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The policy mix in the euro area

An intrinsically unstable balance

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• Introduction

In the absence of a political union, the Treaty on the European Economic and Monetary Union (EMU)[1] defines an original policy mix model in which fiscal policy remains the prerogative of Member States while the single monetary policy is delegated to the European Central Bank, the independent federal institution at the centre of the Eurosystem. In this unprecedented configuration, the interactions between the centralised monetary policy and the fiscal policies coordinated under an intergovernmental system were complex from the outset and the policy mix has struggled to strike an unsteady balance across the events which have punctuated its development[2].

On an institutional level, another important point is that, by nature, the single monetary policy only concerns the euro area, while the framework for economic coordination, which in particular includes fiscal rules, encompasses the European Union as a whole. This gap has never been bridged and runs contrary to the definition and performance of a policy mix specific to the euro area[3].

1 *Cf.* Treaty on European Union (TEU), 1993.
2 For an overview of the theoretical questions raised by the model, see Kempf [2019].
3 The acknowledgement in the Treaty of Lisbon in 2007 of the Eurogroup, the “informal” meetings of the finance ministers of the euro area, consolidated this intergovernmental coordination model without providing a solution to this institutional conundrum.

This policy paper will first of all present the weaknesses of the economic branch of the EMU, its "Achilles' heel" to quote Jacques Delors (2003). Secondly, it will review the various phases of the policy mix in the euro area, from 1999 to the major financial crisis of 2008-2009 and the ensuing euro area crisis, then from the ECB's commitment in 2012 to preserving the integrity of the monetary area at all costs to the budgetary dominance that culminated during the Covid crisis, before the 2021-2022 inflation shock enforced a turnaround in monetary policy and a rebalancing of the policy mix. The last section of the paper will take a brief look at the proposals, such as those recently put forward by the European Commission, aimed at improving the euro area's economic governance.

I. The shortcomings and failure of a model of minimum economic coordination

The fiscal coordination of the EMU was originally intended to be based on three complementary elements: the prevention of externalities related to diverging policies and excessive public debt, the effectiveness of national automatic stabilisers (in the absence of an EU budget and transfers), and the consistency and visibility of the area's macroeconomic directions. Assuming that these conditions were met, regular dialogue between fiscal and monetary authorities still had to be ensured if policy mix conflicts were to be avoided. Yet the former were expecting first and foremost favourable financial conditions, while the latter reluctantly agreed, in the name of their independence[4]. In this respect, the belief that this model introduced a bias in favour of the monetary branch of the EMU was relatively common at the outset. Conversely, other leaders deemed the model viable, provided that Member States complied with the common rules (Issing [2006]). The experience of the first two decades of the EMU showed, however, that this incomplete policy mix model ran the risk of overburdening the monetary policy, with the ECB regularly finding itself in the awkward position of on-duty firefighter, as insurer of last-resort of the euro area's integrity (and often scapegoat…).

These institutional restrictions resulted in a minimum fiscal framework that was mostly prudential in nature. This system quickly proved to be ineffective (Jaillet and Pfister [2022]):

- Deficit rules were often not respected and public debt, with some exceptions, left the required reduction path of 1/20 per year, notwithstanding the steady decline in interest expenditures related to the ECB's policy after 2012;
- EU oversight did not prevent Member States' credit abuses and external imbalances that led to the crisis of 2010-2012;
- The markets did not play the expected stabilising role in addition to the fiscal rules, with sovereign spreads aligning with those of core countries before reaching unreasonable levels during the crisis.
- The no bail-out rule had to be broken, with the contingent pooling of risks by the intergovernmental institutions created during the euro area crisis (EFSF and ESM), and implicitly by the ECB's use of various instruments (see below) to preserve the integrity of the euro area.
- The prohibition of "monetary" financing[5] by States became purely notional with the implementation of quantitative easing (QE) by the ECB in 2014.

