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THE CHALLENGES EUROZONE STAGFLATION POSES FOR HOUSEHOLDS, BUSINESSES AND HIGH-DEBT COUNTRIES: SOME POSSIBLE SOLUTIONS*

ABSTRACT

The paper presents a holistic perspective of challenges and possible solutions to the euro area's current vulnerabilities. Stagflation, structural energy problems, decarbonization, irreversible supply chain modifications, shock waves on crypto currencies and the war in Ukraine concur in shaping a permacrisis with severe consequences for households, firms and high-debt governments. This unstable environment represents a major challenge to economic policies. Monetary policy is primarily tasked with lowering inflation to the medium-term target of 2%, but without unduly prolonging the stagnation. Fiscal policy was very successful in establishing the NGEU–PNRR framework. This required the suspension of the EC fiscal framework – the SGP – which will be reinstated at the end of 2023 with reforms now under discussion. The NGEU is a major step forward, but it is a temporary mechanism: ways and means are explored to consolidate it. A true European debt – having as counterpart reproductive commonly agreed infrastructures – is a key element of the solution proposed, which would ultimately comprise the creation of a political, fiscal, and monetary union. Current inflation is partly predicated upon the excessive, prolonged expansion of the monetary base by the ECB. The end of monetary easing and of negative interest rates was highly appropriate, but, if the monetary expansion is reversed too abruptly, the ensuing depression can discredit the entire process.

Keywords: Stagflation; Vulnerabilities of the Euro Area; Economic and Monetary Union; NGEU; Public Debt; Concentric Europe
JEL Classification: E0; E4; E5; E6; E63

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RIASSUNTO

Stagflazione nell'euro area. Vulnerabilità delle famiglie, delle imprese e dei governi con alto debito: come affrontare le sfide

Questo articolo offre una prospettiva olistica delle sfide e delle possibili soluzioni alle attuali vulnerabilità dell'euro area. Stagflazione, problemi energetici strutturali, decarbonizzazione, modifiche irreversibili nelle catene di offerta, onde d'urto sulle criptomonete e la guerra in Ucraina concorrono nel determinare condizioni di permacrisi con gravi conseguenze per famiglie, imprese e governi con alto debito. Queste condizioni instabili costituiscono una grave sfida per la condotta delle politiche economiche. La politica monetaria ha il compito principale di ridurre l'inflazione all'obiettivo di medio termine del 2%, senza tuttavia indebitamente prolungare la fase recessiva. La politica fiscale ha avuto grande successo nello stabilire lo schema NGEU/PNRR. È stato necessario sospendere il quadro fiscale di riferimento – il SGP – che sarà reintrodotto alla fine del 2023 con modifiche attualmente in discussione. L'NGEU rappresenta un grande passo in avanti, ma è un meccanismo temporaneo.

In questo lavoro sono esplorate le strade per consolidarlo. Elemento chiave della soluzione proposta è rappresentato dalla creazione di un vero Debito Europeo. Questo debito avrebbe come controparte infrastrutture fisiche e umane "riproduttive", concordate in comune nell'Unione Europea. A sua volta ciò richiederebbe la creazione di una unione politica, fiscale e monetaria. L'inflazione corrente dipende anche dalla eccessiva e troppo prolungata espansione della base monetaria da parte della BCE. Il termine delle politiche di monetary easing e dei tassi d'interesse negativi è stato molto appropriato, ma, se l'espansione monetaria viene invertita troppo bruscamente, le conseguenti pressioni recessive possono mettere a repentaglio l'intero processo.

1. INTRODUCTION

The European Central Bank's most recent *Financial Stability Review* (ECB, 2022) underlines that the risks for the eurozone have increased markedly as a result of rising inflation, price and energy shocks, and the predicted recession for 2023.

Such a negative outlook has been aggravated not only by uncertainty regarding the conflict in Ukraine, but also by significant errors in the EU's and ECB's economic forecasting, by uncertainty and delays in energy and economic policies as well as by the enormous expansion in the monetary base and money supply during the period 2013 to 2022.

