European Stabilization Policy After the Covid-19 Pandemic: More Flexible Integration or More Federalism?

Andersson, Fredrik N G; Jonung, Lars

2022

Document Version:
Other version

Link to publication

Citation for published version (APA):
Andersson, F. N. G., & Jonung, L. (2022). *European Stabilization Policy After the Covid-19 Pandemic: More Flexible Integration or More Federalism?* (Working Papers; No. 2022:11).

Total number of authors:
2

Working Paper 2022:11

Department of Economics
School of Economics and Management

European Stabilization Policy After the Covid-19 Pandemic: More Flexible Integration or More Federalism?

Fredrik N. G. Andersson
Lars Jonung

June 2022

European stabilization policy after the Covid-19 pandemic: More flexible integration or more federalism?

Fredrik N. G. Andersson and Lars Jonung,
Department of Economics, Lund University

June 21, 2022

Abstract

Crises are a major driving force behind cooperation in the European Union. This holds also for monetary and fiscal policy. During severe crises, cooperation has been enlarged and intensified. The recent covid-19 pandemic is a clear example of this pattern. The pandemic has had huge impact on the conduct of stabilization policies in the EU. Public debt has grown rapidly in many EU member states. The ECB has carried out a highly expansionary monetary policy. In this paper, we discuss the implications for the EU of a move towards increased fiscal federalism following the pandemic. First, the role of crises as a driver of political change is analysed. Next, we examine in greater detail, the effect of crises on the design of stabilisation policies in the EU since the introduction of the euro, the common currency. Finally, we discuss the significance of the recent pandemic-induced steps towards increased federalism for the EU. We raise the question as to whether this is a desirable path for the future of European cooperation.

Keywords: Monetary policy; fiscal policy; fiscal rules; stabilization policy; European Union; ECB; crises

JEL codes: E6, F42, H6

Email to the authors: fredrik_n_g.andersson@nek.lu.se and lars.jonung@nek.lu.se

European stabilization policy after the Covid-19 pandemic:
More flexible integration or more federalism?

Introduction[1]

Crises are a major driving force underlying European cooperation. During severe crises, cooperation has been enlarged and intensified. This holds for monetary, and fiscal policy as well. Since the introduction of the euro, the common currency, in January 1999, both monetary and fiscal policy have been subject to a series of reforms that reflect the experiences and interpretations of economic crises hitting the European Union (EU).

Following the international financial crisis in 2008-09, the European Central Bank (ECB) was given a clearer mandate concerning financial stability. New tools were added to its set of policy instruments. At the time of the introduction of the euro, fiscal policy was mainly the responsibility of the member states. However, this approach to fiscal policy was modified because of the international financial crisis and the subsequent European debt crisis. The central coordination and monitoring of fiscal policy increased. The integration process was flexible in the sense that not all EU member states were required to fully participate in this closer cooperation. Above all, fiscal policy integration was a matter for the countries of the euro area. During the pandemic in 2020-21, fiscal policy cooperation was further intensified. On this occasion, a more federal approach was adopted. All EU members agreed on a common recovery plan that provided for the distribution of expenditure between member states as well as for new powers of borrowing and taxation by the European Commission.

The major role played by economic crises in driving the evolution of economic policies is not unique to the European Union. There are numerous historical examples of crises that have given rise to new scientific theories and ultimately new economic policies. In the rear mirror of history, two crises stand out: the Great Depression of the 1930s and the stagflation of the 1970s and 1980s. The Great Depression paved the way for Keynesian stabilisation policies inspired by the thinking of John Maynard Keynes. During recessions, the economy should be stimulated while periods of rapid economic expansion should require fiscal policy constraints that will raise taxation and/or curtail government expenditure. The oil price shocks of the 1970s helped to bring about a new phenomenon, stagflation, i.e., a process of simultaneous high inflation and high unemployment which was not envisaged by the prevailing Keynesian theories. This brought about a new paradigm shift that moved

---

[1] We have received constructive comments from Benny Carlson, Eoin Drea, Alan Harkess and Martin Larch. The usual disclaimer holds.

responsibility for stabilisation policy from governments and parliaments to politically independent central banks while downplaying the role of fiscal policy.

It was in this environment that the European Economic and Monetary Union (EMU) was formed in the latter part of the 1990s. The European Central Bank became politically independent. By the early 2020s, it was commonly regarded as one of the most independent central banks in the world. In the Maastricht Treaty of 1992, price stability became the principal objective of monetary policy. The fact that authority over fiscal policy during this period remained decentralised at the level of member states serves as an indication of its limited role in terms of overall stabilisation policy.

This policy framework has subsequently had to deal with three crises that have gradually led to changes in the role of fiscal policy. Both the academic and political debates have once again underlined the importance of fiscal policy as a powerful instrument for combatting major crises. The division of stabilisation policy into a common monetary policy and a national fiscal policy based on the member states of the euro area has increasingly been called into question, most prominently because of the covid-19 pandemic. As in previous crises, the accepted framework for stabilisation policy has come under pressure.

In this paper, we consider the implications for the EU of the present crisis-induced move towards increased fiscal federalism. We organize our discussion in the following way. First, the role of crises as an agent of political change is analysed. Next, we examine in greater detail, the effect of crises on stabilisation policy in the EU in the past 20 years. Finally, we deal with the recent steps towards increased federalism in the EU and raise the question as to whether this is a desirable path for the future of stabilisation policy in Europe once the pandemic has waned from the agenda.

Crises and stabilisation policy

The goal of fiscal and monetary policy is to control the aggregate level of demand in the economy to dampen the cyclical movements and to counteract the emergence of economic crises. The planning horizon for stabilisation policy applies to the short term, commonly defined as the business cycle, that is the next three to five years. Stabilisation policy is frequently described as demand management policy as opposed to supply side policy that seeks to influence the long run rate of economic growth, the rate of economic development that applies when cyclical factors are removed.

In practice, it has proved difficult to stabilise the economy according to the prescriptions of traditional macroeconomic theory. It has frequently been the case that the conduct of stabilisation policy has amplified rather than dampened cyclical fluctuations. In certain instances, it has even created major economic crises.

Economic crises are frequently followed by a lively debate regarding the lessons to be learnt from the crisis. An opportunity arises for new ideas and theories to become established among both academic economists and political practitioners. As Milton Friedman stated in 1982, "*[o]nly a crisis – actual or perceived – produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around*". However, a single crisis might not be sufficient to bring about a significant change in stabilisation policy. According to Jacobs and Laybourne-Langton (2018), a major shift in the approach to stabilisation policy requires that both economists and politicians at government level find themselves in agreement at the same time as a network of think tanks and interest groups help to generate support for a new perspective.

Figure 1 illustrates the dynamic relationships between economic crises and stabilisation policy. When a crisis emerges, it triggers an economic policy response to counteract the crisis. The policy reaction is formulated within the prevailing paradigm regarding the conduct of stabilisation policy which in turn draws on the lesson learnt from the previous experience of dealing with crises. Subsequently the crisis policy will generate a certain economic outcome. As the effects of the crisis tail off, researchers will attempt to evaluate the crisis policy. This appraisal will reach certain lessons that will form the basis for the policy response during the next crisis in the future - for good or bad. It cannot be assumed a priori that these lessons will bring about an improvement in the conduct of stabilisation policy. A crisis may lead to reforms that will give rise to future crises.

The effects of major crises on stabilisation policy are obvious. However, a number of small crises may have a similar effect as a single, large crisis. Both types of crises may bring about significant changes in the objectives, policy instruments, and institutions of stabilisation policy.

