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The Euro zone: from impossible reform to bifurcation

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Abstract

In spite of the improvement of the macroeconomic conditions in the Euro area since 2016, unemployment remains high in the South and income inequalities very wide. All this leads to persistent social tensions. Destabilising factors remain with high levels of both public and private debts, fragile banks and the threat of higher interest rates to come. Intra-European imbalances are large with important heterogeneity between European countries and regions. The necessity of a deep reform of the European institutional framework has been reaffirmed. Several typical alternative structures have been suggested: a reaffirmation of the no bail-out clause for member state governments; the fiscal federalism; the model of European budgetary integration with public debt centralised at European level; the creation of a Euro Treasury. These alternatives raise serious problems and/or are hardly realistic in political terms. It reflects the lack of solidarity and trust between European countries. The Euro zone members have the same currency but their national public debts are not equivalent. There is no political agreement to allow the ECB to guarantee the national public debts, nor for permanent transfers between countries. The better economic conditions and the large political divergences between European countries add up in favour of the status quo.

Facing this risk, more hybrid proposals have been presented. The first one (CEPR, 2018), rather technocratic but close to policy makers, is based on new rules and institutions: a simple public expenditure rule, the possibility of sovereign debt restructuring and a more credible no bail out rule, a euro area fund to help countries facing large shocks, the creation of a synthetic euro area safe asset, a reform of the governance. Analysed in detail these proposals are not convincing. They mean an approval of the no bail out principle, a strengthening of the financial markets, a risk of more financial instability, a weakness of the institutions to be created and an enhancement of the technocratic controls.

The second proposal (IMK, 2018) is an attempt to find a pragmatic compromise between unconditional support by ECB and national fiscal policy and strict conditionality on risk-sharing measures. It implies to have symmetrical and counter-cyclical policies in all member states and to increase mutual trust between all the actors. However the difficulty of implementation of the IMK proposal cannot be ignored. A third scenario could be considered, a "Union of large countries" ready to accept political and fiscal union (Piketty, 2008), which would be also rather unlikely. Last the proposal of a complementary currency has always partisans.

In this context the minimalist compromise remains the more likely scenario, as it is illustrated by the project of European budget presented in May 2008 by the European commission. At the best a small line in the EU budget would be reserved to the Euro zone and a reduced investment programme would be designed. However, an ultimate bifurcation could appear if a large country like Italy faced an unsustainable political shock.

An exhausted economic recovery

In spite of the economic recovery since 2016 in Europe, including in the South, the euro-scepticism remains strong, as it has been shown by the Brexit, the Italian, Austrian and, to a less extent, German elections. Strong nationalist movements exist in Eastern European countries. Macron's reform proposals have been received with reserve. Political and social tensions are important.

The economic recovery has been blocked since the first quarter 2018. Income and wealth inequalities remained high and characterize the growth regime which settled since the 1990s. The rate of unemployment is always high in many countries or regions. In most of the cases unemployment has only decreased with the multiplication of precarious jobs. The liberal adjustment through wage deflation and fiscal austerity has been at work with high social costs. It has been more efficient in the "small open countries" of North Europe for two main reasons. In these widely open countries the decrease of the domestic demand induced by the wage deflationist policy can be more easily compensated by the foreign trade. The small size of these countries and their greatest homogeneity have allowed to find social compromises for carrying out the necessary adjustments. These countries are in favour of an institutional status quo and plead for the sole respect of the common rules. The German block has consolidated its manufacturing core with its networks of subsidiaries and subcontractors in the countries of its periphery. The Eastern European countries have been partly catching up, thanks to the European Funds, to the foreign direct investments and, in some cases, to a flexible exchange rate policy. But inequalities are important. The repatriation of profits by the multinational firms exceeds the European aids and generates some discontent (table 1).

