposed a "European Reinsurance System" for bank deposits to complete the banking union (DW 2019).

Lastly, the most crucial development, which postpones more ambitious reforms, is related to the new European Commission' priorities, under President Ursula von der Leyen. Instead of the previous Commission' strategy under Jean-Claude Juncker, whose strategy implied a more "political" management of the European Union's economic crisis, der Leyen identifies the adaption of Europe to geopolitical developments as top priority. Europe has to deal with the consequences of US President Donald Trump's unilateral initiatives; Turkey's invasion in Syria; Libyan crisis; and the new state of the agreement on the Iranian nuclear program after the assassination of Qasem Soleimani by an American drone (Pagoulatos 2020).

4. The hesitant reform steps and the still incomplete banking union

In 2018, the joint proposals of fourteen economists in France and Germany on the reform of the Eurozone opened de novo a pan-European debate on its future architecture (Benassy-Quéré et al. 2018). These proposals seek to strike a balance between risk-sharing and crisis prevention by finding a middle-ground between solidarity and responsibility in order to break the "bank-sovereign nexus": the fact that European banks hold a large bulk of government bonds of their home country ("home bias"). The open debate already includes the French President' package of reforms (DW 2018) as well as the Spanish proposals (Almunia et al. 2018), which entail more banking and fiscal integration. In this direction, we have to include the Commission Communication of October 2017 "on completing the banking union" (European Commission 2017). On the other hand, there is strong opposition on such a prospect from creditor countries, due to moral hazard and the legacy of "bad" debt of the periphery banks (Euractiv 2018). After the launch of these proposals, a series of political initiatives has taken place. As it will be shown these initiatives are closer to the joint proposals of the Franco-German economists than those that imply deeper banking and institutional integration.

First, the Heads of State or Government in December 2018 approved a package of measures to complete the Banking Union and to strengthen further the Economic and Monetary Union (EMU) and the European Stability Mechanism (ESM). Nevertheless, a common system for deposit insurance and a common safe asset as well have not yet been decided and further measures are needed to tackle the non-performing exposures of the banking sector via a European "bad" bank.

In 2019, there were the Euro Summit of June, a Eurogroup meeting on December 4, and the Euro Summit of December. Eurozone leaders agreed on further technical work on previous decisions (i.e, the Euro Summit of December 2018) for strengthening the banking union in particular. This is important because the timing of the intervention really matters, with speedier resolutions often entailing lower ex-post fiscal burden (Claessens et al. 2012). Little has been done, however, to weaken bank-sovereign nexus; for example, through a pool of assets diversified across countries. For the euro area, where fiscal stabilization policies are national in nature, the creation of sovereign-bond-backed securities would have the potential of increasing private risk sharing across borders. This would automatically spread default risk across borders, curtailing banks' exposure to sovereign risk, and limit the sovereign-bank nexus (Dell'Ariccia et al. 2018: 38). Nevertheless, creating safe European assets, such as euro bonds, would involve a number of joint liabilities of all member states within a common fiscal policy (Brunnermeier et al. 2011). Such political initiatives (that is, a common fiscal policy) have not been taken. The ESM reform, for example, provides a limited and strictly conditional financial assistance toolkit.

5. Struggling to balance solidarity and responsibility

The Franco-German economists have become disappointed by the lack of progress on reform path (Bénassy-Quéré et al. 2019). The authors argued that risk-sharing and market discipline are not antagonistic but rather complementary, compromising thus between those who advocated a specific stabilization budget for the euro area (France and Spain) and those who rejected the priority of a common euro area budget (Pisani-Ferry and Zettelmeyer 2019). However, the economists' proposals imply more market discipline than risk-sharing. That said, more ambiguous progress in the banking union's completion is out of play. Furthermore, these proposals include a "conditional solidarity". More analytically, three basic mechanisms are proposed for a "conditional" and limited debt mutualization:

The first mechanism concerns the bank debt and involves the creation of a deposit insurance scheme, which however remains fragmented. In particular, it is proposed that "losses should first be borne by the relevant 'national compartment' of the scheme, while common funds (either a separate mutualized compartment, or all other compartments jointly) can be tapped only in large, systemic crises which overburden one or several national compartment(s)". In this way, "separate collective deposit insurance schemes (e.g. associated with national or cross border institutional protection schemes) could be treated as separate compartments, on a case-by case basis under general criteria to be set in order to deter abuses" (Benassy-Quéré et al. 2018: 8).

The second one concerns the allocation of financial risks to minimize the insolvency risk, which is more pronounced for the Eurozone member states in comparison with similar countries which have a national currency. According to the economists' view that finally was adopted by policymakers, the fundamental principle for a member state to be granted with ESM's assistance is to comply with the fiscal rules on budgetary limits and public debt sustainability. Moreover, the requesting country should have access to international capital markets on reasonable terms and a sustainable external position. As a result, market discipline, introduced through these requirements, imposes stricter constraints to risk-sharing and does not mitigate the sovereign-bank risk nexus. And here comes the following paradox: Such a mechanism is created for ensuring fiscal and financial stability, but it ultimately makes financial markets key in decision-making for states' access or not to financial assistance. In theory, these proposals focus on minimizing the risk of idiosyncratic demand shocks and the risk of a national banking crisis. Nevertheless, they neglect the insolvency risk of euro area membership, which is, as mentioned earlier, absent for similar countries with monetary autonomy (Bofinger 2018).

The third mechanism, in line with the above proposals, is the creation of a "euro safe asset". Safety is achieved by some combination of diversification and seniority, which means that financial intermediaries buy a standardized diversified government bond portfolio and use it as collateral for the newly issued securities in several tranches. Introducing such assets in parallel with a regulation on limiting sovereign concentration risk is expected by the authors to further contribute to financial stability. However, given that the government bonds of the debtor countries have lower credit ratings, it is difficult to find buyers for subordinated debt in times of crisis, as the Franco-German economists themselves admit. This proposal therefore limits risk-sharing, since "bonds of countries that lose market access should no longer be eligible for purchase by safe asset issuers" (Benassy-Quéré et al. 2018: 18). A weak point of this proposal is that the unequal position of the member states is not considered. Due to the existing high debt ratios of some countries, the disciplining role of financial markets over states will perpetuate pockets of weakness between debtor and creditor countries. For this reason, the real problem that remains untouched from the Franco-German economists is how to compromise market discipline with financial stability, without causing a crisis at the time of introducing the proposed regime ("transition problem").

Another deficiency of their proposals is the lack of measures to limit the risk of non-performing exposures of banks. Low interest rates, combined with high stocks of non-performing loans (NPLs), negatively affect bank profitability. Only if we find a solution to reduce the outstanding stock of NPLs, we pave the way for a real single deposit insurance system, which "will contribute decisively to breaking the vicious circle of bank and state debt", as the governor of the central bank of Spain commented in the same vein (Reuters 2018). But the main obstacle to this process is again the fear of moral hazard. Some member states are worried about the potential losses stemming from the "bad" debt of other member states. Germany, the largest economy in the EU, has rejected plans of risk-sharing on the banking market, fearing that German taxpayers will end up paying the bill for banks of the debtor countries. These objections may be dispersed if the nominated entity to absorb "bad" loans raises money issuing bonds or equity. That is the case of a European "bad" bank. In more detail, the proposal of the head of the European Banking Authority, Andrea Enria, includes the establishment of a European Asset Management Company, financed mainly by private resources. This entity will buy non-performing loans at the market value or at significant discount, selling them within the next three years (Enria 2017). Should sales not be realized, the states and the shareholders will cover the losses. If a specific trade operation fails, the state is required to recapitalize the bank; also the shareholders of that bank will bear the cost of the failed trading operation. In this way, the fear of moral hazard seems to be reduced (Enria 2017). On his part, Klaus Regling, the director of the ESM, supported the proposals of the European Banking Authority (EBA) to create a pan-European "bad" bank. Regling pointed out that such a plan "may need a role for the public sector", and that "the new (public) entity will aim to acquire up to €250 billion, of about €1 trillion of bad loans in EU lenders' balance sheets" (Reuters 2017).

