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PAPER

The Bruegel Debate and Risk –Sharing Mechanisms. A New Proposal in the Context of Secular Stagnation

Antimo Verde

Abstract The starting point for this paper is given by the disintegration risk of EMU. Europe faces more than a Greek tragedy. The author of this paper believes that the euro could still be saved but the Union should assume daring choices. In turn these choices need a dose of imagination. Such as the proposal in this paper. It suggests a new risk-sharing mechanism, which rests on two assumptions: the flaws (or what the author deems to be) of the Macroeconomic Imbalances Procedure (MIP) and on the implications surfacing from the Summers's thesis of an ongoing Secular Stagnation (SSH). The proposed new mechanism has two objectives: to provide an effective engine to face external imbalances in EMU and make it safer to do so. The analysis develops in a linear way, dividing the paper into parts. The first is devoted to the Bruegel (BC) Debate, i.e to the BC's contributions concerning the nature of Monetary Union as well as types, purposes and limits of risk-sharing mechanisms elaborated in the economic literature. The second starts with the important consequence of SSH – a deep and lasting economic slowdown - which are relevant for the future of EMU. After, the author reflects on the MIP's four flaws before suggesting a radical reform to make it an effective instrument to face macroeconomic imbalances. Finally the core of the proposed new mechanism is provided by a Stabilisation Fund, funded by the (structural) surplus countries and designed to help member states in deficit which suffer structural high unemployment. The proposal presents an important byproduct. Indeed the Eurozone is continuously and dramatically exposed to the International cycle; more than its strength would leave to suppose. Had the suggested instrument be timely and generously applied, it could be, thanks to the automatic recycling of national demands, an effective device to endogenously create a self-sufficient internal demand of the Eurozone as a whole.

Keywords European Fiscal Policy - Monetary and currency unions - European Monetary Union Financial Crisis - Fiscal Rules

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Antimo Verde (✉)
Associate Professor of International Economics, Tuscia University, Viterbo, Italy
e-mail: averde@luiss.it

1. Introduction

From 2010 on, the European Union (EU) was shattered by a dramatic crisis; its survival is now seriously at risk, especially after the turmoil faced by Greece. The possibility of ‘Greexit’ (Greece exiting the Union) has made the risk of the disintegration of Economic and Monetary Union (EMU) real. The Bruegel Center (BC) has thus published several papers linked to the most dramatic problems in the attempt to help the European policymakers to identify the possible ways to take the Union out from this standstill. Talking about BC debate I refers to these papers about the EMU problems.

It first focuses on the very nature of EMU. In the Nineties economists questioned whether the ongoing EMU would have been an Optimum Currency Area (OCA). Clear-cut negative answers came out from many empirical works. The merit of BC’s contributions has been in updating those results, trying to verify if anything has changed and how the financial crises have affected the character of EMU. Indeed, the incomplete and asymmetrical nature of the Union has been confirmed, amplified by financial crises. As a result, the probability of asymmetric shocks continues to be high, or even higher, and are typically given by macroeconomic cyclical imbalances among Member States (MS). This aspect puts the survival of EMU at risk. Thus, the issue of insurance mechanisms which could cushion those imbalances is important, or even, crucial. On the topic of risk-sharing mechanisms, the think-tank based in Brussels, has opened an interesting debate.

Almost all the recent contributions from Bruegel focus on budgetary union as well as the stabilisation mechanisms against unemployment and movements within the Union. I have taken a cue from this debate to propose a new insurance mechanism, which this paper refers to. In it, I suggest a new insurance mechanism able, in my opinion, to face external imbalances or asymmetrical cyclical developments among MS. It aims at pursuing a public good objective, given by the EMU stability, as well. At this juncture, it is important to underline a significant further point. The geopolitics of EMU has deeply changed since its beginnings. The retreat of the UK and the withdrawal of France have left Germany as the hegemonic country in the political economy of the EU. This implies, as in the past for Britain and the US, a particular interest in the stability of the “system” (i.e EMU) as a whole. The same explained the success of the Gold Standard and of the Bretton Woods systems. Today, Germany is persistently reluctant to assume the leadership of EMU. Yet, it is time that Germany’s leaders become aware of their historical role taking into account the stability of EMU as a whole and neglecting, if useful, German taxpayers’ political interests. Without this change, the euro’s fate may well be sealed.

The starting points of the proposal are twofold: the first is Larry Summers’s thesis about a deep secular stagnation (SSH), which is involving, or will involve, the US, Japan and Europe. It is highly probable that this SSH, if real, will significantly affect EMU policy choices. The second originates in a detailed analysis of the Macroeconomic Imbalances Procedure (MIP) implemented in 2011 by the European Commission with the purpose of cushioning asymmetric shocks or macroeconomic imbalances within the Union. The core of the proposal is represented by a drastically new MIP and a new Stabilization Fund. The Stabilization Fund, funded by the (structural) current account (CA) surplus MS, should enable MS to cope with macroeconomic imbalances and unemployment. The paper also re-defines, from another point of view, a couple of delicate subjects, such as "solidarity" and "distributional income neutrality condition which the BC have long dwelt on.

The paper is structured as follows. The next section is about the nature of EMU, starting from the traditional Optimum Currency Union (OCA) theory and the empirical works published in the Nineties. More recent papers are also considered. It then focuses on the main insurance mechanisms, represented by a "federal" budget of adequate dimensions, as well as by other risk sharing tools having more defined stabilization goals and different reference cyclical variables.

The second section starts with a hypothesis that is currently gaining ground, on secular stagnation as advanced by Larry Summers in 2013. It seems an economic scenario able to affect EMU's policies. In this paper the SSH adds a further rationale for the proposal discussed below. The section then addresses the Macroeconomic Imbalances Procedure (MIP), its flaws and ways of making it more effective. It is followed by the core of the paper in which the proposal of a new risk-sharing mechanism is presented.

a. Is EMU an Optimum Currency Area? An Updating of the Nineties Debate

The theoretical basis of an insurance mechanism is given by the nature, incomplete or asymmetrical, of a monetary union. To discuss it we must go back to the traditional OCA theory. According to this, two or more countries can form or join a monetary union only if some conditions are met[1]. The conditions, or criteria, are: a) high factor mobility; b) high economic syncronisation; c) fiscal integrations or fiscal federalism; d) financial integration. If these conditions are met, asymmetric shocks (the principal problem of monetary union) can be cushioned or made less probable (point b).

The OCA four criteria can be associated with leading economists and the following seminal works. High labour mobility and high sync have their roots in Mundell I [1961]; fiscal integration in Kenen [1969] and in

1 It is usual to use the two terms "monetary union" or "currency union" with the same meaning to exploit the traditional theory on the argument of the Sixties. However this terminological equivalence is not correct.

Jenkins-MacDougall [1977]; financial integration in Mundell II [1973][2,3].

According to Mundell I, two or more countries can create a currency union if high labour mobility exists among them. If the union is hit by an asymmetric shock, then labour can move from the countries hit towards the others, cushioning the effect of the shock. If the economies of the currency union are characterised by high cyclical syncronisation, i.e. they have economic cycles which are highly correlated, then the probability of asymmetric shocks is very low. Then, the union is an optimum currency area or OCA. According to Kenen [1969], and still more to the Jenkins-MacDougall Report [1977], a currency or monetary union is optimal, if a "federal" or centralised budget of adequate dimension exists and it allows large transfers among MS to cushion asymmetric shocks. Beside this public insurance mechanism, based on a federal budget, the traditional OCA theory includes a private risk-sharing mechanism based on financial markets which are highly integrated. It works mainly through consumption smoothing, providing a buffer against idiosyncratic shocks. The effects are different if markets are complete or not.

