Klein, Carlo

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The Never-Ending Quest for the European Fiscal Policy's Objectives: Stability vs. Convergence or Stability and Convergence?

By Carlo Klein[*]

The aim of this paper is to analyse the permanent struggle to define European fiscal policy objectives, hence to define the corresponding structure of such a policy. To discuss the objectives of fiscal policies in the European context our starting point will be the idea that politics has to define clear objectives, then economic policies, fiscal policies included, should be designed to attain the fixed objectives. In the European context, the Economic and Monetary Union (EMU)'s main objectives have been restated in 2015: "balanced economic growth and price stability, a competitive social market economy, aiming at full employment and social progress" for all member states. Our conclusion, based on these objectives, will be that the EMU needs a fiscal policy as well to cope with asymmetric shocks as to foster real convergence among member states. Therefore, a clearer presentation of the corresponding policies with the expected outcomes on the member state level has to be added. This has to be achieved through an improved communication policy to convince European citizens that the European integration is not just about maintaining peace in Europe but that a real improvement in living conditions can be achieved. (JEL E61, E62, F15, F55)

Keywords: *Economic and Monetary Union, Optimum Currency Area, Real Convergence of European Economies, Common Fiscal Policy, Interventionist Supply Side Policies.*

Introduction

To discuss the objectives of fiscal policies in the European context, our starting point will be the idea that politics has to define clear objectives, and then economic policies, fiscal policies included, should be designed to attain the fixed objectives.

In the European context, the EMU's main objectives have been restated in the 5 Presidents' Report (European Commission 2015a): "balanced economic growth and price stability, a competitive social market economy aiming at full employment and social progress" for all member states. Fiscal policy should then be one of the available means to achieve these goals. The classical textbook definition of fiscal policy simply refers to governments' choices regarding levels of spending and taxation without referring to any objective of these policies. Thus, two questions have to be addressed: In the context of a lack of real convergence, should fiscal policy be used for potential bailouts as well as to achieve real convergence and what should be the structure of such a policy? Or, despite the lack of real convergence, should a European fiscal policy, whatever its structure, be designed with the sole objective to organize bailouts of national economies in case of emergencies? The answers should be based on the analysis of fiscal policies as

[*]Lecturer, Miami University Dolibois European Center (MUDEC), Luxembourg.

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means to improve real convergence and hence the resilience of the EMU's national economies.

Answers to these questions have been formulated over time, mainly through the theoretical analysis of a monetary union, based on the discussion about Optimum Currency Areas (OCA hereafter) and through the corresponding political decisions taken in Europe.

A known major criticism addressed at the EMU structure is the lack of a common fiscal policy in case of asymmetric shocks hitting the euro area. Discussions about potential fiscal policy in the euro area almost exclusively refer to these cases of "shock-contingent bailouts" (Brunnermeier et al. 2016; Bénassy-Quéré et al. 2018, for example), not mentioning the potential need for a structural fiscal policy to foster real convergence.

This discussion can be found in some official documents established by the European Commission (2017a, 2017b, for example) but the mainstream theoretical point of view is that fiscal and monetary policies have no impact on real economic variables in the long run (De Grauwe 2016, for example). Consequently, mainstream theory suggest that the needed structural reforms should be market-oriented to make the economies of the euro area more efficient and thus more resilient in case of asymmetric shocks.

We consider that the discussion on fiscal policy objectives should make a clear distinction between the consequences of asymmetric shocks and those of a potential lack of real convergence of the economies of the euro area, and at the same time, the interaction between real convergence and asymmetric shocks also has to be considered. Then, the question arises if market-oriented structural reforms will be enough to make euro area economies more resilient in case of asymmetric shocks and if they will contribute to real convergence among member states.

The aim of this paper is not to develop new theories of fiscal policies or to assess empirically the effects of the existing policies, but to analyse the permanent struggle to define European fiscal policy objectives, hence to define the corresponding structure of such a policy. Based on these reflexions this paper will be organized as follows.

In section 2, we will present a literature review about economic and political conditions that should be fulfilled to build a monetary union with a specific focus on fiscal policy. In section 3 we will refer to the fact that apart from OCA considerations, long term objectives of the EMU have to be considered: real convergence of member states' economies and sustainable and inclusive growth when fiscal policy objectives are defined. In section 4, we will have a closer look at the indicators used to evaluate the economic situation within the EU and the EMU, then, in section 5 we will discuss the need for a supranational fiscal policy based on the main results of the preceding sections. Finally, we will conclude in a last section.

The focus of our paper clearly lies on fiscal policy in the EMU, even if we cannot neglect potential consequences of such policies on the EU, hence on future EMU members.

Literature Review

Economic Theory: No Monetary Union without a Common Fiscal Policy

The discussion about the need of a common fiscal policy has to be seen in the context of the analysis of monetary unions, based on OCA theory. This discussion was already launched during the sixties with Mundell's seminal paper (1961) about optimum currency areas, and then completed by McKinnon (1963), Kenen (1969) and later by Tavlas (1993), for example.

The reasons for joining a monetary union should be obvious from an economic point of view: the benefits for a joining country should be larger than the costs. According to De Grauwe (2016) these benefits will be the reduction of transaction costs, reduced uncertainty, increased economic growth and benefits due to the international use of the common currency. The corresponding economic costs are the acceptance of sovereignty losses due to the loss of the country's national monetary and exchange rate policies. Non-economic costs could be the loss of national symbols, national currencies.

Furthermore, member states have to accept structural adjustments to foster real convergence within a monetary union and so fulfil the conditions of an OCA.

