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A new framework for the European Economy - how to ensure balanced and sustainable growth for all?

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Arne Heise

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1. Introduction

In July 2019, Ursula von der Leyen was confirmed by the European Parliament as the successor to Jean-Claude Juncker as president of the European Commission. She formed a new team comprising a college of 27 commissioners for a term of 5 years from 2019–2024.

In her guidelines for the policy of the EU Commission, Ursula von der Leyen presented – along with other projects such as a Green New Deal and the digitalisation of the EU economies – her re-assurance that she would further deepen monetary and economic union (von der Leyen 2019). As part of and as a basis of this objective, she promised to review the economic governance system of the EU and especially the Eurozone and to launch a debate about the need for reform with stakeholders such as EU institutions, Member States and civil society.

As one of these stakeholders, the European Parliament is thus requested to form its own view.[1] In order to do so, the formation of the European economic governance system in historical perspective and its theoretical underpinning need to be reviewed, its effectiveness assessed and potential reforms presented and discussed.

Economic policy-making is a battleground in general and particularly in the EU and the Eurozone, given that the latter is composed of a great number of Member States that not only display different levels of economic development but also have different political cultures and goverments with different ideological orientations. This is due to the fact that economic policy is not just the undisputed, technical application of means to achieve given objectives but also entails controversial deliberation about alternative objectives and alternative policy stances and instruments based on a plurality of economic paradigms.This study seeks to contrast orthodox views on economic policy-making with heterodox views in order not only to provide more space for alternative conceptions but also to account for the fact that the formation of the EU's system of economic governance has been partially based solely on one paradigm. Hence pluralising the theoretical foundations may produce new reform options. Part 2 will place economic policy-making in the EU in its historical context – showing that the time and way in which the EU resumed responsiblity for particular policy areas depended on critical events, dominant ideas and interests. Parts 3 and 4 are concerned with the workings of the European economic governance system under normal and expectional circumstances. Part 5 translates theses experience into reform options and part 6 summarises the findings.

[1] And the European Parliament (2021) clearly claims this responsibility.

2. The Making of a Macroeconomic Policy Framework for the European Union

European integration is a history of ever deeper economic, political, social, cultural and institutional ties between ever more European countries over a period of more than 60 years. After successive EU enlargments and the exit of the UK from the EU in 2020, today the EU comprises 28 Member States (MSs), nineteen of which form the Eurozone.

The prime motive for European integration was to overcome the antagonisms that had resulted in two devasting wars in the first half of the 20th century, but economic aspects creating economies of scale and scope for the European economies in order to prepare for fierce global competition in the Western world under US hegemony were certainly very important too. Moreover, (neo-) functionalists always argued that measures of economic integration such as the elimination of tariffs on goods and services and capital controls would 'spill over' to other areas – e.g. taxation, social and employment policies – in order to keep national policy-making functional and even create the need for supra-national (i.e. European) policy-making. This, however, meant that national governments had to perform a balancing act between functional needs and the commitment to national electorats demanding the defence of national sovereignty (i.e. vested national interests).

Under these circumstances, the evolution of economic policy-making during the process of European integration is not designed on a chartboard but, as neo-realist scholars always claimed, follows events and interests and, as social constructivists would maintain, is always embedded in dominant ideas. This triangle comprising events, interests and ideas not only provides the space in which the evolution of economic governance can be explained *ex post* (i.e. positively) and *ex ante* (i.e. normatively), but also draws attention to the fact what is important is not only stuctures but also content. For instance, it was always clear that further European integration needed – for a functional economy as much as political symbolism – a common currency including far-reaching economic cooperation, yet the envisioned stance or content of such economic cooperation was very different in the 'Keynesian era' of the 1960s (when the Werner Report on monetary union was set up) than in the 'neo-liberal era' of the late 1990s and the early 2000s (when the Delors Report on monetary union was paraphrased in the Maastricht Treaty and finally came into extistence as the European Monetary Union; see Andrews 2013). Moreover, as the EU is politically still a federation of (sovereign) states rather than a federal state, policy-making in most areas has preserved the sovereignty of the Member States by applying an open method of coordination

which works via deliberation rather than top-down administration or sanctions-based rules.

A short history of EU Macroeconomic Governance

Over the years, in a piecemeal way a thick net of economic governance procedures (s. tab. 1) has been created which can be differentiated along the lines of actors (the EU commission, intergovernmental organisations, national actors), modes of coordination (unitary, soft or hard) and efficiency (low or high). As mentioned above, most economic governance procedures assume the 'open method of coordination' (OMC), in which the EU Commission takes a strong position in orchestrating national policy-making. Due to the soft, non-sanctionable form of coordination, these governance procedures are considered 'sovereignity-preserving' yet quite ineffective. More effective, yet quite rare mechanisms are governance procedures which establish intergovernmental or supranational institutions pursuing their policy independently (of the EU Commission as well as of the Member States). The best known, of course, is the European Central Bank (ECB), and the European Stability Mechanism (ESM) is another example. Hard, sanctionable modes of coordination are mainly found in the fiscal policy area, the European Stability and Growth Pact (ESGP) being the best known example. However, it should not go unnoticed that some crucial policy areas for the functioning of an increasingly integrated region – tax policy, wage policy or social policy for instance – have been omitted from European governances procedures almost entirely, instead remaining under national control.

When the post-WW2 currency architecture of fixed exchange rates forming the Bretton Woods System (BWS) in the Western world started to disintegrated in the late 1960s, the European Economic Community of six nations of quite similar economic texture and development with growing internal economic relations dared to propose a bold step forward in European integration by planning a currency union which would irrevocably fix the exchange rates of the Member States (the so called Werner Report). However, the path towards the currency union was disputed by the 'Monetarists' (mainly from France and Belgium), who favoured a quick transition in order to put pressure on the Member States and their economic actors in order to harmonize policies and actions quite in line with the (neo-)functionalist position.

Table 1: Evolution of European economic governance

Governance	Measures	Events	Interests	Ideas
Monetary Union – Werner Report (1970) (suspended)	Fixing exchange rates	Problems within Bretton- Woods-System	Stabilisation of exchange rate; speeding-up of European Integration	Dispute between Economists and Monetarists
European Monetary System (1978)	Fixing exchange rates with	Break-down of Bretton-Woods-System	Stabilisation of exchange rates	Excessive exchange rate volatility harms intra-European trade
European Single Act (1985)	Deregulation and liberalisation measures	End of post-WW-2-period of extraordiniary growth	Common European market	Mainstream international economics
Monetary Union – Delors Report (1989)	Common currency	German Re-unification	Breaking German currency hegemony	Optimal Currency Area/ Dispute between Economists and Monetarists
Broad Economic Policy Guidelines (BEPG) (1993)	Coordination of national macroeconomic and structural policies	Prepartion for European Monetary Union (EMU)	Convergence of economic policy in common currency area	
European Stability and Growth Pact (ESGP) (1997)	Rule-based fiscal policy (sanctionable)	Safeguarding German support for EMU	Enforcing ‚solid' fiscal policy	NCM fiscal policy, New Political Economy
European Employment Strategy (EES) (1997)	Coordination of labour market policies	‚European Skeloris'	Liberalisation and De-regulation of labour markets	Mainstream labour market theory
European Macroeconomic Dialoque (EMD) (1999)	Coordination of fiscal, monetary and wage policy	‚window of opportunity' of Social Democratic dominance	Macroeconomic responsibility for employment and growth	Keynesian theory of policy coordination
European Stability Mechanism (ESM) (2012)	Conditional financial support for liquidity-constraint MS	World Financial Crisis, European debt crisis	Safeguarding EMU	IMF inspired reform obligations
European Semester (ES)(2010)	Coordination and surveillance of budgetary plans of MS	World Financial Crisis, European debt crisis	Enforcing sound fiscal and supply-side structural policies	New Political economy
Macreocnomic Imbalance Procedure (MIP)	Surveillance of potential regional or financial imbalances	European debt crisis	Preventing regional, structural and financial imbalances that threatens EMU	Brussels-Frankfurt consensus
Single Supervisory Mechanism (SSM) (20212) incl. the Single Resolution Mechanism (2015)	Supervison of Banks and Financial Institutions by the ECB and orderly resolution of failing banks	World Financial Crisis; European debt crisis	Monitoring and reducing of financial risks	
European Recovery and Resilience Facility (ERRF) (2020)	Conditional financial assistence to MS	Corona crisis	Supporting MS in their anti-cyclical stabilisation policies	NMC

On the other side were those called 'Economists' (mainly from Germany and the Netherlands) who argued for a long-term perspective in which a preceding real convergence in terms of economic development and fluctuations and economic policy should be crowned by a fixing of exchange rates only. The compromise – a

three-stage schedule for currency union by the end of the 1970s – was never implemented when the Bretton Woods Sytem was finally abandoned in the early 1970s and the **European Monetary System** (EMS) was all that could be preserved. The EMS was a multilateral adjustable exchange rate regime designed to reduce exchange rate volatility of the then twelve Member States of the EEC. According to international trade theory, exchange rate volatility may harm intra-EEC trade and thus allocative optimization and was to be prevented.

After the failure to establish a currency union, a period of relative stagnancy in European integration and the apparent end of exceptional economic growth in Europe (the 'Golden Age' and the 'Wirtschaftswunderzeit'), the **Single European Act** (SEA) of 1985 can be understood as a fresh start to deeper integration and a search for new growth potential by completing the internal (common) market and envisioning another attempt at a common currency scheduled for the 1990s. While the completion of the Internal Market was mostly concerned with reducing still existing formal and informal barriers to the free movement of goods, services, capital and people ('four freedoms'), i.e. using the 'negative integration mode' (see Scharpf 1997), creating a European Monetary Union (EMU) in accordance with the 'Delors Report' and stipulated in the Maastricht Treaty was clearly an act of 'positive integration'. In this way, a supranational institution – the independent European Central Bank – was established that determines the common monetary policy for the common currency of all Member States that were allowed to enter the EMU. The determination to pursue this road against all odds – actually, the EMU was fiercely embattled, showing fault lines well beyond the ordinary orthodoxy–heterodoxy, Economist–Monetarist or left-wing–conservative distinctions (see Heise 2015) – can only be understood against the background of the fear of growing German dominance after re-unification in 1990 and the desire to fence in German monetary hegemony by 'Europeanizing the Bundesbank' (see Heise 2005).

With monetary union came the need for more macroeconomic coordination: in order to safeguard Germany's participation, the so-called fiscal 'Maastricht criteria' were enshrined in the **European Stability and Growth Pact** (ESGP) in 1997: it was stipulated in the Maastricht Treaty that MSs willing to enter the EMU would have to credibly prove their ability to pursue 'sound public finances'. Threshold levels of 3% of GDP for the public deficit and 60% of GDP for public debt were set to be met in the year before entering the EMU – Germany wanted these criteria not only to be applicable as gate-keepers but also as guidelines for fiscal policy within the EMU. Moreover, as a common monetary policy cannot take regional disparities into account, it was agreed in 1993 that **Broad Economic Policy Guidelines** (BEPGs) were necessary to further coordinate other areas of economic policy such as budgetary, industrial and wage policies in order to align the MSs

with common economic policy targets. As budgetary coordination was dealt with separately in the ESGP and wage policy was not subject to governmental control in many MSs (particularly in Germany with its *Tarifautonomie*), BEPGs merely describe common policy orientations and national recommendations to the MS concerning particular policy areas without any commitment to compliance on part of the MSs.

Before the EMU eventually took shape, two further governance procedures were agreed upon: the **European Employment Strategy** (EES) in 1997 and the **European Macroeconomic Dialogue** (EMD) in 1999. The EES uses the OMC to coordinate employment and labour market policies which were hitherto considered the prerogative of national policy-making, in accordance with the principle of subsidiarity. However, with growing unemployment in the EU during the 1990s and the dominance of neoclassical labour market theory in explaining unemployment as being basically a supply-side problem (over-regulation of labour markets, excessively generous social systems reducing incentives to work, collective bargaining systems giving trade unions too much power, etc.) – 'Eurosclerosis' as it was dubbed by Herbert Giersch (1985) – the EU finally succeeded in lifting the fight against unemployment to the EU level without really clipping national sovereignty. Under the OMC, the EU would issue recommendations (Employment Policy Guidelines – EPGs) to the MSs, which would have to react with so-called National Action Plans (NAPs). Although there was no sanction mechanism once MSs failed to comply with the EPGs, the EES was an important agenda-building tool in keeping the labour market policy focus on issues pertaining to the deregulation and flexibilisation of labour markets and the decentralization of collective bargaining systems. A quite different and quite exeptional element in the history of economic governance in the EU is the Macroeconomic Dialogue (EMD) agreed upon at the EU summit in Cologne in 1999. On the one hand, it is exeptional because the EMD was launched under a short spell of social democratic dominance in the EU (see e.g. Niechoj 2005: 68). On the other hand, the EMD is certainly not based on neoclassical policy prescriptions – which would always recommend a clear assignment of objectives and instruments to single policy actors in order not to confound responsibilities – but requires the acceptance of policy interferences (interdependencies) based on neo- or post-Keynesian ideas (see Nordhaus 1994, Heise 2008). Only for a very short time – when then German Finance Minister Oskar Lafontaine was in office and Germany held the EU Council presidency (in the first half of 1999) – did a window of opportunity open to add some progressive orientation to the EU economic governance process by introducing an institutionalized stage of macroeconomic policy coordination comprising the ECB and monetary policy, the finance ministers of the EMU and fiscal policy and the social partners and wage policy (see e.g Heise 2002a). Unfortunately, when the particular political

constellation changed later in 1999, the window of opportunity closed again and the EMD became ineffective: due to a lack of proper institutionalisation of antagonistic cooperation, the EMD is no more than a forum of communication ('talking shop') for actors (such as the ECB) that are not really interested in anything that may undermine their independence.