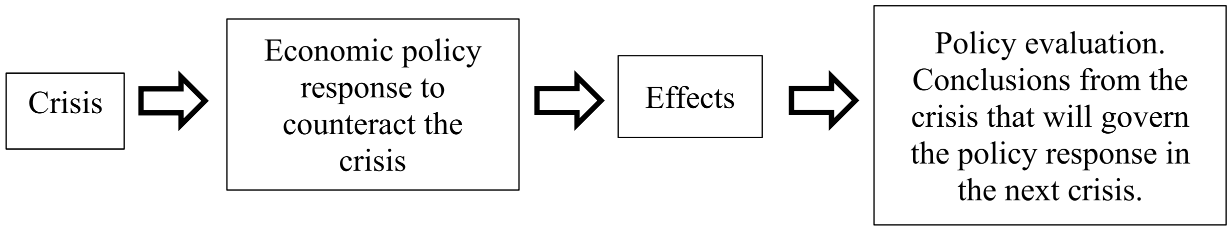

Figure 1. Crises and changes in stabilisation policy. A schematic illustration.

Stabilisation policy in the European Union

The introduction of the euro in eleven EU member states on January 1st. 1999 represents an important step in the process towards a common stabilisation policy for the EU. Now the euro members obtained a common monetary policy, while all Member States were required to follow a prudent path for fiscal policy as set out the SGP.

Large parts of the original framework established in 1999 following the introduction of the euro are still intact. However, a shift has taken place regarding the role of stabilisation policy during the past two decades. Table 1 briefly illustrates the major changes that have occurred. The timeline from 1999 to 2021 has been divided into four separate periods. The transition from one period to another is determined by a crisis along the lines proposed by Figure 1.

The first period commences with the introduction of the euro and concludes with the international financial crisis in 2008-2009. The aim of the common monetary policy was to maintain price stability. Fiscal policy was conducted at the member state level based on rules, although in effect just recommendations, regarding the control of the budget deficit and the overall size of public debt in relation to GDP as set out in the Maastricht treaty and the Stability and Growth Pact (SGP).

The second period starts with the financial crisis of 2008-2009 which eventually led to increased monitoring of national fiscal policy by EU. The European debt crisis between 2010 and 2015 introduced a third phase. As a result of the debt crisis, the member states worst affected received temporary economic support in the form of a series of jointly agreed rescue funds. Periods 2 and 3 are closely related. They can be seen as two halves of the same period. However, the underlying driving forces are somewhat different. The outcome of period 3 had a larger effect on the fourth period that started with the corona pandemic.

Macroeconomic disturbance (1)	**Policy reaction (2)**	**Results (3)**	**Policy evaluation and change (4)**
Period 1: The first years of the euro (1999-2008)			
Stagflation during the 1970s			Common monetary policy based on price stability via the ECB. Constrained fiscal policy at the national level.
Period 2: Global financial crisis (2008–2010)			
2008–09 International financial crisis	Expansionary monetary policy. National fiscal policies. Limited fiscal coordination.	Slow recovery. Growing imbalance in the euro area. Start of the euro area debt crisis.	Fiscal policy recommendations become regulatory. Increased coordination of fiscal policy.
Period 3: The European debt crisis and economic recovery (2010–2019)			
2010–15 European debt crisis	Loan guarantees to countries in need of financial assistance via EFSM, subsequently ESM. Financial support program that included fiscal austerity measures for a number of highly indebted countries. ECB conducts and expansionary monetary policy.	Economic depression in Greece. Growing public indebtedness. High unemployment.	Loan guarantees and austerity measures aggravate debt problems and economic stagnation. ECB's expansionary measures lead to growing financial imbalances.
Period 4: Covid19-pandemic: initial steps towards a common fiscal policy (2020-)			
2020–21 Covid19-pandemic	Initial and temporary steps towards a common fiscal policy (NextGenerationEU). Provision of grants and loans to weaker economies, steps towards an additional common system of taxation.	Countries that have low levels of indebtedness provide support for heavily indebted countries.	The lessons to be drawn from fiscal and monetary policy during the pandemic will become evident in the future.

Table 1: Crises and stabilisation policy in the EU during four periods 1999-2021.

Note: EFSF denotes the European Financial Stability Fund and EFSM the European Financial Stability Mechanism. ESM is an abbreviation for the European Stability Mechanism.

In hindsight, it is tempting to view the developments of the past twenty years in a deterministic fashion. Each major macroeconomic disturbance has been accompanied by a step towards increased fiscal federalism. It is evident from the discussion that this was not the case. The move towards a fiscal union was the result of crises and their consequences, not of any initial overriding plan to move EU into a fiscal union.

Period 1: The first years of the euro 1999-2008.

The institutional framework of stabilisation policy in the euro area is based on the views that were prevalent during the 1980s. Consequently, the establishment of the common currency in 1999 was accompanied by the creation of a politically independent central bank, the ECB, with the responsibility for the conduct of monetary policy throughout the new monetary union. Once price stability had been achieved, the central bank would be able to contribute to real economic development but only to the extent that it did not jeopardise price stability.

At the same time as the responsibility for monetary policy was centralised in the hands of the ECB, authority over fiscal policy remained at the level of the member states. A common fiscal policy for the EU conducted by a federal authority with the right to spend, borrow and tax was absent from the original design of the institutional framework. In order to avoid that individual countries could threaten the economic stability of the entire monetary union, limits were placed on the levels of budget deficits and public debt. These limits were set out in the Maastricht Treaty and the Stability and Growth Pact, requiring that annual budget deficits of member states did not exceed 3 % and that the level of public sector indebtedness would be kept within 60 % of GDP. Furthermore, countries committed themselves to balancing public sector finance in the medium term, generally speaking, over the cycle. As a result, it would be possible to conduct an expansionary fiscal policy during a recession without endangering the rules for the size of budget deficits. In addition, a no-bail-out clause was entered into the Treaty.

It became readily apparent that the rules of the Stability and Growth Pact were not actually binding in practice. Countries were able to break the rules without any obvious sanctions. Only five of the original 12 member states of the euro area (the 11 countries that introduced the euro in 2001 and Greece that followed in 2001) succeeded in keeping their public debt ratio below 60 % of GDP, namely Ireland, Luxembourg, Netherlands, Portugal, and Finland. The others exceeded that limit. See Figure 2 indicating that during the entire period 1995-2020, the average public debt ratio was below its target in only one year, 2007. The maximum level of public debt exceeded 100 % of GDP during every year of the period 1995-2020.