The main theoretical conditions that should be fulfilled for an economic area to become an OCA are:

- the optimum currency area should have perfect factor mobility (capital and labour) which means geographical and professional mobility for workers (Mundell 1961) and an integrated financial market for capital (Mundell 1973 and McKinnon 2004) even if improved capital mobility may cause a volatility paradox as described by Brunnermeier et al. (2016): "Counterintuitively, financial deepening via a partial removal of financial frictions may actually increase financial instability by facilitating excessive capital flows";
- linked to this mobility condition is the condition that prices and wages in such an area should be flexible (Friedman 1953, p. 165);
- the different economies of an OCA should have highly integrated markets for goods and services and free factor mobility across industries (McKinnon 1963) with the risk that this deeper integration may lead to divergent specialisations depending on national comparative advantages but may make national economies more vulnerable to asymmetric shocks (Krugman 1993);
- the different economies of an OCA should be diversified in production and in consumption to "dilute" the impact of economic shocks (Kenen 1969);
- an OCA should have common policies: a supranational fiscal policy ("fine-tune shock-contingent bailouts" [Brunnermeier et al. 2016]; Kenen 1969) and, a logical consequence of a single currency, a common monetary policy;
- then, Baldwin and Wyplosz (2015) have restated the fact that citizens' political preferences should be homogeneous within the OCA. People

living in a currency union should have a sense of solidarity and a belief in a common destiny. This need for political integration was already highlighted by Mintz (1970) and Haberler (1970) when the discussion about monetary integration started.

The respect of these conditions should allow the different economies within a monetary union to reduce the risks of asymmetric shocks and to face easier and faster market and/or policy adjustments in case of economic shocks.

This need for economic convergence has been restated by Tavlas (1993) for joining countries, especially the convergence of inflation rates and the need for real exchange rate variability which refers to price and wage flexibility.

A second set of theoretical analyses about the consequences of a deeper international integration focusses on the trade-off between integration and national sovereignty. Agreeing on a common currency, thereby abandoning a floating exchange rate system among member states of a monetary union, leads us directly to the monetary trilemma (based on Fleming 1962 and Mundell 1963) that states that a country or geographical area, can only achieve two out of three objectives:

- stable exchange rates (or adopting a common currency);
- a nationally oriented monetary policy;
- international capital mobility.

Padoa-Schioppa (2004) considered that free trade has to be added so that the trilemma became an "inconsistent quartet". According to Padoa-Schioppa, the introduction of a common currency is the logical consequence of the "inconsistent quartet". The European Union, based on the four freedoms of free movements of goods, services, capital and people, needs to become a EMU.

Additionally, to that first trilemma or quartet, Europe has been and is still facing a financial trilemma (Schoenmaker 2011): if we have capital mobility as well as economic and financial integration, national macroprudential policies will be insufficient to limit financial crises. As for the monetary trilemma, national policies have to be replaced by supranational policies, hence by deeper integration.

Finally, from a political point of view, Rodrick (2000, 2017) highlighted "the political trilemma of the world economy" which also applies to the EMU: integrated national economies can only function either with a supranational democracy and fading nation-states or with strong nation-states and a fading democracy! So, during all these years, at least since the signing of the Maastricht Treaty, it should have been quite clear that some national sovereignty has to be abandoned if European integration was to be deepened through common policies and if democracy was to be maintained as a fundamental European value. Rodrick's trilemma simply restates the need for homogenous political preferences within a monetary union.

A logical consequence of these analyses, be that an analysis in terms of the trilemmas and/or based on OCA conditions, is that the EU needs a more deeply integrated economic region to attain its general objectives through the EMU.

If we agree with these theoretical analyses, then a second point has to be discussed which is whether these conditions should be fulfilled by a member state before joining a monetary union or if member states' economies converge further after having joint a monetary union. This "OCA theory in reverse" (Mongelli 2008) can arise from two situations: a situation of an endogenous OCA (Frankel and Rose 1997), where market forces bring member states closer to the expected OCA conditions or an exogeneous OCA where institutions and peer pressure force member states to adjust their economies to come closer to the OCA conditions.

This distinction between endogenous and exogeneous OCAs was and still is important to understand two points of view of how a monetary union should be achieved: the economist and the monetarist views (James 2012; Mongelli 2008; Masini 2014).

According to James (2012; p. 93) "European 'monetarists' believed that the establishment of a series of monetary rules might create the framework for general economic convergence, whereas 'economists' stressed that convergence needed to precede the imposition of a single monetary framework".

A similar statement can be found in Mongelli (2008): the monetarist view considers that "nominal convergence was not indispensable as EMU represents a change in policy regimes: a new common central bank will shape future expectations while past expectations become irrelevant", whereas the economist view considers that "convergence of economic performances is a precondition for EMU".

The monetarist view, suggesting that internal changes bring the economies closer to an OCA, can also be linked to Frankel and Rose's (1997) hypothesis that "more integration can be expected to lead to more trade; and more international trade will result in highly correlated business cycles, …, while integration is also affected by policy". This hypothesis was then challenged by Eichengreen (1992), Kenen (1969) and Krugman (1993) stating that a deeper integration leads to more specialized economies based on comparative advantages and so making different economies more exposed to asymmetric shocks.

These theoretical considerations will be the basis of our discussion about indicators to assess the EMU. Are these indicators designed to assess the endogeneity of OCA, the exogeneity of OCA or even an OCA theory in reverse (Mongelli 2008)? Then, when we discuss fiscal policy, should we focus either on its links with asymmetric shocks, or on the question of real convergence or possibly on both problems?

Before we address these questions, we will firstly summarize how these issues have been considered from a political point of view and what the consequences for a supranational fiscal policy were and still are.

The Political Debate about Fiscal Policies in a Monetary Union

As OCA theory has developed over time, so have the political considerations about how to organize a monetary union in Europe. Major political documents have been produced to justify and to prepare the introduction of the euro.

In 1969, the Council of the European Communities decided to create a committee to present a report giving guidelines for an EMU within the European Communities. The "Werner report" (Council of the European Communities, 1970) implicitly refers to the OCA theory by mentioning the existence of structural differences between member states and by suggesting that factor mobility has to be improved, that a common monetary and fiscal policy, tax harmonization included, will be needed and that, hence, the integration of member states' economies has to be deepened, with fiscal transfers as a consequence. Apart from these common policies, national policies, mainly fiscal policies, should be better coordinated. Hence, the idea of achieving real convergence of national economies through supranational policies, structural fiscal policies included, was present right from the beginning when the political idea of a monetary union was developed.

The authors of the report also added that political problems to reach these aims should be expected and that the creation of a common currency should be discussed with social partners to work out a consensus and to generate a convergence of political preferences.

