

EURO ZONE BUDGET AND ITS EFFECTS ON THE EUROPEAN AND MONETARY UNION (EMU) INTEGRATION

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ABSTRACT

The implementation of a monetary union in Europe, to take full advantage of the Single Market's potential benefits, has not hitherto delivered the expected results. On the contrary, the euro area has been afflicted by many troubles, including anemic growth, unemployment, and inequality. Many blame the euro's defective design, and especially its incapacity to promote economic convergence and provide adjustment and stabilization mechanisms. The latter view prevailed when shaping the austerity policies imposed on the countries more affected by the financial and sovereign debt crises, intensifying an economic recession with dramatic social consequences. Citizens' distrust in the European Union's institutions grew, along with support for nationalistic political forces opposing the European integration project. Some of EMU's needed reforms will both promote convergence, and help smooth economic activity and maintain citizens' wellbeing when crises occur. The creation of an autonomous budget for the euro zone was mentioned in a European Commission discussion paper on the future of the EU. This is an eminently political matter, very sensitive to domestic public opinions. In fact, the existence of a budget for the euro zone, in recognition of the fact that this subset of EU countries has specific needs, distinct from those of other non-EMU members, would translate into a situation requiring the design of different budgets within the EU. Such issue is at the heart of the intense debate between holders of different views concerning the future of the EU and of the euro zone, especially in what concerns the question of which of these geometries will in the future be the engine for further economic and political integration in Europe. This paper assesses one of the main deficiencies of the euro's governance model – lack of automatic stabilization – and discusses proposals to overcome it.

Keywords : *Budget, Crisis, EMU, Integration*

1. INTRODUCTION

The creation of an economic and monetary union (EMU) in Europe was a notable achievement. Never before did such a large group of countries voluntarily surrender autonomy over domestic monetary and foreign exchange policies, while maintaining, *de jure* if not absolutely *de facto*, fiscal and political independence. In fact, the introduction of the euro twenty years ago, after decades of advances and setbacks, and much debate over its most adequate institutional framework and probable advantages and costs, marked the beginning of a rare real life experiment – one where a group of diverse economies adopt a common currency without

having created mechanisms to promote real convergence, and to provide stabilization in the aftermath of shocks.

So far, the experiment has not lived up to expectations. If the euro is assessed taking into account its broader historical context, the outcomes up to now are, in many facets, almost the exact opposite of what they should have been. For the single currency was not an end in itself, but a phase in a process initiated after the Second World War primarily to end a long time series of military confrontations in Europe. The project of economic integration initiated in 1957 was conceived as a pact for peace, a first step for the creation of a community of prosper and with solidarity citizens. The Treaty of Rome reflects these ambitions. In its preamble, the signatories proclaim their determination to attain economic and social progress, balanced trade and fair competition, to eliminate the barriers dividing Europe, to improve living and working conditions, to promote harmonious economic development by reducing existing regional differences and the backwardness of the less favoured areas.

Thirty five years later, when agreement was reached over the conditions for adopting a common currency, the Treaty on European Union (EU) – often referred to as Maastricht Treaty – confirmed the compromise to promote “a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment, a high degree of convergence of economic performance, a high level of employment and of social protection, the raising of the standard of living and quality of life, and economic, social cohesion and solidarity among Member States”(Title II, p. 11). However, EMU’s design ended out somewhat misaligned with such objectives. The convergence criteria to allow membership comprised a set of nominal (rather than real) macroeconomic indicators, the union’s monetary policy was solely assigned to price stability, and no common risk sharing and stabilization institutions were created. In the subsequent years, real convergence did not occur and financial markets’ euphoria triggered a credit boom that contributed to intensify current account disequilibria amongst member states. By the time the 2007 financial crisis hit, the consequences of EMU’s deficient architecture became painfully visible. The shock impacted the euro area differently and no stabilization device was available to help the more affected peripheral members. A sovereign debt crisis and economic recession ensued.