When talking about financial integration or market-criterion, has become usual, in the literature, to make reference to Mundell II. It is interesting to understand why. First of all, the OCA concept is typically Keynesian, as it excludes price and wages flexibility while assuming nominal rigidities. Mundell [1961] maintains that in the Keynesian context two or more countries can join a monetary union if there exists high factor mobility. In this seminal work, Mundell is pessimistic about monetary unions and skeptical about the success of the EEC, because he judges the loss of the exchange rate to be too important (as this is the most efficient policy instrument to face asymmetric shocks). However, in his paper written in 1970 (but published in 1973), Mundell changed his mind. He argues, in line with the monetarist thesis, that the (fixed) exchange rate is a "problem" for policy-makers because of speculative attacks so it would be convenient to get rid of it by creating or joining a monetary union. On the other hand, monetary union could be useful in providing adequate financial resources against possible attacks, because the country under attack could draw official reserves from another MS's central bank, to the MS' s official reserves pooling. If *one* of these criteria is met, the union is optimal.

Yet, the *optimality of a currency area* has two different meanings in the literature. 'Optimal' means that MS are able to achieve the traditional policy objectives: full employment, satisfactory monetary stability and balance of payments in equilibrium,

2 Usually, talking about the OCA criteria, also the McKinnon [1963] criterion- openess- is included. Indeed the openness criterion allows MS to reduce the cost of the participation to a monetary union. It is not a condition to join it. In the same time, very often Peter Kenen's linked to another criterion: the production diversification. A high production diversification allows a country to join a monetary union. The opposite happens if a production specialisation is the case. (Verde [2008])

3 On Mundell I and Mundell II I will return later. The term Mundel II is due to McKinnon [2004]. (Verde [2008])

using the traditional policy instruments (McKinnon [1963]) According to the other definition of 'optimal', a monetary union is optimal if benefits exceed costs for MS when joining the union.

The mentioned criteria have a positive characteristic of being measureable and therefore empirically verified.

Thus, starting from the first years of Nineties and the aftermath of the Maastricht Treaty signature in 1992, several papers came out in an attempt to verify the traditional criteria that would have been met in the future EMU. These papers were based on a comparison between the US and the ongoing EMU on the basis of the criteria mentioned above. This comparison was inherently wrong, as the US was for long time a real federation while the Eurozone was not. Despite this "starting flaw" many economists did not hesitate to use the comparison US-EMU to guess the answer to the very appealing question: *Is the EMU an optimum currency area?*

The answers were all negative. Blanchard and Katz [1992],Eichengreen [1993] maintained that in the euro-zone *labour mobility* was not a real shock absorber, while in the US it was[4]. Obstfeld and Peri [1998] reached the same conclusion. As regards the *sync criterion,* Bayoumi and Eichengreen [1993] showed that the autocorrelation among economic shocks in EMU was significantly lower than the in the US. As concerns the criterion of *fiscal federalism*, Sachs and Sala-i-Martin [1992]'s results pointed out that in the US a fall of GDP of 1 dollar was cushioned by the federal budget in a measure between 35 and 45 cents (Pisani Ferry et al. [1993]) In EMU this value was found to go down to 0.5%. Krugman [1993] was sure that in the EMU in the future *production specialisation* would have prevailed and with it asymmetric shocks[5]. Thus also for Paul Krugman the perspective on EMU was negative. No empirical works surfaced with reference to *integrated financial markets* because at that point there were none in Europe.

In conclusion: the answers to the question 'Is EMU an OCA?' in these first empirical studies were completely negative. This meant that in the case of EMU the above mentioned criteria for an OCA were not met. Or, in other words that for the EU's MS, or rather for some of them, costs would have exceeded the benefits of joining the union. From another point of view, the no-optimality of EMU should have meant that there was little hope for it to survive shocks and crises. In this vein, a paper by Frankel and Rose [1998] published in the last part of the Nineties, advanced the impressive thesis of the *endogeneity* of the OCA criteria. With this term, the authors maintained that even if *ex-ante* (before the launch of the Union) those criteria were not met, they could be *ex post*. (after the launch).

4 Moreover they show it is possible to identify on the reactivity to shocks criterion, a centre- formed by Germany, Austria, France, Denmark, Belgium, Netherlands, Luxembourg- and a periphery formed by Italy, Spain, Portugal, Ireland, Greece and United Kingdom.

5 Cfr footnote 2

It would have been through the constitution of the monetary union, or endogenously that those conditions or pre-requisites would have been met. Highly dubious estimates presented by Frankel and Rose in their paper to support their thesis did not help to avoid the widespread belief that their hypothesis was completely wrong.

On the eve of the introduction of the European single currency, some papers clearly reversed the conclusions achieved in the Nineties. This reversal was driven by a changed theoretical climate[6]. Mundell II [2000, pag. 391] deemed EMU to have 'satisfied the basic requirements of an optimal currency area'. Alesina and Barro [2002], Alesina, Barro e Tenreyo [2002], completely changed direction. They distinguished between large and small economies, the latter were better candidates for a monetary union in their attempts to achieve credibility[7]. However, to a certain extent these papers blurred the first and more convincing results about the ongoing EMU's inability to meet the OCA criteria. Also for these reasons we can overlook them.

Anyway, the conclusions reached by the OCA empirical literature of the Nineties were completely overlooked by the countries which signed the Maastricht Treaty in 1992. The Treaty instead provided quite different criteria, according to a different approach, that of New Classical Macroeconomics, whose economists deemed that monetary stability and fiscal consolidations were sufficient to make the EMU vital and sustainable. But, problems debated in the Nineties have again emerged, since a couple of years after the introduction of the euro. Problems have become dramatic during the awful period 2007-2013 dominated by the global and the sovereign crises. Thus the attempt made by *Van Beers N. et al.* [2015] to update the results of the previous papers, to verify if the EMU flaws signaled many years ago still threat its survival is particularly significant. In particular, several papers published by the BC come back on the problems empirically analysed twenty years ago, in this way confirming that those problems have always been on agenda.

Summing up: EMU is not an optimal monetary union, because it does not meet the required conditions of high factor mobility, high economic synchronisation, adequate fiscal federalism and adequate financial integration. The empirical studies of the Nineties already mentioned in this paper provide convincing proof of that. Despite new contributions from studies since the launch of the Euro, this conclusion has not changed.

3. Risk-Sharing and Insurance Mechanisms: The Bruegel Debate

We have then, demonstrated that the asymmetrical nature of EMU gives a rational basis to insurance mechanisms designed

6 The New Classic Macroeconomics came out in the Eighties followed by the real business cycle and New Keynesian Theory.

7 The credibility is of New Classic Macroeconomics.

to cushion asymmetric shocks or macroeconomic imbalances[8]. Indeed, as noted by De Grauwe 'the surprising thing is that so many have been living under the illusion that the eurozone would work without such an insurance mechanism. The official view was that the Eurozone did not need an insurance mechanism and certainly not a budgetary union.' (De Grauwe P. [2010], p.345). Still more, 'the euro has been a disaster. No other word will do' (Martin Wolf [2014,p.289]).

Yet, this is only partially true. And it is so because of the lack of effective policy choices and institutions designed to turn an incomplete monetary union into a sustainable project. The chance of reaching this objective depends on the capacity to deal with asymmetrical shocks.

The BC, as already mentioned, has published several studies in the last few years dealing with fiscal union, banking union, risk-sharing and insurance mechanisms, euro area governance. The approaches to international risk-sharing are two. The first (fiscal union) stems just from the traditional OCA literature (Mundell, Kenen) and regards international transfers as an instrument aiming at economic stabilisation of output and employment within states. The other has to do with those economists who regard international risk-sharing as a special case of consumption smoothing (Asdrubali et al. [1996], Atkson and Bayoumi [1993]). In the first case, we have a public risk-sharing mechanism, in the other it is 'private' or market-driven.