Almost 20 year later, in 1989, a second report, the "Report on the Economic and Monetary Union in the European Community" or Delors report, was published (Committee for the Study of Economic and Monetary Union, 1989). Again, the report referred to OCA conditions without naming them explicitly and insisted on the "need to achieve a substantial degree of economic union if monetary union is to be successful, and given the degree of monetary coordination already achieved, it is clear that material progress on the economic policy front would be necessary for further progress on the monetary policy front". The report favours an exogeneous approach to OCA, as the authors insisted on the fact that some conditions have to be fulfilled before the creation of the EMU, even if the process of convergence and integration has to continue after the launch of the EMU.

Nevertheless, the report insists that the EMU remains a market-oriented environment and highlights the need for a more effective coordination of national policies through the transfer of the decision-making power to the Community level but based on the subsidiarity principle (art. 5 of the Treaty on the European Union; Official Journal of the European Union 2016). The two objectives of real convergence and countercyclical interventions were mentioned when the authors recommended common structural and regional policies based on interventionist supply side policies and cyclical adjustments through coordinated national fiscal policies based on fiscal rules.

Three stages to achieve the EMU were defined: a first stage where all the participant member states had to commit to the EMU, a second transitionary stage and finally the adoption of the common currency accompanied by a strengthening of the regional and structural policy and compulsory fiscal rules. Again, the need for common policies, apart from defining simple fiscal rules, were highlighted.

At the same time a more theoretical paper was published by the Commission of the European Communities (1990): "One Market, One Money" highlighting the same objectives for fiscal and market-oriented structural policies as the Delors report: real convergence of member states and the treatment of asymmetric shocks.

The paper recommends common rules for national budgets and recognizes shock-absorbing functions of budgets. To satisfy both aims, the authors expected disciplined national budgets and a coordination of budgetary policies. The overall gains of such a structure of fiscal policies should be a catch-up effect of backward areas and recoveries of areas hit by shocks which clearly refers to the two policy goals, real convergence and a better higher resilience in case of economic shocks.

Even if there were no explicit references to a supranational fiscal policy, the authors recognized that economic policies should be assigned to the community level if economies of scale or externalities were to be observed. Two major domains have been mentioned: R&D and environmental investments, two major types of investments nowadays.

These reports then led to the Maastricht Treaty signed in 1992 and ratified in 1993 (Commission of the European Communities, 1992). This treaty fixed, from an EMU point of view, the three stages to the common currency mentioned in the Delors report, the statute of the European Central Bank (ECB) as well as the conditions that have to be fulfilled to adopt the euro even if these criteria were not based on OCA theory. The Maastricht nominal convergence criteria are more about financial stability to avoid excessive fiscal deficits and to limit inflation in member states than about creating an OCA even if these criteria were assumed to contribute to the convergence of the EMU towards an OCA. A timid incentive for labour mobility was introduced through the definition of a European citizenship allowing free circulation within the European Union. The basic idea of national responsibility of member states clearly dominated compared to the idea of solidarity between member states in cases of economic shocks.

Nevertheless, the Treaty of the Functioning of the European Union (TFEU; Official Journal of the European Union, 2012) synthetizing the major European Treaties, gives a framework of how real convergence should be achieved within the EU and EMU[1]: the Treaty clearly refers to shared competence for economic, social and territorial cohesion, mentions actions to foster these cohesions and refers to the need for coordination of national policies (employment and social policies included) and to the need for supplementary actions by member states. This means that a close coordination of national economic policies with common objectives should be achieved, but no bailouts and no monetary financing through central banks will be allowed. Therefore, fiscal rules have to be developed and to be accepted by member states. The European Social Fund; Structural Funds (European Agricultural Guidance and Guarantee Fund, Guidance Section; European Social Fund; European Regional Development Fund), the European Investment Bank and other existing financial instruments should distribute financial resources available for economic, social and territorial cohesion policies and thus contribute to real convergence within the EU in general. Implicitly clear distinctions between the two major objectives of fiscal policies are made in this Treaty: asymmetric shocks should be treated on the EMU level mainly through monetary policy and accessorily through a disciplined fiscal policy. The achievement of long-run objectives should be fostered through mainly market-

[1]The basic idea is that all EU member states should join the EMU, except Denmark and of course the United Kingdom.

oriented supply-side policies and accessorily through an interventionist supply-side policy with a strictly limited supranational budget as we will see.

The definition of these interventionist policies clearly refers to the fact that the EU remains a market based economy despite limited public interventions either on the European level or on the national level: "The Member States and the Union shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119". (TEU; Official Journal of the European Union, 2016).

The sole reference to solidarity between member states mentioned in the Treaties are the cases of important energy crises or natural disasters hitting individual member states.

In general, the need for common policies has been highlighted in all the documents leading to the EMU. A combination of a common fiscal policy combined with national and rules based fiscal policies were recommended, apart from common structural (supply-side) policies. The decision if a policy should be led on the supranational level or on the national level is based on the subsidiarity principle: the policy should be executed on the most efficient level depending on the existence of economies of scale or on externalities, even if these explicit economic criteria are not mentioned in the final version of the Treaty on the European Union (TEU; Official Journal of the European Union, 2016), neither in its article 5, nor in protocol n° 2. The Treaty of the Functioning of the European Union (TFEU; Official Journal of the European Union, 2012) only defines areas where the Union has exclusive competences and areas where the Union and member states have shared competences without specifying any economic criteria to justify this split of competences.

Combining the Objectives of the Emu and OCA Theory: The Need for Convergence and Sustainable Growth

As the aim of the European integration is to improve the standards of living, apart from the broader aim of keeping peace in Europe, the EMU's structure needs to be adjusted to the conclusions of OCA theory so that the expected gains for member states become larger than their costs. Therefore, there is still a need for real convergence, even after twenty years of a common currency. But this concept of convergence has to be clarified, as even the European Commission considers different concepts.

The EMU's Objectives and the Need for Convergence

The achievement of real convergence has always been a concern during the different steps of monetary integration in Europe.

In a Reflexion Paper on the Deepening of the EMU (European Commission 2017a), three types of convergence are mentioned and presented as conditions to be fulfilled to attain the EU's general objectives.

The first and most important concept mentioned is real convergence defined as "moving towards high living standards and similar income levels" which is considered as "key to achieving the Union's objectives". This type of convergence suggests that the EMU is not an objective in itself, but a means to achieve the EU's objectives.