Table 1: Incoming and outgoing flows in East European countries, average 2010-2016, in % of GDP

	Poland	Hungary	Czech Rep.	Slovakia
EU transfers (incoming flows)	2.8%	4%	2%	2%
Profits and other property incomes (outgoing flows)	-4.8%	-7%	-7.5%	-4.2%

Source: Piketty (2018a) ; Eurostat and EU budget

The refugee flows in 2015 have led to rising xenophobic movements in Western and Eastern Europe. Its extent has to be mitigated. The shock has mainly been important in Germany and the flow has been restrained thanks to agreements with countries of the European periphery, first with Turkey. But the migration problem is larger with the huge demographic imbalance which is expected at medium-long term, especially in Africa.

The intra-European imbalances remain deep with a large heterogeneity between Europe and regions. The social tensions are great. The factors of financial fragility remain and the reforms have not been brought to an end. The Banking Union is unfinished with two pieces missing: the Single Resolution Fund is too limited to be able to stabilize the European financial system; no compromise has been found for the European Deposit Insurance Scheme. The necessity to deeply reform the euro zone institutional framework is often reaffirmed. But the

current economic recovery and the huge political divergences between European countries favoured the status quo and the search of a minimalist compromise.

Unconvincing or unlikely alternatives

Four alternative architectures have been proposed for the euro zone: a return to the no bail-out clause; the model of fiscal federalism; the model of European budgetary integration based on a partial mutualisation of the national public debts; last the creation of a Euro-Treasury.

A return to the no bail-out clause

In this regime the original principles of the monetary union are restored and completed. States preserve or recover their budgetary sovereignty at the national level but reassert the no bail-out clause. States are no longer constrained by inappropriate rules such as the limit of 3% of GDP for the deficit or 60% of GDP for the debt, but are subjected to the discipline of the markets. There is no solidarity between states. In the event of over-indebtedness and default on the debt of a state the investors (that is, essentially, the banks) suffer a loss. In theory this is made easier because states are protected from bank failures by the Banking Union. To reduce the risk of crisis the banks have to cover their purchases of government debt with more of their own capital. Government bonds are no longer regarded as risk free from the point of view of prudential supervision. Experience shows, however, that investors do not always assess accurately the solidity of states. To avoid large-scale panics the ESM could be activated and the debt rescheduled by means of a strictly controlled adjustment plan.

This model has resonated to some extent in Germany (Fuest and al., 2016). In theory it gives autonomy back to the states while retaining the possibility of a stabilisation role for the EU in the event of an asymmetric shock, at least while the state concerned was regarded as solvent. It avoids both the ex ante and ex post co-ordinations and controls which function very badly.

But there are many difficulties. The possibility of a crisis of over-indebtedness leading to debt restructuring inhibits a state's capacity to use budgetary policy to respond to an asymmetric shock. We come up against the basic problem posed by the functioning of the eurozone. To avoid costly, difficult to control, dislocations, general patterns of convergence in tax regimes and public expenditure would be necessary. The budgetary autonomy which is supposedly recovered would be a trap. Government bonds would lose their status as risk-free assets which is one of the pillars of the financial system and the functioning of the financial system would be impaired. There is a risk that crises in the public finances could be amplified. This regime rests partly on the Banking Union which is unfinished. The failure of a very big bank would be difficult to manage and the resolution fund does not have sufficient resources. Lastly, in the event of a restructuring of its debt the size of the state concerned could raise a problem. The limits of market-based regulation would appear if a large state such as Italy were affected.

The model of fiscal federalism

In this model a stabilisation function is introduced at the level of the euro zone by establishing a federal budget financed by new taxes (a tax on financial transactions, a carbon tax) or by moving some taxes from national to euro zone level in order to avoid a ruinous race to the

bottom (taxes on interest on savings and on dividends, taxes on corporate profits). In the very probable case of difficulties in establishing such a fiscal base, a simple borrowing capacity would be introduced for crisis periods. In both cases transfers or investments could be undertaken to assist states affected by negative shocks.