However, we may have temporary or permanent mechanisms; automatic or discretionary ones. Let us start with Kenen's definition of a fiscal union stated that 'it is a chief function of fiscal policy, using both sides of the budget, to offset or compensate for regional differences, whether in earned income or in unemployment rates. The large-scale transfer payments built into fiscal systems are interregional, not just interpersonal' (Kenen [1969, pg. 47)]. If this is the case, then monetary union is provided with *automatic* stabilisers across regions or Member States, that is, large public transfers (e.g. unemployment insurance programmes, federal income and social security taxes) capable of cushioning asymmetric shocks. To make the Union into an OCA, an optimum federal budget must be of adequate dimensions. According to the Jenkins-MacDougal Report [1977] the budget of the future EMU should have had to count on resources equivalent to 5-7% of the union's GDP, as found in the USA. The current share in EMU is instead only about 1%.

Marzinotto and Sapir [2011] raise the question: 'what kind of fiscal union?'. They start with the consideration that the core reason of the EMU failures is the lack of a fiscal union and propose the creation of a euro-area finance ministry, with a minister with veto rights over national budgets that could threaten the sustainability of the Union. However, their proposal implies a significant transfer of sovereignty from national to federal level and a change of the Treaty.

8 The idea of an insurance mechanism was put forward in the Jenkins- MacDougall Report [1977] of a "conjunctural convergence facilty" and in Majocchi and Rey [1993]

This aspect makes the proposal unattractive.

The paper by Guntram B. Wolff [2012] is interesting because it addresses a traditional form of fiscal union characterised by a federal budget. This is designed to work as an insurance mechanism through transfers of financial resources from a federal budget of adequate dimensions, towards MS in trouble. According to Wolff a common currency-area budget aims at reaching the following three objectives:

a. to provide an adequate transfer of financial resources to a MS hit by a large regional or asymmetric shock;

b. to cope with severe recessions or asymmetrical cyclical evolutions within the union;

c. to ensure financial stability.

The main mechanisms with which to pursue these objectives are (G. Wolff [2012]):

1) an unemployment insurance mechanism;

2) payments to MS in case of deviations of current output from their potential;

3) payments designed to narrow large interest spread;

4) discretionary intervention from the Union.

To these risk-sharing tools we can add:

5) a stabilisation fund designed to realise temporary transfers between MS according to the cyclical phases. (French Eecon [2015])

More details regarding these cross-country risk sharing mechanisms are also crucial for a comprehensive evaluation of our proposal discussed in later in this paper. For this reason it is useful to concentrate on them for a moment.
Let us start with unemployment insurance.

1) An important instrument of automatic stabilisation is *unemployment insurance*. In this case insurance payments and payments to the unemployed work *automatically* and rapidly. Thus this policy tool works like a traditional automatic fiscal stabiliser. In the aftermath of the last two major crises in the advanced world, a widespread opinion suggests that in Europe things would have gone better if the Union had been endowed with a European system of insurance against unemployment. The first one is based on automatic transfer among Member States according to the evolution of unemployment rates. This form of intervention is the most intuitive way to intervene at “federal” level. It seems in sufficient condition to immediately spur domestic demand. However this mechanism meets some important criticisms: it could favour moral hazards

by the recipient States; it does not ensure neutrality in income distribution[9]. Indeed, in the euro area the principle of distributional neutrality should hold. With this term we mean two things. First: distributional neutrality could be defined as no net transfers over a given period. That is: a MS hit by a negative shock receives net positive transfers from the federal budget over a number of years, but after some years those transfers should be offset. The second case is closer to our analysis: it sees the federal budget as a kind of insurance mechanism. So the contributions to the federal budget will depend on the likelihood of a shock. In case a shock occurs, the insurance would be triggered and a net transfer of resources would take place.

2) The second mechanism is linked to the *output gap*. It would trigger when the output gap reaches significant values. That is, when actual GDP is sensibly below the potential one. In this case, the problem is given by the estimate of potential GDP. Indeed there exist at least two ways to estimate potential GDP: the production function and the Hodry-Prescott filter (HPF). This aspect clearly reduces the advantage of this second stabilisation mechanism, even if it has positive implications in terms of the neutrality of distribution and its clear meaning. (Pisani- Ferry J. et. al.[2013]).
3) Another stabilisation mechanism is slightly complex in the sense that a Member State in trouble can issue public bonds, the yield of which is linked to the GDP evolution. The main flaw of this financial instrument is given by the fact that the recipient State might be discouraged to introduce structural reforms.
4) An intuitive mechanism of cyclical stabilisation is given by discretionary temporary transfers to countries in trouble established on the basis of a political decision by the Union. Theoretically it is the best road to a stabilisation policy, but the decision should be timely and it should require progress towards a political union which, at the moment, is not a reasonable option.
5) Finally, it is worth mentioning a French proposal concerning a Stabilisation Fund designed to carry out temporary transfers among the Member States according to cyclical phases. This scheme is funded with a European social contribution drawn on wages and not on the pre-existing national contributions; the insurance is limited to cyclical or temporary unemployment.

BC and other economists (for all: M. Wolf [2014]) show a great interest in other policies designed to reduce, if not resolve, the EMU's problems which stem from its nature. For instance:

The Banking Union (Pisany-Ferry et al. [2012], Obstfeld [2013]).

The traditional OCA theory completely neglects financial aspects and in particular

9 On the income distributional condition see section 6

those having to do with banking and stability problems. Instead, the banking union is currently deemed crucial because the EMU crisis has unveiled the inability of weak MS to provide backstops for their banks. In the Union, banking rests on four pillars (Pisani-Fery et al. [2012]: a) central regulation and supervision of financial institutions; b) deposit insurance; c) resolution of failing banks or systemic banking crises; d) a common fiscal backstop. The Eurozone made some steps to meet these pre-conditions[10], but the MS need another condition to ensure the banking union works effectively: an adequate supply of *safe* assets in order to break the *'doom- loop'* which links the solvency of banks with that of sovereigns. Relying on the debt of a few countries for this is certainly inadequate. For this reason there is a need for a supply of Eurobonds, i.e. an asset for which the Eurozone as a whole is liable.

The Eurobonds

A Eurobond market of adequate dimensions would give banks a safe asset and therefore give the ECB the ideal collateral for its operations. It would make public debt restructuring easier.

After having listed the main stabilisation mechanisms, a couple of questions arise: a) should the mechanism be temporary or permanent? And b) should it be automatic or discretionary? Hammond and von Hagen (1995) help with their definition of the optimal risk sharing mechanism. It should have, among others, the following characteristics:[11]

i) *simple:* in order to obtain a more widespread knowledge among citizens,
ii) *automatic*: in this way strategic behaviours are reduced and then the effectiveness is increased;
iii) *temporary*: in order to meet the distributional neutrality;
iv) *important:* in order to cushion a large part of the shock.

4. A Caveat: The Secular Stagnation Hypothesis (Ssh)

The hypothesis of Secular Stagnation (SSH) - i.e. a sharp fall in growth rates lasting a very long time, which has recently been advanced by former US Treasury Secretary Larry Summers, is gaining a growing consensus[12]. Indeed this thesis is spurring much debate, enlarged now with the intervention by Ben

10 See the Agreement on the Banking Union of March 2014

11 These characteristics are to some extent similar to those identified for the European fiscal rules (Von Hagen [1998], Verde [2003])

12 Against Summers' thesis, Ben Bernanke, former FED President, sees in the current sluggish growth the excess of savings over investment. (W. Munchau (FT April 13 2015) However, as we will see, Summers also put emphasis on the excess of saving.

Bernanke who opposes to Summers' thesis of the 'saving glut' advanced in 2005[13]. The term 'Secular Stagnation' was first used in 1939 by Alvin Hansen (the American Keynes) in his Presidential Speech[14]. This hypothesis is important for us, since from a general point of view, the outcome of a policy measure, such as that suggested in this paper, also depends on the cyclical phase the country is, or will be, going through. This is especially the case if, from a structural point of view, the economic context changes dramatically, or is expected to do so. In this case, the tenets of the dominant economic theories would make little sense and policy recipes would suddenly become ineffective or unsuitable. This is particularly true today as regards the problems of EMU.