4 Other ECB leaders argued that a legitimate and independent central bank could afford to operate opposite a strong political counterpart in the EMU's interest (Bini Smaghi [2010]).

5 The concept of monetary financing is highly ambiguous. In the Treaty, it refers only to direct government financing, in the form of cash advances from central banks to Treasuries or purchases of public securities at the time of issuing. In practice, most monetary financing is conducted through the purchase of State securities on the secondary market by the central bank, which then brings them onto its balance sheet.

Moreover, this system has never resulted in a common direction for the euro area's economic policy, a coherent fiscal stance against the ECB's monetary stance, not merely the sum total of aggregated fiscal policies. This would have required Member States to conform to EU arbitration and to a principle of symmetry for their macroeconomic adjustments.

This failure can be explained by several factors. First of all, we can leave aside the arguments that are frequently put forward, such as the supposed "complexity" of a system that in practice is based on a few simple rules, or its excessively coercive character, in which some countries have been regularly able to abstain while others complied without difficulty. It would appear, however, that the shield provided by the euro and the ECB's extremely accommodating policy (from 2013) created a kind of moral hazard that did not encourage Member States to comply to a rule of "good conduct" preventing "free rider" behaviours. Furthermore, the relevance of the 3% and 60% reference values has been challenged (Blanchard [2021]), as the public debt standard seemed unrealistic for many countries following the financial crisis and the COVID-19 pandemic. Lastly, the medium-term objective concerning the structural balance, a key variable to assess the discretionary direction of fiscal policies, has been criticised for its alleged complexity and has been broadly neglected[6].

Economic factors cannot be overlooked. The euro did not bring about a long-term dynamic of real convergence expected upon its introduction. The economies of the South lost most of the gains won prior to the 2010-2012 crisis and per capita incomes differed between the major economies of the area[7]. Intracommunity trade has stagnated and, thirty years on from the implementation of the single market, the euro circulates in a banking and financial area that remains fragmented. Yet, without sharing public risks (through transfers between States or an EU budget) or sufficiently diversifying private risks (fostering a more optimal allocation of savings towards investments in the area), the absorption of cycles and shocks is chiefly a matter for Member States, which do not have the same leverage. The shortcomings of the single market thereby contribute to difficulties with the euro area's budgetary framework and policy mix.

II • Until the 2010-2012 crisis, monetary policy was (relatively) dominant

It was natural that the ECB's structure, mandate and targets would derive from the Bundesbank model, a concession to Germany from partners, in return for the sacrifice of the Deutsche Mark, the anchor currency of the European Monetary System. In practice, the federal organisation of the Eurosystem, its governance (ECB Executive Board with extended prerogatives), its independent status and naturally its primary mandate of price stability, were transferred from the Bundesbank model. Upon its creation, the ECB opted for a strategy that combined a "monetary pillar" with a reference value for M3 growth of 4.5% and a "price stability pillar" with an inflation rate below 2%. In 2003, however, the inflation target was clarified ("(…) *inflation rates below, but close to, 2% over the medium term*"), (ECB [2003]), with the M3 monetary aggregate being downgraded to an indicator. The monetarist legacy of the Bundesbank was conclusively wrapped up. Lastly, as part of its 2021 strategy review, the ECB announced that its medium-term 2% inflation target would now be symmetric and that it would tolerate positive and negative deviations.

6 This objective is based on output gap estimates subject to review. However, these estimates, standing at roughly 0.5 percentage points of GDP for the main euro area countries, appear to be secondary to Member States' fiscal excesses in relation to their European commitments.

7 Per capita income fell by more than 10% in France, Italy and Spain, compared to that of Germany between 2010 and 2019 (DataBank - The World Bank).