As for the previous regime budgetary sovereignty would be restored to member states with no constraining European rules but this would be matched by a reassertion of the no bail-out principle. Consequently there is a possibility of debt restructuring in cases of over-indebtedness. This is what can be observed in the US, where the states of the union and cities are responsible for their own debts and where the federal government does not impose rules. Chapter 9 of the bankruptcy code provides the framework for debt restructuring of cities, counties, townships and school districts and of public agencies (case of Jefferson County, Alabama in 2011, Detroit in 2013). But states cannot access chapter 9. In the event of a negative shock, as well as the stabilisation effects linked to the working of the federal budget, there may be transfers or loans from the federal budget, accompanied by sanctions and direct budgetary control (New York in 1975, Columbia in 1996). More recently, however, a debt restructuring procedure has been carried out in Puerto Rico together with controls over its budget.

Transposing this American model into the European context would involve several problems which would be difficult to overcome. The establishment of a federal budget is hardly probable because of the absence of any spirit of solidarity among eurozone countries and the scale of the changes which it would require. A less ambitious solution would involve opting for a mechanism where there were no permanent transfers across states (states being net contributors or net beneficiaries according to the changing circumstances) and where, over the long run, accumulated transfers would be close to zero. Several studies, of which the first go back to the early 1990s (Italianner and Pisani-Ferry, 1992) have shown that a common system of unemployment insurance at the European level would meet this objective and achieve a certain macroeconomic stabilisation at a limited cost (Benassy-Quéré, Ragot and Wolf, 2016). It would be limited to periods of crisis and based on changes in the unemployment rate rather than its level. To illustrate the possible order of magnitude one can point to the American unemployment insurance system which supported some 0.4% of GDP each year between 2008 and 2011. But the successful introduction of even such a relatively modest mechanism would presuppose that a minimal harmonisation of labour markets had been achieved in order to avoid the same shock having opposite effects in different countries. Now the labour markets are very heterogeneous and even a minimal harmonisation would take time. And the more successful countries fear having to contribute more than the countries with a weaker performance.

Finally, the no bail-out principle would raise the same problems as in the previous regime. The American model, combining a federal budget with a no bail-out principle cannot be transposed to the euro zone. In the US the federal debt represents 100% of GDP, that of the states and municipalities about 30%. In the euro zone there is neither a federal budget nor European debt and all public debt is at the national level. To reassert the no bail-out principle

for member states would be a destabilising factor and a constraint on national budgetary policies.

A Model of European Budgetary Integration

This model draws lessons from the problems raised by the two models considered above. It starts from the observation that the principle that each state is individually responsible for its debt leads to an increased risk of crises of public debt even for countries regarded to begin with as solvent. To make it possible for the euro zone to function a mutualisation of at least part of the debt would be introduced. Mutualisation could take different forms.

The most natural form would be a European fund for the redemption of public debt, issuing long-term debt instruments (*Eurobonds*) and mutualising national debts above the threshold of 60% of GDP. Debts below that threshold would remain the responsibility of the member states because it would be too costly to mutualise the whole of the debt. However the market value of the public debt which would not be covered by the Eurobonds could decline or, even, collapse. The banks would therefore be unable to use it as collateral for refinancing at the ECB which could be at the source of a financial crisis. Another solution which is sometimes put forward, to mutualise debts *below* the 60% threshold and leave debts above that level to the member states, seems to be less realistic because it would leave the most indebted states under market pressure. The ESM could play the role of redemption fund and organise the exchange of national debt for the European debt it would issue. This would require a substantial increase in its capital to allow it to carry out operations not in its original mandate.

However that may be, the mutualisation of debts would help to bring down the cost of the debt and to reduce the risk of default by the most indebted countries. There would be a transfer to the disadvantage of the less indebted countries linked to the difference in interest rates and the collective management of risks. With the diffusion of Eurobonds as substitutes for national ones, the banks which hold the bulk of national bonds would be protected against the tensions which could come from the most fragile countries.