The two dramatic financial crises have left their marks on the European economies. We are experiencing a phase of lasting and Great Stagnation, after having lived through the Great Moderation. We do not know if this stagnation will really be 'secular', but it is very probable that the recessionary phase will last a long time. This is very relevant for about the topic of this paper.

To understand the ties between the SSH and the proposal of a new policy mechanism let us dwell on three points:

a) the main aspects of the SSH;

b) the consequences of SSH;

c) the policy implications stemming from SSH.

As concerns a), in short we can say that Summers takes cue from: the persistent fall of potential output, the persistent gap between saving and investment, lasting low inflation, if not deflation, and consequently a persistent glut of capital and low or negative interest rates. b) The consequences of SSH are very interesting according to Summers. Let us divide them in theoretical and in economic ones.

On a *theoretical level*, according to the still dominant economic theory[15], a major role is assigned to potential output levels, not to current ones. That means the long-run perspective prevails with respect to the short-term.Now, instead, according to the thesis of SSH, this aspect is completely reversed. Indeed, in this respect, Summers [2014 p.1] writes: 'what happens in the short run has

13 The Bernanke's thesis on the saving glut was advanced in a speech of 2005 regarding the external imbalance between the US and China. On the external imbalances, models and historical experiences see Verde [2015]

14 Hansen held his talk after an era of unprecedented expansion of the US economy, both in terms of population and the land available. The end of this period and the experience of the Great Depression led Hansen to wonder whether there would be sufficient investment demand to sustain future economic growth. Other economists sharing the idea of SSH' are Paul Krugman, Blanchard, Eichengreen.

15 With the term –the still dominant economic theory, we mean the New Classical Macroeconomics (NCM), the Real Business Cycle (RBC), the New Keynesian Theory (NK).

a profound impact on the long run. To reverse Keynes a bit, if you die in the short run, there is no long run'. This is Keynes' first vindication of the re-valuation of short termism in macroeconomics and in economic policy (point c)[16]. Excessive fluctuations in output and employment give rise to detrimental impacts on long run growth: a conclusion in clear-cut conflict with NCM's (Lucas R. [2003]). Moreover, demand-management policies (monetary and fiscal) now are again prevailing, because they are effective, as in the Old Keynesian scheme. To be more precise, fiscal policies are now more effective as macroeconomic stabilisation instruments than monetary ones. In fact, fiscal policy is more effective in a context of zero-to-low-bound interest rates (ZLB) because in this case its multipliers assume higher values.

However, according to Summers, fiscal policy may also need a rethink. Fiscal policy should essentially be a higher quality; able to avoid systematic S-I imbalances; capable of raising long-run growth potential. This could be possible if public expenditures aimed at improving the education system, increasing infrastructures, removing barriers for labour mobility between firms and so on.

On *economic grounds* the more important consequences of SSH partially coincide with its aspects (point a). In particular, the excess of savings is a telling *prius* feature of the SSH. This excess brings with it very low or negative interest rates, a very dangerous perspective for growth. Why? Basically for two reasons. In first place, if ZLB is the case, reaching full employment could require even negative interest rates [17] and this means financial instability and monetary policy ineffectiveness[18]. Nowadays, low or negative interest rates and ZLB rates absolutely prevail in the advanced economies and look likely to continue to do so.

Above all, the main economic consequence is a generalised lack of an adequate level of internal demand, in Europe in particular. This aspect has now been formally recognised. In a context of SSH the economic situation of the European Monetary Union is doomed to worsen.

c) The policy implications of SSH are of crucial importance. Let us distinguish the general case from that of EMU.

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16 Alvin Hansen put the SSH in the following terms: if long term long-term structural mechanisms, such as growth of both labor stock and land, is slowing down, will the increase of the investment demand be sufficient to sustain long term economic development? Put in these term, the problem clearly assumes a Keynesian vision of macroeconomics, not only as concerns the causes of persistent stagnation, but also as regards consequences and cures.

17 Linked to the definition of secular stagnation is the inevitability of negative real interest rates are needed to equate saving and investment with full employment.

18 Or better according to Summers: "I explain why a decline in the full employment real interest rate (FERIR), coupled with low inflation, could indefinitely prevent the attainment of full employment. I argue that even if it were possible for the FERIR to be attained, this might involve substantial financial instability."

First the situation of sluggish growth is doomed to last.

Second, following New Classical Macroeconomics and Real Business Cycle Theory, government and policymakers have seen *fiscal austerity,* as the way, for government and policymakers to acquire credibility and make the achievement of their policy objectives more likely.

Now, within the SSH context, this is no more the case. On the contrary, *austerity* restrains further internal demand, forces countries to internal devaluation policies, increases poverty and inequality, reduces domestic demand and then worsens macroeconomic policy outcomes[19]. Instead, priority must be given to policies designed to spur consumption and to boost investment rather than to structural reforms. These policies are designed to alter the perspective for future years.

Third, symmetrical adjustment is essential, especially in a monetary union such as EMU. On the contrary, ‘the present system places the onus of adjustment on borrowing countries, while the world now requires a symmetric system, with pressure also placed on “surplus” countries’ (Summers [2015]).

c1) SSH and policy choices for EMU

Three points are particularly important in our the case of EMU:

1) Under EMU economic growth is dangerously sluggish. This situation is likely to continue for a long time. The main policy problem is how to guarantee an adequate level of internal demand of the union as a whole, in order to prevent the fall in output and employment. This objective could be hit, pushing those MS with high current account surpluses to spur their domestic absorption and avoiding vulnerable MS being compelled to restrain their demand.

2) Obviously fiscal discipline cannot be put aside. Absolutely not. It is essential to avoid a dramatic fall of credibility, free riding problems, and opportunistic behavior; in sum, to avoid the disintegration of EMU. However fiscal discipline should not be the reason for Gold-Standard type adjustment for weaker countries engaged in attempting meet the European fiscal constraints;

3) Fiscal discipline must assume a second-tier plan with respect to demand policy, as the main policy aim today should be to reverse the current situation of a generalised lack of national demand. To do so, monetary policies (including

19 Some recent research have shown an evident and strict link between inequality and fiscal austerity or fiscal consolidations (Furceri [2013]) Also from this point of view fiscal austerity can contribute to the secular stagnation because inequality in income distribution negatively affects private consumption and the economic growth. Linked to the definition of secular stagnation is the inevitability of negative real interest rates are needed to equate saving and investment with full employment.

quantitative easing too) are insufficient: in a ZLB context it will lose effectiveness. Fiscal policies would gain effectiveness, increasing the value of fiscal multipliers.

4) Demand policies should prevail also with respect to structural reforms.

5) Last but not least, symmetrical adjustment should prevail in EMU to successfully cope with external imbalances and idiosyncratic cyclical evolutions among MS and to increase the demand of EMU as a whole. In particular, surplus countries should be penalised in case of having a persistent and relevant current account surplus, as they tend to develop levels of domestic demand which are systematically lower than their potential.

5. The Macroeconomic Imbalances Procedure (Mip)

The five previous points represent, together, the starting point of the new proposal. The second addresses the MIP and its serious flaws. It is important to warn that when we discuss the MIP we basically take in account what its Regulation says, not the occasional and new attitudes of the EC on particular aspects of the Procedure. For instance, even if this year the first step of the MIP has been applied to Germany, it does not imply the correction of the widespread and well-founded impression that MIP *de facto* favoured Berlin. No single correcting step can reverse a general evaluation of the current MIP. That is: 'if one wants to understand how far the folly goes, one must study the European Commission's work on its "macroeconomic imbalances procedures' (M.Wolf [2014] p.303). This is an illuminating sentence that encapsulates my own thoughts for a long time since the MIP was published. That said, it should be interesting to remember when and why the MIP was born.