When the global financial crisis hit the EU as a severe external shock, all MSs had to react in pragmatic yet uncoordinated fashion to stabilize the real economy and, even more urgently, the financial system. However, when deficit and debt levels rose drastically – and far beyond the threshold levels of the ESGP – due to huge recovery and bank rescue programmes, yield spreads on the government bonds of MSs began to increase immensely: while interest rates on German government bonds even fell, those on Italian, Spanish and particularly Greek government bonds rocketed. For most economists, this was simply the 'reward' for sound (in the case of Germany) and unsound (in the case of Italy, Spain, Ireland and Greece) public finances in the past and, therefore, a necessary penalty for those MSs that did not do their homework in good times ('wasted good times' as Schuknecht et al. (2011: 10) put it). For others, it was the consequence of rumour and speculation about a potential dissolution of the EMU or, at least, the exit of some MSs such as Greece. Whatever the reason was[2], the interest rates on some government bonds reached prohibitive levels and triggered what became known as the 'euro crisis' of potential defaults by MSs. As EU law does not allow the direct bailing out of MSs by other MSs, the solution found was the **European Stability Mechanism** (ESM or its forerunner the European Financial Stability Facility – EFSF). This intergovernmental organisation provides conditional financial support to MSs at much lower interest rates than some MSs would have to pay on international financial markets. The conditions, however – reforming tax and social systems and labour markets in order to allegedly restore budgetary sustainability and competitiveness – were the roots of much dissatisfaction and growing Euroscepticism in the receiving countries (see e.g. Braun/Tausendpfund 2014, Clemens/Nanou/Verney 2014).

The 'euro crisis' has been interpreted by many mainstream economists and policy advisers as a 'debt crisis' of those MSs which pursued an 'unsound fiscal policy' despite the regulations of the ESGP (see e.g. Schuknecht et al. 2011). As a consequence, existing regulations were deemed ineffective and in need of intensification. The ESGP was strengthened by reversing the automatism in sanctioning non-compliance: the decision to impose financial sanctions on MSs in accordance with the 'Excessive Deficit Procedure' (EDP) no longer required a

[2] The argument of 'wasted good times' certainly cannot be upheld in the cases of Spain and Italy, which were among the 'champions of consolidation' in the first phase (1999–2008) of the EMU's history.

qualified majority to be confirmed; rather, the enforcement of sanctions could only be avoided with a qualified majority in the European Council. Moreover, the debt theshold of 60% of GDP of the ESGP was given more prominence and now can also trigger an EDP if missed. Also, budgetary surveillance was stiffened by introducing the **European Semester** (ES), which integrates the issuance of Country-Specific Recommendations (CSR) into the drafting of national budgets to ensure that unsound behaviour on the part of MSs can be corrected in time.

The theory of Optimum Currency Areas (OCA) claims to spell out the requirements two or more countries must fulfil to optimally adjust to asymmetric external shocks without having to resort to the exchange rate mechanism: the more flexible the labour markets, the more mobile the factors of production and the more vertically integrated the economies, the better they will be able to cope with such shocks in a monetary union. However, none of these criteria – measuring 'real convergence' in the above sense – found their way into the Maastricht Treaty as entry criteria. Therefore, and additionally due to dysfunctionalities highlighted in the theory of Optimum Wage Areas (OWAs) which may cause internal shocks (see e.g. Heise 2000), the global financial crisis not only called the approriateness of the ESGP into question but also revealed structural imbalances beyond the public budgets of MSs: imbalances in real and nominal growth rates, balances of payments, unit labour costs, labour market regulations, developments of private inbebtness, etc., all of which could potentially be taken as signs of the sub-optimality of the EMU that need to be taken account of. The **Macroeconomic Imbalance Procedure** (MIP) addresses these questions by providing a scoreboard of critical indicators that could be used as an alert mechanism for economic developments that may jeopardise macroeconomic stability. Alert mechanism reports (AMRs) and in-depth reviews (IDRs) are the tools for identifying potential threats and urging MSs to structural reforms. However, in contrast to the ESGP, there are no quantifiable rules to be followed in order to avoid sanctions, giving the EU Commission considerable discretion (see e.g. Hodson 2018: 1618, Scharpf 2011:29).

The global financial crisis originated in US subprime housing markets that quickly spread cross the world, demonstrating the integration of world financial markets. The degree of integration of European financial markets called for better surveillance, orderly resolution and a common deposit guarantee scheme to reduce financial risks and secure undistorted financial markets – something called a 'banking union'. The **Single Supervisory Mechanism** (SSM) including the **Single Resolution Mechanism** (SRM) provided two of the three pillars of such a banking union. The third pillar – a common deposit guarantee scheme – has yet to be established, as it was seen to mutualise past financial risks.

Finally, the corona pandemic provided the background for yet another extension to the economic governance system of the EU: in order to support and steady economic recovery after the deep recession in 2020/21, the EU crossed a red line by introducing the **European Recovery and Resilience Facility** (ERRF) as part of the recovery programme 'Next Generation EU' (NGEU). The ERRF will conditionally channel 672 billion euros over a period of seven years to MSs according to criteria of economic performance and crisis affliction – partially as loans, partially as grants. It is the first time in EU history – its legal foundations being questioned – that the EU itself has become a debtor on financial markets and a fiscal capacity has thus been created to establish an EU stabilisation policy in its own right.

Theory of Economic Cooperation

'Politics' is the targeted use of resources to attain pre-set collective objectives. It is the positivistic concept of the power to make collectively binding decisions, while 'policy' is the normative approach to the feasibility and viability of means–ends sytems to achieve (given) objectives and 'polity' is about the choice and implementation of instruments – all three levels jointly constitute what is commonly subsumed under the heading 'politics' and is ultimately confined to a regional jurisdiction – the Nation State. (Economic) policy-making can be sensibly analysed in terms of the provision of public goods: social security or infrastructure and economic and price stability, fiscal and environmental sustainability, public education, lighthouses and public utilities etc. – the comprehensiveness of public goods provision has vastly increased over the past century. However, policy-making is confronted with several problems: 1) model uncertainty: which economic theory best explains economic reality? 2) Instrument uncertainty: is the causal relation between instruments and objectives linear or non-linear? How long are time-lags? Etc. 3) Assignment uncertainty: are there unique instrument–objective relationships or are objectives interdependent? Model uncertainty implies that even if a political intervention by providing public goods is assertained, policy orientation (i.e. the content of policy-making) may be disputed. Instrument uncertainty means that questions about timing and dosage may arise and, finally, assigment uncertainty is about the need for cooperation among policy actors in order to coordinate instruments to realise targets that might even be conflictual or antagonistic.

European integration poses yet more problems to economic policy-making on the national level: firstly, external effects such as competitive aspects of social security systems or spill-over effects of fiscal and monetary stabilisation policies across borders may harm the effectiveness and sovereign controllability of national policy-making. Secondly, some actors – those with the least cost of mobility – may also use the 'exit-option' if the provision of public goods is not in line with their preferences (or they want to avoid paying for them). The result of both problems

may be either a deficient supply of public goods (e.g stabilisation policies or social security) or a ‘justice gap’, as the less mobile actors – particularly workers and the less skilled – will be increasingly burdened.

To cure the problems of national policy-making, at least to the extent caused by European integration, cooperation between economic policy actors and a coordination of policies in the areas of fiscal, social, budgetary, tax and probably even wage policies are necessary. However, coordination can take different forms: 1) it might be thought of as **‘hierarchical coordination’** with a supreme unitary body at EU level predefining the policy stance and subordinated bodies (national governments) administering it. 2) A **hard mode of coordination** will be based on rules or guidelines on which the national actors have agreed upon and which a body at EU level (the EU Commission for instance) will monitor and, in the event of non-compliance, sanction. 3) **Soft coordination** leaves discretion to national governments, as the rule- or guideline-based policy prescriptions are not binding but rather serve as exchange of information and orientation.

Which mode of coordination is chosen depends on functional and strategic approriateness[3]: strong instrument interdependencies and no common goals[4] (a so-called ‘zero-sum game’) would require strong ‘hierarchical coordination’ to be effective. If there are strong instrument interdependencies but common goals (‘positive-sum game’) shared by the actors involved, ‘hard coordination’ would suffice. If there are no instrument interdependencies to be expected, yet the actors share common goals, ‘soft coordination’ may still be feasible. And, finally, if there are no instrument interdependencies and no common goals, cooperation and coordination would make no sense and policies should be left entirely under national control (subsidiarity).

Against this background and in the light of a variety of path-dependent, historically grown institutional systems in the now 28 EU Member States and the lack of conscious European public opinion (see Abromeit 1998; Etzioni-Halevy 2002), it is hard to imagine the provision of European public goods in the form of hierarchical coordination – i.e. government in a ‘European Republic’ (see e.g. Collignon 2003) – but must be established as a process of multi-level cooperation with most legal and financial resources and the political legitimacy still at a national (or even sub-national) level. Monetary unification with the provision of a single currency and

[3] Game theory has pointed out that cooperation of actors and coordination of their actions include a strategic perspective in the sense that rational actors may have an incentive not to cooperate (i.e. to defect as it is called) as long as there is uncertainty about the behaviour of the other actor(s). Depending on the peculiar setting of the interaction, non-cooperation (the so called Nash equilibrium) may even become the most likely scenario.

[4] This case also includes the possibility of common goals but, due to model uncertainty mentioned before, different opinions about timing, dosage or application of instruments to achieve common goals.

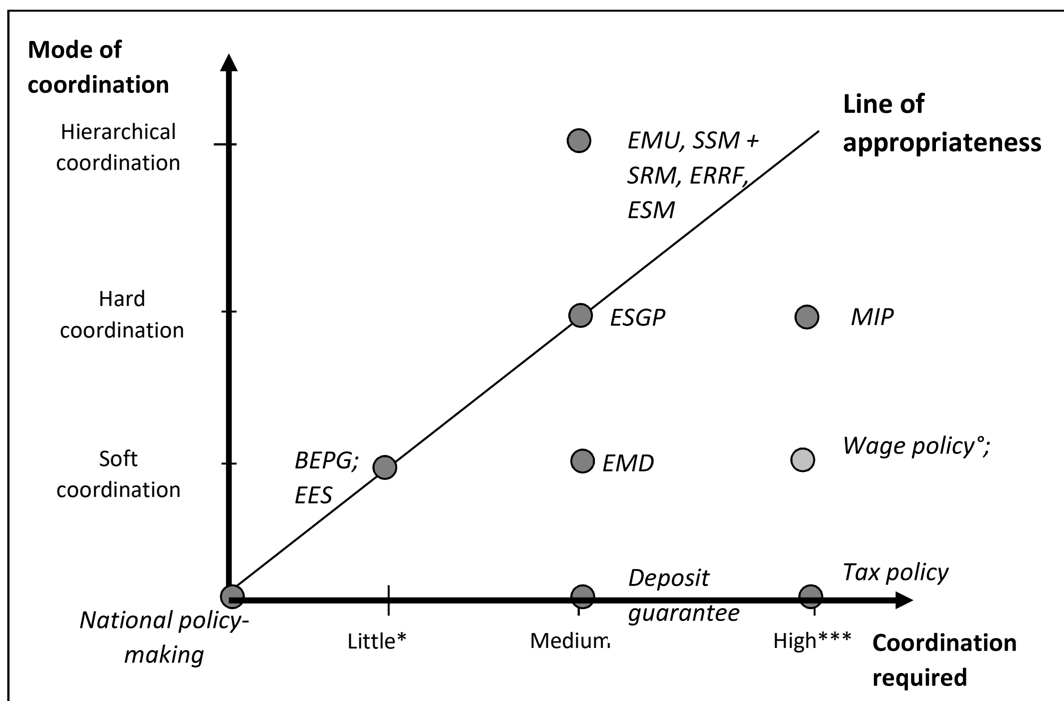
the hierarchical cooperation of national Central Banks in the European System of Central Banks (ESCB) headed by the ECB must, therefore, be seen as the exception rather than as a viable blueprint for a system of European economic governance. A common monetary policy, however, is more than the setting of interest rates but includes the prudential surveillance of the banking and financial sector. Again, as the European financial markets are highly integrated, national measures of surveillance and resolution and deposit guarantee schemes are highly interdependent. As common goals can be assumed, hard coordination would suffice. However, with a unified monetary policy at the ECB, a unified banking surveillance and regulation ('banking union') seems appropriate. To date, the Single Supervisory Mechanism (SSM incl. the Single Resultion Mechanism – SRM) has only covered part of that duty.

As we have seen, the 'soft coordination' of economic policy areas in the EU is called the 'Open Method of Coordination' (OMC) and is quite appropriately used for the coordination of economic policies in general in the 'Broad Economic Policy Guidelines' (BEPGs) and the European Employment Strategy (EES). In both cases, there are no strong instrument interdependencies, but common objectives. The European Macroeconomic Dialogue (EMD) is about the coordination of the major macroeconomic policy areas (monetary, fiscal and wage policy) joining a unitary actor representing monetary policy – the ECB – with a multitude of national actors representing fiscal policy – the Ecofin Council – and a variety of European umbrella organisations of the social partners for wage policy. Taking for granted that the different actors do not share common goals and that the policy areas are highly interdependent, anything less than hierarchical coordination would not suffice. And even if one could persuade the different actors – or, rather, groups of actors – to assume the attitude of 'encompassing organisations' with a European orientation able to unite behind a common goal (e.g. full employment and price stability), hard coordination would still be necessary to achieve results. Although a sanctions-based hard coordination of the EMD can be envisioned (see e.g. Heise 2002), in reality the EMD exhibits the softest from of coordination: it simply provides a forum for an exchange of information and points of view. We know from game theory literature that communication is a nessesary yet insufficient prerequisite for effective coordination.