A final concern that emerges from the Franco-German economists' proposals is whether the market discipline ensures financial stability. The global financial crisis of 2007/8 has shown that credit flows are particularly procyclical and volatile. Accordingly, for some countries, the global financial cycle can lead to excessive credit growth in boom times and excessive retrenchment in bad times. In short, the global financial cycle seems to be associated with "surges and retrenchments in capital flows, booms and busts in asset prices and crises" (Rey 2018: 2).

6. Conclusion

During the euro area sovereign debt crisis, sovereigns were exposed to bank risk, and banks were exposed to sovereign risk. This two-way risk exposure generated a "vicious circle". In this regard, the role of a fully complete banking union in the euro area is two-fold: (a) to mitigate the credit risk arising from troubled banks to the balance sheet of their sovereigns and (b) to mitigate the credit risk generating from sovereigns to the banking system holding public debt. Yet the establishment of the European banking union is not complete. On the one hand, all systemically important banks have been subject to a joint supervision at supranational level under the Single Supervisory Mechanism (SSM). Moreover, introducing the common backstop for the Single Resolution Fund (SRF), to be provided by the ESM, further enhanced the credibility of the Single Resolution Board (SRB) as the resolution authority in the banking union. On the other hand, breaking the doom loop between banks and sovereigns requires more risk-sharing and initiatives to help banks diversify their investment in sovereign bonds. To this end, the adoption of a common safe asset to manage the flow of credit risk emanating from sovereigns to the banking system is needed. Accordingly, a European Insurance Deposit Scheme (EIDS) is still lacking, along with further measures to tackle the remaining risks of the banking sector; in particular, those related to non-performing loans (e.g. a European-level "bad" bank).

On these crucial issues, a battle of interests between core and periphery economies is unfolding. The European "South" advocates more solidarity and deeper banking integration. In the opposite direction, limited risk-sharing and fiscal responsibility seems to be the priorities of the core economies. Accordingly, in an attempt to reconcile solidarity and responsibility, certain political initiatives and proposals on the future of the Eurozone consider risk-sharing and market discipline as complementary elements, which should be conditio sine qua no for the new Eurozone architecture. Building bridges between the two poles is extremely important, from a political, economic and financial perspective. However, the "window of opportunity" for significant political initiatives, as it was the case in 2012, no longer exists. In fact, the lack of substantial risk-sharing arrangements creates higher risk of financial instability. The negative legacy of crisis in the banking sector reduces the attractiveness of common safety networks. Market discipline seems to be the concept for the organization of the Eurozone, as Eurozone's policy makers assign a disciplining role to financial markets over states. This development marks a significant shift in the relation between governments and financial markets, in the after 2007/8 era; and as Habermas says "the imbalance between the imperatives of the market and the regulatory power of politics has been identified as the real challenge under these conditions" (Habermas 2012: 337).

Notes

1. "The policy window is an opportunity for advocates of proposals to push their pet solutions, or to push attention to their special problems" (Kingdon 2015: 165).
2. The number of significant institutions that was directly supervised by the European Central Bank (ECB) from 1 January 2019 stands at 119 following the annual review of significance and ad hoc assessments (ECB 2018).

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Towards a re-allocation of responsibilities and a new division of power in the EU*

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Abstract

The crisis has brought about a major re-allocation of responsibilities and power between and within states and institutions. The radical change in EU economic governance does not only refer to the involvement of supranational institutions and bodies in the decisions on the total national budget but also on the structure of national revenues and expenditures and the level of specific categories of revenue and expenditure of national budgets. In addition, the introduction of all sorts of conditionalities adds a wide range of measures and policies to those in which the EU and the member states have co-responsibility. Furthermore, the economic crisis has brought about significant changes in the institutional balance of the European Union. More and more critical decisions seem to be taken solely as a result of intergovernmental consultations. The European Council is strengthened and assumes the dominant role, the European Parliament is marginalized, the Council of Ministers often becomes a simple forum for validation of major decisions taken in other informal bodies and the European Commission sees its role restricted to its executive responsibility.

KEY-WORDS: Economic governance, EU Institutions, New intergovermentalism.

Προς μια ανακατανομή των αρμοδιοτήτων και έναν νέο επιμερισμό ισχύος στην Ε.Ε.

Αχιλλέας Μητσός, *πρώην Γενικός Διευθυντής της Ευρωπαϊκής Επιτροπής και Καθηγητής Διεθνών Οικονομικών Σχέσεων στο Πανεπιστήμιο Αιγαίου*

Περίληψη

Η κρίση έχει επιφέρει σημαντική ανακατανομή αρμοδιοτήτων και ισχύος μεταξύ και εντός κρατών και θεσμών. Η ριζική αλλαγή στην οικονομική διακυβέρνηση της Ε.Ε. δεν αναφέρεται μόνο στη συμμετοχή υπερεθνικών θεσμικών οργάνων και οργανισμών στις αποφάσεις για τον συνολικό εθνικό προϋπολογισμό, αλλά και στη διάρθρωση των εθνικών εσόδων και δαπανών και στο επίπεδο των ειδικών κατηγοριών των εσόδων και των δαπανών των εθνικών προϋπολογισμών. Επιπλέον, η εισαγωγή αιρεσιμοτήτων προσθέτει ένα ευρύ φάσμα μέτρων και πολιτικών σε αυτές που η Ε.Ε. και τα κράτη μέλη έχουν συνυπευθυνότητα. Ακόμα, η οικονομική κρίση έχει επιφέρει σημαντικές αλλαγές στη θεσμική ισορροπία της Ευρωπαϊκής Ένωσης. Όλο και πιο κρίσιμες αποφάσεις φαίνεται να λαμβάνονται αποκλειστικά ως αποτέλεσμα διακυβερνητικών διαβουλεύσεων. Το Ευρωπαϊκό Συμβούλιο ενισχύεται και αναλαμβάνει τον κυρίαρχο ρόλο, το Ευρωπαϊκό Κοινοβούλιο περιθωριοποιείται, το Συμβούλιο Των Υπουργών γίνεται συχνά ένα απλό φόρουμ για την επικύρωση των σημαντικών αποφάσεων που λαμβάνονται σε άλλα άτυπα όργανα και η Ευρωπαϊκή Επιτροπή βλέπει τον ρόλο της να περιορίζεται στις εκτελεστικές της αρμοδιότητες.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Οικονομική διακυβέρνηση, Θεσμοί της Ε.Ε., Νέος διακυβερνητισμός.

