

Cooperative Behaviors in the European Union. Keynesian Reflections on the Way out from the Crisis

SILVIO BERETTA* and ALBERTO BOTTA **

Abstract. *The paper connects the eurobonds issue to the political aspects of the current eurozone crisis. It firstly emphasizes that the possible future issuance of eurobonds, or the refusal to do so, represent signs of the emergence of cooperative or, alternatively, non-cooperative behaviors among eurozone countries. Such a dichotomy, in turn, appears as a clear proof of the political roots of the crisis. Accordingly to this perspective, the persistent demand for a full European political integration as the decisive step out of the crisis is reviewed by analyzing a list of works, particularly the conclusions of the Reflection Group on the future of the European Union and the concluding remarks of the Governor of the Bank of Italy. The Authors sadly note the close similarity between the kind of problems raised by the above contributions and the observations by John Maynard Keynes on the blindness of European countries' Heads of governments at the time of the Paris peace agreement at the end of the World War I. A comparison between eurozone macroeconomic records and public balance-financial data (i.e. the dynamics in the debt-to-GDP ratio and in the corresponding government bonds' yields) from monetarily sovereign countries is carried out. Full political integration and mutualization of public debts through a central (federal) government budget seem to impede "debt intolerance" to emerge in monetarily sovereign countries. Once again, the political cooperation among eurozone member States turns out to be the ultimate solution to the existing problems.*

Keywords: *Eurobonds; Fiscal Union, European Political Integration*

1. *Introduction: Who is to Blame? Policies or Politics?*

Five years after the outbreak of the eurozone sovereign debt crisis at the end of 2009, economists are still debating on the main causes of the ongoing crisis. Various perspectives, some of which overlapping, exist. Yet, prevailing positions could be roughly summarized as follows. On the one hand, most European institutions do believe that existing problems are due to wrong government *policies*. Emphasis is on fiscal policies and on lack of fiscal discipline, which has eventually resulted in unsustainable public debt stocks once national governments had to intervene against the economic consequences of the worldwide 2007-2008 financial meltdown¹. On the other hand, some economists

* University of Pavia, Italy

** Mediterranean University of Reggio Calabria, Italy

¹ This is the perspective embraced by the European Central Bank in EUROPEAN CENTRAL BANK (ECB), *A Fiscal Compact for a Stronger Economic and Monetary Union*, ECB

blame *politics*, here intended as the institutional framework defining the set of economic policies that policy-makers may adopt and reactions they may give to market behaviors, as a leading factor behind existing difficulties. Paul Krugman clearly stresses that eurozone does not respect most of the optimal currency area criteria that Robert Mundell and Peter Kenen (among others) have brightly pinpointed all along their academic careers². In presence of low labor factor mobility, eurozone does not have any (apt) centralized fiscal transfer system from booming regions to depressed ones in order to effectively face asymmetric shocks. The burden of anti-cyclical policies is on the shoulders of Member States. Since monetary policy is centralized, and not available at least to counteract regional shocks, Member States are exposed to huge default risks or, eventually, are forced to leave.

The above perspectives do not necessarily exclude each other. Some common points can exist. Yet, policy implications are pretty different. Should the fiscal profligacy perspective prevail, austerity programs are to be implemented, and more stringent rules ensuring fiscal discipline are to be urgently enacted by European institutions and Member States. No need for a fast move towards a full-fledged federal European entity with a pretty large federal government budget is perceived. On the opposite, supporters of the “political nature” of the existing crisis see the creation of more space for centralized anti-cyclical fiscal policies, and of some sort of collective mutualization of regional problems, as the first point in the reform agenda of European institutions.

In this paper, we first provide a detailed survey of the aforementioned (competing) standpoints on the causes of (and most promising remedies to) the current crisis. Even though it is not possible to neglect some critiques to member countries’ past fiscal policies, we stress the chiefly political dimension of eurozone difficulties. We shall do so by reviewing a considerable body of analyses proposed by a vast number of economists, study groups, representatives of European and Member States economic authorities. Public speeches by Bank of Italy’s Governor Ignazio Visco will be given special attention. On the one hand, all these speeches are extremely keen on underlining that the current crisis would have likely not emerged had

Monthly Bulletin, May 2012, and by Charles Wyplosz in C. WYPLOSZ, “Europe’s Quest for Fiscal Discipline”, in *European Economy*, Economic Papers no. 498, April 2013. Kosters expresses the same view criticizing the possible issuance of eurobonds as a viable solution to the crisis (on this point, see W. KOSTERS, “Common euro bonds: no appropriated instrument”, in *Intereconomics - Review of European Economic Policy*, no. 3, 2009, pp. 135-138).

² P. KRUGMAN, *Revenge of the Optimal Currency Area*, NBER Macroeconomics Annual, Vol. 27, 2012, pp. 439-448.

the European Union (and the eurozone) worked as a full-fledged political entity. On the other hand, and accordingly to the previous point, they all envisage the creation of a European federal State as the definitive step out of the crisis. In this regard, we briefly analyze the recent experience of some monetarily sovereign countries such as USA, UK, Japan and Canada, as a proof that a full-fledged European political Union may represent a possible effective solution to the present crisis.

In the second part of this paper we argue that the path towards the creation of, say, the United States of Europe would entail a significant widening of the economic policy options available to European policy-makers. On the one hand, ECB's statute should be emended so that ECB could behave according to multiple objectives and not concentrate on price stability only. Price stability targets should be combined with financial stability and support to economic growth (and employment). On the other hand, European institutions should be entrusted with adequate tools (rights to impose taxes and proper financial instruments – for instance eurobonds – to run expenditures) in order to implement anti-cyclical fiscal policies. In practical terms, all these reforms are intended to help the European Union, and the eurozone in particular, to promptly and effectively stabilize economic cycles and counter-act negative (perhaps regional) shocks. More in general, they hinge on a radically different philosophy compared with the philosophy shaping the European institutional building so far. *Cooperation* among member States should replace the mistrust and suspicion with which allegedly virtuous (central) countries have so far accepted to (only partially) integrate with supposedly undisciplined (peripheral) ones. From an historical point of view, we argue that such a search for cooperative behaviors is similar to the one that inspired John Maynard Keynes's participation to 1919 Paris Peace Talks, which were held after the end of the First World War in order to stabilize the European economic and, above all, political scenario. Further, our arguments follow (and take inspiration from) seminal observations by Nicholas Kaldor, who wisely advised that “the objective of a full monetary and economic boom is unattainable without a political union; and the latter presupposes fiscal integration, and not just fiscal harmonization”³. Recent steps towards the creation of a fully developed European banking union and ECB's endorsement of supranational bank supervisory functions, as well as the

³ N. KALDOR, “The Dynamic Effects of the Common Market”, *New Statesman*, 12th March 1971, p. 205. This contribution has been subsequently republished in N. KALDOR, *Further Essays on Applied Economics*, London, Duckworth, 1978, pp. 187-220.

previous creation of the European Stability Mechanism (ESM)⁴, are positive signs that Europe is moving in the right direction. We think that the (desirable) future issuance of eurobonds might represent a further step towards fiscal integration and, above all, full cooperation among European (and eurozone) Member States⁵.

2. *Competing Perspectives on the Roots of the Eurozone Crisis: A Review*

The belief that fiscal indiscipline and a lax enforcement of public budget rules lie at the base of the current crisis is pretty widespread among economists and European Institutions. Kosters and the ECB, for instance, trace back the origin of the problems to the beginning of the 2000s, when large and influential countries such as France and Germany, with the support of Italy, forced a revision of the Stability and Growth Pact (SGP) in order not to incur excessive budget deficit sanctions. According to Kosters, these behaviors instilled a bad perception in Member States that budget rules were not binding and could be violated. Eventually, in 2007, the public budgets of some eurozone countries were unprepared to face the effects of the worldwide crisis: hence the financial turbulences on some national bonds' markets and the outbreak of the sovereign debt crisis.

Wyplosz notes that peripheral countries such as Spain and Ireland were generally considered as virtuous in managing their own public balance prior to the outbreak of the worldwide financial crisis. Inside the eurozone, however, the ECB does not act as a lender of last resort, and the soundness of national financial systems mostly relies on national governments' intervention. National governments must take care of (eventually) bailing-out troublesome domestic financial institutions. In such a context, Wyplosz says, the concept of fiscal discipline should be extended in order to take into account the solidity of the financial system (and not only of the public budget). With this

⁴ See C. Wyplosz (quoted) for a different and negative opinion on the introduction of the European Stability Mechanisms, as well as of previous financial help provided to troublesome peripheral European countries.

⁵ It is perhaps worth stressing that cooperation also implies strict respect of common rules by member States. In our view, cooperation means providing European institutions with apt policy instruments to counteract negative economic shocks, and break up vicious circles among mounting recession, the emergence of extremist political movements and risks of a European Union collapse. It does not imply in any way a blind acceptance of free-riding behaviors by European Union's countries. Actually, cooperation should combine effective enforcement of common rules with enough (centralized) flexibility to face adverse shocks.