The first reactions to such dire state of affairs were also not in line with the treaties’ principles. The countries more in need of help were held responsible for problems they mostly did not create, and could not have avoided, and forced to endure the whole weight of the measures taken to resolve them. Financial funds were provided but at high interest rates and under the obligation of applying a pro cyclical austerity program which comprised many ill-timed and counterproductive reforms. The conditions were so harsh and so at odds with promoting repayment that it has been questioned whether the intention was to help or to punish. The result was a prolonged recession, very high unemployment, especially amongst youngsters, and increased inequality between and within euro members. Instead of prosperity and cohesion, the euro had produced the opposite. As a result, the divide between countries grew up, confidence in EU’s institutions is fading and political extremism is on the rise.

Driven by these events that might ultimately endanger EMU’s survival, EU leaders and institutions have eventually introduced some reforms in the euro zone governance. However, more actions are required, since the slowness and complexity of the ongoing reforming process is not generating the desired immediate corrective effects or promoting the structural modification of existing imbalances. This is an essential issue because, in the absence of responses to the institutional failures in the functioning of the euro, the reaction of financial markets will be heavy and its effects may devastate the weakest links, as the recent crises have shown. Therefore, to delay the implementation of effective reforms is a risky strategy. In the meantime, the monetary union remains incomplete and fundamentally destabilizing. There are thus crucial questions that need to be addressed in the short-term, which are mainly related to the degree of sovereignty that states are willing to abdicate in order to accept greater risk-sharing in EMU and to support greater economic convergence. Some relevant steps forward have already been taken, or are being proposed. Amongst them, the measures more directly related to the stabilization function at the euro area level are assessed in this paper.

Following these introductory remarks, the paper is organized into six sections, totally. The second presents a literature review and the third presents an analysis and describes one of the debates that took place before the adoption of the single currency, concerning the adequate preconditions for EMU membership and the potential consequences in case they were not met. Also, this section assesses the critical events occurred in the euro’s first two decades, confirming the monetary union’s deficient

design and the concretization of the most pessimistic anticipated scenarios. In the fourth section, the focus is on one of the most problematic institutional failures of the single currency – the absence of stabilization and adjustment mechanisms to replace those lost in the process of integration. The fifth section discusses ways to overcome such failures. The last section concludes, defending one of the options currently being considered to solve the many problems generated by the lack of an EMU wide stabilization function, on the basis of its economic rational and political feasibility.

2. LITERATURE REVIEW

There was always criticism of the criteria for EMU membership and the single currency's institutional architecture although in the euro's early years, domestic economic cycles did not lead to major setbacks. Nevertheless, as many had predicted, monetary integration failed in promoting the real convergence of central and peripheral economies. Income convergence stagnated at first and reversed following the financial crisis (Franks et al., 2018).

The 1997 Stability and Growth Pact, established to enforce the fiscal rules of the Maastricht Treaty and to promote fiscal discipline and fiscal coordination in the euro zone, was reformed in 2011 by the so-called Six Pack, which included more fiscal rules and conditions to penalize non-compliant countries, as well as the Macroeconomic Imbalance Procedure, to monitor and prevent events capable of disturbing macroeconomic stability. Subsequently, in 2012, the Fiscal Compact contained in the Treaty on Stability, Coordination and Governance imposed the rule of balanced budgets into domestic legal orders. In 2013, the Two Pack forced the members of the euro zone to submit the drafts of their budgets for the following year in order to have them evaluated by the European Commission before approval by the respective parliaments.

Therefore, until 2013, these operational reactions of the European authorities suggested that the foremost reasons for the single currency problems rested chiefly on the leniency of the fiscal discipline procedures. The answers to the crises consisted mostly in reinforcing rules and procedures that had previously failed, prompting Eichengreen and Wyplosz (2017, p. 63) to recall "Einstein's definition of insanity: doing the same thing over and over again and expecting different results". Additionally, the new procedures made the euro governance model more complex, less transparent and less democratic and did not contribute to reverse the economic recession and rising unemployment, and thus the social unrest. The distrust of citizens towards EU institutions grew and substantial support for nationalist and populist movements that had for long been absent from most countries' political scenes emerged, putting at risk the whole European integration project (Armingeon and Guthmann, 2014).