1. In addition to unprecedented and multiple redistribution of income, the crisis has brought about a major re-allocation of responsibilities and power between and within states and institutions

The crisis led to a large transnational redistribution of income and wealth. This uneven and asymmetric impact has reinforced the already significant imbalances between the EU center and the countries of the periphery, with the South as the big loser. The major victim of this redistribution, Greece, in terms of GDP per capita, ranked 15th among the 28 member states in 2008 (with 93% of the EU average) and, ten years later, with 67% of the average, ranked 25th, with only the last three acceding countries, Bulgaria, Romania and Croatia, to follow.

Perhaps less prominent, but equally if not more impressive, is the redistribution of income and wealth within each country. In many member states, including Greece, large class, occupational, interregional and intergenerational redistributions are taking place and there is a clear deterioration in income and wealth inequality indicators.

But beyond that, the institutional balance on which the European Union rests is being disrupted by major long-term consequences and new balances are sought in the division of responsibilities and power between member states and the EU, among the institutions that make up the EU, as well as between the methods of decision-making and the two functions, transnational and supranational, which have always co-existed in the process of European integration.

2. New powers are transferred to the EU "by stealth", without altering the Treaties

The neofunctionalist account describes the process of integration as an incremental process which is driven by the demands of interest groups for market integration and supranational institutions responding to these demands, following the functional logic which characterizes highly interdependent economies and linkages between different policy areas (Vilpišauskas 2013, p. 364). This process, 'integration by stealth' according to Majone (2005), had reached its limit when the next step was to transfer national sovereignty on the particularly sensitive area of redistribution and the harmonization of social policy through fiscal policy (Habermas 2015). And yet, with the need for 'result-based legitimacy', even this 'red line' now seems to be overrun (Chalmers, et al. 2016). The crisis has resulted to a new wave of "legislation through the back door".

The radical change in EU economic governance, with the adoption of the "European Semester" and all the procedures for more effective coordination of member states' financial and budgetary plans, does not only refer to the involvement of supranational institutions and bodies in the decisions on the total national budget and the relationship between revenues and expenditures. The need to prevent future toxic problems for all countries leads to a direct EU involvement, in practice a co-decision of EU and the member states, on the *structure* of national revenues and expenditures and *the level* of specific categories of revenue and expenditure of national budgets.

EU member states (and not just the countries under surveillance, not even only the eurozone ones) delegate national competence to areas for which the Treaty does *not* provide for harmonization. The level of pensions and more generally the insurance and pension policy, the extent of tax burdens and the efficiency of the national tax system are classic examples in this regard. Through the surveillance process, the EU intervenes and co-determines with each country not only the annual budget, but also policies that would otherwise remain almost completely in the hands of governments.

In addition, the introduction of all sorts of *conditionalities* add a wide range of measures and policies to those in which EU and the member states have co-responsibility. Input and output conditionalities are introduced in the structural funds, the use of macro-conditionalities is generalised and, according to the Commission's proposal for the future budget, a new, "political" conditionality would be introduced, linking participation of a member State in the budget with the acceptance of the rule of law and EU values. In some cases, this extension of the areas of co-responsibility goes beyond the areas defined by the Treaty as areas of "shared competence"[1] and, as a result, many aspects of social or education policy or even the way justice is delivered, are influenced by this new form of economic governance.

The advantage EU gets from this generalized use of conditionalities, is that the effectiveness of Community goals and policies may significantly increase, turning "soft", non-binding, decisions into "hard" ones. The threat, for example, that failure to implement a specific pension reform will cut off financial aid makes the choice of the pension system an EU policy, while previously the EU could only express wishes in this regard. It should be noted that the establishment of conditionality has always been a classic consequence when it comes to external assistance from organizations such as the International Monetary Fund or the World Bank, but its use within the EU is a relatively new phenomenon[2]. The prevailing perception was that the establishment of conditionalities was a practice of international organizations, but was not appropriate for the implementation of Community policy. After all, it is difficult to imagine the use of such conditionalities within a single state, or a "quasi state".

What needs to be emphasized is that this intrusion of EU in new areas and policies is not politically or ideologically neutral. What is strengthened is the role of the EU in promoting more «liberal», market creating policies vis-à-vis more «interventionist» policies (industrial, research, regional development, etc.). The dominant position of the economy in relation to the social dimension is exacerbated.

3. The economic crisis has brought about significant changes in the institutional balance of the European Union

The financial and economic crisis has brought about significant changes in the institutional balance of the European Union. This institutional re-balancing of recent years has been the result of the crisis, its expression and the cause of new imbalances, even if specific institutional arrangements of the Treaty of Lisbon, coupled with a substantial shift in the overall approach on the part of Germany,[3] a federalism-friendly member-state, have provided the ground for this new institutional balance.

The European Council is the big winner. It is precisely because of the particular political weight of the crisis and the widespread perception of high risk, that the European Council's leadership is considered indispensable and irreplaceable. As Bressanelli and Chelotti (2016, p. 515) write: "indeed, the European Council is perfectly located within the institutional architecture to determine and/or modify the Best Alternative to a Negotiated Agreement (BATNAs) of the negotiating parties".

The number of European Council meetings has almost tripled during the crisis *(*Fabbrini and Puetter 2016, p. 489)*,* but with the main characteristic that fundamental decisions are taken essentially *outside* the European Council, by one country, or, at best, by a group of countries. Never before has the concept of '*directoire*' been so obvious. Too often, Germany and its 'allies', or, sometimes, Germany together with France, made all substantive decisions. In practice, formally, it was at the European Council that all major decisions to deal with the crisis were taken (after, often difficult, intra-governmental negotiations were mediated in some countries, such as in Germany, between the Chancellor and the Minister of Finance) and the ECFIN Council, and in particular the "informal" Eurogroup of eurozone finance ministers, were simply invited to implement them,[4] serving in reality only as a forum for communication and enforcement of those decisions, while the Commission's role was reduced to that of the secretariat, and the European Parliament was completely absent.

The European Council is strengthened and assumes the dominant role, the European Parliament is marginalized, the Council of Ministers often becomes a simple forum for validation of major decisions taken in other informal bodies and the European Commission sees its role confined to the implementation of decisions. The Commission is often referred to as the "big loser" of the new institutional balance (Laffan 2016: 919), while perhaps the "major transformation" of its role should be emphasized. Finally, another institution, a genuine "federal" one, the European Central Bank, sees its position being upgraded, even though it did so by reinterpreting the rules without admitting to this publicly – in other words, "by stealth", (Laffan 2016:919).

4. Towards a "new intergovernmentalism"

The dominance of the European Council caused a serious blow to the "Community method", the central elements of which have always been the following: (a) The Commission has the exclusive right of (legislative) initiative, (b) the final decision is taken jointly by Parliament and the Council (of Ministers), by a simple majority of members of Parliament and a qualified majority of member states; and (c) the implementation of any decisions is left to the Commission (often, as in the Structural Funds in a 'partnership' with the member states).

The European Council, precisely because it expresses the leadership of the governments of the member states, that is to say, the people in charge of the major decisions, now functions as "deus ex machina", as opposed to the necessarily complex and time-consuming classical Community method (Bertoncini and Kreilinger 2012). In practice, not only at the European Council, but also at the Council of Ministers, the principle of unanimity reverts to major decisions, thereby forcing the European Parliament to marginalization.

This "new intergovernmentalism"[5] marks a paradox. While the Lisbon Treaty increases the number of policy areas where decisions are taken by the 'Community method', in practice the European Union has become no more a 'federation'. On the contrary, more and more critical decisions seem to be taken solely as a result of intergovernmental consultations, at least on major issues, with Parliament complaining about returning to an exclusively advisory role and with the Commission restricted to its executive responsibility.