To improve the functioning of the EMU, nominal convergence is defined by its "nominal indicators, such as interest rates, inflation and exchange rates, government deficit and debt ratios, [that] have been used since the Treaty of Maastricht. Fulfilling essential nominal targets is a prerequisite to becoming a member of the euro area". These indicators still refer to financial stability, without referring to OCA theory, but through these criteria the EMU is expected to contribute to real convergence of member states' economies.

An implicit reference to OCA theory can be found, when the document defines cyclical convergence: "Cyclical convergence means that countries are in the same stage of the business cycle, such as an up or down swing. This is important for EMU because conducting a single monetary policy is harder and possibly less effective if countries are in very different stages of the economic cycle – some will need a more restrictive/expansionary policy stance than others". here, the authors clearly refer to the problem of asymmetric shocks that may affect economies of member states differently and complicates the task of policymakers. This definition implicitly suggests again the need for real convergence of national economies in a broader sense than just convergence of real income per capita.

How are Short-run Macroeconomic Stability and Long-run Sustainable and Inclusive Growth Linked?

If we reconsider the EMU's objectives as formulated by the European Commission, it becomes obvious that after having respected the nominal criteria to join the EMU, member states should benefit from the EMU through real convergence which means that disadvantaged economies should catch up with the advantaged economies in the EMU, whatever the criteria considered to define this real convergence. Studies have summarized the empirical evidence showing that we cannot observe real convergence within the EMU (ECB 2015, Demertzis et al. 2019 and Coudert et al. 2019, Aiyar et al. 2019, for example).

To achieve real convergence, measured by real GDP per capita, the ECB (2015) recommends that three conditions for sustainable and inclusive convergence should be fulfilled:

- macroeconomic stability which means the reduction of imbalances and of the risks of asymmetric shocks;
- increased economic flexibility to avoid further misallocation of resources;
- and higher productivity growth, measured by Total Factor Productivity (TFP), through improved quality of labour and capital and a better support to innovation in businesses.

Demertzis et al. (2019), who have a broader definition of real convergence, add that a "euro area-level budget will contribute to investment and should become supportive of macroeconomic management". A major argument for this more interventionist view is the existence of positive externalities of interventionist policies that are often neglected when analysing the question of real convergence, but this fact had already been recognized by the European Commission in 1990 (see paragraph 2.2.). These positive externalities can mainly be generated through investments in human capital, in R&D, in infrastructure, and through industrial policies.

The Eurostat Sets of Indicators: an Evaluation of the Convergence and of the Level of Attainment of the EMU's Objectives

To evaluate these levels, Eurostat[2] has established a series of indicators that can be more or less directly linked to the different concepts of convergence defined by the European Commission:

- the Europe 2020 indicators that refer directly to sustainable growth and social cohesion;
- the UN Sustainable Development Goals (SDGs) also refer directly to sustainable growth and social cohesion;
- the European Pillar of Social Rights; a set of indicators referring directly to social cohesion through the structure of labour markets and social protection.
- The remaining sets of indicators focus more directly on the structure of the European economy, but also consider some broader objectives:
- the circular economy indicators reflecting structural changes in member states' economies with links to sustainable growth and development;
- the Macroeconomic Imbalance Procedure (MIP) Scoreboard; a set of indicators considered as the main surveillance mechanism to guide economic policies in the EU on all levels. We will have a closer look at these indicators in a specific paragraph;
- and finally, the Principal European Economic Indicators (PEEIs); a set of general indicators about the economy of the EU on all levels.

Should Other Indicators Be Considered?

Masuch et al. (2018), in an ECB Occasional Paper, focus on market-oriented structural policies that should improve the functioning of the EMU and the effectiveness of monetary policy. The authors refer to the quality of the institutional framework (quality improvements of public institutions, law enforcement, transparency and accountability, reduced corruption and tax evasion), to more flexible labour markets (adjustments of relative prices and wages, less regulations, improved active labour market policies, higher mobility), to more competitive

[2]EU policy Indicators can be accessed on Eurostat's Home page: https://ec.europa.eu/eurostat/ accessed on 15.04.19.

product markets (lower administrative and market entry costs), to a more efficient financial sector (development of the banking and capital market union), and finally to improved fiscal structural policies (improved functioning of tax administrations, reduced tax biases against equity financing, lower tax burden on labour, higher retirement age).

Demertzis et al. (2019), in a Bruegel Policy Contribution, consider fewer indicators to assess "sustainable and inclusive growth and convergence in the European Union":

Standard economic indicators, GDP growth rate and GDP per capita, should be used to assess the present state of convergence between member states. Then Total Factor Productivity (TFP) and the number of European universities in international rankings should be used to evaluate efforts in R&D. Gini coefficients and trust in institutions should be used to evaluate social cohesion and finally CO_2 emissions should be considered to evaluate green goals.

Alesina, Tabellini and Trebbi (2017) consider similar indicators that should be observed and improved to achieve an optimal political area, a broader concept than the EMU. They group the indicators into three categories:

- economic convergence (of member states' GDP per capita, income inequality and the business cycles stages of their economies);
- cultural convergence (of citizens' religiosity, sexual morality, gender equality, cultural capital and their appreciation of the role of governments);
- and institutional convergence (of different indicators of quality of government and public administrations, governance, quality of legal institutions, educational outcomes and regulatory environment).

Finally, their approach follows the same logic as the previously mentioned studies, as most of the policy recommendations focus on a deeper integration to improve the functioning of the EMU and hence achieve the Union's objectives. This deepening should lead the EMU towards an optimal policy area that can and must be considered as the logical consequence of monetary integration.

Considering the different concepts of convergence and the different sets of indicators developed by European institutions to evaluate real convergence within the EMU, it should become obvious that achieving and maintaining the levels attained of these objectives cannot be obtained by sole bailout mechanisms or market-oriented structural policies within the EMU. The same remark will also be valid for the EU in general.

Imbalances in the Euro Area: OCA Indicators and/or Structural Indicators?

The next paragraph focusses on two major sets of indicators, the MIP scoreboard[3] and the cohesion indicators.

[3]The scoreboards can be accessed on Eurostat's website: https://ec.europa.eu/eurostat/web/macro economic-imbalances-procedure/publications; accessed on 30.06.19.