In one policy area, namely budgetary policy, a method of hard coordination has been established: the 'European Stability and Growth Pact' (ESGP) restrictively coordinates national budgetary policies within the European Semester (ES) to ensure 'zero-deficit budgets' as fiscal policy rule in the European Monetary Union. It was the German government which believed this kind of hard coordination to be necessary in order to prevent national governments from pursuing an overly expansionary (unsound) fiscal policy – and to sweeten the farewell to the

Deutschmark for the Germans. Assuming instrument interdependencies and a common goal (economic stability and sustainable public budgets), hard coordination appears appropriate. The basic problem with the ESGP is, therefore, not the inappropriateness of its mode of coordination but the fact that its coordination rule is based on a very limited and one-sided understanding of the working of economies in general and budgetary policies in particular (model uncertainty) and that this understanding clashes with the understanding underlying the EMD. Moreover, by denying its effectiveness as the dominant view on fiscal policy at the time of its enactment, the ESGP in its present form prevents national governments from pursuing any means of stabilisation policy beyond playing the role of 'automatic stabilisers'. If fiscal stabilisation policy is deemed necessary (in the presence of an economic slump and a change in the dominant view on fiscal policy), this can only be provided at the EU level, as has been the case with the European Recovery and Resilience Facility (ERRF) and the European Stabilisation Mechanism (ESM).

Figure 1: Governance – requirements and status quo



Notes: * = no interdependencies + common goals; ** = interdependencies + common goals; *** = interdependencies + no common goals; ° = for rudimentary (self-)coordination see Schulten 2004

Finally, national tax policy is highly interdependent (impacting on the allocational functioning of the internal market) but only shares the common goal of providing financial resources with many national differences in the desired impact on income (re-)distribution and structural steering effects. Therefore, tax policy

certainly needs a modus of hard, if not hierarchical, coordination in order not to suffer in effectiveness. However – and this could be due to the overwhelming importance of the sovereign taxation of nations for the EU's statehood – tax policy in the Union has not yet even reached the state of soft coordination.

Figure 1 depicts theoretically derived requirements for the mode of coordination to be rated as appropriate in delivering what is expected: overcoming the restrictions on national policy-making in different economic policy areas stemming from European integration. This is set in relation to the actual mode of coordination in the different policy areas in the EU. The 'line of appropriateness' indicates a congruence of requirement and actual mode. Above that line, the actual mode of coordination would be 'harder' than necessary, below that line, it would be 'softer' than required. A harder mode of coordination implies unneccesary limitations on sovereignty; a lower mode of coordination hence indicates potentials for ineffectiveness. Quite a few policy areas – tax and wage policy, part of prudential financial regulation and the coordination of macroeconomic policy areas – are yet to be effectively governed. Ineffectiveness may show in tax distortions and even a curtailment of tax income, growth impediments and imbalances in regional developments, trade balances or financial market instability. To take account of these deficiencies, the Macroeconomic Imbalance Procedure (MIP) has been created. If these imbalances are the result of a lack of coordination – as may be the case, for instance, when corporate tax dumping causes Foreign Direct Investment (FDI) in EU Members States to vary drastically – common goals hardly appear to exist preventing a better result. In such a case, hard coordination of the particular policy area causing the imbalance may not be enough – yet it may cause irritation if, as in the case in MIP, sanctioning is based not on rules specified in advance (as in the ESGP) but on recommendations given by the EU Commission in Corrective Action Plans (CAP).

Finally, it should be noted that the 'line of appropriateness' is a reference point for 'good governance' only in the sense of the likelihood of achieving coordination. Of course, the direction or content of coordination is as important as its mode. However, this is the same as in policy-making on the national level: if there are policy rules – in fiscal or monetary policy for example – how binding ('effective') such rules are is one thing, but how good they are in terms of achieving their objective is another.

3. European Macroeconomic Governance and the Legacy of Crisis

As we have seen, the European economic governance system covers a wide area of policies which, on the one hand, could easily be extended if social policies were included and, on the other hand, still has blank spots. If talk comes to the European macroeconomic framework, it is therefore necessary to make clear which

economic policy areas are included and whether the entire European Union is meant or merely that part of the EU which is united by a common currency: the Eurozone. As most of the governance procedures cover the entire EU, yet are more strict (in terms of the applicability of sanctions) in the Eurozone and can better be made plausibel in the absence of exchange rate adjustments, the arguments for a reformed European macroeconomic framework will be made against the background of a common currency. And this European macroeconomic framework will cover only such core elements which are typically addressed when the stability of economic development in real and monetary terms is to be investigated: monetary and fiscal policies as well as wage policy must be taken into consideration and, particularily in an economy with large regional divergencies such as the Eurozone (and especially the EU), must be specified regionally.

In 2008 – just 10 years after the final decision to introduce the Euro as the common currency in the majority of EU Member States and only a few months before the Lehman Brothers insolvency turned the US subprime crisis into a veritable global financial crisis – the EU Commission evaluated the first decade of its experience with EMU. The EU Commission is full of praise:

The launch of the euro represented a sea change in the macroeconomic environment of its participating Member States and beyond. A single monetary policy combined with national but coordinated fiscal policies has fostered macroeconomic stability. The exchange rate realignments that periodically traumatised the European economies have become a thing of the past. The European Central Bank (ECB), to which the euro area's monetary policy is entrusted, quickly established its credibility. Budgetary discipline has improved significantly, strengthened by the Stability and Growth Pact (SGP). The euro-area economy has pursued a faster track of economic and financial integration than the rest of the EU and its resilience in the face of external shocks has become stronger. Overall, progress has been made on many fronts,… (EU Commission 2008: 2f.).

In particular, price and economic stability, sound fiscal policies, further real and financial integration, real convergence and "sound structure of economic governance" (EU Commission 2008a: 5) are highlighted, yet low potential growth and regional divergencies (e.g. in unit labour cost and trade imbalance) are mentioned as challenges.

The first decade of the EMU

Evaluating the macroeconomic framework of the Eurozone (and the EU) comes with many problems: firstly, there is no objective benchmark against which actual economic development could be compared. Therefore, evaluations are often made by either using different time periods as yardsticks or by using other

countries during the same time period for comparison. The former is problematic if circumstances (the global economic environment, etc.) cannot be kept constant, while the latter requires countries that are similar in many facets yet different in terms of macroeconomic framework. Secondly, many indicators which will be used to nevertheless make evaluative judgements are prone to methodical problems[5] – the implication here is to always take assessments very cautiously.

Table 2: Selected economic indicators, 1999–2008; annual change in %

	(a) (Real) GDP	(b) Deficit	(c) Structural deficit	(d) Output gap*	(e) Inflation+	(f) Real wage	(g) Labour prod.
Eurozone	2.1	-2.0	-2,4	0.9	2.0	0.4	0.9
USA	2.7	-3.9	n.a.	0.5	2.3	1.5	1.6
UK	2.6	-2.0	-2.7	1.5	2.2	2.9	1.5

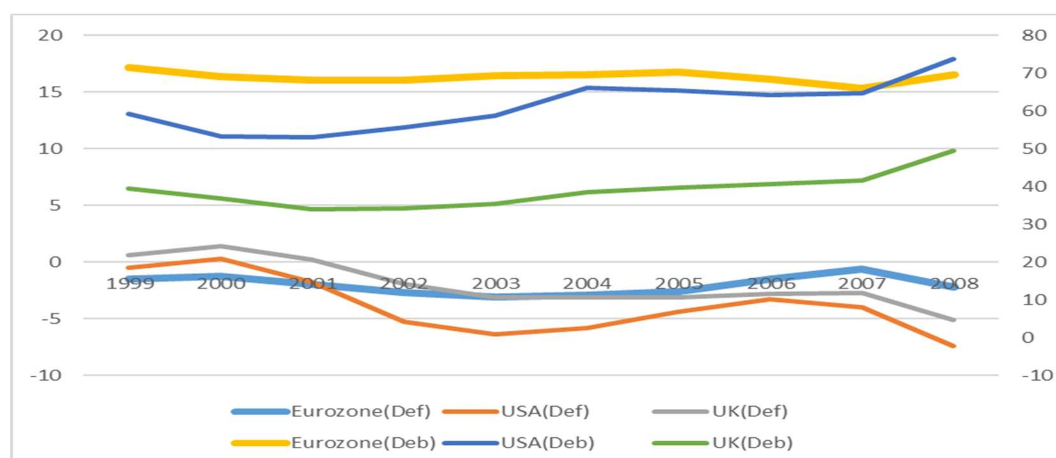
Note: * potential output gap; + GDP deflator; n.a. = no comparative data available
Source: Source: European Economy, Statistical Annex Spring 2020

Tab. 2 provides a first overview of the economic development in the Eurozone compared with the USA and the UK – countries of similar economic status, yet with different governance systems: unitary governments in the US and the UK and hybrid governance in the Eurozone. During the first decade of the EMU's existence, **economic growth** was markedly lower in the Eurozone than in the USA and the UK (column a). Taking the (potential) **output gap** as a yardstick (column d), growth problems become even more apparent when compared to the UK as a then EU MS that was not a member of the Eurozone. **Inflation** reached the 2 % objective pursued by the ECB (column e) precisely – and although this was far lower than the levels of inflation in the MSs during the decades before the EMU, the US and UK experience show that inflation taming was obviously a common experience of highly developed economies in the early 2000s. If we take a glance at **public budget** indicators, it becomes apparant that fiscal governance regulations (i.e. the ESGP) were not effective enough to assert a balanced budget as intended: the average annual public deficit of 2.4 % of GDP was just inside the

[5] Just to give one example: In order to measure the position of an economy in the business cycle, an ‚output gap' is used which is defined as the actual level of output (GDP) compared to the level of output which would be measured in a ‚0-position'. This ‚0-position' is obviously virtual and needs to be constructed itself. It can either the constructed as the potenial GDP in conditions of full employment and full utilisation of all factors of production (‚potential' output gap) or as trend GDP (‚trend' output gap) – both of which may differ quite largely. Moreover, actual data are often and sometimes quite strongly revised which implies that the output gap measured at the time when political actors have to make decisions may differ from the output gap calculated (and published) later.

3 % threshold level of maximum deficts (column b and c), yet far away from the zero deficit stipulated in the ESGP as the normal position. Taking the positive output gap into consideration, the fiscal policy stance appears too lax. However, in comparison to the policy stance in the UK and the US, but also when compared to earlier decades (when the annual average structural deficit in the countries now under ESGP regulations was between -4 and -5 % of GDP), fiscal policy in the Eurozone was stricter than elsewhere and less responsive to business fluctuations (see fig. 2). As can be seen from fig. 2, this came with a slight reduction in public debt as a percentage of GDP in the Eurozone (-2.1 percentage points between 1999 and 2008) while public debt levels rose in the USA and the UK (+14.6 percentage points in the USA and +9.9 percentage points in the UK). Although tighter fiscal policy does not simply translate into lower economic growth, there is a positive correlation between higher (structural and, as no comparable data are available for the US, overall) public deficits and GDP growth rates; it can be surmised that fiscal policy regulations in the Eurozone explain part of the problems in growth potentials mentioned by the EU Commission.

Figure 2: Evolution of public defict and debt in the Eurozone, USA and UK; 1999–2008



Note: right scale: public debt level in % of GDP; left scale: public deficit in % of GDP
Source: European Economy, Statistical Annex Spring 2020

Tab. 2 also indicates that not only did the income of **wage-earning households** in the Eurozone (column f) grow far less than in the UK and the US, but the distributional margin provided by the increase in **labour productivity** (column g) was also less exhausted than in the UK and the US. In conjunction with growing income inequality, this development suggests that lower-(wage-)income households did not profit from economic growth during the first decade of the EMU.

Behind these general developments for the Eurozone lies hidden a highly differentiated picture for the individual MSs:

Table 3: Selected economic indicators, 1999–2008

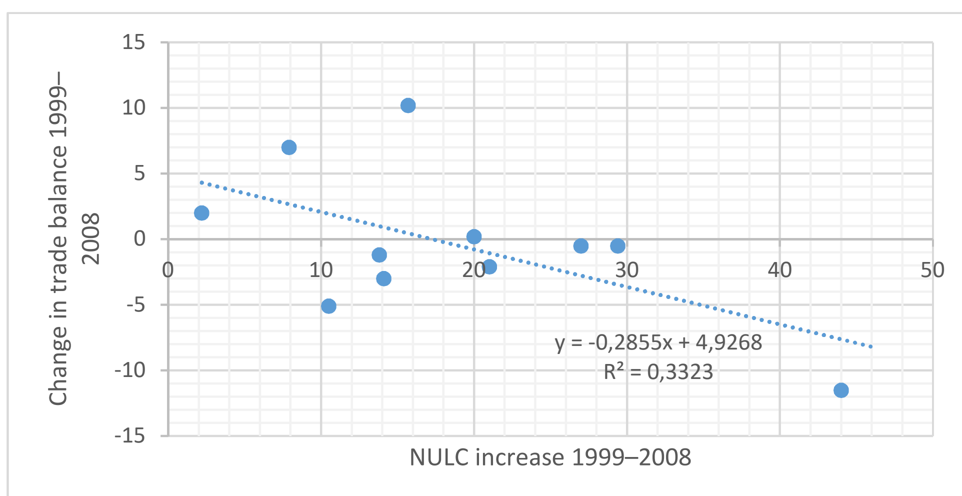
	(a) (Real) GDP*	(b) NULCs+	(c) Inflation	(d) Intra-EU trade balance+	(e) Unemployment rate+
Austria	2.2	7.9	1.6	+7.0	+0.4
Germany	1.5	2.2	0.8	+ 2.0	-1.2
France	2.0	14.1	1.9	-3.0	-2.6
Belgium	2.4	13.8	1.8	-1.2	-1.6
NL	2.5	15.7	2.5	+10.2	+0.4
Finland	3.4	10.5	1.2	-5.1	-5.8
Italy	1.2	20.0	2.4	+0.2	-4.7
Spain	3.5	27.0	3.6	-0.5	-4.4
Portugal	1.7	21.0	3.2	-2.1	+3.1
Greece	3.5	29.4	3.2	-0.5	-4.3
Ireland	5.2	44.0	3.5	-11.5	+0.9
Eurozone	2.1	12.2	2.0		

Note: * average annual increase in %; + change between 1999 and 2008 in percentage points; inflation = GDP deflator
Source: European Economy, Statistical Annex Spring 2020

Tab.3 indicates some real convergence with higher growths rate in lower income MSs, as was intended when establishing the EMU. However, there is quite some divergence with respect to nominal unit labour costs (NULCs), which are an indicator of price competitiveness in a monetary union, as differences in NULCs can no longer be compensated by exchange rate adjustments. Moreover, experience of inflation was quite varied in the EMU, with annual average inflations ranging from 0.8% in Germany to four times as much (3.6%) in Spain. Divergencies are also visible in the development in intra-EU trade balances with growing surpluses particularly in Germany, Austria and the Netherlands and growing deficits particularily in Ireland, Finland, France, Spain and Greece.