In the long run, the new institutional equilibrium may prove to be the most significant impact of the crisis on the European integration process. As emphasized by Dawson (2015), the crisis has challenged existing forms of accountability. The intergovernmental and Community methods are not only descriptive categories but contain specific structures of democratic accountability. The intergovernmental method is based on democratic legitimization through national parliaments, the Community through mainly the European Parliament. On the contrary, post-crisis economic governance tends to move to a 'grey zone'. Jürgen Habermas' "executive federalism" (Habermas 2015, see also Konstantinidis-Treurniert 2018, p. 138) seems to be prevalent, while "democratic federalism", namely the transformation of the European project into a process increasingly driven by the people, not the technocratic elites, fades away. Perhaps most importantly, this new institutional equilibrium does not represent a simple parenthesis in times of crisis, but a new, permanent distribution of roles and responsibilities.

Notes

* Many of the thoughts contained in this article are also included in A. Mitsos, in collaboration with D. Katsikas, *EU Fiscal Policy. Towards "fiscal union"?* ELIAMEP for the Bank of Greece, forthcoming.

1. It is recalled that, while for most policy areas the Treaty provides for "multi-level governance" ("shared competence"), there remain areas for which either the Union or member states maintain exclusive competence. The latter include e.g. educational policy.
2. Concerning the financing of the European Structural and Investment Funds it is recalled that the original conditionalities were reserved exclusively for the Cohesion Fund, but since 2014 they are extended to other Funds (Regional, Social, etc.).

3. Chancellor A. Merkel, already in 2010 in her speech at Bruges 2010 (Merkel 2010), has argued for the need, at least in part, to abandon the 'Community method' and to adopt the 'Union method', essentially that method which member states would consider every time to be the most appropriate.
4. The establishment of the Eurogroup is one of the key institutional reforms (Von Ordarza 2013), with a permanent presidency and, although introduced into the Treaty by Protocol 14 as an "informal" body, it has, in practice, direct implementing powers. On the legal nature of the Eurogroup, see Καραγκούνης and Ράντου 2013.
5. On 'new intergovernmentalism', see in particular Bressanelli and Chelotti (2015), Bick-eton, Hodson and Puetter (2015), Dawson (2015), as well as Dehouse (2016) and other articles in the related issue 38: 5 of the Journal of European Integration, 2016, as well as Buti and Krobath (2019).

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From Varieties of Capitalism to European Growth Models: towards a critical synthesis

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Abstract

The widespread belief that globalization would lead to the gradual convergence of advanced capitalist economies was challenged by the emergence of the Comparative Capitalism (CC) literature. Arguably the most influential approach within CC is the Varieties of Capitalism (VoC) model which argues that differences among advanced capitalist economies not only do not fade away but may be amplified due to the disparate comparative institutional advantages that various socioeconomic models may hold. VoC, nonetheless, was soon criticized -among others- for its binary ontological framework and heuristic shortcomings by the second generation CC. Contemporary writings within the third generation CC suggest a radical break from VoC as the focus should be, it is argued, on the demand, rather than the supply, side of the economy. This article posits that while the third generation CC has shifted attention to other institutional and policy fields, emphasizing essentially macroeconomic issues vis-à-vis economic policy reform, an epistemological rapprochement between the two main strands of CC could offer a more contextualized understanding of the different proposals put forward by the member states regarding the on-going Eurozone reform effort.

KEY-WORDS: Comparative Capitalism (CC); Varieties of Capitalism (VoC); Growth Models; Eurozone Reform.

Από τα Μοντέλα Καπιταλισμού στα Ευρωπαϊκά Μοντέλα Ανάπτυξης: Προς μια κριτική σύνθεση

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Περίληψη

Η ευρέως διαδεδομένη πεποίθηση ότι η παγκοσμιοποίηση θα οδηγούσε στη σταδιακή σύγκλιση των ανεπτυγμένων καπιταλιστικών οικονομιών αμφισβητήθηκε με την ανάδειξη της βιβλιογραφίας του Συγκριτικού Καπιταλισμού. Αναμφίβολα, η θεωρία των Μοντέλων Καπιταλισμού αποτελεί την πιο σημαντική προσέγγιση στο πλαίσιο του Συγκριτικού Καπιταλισμού. Σύμφωνα με την εν λόγω Θεωρία, οι όποιες διαφορές παρατηρούνται μεταξύ των προηγμένων καπιταλιστικών οικονομιών, όχι μόνο δεν απαλείφονται, αλλά, αντιθέτως, ενδέχεται να ενισχυθούν ως αποτέλεσμα των διαφορετικών συγκριτικών θεσμικών πλεονεκτημάτων που διατηρούν τα εκάστοτε κοινωνικοοικονομικά μοντέλα. Ωστόσο, σε αυτήν τη βάση, σύντομα αναδύθηκε μία δεύτερη γενιά Συγκριτικού Καπιταλισμού, η οποία επέκρινε τη Θεωρία των Μοντέλων Καπιταλισμού -μεταξύ άλλων- για το δυαδικό οντολογικό της πλαίσιο, καθώς και για τις διάφορες εμπειρικές της ελλείψεις. Κατά την παρούσα χρονική περίοδο, έχει αναπτυχθεί μία τρίτη γενιά Συγκριτικού Καπιταλισμού, η οποία διαφοροποιείται ριζικά από τη θεωρία των Μοντέλων Καπιταλισμού, επικεντρώνοντας τις αναλύσεις της στην πλευρά της ζήτησης αντί της προσφοράς. Το παρόν άρθρο υποστηρίζει ότι, ενώ η τρίτη γενιά Συγκριτικού Καπιταλισμού έχει μετατοπίσει την προσοχή της σε άλλους θεσμικούς τομείς και πεδία πολιτικής, δίνοντας έμφαση κυρίως σε μακροοικονομικά ζητήματα, ιδίως σε ό,τι αφορά τη μεταρρύθμιση της οικονομικής πολιτικής, ένας επιστημολογικός συγκερασμός μεταξύ των δύο κυρίαρχων προσεγγίσεων του Συγκριτικού Καπιταλισμού θα μπορούσε να συμβάλλει στην καλύτερη κατανόηση των διαφορετικών προτάσεων που προωθούν τα κράτη-μέλη αναφορικά με την επικείμενη μεταρρύθμιση της Ευρωζώνης.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Συγκριτικός Καπιταλισμός, Μοντέλα Καπιταλισμού, Μοντέλα ανάπτυξης, Μεταρρύθμιση της Ευρωζώνης.

1. The VoC approach: a brief description

Post-WWII political economy literature has been largely couched on two major premises. Firstly, that advanced capitalist economies would gradually converge in terms of their institutional make-up in order to successfully compete one another in a global economy. Secondly, within this environment, the economic development models which gave primacy to structural coordination and social values [such as the ones encountered in continental Europe and South-East Asia] would eventually wield to deregulating neo-liberal political-economic models (see, for instance, Eichengreen, 2007; Friedman, 2000; Phelps, 2006; Polanyi, 1944). The emergence of Comparative Capitalism (CC) scholarship, however, challenged this idea by suggesting that varying models of capitalism can not only co-exist but even manifest stark differences. Amidst some earlier and parallel developments in this subfield of political economy (Jackson and Deeg, 2006: 7-11, 21-30), the ‘varieties of capitalism’ (VoC) approach as formulated by Hall and Soskice (2001) clearly is widely accepted as the focal point of the first CC generation. Despite the criticisms that have been eventually raised towards VoC, and more recently specifically regarding its potential to explain the Eurozone crisis - as we will see later in this article - this perspective is still influential primarily because of its canonical formulation of many core concepts Nölke (2016: 145).