From 1999 to the euro crisis of 2010-2012, the monetary policy was neutral or slightly restrictive. The ECB's main leading interest rate was therefore always above inflation which itself was close to 2% on average (see graph), while the short-term real interest rate was positive. The ECB then appeared to follow a Taylor rule to minimise the gap between its inflation target and potential growth, with a neutral rate of around 1.5%. The aggregate fiscal policy of Member States was slightly restrictive until 2007. It became expansive and counter-cyclical during the financial crisis and remained so until 2010 (EU Commission [2023]). Overall, the euro area's policy mix seemed quite balanced over this period, masking the build-up of private and sovereign debt of so-called "peripheral" economies of the EMU, mirroring imbalances in their current accounts which resulted in the first major crisis of the euro area in 2010.

Over this period, the ECB was very responsive when inflation exceeded its target. While providing to banks plenty of liquidity to support credit during the financial crisis, it increased its interest rates in June 2008 when inflation exceeded 4%, then again in April and July 2011 when it reached 3%. This was in the middle of the euro area crisis. At the time, these measures were criticised, including by some political leaders, on the grounds that the ECB was overreacting to a supply shock (the rise in oil and food prices) while national fiscal policies and EU resources were taking strong action. This episode constituted the first policy mix conflict in the EMU's history.

III • ECB interest rates and inflation in the euro area

Taux de la facilité de prêt marginal	Marginal lending facility rate
Taux de la facilité de dépôt	Deposit facility rate
Taux des opérations principales de refinancement	Rate for the main refinancing operations
Taux interbancaire au jour le jour EONIA/ESTR	Interbank overnight rate EONIA/ESTR

By launching its first Securities Markets Programme (SMP) in 2010, the ECB actually contributed to reducing the risk of a fragmentation of the euro area. Yet this programme was deemed too timid: purchases (limited to €15 billion per month for a final figure of €200 billion) were sterilised so as not to interact with monetary policy (standing apart in this respect from the future QE, aimed at reducing term premiums). Nevertheless, the SMP was the ECB's first foray outside its primary mandate of price stability, as well as the creation that same year of the European Financial Stability Fund under the aegis of Member States was the first infringement of the Treaty's no bail-out principle.

It remains that these measures did not ease tensions on the sovereign debt markets, against a backdrop of political dissent concerning the response to the crisis. In the early summer of 2012, the spreads had grown to dangerous levels, with the Italian and Spanish ten-year rates coming close to 7% (and the Greek rate exceeding 20%!). These levels were clearly incompatible with these countries' debt sustainability, while the markets, beyond assuming a Grexit, were speculating on the collapse of the euro area which could have sent it into a self-fulfilling spiral. EU solidarity had to take on a new dimension.

IV • 2012-2019 - An about-turn in the policy mix and new budgetary pressures

In July 2012, Mario Draghi entrusted the ECB with the task of doing "whatever it takes"[8] to preserve the euro area's integrity. Two months later, Member States created the European Stability Mechanism (ESM), which merged with the EFSF and was endowed with an intervention capacity of €700 billion. These two actions eased speculation and brought sovereign spreads back down to reasonable levels (around 4% in Spain and in Italy). They also heralded a new era for the EMU's policy mix: Member States implicitly scrapped the no bail-out rule and the ECB explicitly took on its role as insurer of last-resort of the euro area's integrity.

However, from 2012 to 2016 the ECB had to address an unprecedented drop in inflation, which fell temporarily below the 0% mark (underlying inflation stabilised at around 1%). This phenomenon was in part due to the sharp drop in the oil price, which fell from $110 to $40 per barrel between 2012 and 2016. Also, on a structural level, the expansion of global trade was a factor (Diev et al. [2021])[9]. However, the ECB, like most OECD central banks, favoured cyclical factors and the risk of deflation related to GDP gaps and decided to launch an exceptionally expansive monetary policy. It reduced its interest rates to almost 0%, then used "non-conventional" instruments combining the almost unlimited and low-cost refinancing of the banking system and the launch of large-scale public and private securities purchase programmes (quantitative easing). The ECB's QE was launched in January 2015 (seven years after the Fed and just as it was starting to reduce its own), when the economy was gaining strength, the euro area's output gap were narrowing (from -3.5% to +1.5% between 2013 and 2019) and inflation was climbing back up to its 2% target (see graph). This brought about a spectacular fall in long-term rates (the nominal rate of the French ten-year treasury bond , for example, was 0.3% on average between 2015 and 2019, dropping to negative figures). This was a boon for Member States, as it significantly eased, their debt sustainability constraints.