Finally, labour market developments in the Eurozone are quite diverse, with stronger reduction in unemployment rates in southern Eurozone countries than in northern ones.

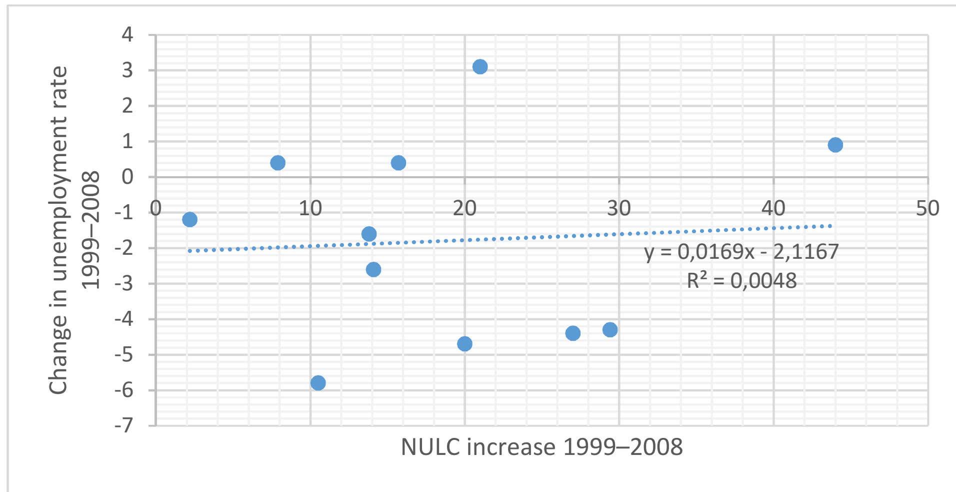
Figure 3: Nominal unit labour cost and trade imbalances; 1999–2008



Source: European Economy, Statistical Annex Spring 2020

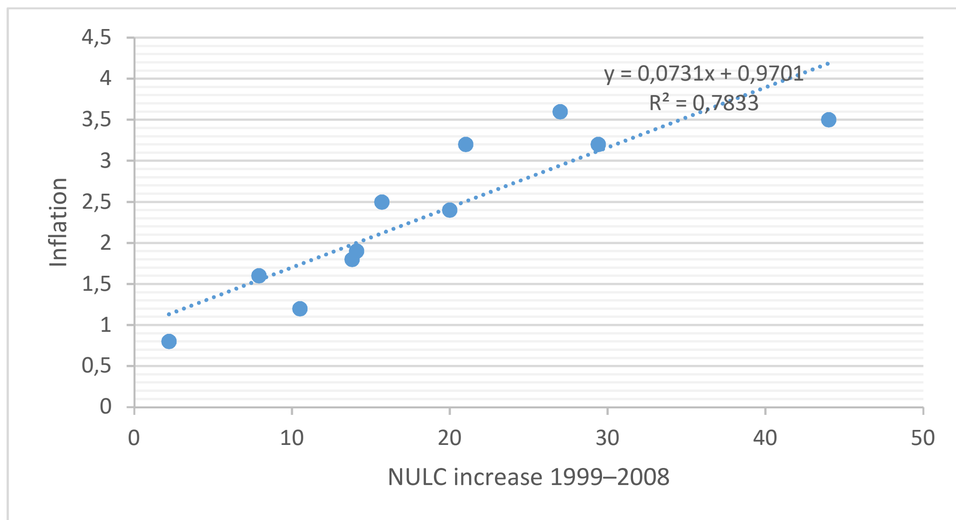
Such divergencies and imbalances in a monetary union are not necessarily problematic. According to the Balassa–Samuelson effect, catching-up countries are expected to experience higher inflation rates than the higher income countries. And as catching up implies higher growth rates of internal demand (incl. imports) than external demand (incl. exports), the deterioration of trade balances for catching-up countries (and the improvement of trade balances in higher income countries) is to be expected and financed by capital exports from higher income countries to catching-up countries. Actually, these developments ascertain that catching up will eventually come to an end and can be seen as a balancing mechanism. However, in the case of the Eurozone there are indications that point to a less smooth process: as there is no correlation between labour market developments and NULCs (see fig. 4; R^2 = 0.0048)) but a strong correlation between NULCs and inflation (fig. 5; R^2 = 0.7833) and some correlation with changes in intra-EU trade balances (fig. 3; R^2= 0.3323), real divergencies appear to be driven, at least partly, by nominal divergencies via price competitiveness resting on institutionally divergent and uncoordinated wage-setting behaviour. Particularly Germany, with its export-oriented growth model ('German mercantilism'; see e.g. Cesaratto/Stirati 2010, Cesaratto 2011) based on wage restraint and some southern European Eurozone MSs' unability or unwillingness to align their wage increase to increased productivity, jeopardised a regionally balanced working of the EMU prior to the advent of the global financial crisis after 2008.

Figure 4: Nominal unit labour cost and labour market developments, 1999–2008



Source: European Economy, Statistical Annex Spring 2020

Figure 5: Nominal unit labour cost and inflation; 1999–2008



Source: European Economy, Statistical Annex Spring 2020

The EMU during the global fincancial crisis and the euro crisis

The insolvency of the US investment bank Lehman Brothers in September 2008 is commonly seen as the onset of the global financial crisis that hit the EU and the Eurozone as an external shock. It struck a common currency area which was, as seen above, characterised by structural imbalances mainly stemming from the fact that its biggest central economy – Germany – followed a growth regime which was shaped during the Bretton-Woods post-WW2 era, when Germany was a catching-up economy itself, and prolonged during the 1970s and 1980s, when it jeopardised the smooth working of the EMS. Within the Eurozone, the core country needs to boost domestic demand and allow moderate inflation in order to enable the

catching-up countries to build up productive capacity, sell their commodities (and services) and eventually balance trade and capital accounts – something repeatedly demanded of German economic policy at international policy meetings such as G-8 or G-20 summits. However, Germany countered such demands by proposing other countries follow its growth model and by shaping the European macroeconomic framework according to its ideas – ignoring not only different institutions and policy cultures in the other MS but also the fact that its model cannot work for all MSs simultaneously.

Table 4: Selected economic indicators, 2009–2012

	GDP+	Defict	Structural Deficit	Debt*	Unem-ployment rate
Eurozone	-0.4 (-4,4)	-5.4	-3.9	+22.8	+3.8
USA	1.0 (-2.5)	-11.1	n.a.	+31.7	+2.3
UK	0.4 (-4.2)	-8.8	-6.4	+37,7	+2.3

Note: * change between 2008 and 2012; + number in brackets: GDP growth rate during economic trough in 2009
Source: European Economy, Statistical Annex Spring 2020 and various other years

Tab. 4 shows that the economic downturn during the global financial crisis and the euro crisis were more pronounced in the Eurozone than in the USA and the UK and hence unemployment rose more strongly in the Eurozone than in the comparative countries.[6] Considering deficit ratios and debt levels, the USA and the UK initiated a markedly more expansionary fiscal policy stance involving bank rescue and recovery packages than the MSs of the Eurozone. This strategy was obviously rewarded with quicker and stronger return to economic growth, yet caused the public debt level to rise more strongly. This outcome is exactly what the critics of the European macroeconomic framework argued, namely that the discretionary capabilities were curtailed and fiscal policy turned actively pro-cyclical under the then policy framework (see Eichengreen 1996, Eichengreen/Wyplocz 1998a, Eichengree/Wyplocz 1998b).

If the critics of the European governance system are right, in a situation of a negative external shock one would not expect to find a policy reaction that is gauged towards the needs of the different regions of the Eurozone (i.e. the ensuing output gaps of the Member States) but a policy reaction that is led by the restrictive principles of policy coordination in the Eurozone, or by what may be termed the 'fiscal space'.

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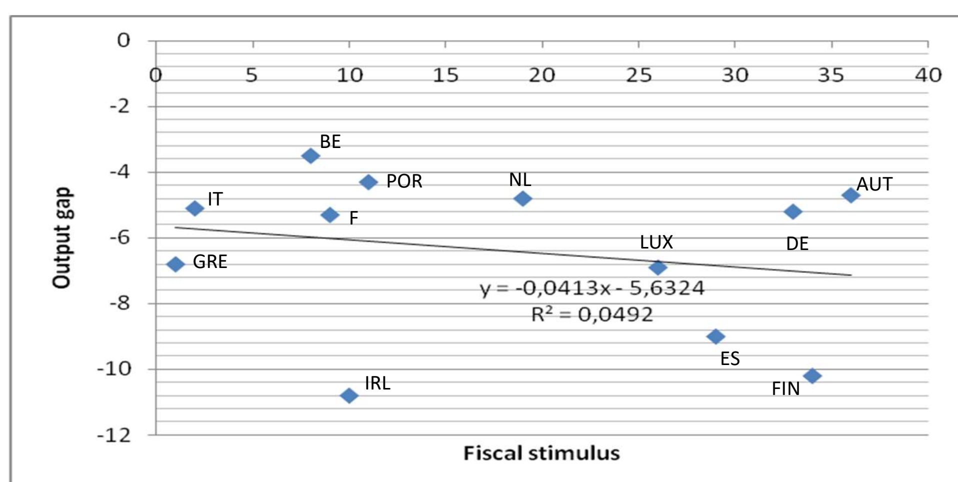
[6] Again, there are huge divergences in GDP growth rates (from -1.9% to -14.1%), deficits (-2.0% to -11.4%) and changes in unemployment rates (-1.9 to +16,7 percentage points) between Eurozone MSs.

Figure 6 and 7 provide evidence that this is exactly the policy pattern that can be traced in the Eurozone: there is almost no correlation (R^2 = 0.0492) between the **external shock** of the global financial crisis (measured by the output gaps in 2009 and 2010) and the size of the **fiscal stimulus packages** being implemented in the Member States of the Eurozone – and this appears to contradict the result published by the EU Commission with respect to the entire EU, where "(t)he analysis [...] suggests that, overall, Member States whose negative output gap (i.e. their degree of economic slack) is largest are also the ones that pursue the strongest fiscal stimulus – and *vice versa*" (EU Commission 2009a: 67f.).

Figure 6: Fiscal policy reactions during the Great Recession in the Eurozone



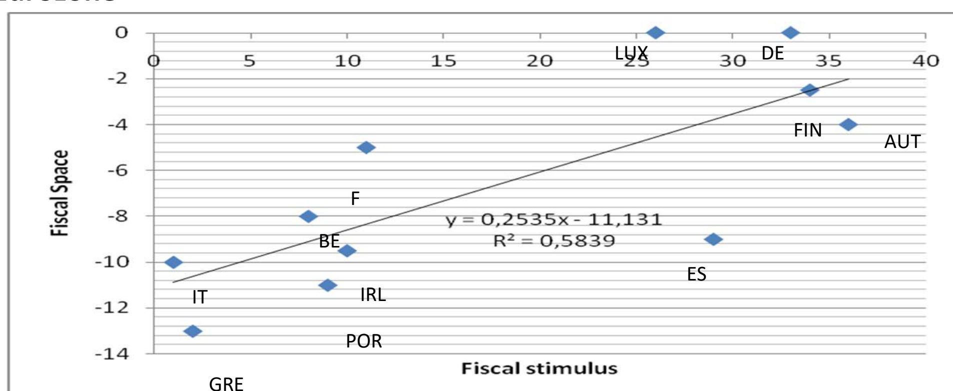
Note: Output gap measures the (aggreagte) difference of actual from potential output 2009 and 2010, fiscal stimulus in 0.1 % of GDP: 10 = 1% of GDP
Source: European Commission – Ameco data bank and European Commission (2009b)

Taking the EU Commission's result for granted, there must be a marked difference in the governance of the Eurozone and the non-Eurozone EU member states. This becomes more obvious when **'fiscal space'** is considered as a measurement of national governments' room for manoeuvre: using the composite index 'fiscal space' created by the EU Commission (see EU Commission 2009b), which covers ESGP criteria and, therefore, institutional pressure (such as the debt ratio) as well as criteria that may capture market pressure (such as contigent liabilities to the financial sector and external imblances)[7], a clear (positive) correlation (R^2 =

[7] The variables defining the composite indicator 'Fiscal space' are: a) the gross debt ratio, b) contingint liabilities in the financial sector, c) medium term tax shortfalls, d) current account balance and e) non-discretionary expenditure ratio. The market pressure of 'fiscal space' works via influencing risk premia on government bonds: The smaller the 'fiscal space', the higher the risk premium and the dearer it will be for governments to finance their deficits. Correlations between governments bond spreads and the 'fiscal space' indicator imply such market pressure. However, the weakness of this correlation and the fact, that the correlation of both indicators in non-Eurozone-countries (not restricted by the ESGP) is even weaker appear to hint to the presumption

0.5839) between 'fiscal space' and the size of the **fiscal stimulus package** is discernable – a result very much in line with the 'European Economic Recovery Plan' (EERP) which had been agreed upon by the European Council in December 2008 and which was based *expressis verbis* on the restrictions of the ESGP (see European Commission 2008b).