But to counterbalance the mutualisation of debts there would have to be substantial control over national budgets to avoid the risks of slippage in countries which are insufficiently disciplined in their public finances. Two contrasting methods can be envisaged. The first would rely on the greater budgetary discipline imposed by some independent body such as the European Fiscal Board, created by the Commission in 2005, whose role might be extended. On the basis of its diagnosis (favourable periods permitting budgetary surpluses, unfavourable ones allowing wider deficits) it would fix binding limits to the overall position of national budgets. The second method would be based on democratic progress with the establishment of a parliament of the euro zone which would determine broad budgetary guidelines for the euro zone as a whole and the allocation of corresponding targets to individual countries. The comparative strength of different countries within this euro zone parliament (23% for Germany, 50% for France, Italy and Spain if they formed a bloc, 27% for the others) allows some commentators to hope that a majority less inclined towards austerity might emerge. It’s far from obvious that this would happen. In any case, whether the procedure is technocratic or more democratic, it would establish tutelary supervision over the broad structure of national

budgetary policy. The importance of that problem should not be underestimated. Further, there is the reluctance (or even the straight refusal) of the Germans to accept the largest part of the costs of this mutualisation. All this explains why nothing has come of this idea which was put forward at the beginning of the 2010s, in spite of the way it could make the monetary union more viable.

Beyond these observations, two basic problems would remain unresolved: macroeconomic stabilisation and the heterogeneity and unequal competitiveness of member states or, in other words, the persistence of misaligned real exchange rates.

The problem of stabilisation would arise since, because of the budgetary rules to be introduced, the highly indebted countries would have no more room for manoeuvre in the case of a negative shock. In theory the solution would involve a federal budget. This would be difficult unless it took the form, as discussed above, of a small budget making temporary transfers to stabilise economic activity but required to balance these out over the cycle, or the form of a European unemployment indemnity which, as we have seen would be equally difficult to organise. Another mechanism which has been suggested is the creation of national adjustment accounts to smooth out public expenditure over the cycle (Benassy-Quéré et al., 2016). In a period of crisis certain expenditures could be taken out of the calculation of the deficit and transferred to the adjustment account. They would be taken back into the budget calculation when things had returned to normal. The ECB would play a central role in the functioning of this technocratic arrangement in order to avoid it becoming a basis for excessive budgetary autonomy at member state level.

The persistence of misaligned intra-European real exchange rates, illustrated by current account surpluses in Germany and deficits in France, is more problematic, even though they have been reduced. In 2016 the euro remained under-valued for Germany and over-valued for France (Duwicquet et al., 2016). In the framework of a monetary union there is no mechanism which can respond in a satisfactory way. If wage deflation in the South of Europe is rejected and wage increases in Germany are difficult to bring about then there only remain reductions in taxes and other charges such as the CICE (Crédit d'impôt pour la compétitivité et l'emploi; tax credit for competitiveness and employment) which have a high budgetary cost and thus cannot deal with the problem. Structural policies aimed at improving non-price competitiveness could also contribute to the response to the problem. They ought to be used but are difficult to design and to implement and only make a difference in the long term.

European budgetary integration would amount to a considerable leap forward. The mutualisation of national debts might be used to avoid the need for a federal budget. Member states would no longer be threatened by the no bail-out principle but the counterpart for this would be a loss of autonomy in national budgetary policies which would be controlled by an independent European institution or a euro zone parliament. This would be a difficult hurdle to clear and beyond it two problems would remain. For stabilisation purposes some substitute for a federal budget would have to be introduced and it is not obvious how this could be done. Nor would a mutualisation of debts resolve the problem of misaligned real exchange rates among European countries and the structural imbalances linked to the heterogeneity of the euro zone.

The creation of an Euro-Treasury

The creation of a Euro-Treasury (Bibow, 2016) is based on the distinction between current expenditures and investment expenditures. In the national budgets the current expenditures should be balanced. The investment expenditures (around 3-4% of the GDP) would be financed by indebtedness through a specific account managed by the Euro-Treasury. This one would get into debt and would issue euro-bonds. It would reverse investment grants to national governments in line with member states' GDP shares (or with the ECB's capital key). The same structure would be used to calculate their interest payment obligations. The Euro-Treasury would raise taxes to meet the interest service on the common debt. The national debts in % of GDP would decrease tendentiously while the common European debt would rise and could cap at 60% of GDP at medium-long term.