Eventually, the seriousness of the economic and social consequences endured by some members of the single currency forced the EU leaders to admit that substantial change was required to give rise to a 'genuine economic and monetary union' (European Council, 2012). Various institutional and interinstitutional initiatives were proposed (a review is provided in D'Alfonso and Stuchlik, 2016) and the agenda appears to be currently framed within the documents produced by the report on "Completing Europe's Economic and Monetary Union" (also known as The Five Presidents' Report, which is based on previous documents, namely the June 2012 Van Rompuy's report and the December 2012 Report of the Four Presidents). The objective of this document was the definition of a concrete plan, containing specific stages to deepen and to increase fairness in EMU and to make its members more prosperous.

The four building blocks of such process for EMU completion are: the economic union (to promote convergence, prosperity and social cohesion), the financial union (including the banking union and the capital markets union), the fiscal union (for sound and integrated fiscal policies), and improvement of democratic accountability and legitimacy, and institutional consolidation. In what follows, the focus of analysis is on the financial and fiscal unions, which are both relevant in the context of the main fragility of the single currency discussed in this paper – the lack of automatic adjustment and stabilization mechanisms.

3. ANALYSIS OF THE EMU'S FIRST TWO DECADES

In order to better understand some of the euro's shortcomings, the potential economic and social consequences of its design, and discuss some possible solutions for the particular problem of the lack of a stabilization mechanism that addresses the heterogeneity of its member countries, it is crucial to review the two decades of the single currency, with a particular consideration to the effects of the financial and sovereign crises.

3.1 Before the Crises

In such circumstances, the euro was prone to be a dangerous hindrance to member states. Given the impossibility of adjusting foreign exchange rates and the limitations of domestic fiscal policies, a common interest rate has the potential to become disruptive. In fact, even if monetary policy is tuned to benefit the majority of EMU members, there will always be some for which it is inadequate and that therefore need assistance. This cannot however be granted because the institutional framework of the euro prevents risk-sharing and transfers amongst members. As a result, imbalances accumulated in the euro area.

Financial markets did not help and even aggravated the limitations of the single currency. Mistakenly believing that the common currency had abolished not only foreign exchange risk but also sovereign credit risk, they fueled a credit boom that sustained the growth of current account disequilibria steadily building up from the inception of EMU amongst its members. Following the crisis, various countries did not have the fiscal margin required to adopt countercyclical policies to sustain economic activity and income while, simultaneously, respecting the limits of the Maastricht rules. As national banking systems increasingly required governmental bailing outs, indebtedness levels soared and financial markets prevented some countries from accessing funds to service their obligations. The financial crisis plus the euro's flawed design had produced the sovereign debt crisis.

3.2 Outcomes and Reactions to the Crises

One of the euro's key problems is that it was conceived to circulate within a homogeneous economic area where all member states run nearly equilibrated public budgets. It was hoped that such conditions would prompt overall economic growth, which in turn would expand employment and improve standards of living. In such conditions, one interest rate would be adequate for most members and those out of line with the dominant business cycle, or suffering from asymmetric disturbances, would be able to accommodate their specific needs within the Maastricht fiscal limits. As economic diversity prevailed instead and many EMU members were not able, without extraordinary measures, to contain their public deficits well below the imposed maximum threshold, many euro area members were not prepared to absorb the impacts of shocks. However, and in spite of the single currency's foundational and structural problems, after the first crisis occurred, there were economic policy and political choices that could have contributed to reduce the social and economic costs. They were not sufficient, yet.

At first, in line with the strategy adopted in many countries (including the US, the country originating the financial crisis), the EU launched a recovery plan to stimulate demand, investment and reforms. As a consequence, substantial fiscal stimulus packages were implemented, prompting record increases in public expenditures and raising anxieties amongst defenders of fiscal restraint. Consequently, against many economists' advice and forgetting the relatively fresh experience of Japan's 1997 premature fiscal tightening and ensuing new prolonged recession, the fiscal stimulus to drive recovery was short-lived in the EU. By June 2009, Germany was announcing its return to fiscal discipline and pressing the other members to follow suit. Various countries did not agree initially, either anticipating that it was too soon or following electoral timetable convenience.