“extended” fiscal discipline criteria well fixed in mind, Spain and Ireland would not have been judged good disciples of the SGP doctrine any longer.

Policy implications of the above perspective are straightforward. Fiscal discipline must be restored soon by tightening rules that impose balanced public budgets (or, even better fiscal surpluses). Austerity programs should be implemented in order to gain financial credibility back. This is even more so if high public debt stocks significantly impinge upon economic performances and impede Member States to grow out of the debt. Indeed, Wyplosz emphasizes this final point by quoting a recent empirical contribution by Carmen Reinhart and Kenneth Rogoff⁶. According to the authors, a significantly negative relationship exists between high public debt stocks, in particular if higher than 90 percent of GDP, and economic growth exists not only in the case of developing countries, but also in the case of developed economies⁷. The same view, and the ensuing policy implications, are shared by Olli Rehn, the EU Commissioner for Economic and Financial Affairs, who explicitly states in a public letter sent to EU countries’ Finance Ministers on 13 February 2013: “...it is widely acknowledged, based on serious academic research, that when public debt levels rise above 90 percent they tend to have a negative effect on economic dynamism, which translates into low growth for many years. This is why consistent and carefully calibrated fiscal consolidation remains necessary in Europe”⁸.

There are no doubts that fiscal indiscipline was protracted and badly affected the solidity of Greece’s fiscal position. Yet, Greece does not represent a paradigm of the whole peripheral eurozone countries, and cross-country differences cannot be downsized. Accordingly, the above “one-fit-for-all” “fiscal-policy-is-to-blame” view can be criticized on, at least, two points.

⁶ C. REINHART and K. ROGOFF, “Growth in a Time of Debt”, in *American Economic Review: Papers and Proceedings*, no. 100, 2010, pp. 573-578.

⁷ According to Reinhart and Rogoff, the negative relationship connecting high debt stocks to economic growth depends on a sort of “debt intolerance” that financial operators show against too high debt levels. Once debt levels get higher than a given threshold (90 percent of GDP), financial operators lose confidence in public balance solidity. Accordingly, interest rates start to increase and economic growth slows down (or, eventually, turns out to be negative). Interestingly, the “debt intolerance” hypothesis was originally referred by Reinhart, Rogoff and Savastano to past experiences of developing countries, having in mind a negative impact of *external*, both public and private, debt stock on economic performances (see C. REINHART, K. ROGOFF and M. SAVASTANO, “Debt Intolerance”, in *Brookings Papers on Economic Activity*, Vol. 1, 2003, pp. 1-74). In the light of the most recent worldwide financial turbulences, Reinhart and Rogoff suggest this theory may also apply to the case of developed countries with excessively high public debt stocks.

⁸ O. REHN, *Cap to Ecofin Ministers*, 13th February 2013, document available free of charge for download from the website of the European Commission www.ec.europa.eu.

First, as already mentioned, countries such as Spain and Ireland were unanimously recognized as examples of fiscal virtue before the eruption of the 2007-2008 financial crack. Further, even admitting the “extended” version of fiscal discipline advanced by Wyplosz, it is hard to understand how public balances could create enough fiscal buffer to prevent and contrast wide private sector disarray. Indeed, this is why central banks, i.e. those institutions which *de facto* can rely on unlimited financial resources, and not governments, are firstly asked to provide emergency loans (directly or indirectly, that is by backing government expenditures in the event financial institutions should be bailed-out and nationalized) to troublesome financial institutions in almost every country worldwide. Blaming governments for widespread private sector indiscipline seems quite inappropriate actually⁹.

Second, the “debt intolerance” hypothesis, when applied to developed countries, has been heavily criticized and much discredited by some contributions discovering empirical flaws and calculus mistakes at the base of Reinhart and Rogoff’s work¹⁰. Indeed, when the above-mentioned mistakes and debatable assumptions are removed, the alleged negative relationship between public debt stocks and economic performances simply disappears. Further, any sign of “debt intolerance” seems to have recently appeared in some monetarily sovereign countries even in the presence of considerable and fast increasing public debt burdens. We will provide more details on the concept of monetary sovereignty later on when we analyze some counterfactual case studies with respect to the debt intolerance theory. Here suffice to say that such case studies may demonstrate that financial operators’ aversion against public debts largely depends on the political and institutional framework in which public bonds are issued rather than on a scrupulous assessment of a country’s macroeconomic fundamentals.

In the light of these last observations, we think that a better and more comprehensive explanation of the existing eurozone crisis should take into account the political dimension. The sovereign debt crisis, we argue, has erupted in the eurozone because the eurozone is not equipped with those policy institutions, hence economic policy options, that help to provide fast

⁹ This is even more so if one considers that, before the emergence of the “Great Recession”, the prevailing economic thought considered economic agents and unfettered market forces perfectly capable of properly identifying, assessing, punishing and preventing financial adventurism.

¹⁰ On this point, see T. HERNDON, M. ASH and R. POLLIN, *Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff*, PERI Working Paper n. 322, 2013.

and effective responses to deep economic downturns and, at the same time, render financial systems and public finances more resilient to financial turbulences. In the eurozone, monetary policy (and institutions) have been separated from fiscal policy (and authorities). Further, any euro-level central fiscal authority has been created leaving all the burden of anti-cyclical measures and financial system rescue packages on the shoulders of no (longer) monetarily sovereign Member States, thus exposing them to serious default risks. In our view, it is pretty easy to see how this incomplete and hardly viable institutional setting may have strongly fed, if not directly caused, the ongoing crisis. In order to make out point clearer, let us review some observations that well-known economists and policy-makers have for a long time advanced on the institutional requirements characterizing optimal currency areas (read viable monetary unions), as well as the shortcomings of the European monetary unification process in particular.

Peter Kenen is probably one of the most eminent scholars of the optimal currency area theory. In particular, he has been well aware of the huge difficulties with which some regions of a monetary union could face asymmetric shocks once lost monetary independence and in the absence of a sufficiently high labor mobility¹¹. This is why Kenen is very clear in stressing that "...economic sovereignty has several dimensions, two of them particularly relevant to the problem of managing aggregate demand and maintaining full employment. Fiscal and monetary policies must go hand in hand, and if there is to be an 'optimal policy mix', they should have the same domain. There should be a treasury, empowered to tax and spend, opposite each central bank, whether to cooperate with monetary policy or merely to quarrel with it"¹². Talking about the anti-cyclical rule possibly performed by federal budgets in the event of asymmetric regional shocks, Kenen adds: "...the [federal] budget can still combat localized recessions. When a region or a community suffers a decline [...] its federal tax payments diminish at once, slowing the decline in its purchasing power and compressing the cash outflow of its balance of payments. There is also an inflow of federal money – of unemployment benefits..."¹³.

¹¹ P. KENEN, *The Theory of Optimum Currency Areas: An Eclectic View*, in P. KENEN, *Exchange Rates and the Monetary System: Selected Essays of Peter B. Kenen*, Cheltenham-Northampton, Edward Elgar, 1994, pp. 3-22.

¹² P. KENEN, op. cit., p. 7. More recently see, on the same point, B. EICHENGREEN, *The Breakup of the Euro Area* in A. ALESINA AND F. GIAVANZI (eds.), *Europe and the Euro*, Chicago, The University of Chicago Press, 2010, pp. 11-51 (particularly p. 41).

¹³ P. KENEN, op. cit., p. 9.

Kenen's words implicitly suggest that the creation of a centralized European monetary authority, the ECB, should have been accompanied by the establishment of a Europe-wide fiscal authority, let's say a European federal government, moving fiscal levers. This is precisely what Kaldor stressed in 1971 in an article, already quoted at the beginning of this paper, in which he criticizes the conclusions of the *Werner Plan*. In particular, after having examined the costs and benefits for Great Britain's possible entry into the Common Market, Kaldor criticizes the setting up of the *Werner Plan* when it says that monetary union would only be achieved when monetary union, fiscal harmonization and the centralized supervision of the Member States' budgets had completed each of the three expected stages with their predetermined contents. Each of these stages was to last about three years. Kaldor believes that leaving national authorities a predominant responsibility as regards public spending and fiscal taxation was a radical weakness of the project which could be blamed on the (restrictive) concept of fiscal harmonization. If, as regards spending this would bring about uniformity in the supply of public services, as regards income (unless the Member States all had the same level of prosperity and growth) the result would be to oblige those less prosperous countries (or those with less growth) to "tax" their citizens more than others. The simple policy of harmonization together with the centralized supervision of public budgets would have determined a perverse divarication effect among countries which Kaldor sums up in the following way: "The Community will control each member country's fiscal balance – i.e. it will ensure that each country will raise enough in taxation to prevent it from getting into imbalance with other members on account of its fiscal deficit. To ensure this the taxes in the slow growing areas are bound to be increased faster; this in itself will generate a vicious circle, since with rising taxation they become less competitive and fall behind even more, thereby necessitating higher social expenditure [...] and more restrictive fiscal policies. A system on these lines would create rapidly growing inequalities between the different countries, and is bound to break down in a relatively short time"¹⁴. Consistently with Kenen analysis, Kaldor notes that the much needed fiscal *integration*, instead of fiscal *harmonization*, in turn "... requires the creation of a Community Government and Parliament which takes over the responsibility for at least the major part of the expenditure now provided by national governments and finances it by taxes raised at uniform rates throughout the Community. With an integrated system of this kind, the prosperous areas automatically subside the poorer areas; and the areas whose

¹⁴ N. KALDOR, op. cit., p. 205.

exports are declining obtain automatic relief by paying in less, and receiving more, from the central Exchequer. The cumulative tendencies to progress and decline are thus held in check by a ‘built-in’ fiscal stabilizer which makes the ‘surplus’ areas provide automatic fiscal aid to the ‘deficit’ areas”¹⁵.