The idea of the Euro-Treasury is attractive. It allows the funding of the public investment expenditures which have suffered long lasting erosion in the past and a progressive increase of a genuine European debt without mutualising the existent national public debts and without intra-European transfers. It creates a counterpart at the fiscal level to the ECB which, in case of crisis, would have with this European debt the possibility to act as a lender of last resort in a less controversial manner than with the current national public debts.

But it raises several difficulties which make the project not very operational. First, it is based on a fiscal rule, the "true golden rule for public finance": current expenditures in equilibrium, public investment expenditures financed by government debt, as they can improve the productive potential and the future fiscal income. This rule has an objective basis in spite of the difficulty of definition of the notion of public investment. In practice it is far from being accepted at the European level, especially in Germany. It would lead to a permanent public deficit around 3-4% of GDP.

Second, the public investment expenditures would be financed by a European debt but would always be managed at the national level, which is well adapted for practical reasons. The problem of the control of these expenditures would none the less exist, as in the case of mutualisation of the national debt. Which institution would be in charge of this control beyond the national governments, a technocratic institution as a European Fiscal Council or a parliament of the euro zone?

Looking for operational compromises

The alternative architectures for the euro zone considered above (return to a no bail-out clause, an American model, European budgetary integration with a mutualisation of debts, the creation of a Euro-Treasury) raise a multiplicity of problems and/or are hardly realistic in political terms. More pragmatic proposals of varying kinds have been put forward. The first comes from a group of 14 economists from Germany and France, close to policy makers; the second made by IMK is an attempt to find a pragmatic compromise; the third is advanced by Piketty in favour of a political union of the large countries; last the proposal of a complementary currency has always partisans.

Reconcile market discipline and solidarity

The proposal coming from the 14 economists (CEPR, 2018) wants to be constructive and tries to reconcile risk sharing and market discipline with a very limited form of solidarity

(Sterdyniak, 2018). First, the current fiscal rules are too complex and would be replaced by a simple one: the growth of public expenditures must not exceed the long term GDP growth and must allow a reduction of the public debt. This rule would be in practice imprecise and would be very controversial. More worrying, if the public expenditures are considered as excessive (we will see below by who), the surplus of expenditures would be financed at a higher cost by the markets and the associate bonds would be downgraded.

Second, the public debts would be risky and could be restructured according to the principle of no bail out. Banks would take variable risks according to the countries. In this framework the Banking Union would be finished to make a firewall between bank risks and public debts. A system of deposit insurance would be created but the banks' assets would be diversified according to the public bonds of the different States. The insurance premium paid by the banks would depend on the specific country risks. Restructuring of public debts would be possible in case of necessity under the control of the European Stability Mechanism (ESM). This would encourage the financial markets to impose risk premium and would favoured the speculation on public securities.

Third, a Fund would be created to help euro zone's countries in the event of crisis with the usual strict conditionality (fiscal rules, European semester). Transfers would be temporary. The contributions of the member states to the Funds would be so much higher than the country is more instable and has been using the Funds. In other word it would be the countries the most in difficulty in the past which would more contribute to the Funds and finance the countries now in difficulty. The countries in better economic situation would less contribute. A strange conception of the solidarity.

Fourth, a synthetic safe asset without risk would be proposed to investors as an alternative to national public debts considered as potentially risky. It would be a basket of public debts of the different States whose only the most secured segments would be kept. In practice the German bonds would occupy a central place in this synthetic asset. Such a framework would only accentuate the financial disparity of the euro zone and would offer a new field for the speculation.

Last, the supervision of the national fiscal policies would be ensured by an independent European commissioner. The president of the Euro-group, Finance minister of the euro zone, would have the decision-making power.

On the whole this CEPR proposal cannot be recommended. It is a new flight forward with the reaffirmation of the principle of no bail out, a strengthening of the financial markets, a risk of more financial instability and insufficient accompanying measures (the European fund). The technocratic control would be reinforced.