Does this mean that fiscal policy was dominant in the euro area's policy mix at this time? It would be more correct to say that most Member States optimised the extremely expansive monetary policy to roll out their own pro-cyclical fiscal policies, rather than building up their counter-cyclical leeway , which proved to be largely insufficient when the major shock of the pandemic hit in 2020. The governments had then no other choice than to request massive assistance from the central bank (ECB [2021]).

V • The COVID-19 crisis – Fiscal policy takes precedence in the emergency

The systemic shock of the health crisis provoked a 6.1% drop in GDP in the euro area in 2020, giving rise to budget support plans that brought public deficits to 7% of GDP on average, with major disparities (between 9% and 10% of GDP in France and Italy, for example, less than 4% in Germany and the Netherlands, etc.), reflecting the specific strategies rolled out in response to the pandemic. The Stability and Growth Pact was suspended until 2023 (then 2024, following the start of the war in Ukraine).

8 "*Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough*" (Mario Draghi, President of the ECB, Speech at the Global Investment Conference, London, 26 July 2012.

9 These two explanations are not antagonistic. Global trade growth (particularly driven by China, optimising its joining the WTO in 2001) had a major effect on the prices of imported goods and production costs, and compounded the growing GDP gap over the same period (also characterised by the flattening of the Phillips curve).

Overall, the governments of the euro area absorbed almost 90% of the shock of the pandemic (Fatton et Ponton [2021]). With hindsight, we can question the relevance of such a massive response decided in a hurry to offset (and sometimes even more) the loss of earnings of households and companies. States played the unprecedented role of all-hazards insurers of a macroeconomic shock without an ex-ante analysis of its impact on the different categories of households or business sectors. More often than not, assistance was not targeted, leading to unwarranted advantages and redistribution to high-income households or companies that were little or not affected by the crisis, thus reducing its economic and social utility. Moreover, due to the lockdown and supply constraints, much of the assistance was sterilised (the household savings rate rose from 13% to 20% between 2019 and 2020), before fuelling inflation at the end of the pandemic and during the war in Ukraine.

This unevenly shared "whatever it costs" attitude resulted in an unprecedented ballooning of public debts representing 13 percentage points of GDP between 2019 and 2021. In view of this mobilisation of budgetary support, the ECB, while keeping its rates at 0% (and even at -0.50% for its deposit facility rate which became its de facto main leading rate), initially only increased its reduced-rate refinancing (TLTRO-III) and announced on 12 March 2020 that it would increase its asset purchase envelope by €120 billion. When asked what the ECB would do if public debt spreads in the countries worst-hit by the pandemic increased, ECB President Christine Lagarde claimed that the ECB "(…) was not here to close the spreads"[10]. This statement, while officially consistent with its mandate, sparked an outcry on the markets and among certain European leaders. On 2 March 2020, Lagarde changed tack and announced the launch of the €750 billion Pandemic Emergency Purchase Programme (PEPP) which was increased to €1,350 billion in June and to €1,850 billion in December (i.e. around 16% of euro area GDP), in addition to the QE programmes. This was a major financial back-stop, going far beyond the budget support plans announced (and providing governments with substantial cash advances).

In doing so, the ECB approved ex-ante, without prior dialogue or reserve, budgetary activism and a hike in public debt that was in many ways justified but whose the economic and social effectiveness were in some respects questionable. This massive transfer of "Covid debts" to the ECB's balance sheet (qualified by some political leaders and observers as perpetual debt that is not intended to be reimbursed), may be viewed as an implicit form of pooling. At this stage, the concept of the policy mix was no longer relevant at all. The ECB played the role of funding agency for the euro area's treasuries, in a stance similar to "helicopter money", or more exactly Modern Monetary Theory, in which the central bank's role boils down to paying the bills submitted by the State (Drumetz and Pfister [2022]).