However, faced with the additional pressure of financial markets (which, disregarding the fact that most of the fiscal stimulus in the EU had been employed to rescue domestic banks, accused governments of overspending and increased the cost of sovereign credit) the EU followed Germany. The expansionary fiscal stance gave way to the reinforcement of fiscal discipline and austerity. For some members of the euro area such strategy overturn was voluntary. Others were forced into it, in some cases even against the will of the elected governments, a disregard for the principles of self-government and democracy and a fertile ground for political extremists and EU 'leavers'.

The leaders of the EU's central economies did not recognize that the main problems affecting mostly the peripheral euro members were a consequence of the way the single currency had been projected and implemented. Having failed in promoting real convergence, the euro governance model forced a diverse set of economies to co-exist under one single monetary policy (which could only be adequate for some), a set of fiscal rules that enhance the effects of booms and busts, no central budget to provide stabilization, and no banking union or single financial market to provide private risk sharing and reduce the relevance of unbalanced trade relations within the euro area.

Faced by the high probability of sovereign defaults, and anticipating that such extreme scenarios would also hurt investors in their own countries, the dominant economies decided to assist the countries in crisis. But they did not accept the euro needed fundamental reforming and pointed out the faults that, according to them, had been committed by the more affected countries: their governments and citizens

had been living in profligacy and the necessary measures to boost competitiveness had not been implemented.

Therefore, and again in their view, the peripheral countries needed punishing, and punished they were. Money was lent to those lacking access to financial markets but at very high interest rates and under the obligation of applying harsh reforms and austerity. The latter aggravated the already dire economic and social conditions and the reforms, announced as a way to promote competitiveness, were misdirected and ill-timed, and consequently counterproductive. The programs did nothing to stimulate adjustment after the crises and contributed to worsen their social and economic impacts.

It took years and a large number of victims to admit that the crises had highlighted shortcomings of the Maastricht model. And even when this started to occur, official reactions were very slow and ineffectual remaining focused on reforming individual countries rather than the single currency's model and on reinforcing strategies that had been proven incapable of avoiding fiscal and other imbalances across the euro area.

3.3 Reflections on the Future of EMU

In the short life of the single currency, its member countries have experienced shocks with differentiated impacts that jeopardized their social and economic stability, exposed the fragility of EMU's governance model and the urgency of its transformation. A broader agreement has been reached over the fact that monetary integration is still incomplete and that its completion must take place within a context of price stability and fiscal discipline, but also of social well-being and inclusive and balanced growth. While the crises' divergent effects were also due to imbalances accumulated from the first years of the single currency, it is also clear that the weakness of EMU's reaction to external shocks has worsened their consequences, provoked deflation and prolonged the recession. Unemployment reached unimaginable levels, wages had to be adjusted downwards to restore competitiveness and the purchasing power and living conditions of millions of people deteriorated, generating distrust and disillusionment within the euro zone.

Structural reforms to make economies more resilient to shocks are crucial but it is also essential to trigger a process of real economic convergence capable of restoring confidence in the European institutions. Higher income and better living standards are needed, as the ultimate goals of the whole integration project. Hence the first pillar in the defined process to complete EMU and to make it more deep and just is the economic union, aimed at promoting convergence, prosperity and social cohesion.

Without these, it makes no sense to discuss the other aspects related to the smooth functioning of the single currency because the whole project of European integration will be destroyed by the extremist political forces that oppose it. The other three unions – banking, capital markets and fiscal – are essential to provide an element to support a successful monetary union: risk sharing. Even though some view it as a moral hazard inducer, and thus oppose it in principle, both economic theory and historical evidence indicate that risk sharing does not promote moral hazard as long as credible and clear rules are enforced at the regional level (Bordo, et al. 2011).

The Banking Union, consisting of single supervisory and resolution mechanisms plus common deposit insurance is a way of solving problems resulting from the “deadly embrace” between banks and sovereigns. The banking Union would allow the inclusion of the private sector in the risk sharing process and prevent taxpayers from ultimately shouldering the full costs of saving banks. In the recent past, and also in the present, taxpayers have not only paid for the banking sector rescue with their money but also by enduring the related consequences of public spending cuts in education, health care, security and basic infrastructures.