Figure 7: Fiscal policy stance and fiscal space during Great Recession in the Eurozone



Note: Fiscal space is measured as a composite indicator provided by the European Commission (2009b). The Netherlands is omitted here as a strong outlier (not using its fiscal space for fiscal stimulus). If the country were included, R-squared would drop to 0.3336

Source: European Commission (2009b)

The inherent logic of the European economic governance system – decried by its critics – is that whoever has 'messed around' with its public finances in the past will not be able to react appropriately to external shocks and will thus suffer economic hardship. Whether one subscribes to this logic – which may work as a pedagogical device only if it is executed in due course – or not (as it does not discriminate between different possible reasons for fiscal inordinateness in the past, such as external shocks or internal misbehaviour), it needs to be scrutinized in the light of deep recessions such as the global financial crisis: if the fiscal stimulus fails to spark a cyclical turn, a country may easily find itself in a vicious circle of unsustainably high and illicit budget deficits, consolidation efforts, economic impairment and persistent or even growing budget deficits. Again, there is empirical evidence that some Member States of the Eurozone were caught in such a vicious circle or, to put it differently, that the European economic governance system may systematically aggravate instead of containing initial economic slacks.

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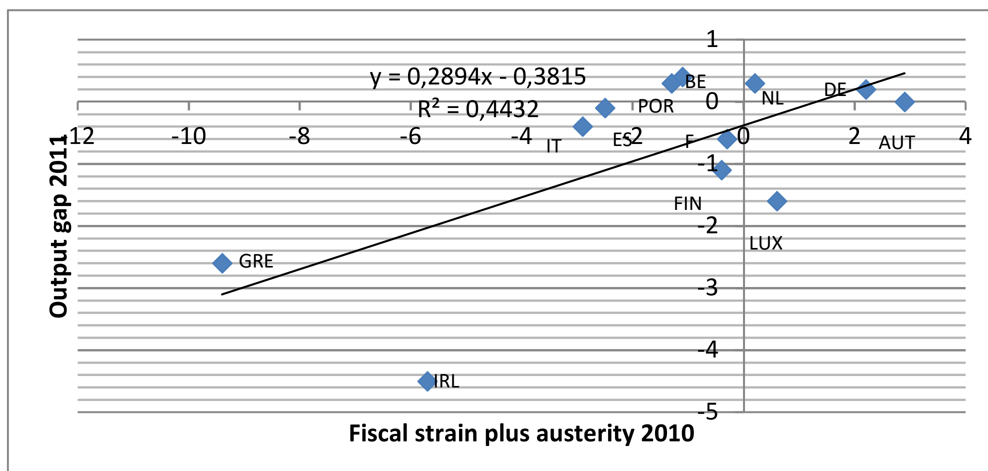
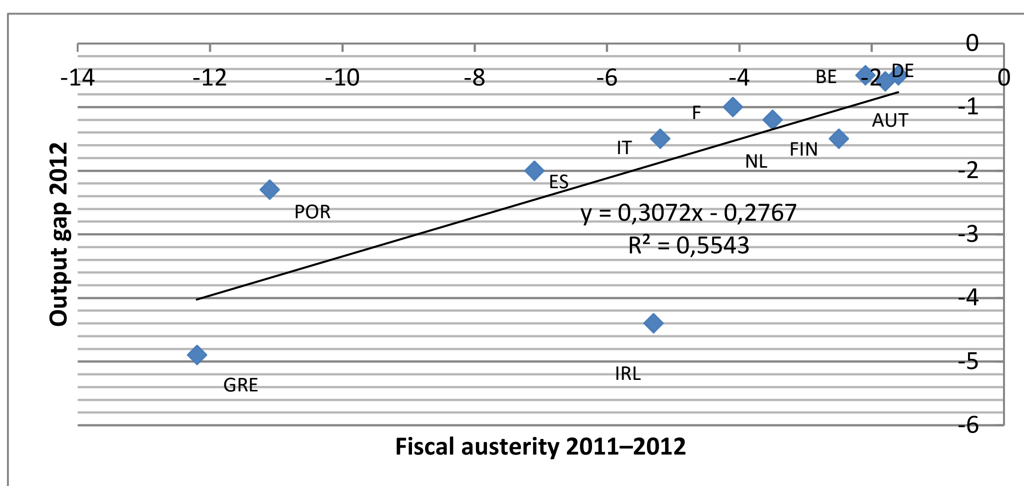
that the institutional restrictions of the ESGP work directly and also indirectly via inducing extra market pressure; see EU Commission (2009b: 186ff.).

Figure 8: Fiscal strain, austerity measures and output gaps 2010–2012



Source: Ameco database, IMK Report No. 71, 2012, European Economy statistical annex spring 2012; own calculations

Figure 9: Austerity measures and output gaps 2011–2012



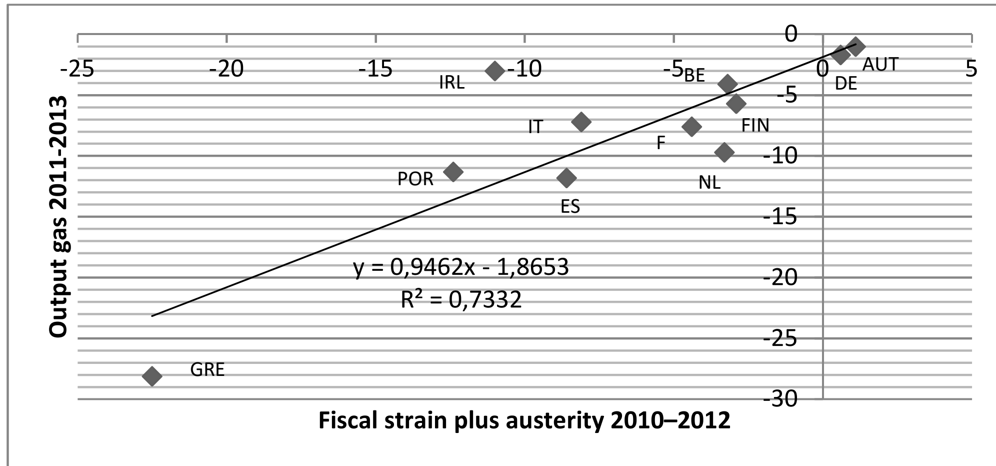
Source: Ameco database, IMK Report No. 71, 2012, European Economy statistical annex spring 2012; own calculations

It has been pointed out before that – partly due to the lack of 'fiscal space' – the fiscal stimulus given in 2009 and 2010 by the national governments under the 'European Economic Recovery Programme' did not have the appropriate dimensions to meet the requirements of the Great Recession. The difference between an appropriate stimulus[8] and the actual (realised) fiscal stimulus may be termed 'fiscal strain'. As Figures 9 and 10 suggest, there is a mounting correlation

[8] To simplify the analysis, an 'appropriate stimulus' has been calculated as follows: (GDP_{2009} – [-2]) x 3/5. A fall in GDP by -2% is supposed to be handled within the rules of the ESGP, i.e. the automatic stabilizers will not surpass the deficit threshold of -3% of GDP. Assuming a trend GDP of 3% at which the public budget is supposed to be balanced, this implies a fiscal multiplier of roughly 3/5.

between initial fiscal strain, austerity policies[9] to bring down high deficits in line with consolidation programmes (as part of the ordinary Excessive Deficit Procedure (EDP) of the ESGP or measures agreed upon with the 'troika' consisting of representatives from the IMF, the EU Commission and the European Central Bank (ECB)) and ensuing output gaps.

Figure 10: Fiscal strain, austerity and output gaps 2010–2013



Source: Source: Ameco database, IMK Report No. 71, 2012, European Economy statistical annex spring 2012; own calculations

The response of international financial markets – sanctioning those governments that find themselves unable to reduce deficits and debts as desired by raising interest rates to unprecedented levels – only adds to the stress. For some, the immense increase in government bond risk premia are the main cause of the ongoing 'euro crisis', requiring fiscal adjustments impossible to achieve without adverse growth effects. Yet, although the short-run liquidity and the long-run solvency of governments are surely much affected by adverse financial market reactions, the evidence provided here is to argue that the 'euro crisis' is not fundamentally based on such market reactions (see also Cafiso 2012). And others regard goverment bond risk premia merely as the consequence of unsolid fiscal behaviour in the past. However, new empirical evidence (see e.g. Pusch 2016, Bayer/Kim/Kriwoluzky 2018)) shows that the risk premia on Eurozone government bonds are determined by 'fiscal fundamentals' (such as past public debt and deficit levels, for which national governments bear some responsibility) only to a minor degree – leaving explanatory space for 'fundamental uncertainty' in a Keynesian sense about financial market developments, the economic future of the Eurozone in general and some Member States in particular (for which national governments bear only limited responsibility). In this case, there is a good rationale for a

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[9] In most Eurozone Member States, fiscal stimulus programmes and consolidation programmes overlapped in 2010!

common responsibility to allow access to financial markets at affordable interest rates (i.e. the workings of the European Stability Mechanism).

For long time, monetary policy was at the centre of macroeconomic intervention, as it was seen as superior to fiscal policy in dominant economic theory. However, the global financial crisis and the euro crisis have sparked a renaissance of fiscal policy which – as demonstrated – could not be catered for in the institutional setting of European economic governance. Nevertheless, it is not necessary to investigate ECB monetary policy in greater detail, as its policy stance has not changed since the outbreak of the global financial crisis. Until 2008, the ECB was applauded for issuing a new currency which quickly gained credibility and became the second international reserve currency after the US dollar. As expected, this was achieved with an overly restrictive monetary policy – measured by comparing the actual interest rate policy of the ECB against a Taylor-rule-generated interest rate (see e.g. Zahner/Gross 2020: 3) – in the first years of the euro's existence. Moreover – and this has been criticised by many economists – the overall monetary policy stance of the ECB appears to have been less bold and slightly more restrictive than that of the US Fed (see e.g. Mathieu/Sterdyniak 2007: 287f.). However, during the global financial crisis and the euro crisis, the ECB not only swiftly lowered its bank rate to zero, thus reaching a lower bound, but also provided the commercial banks with the necessary liquidity when the interbank market collapsed, and also stabilised the risk premium on sovereign debts of Eurozone MSs, stretching its mandate as far as possible. Ever since 2009, the ECB's 'whatever it takes' monetary policy can hardly be seen as not providing enough support for economic recovery, but it has lost stabilisation potential and has been quite unsuccessfull in re-inflating the Eurozone.

Preliminary conclusion

The Great Recession at the end of the first decade of the twenty-first century has not proved to be as severe as the Great Depression of the 1930s – and this is surely also due to the swift monetary and fiscal policy reactions of most governments and Central Banks. However, we have seen that it is the institutional framework of economic policy coordination in the EU (and particularly in the Eurozone) which systematically appears to aggravate the problems: the reform of the European economic governance system, hastily pushed through during dozens of special or emergency summits of the European Council, has managed to create **crisis control and emergency measures** such as the European Stability Mechanism which were not in place before the crisis. However, **crisis resolution** has not worked – neither in terms of overcoming slack economic conditions nor in overcoming budgetary problems or in terms of tranquilizing financial markets – as the treatment basically used the same medicine and just increased the dosage: the 'fiscal pact' not only hardened the ESGP further by strengthening both the preventive as well as the

corrective arm of the EDP but also ordered all Eurozone Member States to make a balanced budget a constitutionally based and implemented target. Moreover, the Macroeconomic Imbalance Porcedure (MIP) adressing regional trade imbalances is bound to keep up pressure on governmental (social) spending and wage increases – most likely harming aggregate demand in the longer term and, in the worst-case scenario, initiating a wage-price deflation which has been prevented to date – and is arguably a part of what has been termed 'Brussels–Frankfurt consensus': "The policy mix encompasses the fields of monetary, fiscal and labour market policy and creates through its institutional design a euro-area-wide commitment towards price stability, fiscal discipline and labour market flexibility" (Scholz-Alvarado 2021: 4).

4. Macroeconomic governance in times of high debts, zero interest rates and climate change

Economic Recovery after the Crisis

Economic development in the Eurozone after the global financial crisis and the euro crisis confirms what has already been established (see Tab. 5): economic recovery has been weaker than in the US and the UK (see column a), which is clearly related to a considerably tougher stance on fiscal consolidation (see column f): with interest rates at historically low levels, curbing public spending could not be compensated for by 'crowding in' private investment.

Although **tougher consolidation** came with a slightly **lower public debt level** (see column g), the **inflation performance** (see column c) of the Eurozone must also be considered inferior, since both the US Fed and the Bank of England managed to keep price stability closer to their target of 2%. Moreover, **income growth** of wage-earning households was again lower in the Eurozone than in the US or the UK (see column h) and – with growing income inequality – the pre-crisis trend to reduce poverty could not be extended (see Crespy 2020: 134).

Taking a more differentiated look – and, due to the growing number of Eurozone MSs, it might be approriate to cluster countries in regional groups such as the **Northern Continental countries** (Belgium, Germany, France, Netherlands and Luxembourg), the **Eastern European countries** (Finland, Lithuania, Latvia, Estonia, Slovakia and Slovenia) and the **Southern Mediterranian countries** (Portugal, Spain, Italy, Greece, Malta and Cyprus), leaving Ireland as the only **Liberal Market Economy** standing apart – it appears safe to say that the Northern Continental countries quite strictly followed the German-inspired rules of the consolidation game, while the Eastern European countries spured their catching-up momentum by interpreting the ESGP regulations quite loosely without pro-actively violating them.