Past awareness on Europe’s capability to successfully complete its process of economic and *political* integration re-emerges in a series of much more recent analyses which have been further stimulated by the worrisome financial events affecting Europe since late 2009. In December 2007, a Reflection group on the Future of EU (RG) was set up by the European Commission. Felipe Gonzales was appointed RG President and Mario Monti figured among its members. In May 2010, RG delivered its concluding report¹⁶. Quite interestingly, RG notes that even though “... origins [of the worldwide financial crisis, *ndr*] lie on the other side of the Atlantic, [it] has affected Europe much more than any other region of the world by uncovering *structural weaknesses* [italics is of the authors] in the European economy that have long been diagnosed but too often ignored. The crisis has therefore acted as a wake-up call for Europe to respond to the changing global order. As with all transformations, the emerging order will result in new winners and losers. If Europe does not want to be among the losers, it needs to look outwards and embark on an ambitious long-term reform program for the next twenty years”¹⁷. The management of the crisis is therefore like a permanent trial to evaluate the suitability of today’s European Union to receive the inheritance of its origins. In fact “Confronted by a crisis which they did not create, our citizens will only renew their belief in the European project if their leaders are honest with them about the scale of the challenges ahead, and if they are called upon to make efforts comparable to those that brought prosperity to Europe after the Second World War”¹⁸. As to the priorities that should drive

¹⁵ N. KALDOR, *op. cit.*

¹⁶ REFLECTION GROUP ON THE FUTURE OF THE EU, *Project Europe 2030. Challenges and Opportunities*, A report to the European Council, European Union, May 2010 (later *Project Europe 2030*).

¹⁷ REFLECTION GROUP ON THE FUTURE OF THE EU, *op. cit.*, p. 4.

¹⁸ REFLECTION GROUP ON THE FUTURE OF THE EU, *op. cit.*, p.8. The problem concerning the structural lacks in the European Union and its consequences in a crisis situation had already been firmly underlined in 2009 in THE HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU, Chaired by Jacques de Larosière, *Report*, Brussels, 25 February 2009, which complains saying that (p.12) “The regulatory response to this worsening situation was weakened by an inadequate crisis management infrastructure in the EU, both in terms of the cooperation between national supervisors and between public authorities.... In the absence of a common framework for crisis management, Member States were faced with a very difficult situation. Especially for the larger financial institutions they had to react quickly and pragmatically to avoid a banking failure. These actions, given the speed

such EU efforts, the RG stresses that “our top priority must remain creating jobs and growth”¹⁹. Accordingly, the achievement of such goal might call for a revision of the ongoing pervasive obsession on austerity programs. Indeed, “if spending is cut too early, our recovery could slip into reverse”²⁰, and consequently “...those Member States that can no longer afford to spend, due to costly rescue operations, rising social expenditure and declining sources of revenue, will have to rely on the EU and other Member States to take the lead in setting up the conditions for economic recovery”²¹. The other way round, the European Union can confront the existing deep crisis only if equipped with adequate economic policy tools. Otherwise, “when ambitious objectives are pursued with limited resources and weak implementation mechanisms, we have a recipe for disappointment”²².

of events, for obvious reasons were not fully coordinated and led sometimes to negative spill-over effects on other Member States”.

¹⁹ *Project Europe 2030*, op. cit., p. 4. Well before January 1st 1999, when the euro came into force, several economists had already criticized the strict parameters established by the Maastricht Treaty to evaluate the “sustainability” of the public finances of a Member State. Luigi Pasinetti, for instance, heavily criticized the 3% deficit-to-GDP parameter, and the 60% threshold level associated to the debt-to-GDP ratio (L.L. PASINETTI, “The myth (or folly) of the 3% deficit/GDP Maastricht ‘parameter’”, in *Cambridge Journal of Economics*, 1998 no. 1, pp. 103-116). Pasinetti notes that: “The whole of the Maastricht Treaty seems to have been reduced to the fulfilment of this symbolic figure of a 3% public deficit/GDP ratio... But even symbols cannot escape the reality of their implications. If a 3% public deficit/GDP ratio is to be rigidly adhered to and regarded as a symbol of European fiscal and financial stability (even at the cost of heavy sacrifice), it surely should be an absolutely necessary condition for fiscal and financial stability. Nobody has never proved this (p. 104)”. Indeed, According to Pasinetti, 1) the reference value of the public deficit/GDP has no more than a *symbolic* value, it cannot be justified in any other way; 2) for each country it is possible to identify a *sustainable area* in public finances which is compatible with an *infinite number* of values of the two parameters, as well as of the increased rate of the nominal GDP which the Treaty hypothesised at an annual level of 5%; 3) what is essential for the sustainability of public finances is the difference between the level of interest rates and the rate of increase of the GDP.

²⁰ *Project Europe 2030*, op. cit., p. 4.

²¹ *Project Europe 2030*, op. cit. An interesting analysis on the management of problems regarding insolvency in the member States of a federal Union has been carried out by D. MORO, “Il bailout degli Stati nelle unioni federali e nell’Unione pre-federale europea”, in *Il Federalista*, 2011 no. 3, pp. 171-198. When he deals with the German case (remember that Germany had been in favour of the no-bail clause for State members of the Union to be included in the Maastricht Treaty), he underlines how the German Constitutional Court delivered a different judgment depending on whether it was made before or after the birth of the euro. The extraordinary rebalancing intervention measure by the German government was accepted in 1992 for the city State of Brema and the Saarland, but it was refused in 2006 for the city State of Berlin.

²² *Project Europe 2030*, op. cit., p. 7.

A perhaps clearer recognition of the existence of certain political factors feeding the eurozone crisis is contained in some passages taken from Bank of Italy Governor's annual speeches to Shareholders. In May 2012, in fact, current Governor Ignazio Visco first reminds that "Political inertia, disregard of rules and mistaken economic decisions have favored the emergence of internal imbalances, long obscured by the euro and unheeded by the market, which today put the entire European edifice at risk"²³. And afterwards: "We feel the absence of some of the fundamental characteristics of a federation of States: decision-making processes that favor the adoption of far-sighted policies in the general interest; shared public resources for financial stability and growth; rules that are truly accepted; and commonly agreed and timely measures for the financial system and banks. These are tasks and conditions that lie outside the sphere of the European System of Central Banks: they imply political responsibilities, both at National and European level"²⁴. Nevertheless, he stresses that "if the euro area were viewed as a single entity, having, for instance, the form of a federal State, there would be no alarms regarding the resilience of its monetary and financial structure, notwithstanding the worries about the repercussions of the financial crisis on the economic cycle, banks and markets. But there is no political union in Europe. In the long term this makes monetary union more difficult to sustain; tangible progress must be made in the European construction; a path must be charted with political union as its ultimate goal, and each step marked along the way"²⁵.

Several steps and progress have been made (and we will recall them later on in this paper) to keep under control and possibly to solve the existing economic and financial crisis. Most of them have entailed the creation of financial support funds to EU Member States and the intervention of the ECB on financial markets to calm financial turbulences. Nevertheless, they seem not to have played a decisive role yet. In May 2013, one year later with respect to the aforementioned speech, Governor Ignazio Visco once again stresses that "Monetary policy can guarantee stability only if the area's economic fundamentals and institutional architecture are consistent with that objective... More than any conditionality, however what is essential is the shared determination to advance towards a complete European Union: monetary union, banking union, fiscal union and finally political union"²⁶.

²³ BANCA D'ITALIA, *The Governor's Concluding Remarks*, Ordinary Meeting of Shareholders, Rome, 31 May 2012, p. 14.

²⁴ BANCA D'ITALIA, op. cit.

²⁵ BANCA D'ITALIA, op. cit., p. 13.