The capital markets union will also provide a degree of private sector risk sharing and, at least theoretically, an alternative to absorb shocks. In fact, the free flow of capital, within the context of an integrated financial market, should be capable of sustaining domestic consumption and domestic investment throughout a crisis. This would occur via the capital market channel (geographical diversification reduces the volatility of financial portfolios' returns and their correlation with GDP) and the credit market channel (through cross-border lending and borrowing).

But reality has shown time and again that capital markets can be more a source of disruption than of stabilization. Also, if structural imbalances persist, these capital flows will continually be unidirectional, resulting in the accumulation of large external deficits. Therefore, even though the future capital markets union may function well in terms of providing a degree of short-term stabilization, it will never be able to ensure the reliable, complete and automatic mechanism that EMU needs to be sustainable. A substantial degree of public risk sharing will also be required and thus the relevance of

the fiscal union. According to the strategy already agreed (European Commission, 2017a), the fiscal union will have to provide adjustment and stabilization but its implementation will not take place before a high degree of convergence has been achieved, the level of financial integration has increased, and further transference of autonomy over decision making concerning domestic budgets to the euro area level has occurred. In the meantime, and in the short run, the focus continues to be on fiscal discipline within the context of the established rules. A function that many consider to be of uttermost importance for the survival of the monetary union is thus postponed for an uncertain future date.

4. A EURO AREA STABILIZATION AND REDISTRIBUTIVE FUNCTION

Although no decisions have been taken concerning the type or timing for implementation, various proposals for EMU's common fiscal capacity have emerged. The different approaches are compiled and reviewed by D'Alfonso and Stuchlik (2016). They comprise insurance mechanisms, to absorb cyclical disturbances or crisis generated unemployment, a fund to sustain investment during economic lows, and a euro area central budget. These mechanisms differ in terms of stabilization scope, payment trigger (automatic or discretionary) and funding sources.

The creation of an autonomous budget for the euro zone was mentioned in a European Commission discussion paper on the future of the EU (European Commission, 2017b), which explicitly addresses the possibility of creating a specific budget to support EMU countries. More recently, following a Franco-German summit held in June 2018, the two countries, which have a decisive influence on EU's strategic orientations, have produced the *Meseberg Declaration*, proposing, *inter alia*, the creation of a fund to support investment projects aimed at promoting convergence within the euro zone economies (Keller, 2018). This is an eminently political matter, very sensitive to domestic public opinions. In fact, the existence of a budget for the euro zone, in recognition of the fact that this subset of EU countries has specific needs, distinct from those of other non-EMU members, would translate into a situation requiring the design of different budgets within the EU. Such issue is at the heart of the intense debate between holders of different views concerning the future of the EU and of the euro zone, especially in what concerns the question of which of these geometries will in the future be the engine for further economic and political integration in Europe.

4.1 The Traditional Role of Public Finances in the European Context

In Musgrave's original approach to the role of public finances and of public budgets, the authors argue that the latter are crucial instruments of economic management and their size and structure reflect the political, social and economic objectives of the state or the integration group concerned. In reality, the budget is a key element because it influences an economy in a number of ways, in practice indivisible, but which, for analysis purposes, can be divided into three public policy objectives related to the allocation of resources, the redistribution of incomes and economic stabilization (Musgrave, 1939).

The allocation function is related to the provision or incentive to supply public goods and services (i.e. those not effectively supplied by the market, either due to their specific characteristics or to imperfections in market functioning). The redistribution function deals with the use of fiscal policies to modify the distribution of income provided by market mechanisms. Finally, the stabilization function involves the use of fiscal policies to achieve the macroeconomic objective of stability, that is, to minimize deviation between real and potential GDP and allow more smooth business cycles. The question then arises as to whether, in the case of international groups of countries undergoing economic and/or political integration, these functions should be left to the individual states that carried them out before formal integration, or whether, for reasons of greater effectiveness, they should be allocated in full or in part to central (supranational) institutions, together with any additional functions, including regulatory ones.