A coherent and practical framework

The second proposal, made by IMK (Watt and Watzka, 2018), is an attempt to find a pragmatic compromise between unconditional support by ECB and national fiscal policy (which stabilises but may favour moral hazard) and strict conditionality on risk-sharing measures (which limits moral hazard but may be destabilizing through financial markets). It implies to have symmetrical and counter-cyclical policies in all member states and to increase mutual trust between all the actors. Unconditional and unbureaucratic support can be given for small interventions to avoid self-fuelling crisis. More conditionality would be introduced

in case of greatest support but intervention would also be exerted on surplus countries. Based on these principles, three levels of action can be distinguished.

First, the Banking Union must be completed. Beside the Single Supervision Mechanism and the Single Resolution Mechanism, an area-wide deposit insurance mechanism must be created, irrespectively of which member state the bank is located in. This lack of any national compartment is crucial. It would require a fiscal back-stop to support unconditionally the Deposit Insurance Fund and this could be done through the ESM.

The lender of last resort function of the ECB needs to be strengthened. Instead of only accepting government debt of sufficient rating according to private agencies, ECB could accept all government debt considered as sustainable in a fundamentals-based analysis. In order to reduce the risk of abuse, a preventive approach should be implemented. Conditionality could be introduced on the basis of politically legitimated decision.

Second, symmetric macroeconomic policies should be implemented to prevent imbalances and insure against macroeconomic risk. The CEPR proposal based on an expenditure rule with a debt target is supported in spite of its limits. Collective support measures are also needed in the prolongation of the Juncker Plan and the European investment stabilisation Function but the amounts remain too limited and the procedure too complex. Cross border automatic stabilisation would be necessary but technical and political obstacles are numerous. Among the set of proposals the European unemployment insurance system is the most well known working as a reinsurance scheme for national systems but concrete implementation remains an open question. More broadly the necessity to move to the euro area level with an enlarged budget and a borrowing capacity is underlined but the political obstacles are huge.

Third, institutional reforms should help to improve coordination mechanisms in order to promote convergence and more symmetric evolutions. The emphasis is put on soft coordination mechanisms: creation of an Advisory board for macroeconomic convergence at the national levels; enlargement of the Macroeconomic dialogue and of the Macroeconomic Imbalance Procedure at the European level; elaboration, within the framework of the single monetary policy, of a broad macroeconomic policy mix including fiscal, wage and price developments.

On the whole, the IMK proposal is an elaborated attempt to find a compromise between all the constraints which exist within the European monetary union. It deserves to be supported. It is more realistic than more traditional contributions by Keynesian-inspired European economists (Andor et al., 2018) who underlined the necessity of a small budget for the euro zone, a stabilising mechanism with an European unemployment insurance system, the development of own resources (value added tax, carbon tax, corporate income and capital income taxes) and of an autonomous borrowing capacity, the finance of investments in new technologies and energetic transition at the European level. A democratic jump would be necessary to impose and support these transformations, which is far from being accepted.

However the difficulties of implementation of the IMK proposal itself cannot be ignored in most of the fields. The euro area deposit insurance mechanism and the new form of lender of last resort function would face political obstacles. The soft coordination would be requisite but appears hardly manageable.

The temptation of a "Political Union of the large countries"

Accordingly, a temptation can exist (Piketty, 2018b): the constitution of a subblock at the level of the "large countries" (Germany, France, Spain, Italy?). Two reasons could justify such a grouping. The adjustments through wage deflation, which is within the euro area one of the main substitutes to the exchange rate variations, are there more costly and less efficient than in the "small countries". The "large countries" have less used the fiscal dumping than the "small countries" to attract the foreign investments. The "small countries" have often resorted the unanimity rule to reject fiscal harmonisation policy at the level of the EU.