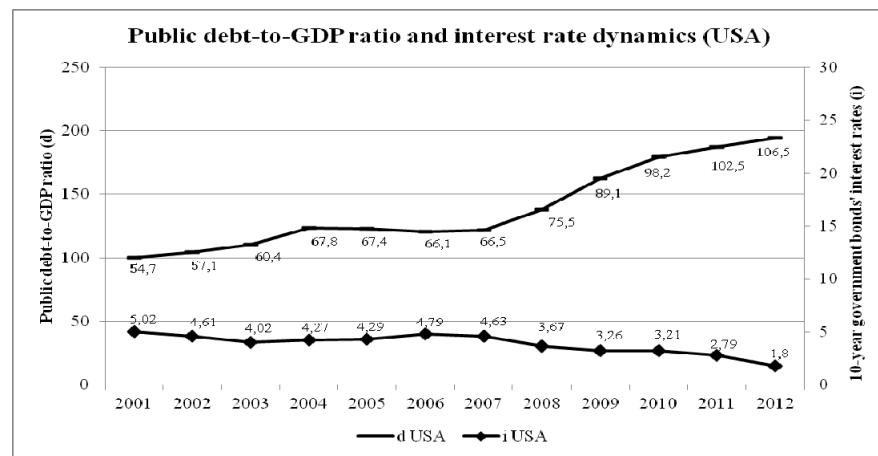
²⁶ BANCA D'ITALIA, *The Governor's Concluding Remarks*, Ordinary Meeting of Shareholders, Rome, 31 May 2013, p. 8.

Is there any *direct* empirical proof that the sovereign debt crisis would have not unfolded had the EU been a full-fledged political union with a lender-of-last-resort central bank and a central fiscal authority? Econometrically speaking, such kind of analysis should require comparing data from two different samples (the main sample and the control sample) based on the two alternatives choices at hand (to be or not to be a full political union). Whilst we can easily observe what is going on in the case of an uncompleted European integration process, we obviously do not have any data referring to a hypothetical European federal Union. Yet, a perhaps *indirect* empirical analysis can be implemented by comparing the EU experience with recent economic and financial trends registered in some monetarily sovereign countries possessing such institutions and economic policy options which typically characterize fully-integrated political unions (being them federalist or not) and are still lacking in the current eurozone institutional setting.

Figures 1.a-1.d below show the dynamics in the debt-to-GDP ratios (left-hand side axis) and in the interest rate on 10-year government bonds (right-hand side axis) registered in four monetarily sovereign countries: USA, Canada, UK and Japan. The data covers the period from 2001 to 2012. These countries are defined as monetarily sovereign due to the fact that there exists a central government running fiscal policy vis-à-vis monetary policy implemented by its own central bank (which can eventually and independently intervene on financial markets to tame financial turbulences, perhaps purchasing government bonds), they issue government bonds denominated in their own currency, and they freely manage their own exchange rate.

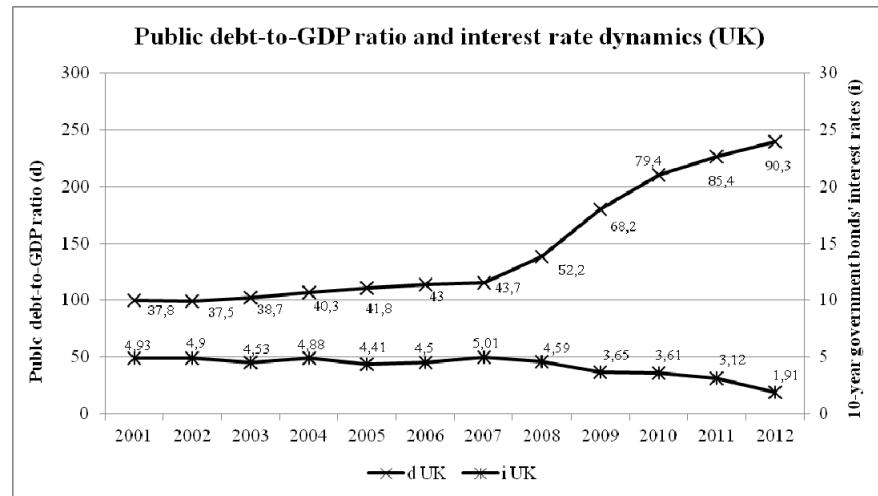
All the countries considered have registered a significant increase in their public debt stock (as a share of GDP) since 2007. In 2012, this ratio was higher than 105 percent in the US (see Figure 1.a). In the UK, the debt-to-GDP ratio was slightly higher than 90 percent, i.e. the Reinhart and Rogoff level identified as the threshold above which debt intolerance starts to emerge (see Figure 1.b). In Japan, the public debt is now close to 240 percent of the GDP (see Figure 1.c). Finally, in Canada the debt-to-GDP ratio has increased by more than one-fourth compared to the pre-crisis period (see Figure 1.d). Despite such sharp increases in public debt stocks, no signs of debt intolerance have emerged in any of the four countries considered. Well on the contrary, interest rates on 10-year government bonds have significantly decreased and reached previously unseen low levels. Accordingly, government bonds are considered no-risk assets.

Figure 1.a - Public debt-to-GDP ratio (2001=100) and 10-year government bonds' interest rates, USA.



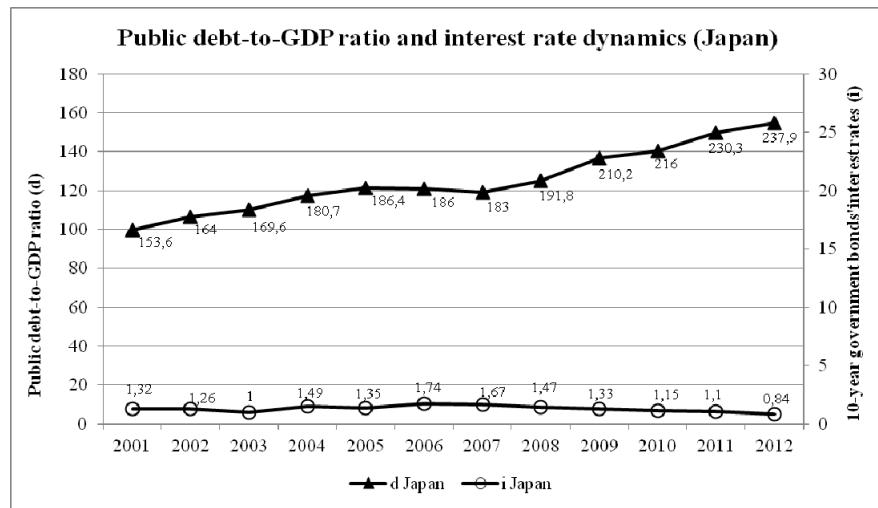
Source: Authors' calculations on data from OCSE.

Figure 1.b - Public debt-to-GDP ratio (2001=100) and 10-year government bonds' interest rates, UK



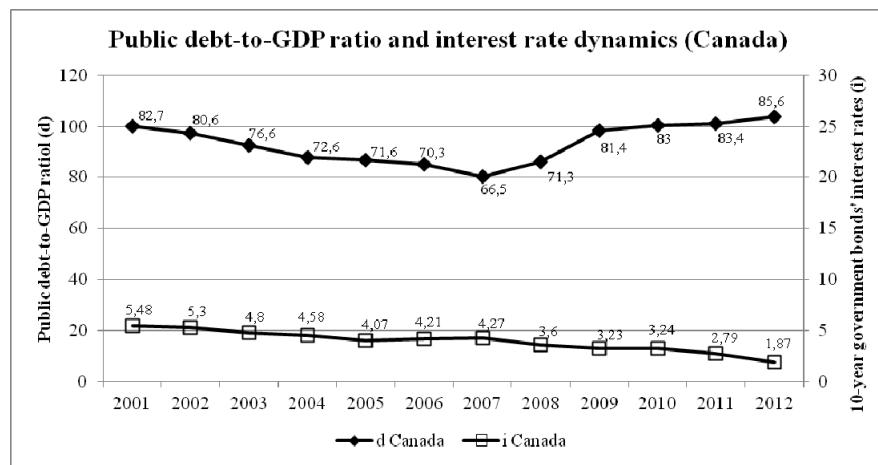
Source: Authors' calculations on data from OCSE.

Figure 1.c - Public debt-to-GDP ratio (2001=100) and 10-year government bonds' interest rates, Japan



Source: Authors' calculations on data from OCSE.

Figure 1.d - Public debt-to-GDP ratio (2001=100) and 10-year government bonds' interest rates, Canada



Source: Authors' calculations on data from OCSE.

These facts appear in stark contradiction to what is going on in peripheral eurozone countries, and do not seem to validate the “debt intolerance” hypothesis.

Paul De Grauwe clearly underlines this fact in a recent paper in which he acutely notes that most fundamentals in the UK are similar or even worse than the Spanish ones. However, whilst UK government bonds are perceived as safe assets, the Spanish government bonds have been repeatedly downgraded, and the Spanish economy is in the centre of a financial storm²⁷. Following De Grauwe, there seems to be no rational explanations for this, unless one recognizes that the eurozone difficulties do not (at least only) depend on “bad” fundamentals in peripheral economies, but on the missing elements in the European institutional design compared to fully monetary sovereign countries.