The MIP Scoreboard

The MIP scoreboard should be considered as the basic statistical tool to guide national and supranational policies based on a two-step procedure: first, the Alert Mechanism Report (AMR) to detect imbalances and then the In-depth Reviews (IDR) in case of severe imbalances (European Commission 2012) to reduce the risks of symmetric shocks and of the need for bailouts.

Economic imbalances can be defined as "situations where stock and flow variables are out of equilibrium for an extended period of time, which is manifested through protracted savings-investment imbalances, losses of competitiveness accompanied by excessive credit and house price growth, and accumulation of debt" (Pierluigi and Sondermann 2018).

The selection of MIP indicators has been mainly based on empirical studies on financial crises and business cycles (European Commission, 2012). These indicators, designed to guide economic policies, do not represent any policy thresholds considered as objectives to be attained, but they are based on simple statistical regularities. The threshold levels for each indicator have been determined by "the upper quartile of the historical distribution" for most indicators. One exception is the national public debt indicator of 60% of national GDP defined by the Maastricht Treaty. This at best implicit reference to policy objectives is clearly a different approach compared to the main objective of the EMU's monetary policy where a precise policy objective has been defined[4].

This ambiguity is confirmed by the fact that the MIP scoreboard indicators "are neither policy targets nor policy instruments" (European Commission 2012) and was restated in 2015, when the number of indicators was increased from 10 to 14: "The inclusion of these variables into the scoreboard shall not have legal implications nor change the focus of the MIP, which remains aimed at preventing the emergence of harmful macroeconomic imbalance and ensuring their correction. … Flashes of the new indicators would not be read as implying, by themselves, an aggravation of macro-financial risks, and consequently will not trigger further steps in the MIP" (European Commission 2015b). This vague statement about the use of these indicators suggests that there are no clear and precise policy objectives defined on how to achieve real convergence within the EMU.

This set of 14 main indicators has been completed, first by 18, then by 28 supplementary auxiliary indicators without thresholds[5] but, again, these indicators are not binding for any policy recommendation (European Commission 2018a). Nevertheless, this increase in indicators gives a broader view of the economic development of member states than the sole main indicators.

If we are looking for improvements in real convergence and in the attainment of the EU's general objectives, it is less obvious that these indicators will be helpful. They give us information of a certain number of imbalances, if we agree

[4]"An inflation rate close, but below 2% over the medium term" as we can read it in every official statement by the European Central Bank (ECB).

[5]These indicators can be accessed on Eurostat's website at: Eurostat (2019): https://ec.europa.eu/eurostat/cache/metadata/en/mips_sa_esms.htm; accessed on 29.06.19.

on the thresholds as policy objectives, but is it enough to become aware of these potential imbalances to generate real convergence and to reach the EU's goals? None of these indicators allow a direct assessment of the state of the EMU as an OCA as there is no information about market integration, factor mobility, structures of national economies or price flexibility[6] in the sense of OCA theory.

Nevertheless, we have to admit that macroeconomic stability is a prerequisite for sustainable real convergence. From this point of view, the main condition that member states should fulfil is the avoidance of asymmetric shocks during the business cycle. This approach, based on a national responsibility approach, considers as given, that the EU or EMU has no supranational fiscal policy and a very limited budget for structural and cohesion interventions within the Union (ECB 2015).

Cohesion Indicators 2014-2020[7]

A broader approach to assess the EU's objectives is the cohesion indicators 2014–2020 published by Eurostat. These indicators assess the state of smart, sustainable and inclusive growth in the member states, linked to the Europe2020 strategy. It is hardly imaginable that these objectives could be solely achieved through market-oriented supply-side policies without complementary intervention-nist policies. The EU's view is that these polices should be achieved on the regional level in cooperation with national organizations. They are considered as "the necessary investment framework to meet the goals of the Europe 2020 Strategy for **smart**, **sustainable** and **inclusive** growth in the European Union". Five targets have been defined: an increase in the employment rate, higher investment in R&D, climate change and energy sustainability objectives, higher efficiency in educational systems and fighting poverty and social exclusion (Eurostat, 2018b).

The supported projects are financed by different European funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund (CF) for a total amount of €351.8 billion for 2014-2020. This amount was expected to be completed by € 100 billion of national contributions[8].

Cohesion Indicators 2021-2027[9]

For the period 2021-2027, new priorities have been defined (European Commission 2018b):

[6]Export market shares, FDI flows and stocks indicators are computed based on Member states' world exchanges and not on intra-EMU exchanges.
[7]These indicators can be accessed on Eurostat's website: https://ec.europa.eu/eurostat/web/europe-2020-indicators/europe-2020-strategy/publications; accessed on 29.06.19.
[8]https://ec.europa.eu/regional_policy/en/policy/what/investment-policy/; accessed on 12.05.19.
[9]These indicators can be accessed on Eurostat's website: https://ec.europa.eu/eurostat/web/cohesion-policy-indicators/cohesion-indicators; accessed on 30.06.19.

1. A smarter Europe, through innovation, digitization, economic transformation and support to small and medium-sized businesses.
2. A greener, carbon free Europe, implementing the Paris Agreement and investing in energy transition, renewables and the fight against climate change.
3. A more connected Europe, with strategic transport and digital networks
4. A more social Europe, delivering on the European Pillar of Social Rights and supporting quality employment, education, skills, social inclusion and equal access to healthcare.
5. A Europe closer to citizens, by supporting locally-led development strategies and sustainable urban development across the EU.

The corresponding resources will be allocated depending on GDP per capita levels combined with social and climate change indicators (youth unemployment, low education level, climate change, and the reception and integration of migrants). For this new period with its ambitious priorities, a total European budget of € 461.117 billion will be available with expected national contributions of € 200 billion (European Commission 2019).