10 "*My point number two has to do with more debt issuance coming down the road depending on the fiscal expansion that will be determined by policymakers. Well, we will be there, as I said earlier on, using full flexibility, but we are not here to close spreads.*" Christine Lagarde, Statement at CNBC Interview, after Press Conference with Luis de Guindos, Vice-President of the ECB; Frankfurt am Main, 12 March 2020.

VI • 2021-2022 – Inflation shock and rebalancing the euro area's policy mix

This situation could only ever be temporary. Beyond the legal risk related to its mandate and independent status[11], the ECB had to weather an inflation shock for which the early stages were discernible as soon as in the summer of 2021, compounded by the supply constraints affecting the global manufactured goods market and tensions on labour markets. Euro area inflation rose from 2% to 5% between June and December 2021 before picking up the pace following the onset of war in Ukraine, peaking at 10% in October 2022. Underlying inflation reacted with a lag at 3% at the end of 2021 and subsequently exceeded 5%.

The euro area's policy mix thus faced the following dilemma: support business (and purchasing power) or combat inflation. Under political and social pressure and subject to the electoral timetable, governments naturally decided in favour of the former option, rolling out new measures to support households and companies, but without any real coordination and in a piecemeal fashion[12]. Initially, the ECB stood ready, attributing the upsurge in inflation to the soaring price of imported energy, which was thought to subside within a year without any long-term effect on underlying inflation or forecasts. In its March 2022 forecast, it predicted that the Harmonised Index of Consumer Prices (HICP) would return to its 2% target as of 2023. Since then, this figure has been revised to more than 5.3%.

This wrong diagnosis (admittedly fairly shared among forecasters) may have been attributed to central banks' excessive confidence in the stability of the nominal anchor and their credibility, following a decade of low inflation (Reis [2022]). It explains the surprisingly sluggish reaction of the ECB, which only raised its rates from July 2022, while the imported inflation had already permeated internal price formation and forecasts. The ECB, like the Fed which was only four months ahead, pursued an inappropriate expansive policy for a year and the rate of its main operating operations – MRO- (at 4.00% in June 2023) is still below an inflation rate greater than 7% (and which, according to its own forecasts, will only reach target levels again in 2025).

This early normalisation of the main interest rates is, however, compounded by the withdrawal of bank financing at preferred rates and the end of QE and the start of quantitative tightening. The ECB reduced its reinvestment in the asset purchase programme (APP) by €15 billion per month from March 2023 before ending it in July 2023. These measures had an impact on the cost of credit and bond rates from the summer of 2022.

The inflation shock therefore triggered a rebalancing of the euro area's policy mix compared to the extreme situation at the peak of the COVID-19 crisis, though the issue of its coherence (Schnabel [2023]) was never settled. This is because the cautious turnaround of the single currency policy now contrasts with fiscal policies that remain expansive[13]. The ECB's attitude in itself suggests a certain ambivalence. On one hand, it must bolster the credibility that was eroded through its role as uncon-

11 In May 2020, the Karlsruhe Constitutional Court (in opposition to the European Court of Justice), challenged the ECB's public securities purchases under quantititative easing, citing a lack of "proportionality" and the risk of a conflict with its primary objective of price stability. Without contesting the PEPP, it stressed that it was exceptional.

12 Beyond factors related to the diversity of energy mixes, these differences in fiscal policy contributed to the unprecedented disparity in inflation rates (from 6% in France to more than 10% in Germany and more than 20% in certain Eastern and Northern European countries at the October 2022 peak in inflation).

13 According to the projections of the European Commission, the structural balance of the public sector will remain at roughly -3.5% of GDP in the euro area in 2022 and 2023.

ditional paymaster of States during the crisis and its sluggish reaction to inflation. On the other hand, it cannot jeopardize the sustainability of sovereign debt made vulnerable by the twofold shock of the pandemic and the war in Ukraine.