The principles pointed out in the literature for the efficient allocation of responsibilities between different levels of authority rest basically on the following three criteria: the existence of cross-border spillovers, economies of scale, and the degree of homogeneity of political preferences (Oates, 1972). The general orientation of these criteria can be described as follows: cross-border spillovers are relevant where policies decided in one country have effects that also impact agents located in other countries and that should therefore be taken into account. Such spillovers are an essential decision factor for assigning policy or activities' responsibility to a higher-level of authority in order to internalize the inherent costs and benefits of the policy in question. Moreover, if clear economies of scale are generated when the function is exercised centrally, it is advisable to refer the function to this governance level. However,

such allocations should only be finally granted when the gains clearly outweigh the costs caused by market failures and the centralization of functions does not lead to an increase in administrative costs or a lower quality of the public policies and goods provided.

4.2 Choosing the Level of Public Policies' Intervention

The political dimension that is always present in any process of assigning functions to a given level of government should not be devalued. In fact, the existence of a high degree of political homogeneity, as measured by the similarity of preferences over the provision of public goods, calls for the assignment of specific functions to the wider territorial jurisdiction. Instead, the diversity of preferences acts in the opposite direction and advocates that welfare will be maximized when deciding on decentralization in the provision of public goods. The theory of fiscal federalism (Oates, 1972 and 1999) is a key framework for the application of these criteria to the functions and objectives of fiscal policy. Its principles, according to Robson (1999), can be summarized as follows: the function of allocating resources should be shared between the upper and lower levels of government, according to the characteristics of the public goods or services to be provided, taking into account the homogeneity or diversity of preferences; the redistribution and stabilization functions must, on the other hand, be exercised at a higher level, i.e. at the central level.

Although the decisions concerning the structure and the size of the budget are clearly political in nature, the pursuits of efficiency and rationality are also crucial in any process of economic integration. It is therefore necessary to assess the efficiency considerations that apply to the allocation of jurisdiction over tax policies in a given community of states. The economic literature produced during the last decades has evolved in order to base the optimal allocation of public functions in a structure with multiple levels of government (see, for instance, Charbit, 2011). Since the exercise of those functions and their policies involve expenditures and resources, this analysis has been largely applied to fiscal integration processes. More recently, the efficiency aspects have also been applied to the assignment of regulatory functions at a central level, although these have generally no significant budgetary implications (Berger et al., 2018). The analysis of policy integration, focusing on different budgetary functions, should thus include not only efficiency considerations, but also a set of other dimensions that are relevant to policy decision making, especially those that have been advanced by the theory of public choice (Wiener et al., 2018). Finally, the proper allocation of responsibilities between the levels of national and supranational authority in a given community should be the reflection of a cost/benefit analysis (Daniele and Geys, 2015).

5. DISCUSSION AND FUTURE RESEARCH DIRECTIONS

Besides the discussion over the ideal level of government to accomplish the musgravian functions, it is also important to investigate whether there should be different budgets for the EU and for the EMU. In its assessment of the possibility of creating a specific budget for the euro area, Wolf (2017) defends that only the economic stabilization function has significantly different characteristics in the EU and in the euro zone. The authors argue that the (re)distribution function refers to the distribution of fiscal resources amongst agents, thus being a political choice based on collective preferences, where each country opts for the level of redistribution appropriate to such function. In this logic, it will not be easy to shift this function from the member states to the central level, given the different views that prevail over the role of the nation-states, which have crystallized over time. This view that 'collective preferences' should only matter at the national level, and that solidarity schemes should not be developed at a European level, may appease some more EU-distrustful fringes of the political spectrum, but is an obstacle to one of the drives behind the Treaty of Rome, to "strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions". As Wolf (2017) admits, to better fulfill this function, the supranational (European) level can supplement national tax systems. Besides, in the EU, the redistribution function has been oriented in recent decades to consolidate the functioning of the single market, since the removal of barriers to economic flows is not neutral in terms of income distribution across the integrated area. The Single European Market created conditions for the free flow of labor, capital, services and products, and the removal of pre-existing obstacles to mobility has generated tensions between countries with different GDP per capita levels. In this context, the redistributive function in the EU has focused on supporting the reduction of economic asymmetries between and within countries and is therefore clearly linked to the EU's operation (Aussilloux et al 2017).