In the aftermath of the two financial crises serious external imbalances came out in EMU. Germany, Netherland, Finland were showing persistent current account (CA) surpluses while Greece, Italy, Spain and Portugal were recording CA deficits (fig.2)[20]. In the attempt to prevent them, the Commission suggested in September 2010 a new instrument: the Macroeconomic Imbalances Procedure or MIP, designed to cope with these imbalances.[21] On that occasion, significant hopes were expressed: 'On 29 September, the European Commission adopted a comprehensive set of proposals to reform and to broaden EU economic governance.

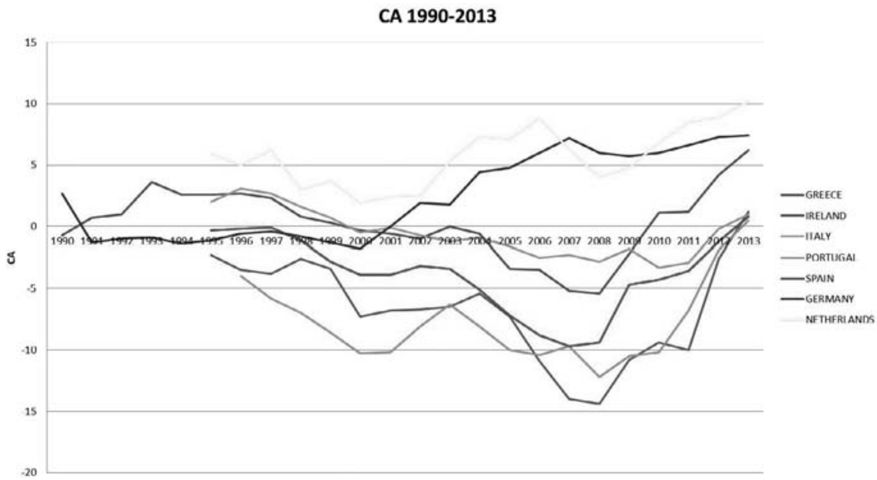
The reform package is the most recent step in a much broader effort to incorporate the lessons of the crisis in the EU policy framework, to prevent economic instabilities

20 For a deep analysis of external imbalances and related models and historical experiences, see A. Verde [2015]

21 See, Scoreboard for the surveillance of macroeconomic imbalances – European Economy Occasional Papers 92/2012

and, ultimately, to protect workers and taxpayers' (Buti M.and Larch M. [2010]). Instead, in 2012-13 the Union has been involved in the worst crisis of its life; in 2014-15 the Union's very existence is at serious risk. Shall we blame bad luck? No! We should blame the lack of proper policy choices to protect the EMU, such as an effective insurance mechanism.

Figure 1 External imbalances in EMU (CA/GDP)



Box 3 The MIP macro-indicators and related thresholds are: current account/GDP: thresholds . -4% +6% moving average of 3 years net foreign investment position/GDP : thr. -35% change export share in value: tr -6% in 5 years unit labor cost .tr. 9% in 3 years real exchange rates change (with respect to 35 countries): tr. -5 + 5%in 3 years private credit flow/GDP : tr. 15% public private debt/GDP :tr 160% change real estate prices (Eurostat) : tr. 6% public debt/GDP: tr. 60% unemployment rate: tr. 10%moving average of 3 years

From the juridical point of view, the MIP is an EU Regulation (n.1176/2011) adopted by the Council on November 16 2011. The MIP is a Procedure based on a list of macroeconomic indicators (the so-called *scoreboard*) containing valuable information about the emergence of economic risks. The scoreboard is formed by eleven indicators and related thresholds: acting as a signaling device for imbalances. A subsequent in-depth review (IDR) would verify the existence of such imbalances and their severity. Some of these indicators are moving averages over three years; in some cases, they are expressed as percentage of GDP. The overtaking of thresholds may warrant an IDR that the Commission carries out to verify the existence of an outstanding macroeconomic imbalance. When the macroeconomic imbalances are identified and in case they are considered excessive, the Commission requires the MS to take decisive policy actions. Only in case these actions are considered insufficient the country enters the *corrective* arm of the MIP and a specific Procedure may triggered, called Excessive Imbalances Procedure (EIP), similar to the Excessive Deficit Procedure (EDP).

Then the involved country is recommended to plan measures aiming at removing/ reducing the imbalances in a Corrective Action Plan. That is, the MIP's goal is: 'to prevent excessive macroeconomic imbalances and to help the Member States affected to establish corrective plans before divergences become entrenched' (art.6). To discuss the MIP from the point of view assumed in this paper, it is preferable to reverse the reasoning, pointing first on its flaws (or the aspects we believe to be) and then linking them the MIP's articles or principles.
Let us start with those we deem the MIP's flaws. That is:

a) *uselessness;*
b) *elusiveness;*
c) *danger* for EMU stability and for MS with macroeconomic imbalances;
d) *partisan spirit*

a) The MIP is useless
The scoreboard is formed by a relatively high number of economic indicators: eleven. (box 1). Therefore, uncertainty is inevitably doomed to rise about the existence of a macroeconomic imbalance: some indicators could signal no imbalance, while others could indicate the opposite. In this sense the new Procedure can be seen as a 'download gun' (Spaventa and Giavazzi), i.e. a useless policy tool. The counter-argument that the Commission does not make a mechanic evaluation of the indicators' evolution does not affect this situation. On the contrary, it makes it worse. The MIP thus is either useless or gives the EC the chance to act with discretion. It makes the MIP an opaque and unpredictable policy instrument.
This problem, confirmed by the uncertain behavior of the European Commission, is destined to become more serious, if rumours about an enlargement of the scoreboard to include other indicators are confirmed.

b) The MIP is elusive
In this case we move on the same ground. Indeed according to art.14, 'the crossing of one or more indicators thresholds need not necessarily imply that macroeconomic imbalances are emerging conclusions should not be drawn from an automatic reading of the scoreboard (the conclusions) are part of a comprehensive analysis.'

In fact, the MIP has not been applied by the Commission, although the number of thresholds breached is usually particularly high, as noticed under point a).

Moreover, art.15 states that ‘in the event of unexpected significant economic developments that require urgent analysis for the purpose of this Regulation the Commission should identify the Member States to be subject to an in-depth review.’ Yet according to art.16 ‘The in-depth review should be discussed within the Council and within the Eurogroup.’

Finally according to art. 10/4, ‘Where it considers that the Member State has not taken the recommended corrective action, the Council, on a recommendation from the Commission shall adopt a decision establish non-compliance, together with a recommendation setting new deadlines for taking corrective action. The Commission’s recommendation on establishing non-compliance shall be deemed to be adopted by the Council unless it decides, by qualified majority, to reject the recommendation within 10 days. The member State concerned may request that a meeting of the Council be convened within that period to take a vote on the decision’.

Thus the MIP could continue to be in action for a long time. However this is not without consequence for the involved MS, in particular the more vulnerable ones: rather, for them it acts as a sword of Damocles while larger MS benefit from it. Thus it is not surprising that Germany can continue to record current account surpluses, breaching its threshold. All in all, the MIP is elusive, that is, *its objectives tend to disappear*[22], since even after the Procedure is opened against a MS and even if then it does not meet the Commission’s recommendation to undertake corrective policy measures, the risk that nothing will happen is very high[23]. It allows the Commission to assume larger decision powers than established by the EU Regulation. This inevitably makes the MIP an opaque and unpredictable policy instrument.

c) The MIP is dangerous for the EMU stability

Art 23 states ‘A member State subject to the excessive imbalance procedure should establish a corrective action plan setting out details of its policies designed to implement the Council recommendations.’ This means: when a MS is hit by a macroconomic imbalance, it is their responsibility to remove it. Usually the involved MS is a vulnerable one, which means that, because of the policy’s corrective action, its macroeconomic problems are doomed to worsen. It is a fact that usually in this action MS are forced to carry out pro-cyclical actions, with negative impact on the macroeconomic scenario.