Potential systemic risks require a profound reassessment of the links between money, public debt, political and economic policy decisions, institutional choices and financial regulation.

Following the holistic approach I adopt in this work, the critical issues in Europe – political consolidation of fiscal and monetary union, EU enlargement, common defense – share the same *leitmotif* that intersects and connects them. A close connection exists between on one hand political choices and on the other those made in social, institutional and economic ambits. Also needed is a critical review of the economic models of probability and statistics that lie at the basis of economic policy design.

A recurring theme in the arguments I will present is the inevitable connection between monetary and fiscal policy. The separation in terms of their respective choices and institutional responsibilities cannot and must not ignore the need for a rigorous analysis of their points of contact and complementariness[1].

On 21st May 2022, the macroeconomic forecasts for Italy for 2022 and 2023 published by the European Commission (2022b) presented the following data:

- Real GDP +2.4; +1.9
- Inflation +5.9; +2.3

Similar figures were forecast for the whole euro area, i.e. real growth for 2022 at 2% and inflation below 6% and rapidly returning to the 2% target in 2023.

Macro forecasts can be seriously flawed in capturing changes in economic conditions, particularly recessions.

This depends also on the methodology typically adopted (EC, 2022a) in constructing the underlying models, especially *Dynamic Stochastic General Equilibrium* (DSGE) models (Kay

[1] Consequently, I reject the approaches of total separation and divorce and on the other extreme those of Modern Monetary Theory (MMT) (Kelton, 2020) and the Fiscal Theory of the Price Level (FTPL) (Brunnermeier *et al.*, 2020). On the interaction between monetary and fiscal policies see for instance Visco (2022) and Pittaluga (2022). Only approaches that identify these interactions can evaluate overall policy thrust, particularly in the event of exceptional shocks such as a pandemic.

and King, 2020). Errors, after six month data are striking and help to explain the drastic, rapid change in monetary policy which, as we will see, risks worsening the recession without achieving the desired effects of a sharp slowdown in rising prices.

At the time of writing – mid-December 2022 – inflation in Italy touched 12%, the highest since 1984, but it is expected to fall sharply in 2023, with a similar outlook for the euro area. In Germany, inflation went above 10% and Real GDP is forecast to fall by 0.5% in 2023. The ECB's Financial Stability Report highlights that

"these recent developments are increasing the vulnerabilities of households, corporates and more-indebted sovereigns".

President Lagarde, who in May 2022 had seriously underestimated both the risk of inflation (regarded as short-lived) and recession (considered unlikely), by December was calling the situation a "permacrisis" (Lagarde, 2022a). In the same month, she accepted the seriousness of inflation, stating however that it came from "pretty much nowhere" (Lagarde, 2022b).

2. Monetary policy, delays and global uncertainty

The underlying causes of current inflationary tensions, according to many, stem from the expansionary monetary policies adopted over the last ten years (see, for example, Fazio, 2021; Masera, 2021; Goodhart, 2021; King, 2021). Important lessons on monetary policy lags have been and continue to be ignored (e.g., Friedman, 1969; Mundell, 1971; Issing, 2008).
Even without accepting the impact of the monetary transmission mechanism on prices, the relevance of conclusions reached by, for instance, Mundell (1971) cannot be overlooked:

"The longer the time required for stabilization, the higher the ultimate price level will be… But the opposite danger is more severe. If the monetary expansion is ended too abruptly, the ensuing depression can discredit the entire process".

The risks of a worsening macroeconomic scenario depend on the tradeoff we can see today between unanchored inflationary expectations and an excessively restrictive monetary policy. We are experiencing the effects of, on one hand, not having recognized the structural importance of energy-driven inflation – leaving aside the impact of the conflict in Ukraine (Schnabel, 2022a) – and, on the other, as already noted a prolonged and excessive increase in money supply. This recognition lag cannot be remedied by an overreaction in the opposite direction. An excessively restrictive monetary policy would inevitably exacerbate the loss in purchasing power of accumulated savings and available income already being felt.