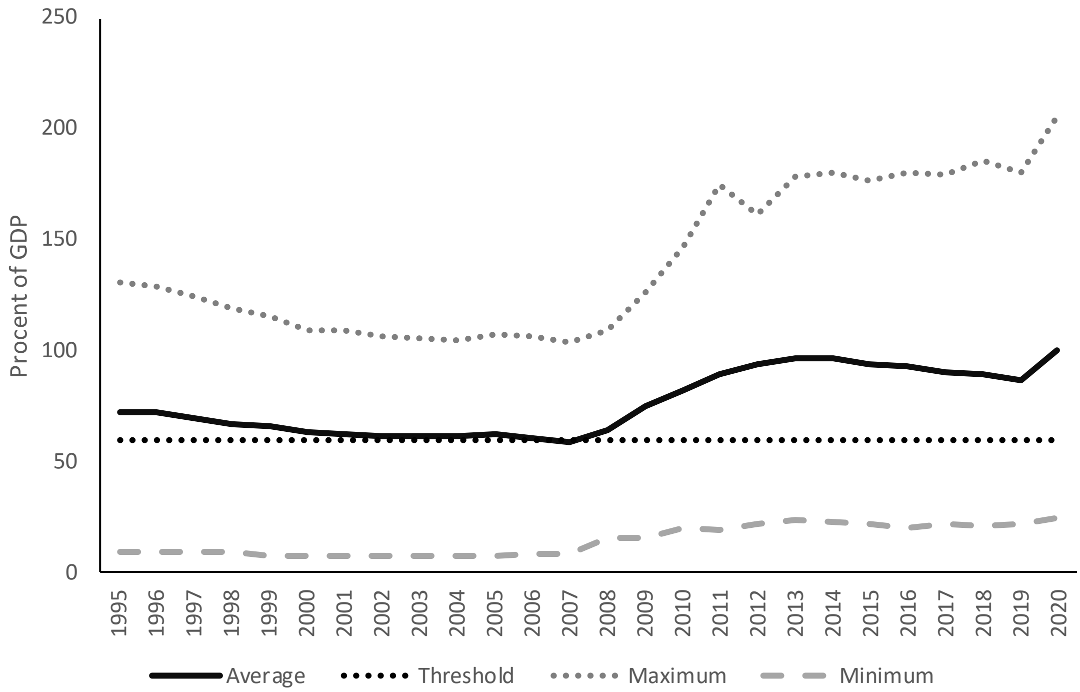

Figure 2. Government debt as per cent of GDP in the euro area 1995 - 2020.
Source: Eurostat.

A similar picture emerges from Figure 3 regarding data on budget deficits. On average, the euro area countries met the SGP requirement with respect to fiscal deficits. However, these average figures are misleading since most member states broke the deficit rule at some point during the period. This was also the case for major economies such as France and Germany that exceeded target levels between 2002-2005/06. Only two smaller euro members, Luxembourg and Finland, were able to record substantial repeated budget surpluses. Regarding the medium-term budgetary objective of approximate balance, only Finland, Ireland, Luxembourg and Spain were able to meet this requirement. The budget deficits of six member states were closer on average to the SGP limit than to medium-term balance. This applied to France, Germany, Greece, Italy, Portugal and Austria. In effect, what had been considered as an upper limit to public sector deficits had become for many countries a medium-term target.

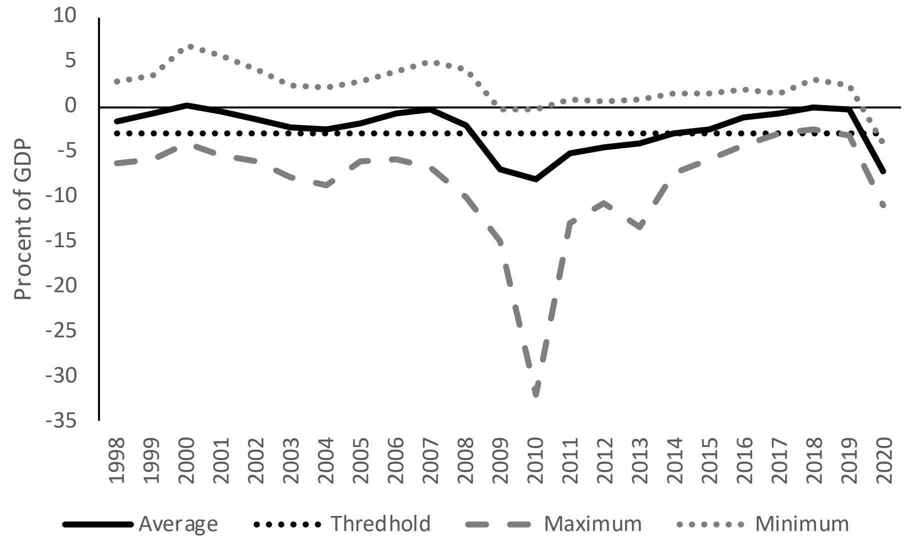

Figure 3. Budget deficit as per cent of GDP in the euro area 1998-2020.
Source: Eurostat.

The rules of the Stability and Growth Pact that were already considered weak were further eased when France and Germany broke the deficit rule. As a result of the 2005 reform, member states were given greater opportunities to breach the 3 % rule during recessions or when major structural reforms were implemented to raise long-term economic growth. Hence Germany was able to justify its deviations from the rules of the Stability and Growth Pact despite having been the principal architect of the Pact.

The euro area entered its first major upheaval during the international finance crisis of 2008-2009. It had a common monetary policy and a statutory price stability goal together with a decentralised national fiscal policy that was in many instances out of alignment with the regulations of the Stability and Growth Pact. This had an impact on economic development during the finance and debt crises that followed.

Period 2: Global financial crisis 2008-2010.
The euro members followed the prevailing stabilisation policy guidelines in dealing with the financial crisis. The focus of attention was on monetary policy. To counter the contractionary effects of the crisis, the ECB lowered its base rate from above 4 % to 0.5 %. The commercial banks were provided with liquidity in order to support the financial system. The ECB's balance sheet doubled from 1 000 billion euros to 2 000 billion euros. See Figure 4. At that time, this rate of increase was exceptional although it pales in comparison with the expansion during the subsequent debt and pandemic crises.

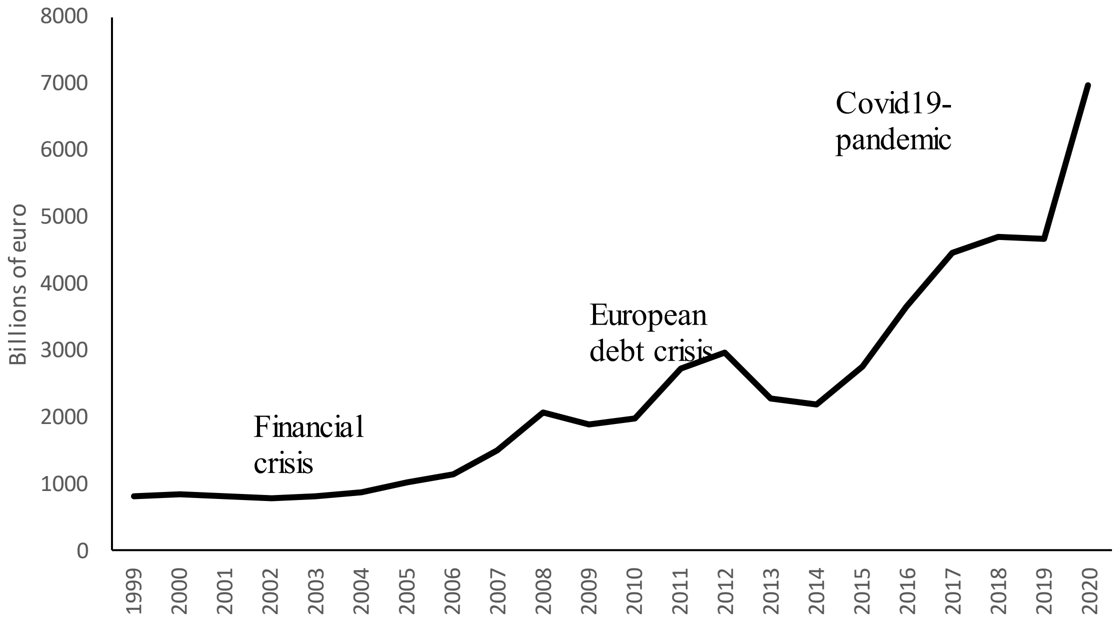

Figure 4. ECB balance sheet 1999-2020. Billions of euros.
Source: ECB

Fiscal policy became generally expansionary. See Figure 3. Each country designed and financed its own stimulus package. At the same time, a certain degree of coordination took place between member states with the aid of the European Economic Recovery Plan (EERP). The depth of the economic and financial crisis permitted countries to temporarily breach the deficit rule of the Stability and Growth Pact. The European Commission emphasised that this departure from the EU rules should be viewed as a temporary measure.