22 Oxford Advanced Learner’s Dictionary

23 We can mention some cases such as Slovenia and Italy’s have been in the MIP’s corrective arm for a couple of years.

Such a scenario is a normal outcome for Southern MS: they are usually in trouble because of a lack or loss of competitiveness and even when they suffer from fiscal policy problems, usually, these have their roots in the current account balance of payments. But today these countries cannot devalue and there are no mechanisms of risk-sharing, as we know. The only option is to resort to 'internal devaluation' carried out with real wages and public spending, eventually squeezing internal demand and increasing unemployment. (cfr. fig.3a). Such an outcome is the opposite of what the MS and the Union need.

Moreover, the outcome described above is a sure way for fuelling political and social distress in countries where anti-euro parties are dangerously gaining ground. This aspect cannot overlooked from now on.

d) The MIP shows partisan spirit

This point is closely linked with the danger of MIP outlined above. As we notice from box 3, the thresholds fixed by the MIP for the current account are asymmetric: + 6 per cent of GDP for surplus MS and -4% for deficit ones.

This asymmetry for current accounts is not easily understandable, but is explained by the ECOFIN thesis, according to which, 'unlike current account deficits, large and sustained current account surpluses do not raise concerns… the risks of negative spill-overs for current account surpluses are therefore less pressing than for current account deficits.[24]

And still, art 17 insists, 'when assessing macroeconomic imbalances account should be taken of their severity and their potential negative economic and financial spill-over ... Given vulnerabilities and the magnitude of the adjustment required the need for policy action is particularly pressing in Member States showing persistently large current account deficits and competitiveness losses. This does not agree with reality, because, 'the most important contributor to the Eurozone's internal imbalances is Germany. It needs to find a way to reduce its current account surplus' (M.Wolf [2014, p.310]). In its second part, art 17 partially rectifies its approach. Yet it is undeniable the MIP favours German[25] making adjustments in EMU dramatically asymmetric. As we have already noticed, in EMU weak countries are forced into dangerous policies because of Germany's

24 Economic and Financial Affair Council meeting Brussels February 12 2013

25 It takes a current account deficit of 4 per cent of GDP as a sign of imbalances. Yet, for surpluses, the criterion is 6 per cent. It can hardly be an accident that this happens to be Germany's surplus. Above all, and amazingly, no account is taken of a country's size in assessing its contribution to imbalances. In this way Germany's role is brushed out. Yet its surplus savings crate huge difficulties when interest rates are close to zero. The omission of German makes the Commission's analysis of 'imbalances' indefensible. Imbalances are a systemic issue, not a country-specific one. What matters is the scale of the imbalances relative to the Eurozone economy. In the broader context, Germany's surpluses are crucial. (M. Wolf [2014], pag.303). It must be said however that in 2014 for the first time Germany has been put in the In-Deep- Procedure.

unwillingness to accept higher inflation, cross border transfers, the absorption of its persistent and breaching MIP rules current account surplus spurring its internal demand.

On this point, MIP should take particular notice. In the next section, a new risk-sharing might suggest how.

5.1 New Proposal to Address the Current EMU crisis

Now we are in a condition to get together all the previous considerations, to put them in the most suitable way to expound a new risk-sharing proposal[26].

The new proposal has its starting point in two of the previously listed flaws of the MIP.

1. First of all, the MIP is **useless,** because it refers to too many (eleven) indicators; that makes the Procedure a 'download gun', according to a just-right definition. Thus the reduction of these indicators is the first step of the new proposal. Only two macroeconomic indicators, **the current account balance** and the **unemployment rate,** are considered. Both are given by a moving average of the previous **two years**. For both of them, specific thresholds are provided: +10 per cent of labour force for the unemployment rate and +4 and -4 per cent of GDP for the CA. When these thresholds are breached, CA and unemployment imbalances are defined **excessive** and the Procedure for excessive imbalances is open. With respect to the current MIP, the suggested thresholds of CA are now symmetric. Surpluses and deficits exceeding 4 percent point of GDP are both considered imbalances. But with a crucial difference, as we will see under the next point.
2. The other serious flaw in MIP is its **partisan-spirit** favouring Germany[27] and the surplus MS (SMS). In order to remove, or mitigate it, the European Commission (EC) should 'divide' MS with imbalances into two groups. The first is formed by the SMS, those with CA surpluses higher 4 per cent of GDP. The other group includes all MS with excessive unemployment rates (Unemployment Member States, UMS), i.e. exceeding the 10 per cent of labor force or UMS. In opening the Macroeconomic Imbalances Procedure, the EC *should* 'invite' the SMS to spur their internal demand through higher public spending and/or favouring more generous wage policies. Thus the internal demand change should reduce the CA surplus, as well as unemployment in the UMS. This should be the desired result of the EC's policy move. But it is very improbable that this objective can be hit. Indeed, it is probable that domestic spending of

26 A similar proposal has been suggested in a preliminary form in 2013 and in 2014 by Verde [2013, 2014]

27 This conclusion cannot change, as we have noticed, after the IDP has been applied to Berlin.

SMS will be directed towards *all markets also outside the Union,* not only towards the MS with unemployment problems. The impact on them of the higher private and public spending of the SMS on the UMS could be negligible[28]. This risk should certainly be avoided. The EC should be sure that the help from the surplus countries will benefit the UMS, with high unemployment rates. *Improvements may come if new demand from the surplus countries is truly directed toward the excessive unemployment in other MS.*

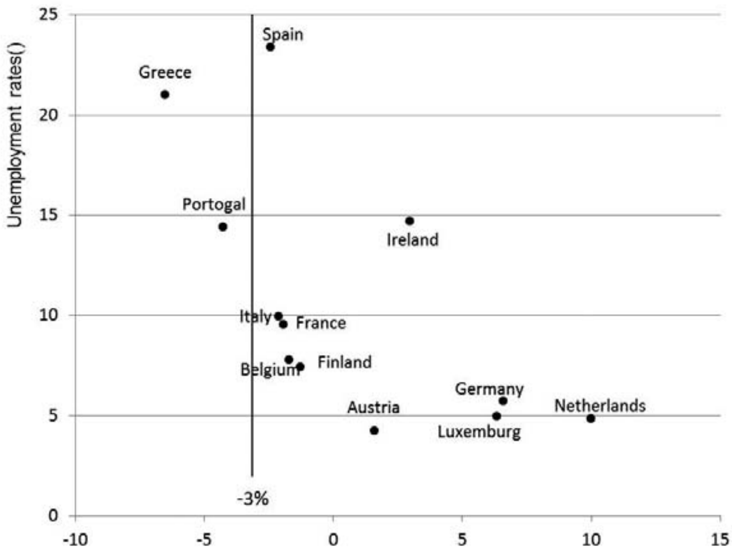
3. **A Stabilisation Fund.** To reach this target, a Stabilisation Fund could be the most immediate solution, which would "gather and distribute" a short term [29] support programme implemented on the basis of EMU macroeconomic data concerning all the Member States from the past two years: those with current account surplus higher than the threshold of 4% of GDP (SMS) and those with unemployment rates more than 10 per cent of labour forces (UMS). This data allows the Commission to determine the amount given by the difference between the excessive current account surpluses, recorded by the SMS, and the respective thresholds (corresponding to 4% of GDP). This amount is divided among SMS on the basis of the respective "excessive" surpluses and represents, for each share, the sanction envisaged by the new suggested MIP. These resources are destined to the UMS. The Commission will decide on the amount of financial resources to be assigned to each UMS on the basis of seriousness of the problems to tackle and the projects presented by countries which the aid is destined to. To avoid having to form a new institution, the Fund should be managed by the European Investment Bank. The resources of the Fund would be designed to spur UMS's internal demand.