A (small) Political and Fiscal Union would be settled under the democratic control of a Parliament of the Union coming from the national parliaments. This union would be open but the member states of this union would be obliged to accept its rules. Own fiscal resources would be created (taxes on high incomes, on land capital and on financial assets, carbon tax, tax on financial flows, increase of the corporate income tax). To make this project more "acceptable" by the public opinion, transfers between member states could not have a permanent character.

This last project has a certain rationality based on the opposition between "large" and "small" countries but it seems also rather unlikely. New taxes (on high income and capital income, on land capital) would need a political majority to go in this direction. An increased taxation of financial assets and of profit could lead to capital flights and outsourcing in the European countries staying outside this new Union. Retaliation could be necessary in case of too large capital flights. If there is no transfer between members of the Union, the project would lose relevance. Disparities between countries would remain, especially in terms of exchange rate misalignments (at the advantage of Germany currently). In this Union divergent evolutions would remain due to the structural heterogeneity. The adjustments would only be possible through real devaluations (in practice through wage deflation, as the coordination of the wage policies, although preferable, is difficult to implement) or through labour mobility (which has a more limited impact and raise other problems). Structural change with an improvement of the non-price competitiveness of the southern large European countries would be a better track but is a long term and complex strategy.

The Political Union of the "large countries" would raise two other problems. First, it is not clear why Germany would accept to split its manufacturing basis formed with the "small countries" of its neighbourhood which would be rejected outside this union. Second, within the union the relations between the central bank of the union (to be created) and the national public debts would not be fundamentally different from what they are within the euro zone. The Italian public bonds could hardly be considered as equivalent to German ones. The existence of a majority in favour of such a project at the level of the "large countries" is far from being evident. It is so much the less than a "southern large country", Italy, has entered into a turbulence zone.

An ultimate spare wheel, a complementary currency

The previous assessment has underlined how difficult it is to find a practicable answer to the current weaknesses of the euro zone. An ultimate spare wheel, the creation of a fiscal complementary spare wheel, has always some partisans (Théret and Coutrot, 2018). The idea is simple and has been defended since a long time, especially in the Greek case (Papadimitriou et al., 2014; 2016). The euro would be kept as a common currency but would be completed by a national parallel currency under the form of Treasury bills of a small

amount (5 to 50 euros), with a limited duration but renewable. This mean of payment, designated as euro-peseta or euro-lira, would be backed as other public debt by the future tax revenues. It would be kept at parity with the euro without being freely convertible on an exchange market. In that sense it would not be a true currency. But it could be used by the State to pay civil servants' wages, social transfers and public procurement. Reciprocally the State would accept these bills in payment of taxes at the same parity and without restriction. This guarantee is a key issue to allow the social acceptance of this complementary currency. According to its advocates, it would reduce the austerity policy and help to implement recovery policy by stimulating the demand side. Due to the non convertibility of this complementary currency, the producers of local goods would be advantaged by comparing with the foreign producers which would be reticent to accept this new currency. A self-centred recovery could be developed. All this would help to reduce the public debt, directly because the State would become less dependent from the financial markets to finance its expenditures, indirectly as the recovery would increase the GDP and reduce the debt ratio.

In practice, the positive effects seem to be overestimated by the advocates of the complementary currency. The self-centred recovery could be limited as it would be quite difficult to favour the producers of local goods. The firms would be reluctant to accept to be paid in this parallel currency as it would be difficult to use it after for other purchases. The positive loop stimulating the activity would exist but could be limited and reduced to the simple return effect on the taxes which would be paid with the complementary currency. The question of the social acceptability of this new (but non convertible) currency is not sufficiently discussed by its advocates.