The decentralisation of fiscal policy led to marked variations in expenditure on fiscal measures between member states. Only a relatively small proportion of the expansion in fiscal measures was coordinated through the EERP. A decisive factor in explaining these differences in the size of fiscal stimulus across member states was their overall fiscal position at the outset of the crisis. The fiscal expansion was lower in countries where the need was greatest. This led to an imbalanced recovery after the crisis which contributed to a widening of the gap between low and high growth EU member states.

The costs of restructuring the bank system were also the responsibility of individual member states. The financial crisis generated substantial losses for commercial banks which threatened financial stability. Major rescue operations were required. According to estimates by Laeven and Valencia

(2018), the total fiscal cost of bank restructuring amounted on average to 4.8 % of GDP, actually a relatively modest amount. However, these costs varied widely from zero percent in the case of Finland to 37.6 per cent of GDP for Ireland. The countries that suffered the most from falling growth and rising unemployment required the greatest injections of fiscal stimulants. At the same time, these countries had the least policy space to stimulate their economies via increased public indebtedness due to the high costs of bank restructuring.

The actual magnitude of the fiscal costs of bank restructuring and economic stimulus measures in the EU was comparable to that of the United States. However, an important difference was that the costs of financial assistance to the banks in the United States was borne by the federal government rather than by the states. As a result of this federal support for the banking system and economic stimulus measures, the United States was able to maintain a more expansionary fiscal policy over a longer period than the EU.

The European Commission recommended an early return to the rules of the Stability and Growth Pact. Kollman et al (2016) together with international organisations such as the International Monetary Fund (2012) argued that the economic recovery was slower in Europe than in the United States due to the earlier adoption of a more restrictive stance to fiscal policy in Europe. In many cases, fiscal policy austerity became a necessity owing to the weak state of public finances prior to the crisis in the EU.

Table 1 shows that a series of reforms were undertaken during 2010-2013 in the aftermath of the crisis. Two reform packages are of particular interest: the “Six Pack” and the Treaty on Stability, Coordination and Governance. The monitoring of the adherence to the rules of the Stability and Growth Pact was strengthened. New regulations were introduced covering deviations from the deficit rule and the pace at which member states ought to eliminate this deviation. In addition to this reinforcement of monitoring procedures, a macroeconomic surveillance mechanism was created to identify real economic imbalances that could threaten the long-run economic stability of the monetary union. Member states committed themselves to strengthen the monetary union by improving competitiveness, increasing employment, and supporting measures to strengthen public finances and financial stability. An annual planning semester was introduced in 2010 to improve the coordination of fiscal policy. It was envisaged that responsibility for the formulation of fiscal policy would remain largely at the national level.

Period 3: The European debt crisis and recovery 2010-2019

The third period covers the European debt crisis as well as the period up to the onset of the Corona pandemic. The origins of the debt crisis are to be found in the weak public finances prior to the crisis and in the individual responsibility of member states for the conduct of their own fiscal policy. Table 2 provides a comparison of public indebtedness in the euro area with the federal debt of the United States. The European debt includes all public debt including regional and local authority debt. The American figures comprise only federal debt, i.e., the debts of the central government. Hence total American debt is higher than is shown in Table 2.

Before the onset of the debt crisis, the debt ratio was just under 70 percent in both the United States and Europe. During the crisis, the debt ratio rose to around 90 per cent in the euro area and to 100 per cent in the United States. Although public debt grew more slowly in euro area states, they were nevertheless more vulnerable to a debt crisis than the United States since the public debt burden in Europe was more unevenly distributed. In Luxembourg, the debt ratio was 22 per cent whereas it reached 160 per cent in Greece.

The finance markets lost confidence in countries with high levels of public debt. This led to rising bond yields. Since these countries had replaced their national currencies with the euro, they were no longer able to finance their budget deficits by means of printing their national currencies. They had no alternative but to borrow in financial markets and pay the higher costs. To a growing extent, the entire euro project was called into question.

	Public debt			Cost of re-financing the commercial banks
	Level (% of GDP)		Change (percentage points)	(% of GDP)
	2008	2012	2008–12	2008–12
Euro area	69.7	90.7	+21.0	4.8
USA	67.4	98.7	+31.3	4.5

Table 2: Public finances in the EU and the USA, 2008-2012.

Source: Eurostat, St. Louis Federal Reserve FRED and Laeven and Valencia (2018).

Five countries were particularly affected by the debt crisis: Greece, Ireland, Italy, Portugal and Spain. In two of these countries, Ireland and Spain, the weakness of their public finances was principally attributable to the financial crisis. In short, they had bad luck. Following the introduction of the euro, interest rates fell by several percentage points because of a capital inflow from other parts of the monetary union. This created a housing bubble which subsequently collapsed. Bank losses increased dramatically once the housing bubble burst in 2008.

Governments had to intervene. The Irish public debt ratio rose from 24 per cent of GDP in 2007 to 120 per cent four years later. Spain had a similar experience during the first years of the euro although not quite to the same extent. Both Ireland and Spain belonged to a group of four countries that had relatively low levels of public indebtedness and budget deficits prior to the financial crisis. This illustrates the importance of monetary policy in restraining increases in the volume of credit in order to avoid a financial crisis.

In Greece, Italy and Portugal, the problem was not brought about by a housing bubble. Economic growth in these countries had long been hampered by the lack of successful supply-side policies. In the case of Greece, the size of its budget deficit and public indebtedness had been under-reported deliberately. The financial markets lost confidence in the Greek government. The interest costs on the public debt rose from 5 percent in 2009 to almost 30 percent in 2011. Greece was unable to manage its debts and requested help from the EU and the IMF.

Similar debt financing problems were encountered by Italy and Portugal. A persistent low rate of economic growth and a weak bank system required international support. A combination of poor loan performance and a structurally weak economy raised the public debt ratio from 72 percent in 2007 to 129 percent in 2012. The interest charges on the public debt rose dramatically.

Italy, similar to Portugal, had suffered for many years from structural economic weaknesses and low rates of economic growth. Ever since the 1980s, levels of public debt had remained high. The country also struggled under weak political leadership. Although the public debt ratio fell slightly between 1999 and 2008, it still remained above 100 per cent of GDP. Once the euro crisis began to take hold in Europe, the financial markets began to lose confidence in Italy’s capacity to deal with its debt problem. The Berlusconi government was forced to resign to be replaced by a technocratic government that would seek to calm the markets.

At the outset, this public finance crisis was treated as a problem for individual member countries. However, as the crisis spread throughout the euro area, it became evident that a common solution was required. Ireland, Portugal, and Greece were unable to finance their debts on their own. Theoretically, these countries could have suspended their debt payments and declared themselves bankrupt. However, the crisis in the banking system would have re-emerged not just in the highly indebted countries but throughout the currency union. The euro area was threatened by an existential crisis.