A Need for a Supranational Fiscal Policy based on OCA Theory and European Objectives

This brief overview shows that the awareness of the structural adjustments needed was present right from the naissance of the idea of monetary integration in Europe and that these problems should be addressed either through market-oriented policies (more flexibility) or through interventionist supranational or common policies, fiscal policies included. Nevertheless, the concept of common policies was not and is still not very clear. Should it be policies decided on the EU level for all and/or specific member states or should it be a sole coordination of national policies with a more or less important part of autonomous decisions by national governments? The concept of subsidiarity has been defined as the guideline for these questions. Again, political preferences of governments and citizens of the different member states are not homogenous, as they should be for an OCA. This fact is the basic problem when the need for and the design of fiscal policies should be discussed, not just for the EMU, but for the EU in general. Based on Musgraves' classification of economic roles for governments, Buti (2019) clarifies these problems when he states that "the Maastricht Treaty leaves the cure of inequality fully in the hands of EU member states, focuses on granting efficiency of markets with the one-market project (even if certain aspects, such as policies to support productivity and structural reforms, are fully decentralized) and sustainability with the fiscal rules, and gives a small weight to stabilization, which is based on monetary policy and automatic stabilizers". This reflects the traditional idea of European integration, that political decisions will be followed by economic adjustments which is the "OCA theory in reverse" approach mentioned by Mongelli (2008).

We will just recall that, from a theoretical point of view, an OCA needs a common fiscal policy in case of economic shocks, but a common fiscal policy, apart from market-oriented policies, will also be needed to reduce economic divergences between member states. Monetary policy, automatic stabilizers and decentralized structural policies seem not to be enough to address both problems.

Fiscal Policy and Asymmetric Shocks

The Need for a Common Countercyclical Fiscal Policy

As we have seen, there is a theoretical consensus that in case of asymmetric shocks countercyclical fiscal policy should be used to limit the impact of such shocks if factor mobility and/or price flexibility are insufficient.

The Commission of the European Communities (1990) has defined a shock as "any unanticipated event which has a direct or indirect impact on endogenous variables of the reference system" (member states). Nevertheless, we have to be more precise about the definition of shocks and about which shocks should be treated through countercyclical fiscal policies and which ones should be treated through structural adjustments.

These shocks may be either country-specific or common to the EMU, but they may have differentiated impacts on countries of a union depending on the initial conditions (economic structure, economic agents' behaviour, policy preferences) of these countries. If these conditions are different from one country to another, then common shocks, like country specific shocks, will be considered as asymmetric shocks with either temporary or permanent consequences.

How to Finance a Common Fiscal Policy?

To limit the negative consequences of asymmetric or endogenous shocks (De Grauwe 2016), OCA theory suggests that a budgetary union with a supranational budget should operate as an insurance mechanism for those economies suffering from asymmetric shocks. These fiscal interventions should be based on public investment programmes, less on simple public consumption (Drèze and Durré 2014). In this sense, the countercyclical policy could at the same time contribute to real convergence by investing in domains fostering positive externalities and economies of scale.

This missing insurance mechanism in the EMU design can be explained again by a lack of homogenous political preferences summarized in the opposition between a responsibility (market discipline) approach, dominating mainly in northern European countries, and a solidarity approach (risk sharing) dominating more in the southern European countries (Brunnermeier et al. 2016). The sovereign debt crisis has nevertheless generated instruments to cope with future crises: the European Financial Stability Facility (EFSF) and then the European Stability Mechanism (ESM), funds that provide conditional loans to member states facing mainly asymmetric shocks.

A lot of discussions on how to improve these mechanisms are led and a general proposal for a euro area reform, including fiscal policy, can be found in the so-called 7 + 7 report (Bénassy-Quéré et al. 2018). According to the authors, the report aims at presenting recommendations for financial stability, incentives for domestic, hence national reforms, and at generating a consensus in the response-bility (market discipline) vs. solidarity (risk sharing) controversy.

The authors recognize the need for a deeper (political) integration for viable supranational fiscal policy but avoid the debate due to a lack of political consensus on this topic: "A proper budget could only grow out of political decisions to finance defined common public goods and to design an institutional framework ensuring adequate accountability to a legislative body".

Therefore, the authors mention a limited focus of their contribution on "macroeconomic, financial and fiscal stability" considered as a public good (Bénassy-Quéré et al. 2018) for all European citizens. This public good should generate obviously positive externalities and hence be financed by a common budget.

The resulting recommendations of their analysis of fiscal policy can be summarized as a call for an improved coordination of national policies through simplified fiscal rules: "nominal expenditures should not grow faster than long-term nominal income … and they should grow at a slower pace in countries that need to pay down their debts". This process should be monitored by "an independent, national-level fiscal council" that would report to the "euro area fiscal watchdog". The advantage of this system still based on national responsibilities is clearly simpler fiscal rules. This simpler structure will not avoid Eurosceptics' criticism of European elites if an independent council of experts monitors national budgets even if the authors suggest that the EMU also needs an overhaul of its institutional structure. Still, a lack of accountability will immediately be highlighted by Eurosceptics'.

For large asymmetric shocks, the authors refer to the existing ESM which should provide conditional loans to member states and euro area safe bonds could be issued. A system of junior sovereign bonds issuing should be developed to finance any excessive spending by member states. Again, complicated solidarity mechanisms are recommended that need to be explained to the public to avoid new criticism of the EMU structure.

OCA Theory and Interventionist Supply Side Policies

The Need for Interventionist Supply-Side Policies

The theoretical discussion on structural adjustments mainly focusses on capital, labour and product markets adjustments to increase flexibility on these markets.

Pierluigi and Sondermann (2018) suggest that structural policies should improve the functioning of economic institutions, labour market structures and product market regulation should become more flexible. A similar approach can be found in Masuch et al. eds. (2018). The authors define structural policies as "efficient labour, product and financial market regulations, …, good governance and efficient institutions, …, the rule of law and the control of rent-seeking".

Even if De Grauwe (2016) mainly recommends increased market flexibility to solve structural problems, except in the case of exogenous shocks considered as permanent shocks due to facts that they cannot be controlled by the EMU (oil price changes, for example). In such a case he suggests that policy answers could either be more flexible labour and products markets or temporary supranational budgetary means to generate convergence.

These permanent shocks; "events that remain present over a time period considered (this does not preclude that it eventually disappears)"; may again be common or asymmetric due to structural differences (differences in domestic natural, human and capital resources) among member countries.

Nevertheless, more interventionist approaches have been developed, partly influenced by the low interest rates environment.