In Canada and the US, the mandates of the central banks define price stability and high employment levels as equivalent objectives to be pursued by monetary authorities. In the UK and in Japan, central banks also care about ensuring the solidity of the financial system, this objective being recently strengthened in the aftermath of the 2007-2008 financial crisis. In general, in all these cases, despite their recognized independence in the decision-making process, national central banks would likely intervene on financial markets, support expansionary fiscal policies, and buy government bonds should national governments act in order to avoid the dislocation of the financial system or to counteract deep economic recession²⁸. To put it another way, fiscal and monetary policies are not separate in monetarily sovereign countries. In case of deep financial and economic distress, fiscal and monetary authorities cooperate to reach shared economic objectives.

We all know that a radically different institutional framework now characterizes the European Union, and the eurozone in particular. Indeed, fiscal and monetary policies have been severely separated since the creation of the ECB and the introduction of the euro currency. Whilst a EU fiscal policy stance does not yet exist, and national governments are still fully responsible for stabilizing the economic cycle and perhaps preserving

²⁷ P. DE GRAUWE, *Managing a Fragile Eurozone*, CES info Forum, 2011-2, pp. 40-45.

²⁸ In this regard, De Grauwe is enlightening when, in his attempt to compare the UK institutional framework with to the Spanish one, he states: “[The UK government]... would certainly force the Bank of England to buy up the government securities. Thus the UK government is ensured that the liquidity is available to fund its debt. This means that investors cannot precipitate a liquidity crisis in Britain that could force the UK government into default. There is a superior force of last resort, the Bank of England” (P. DE GRAUWE, op. cit., p. 40).

financial systems from systemic crises, they no longer rely on the support of monetary institutions. On the contrary, such support is strictly forbidden by the ECB statute, which impedes the ECB from providing any form of liquidity to national and community-wide institutions. Paradoxically, European Union rules impede monetary and fiscal authorities from cooperating in case of deep financial crisis and real shocks. Meanwhile, the European Union is still very far from representing a fully-fledged political entity, in which its (possibly near-to-come) federal government, by means of its own federal budget and eurobonds issued to finance European-wide fiscal policies, embody the highest possible level of cooperation among Member States. In another recent paper, De Grauwe once again blames "...the absence of a sufficiently strong political union in which the monetary union should be embedded²⁹," as the in-depth cause of the ongoing eurozone travail. "Such a political union should ensure that budgetary and economic policies are coordinated preventing the large divergences in economic and budgetary outcomes that have emerged in the eurozone. It also implies that an automatic mechanism of financial transfers is in place to help resolve financial crises. *Mutual solidarity cannot be avoided in a monetary union, even if it implies solidarity with the sinners* [our emphasis, Eds.]"³⁰. Of course, financial markets are well aware of this, and of the break-up risks such institutional arrangements expose the European structure to. We can presume that the profound reasons for the current euro zone crisis hinge on such institutional shortcomings, and on the ensuing non-cooperative attitude European countries are adopting to address community-wide problems.

3. *Nineteenth-century Europe and Today's Europe: The Contribution of Keynes's Experience and Keynesian Heritages to the Shaping of Europe's Future*

At the beginning of this paper we stressed that there seems to be the consolidation of a kind of "orthodoxy of virtue" as a rule for the management of the economic systems among European policy makers, public opinion and the press. Given this "environment" – and as a reaction to it – it is not surprising that a re-visitation of Keynes has become widespread practice among economists who do not fully agree with the above obsession for

²⁹ P. DE GRAUWE, *Fighting the Wrong Enemy*, in F. PRAUSSELLO (ed.), *The Eurozone Experience: Monetary Integration in the Absence of a European Government*, Milan, FrancoAngeli, 2012, pp. 27-35 (especially p. 28).

³⁰ P. DE GRAUWE, op. cit., p. 32.

austerity. Of the many debates, one was held recently on the Italian edition of the *Two Memoirs*³¹, with an introductory essay by Giorgio La Malfa. In the first of the two memoirs which Keynes read to the members of the *Memoir Club* on the 2nd February 1921, the club had been founded the previous year in Cambridge and was the successor of the Bloomsbury Group, he recalls the dramatic events which took place in a succession of meetings in 1919 which led to the definition of the peace conditions for the belligerents. As the representative of the British Treasury within the Supreme Economic Council until June 7th of the same year, Keynes took an active part, on the side of the winners, in the wearying discussions regarding the economic conditions of the agreements. However, he severely criticized the methods and behavior which in his opinion would lead to catastrophic consequences³², in a political climate conditioned by the irresponsible arrogance of the French and the hypocritical, vague indecision of the Anglo-Americans³³. A first example of Keynes's perspective on Paris Peace Talks can be inferred from Keynes's

³¹ J.M. KEYNES, *Two Memoirs* in J.M. KEYNES, *The Collected Writings*, Vol. X, *Essays in Biography*, Cambridge, Macmillan, 1972, pp. 385-453. The text is evidence of Keynes' preference for both the pamphlet version and the deliberately provocative tone of his writings, features which both recall amongst others *Eminent Victorians* by Lytton Strachey, another member of the *Bloomsbury Group*, written in 1918.

³² In the opening of the sixth (and penultimate) chapter of *The Economic Consequences of the Peace* published in December 1919 Keynes writes that "...The treaty includes no provisions for the economic rehabilitation of Europe – nothing to make the defeated Central Empires into good neighbours, nothing to stabilise the new states of Europe, nothing to reclaim Russia; nor does it promote in any way a compact of economic solidarity amongst the Allies themselves; no arrangement was reached at Paris for restoring the disordered finances of France and Italy, or to adjust the systems of the Old World and the New. The Council of Four paid no attention to these issues, being preoccupied with others – Clemenceau to crush the economic life of his enemy, Lloyd George to do a deal and bring home something which would pass muster for a week, the President to do nothing that was not just and right. It is an extraordinary fact that the fundamental economic problem of a Europe starving and disintegrating before their eyes, was the one question in which it was impossible to arouse the interest of the Four. Reparation was their main excursion into the economic field, and they settled it as a problem of theology, of politics, of electoral chicane, from every point of view except that of the economic future of the states whose destiny they were handling" (J.M. KEYNES, *The Economic Consequences of the Peace*, in J.M. KEYNES, *The Collected Writings*, Vol. II, Cambridge, Macmillan, 1971, p. 143). Later on he warns "If we aim deliberately at the impoverishment of Central Europe, vengeance, I dare predict, will not limp. Nothing can then delay for very long that final civil war between the forces of reaction and the despairing convulsions of revolution, before which the horrors of the late German war will fade into nothing, and which will destroy, whoever is victor, the civilisation and the progress of our generation" (*ibidem*, p. 170).

³³ We must remember that in 1933 - Hitler had been Chancellor for a few months – the question of war damages and the relations between the USA and Germany, was one of the main problems to concern the newly elected President Roosevelt.

description of a heated speech by Lloyd George in favor of unblocking supplies to Germany. Keynes said: “The honor of the Allies was involved. Under the terms of the Armistice the Allies did imply that they meant to let food into Germany. The Germans had accepted our Armistice conditions, which were sufficiently severe, and they had complied with the majority of those conditions. But so far not a single ton of food had been sent into Germany. The fishing fleet had even been prevented from going out to catch a few herrings... The Germans were being allowed to starve whilst at the same time hundreds of thousands of tons of food were lying at Rotterdam... The Allies were sowing hatred for the future: they were piling up agony, not for the Germans, but for themselves”³⁴.

Generally speaking, Keynes’s description of his own experience as a negotiator reveals his conviction of the need for *co-operative relations* among States, especially among *European* States, to stimulate a condition of peaceful universal cohabitation. His conviction will be dramatically strengthened following the negotiations which conclude with the “Carthaginian peace” in 1919 and re-emerges more clearly just in *The Economic Consequences of the Peace*, written as soon as he returned to Cambridge. “Very few of us realise with conviction the intensely unusual, unstable, complicated, unreliable, temporary nature of the economic organisation by which Western Europe has lived for the last half century. We assume some of the most peculiar and temporary of our late advantages as natural, permanent, and to be depended on, and we lay our plans accordingly. On this sandy and false foundation we scheme for social improvement and dress our political platforms, pursue our animosities and particular ambitions...”³⁵. A little later on, going over the peace treaties and with reference to literary texts, he observes that “The proceedings of Paris all had this air of extraordinary importance and unimportance at the same time. The decisions seemed charged with consequences to the future of human society; yet the air whispered that the word was not flesh, that it was futile, insignificant, of no effect, dissociated from events; and one felt most strongly the impression...of events marching on to their fated conclusion uninfluenced and unaffected by the cerebrations of Statesmen in council”³⁶. Towards the end of the essay and with reference to Europe as a whole he writes that “Europe consists of the densest aggregation of population in the history of the world. This population is accustomed to a relatively high standard of life, in which, even now, some sections of it

³⁴ J.M. KEYNES, *The Economic Consequences of the Peace*, op. cit., p. 419.