In their VoC approach, Hall and Soskice (2001) not only challenged the argument that globalization leads to the systemic convergence of advanced capitalist economies but suggested that it eventually leads to an amplification of their differences. This happens, according to the VoC perspective, because different socio-economic models hold disparate comparative institutional advantages (Hancké, 2009: 1). In terms of its meta-theoretical premises, VoC has been influenced on the one hand by the developments in the economics of industrial organization (Williamson, 1985; Milgrom and Roberts, 1992), and on the other hand, it has fruitfully synthesized the principles of microeconomics and rational choice institutionalism. Following an actor-centered approach, VoC tries to assess how interactions among interest-seeking agents [primarily, industrial firms] shape the economic and political environment of action (Scharpf, 1997). National political economies, Hall and Soskice argue, should be compared according to the ways that industrial firms resolve potential coordination problems along five areas, as the latter have a direct impact on a country's economic performance. More precisely, this fivefold matrix of comparison includes: *industrial relations* (as bargaining over wages and conditions eventually influence the rates of unemployment and/or inflation), *vocational training and education* (the balance- or lack of- between firm investment in workforce training and workers' decision to invest in their skills affect the competitiveness of the overall economy), *corporate governance* (showing how firms' profitability is contingent on the availability of funds to finance particular projects), *inter-firm relations* (reflecting the balance required between suppliers, clients, and access to technology), and *coordination problems with their own employees* (any potential coordination problems which result in employees being unwilling to advance the objectives of the firm can have an impact on the economy's production model) (Hall and Soskice, 2001: 7).

Drawing from this typology, the advocates of VoC models argue that two dominant ideal-types of National Political Economies (NPE) can be discerned; Liberal Market Economies (LME) and Coordinated Market Economies (CME). In LMEs, firms coordinate their activities primarily via hierarchies and competitive market arrangements while in CMEs, firms depend more heavily on non-market relationships to coordinate their endeavors (Hall and Soskice, 2001: 8). These two types of economies are considered resilient due to the emergence of institutional complementarities that result in different comparative advantages in areas like innovation systems, industrial structures, international competitiveness, political regimes, social policies, and reactions to globalization. In LMEs, the equilibrium outcomes of firm behavior are usually given by demand and supply conditions in competitive markets. On the other hand, the equilibria on which firms coordinate in CMEs are more often the result of strategic interaction among firms and other actors (Hall and Soskice, 2001: 8). Being aware, nonetheless, that all economies cannot fit within the binary distinction, Hall & Soskice also alluded to an intermediate type of capitalism, the so-called "Mediterranean." This hybrid type of capitalism (referred to in Hall's and Gingerich's (2004; 2009) work as Mixed Market Economies) is characterized by frequent state interventionism, a large agrarian sector, liberal arrangements in the sphere of labor relations but with certain capacities for non-market coordination in the sphere of corporate finance. Italy, Spain, Greece, Portugal, but France as well constitute some such examples. Regardless, traditional VoC research assumes that economies that are very close to the CME and LME ideal types are more successful than hybrid cases (Nölke, 2019: 6).

2. The path towards European Growth Models

Despite VoC's epistemological breakthrough, its ideal-typical binary distinction was, among others (Hancké et al., 2007), fiercely criticized for being reductive, overly functionalist and unable to account for institutional changes stemming from globalization and neoliberal policies (see, for example, Crouch, 2005; Schmidt, 2002; Thelen, 2014), for the neglection of the role of the state (e.g. Leibfried and Zürn, 2005; Schmidt, 2009) and of the of capitalist systems in transitional Eastern and Central European economies (Bohle and Greskovits, 2012), as well as for the controversial labelling of 'mixed market economies' (MMEs) in Southern Europe (Molina and Rhodes, 2007).

The *second generation* of CC (Hancké et al., 2007; Schmidt, 2002; Amable, 2003; Thelen, 2014) attempted to address these deficiencies by shifting focus to the significance of history and politics in the emergence of capitalist institutions, and the subsequent role of the state in coordinating unfolding capitalist activities. Post-VoC literature, which largely rests on the premises of historical and sociological institutionalism, retains the principles of institutional complementarities and coherent models but argues that a plurality of efficient NPE models may co-exist. This second-generation CC research has developed important insights into Southern European capitalism, and has also focused on the transformative forces of liberalization and financialization which help explain the Eurozone crisis. Nonetheless, one of its often-cited shortcomings is the neglect of the demand-side institutions and the interaction of national capitalisms, particularly within the context of the Economic and Monetary Union (EMU) (Bruff et al., 2015; Nölke, 2016).

The *third generation* of CC scholarship, often identified as "Critical Comparative Capitalism" (CCC) studies, emerged as a response to the crisis and incorporated the study of European Monetary Integration and the creation of the EMU within growth models which focused on the demand side of the economy. While this generation of CC is more heterogeneous than the previous two, its various manifestations share an obvious interest in power imbalances, income inequalities, sources of tension within the EMU in particular, and the corresponding problematic interdependencies among national VoCs (e.g. Beramendi et al., 2015; Hall, 2012; Hall, 2014; Höpner and Lutter, 2017; Streeck, 2014). The most significant contribution of CCC, nonetheless, has been the emphasis placed on the demand-side of the economy and institutions such as collective bargaining and unemployment insurance, leading some scholars to avoid using the terms CMEs and LMEs, but to speak of export-led or profit-led growth regimes as opposed to the demand-led or wage-led growth regimes (Beramendi et al., 2015; Johnston and Regan, 2016; Johnston and Regan, 2018; Iversen and Soskice, 2012; Iversen et al., 2016).

One of the most influential studies in the third generation of CC is the study of (Baccaro and Pontusson, 2016) which offers an alternative analytical framework to the VoC approach by stressing the relative importance of the different components of aggregate demand -consumption, investment, government spending, and net exports- as drivers of economic growth. In contrast to Hall's and Soskice's VoC approach, Baccaro and Pontusson, who borrow from Post-Keynesian economics in the tradition of Michal Kalecki, argue that there exist numerous export-led and consumption-led "growth models" which exhibit substantial quantitative and qualitative differences; namely, growth models may take multitude forms as compared to the binary distinction of VoC, and, secondly, the former are much more unstable than the latter. What sets this article apart from other CPE literature is its aim to explain both cross-state differences and trajectories of change in advanced capitalist economies. One of the paper's main findings is that two CMEs, in VoC terms, like Germany and Sweden, have adopted different regimes and growth trajectories as despite their equally strong export performance, Sweden was the only one to combine that with robust growth in household consumption. Therefore, the argument goes, growth regimes cut across VoC typology and offer an alternative approach with emphasis on demand and distributional conflicts (Behringer and van Treeck, 2017; Nölke, 2016).