The solution retained to reconcile these two concerns was to announce in July 2022 (the same day as the first increase in its interest rates) the creation of a new contingent facility, the Transmission Protection Instrument (ECB [2022]), a slightly convoluted name for a new anti-fragmentation tool that is close to the former SMP (see above). The TPI could be triggered to make selective purchases of public securities in the event of "unwarranted market dynamics that pose a serious threat to the transmission of monetary policy across the euro area"[14]. While there is still some ambiguity surrounding this instrument (assessment of "unwarranted" spreads, criteria for triggering the instrument, interactions with the monetary policy, etc.), its creation alone eased sovereign spread tensions that emerged in anticipation of the liftoff ofpolicy rates (and assuaged the overplayed remonstrations of political leaders and observers who accused the ECB of leading the euro area into a recession…).

VII • The conditions for a genuine policy mix in the euro area

The ECB will not always be able to plug the gaps in the EMU's economic branch, while Member States and European authorities appear to in denial, in terms of the shortcomings of the single market, the growing economic and financial disparity in the area and the failings of the economic coordination framework. Admittedly, the Commission recently proposed a reform of the fiscal framework which had been suspended until 2024 due to the pandemic and the crisis in Ukraine (EU Commission [2022] and [2023]). The stated objective is to make it simpler and more flexible to promote its endorsement by Member States (Eisl [2022]). Member States would thereby draw up their own spending targets to be compatible with "plausible" national debt reduction pathways. Besides the uncertainty and ambiguity related to their technical implementation[15], it is not clear whether these rules would ultimately prove to be less complex, clearer and better respected than the current framework (Jaillet and Pfister [2023]).

In the negotiations which opened in 2023 between Member States, there is also a risk of providing some with arguments to oppose progress towards programmes of the type of *Next Generation EU* (NGEU) , which they will only accept in return for a credible fiscal framework. In this respect, the political reactions to the Commission's proposals show that the usual divides remain, particularly between Germany and France[16]. Even though they do not specifically concern the euro area and beyond

14 This instrument rounds off existing instruments, in particular Outright Monetary Transactions (OMT), which have never been used since their creation in 2012 and are subject to specific conditions.

15 They concern in particular the operational variable of primary expenditures (net of unemployment benefits - cyclical in nature – although they are supposed to be uncorrected for the cycle), national public debt pathways set for uncertain timeframes, or even the status of the reference values of 3% and 60%, retained without their role being clearly explained. As regards governance, the resources proposed to build up the system (reducing financial sanctions or inviting "deviating" ministers to explain themselves in front of the European Parliament), seem to be lacking in credibility. Moreover, the issue of democratic responsibility and the role of European and national parliaments has fallen by the wayside, with the Commission preferring to promote expert committees or "committees of wise persons", the opinions of which, while useful, have little impact on governments.

16 On 26 April 2023, German minister Christian Lindner stated that the Commission proposals "do not satisfy German requirements", while French minister Bruno Le Maire said that he was firmly against any automatic rule (such as the rule obliging a State to reduce its deficit by 0.5% each year when it stands above 3%).

the key role played in cushioning the impact of the pandemic, NGEU or similar programmes can contribute to strengthening the EMU's economic branch, indirectly fostering a better balance in its policy mix. Firstly, NGEU is a game-changer, in that it is a decisive first step towards a real federal budget in which the Community covers investment spending that is likely to benefit not only individual Member States but the European economy as a whole. Secondly, this instrument also counteracts the centrifugal forces that have been acting on the euro area's economy since 2010. As discussed above, the growing structural disparity of the euro area goes a long way to explaining the different directions taken by national fiscal policies, which in turn makes it more difficult for the single monetary policy and contributes to policy mix imbalances.