Has the introduction of the euro brought social implications in addition to those of the Single European Market, thus justifying a specific budget for the euro zone? The European Commission has defined the features to be included in the social dimension of EMU (European Commission, 2017b), but has not added much to the rationale of its choice, and we therefore believe that it is useful to go into this issue in some detail. In fact, by removing currency uncertainty within the euro zone, the adoption of the single currency has accentuated and deepened the integration of national markets. Therefore, if we admit that the single market requires a redistributive function, then it will be coherent to concede that such function should be strengthened in countries that share the euro. However, contrary to initial expectations, there is no evidence that, at the level of the euro area, integration of factors, goods and services markets has become higher than vis-à-vis the rest of the EU, or that the euro has strengthened the trade flows between the members of the monetary union (Mika and Zymek, 2018). Even before the financial crisis, trade-related effects appeared to be modest (Tenreyro, 2010) and evidence of the euro promoting migration and labor mobility was also not abundant (Farhi and Werning, 2014).

We also believe that the distributive function is not disconnected from the exercise of the stabilization function in integrated economies. In fact, the members of EMU have their fiscal capacity restrained by the quantitative limits imposed on the shares of public deficits and debts on domestic GDPs, but also by the loss of the possibility of issuing debt in their own currency. The latter makes them more prone to liquidity crises and puts them at the mercy of financial markets, which have the power to force their default. Without the support of the ECB, the liquidity provider and the lender of last resort, members of the euro area cannot guarantee conditions for full debt repayment, as was the case before, when they had the sovereignty over monetary policy and a domestic central bank (De Grauwe, 2011).

The redistributive question to compensate for the uneven effects of the creation of the euro persists, since its members still display diverse and often divergent economic performances, expressively highlighted by the recent crises (De Grauwe, 2016). In fact, adjustment mechanisms to asymmetric shocks are distinct when countries do not control their currency, but in the case of the sovereign debt crisis the means of correcting these imbalances have been ineffective, or nonexistent. Without the instrument of foreign exchange rate depreciation, real adjustment is slow and the high current account imbalances display no visible reversing trend (Kang and Shambaugh, 2016). In such conditions, being able to use the compensatory redistributive function of the budget can make all the difference. Redistribution can then be assumed as a way of compensating for imbalances of a more or less lasting nature. However, there are political and economic reasons why centralizing this function may not be adequate. At the political level, the possibility of permanent transfers within the EMU may be considered unsustainable by the net contributor countries. Furthermore, permanent transfers can lead to the crystallization of the imbalances they were intended to compensate for. According to Wolf (2017), correcting imbalances should be a priority exercised through more proactive policies and reforms. Thus, support for the implementation of structural reform programs, to facilitate market adjustments or even to strengthen infrastructure endowments, may be relevant.

6. CONCLUSION

In the twenty years since the adoption of the single currency, social and economic inequality has grown within and amongst its members, economic growth rates have declined and the euro's model of institutional governance has increased in complexity and opacity. Quick and effective reforms are required and a 'road map' has been proposed by EU's main institutions with the objective of deepening economic and monetary integration. Short term plans for completion of the banking union are already being executed but the implementation of a common stabilization function has been relegated as a possible later step. In the meantime, the main focus continues to be on strengthening fiscal countenance rules and promoting the structural reforms that many view as the single way to achieve real convergence and to stimulate competitiveness, and thus as a pre-condition for further integration.