In response to Baccaro and Pontusson's claim of providing an alternative to VoC, Hope and Sockice (2016) argue that the growth model approach is, in essence, congruent with their VoC approach and that the export-led and consumption-led growth regimes correspond with their classification of CME's and LME's respectively. In a similar vein, Hall argues that economies with different varieties of capitalism, in their attempt to secure economic growth, are inclined to run different growth models as well, determined by the ways that the organization of the political economy encourages the production of specific types of goods and restricts or expands the number of instruments available for managing the economy (2018: 9). What is more, Hope and Sockice (2016) reject the claim by Baccaro and Pontusson that post-Fordist regimes (Sweden and Germany) are on different growth trajectories by rejecting their empirical claim that German exports have become more price-sensitive over time due to wage suppression as compared to Sweden. Another line of criticism has been that in their "growth models", the authors confound the institutional foundations of the industrial relations with their potential outcomes (Stockhammer and Mohib, 2018).

3. Discussion

While traditional VoC Research and CCC models are often considered to be competing approaches, it appears that they should be better conceptualized as complementary perspectives. This is so because firstly, they focus on different institutional aspects of contemporary economies (with the former focusing on extreme institutional equilibria and the latter on growth dynamics, which can be led both by domestic consumption and exports). Secondly, they do not necessarily follow the same categorization among advanced economies. Therefore, as part of the ongoing discussions on the economic governance of the Eurozone and the necessary economic policy reforms, I would argue that epistemological bridge-building between the two perspectives can significantly expand our horizon of understanding the current conjuncture. Instead of construing the two approaches as mutually exclusive alternatives, for instance, further research may focus on a fruitful rapprochement between the supply side issues on the company level of VoC and the demand side emphasis of growth models. This will enable us to appreciate, on the one hand, the way that institutional asymmetries of different varieties of capitalism led the member states to adopt divergent growth strategies while participating in the same monetary union; on the other hand, we will be able to decode the proposals that different member states put forward as regards the on-going Eurozone reform effort in light of their attempt to preserve their comparative institutional advantage.

As such, the viability of different economic models should be appreciated within a broader network of interactions instead of being treated as if they exist in isolation. Eurozone rescue policies, therefore, I would like to argue, need to accommodate the co-existence of different growth models instead of aiming for the prevalence of a single ideal-typical one like, for instance, the German export-driven. A case in point is the eventual self-defeating policy devised for economies of the South which conditioned their bailout on the unequivocal implementation of radical structural reforms and adoption of harsh fiscal austerity measures. It is worth noting here that, as Chang et al. (2020) show, despite the policy constraints imposed on program countries -which led, among others, to high unemployment rates, rising poverty levels and large investment gaps- these member states still retained their national growth models, demonstrating how deeply embedded such models are in the economic, political, and even cultural fields of each member state. By abandoning a quasi-evolutionistic perception of growth models, where the state has to supposedly follow a single path towards development and prosperity, a multitude of viable alternatives opens up for member states to follow which, nonetheless, need to be mindful of the broader framework as defined by the Treaty as well as the Stability and Growth Pact. In this sense, the motto of the EU 'unity in diversity' is no longer construed as an empty gesture but becomes a guiding light for creative and inclusive policy making.

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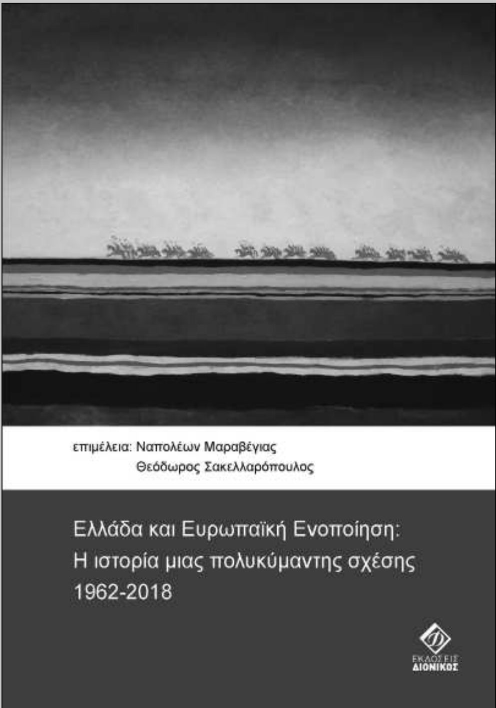

Ναπολέων Μαραβέγιας
Θεόδωρος Σακελλαρόπουλος
-επιμέλεια-

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Η υπερ-πεντηκονταετής περίοδος σχέσεων της χώρας μας με την ΕΟΚ/Ε.Ε, που εκτείνεται από τη σύνδεση και τη Συμφωνία των Αθηνών το 1962 έως την εκδήλωση της κρίσης, την υπογραφή μνημονίων προσαρμογής και την ολοκλήρωσή τους τον Αύγουστο του 2018, αναδεικνύει κρίσιμα ερευνητικά ερωτήματα: Τι είδους επίδραση άσκησε η Ε.Ε. σε θεσμούς και δημόσιες πολιτικές της χώρας; Με ποιους μηχανισμούς μεταφέρθηκαν οι επιδράσεις και πόσο και πώς ενσωματώθηκαν σε εθνικό επίπεδο; Ποιες ευρωπαϊκές πολιτικές επέδρασαν περισσότερο στη χώρα μας και για ποιους λόγους; Πόσο ουσιαστική ή/ και επιφανειακή ήταν η προσαρμογή σε διάφορα πεδία πολιτικής αλλά και σε ζητήματα νοοτροπιών και συμπεριφορών; Ποιο ήταν το τελικό αποτέλεσμα, θετικό ή αρνητικό, των επιρροών από τη συμμετοχή της Ελλάδας στην Ε.Ε.; Δεκατέσσερις ειδικοί επιστήμονες σε επιμέρους τομείς, καθηγητές και ερευνητές, παλαιότεροι και νεότεροι, ένωσαν τις δυνάμεις τους για να απαντήσουν στα πιο πάνω ερωτήματα και να συμβάλουν στη διερεύνηση όσο το δυνατόν περισσότερων διαστάσεων των επιδράσεων που δέχτηκε η χώρα μας από τη συμμετοχή της στην ευρωπαϊκή ολοκλήρωση κατά την προαναφερόμενη περίοδο 1962-2018. Οι καταγραφές και οι αναλύσεις τους συνθέτουν την ιστορία της πολυκύμαντης σχέσης της χώρας μας με το ευρωπαϊκό μόρφωμα και συνεπώς ενδιαφέρουν, εκτός από τους φοιτητές, όλους όσοι θέλουν να ασχοληθούν με τη μεταπολεμική ιστορία της Ελλάδας από τις αρχές της δεκαετίας του ’60 μέχρι σήμερα.

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The missing European Deposit Insurance Scheme

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Abstract

The European Banking Union embarked as a highly ambitious project of the European Union as a response to the significant flaws and weaknesses in the original architecture of the European Monetary Union that became apparent during the economic crisis. However, the establishment of a single European banking system has stumbled upon the creation of a common deposit insurance scheme that could safeguard depositors and create a more stable financial framework in the euro area.

The European Deposit Insurance Scheme (EDIS) was firstly introduced by the European Commission in 2015. As a bold proposal that comprises wide risk mutualization among the euro area member states, it has spurred a vivid discussion in the European public speech and many proposals have been made since then altering its original planning in an effort to tackle the moral hazard concerns that have risen. The present article, after discussing the reasons that keep obstructing EDIS, presents these suggestions that move around, primarily, the role of the national deposit guarantee schemes. However, as highlighted in the article, before moving to any alterations on the structure and role of a proposed common deposit insurance scheme, significant risk minimization on behalf of the national banking systems, must precede by limiting the sovereign exposures of banks and the size of the Non-Performing Loans. Such steps of risk minimization are critical for addressing concerns and the political unwillingness demonstrated by several European countries in moving forward towards deeper integration.