It should be noted that the recent proposals of the Commission, intended to concern "economic governance", merely addresses the revision of the fiscal framework, avoiding the issue of an in-depth overhaul of the EMU's economic branch. The ambition of European authorities is therefore more timid compared to various proposals put forward in recent times. Without going back to the McDougall report which in 1977 recommended a guidance and budgetary stabilisation capacity for the EU, let us name the main converging initiatives issued by various European authorities or bodies, the scope of which went far beyond the issue of fiscal rules (cf. in particular the Five Presidents' Report of June 2015, the "Reflection Paper on the Deepening of the EMU" presented by the Commission in May 2017, and the "Resolution of the European Parliament on budgetary capacity for the Eurozone" - P. Bérès & R. Böge of February 2017), not forgetting the many contributions from academic circles, the private sector, think tanks or the IMF.

Without covering all these contributions in detail, it is useful to highlight their main recommendations for a reform of the EMU's economic branch: (i) the optimisation of oversight procedures, less subject to intergovernmental pressures; (ii) the need to find a common direction for the economic policy (a *fiscal stance* in relation to a *monetary stance*); (iii) the introduction of a specific economic stabilisation and steering instrument that adds to the counter-cyclical action of Member States; (iv) official crisis management procedures; and (v) a common representation of the euro area in international bodies for issues relevant to it.

The performance of these new responsibilities would result in a major change in the nature of economic coordination, shifting from an intergovernmental model to a more federal model. At the very least, it would require the creation of a budget specific to the euro area, with its own objectives, governance and resources, and the introduction of a genuine economic authority, *i.e.* the Eurogroup in a strengthened role with extended prerogatives beyond the current ones of representation and coordination. The SGP regulation would also have to be amended for Members of the euro area to have their own specific coordination rules (which currently concern all EU Member States). Along the same lines, the European Parliament should be able to deliberate and even vote in "euro area" formation on issues concerning the euro area's policy mix.

The institutional conditions for the implementation of this economic coordination model should not be minimised, indeed, as they are pre-requisites for the creation of a more coherent and balanced policy mix than the one in force since entry into the EMU. In this respect, it is not likely that the "closer cooperation" approach put forward by the Commission in its March 2017 White Paper could incorporate all the elements needed for an overhaul of the EMU's economic branch. The intergovernmental method ,which was successfully used upon the creation of the ESM in 2012, is probably feasible to step up the Eurogroup's role[17], but it does not authorise the creation of a specific euro area budget, which would require a revision of the Treaties, according to modalities to be laid down[18].

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In their responses to crises, European authorities have up to now always found emergency solutions (such as the creation of the ESM or more recently the launch of the NGEU programme). However, these key developments are more piecemeal than long-lasting. Europe and the euro area will inevitably have to face other severe crises in the future, related in particular to climate change and the energy transition, against a backdrop of growing geopolitical instability, while the public finances of Member States enjoy limited leeway and at this stage there is no consensus in favour of extending federal budget capacities.

By default, the ECB is currently the only European institution able to internalise the externalities related to Member States' policies through its action, in a role of insurer of the last-resort of the EMU at the limit of its mandate and institutional prerogatives. In the absence of a genuine federal economic counterpart, the euro area's policy mix will remain unclear and unstable, likely to shift from having a dominant focus on fiscal policy to one on monetary policy as events unfold.

If there is a need, there is a will. That is the question. While the revision of the founding Treaties is indisputably a major and complex project, the main obstacle to in-depth reform of the euro area's economic governance lies primarily in the lack of convergence in Member States' positions and of a common political will, while European institutions seem to have resigned themselves to an intrinsically unstable status quo.

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17 For example, according to protocol 14 of the TEU, there is nothing prohibiting the roles of Commissioner for the Economy and President of the Eurogroup being held by the same person.

18 The ordinary revision procedure (Art.48 of the TEU) may be more cumbersome but can be adopted following a simple majority vote, while the simplified procedure (Art.48.6 of the TEU) requires unanimity.

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