Table 5: Selected economic indicators, 2013–2019

	(a) (Real) GDP*	(b) NULCs+	(c) INF	(d) Intra-EU trade balance+	(e) UNR+	(f) Struc Def	(g) Debt	(h) Real wage
AT	1.5	10.9	1.8	+0.2	-0.9	-1.1	-10.9	
DE	1.6	12.8	1.6	-0.3	-2.0	+0.7	-18.9	1.5
FR	1.0	3.2	0.8	0.0	-1.8	-3.2	+4.7	0.6
BE	1.5	4.5	1.4	+3.6	-3.0	-2.3	-6.9	0.1
NL	1.8	5.4	1.3	-1.2	-3.9	-0.1	-19.1	0.1
LU	3.5	13.0	1.9	-2.9	-0.3	+2.2	-1.6	1.1
EE	3.4	17.9	3.0	+6.9	-4.2	-1.1	-1.8	4.8
LT	3.3	31.2	2.1	-2.0	-5.5	-1.0	-2.4	5.6
LV	2.8	32.4	2.0	+3.2	-5.6	-1.5	-3.4	6.1
FI	3.4	1.0	1.5	+0.3	-1.5	-1.1	+3.2	-0.1
IT	0.4	4.5	0.7	+0.3	-2.2	-1.3	+2.3	0.3
ES	2.0	3.2	0.7	-0.5	-12.0	-2.8	-0.3	0.0
PT	1.7	5.3	1.6	-1.2	-9.9	-3.1	-13.7	0.6
EL	0.3	-0.5	-5.7	-0.5	-10.2	+2.9	-0.8	-0.7
CY	1.9	-5.0	0.0	-4.5	-8.8	-1.1	-8.5	-0.8
MT	6.9	4.2	2.1	+2.7	-2.7	-1.1	-25.3	1.3
IE	8.7	-25.7	1.7	-3.3	-8.8	-2.7	-61.1	0.7
SI	2.6	10.4	1.4	+5.4	-5.6	-2.8	-3.9	1.6
SK	2.8	18.4	0.8	-7.6	-8.4	-2.0	-6.7	3.1
EA (19)	1.5		1.2		-4.5	-1.2	-8.9	0.8
UK	1.9		1.8		-3.7	-3,8	+1.2	1.1
US	2.3		1.7		-3.7	-5.5	+6.4	1.2

Note: * average annual increase in %; + change between 1999 and 2008 in percentage points; inflation = GDP deflator
Source: European Economy, Statistical Annex Spring 2020

And the Southern Mediterranian countries showed quite different policies and outcomes: while Italy and particularly Greece had to follow strict obligations under their Stability and Consolidation programmes,[10] resulting in stagnation, Spain and Portugal rather sided with the Eastern European countries in only rudimentarily complying with the ESGP and accepting permanent notifications of non-compliance from the EU Commission whileshowing higher growth and still reducing public debt ratios.

[10] For Greece, see ESM (2020).

With respect to regional imbalances, above-average NULCs in the Northern Continental countries, especially Germany, and below-average NULCs in the Southern European countries, especially Greece, stopped price competitiveness from deteriorating further and remaining intra-EU trade imbalances are much more the result of growth differences than NULC distortions. However, the non-correlation of NULCs and labour market developments does not yet force wage formation in the Eurozone to conform to a proper functioning of a monetary union. That is not to say that putting further pressure on collective bargaining, labour markt and labour relation systems operating through ESM conditions, the MIP or the ESGP is recommended; rather, the European Social Partners – and particularily the trade unions – need to further Europeanise their policies.

Within a decade of the global financial crisis and the euro crisis, the next grave external shock – **the Covid-19 pandemic** – hit the EU and the Eurozone in 2020 and forced the MSs and the ECB to again pragmatically react with stabilisation measures. Due to the particular nature of this crisis, the MSs and the ECB first had to provide liquidity to private and public economic actors when lockdowns and shutdowns paralysed normal economic activity and, after temporarily and partly calling off these restrictions, governments have had to take measures to re-start the economies.

Table 6: Selected economic indicators, 2020

	GDP	Deficit	Debt
Northern Continental	-5.2	-6.7	+11.0
Southern Mediterranian	-7.9	-8.6	+10.9
Eastern European	-3.4	-6.1	+19.8
Ireland	3.4	-5.0	+2.1
Eurozone	-6.6	-7.2	+14.2
EU	-6.1	-6.9	+13.3
UK	-9.8	-12.3	+18.3
USA	-3.5	-16.1	+18.9

Source: European Economy – Statistical Annex, Spring 2021, IMF – World Economic Outlook Database, April 2021

The pandemic was worse in the European South than in the North and East; public deficits and debt ratios were again negatively affected (see Tab. 6) – yet although the economic impact of corona was less strong in the US than in the Eurozone and the EU, fiscal policy turned far more expensionary in the US than in the Eurozone or the EU despite the restrictive regulations of the ESGP being removed during expectional times – clearly, a **culture of fiscal restriction** has taken hold of the Eurozone and the entire EU.

After the global financial crisis and the euro crisis, institutional reform of the European economic governance system concentrated on tightening the ESPG's grip and providing financial support for needy MSs by creating the European Stability Mechanism conditional on neoliberal structural reforms. It has been argued that the Eurozone may be trapped in an 'inconcistency triangle' of neoliberal (economic) policies, a common currency and prosperity and full employment: prosperity and full employment as the foundation for EU citizen's support of the EMU cannot be achieved by clinging to macroeconomic policies of fiscal austerity, structural policies of social retrenchment and market deregulation, or, to put it differently: "if the defence of the euro is a political goal of overarching importance for policy actors […] all over Europe, and economic well-being and full employment are crucial for the mass support of the euro, neoliberal economic policies will no longer do the job (Heise 2015: 450f.). Growing euroskepticism[11] and Britain's exit from the EU mirror the fact that Europe and, particularily, the euro have been increasingly understood as part of the problem, not part of a solution and another serious crisis could well aggravate disintegration tendencies (see e.g. Jones 2009, Kawalec/Pytlarczyk/Kaminski 2020). Therefore, in the midst of the Covid-19 crisis, the EU Commission has been eager to change its, the EU's and the Eurozone's image by signalling it is on the side of the people and supporting the MSs in their effort to overcoming the negative economic impacts of the corona pandemic: the ESM was prepared to financially support needy MSs – something not very well received by most MSs, as the ESM is seen by many citizens and governments alike as an instrument of the 'Brussels–-Frankfurt' consensus. In order to still be able to support economic recovery in a visible way, the EU – both the Commission and the Council – crossed a **red line** which had been defended particularly staunchly by the Northern Continental countries under German, Dutch and Austrian dominance: for the first time and expressly declared unique and exeptional, the EU Commission obtained the right to issue sovereign bonds worth 750 billion euros in finance loans and grants to MSs beyond their own traditional ressources under the banner of the 'Next Generation EU' (NGEU) programme.

NGEU comprises the **European Recovery and Resilience Facility (ERRF)** and some other, pre-existing funds such as Horizon2020 (research & dvelopment), EUInvest and the Just Transition Funds. The ERRF – with 672.5 billion euros over a period spanning from 2021 to 2027 by far the biggest recovery programme – is designed to financially support MSs with 360 billion euros in loans and 312.5 billion euros in grants. Grants and loans will be made available after national Recovery and Resilience Plans have been submitted and the funds have been directed towards

[11] See e.g. Clements/Nanou/Verney 2014, Braun/Tausendpfund 2014, Serricchion/Tsakatika/Quaglia 2013, Usherwood/Startin 2013 and Moore/Trommer 2021.

green (at least 37% of the funds) and after digital transtition (at least 20%), growth, social and territorial cohesion, health and economic and social resilience and strategies for the next generation have been presented and evaluated by the Commision (see Darvas et al. 2021). As the funding, at least during its first phase, will be allocated not by indicators of crisis afflication but by economic development and labour market performance prior to the corona pandemic, the allotment and impact of the ERRF will particularly support Southern Mediterranian and Eastern European countries and thus support real convergence.

Although the ERRF can be critised for its dimensions – the Biden administration, for instance, plans to re-ignite the US economy with a recovery programme on the scale of about 2,000 billion euros and the economic recovery effects of the ERRF may be too small to lift the EU economies back to their pre-crisis growth path (see e.g. Picek 2020, Watzka/Watt 2020) – its vagueness with respect to the exact content of the national Recovery and Resilience Plans, the risk of simply substituting national funds with EU funds and its planned uniqueness, it is nevertheless a remarkable innovation in EU economic governance: it creates a fiscal capacity at the disposal of the EU Commission to stabilise the EU economies, it allocates funds according to economic development rather than fiscal obedience, and it recognises that the 'Brussels–Frankfurt' consensus has failed.

Fiscal policy in times of low interest rates – time to reform the ESGP?

Fiscal policy has always been controversial: on the one hand, there are ideational differences ranging from the ultra-stability orientations of **rational expectations macroeconomics** rejecting deficit spending on the grouds of its alleged long-term ineffectiveness ('crowding out') and supporting fiscal consolidation ('crowding in') to the hydraulic orientation of **standard Keynesianism** favouring discretionary fiscal policy on the grounds of its short-term effectiveness in times of depression ('deficit spending') and booms ('fiscal surplus'), to ideas of **'functional finance'** calibrating deficit-financed fiscal stimuli according to the long-term deviation of economic activity and employment levels from its full capacity and full employment target. On the other hand, there are different interests involved: being able to manipulate the growth path of an economy implies either increasing or alleviating pressure on labour market, collective bargaining and social security systems (by keeping the economy in a semi-slump or stabilising the economy at near-to-full employment levels) (see e.g. Heise 2008: , Pierson 2001). Conservative and liberal parties representing capital interests therefore always favour restrictive fiscal policy preferably engraved in sanctionable rules ('balanced budget'), while social democratic and left-wing parties representing labour interests call for more discretionary policy space ('deficit spending', 'golden rule'). The neoliberal era of the past three to four decades has, of course, been

characterised by an ideational dominance[12] of the 'ineffectiveness hypothesis' and the 'rules versus discretion' debate has been won by those favouring policy rules in order to overcome the 'time inconsistency' problem, to increase policy transperancy and accountability and to bind the hands of the policy actor. Under such conditions in terms of ideas and under the influence of persistently rising public debt levels (as an event), it has become ever harder for social democratic and left-wing parties to sustain their discretionary fiscal policy orientation: particularly the German Social Democrats and Greens became almost as fiscally restrictive as the German Conservatives (and far more conservative than the Austrian and French Social Democrats/Socialists and Greens, for instance) (see Eisl 2020: 14).

The logic of fiscal policy ineffectiveness was based on the idea that deficit-financed public spending will crowd out private spending of the same magnitude (and, of course, a reduction of public spending as a consolidation measure will crowd in private spending), leaving total aggregate demand unchanged. The mechanism to trigger these effects was either an increase in interest rates due to increased (public) demand on the financial market (obviously assuming a fixed credit supply) or the expectation of higher future taxes to repay the debt in the future, which will lead rational economic agents to start saving in the present. This 'expectations'-induced crowding out (or crowding in) only holds true if a 'natural growth path' is assumed that cannot be influenced by public spending. Both channels of transmission may be working in the imaginary world of rational expectations economics but not in the real world of (almost) zero interest rates and growth paths that may be locked in a sub-optimal trajectory leaving room for improvement by public spending which will not be sanctioned by increasing interest rates when credit supply is endogenous and not tightly restricted by a central bank willing to apply quantitative easing measures.

What does that mean with respect to restrictive fiscal policy enshrined in the ESGP? Firstly, it may be the end of the dominance of the 'fiscal solidity and austerity narrative': fiscal policy is effective and austerity will come with great economic and social hardship. Secondly, (almost) zero interest rates – something which must not last forever, yet there is no indication of much higher interest rates in the nearer future (see e.g. Blanchard/Leandro/Zettelmeyer 2020: 6) – imply a very low burden of interest payments on the public budget (and little distributional effect) and thus leave future fiscal space (the primary budget which gives the required budget balance after interest payments have been deducted) almost unaffected. Thirdly, there may be room for an economically appropriate understanding of the 3% and 60% threshold levels of the ESGP: they are not, as is

[12] This ideational dominance came to be known as the 'New Macroeconomic Consensus'.

sometimes suggested, merely arbitrarily set benchmarks, but follow the fiscal arithmetic of Evsey Domar (1944), who mathematically deducted a 'sustainable' deficit ratio depending on the expected long-term growth rate and the debt ratio to be kept stable over the long-term (as the criterium for fiscal sustainability[13]):

$$\mathbf{s/Y = g\ (D/Y)}\ ;$$

with s/Y = deficit ratio, g = growth rate, D/Y = debt ratio

Assuming a long-term nominal growth rate of 5% (2% inflation + 3% real GDP growth rate) and a 60% debt ratio, as the EU Commission did when stipulating the Maastricht Treaty (and probably taking the average EU debt ratio of the time as a score), a 3% deficit ratio is 'sustainable'. However, it must be noted here that this 3% deficit-to GDP-rule determines the **structural deficit ratio**, i.e. the cyclically-adjusted deficit ratio, as we are talking about long-term movements spanning an entire business cycle. The disctinction between structural and **total, cyclically-unadjusted deficit ratios** was only made after the re-inforcement of the ESGP (exploiting some textual ambiguity; see Eisl 2020) and was done so in a way which violated Domar's fiscal arithmetic (by reducing the structural deficit ratio to 'close to balance' according to the 'fiscal solidity narrative'). With the end of the 'fiscal solidity narrative', the ESGP may be spelt in an economically reasonable way: even assuming a more pessimistic (yet more realistic) nominal growth projection of only 3–4% for the EU (and the Eurozone), the sustainable structural deficit ratio around which total deficit would be allowed to fluctuate is between 1.8% and 2.4% of GDP. Moreover, if we take the 60% debt-to-GDP threshold not simply as an arbitary phrasing but somehow reflecting the preferences of the EU citizens, (close to) zero interest rates implying positive growth-rate-interest-rate differentials (which are determinants of the primary budget as an indicator of fiscal maneuvering) would suggest that 'desired' public indebtness (taking citizens' preferences as unchanged) is even increasing: why should citizens still hold on to an indebtness level of 60% of GDP if getting into debt comes almost without a price[14]? Forthly, there is evidently much more fiscal space that could be used to

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[13] Sustainability with respect to public finances is a concept of great textual and ideational ambiguity (see Eisl 2020 for the different forms of ambiguity in finding 'ambigious consensus'). Ordinarily, "sustainable fiscal policy can be defined as a policy such that the ratio of debt to GNP eventually converges back to its initial level" (Blanchard et al. 1990: 11). The ability to stabilise a debt-to-GDP (or GNP) ratio is thus taken as proof that a government is able to service its debt at any time. However, the EU Commission appears to interpret this proof more narrowly as only furnished when the debt service is paid entirely out of tax revenue ('solvency'), i.e. when the structural balance is (close to) zero (see EU Commission 2019: 32). This, however, would imply a falling debt-to-GDP ratio. Moreover, such an interpretation does not sufficiently take into account that governments – as distinct from companies – have some degree of freedom to manage their income (taxation) and expenditures and hence their (structural) budget balance, making the 'solvency' illusion problematic.