KEY-WORDS: European Banking Union, European Deposit Insurance Scheme, risk mutualization, moral hazard.

Η απουσία ενός Ευρωπαϊκού Συστήματος Ασφάλισης Καταθέσεων

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Περίληψη

Η Ευρωπαϊκή Τραπεζική Ένωση αποτελεί ένα από τα πλέον φιλόδοξα σχέδια ως απάντηση στις σημαντικές αδυναμίες στο οικοδόμημα της Ευρωπαϊκής Νομι-

σματικής Ένωσης οι οποίες έγιναν προφανείς κατά την οικονομική κρίση. Ωστόσο, η εγκαθίδρυση ενός ενιαίου Ευρωπαϊκού τραπεζικού συστήματος δεν έχει ακόμα καταστεί δυνατή λόγω της έλλειψης ενός κοινού συστήματος προστασίας των καταθέσεων. Ένα τέτοιο σύστημα θα ήταν ικανό να προσφέρει ασφάλεια στους καταθέτες και να δημιουργήσει ένα πιο σταθερό χρηματοοικονομικό πλαίσιο στην Ευρωζώνη.

Το Ευρωπαϊκό Σύστημα Ασφάλισης Καταθέσεων (ΕΣΑΚ) προτάθηκε για πρώτη φορά το 2015 από την Ευρωπαϊκή Επιτροπή ως ένα σύστημα που περιλαμβάνει ευρύ διαμοιρασμό κινδύνου μεταξύ των κρατών μελών. Έκτοτε, έχουν κατατεθεί στον ευρωπαϊκό δημόσιο διάλογο, αρκετές αντιπροτάσεις που τροποποιούν τον αρχικό σχεδιασμό σε μια προσπάθεια να αντιμετωπιστούν οι ανησυχίες περί «ηθικού κινδύνου» που έχουν προκύψει. Το παρών άρθρο συζητά τους λόγους πάνω στους οποίους εδράζεται ο «ηθικός κίνδυνος» και αποτρέπουν την ολοκλήρωση του ΕΣΑΚ και παρουσιάζει τις εναλλακτικές προτάσεις οι οποίες αφορούν κυρίως το ρόλο των εθνικών αρχών ασφάλισης καταθέσεων. Ωστόσο, όπως υπογραμμίζεται στο άρθρο, είναι ζωτικής σημασίας να προηγηθεί της εγκαθίδρυσης οποιουδήποτε σχετικού συστήματος, σημαντική μείωση κινδύνου μέσω της ελάττωσης της έκθεσης των τραπεζών στα εγχώρια κρατικά χρέη και της μείωσης των Μη Εξυπηρετούμενων δανείων. Αυτό θα συμβάλλει σημαντικά στο να περιοριστούν οι φόβοι και οι πολιτικές ασυμφωνίες μεταξύ των ευρωπαϊκών κρατών σχετικά με τη βαθύτερη οικονομική ολοκλήρωση που επιχειρείται μετά την οικονομική κρίση.

ΛΕΞΕΙΣ-ΚΛΕΙΔΙΑ: Τραπεζική Ένωση, Ευρωπαϊκό Σύστημα Ασφάλισης Καταθέσεων, αμοιβαιοποίηση κινδύνου, ηθικός κίνδυνος.

1. Introduction

The European Union embarked on the highly ambitious plan of establishing a Banking Union back in 2012, when the severe economic crisis highlighted in the most apparent way the need for reforms in the original design of the European Monetary Union. The introduction of such an institutional framework was intended to break the close financial links between banks and their own sovereigns and promote the creation of a single banking market. However, after eight years, the European Banking Union is still not completed and neither of the stated objectives has been achieved.

Despite the progress achieved so far -the creation and operation of the Single Supervisory Mechanism (SSM) and of the Single Resolution Mechanism (SRM)- the European Deposit Insurance Scheme (EDIS), which is crucial for the effective operation of the Banking Union, is far from completed.

A single deposit insurance scheme -meaning a common and uniform guarantee for bank depositors across the monetary union- will provide a greater sense of security to depositors in the weaker economies of the Eurozone by disconnecting banks from the national deposit insurance authorities that constitute today banks' backstop. The relevant legislative proposal was published by the European Commission in 2015;[1] EDIS is supposed to be completed in three stages by 2024: re-insurance, co-insurance and full direct insurance. The final stage will consist of full risk mutualization where the losses and liquidity needs of the participating national deposit guarantee schemes will be fully covered by a European Deposit Fund (EDF) which will be based on banks' risk-based contributions. As expected, the bold proposal of a mechanism that comprises such wide risk sharing has triggered vivid debates in the European public discourse.

This short paper reviews the most prominent proposals that have been made towards the completion of EDIS. All of them seek to effectively address two major obstacles: the doom loop and the moral hazard.

2. The "doom-loop" and the moral hazard issue

The first and most important goal not only of EDIS, but of the banking union as a whole, is to disconnect the banking sector from the public finances, breaking thus the so-called "doom-loop" that proved to be a major source of instabilities. In the years prior to the crisis capital inflows increased within the euro area, mostly due to the introduction of the common currency. This fueled large imbalances in some countries' fiscal and current accounts making them susceptible to crises. These imbalances were financed by domestic banks, which ended up being the biggest holder of the public debt of their own governments, rendering thus the state the greatest debtor of many European banks. Counting in the fact that the task of bank supervision was entrusted to the national authorities, a vicious circle was created whereby the banking system and public finances were intertwined in a precarious way. Fears on the solvency of the former were translated in fears on the solvency of the latter and vice versa, making them both fragile. In this negative feedback process, sovereigns are responsible to bail-out their national banks, something that has a direct impact on the national debt level and an indirect impact on the yields of the sovereign bonds as their prices fall. In turn, this will lead to a deterioration of the banks' balance sheets due to their high exposure to sovereign debt. The cases of Portugal, Spain, Ireland and Greece are indicative of the doom-loop's detrimental results.[2] Elevating main responsibilities of the banking sector, such as supervision and resolution, from the national to the central, supranational level, gives room to harmonized practices within a so far fragmented system, where the weight for banks' support during the crisis was mainly carried by European taxpayers.

Although banking supervision has now moved to the European level, which allows for the establishment of more sound practices regarding banks' portfolios, the national deposit insurance authorities still have a strong role as banks' backstop and the 'doom loop' between banks and sovereigns still exists. This not only affects the quality of bank supervision but it also creates the conditions for contagion from the banking to the public sector. This strong link between banks and sovereigns was a key source of the instabilities that seriously aggravated the Eurozone debt crisis, since European banks remained exposed to the debt of their own governments instead of diversifying their sovereign exposures within a currency risk-free area. Despite the fact that this tendency seemed halt prior to 2008, during the crisis it was revived especially in countries with evident debt problems (Véron, 2017) that were also more likely to face financing difficulties. Today, and after the European leaders have repeatedly highlighted the importance of breaking this 'doom-loop', the vicious circle between banks and sovereigns seems to be still strong, although slowly declining from 2017. Looking at the EBA's latest EU-wide transparency exercises, banks' domestic sovereign exposures stood at 46% in June 2018 a number that fell to 42% a year later. Almost 40% of these exposures respond to 5-year maturity or more, raising thus the risk stemming from interest rate fluctuations. It is evident that the "home-bias problem" is present, triggering fears about the resiliency of banks, especially in high-debt countries such as Italy.