In this context, it is worth noting that after the adjustment programs imposed on some euro area countries have been completed and assessed (Pisani-Ferry et al., 2013), results indicate that the measures to promote competitiveness by lowering production costs, and mainly wages, have been successful in a few cases. Some countries have undertaken labor market reforms to give them flexibility and to promote the liberalization of specific sectors (Auf dem Brinke and Enderlei, 2017). However, the countries more affected by the crises have not as a result attenuated the social impact of the liberalization process. Nor have they improved their long term productivity levels, which would have only been possible through the implementation of active employment policies or the renewal of domestic education and training systems. According to Rubio (2013), two reasons justify this

divergence: first, although reforms are crucial for the sustainability of economic and social adjustment, they are not adequately valued by financial markets, whose perception of risk is often short-term focused; secondly, legislative reforms on the liberalization of the economy are not very demanding in terms of financial resources, contrary to what happens with the labor market or social policy empowerment, which require significant resources and strong coordination of different entities. Thus, scarce resources and poor coordination are decisive for the absence of effective structural reforms, especially in labor markets, justifying specific funding for this dimension. Therefore, while adjustment programs have solved short-term financial issues, they do not appear to constitute the ideal solution for the greatest problem faced by the more affected countries. Indeed, more than an incentive system to facilitate structural reforms, the euro area would benefit from a temporary financial assistance mechanism to promote more socially demanding adjustments, as advocated by Delors (2013). Such an intervention would be justified because the structural shortcomings of EMU contributed to create financial instability and economic degradation in some of its members. If there had been means available to act on divergences of competitiveness, dramatic situations demanding severe processes of internal devaluation would never have occurred. The reflections of academics and of EU policy makers since 2012 suggest that there is now a consensual view that an adequate response to the social effects of the crises is the consolidation of the European Single Market - in particular in what concerns the free movement of workers and the strengthening of human capital capacity to respond to the new labor markets' challenges. Auf dem Brinke and Enderlein (2017) even consider that to make EMU viable, there must be a strengthening of investment capacity, in line with broad structural reforms that promote employment, competitiveness and economic growth.

In what concerns adjustment and stabilization, there is currently more institutional support for the economic arguments suggesting that EMU must quickly provide alternatives to what it has taken away and thus that a fully functional central stabilization scheme is required to stop the repetition of crises induced deflationary and impoverishing vicious cycles. Notwithstanding, the much needed euro budget appears to still be too politically unpalatable to become a short-term reality. In the meantime, and taking into account the various proposals already put forward by academics and politicians, it could be efficiently replaced by two funds, distinct in nature, but aimed at providing effective adjustment and stabilization in the aftermath of shocks. One would provide short-term unemployment insurance in nonconditional terms. It could be funded by euro area countries according to their position in the business cycle and would automatically trigger transfers for countries displaying increases in unemployment rates above a defined threshold. The other, funded by already existing (i.e. the European Investment Bank) or specifically created organisms, and/or commonly issued debt, would finance strategic infrastructural investments. Payments would be discretionary and subject to pre-defined conditionality but they would support domestic economic activity following general or geographically specific crises. The two funds avoid permanent transfers between euro area members and may for this reason be more easily accepted than the more controversial euro budget. Some believe that the creation of a European unemployment protection system should be anchored in a common budget. For instance, Dullien and Fichtner (2013) argue that such a system would have advantages over other types of financial transfers, as it would depend on the trend dynamics of short term unemployment, triggering automatic transfers dependent on the specific business cycle situation of each domestic economy, and preventing any country from becoming a permanent net beneficiary or contributor. But a specific fund with the same objectives would be comparable in terms of stabilization capacity. Provided that it would also respond immediately to avoid the social impacts of economic shocks, it could ensure a minimum level of social protection.

With few examples to put forward as illustrations of the euro's success, mounting social unrest and increasing support for radical, anti EU, political forces, EMU leaders have to realize that the time allowed for procrastinating is rapidly vanishing. Acknowledgement that the euro governance model is more in need of restructuring than the most problematic single currency members is of essence. Implementation of common stabilization devices should not be dependent on the achievement of convergence because the absence of a common stabilizer is one of the inducers of economic divergence. Some of EMU's needed reforms will both promote convergence, and help smooth economic activity and maintain citizens' wellbeing when crises occur. As the experience of other currency areas suggest, a common budget would be an efficient way of achieving such benefits. Yet, if some sensibilities remain incapable of accepting it, the two funds to insure short term unemployment and to promote investment would fulfil the same common stabilization function. When the survival of the whole

project of European integration may be at stake, the substance of the required stabilization mechanism is more important than its designation.

7. LITERATURE

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