³⁵ J.M. KEYNES, *The Economic Consequences of the Peace*, op. cit., p. 1.

³⁶ J.M. KEYNES, *The Economic Consequences of the Peace*, op. cit., p. 3.

anticipate improvement rather than deterioration...For starvation, which brings to some lethargy and a helpless despair, drives other temperaments to the nervous instability of hysteria and to a mad despair. And these in their distress may overturn the remnants of organisation, and submerge civilisation itself in their attempts to satisfy desperately the overwhelming needs of the individual. This is the danger against which all our resources and courage and idealism must now co-operate”³⁷. Furthermore, with reference to the network of debt-credit relations which characterised the reciprocal relations amongst the allies themselves and between the allies and the ex-enemies in the post-war period (“Germany owes a large sum to the Allies; the Allies owe a large sum to Great Britain; and Great Britain owes a large sum to the United States”³⁸), he points out that “The whole position is in the highest degree artificial, misleading, and vexatious. We shall never be able to move again, unless we can free our limbs from these paper shackles. A general bonfire is so great a necessity that unless we can make of it an orderly and good-tempered affair in which no serious injustice is done to anyone, it will, when it comes at last, grow into a conflagration that may destroy much else as well. I am one of those who believe that a capital levy for the extinction of debt is an absolute prerequisite of sound finance in every one of the European belligerent countries. But the continuance on a huge scale of indebtedness between governments has special dangers of its own”³⁹.

Although avoiding forced analogies and imprudent symmetries which would obscure the profound differences (on the one hand, a world conflict which had just finished and on the other a European construction developed in a period of continental peace, although it came after the subsequent conflict which Keynes had predicted), the references mentioned from Keynes’s essay in 1919 do confirm some significant *regularity* or *recurrence of events*, which can help us identify suitable operative approaches – which are all the more urgent in a context of crisis – even for today’s Europe. On the other hand, regularities exist and they are fascinating. The *instability* of the European construction and its institutions is in fact intrinsic to the functional approach which, as Keynes says in 1919, makes it *unusual, complicated, unreliable* and therefore *temporary* in the (current) meaning of *reversible* in view of the federal achievement⁴⁰. It is easy to note the similarities between the work of

³⁷ J.M. KEYNES, *The Economic Consequences of the Peace*, op. cit., pp. 143-144.

³⁸ J.M. KEYNES, *The Economic Consequences of the Peace*, op. cit., p. 178.

³⁹ J.M. KEYNES, *The Economic Consequences of the Peace*, op. cit.

⁴⁰ Cf. M. A. POLLACK, *Theorizing EU Policy-Making*, in H. WALLACE, M.A. POLLACK and A.R. YOUNG (eds.), *Policy-Making in the European Union*, Oxford. Oxford University Press, 2010, pp. 15-44. The author defines this approach as that “...in which the initial

the Conference of Paris, which to Keynes appeared both *important* and *insignificant*, and the packed sequence of today's European summits. In the same way we can see the analogy of Europe which, at the time was used to a relatively high level of well-being and therefore less inclined to happily take a step back in this context, and the recurrent today's fears of a break-up of *social cohesion* which accompany both the financial crisis and the "after", referring to the period following the implementation of restrictive measures to deal with the crisis. In the end, national particularisms (intergovernmentalism together with functionalism remain the prevalent approach) continue to represent a braking element to any "cooperative" intervention, whether it comes from outside Europe (promoted by the US, as hoped by Keynes in the period following the First World War), or whether it comes from the inside because it is has been decided by the European institutions.

When our analysis moves from general political philosophy to the concrete sphere of economic policies, lack of cooperation among European countries is mirrored in the feelings with which they participated and paved the way for the European economic and monetary integration. In an essay written in 2000 and recently re-edited with a preface by Paolo Savona⁴¹, Giorgio La Malfa remarks that "...since the EMU was born without a preliminary decision regarding Europe's political union, when it came to fixing the rules, the reciprocal differences were more important than the common benefits. The Maastricht Treaty did not redesign the institutions of the European Union's economic policy; it tried to limit the risk of contaminating some of the financially solid countries – or at least those thought to be so – by countries which had been characterised by high inflation and imbalances in public budgets throughout the 70's and 80's. This is why the common monetary policy was set up with very rigid requirements and the "stability pact" wanted to sterilise the budget policies of the Member States"⁴². Later on "...in its present form, the EMU is not able to carry out an efficient economic policy to deal with the problem of the reduced growth rates of the European economy: the ECB has the exclusive task of keeping inflation under control even when there isn't any; the European Commission

decision by governments to place a certain sector, such as coal and steel, under the authority of central institutions creates pressures to extend the authority of the institutions into neighbouring areas of policy, such as currency exchange rates, taxation, and wages. Thus...sectoral integration would produce the unintended and unforeseen consequence of promoting further integration in additional issue areas" (ivi, pp. 17-18).

⁴¹ G. LA MALFA, *L'Europa in pericolo. La crisi dell'Euro*, Bagno a Ripoli – Firenze, Passigli Editori, 2011 (the first edition of the essay was called *L'Europa legata, i rischi dell'Euro*, Milano, Rizzoli, 2000).

⁴² G. LA MALFA, op. cit., p. 143.

has limited resources which can be used to support economic development; the Member States are required to have a balanced budget...Therefore the tools of economic policy are sterilized. Without any modification of the treaty or the “stability pact” Europe has to give up its hopes of an economic policy and lay its hopes in favorable circumstances in the world economy and in the economic policy measures adopted by the Member States, the main ones being the flexibility of the labor market and the promotion of competition. This is not enough to give any sense of reassurance about the future”⁴³. We are dealing with an incomplete institutional structure, which is also biased and therefore fragile, built with the spirit of caution reflecting an initial sense of suspicion (therefore of a non-cooperative attitude) among the Member States, a mono-objective central Bank and national States which are politically responsible to their electoral citizens, and are furthermore limited by European constraints as regards real macro-objectives, which the Union itself, cannot adequately achieve (or finance). In brief, this is the disillusioned judgment of a researcher on the condition of Europe at the beginning of this century, when the path towards the European Monetary Union had been completed and in less than two years the new currency would be introduced and the old currency would cease to be valid.

Jean-Paul Fitoussi, in an essay written in 2002⁴⁴, basically shares La Malfa’s view. He focuses his analysis on the tormented issue of the *democratic deficit* of the European institutions, which makes the community policy-maker the protagonist of a *government of rules* (market rules), but not of a *government of choices* through which citizens can express themselves. The problem can be summarised (and simplified) in the following question: since the Union has “emptied” the (State) seats of their sovereignty impeding them from using traditional tools of macro-economic management, who will

⁴³ G. LA MALFA, op. cit., p. 148. Along the same lines cf., amongst others, G. MONTANI, “The Government of the Economy in Europe, A Post-Keynesian Approach”, in *The European Union Review*, Vol. 3, 1998, no. 3, pp. 35-58.

⁴⁴ J.P. FITOUSSI, *La règle et le choix. De la souveraineté économique en Europe*, Paris, Seuil, 2002. A further, critical analysis of the principles which regulate current European governance can be found in J.P. FITOUSSI and F. SARACENO, “European Economic Governance: the Berlin-Washington Consensus”, in *Cambridge Journal of Economics*, 2013 no. 3, pp. 479-496. According to the authors (whose definition of Europe is “...a strange political construct: a set of quasi-nation-states orphan of a federation”) the European *policy maker* absorbed the neo-liberal principles of the Washington Consensus (until it became a Berlin-Washington Consensus), applied them to the European Treaties but ignored their limits and shortcomings. These limits, imposed by monetary and fiscal policies and the unjustified emphasis on austerity and reforms, go some way towards explaining Europe’s low growth over the past two decades and the reasons why the recent crisis has hit the eurozone more than other areas in the world.

make decisions on fundamental *real* objectives (in particular in terms of growth and employment) considering that the goals of the community policy maker are stable prices, balanced budgets and free competition, and that it is only through the more “intense competition” on the single labour and goods market, under the balanced budget constraint, that those objectives can be achieved? As a matter of fact, the government of the Union is based on only three “pillars”: the Central European Bank, the Growth and Stability Pact under the supervision of the European Council and the Commission, and finally the Director General for Competition of the European Commission⁴⁵.

Summing up, institutional precariousness, inefficient decisional procedures, social vischiosity and the tendency to centrifuge behavior were then, after the end of the First World War, and still are, distinctive features of the European continent. We no longer have the dramatic echo of a recently finished conflict, but there is still the diffused and profound worry for the state and for the prospects of the unification process, for the increasing interstate/interregional gaps and the consequences these have on the management of the crisis. Of course, positive steps have been taken to tame and keep it under control. Yet, much more courageous decisions are needed in order to put an end to it and impede it will happen again in the near future. In the next paragraph we outline some further, perhaps Keynes-inspired, initiatives which might have to be taken so as to ensure our priorities, i.e. growth and a quick return to full-employment, will be more easily met.