It is then no wonder that the EDIS has not proceeded yet. Member states with more robust economies and healthy bank sectors, are unwilling to share the same risk with more "fragile" countries that saw their banking sectors on the brink of collapse due to the sovereign crisis and sought external financial assistance. Their unwillingness is rooted in concerns of moral hazard, and the perception that certain sovereigns will seek to ensure preferential funding from their domestic banks under a regime of supranational deposit security, which would facilitate the fiscal deviations observed in some countries before the crisis.

One more critical point to address in regard to moral hazard are the Non-Performing Loans (NPLs) that in the aftermath of the financial crisis have become a major concern for policymakers and supervisors. Although total NPLs have decreased by almost 50% since 2015, their volume still remains alarmingly high in some member states. As such, according to some, the process of "cleaning" banks' balance sheets should be continued in order to achieve risk minimization before moving on to potential risk-sharing through the full participation in the EDIS mechanism.

3. Different proposals for an effective and moral hazard-free deposit insurance system

The diverging views on the structure and role of EDIS reflect a much deeper division among euro area members and mainly between Germany and France, as the two largest member states. The former, along with states such as Finland and the Netherlands, have showed unwillingness in promoting further risk-mutualization based on the notion that most failings of the euro area stem from inadequate national fiscal policies that should be addressed with a stricter regulatory framework. On the other hand, France, and states mostly from the European periphery such as Italy, have over time called for deeper integration and stronger governance and accountability at the EU level. Attempting to reconcile these two positions has brought the completion of the banking union to a deadlock.

However, this is a false dichotomy, which oversees the fact that both domestic fiscal discipline by governments and risk sharing among the euro area member states of a monetary union should be complementary elements of the same architecture and not substitutive, since the lack of the one undermines the effectiveness of the other.

In an effort to break this deadlock several proposals have been made on the way that EDIS development should be altered and proceed. An alternate regulatory regime has been proposed by Véron (2017) based on sovereign concentration charges. It is suggested that euro area banks' sovereign exposures, weighted by coefficients (the concentration charges) should be included in banks' risk-based capital ratio as a second component alongside with the total risk weighted-assets of each bank. The coefficients should increase accordingly to the exposure ratio, beginning from zero, with an "exemption threshold" standing at 33%. Such a scheme can give banks incentives to diversify their portfolios, within the euro area, and limit their sovereign exposure in order to stay above the exemption threshold guaranteeing market discipline and balanced risk-sharing (Véron 2017).

Bénassy-Quéré et al. (2018) suggest keeping national compartments of EDIS under a single institutional framework as the first ones to bear any potential losses since the sources of risk remain national. Insurance then should be unconditional and full for all member states, building up depositors' trust to the system, a crucial element for the success of any deposit insurance system. This scheme of re-insurance by the national deposit guarantee authorities was also put forward by Gros (2015) as a long-run solution, funded by the Deposit Insurance Fund that is meant to be established according to the European Commission's proposal. In both proposals, authors suggest that the ESM should act as EDIS' fiscal backstop as is the case for the SRM. On the contrary, Schnabel and Véron (2018) despite their suggestion that national deposit insurance schemes should remain functional, propose that they are phased out after a transition period and replaced by a European single-authority system, the Single Resolution Board. Any direct payouts to individuals would be made by the national authorities which will remain in place for implementation purposes. While Gros' (2015) planning maintains autonomous decision making, entrusted to the national authorities, Schnabel and Véron (2018) argue that responsibility should be at a central level, where country-blind protection is guaranteed for all banks, in order to build depositors' trust.

In all three proposals deposit insurance fees for banks are differentiated in line with their risk exposure. Preserving national deposit guarantee schemes keeps a significant degree of accountability at the national level easing thus fear about moral hazard under a full EDIS. Schoenmaker (2018) however, treats this arrangement as a potentially destabilizing factor of the national banking systems on the notion that during a recession, the surviving banks have to refill the national scheme through future contributions. As a result, the credit function of banks is compromised as well due to the credit crunch they experience. Addressing the justified concerns on moral hazard by limiting banks' exposure on sovereign debt will better create the proper circumstances within which deeper risk sharing can arise.

4. Future prospects of EDIS and the completion of the banking union

The completion of EDIS remains a politically charged issue in the euro area. Keeping the national authorities involved and moving gradually towards a fully supranational deposit insurance guarantee mechanism could balance out the lack of political willingness due to moral hazard issues, but only temporarily as its effectiveness will be constantly under question. So far, the building of a more resilient European banking sector has stumbled upon the lack of political will and compromise grounded on different national interests on one hand and upon the fragility of national banking sectors and the fear of contagion on the other. At the same time, the flaws in the original design of the monetary union and the poor effort to manage the debt crisis and deal with insolvent countries have spurred political controversies and have given rise to Eurosceptic and populist parties in many member states.

In this landscape of political fragmentation, consensus is a challenging task. This is evident even in the recent EU summits where budget negotiations did not bear any results indicating the difficulty of bridging all individual interests. The funding gap that the Brexit leaves constitutes a friction point as compromise should be achieved between the member states that want to maintain the rebates on their contributions and the need to restrain spending in order to fill the Brexit gap. Once more it is laid bare that economic and monetary issues, especially those that require extensive consensus, are not free of political sensitivities especially in the aftermath of a severe financial crisis.

The choice of Christine Lagarde as the new ECB president has also been discussed as a potential moving force towards deeper integration and the completion of the banking union. Her time as the Fund's managing director during times of economic turmoil equipped her with critical leadership skills and strong relationships with her German counterparts (Wolff and Christie 2019). As a result, and since the main obstacles that hold behind the wider reform agenda are of political nature, Lagarde can use this "space" provided to her to make a shift on economic policy and pursue the consent on the completion of the banking union.

On the other hand, recent statements of the German Finance Minister Olaf Scholz have reignited the hopes that maybe a full European Banking Union is not far. In light of the UK's withdrawal from the European Union, Scholz highlighted the importance of a complete banking union as a shield against external shocks alongside with the necessary risk sharing through a common European deposit insurance mechanism. Counting in the fact that the UK was the financial centre of the EU, further integration among the Eurozone member states could enhance the Union's international financial role. However, Scholz noted as an indispensable precondition that in such a case all sovereign debt of the participating banks should be risk-free. Additionally, he proposed capital requirements for banks that buy euro area governments' bonds, a suggestion that prompted Italy's reaction as it would be harmful for the competitiveness of its banks.

German proposals mean that a wider context of reforms, regarding the banks' balance sheets, should be established before Germany can agree to proceed to some form of risk sharing. As a result, and although the willingness to move forward has been expressed by the EU's net contributor, it will not do so until specific and strict requirements have been met, and risk sharing is realised under its own conditions.

Notes

1. COM/2015/0586 final- 2015/0270 (COD).
2. Portugal received in 2011 from the EU and the IMF financial aid of up to €78 billion for fiscal financing needs and support to the banking system. Simi-

larly, Spain in 2012 was provided financial aid of up to €100 billion for the recapitalization of financial institutions, while Ireland received a package of up to €35 billion for the support of the banking system. Greece had to recapitalize its banking system twice. In 2012 all four systemic banks received the total amount of €18 billion and in 2015 two of them received the total amount of €5.4 billion.

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