To achieve the EU/EMU's objectives through interventionist policies, we can refer to Mazzucato's (2013) suggestions that there should not be a discussion about the size of the public deficit, but about its composition. The author recommends defining strategic domains where governments should invest to foster "smarter (innovation-led)", more inclusive and sustainable growth. A similar idea is presented by Drèze and Durré (2014) when they suggest that growth should be stimulated through "public investments and selective private investments".

Pisani-Ferry (2019) presents a similar argument, referring to the present low interest rates. Governments should take "advantage of persistently low interest rates to finance economically sound investments that will benefit future generations".

Blanchard (2019) also considers fiscal policy, mainly its consequence, the public debt level, in the context of low interest rates. His position is less straightforward than the previous authors' position as he asks the question: even if fiscal costs of high debt levels have been low and so debt rollovers are feasible, are they desirable? Welfare effects have to be considered linked to the fact that public investment was too low in the past. His conclusion is that we should accept certain levels of public debt if they are due to sound investment policies by governments even if his conclusion is based on assumptions that can be challenged as recognized by the author himself.

To foster sustainable and inclusive growth, Demertzis et al. (2019) recommend public intervention to stimulate productivity and innovation. This type of policy should address the problems of climate change and of social cohesion in Europe at the same time. The authors implicitly refer to equity arguments (Rosen and Gayer, 2014) in favour of a centralized budget when they mention that this policy should also be a policy to reduce divergences between member states and regions within the EMU.

In this context the Commission of the European Communities (1990) has defined four levels of macroeconomic policy coordination without referring to a common policy. A degree zero where "each government acts independently taking all its external environment as given"; a degree one where each government leads a "non-cooperative isolationist policy" taking into account potential spill-overs on other member states; a degree two where governments lead "optimal non-cooperative policies with full information exchange"; a degree three where governments accept "full coordination. Governments jointly set their instruments in order to maximize welfare". The major difference between the levels of coordination resides in the importance of information exchange between member states without being more precise on the objectives of such a coordination.

So, what should be considered as sound investments or investments fostering smart, inclusive and sustainable growth? In general, public investments are suggested in four domains that we mentioned already previously: investment in human capital, R&D, infrastructure and industrial policy.

The theoretical justification for public investment is that the four domains are considered as generating public goods with positive externalities, hence corrections of market imperfections (Romer 2001). As we have already stated before, these standard arguments had been retained by the Commission of the European Communities (1990) in its "One Market, One Money" report to define criteria to justify supranational policies: existence of positive externalities on the community level due to supranational policies, indivisibilities and economies of scale. To define the optimal level of intervention, the subsidiarity principle should then be applied, based on these economic criteria.

How to Finance These Interventionist Supply-Side Policies?

The introduction of a European tax, which is not the most popular proposal, could have three advantages: transparency, simplicity and acceptability.

The structure of the system should be clear so that taxpayers would know the tax base and the use of the tax. Then, the system should be simple so that taxpayers would understand how the system works and the cost of the system should be minimized. Consequently, we could expect a greater acceptance of European taxes, especially if the aims of the EMU were formulated in a more precise way than at the moment. Therefore, a better communication will be needed to increase the acceptability of such a tax system. This point will be developed further at the end of our paper.

This basic description of a potential European tax system is probably overoptimistic so that alternatives should be considered. Mazzucato's suggestions (2013) seem to be very useful in this context:

- royalties and the setting up of a European investment funds: when the EU or member states invest in R&D generating returns, then they should get royalties;
- income-contingent loans and equity; depending on the level of returns on publicly financed investments, the EU and member states should be considered like shareholders and get a return on the amounts invested (also in the case of public-private partnerships). In these two cases, these financial resources should be used to service the sovereign debt contracted to finance the corresponding investments;

- development banks: public investment banks should help finance structural projects like the European Investment Bank (EIB) does whereas other public financial institutions, like the ESM, should help finance countercyclical interventions in member states under the assumption that a consensus on a commitment to this policy can be obtained.

The Present Instruments for European Interventionist Policies

The major instruments are the EU budget and the InvestEU initiative[10].

The EU Budget

The EU budget is an investment budget that has to be balanced every year. The annual amounts available are defined by the Multiannual Financial Framework (MFF) for a period of seven years (European Commission 2019b).

Different policy domains corresponding to the general aims of the EU are covered by this budget. The financing covers measures to foster smart and inclusive growth (subdivided in measures in favour of competitiveness for growth and jobs and for economic, social, and territorial cohesion); sustainable growth; security and citizenship; foreign policy and a final part of the budget finances the European administration.

For 2018, a total amount of € 160.114 billion has been allocated which corresponds to about 1% of EU's gross national income (GNI) which is less than Belgium's or Denmark's national budgets.

The main resources are provided by the member states (76% for 2019) and the management of the budget is organized as follows: direct management by the European Commission 18%, shared management with member states 74%, indirect management 8% of the available resources.

The InvestEU Initiative

The InvestEU initiative, an extension of the Investment Plan for Europe or the so-called Juncker plan, relies on the idea that European financial resources combined with financial guaranties given by the EU will trigger a multiplier effect and will generate even larger privately financed investments than the initial European resources. Again, the domains benefiting from these initiatives should correspond to the EU's general objectives: investments in sustainable infrastructure, in research, innovation and digitalization, in small businesses, and in social investments and skills.

The InvestEU fund will manage €15.2 billion of financial resources from the EU budget; then EU budgetary guarantees combined with private partners' resources for investment projects should reach €47.5 billion and the total

[10]We will only refer to the EU in this paragraph as there are no specific budgets or other financial resources for the EMU. We will not consider the ESM because this mechanism only intervenes in case of financing problems resulting from countercyclical interventions.

multiplier effect is estimated at €650 billion for the period between 2021 to 2027 (European Commission 2019a).

This very brief description of the EU's financial resources clearly shows that an annually 1% budget, compared to the EU's GNI, even combined with a still lower annual percentage InvestEU programme cannot be enough to foster real convergence within the EMU and even less in the EU. This fact is the logical consequence of the responsibility or market discipline approach that dominates the political debate in Europe. This approach relies on the idea that real convergence should be achieved through market-oriented policies, but we cannot expect an important impact of these amounts on the future development of the EU and not just for the left behinds.

What Should Be a Future Fiscal Policy in the EU and/ or the EMU?