Since the outbreak of the sovereign debt crisis in late 2009, European institutions and policy-makers have agreed upon and gave life to a long series of reforms aiming to cope with existing difficulties. Most of these agreements have tried to combine inflexible fiscal discipline with temporary financial help to troublesome countries. Final decisions and decision-making have been intricate, obscure, meticulous, and have often run out of time. Consequently, they have mostly appeared as poorly effective and not decisive to the eyes of financial operators and common people alike. Yet, they cannot be neglected. In this section, we provide a brief description of the most relevant decisions, reforms, and policy actions taken by European institutions to contrast the ongoing crisis.

As regards help to those countries in need, a mechanism had already been set up in March 2010 which aimed to help Member States in the eurozone with *bilateral* loans. Two more temporary intervention tools were set up in May: these were the *European Financial Stabilisation Mechanism*

⁴⁵ Cfr. J.P. FITOUSSI and F. SARACENO, *Introduction*, pp. 7-17 e *Les institutions économiques de l'Union européenne*, pp. 83-91.

(EFSM) and later on the *European Financial Stability Facility* (EFSF). The first was administered by the Commission on behalf of the EU and could offer up to 60 billion euros. These funds were guaranteed by the Union's own budget. The second mechanism was entrusted to a shareholding company which could intervene with up to 440 billion euros. These funds were guaranteed by the investment of bonds guaranteed by eurozone countries in proportion to their holding in the ECB. In May 2010, Greece obtained financial help from both the International Monetary Fund and the eurozone countries. This help was given specifically for the country to set up a drastic program to repair its public finances and to set up radical structural reforms. It was then Ireland's turn at the end of November. Once again the Fund, the EFSM and the EFSF were to work alongside Ireland's domestic resources. Once again this time the loan was given on condition that there would be an improvement of public finances, besides reforms in the banking sector. In April 2011 it was Portugal's turn and again help was given by the Fund, the EFSM and the EFSF.

In the meanwhile, in March 2011, the European Council fixed the specifications of the *European Stability Mechanism* (ESM): this was designed as a *permanent*, and not *temporary*, international institution destined to substitute the EFSF from July 2013, and offering loans up to 500 billion euros. As an international organization, the funding of the ESM, unlike that of the EFSF, does not imply a further increase of the State Members' public debt. The arrangement of financial mechanisms to increase the potential of the financial help available and make it structurally more "multilateral" was conceived as a response to persisting situations of tension on euro countries' bond markets.

As far as monetary policy is concerned, since 2009 the ECB has implemented an expansionary monetary policy, persistently decreasing target interest rates or keeping them at never-before-seen low levels. Besides this, two rather unusual quantitative easing measures have been taken in order to confront the crisis, and perhaps stop speculative pressures on peripheral euro countries bond markets. First, in December 2011, the Long Term Refinancing Operation (LTRO) was launched with the aim of providing cheap and long-term loans to banks. On the one hand, this measure was conceived to give relief and support to private banks whose balance sheets' value, and therefore their capability to get financed on financial markets, was under pressure due to relevant capital losses on previously bought euro country bonds. On the other hand, LTRO was also meant to *indirectly* ease conditions on euro country bonds' markets. Indeed, with more fresh liquidity available, banks could have bought newly issued government bonds more easily, thus reducing

the corresponding interest rates. Second, in September 2012, ECB President Mario Draghi announced the implementation of the much debated (and least from the supporters of the stricter monetarist orthodoxy) the so-called Outright Monetary Transaction Program (OMT) through which ECB committed itself to buy unlimited amounts of euro countries' short-term bonds on secondary financial markets. In this case, the basic aim of this initiative was to stop persisting tensions on peripheral euro countries' bond market, and to ensure financial markets about political will (at least European central bankers' will) to guarantee euro currency *existence*. As far as this last measure is concerned, debate is open on whether it violates ECB's statute by providing loans to public institutions such as eurozone national governments. In this paper, we don't want to analyze such a point in detail. Nevertheless, there are few doubts that OMT has probably been the most interventionist and radical measure taken by the ECB against speculation and in defense of the euro currency. In this sense, it is not by chance that, in order to obtain the vastest political legitimacy possible and, in particular, sweeten Germany resistances, ECB's bond buying has been designed to operate on secondary markets only (no direct buying on primary markets has been conceived), that newly created liquidity will be withdrawn from the market through sterilizing operations, and, above all, that ECB's intervention, although unlimited, will be *conditional* to the implementation by supported countries of tough austerity programs and to their participation to ESM's financial help programs.

In relation to the last point, in the field of fiscal policy, call for fiscal discipline has continued, and perhaps it has even been reinforced, as witnessed by the agreement on the so-called *Fiscal Compact*⁴⁶. According to it, European countries are asked to *automatically* undertake fiscal measures in order to maintain their own structural public budgets generally balanced or, preferably, in surplus, and, in any case, to avoid fiscal deficits higher than 0,5% of GDP. Automaticity of these measures is expected to be enforced through balanced budget rules approved by Member States and possibly introduced in their own national constitutions. Further, excessive deficit procedures eventually opened by EU institutions, and the ensuing sanctions imposed on Member States, have been strengthened and subtract to discretionary policy bargain through the introduction of the so-called reversed voting system (*i.e.* EU Commission's proposals of sanctions against a member Country are considered as automatically approved by the EU Council unless a qualified majority expressly reject it).

⁴⁶ The Fiscal Compact represents the fiscal part of the Treaty on Stability, Coordination and Governance signed by all European member States (with the exception of the UK and Czech Republic) on 2nd March 2012 and entering into force since 1st January 2013.

Generally speaking, a rather expansionary and, more recently, a pretty interventionist monetary policy, plus the provision of conditional (and, often, untimely) financial help to troublesome member States, have represented the main policy instruments through which European institutions have tried to cope with the eurozone sovereign debt crisis so far. This are positive facts. The same positive judgment obviously applies to the very recent progress in the creation of a European bank union which increases the supervisory tasks assigned to the ECB, and possibly creates a common European firewall against financial operators' bankruptcies. Nevertheless, it is worth noting that no signs of consensus among Member States have emerged as to the creation of a true common European (or, at least, eurozone) fiscal authority relying on a (hopefully) considerable budget, perhaps financed by issuing collectively guaranteed eurobonds⁴⁷, and empowered to implement counter-cyclical fiscal policies. On the contrary, the European Council has recently decided to cut to 1% of GDP the already tiny resources available to the European Commission, instead of expanding it. Further, fiscal policy still seems to constitute the reign of reciprocal skepticism and mistrust among Member States, so that no progresses have been realized in increasing cooperative behaviors among eurozone countries. Actually, fiscal cooperation and coordination are exclusively conceived in the restrictive sense of imposing general fiscal austerity on Member States, and reducing margins of maneuver to implement significantly appreciable anti-cyclical efforts. In a way, recalling Kaldor's critique, we might say that emphasis is still on the *harmonization* of generally restrictive national fiscal policies, instead of moving on and considering their *integration* thanks to the functioning of a full-fledged European federal government. If changes in the field of monetary policy and bank regulation

⁴⁷ In this paper, we do not provide a detailed analysis of all the different kinds of eurobonds proposed so far. Indeed, proposals on eurobonds are rather heterogeneous. They run from those conceiving eurobonds as financial instruments supporting infrastructural investment (mainly with anti-cyclical purposes in mind: this was the core of Jacques Delors' original idea), to those conceiving eurobonds as useful to confront temporary liquidity crises and to ease the reduction of previously accumulated high public debt stocks. For a fully documented critical review of the main proposals, especially those put forward by De Grauwe and Moesen, Delpla and von Weizsäcker, Hellwig and Philippon see D. D'AMICO, *Dei diversi usi degli eurobonds*, in "Il Politico", 2013 n. 2, pp. 64-91. See also contributions by Marcello Messori and Vincenzo Visco in S. BERETTA and F. OSCULATI (eds.), *Verso un debito pubblico europeo?*, Soveria Mannelli, Rubbettino, 2012, pp. 71-83 and 119-125 respectively. In particular, one of the structural solutions Messori suggests is the setting up of a *European Debt Agency* (EDA) which substitutes both the EFSF and the ESM and works (according to an *inverted auction* mechanism) as much as possible according to "market" rules suitable for maximizing the compatibility among the interests of the "peripheral" countries and those of the "central" countries.

open more rooms to hope for the future, there are few doubts that significant progress on the way of fiscal integration seems still pretty far to come.