   This could be implemented according to different forms. For instance:

   a) through **incentives** to particular typologies of demand: i.e. fashion, typical UMS's products (wines, oil, textiles, etc.:). The choice of demand typologies to be funded is crucial. They could regard those with higher multipliers on output and employment or with larger social impact.
   b) through **bonuses** assigned to the MS's citizens for visiting UMS's **tourist** places;
   c) through new spending in **human capital formation** in the UMS, such as the funding of new schools;
   d) through a temporary purchase of goods produced by factories experiencing a **liquidity crisis** which put their existence at risk.

28 This element has given also new basis to the EC's claim that expansive policies by Germany would have not significantly boosted internal demands of other MS.
29 We are talking about cyclical intervention by the Union.

Figure 2 Unemployment rates (Y axis) and CA surpluses (X axis)



A more symmetric adjustment

Then the Stabilisation Fund should be funded by the surplus countries(fig.3). The amounts of contributions of each SMS to the Fund would be strictly correlated to the difference between the actual surplus and the threshold value (4% of GDP): equal to that difference or to a percentage of it.

In this way the partisan spirit of the MIP would vanish. Not only in this way also the build-up of CA surpluses is discouraged by the SMS[30]*, while it is not in the political interest of UMS to show persistently high unemployment rates.*

The central idea at the basis of the new policy tool is in the need to recycle demand from SMS to the UMS, not simply transfer financial resources to the *recipient countries*[31].

The choice of countries with an employment rate relatively high (UMS) and countries with relatively high current account surplus (SMS) is clearly justified by the need of having not coincident set of countries. In this way we could have

30 This kind of funding recalls to the mind the Keynesian scarce currency clause

31 My proposal has an original birth, but distinguished \names are close to it: as mentioned in section 3, the McDougall-Jenkins Plan launched in 1977; John M. Keynes who in 1943 suggested an automatic recycling of financial resources from the surplus towards the deficit countries. Compared with Jenkins' my proposal has not a continuous application, but the philosophy is the same. The 1943 Keynes's Plan was about a recycling of financial resources, while I believe that recycling of demands of goods and services, i.e. through direct support to them e this is surely more effective for the reasons explained in the text.

the mentioned transfers of demand from the second group toward the first one. This aspect is normally justified also on an empirical basis. That is, normally the SMS *with a significant CA surplus* and UMS *with significant unemployment* do not coincide.

Moreover, already normally in the SMS group relationship between CA and U is *negative* i.e. a higher CA surplus gives way to a lower unemployment rate, as shown in fig.1a. The model able to explain this link between CA and unemployment is a competitiveness-type. Not only: the negative relationship between CA and unemployment, in the SMS, with a CA/GDP > 4% is confirmed by the EMU's historical data (2000-13, fig 1.b).
In contrast, in the UMS the relationship between CA and unemployment is *positive.* In other words, in MS with high unemployment, it is evident that an improvement of the CA balance is linked to a higher unemployment rate. (fig. 1a).

How can this positive relationship be explained within the EMU institutional framework? A very intuitive way could be as follows. A MS with a high unemployment rate is usually a vulnerable country with biting fiscal constraints. To face these constraints, it should reduce its internal demand through a public spending reduction and/or increased taxes, or by favoring a decrease of nominal wages. The cut in domestic absorption will produce an improvement in the CA balance, thanks to lower imports, while the unemployment rate will go up. The basic model in this case is an old Keynesian in which the desired level of internal demand (ID*) is lower than the potential one (ID) to make it consistent with a given level of CA°. (fig 2a)[32]

Indeed this positive relationship between CA and unemployment is also in this case confirmed by 2000-13 historical data regarding GIPS, as shown by fig. 2b. However, on the economic and policy plan, the idea of a Stabilisation Fund financed by the SMS will meet insurmountable objection by the SMS, and *in primis* by Germany. The challenge is: should we give up attempting to *demand transfers from the SMS to the UMS?*
The answer is no, for *at least* five crucial reasons.

i) First, structural reforms, i.e. those in labour markets, as continuously required by Germany and the ECB, could be harmful if they are not simultaneously associated with an expansion of domestic demands.
ii) We should remember that the CA surpluses of SMS mean not only that their internal demand is lower than its potential, but also that they are sucking demand out of the UMS. (M. Wolf [2014] They achieve an internal balance through an external imbalance (surplus). On the contrary, UMS are forced to reach an external balance through an internal imbalance, i.e. an increase

32 We have CA= X-M ; M= a0+a1DI where DI = potential demand and CA°= X- M° and M° = a0+a1DI° where ° mans " desired" with CA° > CA because DI° < DI.

of unemployment. In a word, the SMS' contributions to the Fund could be considered an intra-national 'compensation' .

iii) Surplus countries would be called to support the domestic demand of weaker MS, saving them the option of internal devaluation and making the Union more stable. Thus the suggested risk-sharing mechanism pursues not only stabilisation purposes, but **the public good objective given by the stability of the Union,** as well.

iv) The new mechanism will make the adjustment process more symmetric, avoiding more generalised and dangerous social distress.

v) Not only, the build-up of CA surpluses is in this way also discouraged by the SMS[33] *, while it is not in the political interest of UMS to show persistently high unemployment rates.*

Finally let us to concentrate on the characteristics of the new risk- sharing toll by comparing it to those identified by Hammond and Von Hagen, defined as optimal.

First of all, the new instrument is **simple**. *That is, the conditions which trigger it are a CA surplus higher than 4% of GDP and an unemployment rate higher than 10%. They must refer to the* ***two years before*** *the new instrument is applied.*

Secondly, it is ***automatic:*** *once those conditions are verified the mechanism is immediately and automatically applied,*

Thirdly, it is applied for a period ***of two years.*** The suggested Stabilisation Fund is an instrument of short-term economic policy designed to cope with the cyclical unemployment. Naturally, it would be up to the Commission to control the actual destination of financial resources and to prevent opportunistic behaviour, such as moral hazards, on the part of countries with high unemployment.

All the new public spending by the SMS cannot be considered within the European budgetary constraints. Moreover the Fund's benefits should not be considered an alternative to other forms of fiscal rules relaxation, e.g. like the exclusion of the European Structural Funds' co-financed projects from the Stability and Growth Pact. The particular way that I have suggested to fund the domestic demand of MS in economic and social trouble allows us to qualify the meaning of two crucial terms: solidarity and distributional neutrality.

As concerns **solidarity**, it is often said that SMS should help weaker MS because without solidarity the euro-zone is doomed to fail, or at least to meet many more problems. It is true. But within the suggested risk-sharing mechanism solidarity is not called upon: the contributions of SMS' to the demand of UMS is based on a **rule** established for the stability of the Union as a whole. This aspect – the union stability- is not ignored by the Treaty. The 1992 Maastricht Treaty recognises the importance of Member States '*conducting their economic policies with a view to contributing to the achievement of the objectives of the Community' (art 102a)*

33 This kind of funding recalls to the mind the Keynesian scarce currency clause

stating that Member States must *'regard their economic policies as a matter of common concern and ... coordinate them within the Council' (art 103 (1)).* Moreover if the *'economic policies … risk jeopardizing the proper functioning of economic and monetary union, the Council may ... make the necessary recommendations to the member States concerned'* (art 103).

The same could be said as concerns the **distributional neutrality condition (dnc)** that each risk-sharing mechanism should meet in EMU, according to what we learned from one BC's paper in section 3. Instead, in our case, these **dnc** (in both definitions) should not be stiffly applied, because of the new mechanism's aims for the stability of the euro-zone as a whole.

Anyway if the risk of moral hazard – i.e. the temptation to benefit from the new mechanism without trying to reduce structural unemployment- is real,the distributional neutrality condition should be envisaged as a way to deter it. However it is also not easy to conceive a national government tempted to persistently show high unemployment rates! Finally, it is clear in the evidence that the new mechanism shares Summers' hypothesis on the implications of a **secular stagnation.** That is: there is a need for generalised and significant support for internal demands; the superiority of budgetary policy with respect to monetary policy, as we have just noticed. Stagnation and deflation cannot beovercome without a Keynesian policy of strong recovery of demand.