In order to find a joint solution to the crisis, the European Financial Stabilisation Facility (EFSF) was created in May 2010. It was followed subsequently by the European Stabilisation Mechanism (ESM). At the outset with member countries acting as guarantors, the ESM was able to borrow up to 440 billion euros. This was increased in 2011 to a maximum of 750 billion euros which could be made available as loans to individuals member countries. This support was tied to substantial reductions in public expenditure and structural reforms that would benefit long-term growth. The idea was that countries would receive temporary help to survive the crisis in exchange for a future return to long-term stability of the public finances by their own efforts. The debts would be repaid obviating the need for any redistribution of resources between member countries.

The underlying forecasts for the support programs were soon shown to be overly optimistic. As Andersson (2019) discussed, they were partially based on an oversimplified diagnosis of the underlying economic problems. At the same time as the effects on growth of the reforms were overstated, the effects of austerity on demand were underestimated. On several occasions, the reform packages were revised downwards since the member countries could not meet their commitments. In Greece, average income per capita declined by 20 percent between 2008 and 2019. The corresponding figure in Italy was five percent. Spain and Portugal performed better. However, their weak rate of growth was only half of that in Germany and Sweden during the same period.

The financial markets received the first support programs with a good deal of suspicion. Interest rates remained at a relatively high level. To reassure the financial markets and avoid Italy and Spain being drawn into assistance programs, the head of the ECB, Mario Draghi, promised in 2012 to do "whatever it takes" to save the euro. Interest rates fell following this forthright message from him. However, economic growth continued at a low rate in the debtor countries. To stimulate the slow rate of recovery, the ECB introduced in 2015 a program of "quantitative easing" whereby the central bank aimed-to exert downward pressure on long term interest rates through the purchase of government bonds. In total, the ECB balance sheet expanded by 3000 billion euros which can be compared with the growth of 1000 billion during the financial crisis of 2008-09. See figure 4.

In practice, this type of monetary policy actually "taxed" savers through lower rates of return on their capital. At the same time, borrowers were subsidised through lower rates of interest on their loans than would otherwise have been the case. Indirectly, the ECB was conducting fiscal policy. The resource redistribution to its weaker members that the EU had failed to agree on politically were now being implemented in the form of an expansionary monetary policy. In a democratic perspective, the ECB's crisis policy was problematic. A redistribution policy requires a democratic mandate from the citizens of the European Union. The ECB did not have such a mandate. The German Bundesbank had on several occasions criticised a policy of bond purchase by the ECB, arguing that it contravened the German constitution. However, the German Constitutional Court has so far allowed the ECB to continue with this program on a modest scale.

The absence of a fiscal union contributed to the financial crisis of 2008 -09 turning into a debt crisis. Originally, the euro area lacked a common mechanism for dealing with countries whose public indebtedness had got out of control. When the crisis spread from country to country affecting an ever-larger group of countries, a common response had to be found. The solution became a series of temporary loans and a policy of severe austerity in the countries affected. The economic situation deteriorated, and debts rose in relation to GDP. Greece and Italy fell into a severe depression. Spain, Portugal, and Ireland managed somewhat better. It was not until ECB began to conduct fiscal policy using indirect redistribution from savers to lenders by means of artificially low rates of interest that the economies began to recover.

By the end of the 2010s, the situation had become more stable. However, fundamental problems remained. In 2019, the year before the pandemic, Greece, Italy, and Spain, had a higher public debt ratio than in 2008 and 2012, well over the 60 per cent level in relation to GDP prescribed in the Stability and Growth Pact.

Period 4: Covid-19-pandemic: initial steps towards a common fiscal policy 2021.

The euro countries were able to draw on lessons from the debt crisis during the pandemic. The EU's common recovery plan, NextGenerationEU (NGEU) is an important piece of the puzzle regarding the EU's fiscal reaction to the pandemic. It comprises two elements: temporary fiscal transfers between member states and short-term loans to member states. In total, the NGEU is worth up to

750bn euro at 2018 prices which is equivalent to more than 5 percent of the bloc's annual GDP. These loans and grant allocations will be spent over the five-year period 2021-2026 and is focused on the recovery phase rather than the actual crisis phase. At the outset, the financing of the plan will be conducted through the bond market where the EU Commission has the right to issue its own bonds. The method of repayment for these loans has not yet been finalised. There are far-reaching proposals for the EU to introduce its own system of taxation. The actual form of taxation has still to be determined. Carbon duties, a digital tax and a tax on financial transactions have been considered as possible future sources of finance.

The decision by the EU to use a fiscal recovery plan in addition to expansionary monetary policy to deal with the corona pandemic was hardly a matter of chance. As early as 2015, the Five Presidents Report (EU, 2015) discussed future crisis management in the aftermath of the lessons to be drawn from both the finance and debt crises. The authors were the current EU commission chairman, Jean-Claude Juncker, the chairman of the European Council, Donald Tusk, the head of the euro group, Jeroen Dijsselblom, the chairman of the CEB, Mario Draghi and the chairman of the European Parliament, Martin Schultz. They presented a series of reform proposals designed to strengthen the Economic and Monetary Union, EMU.

One of the proposals considered the creation of a European fiscal stabilisation mechanism, i.e., a common fiscal recovery plan that would complement national fiscal policies during a severe crisis. Its goal, according to the report, would be to accelerate economic recovery while paving the way for sustainable long-term growth. The report also emphasised that fiscal policy redistribution between member states should be of a temporary rather than permanent nature. Each member state should strive to maintain long-term fiscal discipline and to take individual responsibility for its own fiscal expenditure.

The construction of NextGenerationEU followed the lines drawn up in the report of the five chairmen. The recovery program is of a temporary nature that focuses on investments. The largest component in the plan, 360bn euro, comprises loans to members states while the other smaller part, 312.5bn euro, represents grant allocations that are financed collectively. The loans would guarantee that countries that already have a high public debt ratio would be able to expand their economies without running the risk that interest rates would escalate as during the debt crisis. These loans have not so far generated much interest. By October 2021, only four countries, Cyprus, Italy, Portugal and Rumania, had submitted loan applications to the Commission.

The grants to which individual countries are entitled are expected to be financed out of EU- wide taxation. The size of these grant allocations to individual member states will depend on two factors: their growth performance during the years 2015-2019 and the extent to which they suffered from the pandemic. Weaker economies will receive a larger grant allocation than their stronger brethren. Spain and Italy will each receive the highest allocations of just under 70bn euro. Despite its size, the German economy will only receive just over 25bn euro. To qualify for these loans and grants, each country has to present a recovery plan that specifies how they intend to spend the grant allocation. The Commission and the Council of Ministers must accept the plan and are able to stop the payments if any country deviates from the plans or in any other way depart from the basic values of the European Union. Both Poland and Hungary have been indirectly warned that they run the risk of losing their grant allocation. So far this has not happened.

The actual design of the plan follows the report of the five chairmen. Grants are primarily focused on strengthening long term competitiveness and the ability to resist future crises. In line with the Commission's own stated political priorities, national investment plans must devote at least 37 percent of their grant allocation to climate-related objectives and a further 20 percent to investments in digital initiatives. The interest among member states in these grant allocations has been appreciably greater than in the case of loan disbursements. Almost all member states have submitted recovery plans.

In addition to NextGenerationEU, the Commission has also provided 100bn euros in favourable loans to member states within the so-called SURE programme. (SURE stands for support to mitigate unemployment risks in an emergency). This program is aimed at securing employment in the short term during the pandemic by means of shorter working hours, short-term redundancies, and workplace health measures to restrict the spread of the virus. In this context, it is evident that the SURE programme works at the level of short-term support for states whose public finances are under pressure during a crisis phase. The NextGenerationEU plan on the other hand focuses on the long-run recovery and growth of the economy.