As we have de facto two levels of economic integration in Europe, the European budget should be separated into an EMU and a non-EMU part. We will now only refer to the EMU part in this paragraph.

The Structure of Public Budgets Matters

European financial resources available for EMU member states should be grouped in a countercyclical and in a structural component (Drèze and Durré 2014). A deeper integration for these member states needs a more developed budget, even if there will be a risk that real convergence between EMU member states and non-member states might become more complicated.

The countercyclical component should be considered as an insurance instrument in case of asymmetric shocks (De Grauwe 2016) and should be financed by national and ESM resources. This structure should take into account the two dominant approaches to public intervention in Europe: the ESM resources are based on a risk- sharing or solidarity approach between member states and above a certain threshold of sovereign debt, member states should issue junior sovereign bonds at market conditions, which refers to the market rules or responsibility approach. The advantage of such a structure is that the government bond market's fragility will be considerably reduced (De Grauwe 2016).

For the structural component of a European budget, the EU/EMU's objectives have to be defined first of all in a more precise way, then, the corresponding objectives for member states should be defined based on the initial European objectives. Finally, indicators with defined thresholds should be established. Based on this clarification of objectives, policy means have to be defined. Then, the financial needs for these different polices have to be evaluated, hence a structural component of a European budget will be defined. An agreement needs to be found how to combine this European budget with national budgets and private investment initiatives.

This structure does not really need new institutions, but the existing elements should be used (EU budget, EIB and European Fund for Strategic Investments (EFSI), for example), but a clearer commitment to the objectives, to how to reach these objectives and to what to do in case the objectives are not attained will be needed. The sole change that we recommend is to separate the budget in two parts one for the EMU and one part for the remaining member states with a remaining question if the remaining member states need or want to have an insurance mechanism in case of asymmetric shocks.

The major difficulty to build up such a system is the lack of homogenous political preferences in the EMU/EU. This structure clearly pleads for a deeper political integration within the EMU and in the ideal case even within the EU. Then, a supranational fiscal policy based on a broader European tax and on common decisions on how to use these financial resources could be developed. Apart from taxes, the issuing of European bonds, guaranteed by all member states could be another source of financial resources to finance these European development programmes. These bonds would be repaid by the future taxes generated by the investment programmes or by other revenues generated by public investments.

Each investment project should be evaluated based on a cost/benefit analysis: the expected social benefits need to be larger than the expected social costs (Drèze and Durré 2014). The selected projects should mainly be decided in domains with market imperfections, that are labour intensive and should be distributed among member states in a way to foster real convergence (Drèze and Durré 2014).

Rules Based

The remaining problem for all kinds of fiscal policies is the potential sovereign debt that will appear due to public intervention, either on the European level (which is not allowed for the moment) or on the national level.

The existing rules have been criticised for their complexity and measurement problems (Darvas et al. 2018) and also for their pro-cyclical structure and their problems of enforcement (Bénassy-Quéré et al. 2018). These inefficiencies explain their limited acceptance by policymakers and the wider public and why more and more discussions come up on how to make these needed rules more efficient and less complex.

Reports by Bénassy-Quéré et al. (2018) and Darvas et al. (2018) suggest that nominal public expenditures should not grow faster than the nominal growth rate to avoid further increases of debt-to-GDP ratios. At the same time, the levels of nominal expenditure should be compatible with debt reduction targets for those member states presenting unsustainable levels of debt. Finally, an escape clause from these rules should exist if very large shocks appear.

The theoretical link between deficits and debt has to be taken into account when a fiscal policy will be designed. A crucial point is the beforementioned relationship between a country's growth rate and the interest rate on sovereign debt (European Commission 1990, De Grauwe 2016; pp. 218-220; Blanchard 2018). When the interest rate exceeds the growth rate, then the increase of the sovereign debt-to-GDP ratio runs out of control and will cause financial instability. If the interest rate is lower than the growth rate, then this risk will not appear, as long as the relationship will not be reversed. A logical consequence will be that the definitions of fiscal rules to be applied to national and a supranational budget should be based on this relationship as suggested by Bénassy-Quéré et al. (2018).

A Need for a Better Communication Policy in Europe

The previous developments clearly suggest that there is a need for an improved and simpler communication by European institutions to increase the transparency of the EU/EMU's objectives and its corresponding policies. Much clearer statements should be made about the corresponding advantages for member states, about the indicators used to assess improvements in member states and about how to adjust policies in cases where the objectives have not been attained.

Especially simplified rules should be explained to all citizens and how and why European programmes contribute to the defined objectives and why they are the better solution compared to national solutions. Finally, a clearer statement should also be made about short-term vs. long-term improvements for member states.

Conclusion

The process of monetary integration in Europe has generated an everlasting discussion about the need for a fiscal policy and about the definition of the aim(s) of this policy. The theoretical and political statements presented different conclusions from those that were considered to create the incomplete monetary union that we know today.

These limits of monetary integration become even more obvious in the aftermath of the financial and the sovereign debt crises between 2008 and 2011.

The structure of monetary, economic and political integrations in Europe, hence the role of a European fiscal policy, have been reconsidered since then, but the theoretical framework of a monetary union suggests just one solution: a deeper integration. A deeper integration means a political union allowing a budgetary union, so a need for more homogenous political preferences which can only be achieved through a deeper commitment to the EU/EMU by its citizens.

The following quote summarizes the political change and the corresponding change in communication that will be needed in the future to achieve our common goals in Europe: "Words matter: we need a new vocabulary for policymaking. Policy is not just about 'intervening'. It is about shaping a different future: co-creating markets and value, not just 'fixing' markets or redistributing value. It's about taking risks, not only 'de-risking'. And it must not be about levelling the playing field but about tilting it towards the kind of economy we want" (Mazzucato 2018, Penguin edition p. 19).

Therefore, more precise definitions of the objectives of European integration and of the advantages for member states are needed. As a consequence, a clearer presentation of the corresponding policies with the expected outcomes on the member state level has to be added. This has to be achieved through an improved communication policy integrating all the previously mentioned elements to convince European citizens that the European integration is not just about maintaining peace in Europe but that a real improvement in living conditions can be achieved.

If these adjustments cannot be realized, then the common currency risks failing and, with this purely economic aspect, the whole European idea.

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