A minimalist compromise

To conclude, the solution of a minimalist compromise at the European level seems the most likely. A budget of the euro zone could appear but would be reduced to a simple line in the EU budget which would itself suffer of strong constraints. The achievement of the Banking union is considered as a priority but the system of insurance deposit would only be managed at the national level, for lack of sufficient solidarity. Likewise, the Resolution funds would remain with an insufficient endowment, but the possibility of a complementary support by the ESM remains in discussion. The transformation of the ESM in a European Monetary Fund able to intervene in case of crisis of some countries, including in a preventive way or in managing debt restructuring, is more unlikely. The competition policy would remain the core of the EU with a race to the bottom in matter of taxation and the retention of the unanimity rule which is paralytic. Progress could be considered in some more limited fields, a harmonized definition of the consolidated tax base for the corporate income tax, some progress in the taxation of the GAFA, a European fund for investments in the breaking technologies and some forms of control of foreign investments in the EU. This compromise could make illusion but would be fragile in case of economic turnaround.

The Multiannual Financial Framework for the EU for 2021-2027 recently presented by the Commission (2018) is revealing the existing constraints. "Do more with less" is the master word. The targets have been multiplied with less resource. New fields of intervention have appeared (border management, defence, migration policy, neighbourhood cooperation) with limited institutional basis. Debates on the euro zone governance don't appear. Without surprise the common agricultural policy and the cohesion policy which represent each around

36% of the total of the budget are the main potential sources of budget savings to finance the redeployment of the expenditures. On the whole the budget amount is 1194 billion € for 7 years, 1.11% of National Income (instead of 1 .13% during the previous period).

Tableau 2: Multiannual financial framework 2021-2027 (billion euro, 2008 prices, for 7 years and in % of the current Multiannual financial framework)

Single market, innovation and digital	166.3	
RD	91,0	8
Digital	10.8	1
Cohesion and values	392.0	
Regional development and cohesion	242.2	21.3
EMU	22.3	2.0
Erasmus	26.3	2.3
Natural resources and environment	336.6	
Agricultural and maritime policy	330.7	29.1
Migration and border management	30.8	
Migration	10.0	0.9
Border management	18.8	1.7
Security and defence	24.3	
Defence	17.2	1.5
Neighbourhood and the world	108.9	
External action	93.1	8.2
Total	1 134.6	100

Source: European Commission (2018)

Regarding the resources, the Brexit would be used to progressively suppress the rebates which have been granted in 1981. The system of own resources based on VAT could be simplified and new own resources (emission trading system, consolidate tax base for corporate income, contribution on non-recycled plastic waste) could be mobilised for 22 bill € per year (12% of the current budget). They would contribute to finance the new priorities of the budget.

The apothecary calculations which go with the EU budget illustrate the no way of the current status quo. This status quo reflects the lack of solidarity and trust between European countries. The euro zone members have the same currency but their public debts are not equivalent. For each country the single currency appears as a foreign currency. There is no agreement for the ECB to guarantee the national public debts or for permanent transfers to exist between States. The elaboration of a more ambitious compromise is made difficult by the multiple fracture lines which exist within the EU: the “small countries” more flexible facing the “large countries”, the “old countries” facing the former eastern countries, the countries of the “German block” facing the southern countries.

The Italian chock

In this context the arrival of a populist coalition government in Italy after the elections of May 2018 creates a chock which, by its size, can generate a bifurcation in the European integration process. On the political side the accent is put on the migration policy. The economic policy measures are not settled yet and only the general orientations are known: decrease of the income tax with a flat tax system, begin of a universal income system, postponement of the increase of the retirement age. It is a demand policy after 10 years of austerity which will quickly increase the public deficit and will raise a problem of financing. Without the support of the ECB the risk of rising interest rates is great with a cumulative effect on the debt burden and on the Italian banks. In such a context the existing fire walls (ESM and unfinished Banking union) would not be sufficient comparing with size of the Italian economy. The euro exit would appear as a major political crisis. The Italian electors would fear the jump in an unknown territory and a regress could be possible as in the Greek case. A euro exit of Italy would lead to a difficult transition period before the reappearance of a new equilibrium. The euro zone could evolve in two directions: a defence around Germany with, for France and Spain the choice to stay or to leave; a split of the euro zone with a system of euro multiples. These scenarios can never exist in case of quicker return to economic policies more conform to the European rules which could be compensated on the political side by activism in the migration field. It would be the maintenance of the status quo after a big fright. The system resists but the problems remain.

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