It is too early to evaluate the effects of NextGenerationEU and the SURE program. However, three preliminary conclusions may be drawn. In the short run, the recovery plan will probably have a limited effect. The scale of the measures, 750bn euro, is not sufficiently large in relation to the aggregate GDP of the EU to create a sizeable economic effect. Furthermore, few states have shown an interest in using the EU's loan facility. The total stimulus will be far less than the headline amount of 750bn euro. The cyclical stabilisation effects of the SURE program will probably be greater. However, this program does not bring about any redistribution of resources between member states. Instead, it offers loans at relatively low rates of interest to states seriously affected by the pandemic which in the fullness of time will have to be repaid.

In the long run, the NextGenerationEU plan may have two consequences. Firstly, the plan will develop the infrastructure that is required for a future fiscal union conducting a common fiscal policy. The rights to borrow and tax acquired by the EU will establish the basis for transferring parts of fiscal policy from member states to the central authority of the EU.

Secondly, the plan brings attention to the risk for a *moral hazard* problem in so far as it creates incentives for individual member states to conduct an irresponsible fiscal policy in the hope that other members would provide support in the form of fiscal transfers. The Stability and Growth Pact was originally designed to counteract this problem. Economic assistance will not solely be provided for the costs suffered by the country during the pandemic. A major proportion of the grant allocation, 70 percent, will be distributed based on the country's average rate of economic growth between 2015 and 2019. Strong, well-run economies that may well have a relatively high tax burden will become net donors of assistance while less efficient economies become net recipients. Under these circumstances, the motivation to take on full responsibility for the economy will weaken. This poses a threat to economic development.

Summary of the four periods. Since 1999, fiscal policy in the EU in general and in the euro area in particular has changed from being an individual responsibility for member states to one that involves a growing number of issues concerning coordination, cooperation and supervision. The EU has been confronted with several major crises that have led to rising levels of public debt despite having a regulatory framework designed to curtail budget deficits and increased levels of public debt in relation to GDP.

During the debt crisis, when the very existence of the euro was threatened, short term loans were provided to individual member states. These loans were subject to strict fiscal policy constraints and to the introduction of structural reforms. In the short term, these assistance programs aggravated the crises. The ECB's purchases of large quantities of government bonds were essential to keep the euro area intact although they were at the limit of what was permissible under EU rules. In practice, the

ECB's measures to purchase bonds were in fact a form of fiscal policy that involved resource redistribution between member states.

The pandemic at the start of 2020 represented a new phase of European cooperation around a common fiscal policy where the Commission was able to raise loans and impose taxes. The fiscal policy union, based on rules controlling the size of budget deficits and levels of public indebtedness combined with a limited degree of coordination had turned into a fiscal union with powers of taxation for the European Union. The Commission's agenda is at the centre of the formulation of members' recovery plans. This will point the way to the need for a stronger political union that has a clear federal structure and a solid democratic base among the citizens of the European Union.

The future stabilisation policy of the European Union

In the years between 1999 and 2021, stabilisation policy in the EU has moved towards increased fiscal policy integration as a complement to its fully integrated monetary policy. The first stage was characterised by flexible integration where the euro countries increased their fiscal policy cooperation during the financial and debt crises. This was followed by a period of closer involvement among all EU members during the pandemic.

It is likely that few economists in 1999 would have rejected the idea that the euro area would in the future move in this direction. There has hardly existed a currency union with such a clearly defined distinction between a common monetary policy and a decentralised nation-based fiscal policy as the euro area when it was established in 1999. In the United States, the federal budget accounts for 25 percent of GDP while the budgets of the U.S. states are at roughly half of that level, 14 percent. Rich states are net donors while the poorer states are net recipients in the U.S. fiscal union. Federal redistribution accounts for several percentage points of GDP for certain individual states. There is no equivalent to the U.S. federal budgetary redistribution in the EU.

The idea that the EU should allow its member states to take on the individual responsibility for fiscal policy must be seen in the light of the greater economic, political, and cultural heterogeneity in Europe than in other comparable currency unions. This complicates the formation of a pure fiscal union. An efficient fiscal policy requires substantial agreement on how fiscal policy should be conducted, not just in terms of its cyclical stabilisation role but also in relation to the size and role of the public sector in distributing economic resources.

The fiscal policy integration that has taken place since 1999 in the form of increased coordination and monitoring is the result of crises and acute short term crisis policy measures rather than the result of a deliberate plan. The reform process has been re-active rather than pro-active. Each crisis has given rise to a series of reforms as a response to an immediate crisis and the lack of crisis management. The policy has looked backwards rather than forwards. As stabilisation policy has gradually loosened its ties to the original policy framework, the need to examine and discuss how stabilisation policy should be properly planned has become more pressing. Is the federal approach that has now been adopted the right one or are there better alternatives?

There are in principle three different paths for the future design of fiscal policy in the EU:

1) A complete fiscal union with strong central federal government powers.
2) A limited, flexible integration using automatic fiscal risk-sharing mechanisms.
3) Improved crisis preparedness by means of improved real economic flexibility and strong public finances.

We will examine the advantages and disadvantages of these three alternatives below:

Alternative 1. The EU as a complete fiscal union:
NextGenerationEU should be viewed as a first step towards a federal fiscal union. There are several advantages with a highly developed common fiscal policy in a currency union. Some of the strain can be removed from monetary policy during major crises. An appropriate balance between fiscal and monetary policy may succeed in dealing with a crisis in a more efficient manner. Studies have indicated that the slow recovery in the euro area following the international finance crisis of 2008-09 was due to the lack of a common stimulus policy during the crisis. According to estimates made by the US Federal Reserve, the decline in Greek GDP per capita during the financial crisis of 2008-11 would have almost been halved if the EU had had the same fiscal union as in the USA (Malkin and Wilson, 2013).

Macroeconomic risks may be shared between members of the currency union by means of a fiscal union. Individual countries receive automatic fiscal support if they are suffering on their own from an economic crisis or if they are severely affected by a common crisis. By sharing the costs, no individual country runs the risk of going bankrupt. As Table 2 indicates, neither the costs of restructuring the commercial banks in the euro area nor the increase in the public debt ratio were higher in the EU than in the USA. However, because of the unequal distribution of the costs of the debt crisis between the member states of the euro area, it was the European Union rather than the United States that suffered from the crisis.

According to the theory of optimal currency areas, there are in principle two ways of removing the imbalances that may arise between members of the currency union: i) via the mobility of labour and capital between the union's members, or ii) by means of fiscal redistribution from richer to poorer members of the currency union. Owing to the relatively limited labour mobility within the EU, fiscal policy redistribution may become a significant policy instrument to deal with economic imbalances. It can thereby contribute to a more balanced economic, social and political development.

A fiscal union places demands on the degree of democratic support that exists among voters for a common fiscal policy. This would mean by extension a stronger political union in the EU governed by a clear mandate from its citizens. In this respect, fiscal policy differs from monetary policy. In the long run, the influence of monetary policy is limited to the rate of inflation and financial stability. Fiscal policy on the other hand has a decisive influence on growth, the distribution of wealth and income and on social developments. Monetary policy can be conducted entirely separately from the executive branch. Fiscal policy, however, requires popular support in the form of direct elections that offer a choice between different alternatives and where citizens are able to change the direction of current policies if they so desire.