[14] For a theoretical model of 'optimal public indebtness', see Heise (2002).

increase public investment spending not only **to stabilise** the EU and Eurozone economies but also to take care of the huge public investment needs in order to cope with **climate protection** and to fulfil the climate targets.

5. Proposals for a better Macroeconomic Framework

The existing macroeconomic framework kept the EU and particularly the Eurozone in a semi-slump for the decade after the global financial crisis and the euro crisis and also proved deficient in the first decade of the EMU. The shortcomings are different in nature: on the one hand, they are due to misconstructions in the architecture, i.e. existing or lacking structures and processes. On the other hand, they are also due to the policy stance pursued within the structures and processes. Much of the critique has been brought forward previously and the evolution of the framework as described in Chap. 2 was in no sense straightforward and inevitable but rather the outcome of the struggle over interests embedded in a frame of competing ideas under the influences of historical events. Therefore, before we elaborate on proposals for a better macroeconomic framework, we will take a look at some initiatives which, if pursued and implemented, could have made a difference.

A short history of missed chances

Ever since the Werner Report on a Monetary Union in the late 1960s, different opinions on the adequate institutionalisation of monetary integration in Europe have been articulated. In the aftermath of the global financial crisis and the euro crisis, there seems to be a broad devide (see Hacker/Koch 2017) within the EU between those MSs favouring what has been called a 'Stability Union' based on the 'Brussels–Frankfurt concensus' and those MSs which favour a 'Fiscal Union' based on the historical evidence that no monetary union ever lasted without also forming a fiscal union (and, finally, a political union; see e.g. Theurl 1992).[15] As has been seen, most institutional reforms are in line with the 'Stability Union' idea and the position of the 'Stability Unionists' is that what is required is no more reforms but better application and compliance. Yet there have also been several proposals put forward that would have paved the way the 'Fiscal Unionists' favoured involving further reform potential:

* After the global financial crisis and the euro crisis, the **heads of the European institutions** (i.e. the EU Council, the EU Commission, the ECB, the EU Parliament and the Eurogroup) published in a number of statements (a communication from

[15] This is not the place to evaluate the claim that the 'Fiscal Union' ideas has an outspoken Keynesian background (see Hacker/Koch 2017: 14f.) or wether it rather follows a more interventionist policy tradition or sheer economic interest (see Hacker/Koch 2017: 38).

the EU Commission,[16] the 'Four Presidents' Report'[17] and the 'Five Presidents' Report'[18]) their view on the advancement of European integration towards what they call a 'Genuine Economic and Monetary Union' (GEMU). Based on a facetted understanding of the origins of the euro crisis and the acceptance of shortcomings in the EU's economic governance system, they tried to reconcile the 'Stability Union' with the 'Fiscal Union' idea by proposing a 'three-stage schedule': in the first stage, real convergence is supposed to be strenghtened by further improving the competitiveness of MS economies. 'Competitiveness', of course, is the buzz word for those that rely on de-regulation and commodification (i.e. micro-level supply-side reforms) as the basis of economic resilience. Although it has been made clear that the proposed 'Competitiveness Authorities' which each MS is supposed to establish will also be responsible for addressing the 'social performance' of MSs and 'German mercantilism' as a problem, it is not evident how this is going to be achieved and the likelihood of using the concept of competitiveness merely as a substitute for neoliberal supply-side measures is high. Moreover, these measures are taken as a pre-condition before entering stages 2 and 3, implying a priority in policy orientation. In Stage 2, the Banking Union is to be completed – involving a 'European Deposit Insurance Scheme' (EDIS) – and the integration of financial markets ('Capital Market Union') is to be fostered. The third stage is most important for our concerns: in this stage, 'fiscal capacity' at EU level is advocated in order to prevent pro-cyclical fiscal policies under the ESGP regulations in times of very severe crisis. That is to say that the restrictive fiscal policy orientation under the ESPG regulations is still seen as appropriate in normal economic circumstances, yet becomes inappropriate solely in extraordinary economic circumstances. Unfortunately, there are clearer ideas regarding what such a 'fiscal capacity' is not supposed to do – no permanent intra-EU financial flows, no incentives to undermine 'fiscal solidity' – than regarding its precise functioning. There is talk of an 'insurance mechanism' either in broad terms or as a specific 'EU unemployment insurance'. Interestingly, tax or borrowing options – a 'euro area budget' – to finance such a centralised 'fiscal capacity' mentioned in the 'Four Presidents Report' and the EU Commission's communication are not pursued further in later documents.

* **French President Emmanuel Macron** delivered a speech at the Sorbonne University in September 2017 about his vision of a reformed European Union addressing questions of centralised macroeconomic stabilisation on the EU level: "We need convergence and stability through national reforms, but also by coordinating our economic policies and a common budget. […] we need the means

[16] See European Commission (2012)
[17] See Van Rompuy et al. (2012).
[18] See Juncker et al. (2015).

to provide stability in the face of economic shocks, as no state can tackle an economic crisis alone when it no longer controls its monetary policy. So for all these reasons, yes we need a stronger budget within Europe, at the heart of the eurozone" (Macron 2017). Although he did not become more specific, political commentators (e.g. Grant 2018) knew that Macron was crossing 'red lines' when he envisioned a European budget with its own tax base and borrowing capacity and a 'finance minister', triggering German opposition. Yet the hope was (and still is) that the German position may change ('they have to give something') after many MSs (including France) have gone through painful supply-side reforms in the past and a German government formed not only by conservatives and liberals may be more open-minded (see e.g. Ettmeier/Kriwoluzky/Seyrich 2021).

Although not many of the 'Fiscal Union' ideas have been seriously discussed, not only the enactment of the European Recovery and Resilience Facility (ERRF) as a response to the Covid-19 crisis but also its Franco-German backing can be taken as a sign that the particular mix of ideas, interests and events at the beginning of the 2020s may allow bold reform steps.

Reform proposals – new framework or piecemeal corrections?

As has been shown, the EU and particularly the Eurozone is trapped in a growth regime based on the 'Brussels–Frankfurt consensus' that may be suitable for an export-oriented, open economy such as Germany but not for an integrated, rather closed economy such as the EU. It therefore suffers from a loss in potential growth, growing internal imbalances and regional disperities and, more generally, growing scepticism about its own future. It does not suffer, as many had feared, from inflation-proneness or frenzied public indebtness. Some may argue that the latter is exactly the result of the monetary and fiscal orthodoxies implemented in the EU macroeconomic governance system. If that is the case, it comes with huge costs, indicating that it is time to move on to another growth regime combining sustainable and balanced green growth without giving up on price stability and fiscal sustainability.

Before answering the question whether such a new growth regime calls for a new macroeconomic framework or rather piecemeal corrections within the old governance system, we should remember the 'inconsistency triangle' mentioned above: safeguarding the Eurozone, pursuing neoliberal economic policies and achieving economic stability and resilience in order to preserve popular support for this kind of European integration has been described as impossible. This verdict is based on a heterodox understanding of capitalist economic activity as inherently unstable and, if uncorrected, permanently waisting potential ('unemployment equilibrium'). A very similar idea to the 'inconsistency triangle' has been put forward under the term 'existential trilemma of the EMU', based on orthodox,

mainstream economic thinking: “its [the EMU’s, A.H.] integrity can only be saved by relaxing either monetary orthodoxy, or fiscal orthodoxy, or both” (Della Posta/Tamborini 2021: 2). Although this understanding goes along with the mainstream idea of economic self-regulation and a tendency of unfettered markets to achieve ‘natural’ (optimal) positions, it can be shown that ‘fiscal solidity’ requiring fiscal consolidation under ESGP regulations may come with (short-term) costs that exceed its (long-terms) benefits and, therefore, would prompt affected governments to quit the EMU in order to prevent a sovereign default. However, this would be the case only under extremely negative economic conditions, yet requires some ‘emergency backstop’ to prevent the potential break-up of the EMU. The point is that even mainstream economic thinking can corroborate both ‘Stability Union’ and ‘Fiscal Union’ positions, the former being applicable to ‘normal’ economic times when an overhaul of the EU macroeconomic framework boils down to rather technical issues (simplifying and yet strengthening ESGP by reducing exemptions or relying on expenditure rules rather than deficit rules; see e.g. Heinemann 2018), while the latter requires complementing the existing framework with some supra-national, i.e. EU-level measure which no single nation can provide. As this addition does not interfere with the workings of the EU governance system in general – i.e. in normal economic times – it cannot be taken as a ‘grand reform’ but is still merely a piecemeal supplementation to the existing system attempting to reconcile ‘risk-reduction’ approaches with ‘risk-sharing’ approaches (see Pisani-Ferry 2018).

On the basis of heterodox economic theorizing, the entire governance system must be overhauled, as it cannot deliver what is needed: a smooth functioning of highly integrated national capitalist economies. In trying to do so, we do not have to start from scratch but we must accept the existing governance system as a backcloth. Moreover, arguments for policy cooperation are still valid, as are arguments for a unitary actor in the case of ‘zero sum games’ and ‘hard coordination’ even in case of ‘positive sum games’[19]. With respect to macroeconomic policy-making in the EU and, particularily, the Eurozone, this means:

* Fiscal policy, particularly under the conditions of (close to) zero interest rates, is a necessary tool of stabilisation policy even under ‘normal’ economic conditions.

* Fiscal policy, particularly public investment spending, is a necessary tool for a green transition supplementing industrial policy as the main policy area concerned.

[19] Which is why I am not following a ‚cooperative system of fiscal governance‘ proposed by Fargnoli (2020) and based on negotiations between the national governments and ‚a competent EU authority‘ without clear rules and sanctions.

* Fiscal policy is a necessary tool to cope with regional economic imbalances (particularily trade imbalances that undermine the smooth functioning of the EMU) and disparities.

* Fiscal policy must be coordinated with monetary policy (particularly in 'normal' times beyond zero interest rate periods) and wage policy to prevent 'macro conflicts'.

* Supply-side policies of structural reforms ('competitiveness') need to be controlled for their dynamic impact on prodcutivity, inequality and social provisioning.

A New Macroeconomic Framework – EU-level versus national improvements

As we have seen, the EU macroeconomic framework is multi-leveled: monetary policy and financial regulation are centralised (or, more correctly, centrally decentralised), crisis emergency measures on the EU level (ESM) have been institutionalised and crisis resolution measures (ERRF) have been provisionally created. There is only little dispute – and this appears to be interest-laden and backwards-bending rather than theoretically founded – about the need to complete the Banking Union with a 'European Deposit Insurance Scheme', particularily as the European financial markets become ever more integrated. The nitty-gritty of economic governance – broad economic policies, fiscal policy and taxation – has been left to the MSs, yet fiscal policy has been coordinated in a hard mode, while broad economic policies are coordinated softly using the OMC and taxation has not yet been coordinated at all.

Particularily on allocational grounds, but also to avoid it becoming a major playing field in the competitiveness game, taxation should be part of hard or even hierarchical coordination – something unfeasible in the near future. However, in the vein of the agreement on minimum global corporate tax rates reached under OECD auspices, the EU must set higher minimum standard rates on corporate taxes and, particularly, must harmonise preferential tax regimes within the EU.

Broad economic policies should be left to OMC as long as no cross-border externalities can be assumed. Whether fiscal policy should remain coordinated in a hard mode, as in the existing governance structure, or coordinated hierarchically by creating an EU fiscal capacity theoretically depends on the strategic position of the fiscal actors: if we can assume a common objective – providing a common public good (stabilising an unstable economy) – the existing structure is sufficient. If we assume no common objective – e.g. systematic re-distribution between regions with different levels of development – hierarchical coordination would be required but also democratically legitimised.

A new fiscal policy framework

An optimal design for fiscal policy in the EU and particularly the Eurozone really depends on the associated objectives and the given legal framework:

* As already mentioned, a positive-sum game that can be assumed as long as the objective is merely to stabilise unstable EU economies would be sufficiently coordinated in a hard mode leaving resources and legitimisation on the national level. However, coordination would still be needed – not so much for 'moral hazard reasons' to prevent 'unsolid behaviour' but rather for 'game-theoretical' reasons to prevent strategic behaviour: without coordination, particularly small, open economies would have strong incentives to leave deficit-financed stabilisation policies to bigger, more closed economies (see e.g. Blanchard/ Leandro/Zettelmeyer 2020: 11).

* A rule-based fiscal policy – quite similar to the 'Taylor rule' of monetary policy – has been proposed by John Taylor (2000). This rule comprises a 'structural' component and a 'cyclical' component. The cyclical component can be taken as containing the 'automatic stabilisers' while the 'structural component' is purpose-built: if the purpose is to keep the economy as close as possible to the target of full-employment, full-capacity utilisation under the restrictions of fiscal sustainability (defined as maintaining a stable public debt level across the business cycle), a 'golden rule' should be employed. This is to say that the sustainable structural deficit – which is required to finance public investment only – depends on the desired public debt ratio to be stabilised and the expected potential growth rate. In the case of the EU, the desired public debt ratio is 60% of GDP, as stipulated in the Maastricht Treaty and successive fiscal regulations – since this ratio surely has no serious foundation in the European public's preferences but was arbitrarily chosen under very different economic circumstances in the early 1990s, it surely must not be taken as a benchmark triggering sanctions in the event of non-compliance in the 2020s, but is merely a symbol with which to anchor expectations and pin down a deficit threshold. Taking into account the uncertainties (concerning future potential growth, the feasability of a certain debt ratio, etc.), the 'fiscal rule' should rather be taken as a 'fiscal standard' (see Blanchard/Leandro/Zettelmeyer 2020: 17f.).