4. *Conclusions: European Integration Process in a Wider Worldwide Perspective*

There are no doubts that since mid 70s the processes of trade and financial globalization have radically changed how national economic systems work, how different social classes interact, how governments try to regulate economic dynamics in order to ensure prosperity. Nobel prize Michael Spence addresses these points in an essay on economic convergence in a multi-speed world⁴⁸. In particular, he highlights that “the scope and depth of the interdependencies in the global economy have run well ahead of global governance structures. Maybe the governance structure (the tortoise) will catch up with the economy (the hare). But it is not a done deal, nor a sure thing. It may not even be a good bet. But how this comes out is likely to have a profound effect on the future of growth...of the whole global economy. This mismatch between governance and the market creates, at the very least, tensions...Economic integration has its limits without a parallel process of building effective and legitimate supranational political institutions⁴⁹”. Furthermore “The economy remains the domain of self-interest, but the political structure is not unified and consists of groups of people, called nations, pursuing their individual collective self-interest. There is no evidence or theory that suggests this structure will work...or that it will produce good results. On the economic side it may turn out to be unstable, or incapable of protecting the relatively more vulnerable people and nations...The non cooperative equilibrium...sounds bad. But it is actually good, provided there is credible governmental entity that pursue, perhaps imperfectly, the common

⁴⁸ M. SPENCE, *The Next Convergence. The Future of Economic Growth in a Multispeed World*, New York, Farrar, Straus and Giroux, 2011. The theme of transnational governance is also developed in a recent volume edited by Guido Montani: G. MONTANI (ed.) *The European Union, Nationalism and Cosmopolitanism*, Soveria Mannelli, Rubbettino, 2012 (see issue 3/2012 of *Il Politico*). Also by Montani and in keeping with this cosmopolitan view, see G. MONTANI, “One Market, One Money. The Political Economy of Supranational Integration”, in *The European Union Review*, Vol. 7, no. 2, 2002, pp. 43-59, and G. MONTANI, “The European Union, Global Public Goods and Post Hegemonic World Order”, in *The European Union Review*, Vol. 8, no. 3, 2003, pp. 35-64, as well as the more recent R. FIORENTINI – G. MONTANI, *The New Global Political Economy, From Crisis to Supranational Integration*, Cheltenham – Northampton, Edward Elgar, 2012.

⁴⁹ M. SPENCE, op. cit., pp. 244-245.

or collective interest...In the global economy, the piece that is largely missing is the global effective government pursuing the common interest”⁵⁰.

These observations make the European experiment very important for worldwide power balances. As Michael Spence notes: “After World War II, Europe began a process of economic and then political integration that is still in process sixty years later... It is a very large-scale attempt to build a functioning supranational unit with economic, political, and governance dimensions...If it succeeds, there will be authoritative governance structures functioning above the level of the national-State. In many ways it is a massive real-time experiment in transnational governance”⁵¹. Accordingly, “...the [European experiment] is important in itself, for those who live there and for the global system. At the very least it is a very big economy. As such it changes the balance of power and influence. But it is also a huge pilot project in building supranational governance capability. The issue is whether people...whose collective identity is deeply rooted in their nations and languages and cultures will be willing to cede control to supranational entities”⁵².

However, Europe does not (yet) have the suitable characteristics to be successful in the role of a European Union. Therefore it cannot play a part in the establishment of worldwide co-operative relations because to date it does not even have the necessary measures to consolidate its own survival, nor that of the aims which have so far been achieved (euro). This makes the Union itself a *producer of both internal and external instability*, especially in a period which is experimenting with the great phenomenon known as the *Eastward shift*, a phenomenon which Giovanni Arrighi describes as an “...ongoing shift of the epicenter of the global economy from North America to East Asia”⁵³. Its uniqueness creates the need for an equally unique cooperative behavior which Europe does not satisfy.

Progresses, we noted, have been achieved in the field of monetary policy, with the ECB acting as a the principal European institution contrasting mounting financial turbulences and the fears of a eurozone break-up. The recent news about the (hopefully) near-to-come European banking union may feed optimisms as to the good end of the European economic and political integration process. Yet, deficiencies are still evident and acute divergences among Member States still exist in the fiscal field, and in the definition of a

⁵⁰ M. SPENCE, op. cit., pp. 245-246.

⁵¹ M. SPENCE, op. cit., p. 244.

⁵² M. SPENCE, op. cit., p. 246.

⁵³ G. ARRIGHI, *Adam Smith in Beijing. Lineages of the Twenty-First Century*, London-New York, Verso 2007, p. XI.

European authority empowered to effectively implement fiscal policy. There are no signs that European countries will soon agree on the creation of a European federal government endowed with its own federal budget and with the right to impose taxes, undertake expenditures, and issue common eurobonds.

In this context, we think the eurobonds topic is of crucial importance. In our view, its relevance lies in the fact that Eurobonds, by virtue of their very existence, could be a sign of an extraordinary act of institutional discontinuity, and demonstrate in themselves the progress made by the Union towards a *fiscal integration* among the Member States. In a way, eurobonds might represent on both an operative and symbolic level a *strong* and *structural* expression of “joining forces” beyond the technicalities and a “sign of contradiction” among the diverging views in the European structure. From an historical point of view, eurobonds issuances may give a sign that Europe might be ready to follow a process closely similar to that marked by the paradigmatic federation worldwide, namely that of the United States⁵⁴. Indeed, soon after the Declaration of Independence, a heated debate emerged between Alexander Hamilton and Thomas Jefferson (whose ideas were also shared by James Madison and John Taylor) throughout the 1790s⁵⁵. These were the “developmental” and “industrial” theses in favor of Hamilton’s financial capitalism, which prevailed over the conservative and mercantile ideas from Jefferson’s “Republic of free farmers” inspired by Rousseau. From that debate in 1791, the First Bank of Philadelphia emerged as well as a *strong* federal structure, as opposed to the agricultural model based on the autonomy of the American republics. In the end, Hamilton’s thesis prevailed and it proved to be the idea which promoted the *undertaking of the States’ debts by the Union*, alongside the setting up of a national bank authorized to issue money and give credit to a federal government directly committed in supporting the development of manufacturing industries in view of promoting economic independence and the general progress of the Union itself. The logical link connecting the historical experience of the United States of America to the ongoing European integration process and the eurobonds issue

⁵⁴ The European experience is a unique “constituent” experience and if we compare it to the American one, the former is characterised by having the Constitution as one of its *objectives*, the latter uses it as a reference point like a presupposition. This makes a big difference which goes in favour of the American situation. The American response to crisis situations is much faster and more incisive because of the federal decisional process and is not hampered by the need for unanimous votes as in Europe. The American system is not governed by the logic of coordination which is structurally inadequate to deal with emergency situations.

⁵⁵ For a recent, accurate reconstruction of the debate cf. G. BOTTARO, “Alexander Hamilton: potere politico e potere economico in America”, in *Il Politico*, no. 2, 2012, pp. 15-32.

is highlighted by Lorenzo Bini Smaghi in a recent essay on the disappointing results of austerity policies implemented so far: “The best way to create a fiscal union is to create just one tool by which States can have debts...The creation of eurobonds follows the same solution the United States adopted after the war of Independence to create a fiscal union. The Treasury Secretary Hamilton convinced the Congress that it was only by sharing the debts the State members already had, that financial disaster could be avoided”⁵⁶.

From a economic policy point of view, we have already stressed that the present distribution of policy tools at different decisional levels (Union, central bank and the States), and the limits and competences which regulate their activity are not functional to the full achievement of the continental social well-being objectives identified in article 2 of the Treaty of Rome of 1957 which says: “The Community shall have as its task, by establishing a common market and progressively approximating the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it”. The fact that since then the “orientation towards stability” has become of primary importance has not reduced the *political* significance of that declaration nor the *technical* importance regarding the necessity of complementarity of macroeconomic policy tools. In this sense, the progressive setting up of a unified market of sovereign bonds in the euro currency, and a stock of public European debt would strengthen the efficiency of the intervention tools available to the Union and the way they are implemented would be more powerful, as happens at the single State level. The present asymmetry, among intervention tools and decisional levels, emphasizes the centrifugal forces, widening the gap among the Member States even more, especially when exogenous shocks overlap existing structural imbalances and which as yet have not been overcome. The primary objective of the decision-makers should be the opposite, they should be geared to strengthening each institution until it can *internalize the externalities* to produce *transnational public goods*, and making sure they have adequate powers and resources to do so. However, both the internalization of the externalities and cooperative behavior can only be optimally pursued (and achieved) by a “credible government entity”, as Spence said⁵⁷, that is by a “new European nation”, according to Kaldor⁵⁸. The

⁵⁶ L. BINI SMAGHI, *Morire di austerità. Democrazie europee con le spalle al muro*, Bologna, il Mulino, 2013, pp. 147-148.

⁵⁷ M. SPENCE, *The Next Convergence. The Future of Economic Growth in a Multispeed World*, op. cit., p. 246.

“orthodoxy of virtue”, like the Carthaginian peace in 1919, is demonstrating the opposite effect as a powerful promoter of both new externalities and renewed non-cooperative behavior, which Keynes had fought in vain against, after the war, in the attempt of “saving... (Europe)... from herself”⁵⁹.

⁵⁸ N. KALDOR, *The Dynamic Effects of the Common Market*, in N. KALDOR, *Further Essays on Applied Economics*, op. cit., p. 206.

⁵⁹ J.M. KEYNES, *The Economic Consequences of the Peace*, op. cit., p. 181.

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