If the goal is to create a fiscal union, the present political model in the European Union is in the long run inadequate. The demands raised by NextGenerationEU that the recovery package should be based on the political agenda of the Commission is already raising governance issues with respect to the democratic legitimacy. The voters have not had the direct opportunity to vote for or against the agenda.

An important question in this context is whether it is possible to create a common fiscal policy that will receive a high degree of popular support. Hall (2018) has divided Europe between three to five economic models that have emerged from the historic, economic, and social experiences of the euro states. Each model has unique characteristics that makes it difficult to gather them under the same economic policy umbrella. There are for example significant differences between countries in relation to tax and welfare systems. The national responsibility for fiscal policy by member states following the creation of the euro in 1999 reflected these different characteristics. There were inherently major risks in trying to bring the euro states together in a deeper fiscal union. It could have led to conflict that would have paralysed fiscal policy. In practice, the creation of a well-functioning fiscal union will be a contentious matter for the foreseeable future.

Alternative 2. The EU as a union based on risk-sharing:
An alternative approach to a fiscal union would be to supplement the increased coordination that has taken place since 2010 through the introduction of so-called planning semesters for a comprehensive European unemployment insurance and a common guarantee for bank deposits. An automatic mechanism would thereby be put in place that would provide temporary support for countries undergoing a major economic crisis. It would spread the economic risks without the intervention of a federal government conducting an active fiscal policy. A rise in unemployment would give rise to the automatic redistribution of resources via an unemployment insurance system for those member states most severely affected. The same would occur in the case of a financial crisis when the banking system could be saved by means of a procedure for bank deposit guarantees. If these two systems had been in operation during the financial crisis, the actual extent of the crisis would have been reduced together with the high levels of indebtedness in many of the most severely affected countries.

This risk-sharing model has created substantial interest among both researchers and politicians. A report that attracted considerable attention published in 2018 by seven French and seven German economists (Benassy-Quere et al, 2018) argued in favour of this approach as a compromise that could mobilise a greater degree of support than a comprehensive fiscal union. The European Commission has for example offered support for a bank union with a common bank deposit guarantee and a comprehensive unemployment insurance system. The SURE program may be seen a small step on the way although the program's risk-sharing mechanism is restricted to the provision of loans at low rates of interest to member states during the pandemic.

Work on the common bank deposit guarantee has been ongoing since 2015. In October 2021, this work has still not been completed. Several questions remain. For instance, the question of the distribution of costs has not been resolved. Countries that have weak bank sectors would appear to be economic winners while countries that have more robust bank sectors would appear likely to be losers when all member states take on joint responsibility for the costs of a banking crisis. There are, however, unresolved issues concerning the *moral-hazard* problem. The incentive for weak economies to implement reforms that would strengthen their bank sector or decrease their susceptibility to economic crises will become weaker when the costs of a crisis are shared equally. The lack of reforms will in turn increase the risk of future crises.

Although a risk-sharing model will require less coordination of fiscal policy than would be the case with a fiscal union, the question of democratic support for the creation of a comprehensive unemployment insurance system will still have to be addressed. It is difficult to separate unemployment insurance from the rest of labour market policy. Hence a common unemployment insurance implies in practice a common labour market model. Although the risk-sharing model may seem to be a more feasible approach - at least in the short term - it remains somewhat vulnerable to the same problems that arise in the case of a comprehensive fiscal union.

Alternative 3. A European Union based on flexibility and national fiscal preparedness:
A third alternative for the EU would be to reduce the amount of central control over fiscal policy by focusing on the solution of problems that arose out of the financial and debt crises. By focusing on the main problems, stabilisation policy would be able to return to the original plan for a common currency that was based on Europe's unique conditions.

Attention is placed here on two principal explanations for these crises. Firstly, there is limited real economic flexibility in the euro area. Secondly, fiscal policy suffers from a lack of preparedness to meet crises. In this context, weaknesses in the coordination of fiscal policy are also relevant to the argument. If these weaknesses can be resolved, the original separation between an independent central bank that conducts the common monetary policy, and a nation-based fiscal policy could be restored - in accordance with the Maastricht treaty from 1992 and the Stability and Growth Pact from 1997. Let us discuss these two challenges for the EU, first how to raise the growth rate, and then how improve national fiscal preparation for future crises.

Increased real economic flexibility. During an economic crisis, fiscal and monetary policy will play an important role in limiting the damage of the crisis. In both the medium and long term, stabilisation policy, i.e., aggregate demand policy, will never be able to replace efficient and flexible markets that help economies to adjust to new conditions. Supply side policies, also known as structural policies, will thereby come into focus. Research findings indicate that countries with flexible economies grow more rapidly and are subject to fewer crises, see Björnskov (2016). This study has also found that countries with fewer economic regulations will suffer less from an ongoing economic crisis and will also recover more rapidly.

It is easy to understand that flexibility has a positive effect on economic development. When economic conditions change, companies and households need to adapt. If the economy is flexible, the rate of adjustment will be more rapid compared to that of an economy subject to strict regulations that impede adaptation. This helps to explain why the aftermath of crises often lead to liberalisation reforms that seek to improve the rate of growth and boost crisis preparedness (Andersson, 2016).

The prioritisation of structural reforms in the EU is hardly a recent phenomenon. During the last decade, the Commission has placed considerable emphasis on structural reforms aimed at increasing the potential for growth. Support for individual countries during the debt crisis was conditional on the implementation of structural reforms. Studies by among others Manassee and Katsikas (2018), have, however, found that the effects of these reforms have varied between countries. Andersson (2019) suggests that among other factors, this may be a result of an excessive concentration on measures directed towards individual member states rather than more comprehensive reforms designed to strengthen the common internal market. The internal market for capital and services, not least digital services is underdeveloped compared to the market for goods. There is consequently substantial space available to expand integration, raise economic growth and strengthen the capacity of the EU to withstand future crises.

Improving fiscal performance. The high level of public indebtedness in several member states is a major current problem. See Figure 2. The Stability and Growth Pact has not succeeded in maintaining sufficient fiscal policy discipline despite the reforms undertaken. The overall level of public debt in relation to GDP has increased over time. The curve may be described as an upward sloping staircase without an end. Debt increases during crises and recessions. In subsequent periods of economic expansion, the debt level stabilises at a new higher level without any signs of declining to any great extent. When times once again deteriorate, the level of debt climbs again to reach a new higher plateau.

As a result of this process, the fiscal space available to meet future crises contracts over time. In 2020, France had a higher level of public indebtedness than both Greece and Italy in 2008 when the public finances of both countries were under extreme pressure. The fact that France has so far avoided a debt crisis may be explained by the ECB's purchase of government bonds, see Figure 4. These purchases have succeeded in temporarily suppressing interest rate rises and dampening crisis pressures. This indirect monetarisation of the public debt does not however provide a long-term solution to the problem of weak public finances in the euro area.

As we have shown, fiscal policy should be designed in such a way that the public debt ratio falls during the good times and then remains at a low level until the next crisis, see Andersson and Jonung (2021). When a new crisis strikes, the government will be able to borrow without having to risk markedly higher rates of interest or becoming bankrupt.[2].