Here is an important by-product of the new mechanism. Indeed, the Eurozone is persistently and significantly exposed to the International economic cycle. That in a measure higher than its dimensions would leave to suppose. The new suggested instrument could be, tanks to the automatic recycling of national demands, an effective device to endogenously create a self sufficient internal demand of the Euozone as a whole.

7. Some Concluding Remarks

To sum up:

1) According to Martin Wolf [2014] the euro has been a mistake. This is not true. The real mistake has been to not have provided the Union with an insurance mechanism able to cushion asymmetric cyclical developments. If this is not possible in the more or less immediate future, then the life of the euro will come to an end. This is why the "Bruegel debate" on risk-sharing mechanisms is very important: it surfaces in a delicate phase of the euro's life.

2) A growing number of economists are proposing that monetary policy, even unconventional measures such as quantitative easing (QE), recently adopted

by the ECB are unable to draw the weakest MS from the current phase of stagnation. The same is heard about banking unions or other tools designed to repair failures but insufficient to avoid them in the first place. Also structural reforms of goods and labour markets are insufficient if not implemented in a context of economic growth. The ongoing Bruegel debate on the Secular Stagnation Hypothesis is gaining ground. It is a reasonable perspective which makes the adoption of risk-sharing mechanisms even more urgent.

To overcome the well-known lack of solidarity in EMU it is necessary to underline that the "stability of the Union" is a public good, a superior objective to which all MS must contribute. In this vein, we can imagine a drastic reform of the Macroeconomic Imbalances Procedure (MIP). The MIP has many flaws which we have dwelt on and these should be addressed.

As it has been said, if we wish to understand how far the folly may go, we should study the MIP. The reform here suggested aim at reducing its scoreboard to an indicator of social and economic pain and another of economic strength. The unemployment rate is the first; a structural current account, the second. The latter is a prove of a level of domestic demand lower than potential's.

This paper focuses on these two indicators in order to forge an insurance mechanism able to guarantee macroeconomic stability. The importance of the suggested mechanism crucially depends on its capability to generate automatically an adequate level of demands at national and federal plan and to fight against their uneven distribution within the Union.

Finally, the new mechanism, allowing an automatic recycling of national domestic demands, might represent an important step towards the creation of a high domestic spending of the Union as a whole making it less dependent on the external macroeconomic cyclical conditions.

Figure 1a Current accounts and unemployment rates of CA deficit countries: average historical data

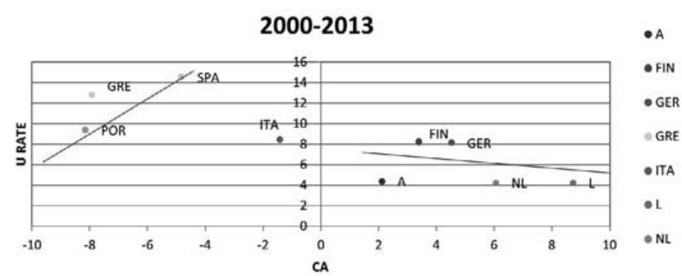


Figure 2a Current account and unemployment rates : theoretical scheme for CA deficit countries. Internal devaluation model. Goal : to improve CA through demand squeeze (lower Y) . Relationship between CA and U from 1 to 4

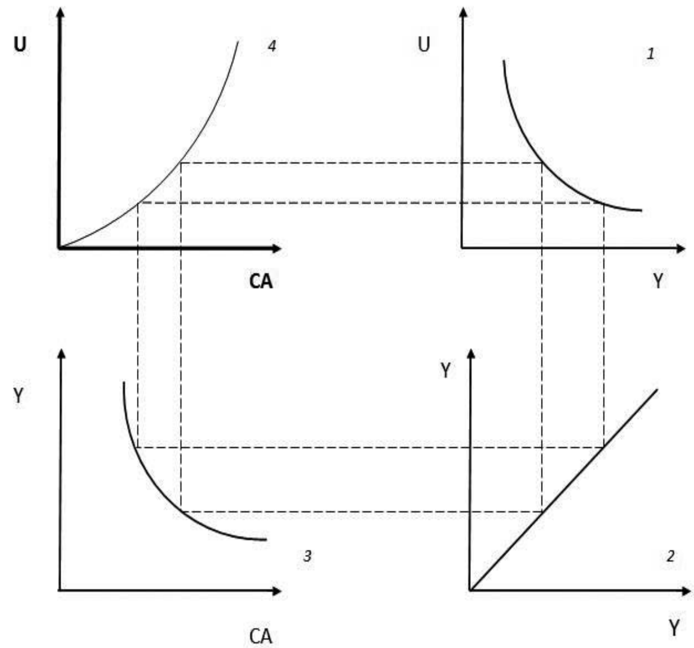


Figure 2b Current accounts and unemployment rates : theoretical scheme fordeficit countries. Real exchange rate devaluation. Goal: improvement of CA through RER devaluation- Relationship between CA and U from 1 to 4

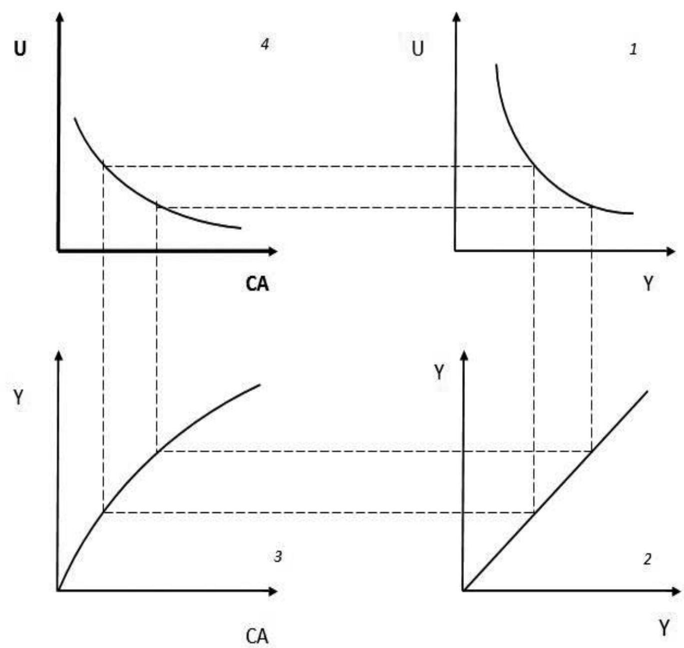
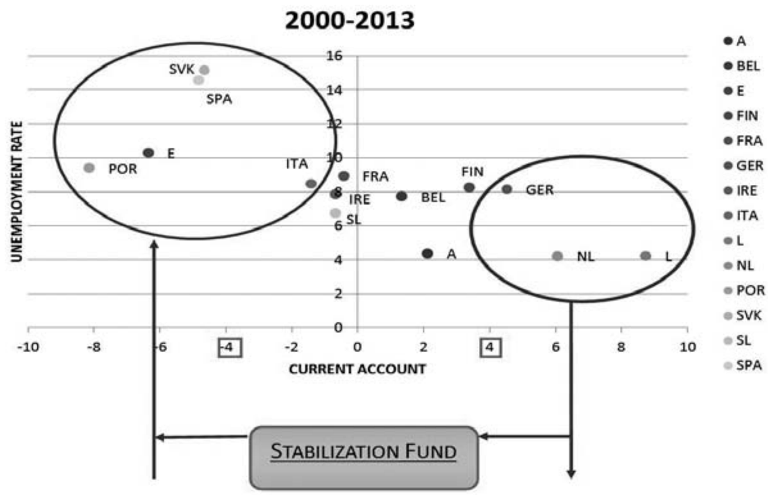


Figure 3 Stabilization Fund Mechanism. Current Account and Unemployment Rate 2000-2013



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