Moreover, as the expected long-term potential GDP growth rate is different for each EU member state – higher for those with catch-up potential – a uniform 'one-size-fits-all' deficit rule is inadequate even if simplicity (for transparency reasons) would be a value in itself. If an MS, for instance, offers the expectations of an average nominal GDP-growth rate of 7% in the medium to long term, it may target a sustainable structural deficit ratio of about 4% (assuming an unchanged 60% cap on the public debt ratio), while another MS with expected growth performance of only 3% would have to target a 2% structural deficit ratio in order to safeguard a 60% debt ratio as a sustainability criterion.

Table 7: Public Investment as % of GDP

Country	Gross fixed capital formation	
	2001–2010	2011–2020
EU	3.4	3.0
Eurozone	3.3	2.8
- Continental	3.9	3.2
- Mediterranian	3.0	2.7
- Liberal	4.0	2.1
- Eastern European	4.1	4.2
UK	2.6	2.7
USA	3.9	3.1

Source: European Economy – Statistical Annex spring 2021

Therefore, the ESGP should be integrated into the BEPG and a medium-term structural defict ratio should be determined and monitored in close cooperation between the EU Commission, the national governments, the ECOFIN Council and the European Parliament – fine-based sanctions are not to be included in the process. Although Tab. 7 does not disclose any particular weakness in public investment spending in the EU and the Eurozone if compared to the US and UK, higher structural deficit options will help break the downward trend in public investment so fatal in maturing economies facing huge challenges in digital and ecological transformation.

* According to the 'Tinbergen rule', the number of (economic) policy instruments and independent (economic) targets should be equal, i.e. fiscal policy assigned for stabilisation purposes can only be used for other objectives as long as these objectives are not conflicting. Therefore, the sustainability requirement of EU fiscal policy can be substantiated with ecological sustainability requirements in as much as the investment orientation of the 'golden rule' could be specified to cater to a 'green transformation'.

* At Germany's initiative, the balanced-budget rule of the ESGP had to be substantiated by similar national regulations on the constitutional level, including restrictions to reform. Therefore, amending fiscal regulations on the EU level would not help as long as more restrictive national fiscal rules prevent a more appropriate fiscal policy stance. In this case, either national regulations need to be reformed accordingly or, if that is unlikely or uncertain, regulations at supra-national level must be sought.

This argument for an EU fiscal facility or an EU budget beyond existing own resources would hold true not only in exceptional economic circumstances but whenever growth falls permanently below potential output. It could be envisioned as a perpetuation of the ERRF with an annual volume determined by the expected long-term difference between planned (private) investment and savings that would be saved from full-employment income ('investment gap') – an orientation of fiscal policy which Abba Lerner (1943) dubbed 'functional finance' in distinction to the 'sound finance' (aka a balanced budget) of traditional reasoning and which Keynes (1943) envisaged rising to levels as high as over 10% of GDP in mature economies. If this entire 'capital budget' (Keynes) were to be deficit-financed, the debt level would grow to heights (above 300%) under normal growth conditions (around 3% on average), which would necessitate a primary public budget (3–6%), which could be considered unfeasible. Therefore, a sustainability cap would be needed in order to stabilise a much lower maximum debt level or a primary deficit ratio that can be taken as manageable. As the EU already has some experience with a debt threshold level, this can be implemented (propably adapted to today's economic circumstances) and would result in fiscal capacity of about 2.5–3.0% of GDP or 300–400 billion euros per year[20].

The financial resources should be handed out as grants to MSs according to forcast potential output gaps and, potentially, other criteria covering structural issues (i.e. green transformation) and the state of economic development and real convergence. In order to cope with moral hazard problems,[21] grants could be coupled with a fraction of national co-financing. Including indicators of economic development (implying permanent intra-EU income flows based on solidarity rather than economic functionality) would strengthening the argument for hierarchical coordination on the EU level, yet would make support from net-contributing countries less likely.

Additionally, interregional discrepancies in business fluctuations in the EU and particularly in the Eurozone can be taken into consideration by supplementing national unemployment insurance schemes with an EU Unemployment Benefit Scheme (EUUBS) which collects contributions and pays unemployment benefits according to the national regulations and rates, yet only for a restricted period (no more than one year, for instance). This instrument would channel financial resources from MSs which are less affected by cyclical downturns or external

[20] The European Parliament (2021: 7) calculates 'investment funding gaps' in the EU of around 800 billion euros per year over the medium term, 470 billion of which are for enivironmental objectives, 140 billion for social infrastructure and 190 billion to stabilise the public capital stock.

[21] It is often assumed that the use of common EU resources undermines the readiness of MSs to perform potentially painful structural reforms (see e.g. Kawalec/Pytlarczyk/Kaminski 2020: 95ff.). However, structural reform cannot be dealt with by fiscal policy for stabilisation purposes but must be dealt with in the BEPG, the EPG and the MIP.

shocks towards MSs which suffer more from these downturns or shocks in order to contribute to EU stabilisation policy, yet the temporal restriction prevents structural unemployment from leading to permanent interregional payments and thus avoids long-term redistribution between MSs.[22]

Further amendments

As pointed out above, the Macroeconomic Imbalance Procedure (MIP) was created – broadly speaking – to somehow take care of those real divergencies that are likely to accrue in non-optimal currency areas undermining the functioning of EMU. In this sense, it is a very broad procedure covering a wide range of policy areas from energy and transport to social topics, taxation, the labour market, the financial sector, health care and pensions, but also fiscal policy and competitiveness issues (see e.g. Bokhorst 2019: 111). The MIP operates via the issuance of Alert Mechanism Reports (AMRs) and in-depth reviews (IDRs) seeking to monitor imbalances that may have significant effects on the economic development of an MS or the EU *in toto* based on a scoreboard of indicators. If such an imbalance is detected, recommendations are given to the affected MS via the Country-Specific Recommendations (CSRs) as part of the European Semester (ES). As the MIP allows fines in the event of non-compliance, the CSRs pertaining to the MIP need to be taken more seriously than those recommendations pertaining to the BEPG or the EPG. Specific to the lMIP is that MIP recommendations are sanctionable, yet ambivalent, giving the EU Commission a good deal of discretion.

Taking for granted the research results indicating that the scoreboard indicators of the MIP are poor predictors of 'economic crisis' or 'system-relevant' imbalances (see e.g. Erhart/Becker/Saisana 2018) and that CSRs pertaining to the MIP are ambivalent in their ideological or ideational direction (see Bokhorst 2019: 118ff.), the MIP should concentrate on its surveilling and monitoring function while relinquishing sanctions-based correction (although sanctions might be deemed to be unlikely anyway). Additionally, it should focus on a very limited number of policy fields directly related to the problem areas of uneven economic development (including income inequality in its regional and socioeconomic dimensions) and economic and financial instability subject to the acknowledgement not only of competitiveness requirements but also of institutional compatibilities and social standards.

Additionally, the European Macroeconomic Dialogue (EMD) needs to be adequately institutionalised in order to serve its purpose: to coordinate monetary,

[22] A comprehensive study about different models has been provided by the European Commission (see Beblavy/Marconi/Maselli 2017).

fiscal and wage policies.[23] Instutionalisation would have to add to the existing forum of communication a body serving to elaborate and monitor cooperation rules (contributions which every actor has to render) and propose sanctions in the event of non-compliance (for a proposal, see Heise 2002). Reliable cooperation is increasingly important in a post-zero interest rate era and in a fragmented wage area such as the Eurozone in order to prevent macro-conflicts.

Indispensable piecemeal reforms

As mentioned earlier, (economic) policy-making is always confronted with the problem of 'model uncertainty': which model or paradigm is appropriate for understanding and explaining the real world and, thus, to provide explanations for policy intervention? The above proposal of a 'grand reform' of the existing macroeconomic framework was based on a heterodox understanding of the capitalist economy as inherently unstable and developing along a sub-optimal growth path. Admittedly, this paradigmatic orientation is not shared by most economists and does not provide the theoretical background to the counselling work of international organisations (such as the IMF or the OECD) or political institutions (such as the EU Commission and the ECB). Arguing on different paradigmatic grounds can make communication and political exchange difficult and may even 'disqualify' the reform proposals – something experienced by the former Greek finance minister Yanis Varoufakis.

Being open to a more mainstream understanding of the capitalist economy may imply rejecting a 'grand reform' of the EU economic governance system, but it does not mean dismissing indispensable piecemeal reforms: establishing an 'emergency fund' *à la* ERRF appears to be a necessary and acceptable concession by the 'Stability Unionists' to the 'Fiscal Unionists'. However, what is more important is restricting the pro-cyclical bias of the 60% threshold, particularly after a major recession: even in a mainstream economic perspective, the 60% threshold cannot sensibly be derived but will trigger an overly restrictive fiscal policy stance if it continues to coercively impact on the medium-term obejctives (MTO) of structural deficits.[24]

The role of the European Parliament in a new macroeconomic framework

Policy-making needs resources, orientation and legitimacy. In liberal democracies, legitimacy is derived from parliamental endorsement of policy programmes using

[23] A study by the German think tank DIW simulated the different impacts of fiscal policy under conditions of cooperative (supporting fiscal policy) or uncooperative (fixed on price stability) monetary policy: in the latter case, GDP growth caused by fiscal policy is markedly lower than in the former (see Ettmeier/Kriwoluzky/Seyrich 2021).

[24] The negative growth effects of such a policy are simulated in an ordinary neo-Keynesian model: see Ettmeier/Kriwoluzky/Seyrich (2021).

resources provided by taxation and borrowing (input legitimacy) and popular scrutiny in elections (output legitimacy). European policy-making is a delicate mixture of intergovernmentalism, decentralised centralisation and some traces of centralised decentralisation with the European Council and the European Commission in the driving seat and the European Parliament very much on the sidelines. Although the Treaty of Lisbon gave the EP more co-decision rights, it can hardly be maintained that the EP has assumed genuine parliamentary law-making functions – and at least in the case of soft and hard modes of coordination of national (economic) policies, it could be argued that these functions must remain with the national parliaments. However, in these cases national parliaments were involved in shaping the procedures, yet no longer control their implementation. Moreover, the few cases where hierarchical coordination has been created (i.e. the 'Treaty on the European Stability Mechanism' (ESM) and the 'Treaty on Stability, Co-Ordination and Governance in the Economic and Monetary Union' – the Fiscal Compact – hardening the SGP and creating the MIP and the ES), this has been done under international law rather than European law, again diminishing national parliamentary functions without replacing them with appropriate involvement and co-decision rights of the EP. This evolution – extremely visible in Greece during the euro crisis, when the outcome of the 2015 elections could be taken as a referendum against austerity policies imposed by 'the institutions' in order to receive emergency funding from the ESM, which the Syriza government ultimately had to accept – has been termed 'postdemocracy' (Crouch 2004) and is perceived by many as 'defunct' or 'repressive' democracy.

Despite these critical developments, the EP has been fairly successful in expanding its areas of responsibilities to hold the EU Commission and the EU Council accountable by introducing Economic Dialogues into the ES procedure (see e.g. Schoeller/Heritier 2019, Fromage 2018) – "[a]ll these instruments are however rather soft in their nature: the EP is not formally deciding on anything and it is not able to truly balance the Commission's extended powers" (Fromage 2018: 290).

Therefore, any governance procedures of a supranational, unitary nature must come under the control of the EP for legitimacy reasons – this applies as much to the EMS as the MIP and, most importantly, the fiscal facility to be established. 'Coming under control' means conceding to the EP not not only information and consultation rights, in order to strengthen transparancy and accountability, but also the democratic right to determine the broad policy guidelines to be followed by the respective administrative bodies (as already urged by the Four and Five Presidents reports) which will, of course, be responsible for the administration of policy programmes. The principle of 'no integration without representation' has accompanied European integration throughout its history and is supposed to continue to do so (see Rittberger 2014: 1176).

6. Conclusion

Ever closer economic integration of the Member States forming the European Union and the Eurozone demanded ever closer coordination of national economic policies as well as ever closer cooperation of different economic actors in different policy areas in order to maintain the capacity to provide the public goods that are desired by European citizens and are necessary to increase the welfare of the people.

A European economic governance system providing necessary coordination and cooperation was not designed on a chartboard, but developed within the triangle of interests, ideas and events. Neoliberal dominance over the past two decades has prevented the establishment of a macroeconomic framework, enabling stabilisation policies to cope with the aftermath of major economic turbulences, to keep the European economies on a growth path comparable to other major economies or to guarantee a convergence of economic performance in the EU and the Eurozone. It became evident that particularily the Eurozone is stuck in an 'inconsistency triangle' or 'existential trilemma' which can only be solved by either ending the project of a single currency or by giving up monetary and fiscal orthodoxy.

Assuming that ending the EMU is not a feasible option, giving up monetary and fiscal orthodoxy is not only what needed to be done on a pragmatical level – as has been practised by the ECB ever since the global financial crisis and temporarily by the governments of the Eurozone MSs during crisis years – but need to be reflected in a transformation of the institutionalised macroeconomic framework towards balanced and sustainable growth. Proposals have been made for a major overhaul of the existing procedures and for piecemeal reforms. However, in order to give such proposals a realistic chance of being implemented, the triangle of ideas, interest and events must open a widow of opportunity. The corona pandemic in the very short term and the climate challenge in the medim to long term appear to be the events that may trigger a rethink based on a breakdown of the New Macroeconomic Consensus – facilitating the renewed interest in Keynesian stabilisation policies on the ideational level – and a possible shift in the German position towards fiscal policy needs in a monetary union – strengthening the fiscal unionists at the level of interests.

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