If a country reduces its public debt prior to a crisis, it will be able to increase its indebtedness during the actual crisis with minor negative side effects. During the recent pandemic, Sweden provides a clear example. In 2019, the Swedish public debt ratio was 34 percent of GDP. It rose to 44 per cent during the pandemic. According to official estimates, it will decline to around 35 per cent in the next few years. If we draw a comparison with France and Italy, we find that the public debt ratio of the former rose from 98 per cent to 116 per cent between 2019 and 2020 and in Italy from 135 per cent to 156 per cent over the same period. In Germany as well, public indebtedness rose from 60 per cent of GDP in 2019 to 70 per cent a year later. This was considerably above the limit laid down in the Stability and Growth Pact.

Our reasoning applies not only to individual member states but also to the European Union as a whole. Even though the EU would form a fiscal union in the future, the room for manoeuvre during a crisis would be limited by the high levels of public debt prevailing presently and in the future. A major reduction of public debt will be essential irrespective of which path the EU decides to follow. A restrained fiscal policy in normal times linked to structural reforms will not only improve the capacity to deal with a future crisis but also strengthen the long-term growth of member states.

Despite increased real economic flexibility, and an improved fiscal space, a substantial economic downturn would require a common fiscal policy reaction as a complement to an expansionary monetary policy. The reforms carried out during the last decade have already created the institutions that will be essential to deal with this type of situation. Furthermore, the ESM offers countries that have landed in a difficult situation, despite improvements in crisis preparedness, the opportunity to

[2] During recent years, Modern Monetary Theory has questioned the importance of maintaining low levels of public debt. According to this line of reasoning, the public sector can be financed by the central bank's printing presses. Historical experience, however, suggests that this approach is subject to substantial economic costs in the long run. Modern Monetary Theory rests on weak empirical and theoretical foundations and should not act as a guide for economic policy.

borrow when they no longer have access to funds in the capital markets. The need to borrow from the ESM is however limited once countries show that they have stable public finances and low levels of public debt. Given the prevailing infrastructure, improved real economic flexibility and strong public finances will reduce the need for a fiscal union. Each individual member country would retain powers over its own fiscal policy which it would adapt to meet its own social, economic, political, and historical requirements.

The establishment of better economic flexibility and stable public finances would place huge demands on the euro members. It would also require major efforts by the EU to find ways to finalise the creation of the internal market. Denmark in the 1980s, Sweden in the 1990s and Germany in the early years of the present century are examples of countries that succeeded in finding a new way. By means of structural reforms and fiscal policy restraint, they succeeded in turning around their economies and establishing the basis for satisfactory economic growth and fiscal policy stability. Unfortunately, there are also examples in the EU that head in the opposite direction.

Summing up. A flexible EU well-prepared to meet future crises

It is hardly surprising that a series of crises has driven the euro area towards deeper fiscal policy integration. At the same time, this journey has been neither unavoidable nor desirable. The route followed has been the result of short-term political reflexes during acute crises together with a lack of crisis preparedness. It is less likely that the debate on a common fiscal policy would have been as lively if the member states of the European Union had followed the rules of the Stability and Growth Pact from the beginning, strengthened their economies by growth-oriented reforms and completed their work on the internal market prior to the introduction of the euro. Hence the debate is driven by crises, weak economies, and a lack of preparation with regards to fiscal policy.

Our assessment is that the political, economic, and social differences between the European countries act as a barrier to the creation of a well-functioning political union governed by a popular mandate and pursuing a common fiscal policy. The differences between the countries have deep historical roots. With the passage of time, these differences may naturally diminish as a result of increased economic and social change. Acemoglu and Robinson (2021) provide historical examples where major cultural and institutional changes have taken place. This would seem to suggest that it is possible to create conditions within the EU that point to greater cohesion. At the same time, Andersson and Opper (2019) find that regional differences within a country may remain for centuries despite migration and trade. These results are confirmed by studies that show how membership of the European Union has influenced individual countries. Some have converged towards an EU average while the pattern has been one of divergence for others. Change per se is not necessarily favourable for federal integration. In the U.S., a political union of more than 200 years standing, political polarisation between different states has tended to increase rather than decrease in recent decades. This process has had negative consequences for the capacity of the federal government to deal with economic, political, and social problems.

Crises often lead to political reforms. Sometimes, these reforms help to improve economic performance. However, it is frequently the case that greater attention is given to short term considerations to the exclusion of what would be better for society in the long term. Europe’s principal problem is a lack of supply-side flexibility to meet new situations that arise at both the national and the EU level. These problems are not solved by means of a fiscal union. Profound structural reforms are required. Based on our discussion, a third alternative for the EU that supports growth reforms and strengthen the capacity of fiscal policy to deal with economic crises would provide the EU with a proper way forward. This path builds on the vision of a European Union that fosters economic progress through the single market and close collaborations and does not require the creation of new political institutions.

References

Acemoglu, D., and Robinson J.A. (2021). Culture, Institutions, and Social Equilibria: A Framework. NBER Working Paper 28832.

Andersson, F.N.G. (2016). A Blessing in Disguise? Banking Crises and Institutional Change. World Development 83(July), 135-147.

Andersson, F.N.G. (2019). The Euro and the Nation-state that Never Disappeared: Would Europe Benefit from the Return of National Currencies? In Bakardjieva Engelbrekt, A., Leijon K., Michalski, A. and Oxelheim, L. (eds). The European Union and the return of the Nation State. Palgrave MacMillan.

Andersson, F.N.G., and Jonung, L. (2021). Preparing for the Next Crisis: Lessons from the Successful Swedish Fiscal Framework. In Poulsen, B., Merrifield, J., and S. Hanke, (eds). *Public Debt Sustainability: International Perspectives*. Lexington Books.

Andersson, F.N.G., and Opper, S. (2019). Are Entrepreneurial Cultures Stable over Time? Historical Evidence from China. *Asia Pacific Journal of Management*. 2019. 36(4), 1165–1192.

Benassy-Quere, A., Brunnermeier, M., Enderlein, H., Farhi, E., Fratzsher, M., Fuest, C., Gourinchas, P-O., Martin, P., Pisani-Ferry, J., Rey, H., Schnabel, I., Veron, N., Weder di Mauro, B., Zettelmeyer, J. (2018). Reconciling Risk Sharing with Market Discipline: A Constructive Approach to Euro Area Reform. CEPR Policy Insight 91.

Björnskov, C. (2016). Economic Freedom and Economic Crises. *European Journal of Political Economy* 45, 11-23.

EU (2015). Completing Europe's Economic and Monetary Union. The European Commission: Brussels.

Friedman, M. (1982). *Capitalism and Freedom*. The University of Chicago Press: Chicago and London.

Hall, P. (2018). Varieties of Capitalism in the Light of the Euro Crisis. *Journal of European Public Policy* 25(1), 7-30.

International Monetary Fund (2012). *World Economic Outlook (October)*. International Monetary Fund: Washington D.C.

Jacobs, M., and Laybourn-Langton, L. (2018). Paradigm Shifts in Economic Theory and Policy. *Intereconomics* 3, 113-118.

Kollman, R., Pataracchia, B., Raciborski R., Ratto, M., Roeger, W., and Vogel, L. (2016). The Post-crisis Slump in the Euro Area and the US: Evidence from an Estimated Three-region DSGE Model. *European Economic Review* 88, 21-41.

Laeven, L., and Valencia, F. (2018). Systemic Banking Crises Revisited. *International Monetary Fund Working Paper* 18/206.

Malkin, I., and Wilson, D.J. (2013). Taxes, Transfers, and State Economic Differences. *Federal Reserve Bank of San Francisco Economic Letter* 2013-36.

Manasse, P., and Katsikas, D. (2016). Economic Crisis and Structural Reform in Southern Europe: Policy Lessons. VoxEU.org. 1 February 2018.