I am not, unlike some economists, suggesting a reassessment of the validity of the 2% inflation rate target adopted by major central banks. I am, however, suggesting that given the heightening of recessive features incurred by uncertainty about the effects of a restrictive monetary policy, inflation will probably not be brought down before late 2023 and early 2024.

The quantitative easing and fiscal support packages for investment in 2020-21 in response to Covid-19 represented a necessary change to the ECB's established approach based on an assumption of stable money supply and demand and the need to separate monetary policy from public debt funding. The sole objective prior to the pandemic was to keep inflation within the 2% target (Issing, 2008).

Fiscal policy was trapped in the Stability & Growth Pact's straitjacket, which imposed a structural reduction in public debt levels in a context of economic growth in the euro area (apart from compliance with the Maastricht criteria's 3% and 60%). Public debt was seen as burden for future generations in line with the theories of Ricardian equivalence and dynamic intertemporal efficiency (Debrun *et al.*, 2019).

The EU's correct and innovative approach adopted in the NextGenerationEU (NGEU) and Recovery and Resilience Facility, approved in July 2020, conflicted with the SGP, which was in fact put on hold until the end of 2023 (Paganetto, 2022a). Mario Draghi's 'good public debt' (Draghi, 2020), connected to investment in infrastructure, the digital economy and decarbonization, was not recognized.

Expansion of the monetary base in the euro area had overshot. High-powered money recorded a sixfold increase in twelve years, from €1 trillion in December 2009 to €6 trillion in June 2022. Reversal in terms of stocks is inappropriate. Nevertheless, the ECB's sharp U-turn on monetary base creation by itself has pushed down inflationary pressure just as the collapse of cryptocurrencies, considered in the broadest sense as money, has (Savona, 2021; Masera, 2022).

The long and variable lags of monetary policy[2] raise methodological problems based on the stationarity and ergodicity of the stochastic distributions under analysis and affect the distinction between risk and uncertainty in probability, statistics and economics[3].

The existence of significant lags (recognition, implementation, policy) in monetary policy means adopting a forward-looking approach. Where statistical series are stationary, the economic shocks produce mainly temporary effects that can be to some extent ignored. Where, however, the shocks are persistent and imply structural changes, serious forecasting and policy errors entail. A recurring problem in applying econometric models is that the time period of observations has to be long enough to be able to produce stable results, whilst at the same time not too long so as to avoid capturing any significant changes in the underlying economic relations during the period analyzed (Hicks, 1979); this means essentially satisfying stationarity.

Policy makers cannot depend primarily on past data but should consider present and future information and expectations that impact inflation and product. They should also recognize monetary lags.

The introduction on 21st July 2022 by the ECB of the Transmission Protection Instrument (TPI), which accompanied a 50-basis point rise in rates, potentially improves the efficiency of transmitting policy decisions. The new tool is less fiscally conditioned, unlike for instance the Outright Monetary Transactions (OMT) program[4], unused for more than ten years basically due to the strict eligibility conditions connected to the concomitant recourse to the European Stability Mechanism (ESM, 2022).

Countries that use the TPI will have to fully comply with the new fiscal framework outlined by the European Commission. Considerable uncertainty reigns given that the SGP is due to be overhauled by the end of 2023. In effect this marks a return to certification via the European Stability Mechanism (ESM, 2022), whose ratification process by Italy should follow a holistic

[2] Similar problems exist in fiscal policy lags.
[3] For a detailed overview of these issues, see Hicks (1979), Gruen *et al.* (1997), Masera (2020), Kay and King (2020).
[4] For a critical analysis of the reasons and operating mode of this program see ECB (2012).

assessment, bearing in mind the difficulties encountered by the Donohoe Plan (2022a, 2022b)[5].

An *a priori* rejection by Italy of the EMS would weaken its position, but it can nevertheless argue strongly at all European levels – Parliament, Council, Commission as well as with the ECB directly – that the country's support to the Banking Union proposal foreseen in the Donohoe Plan was on analytical grounds and in defense of the resilience of the euro-area banking system.

As regards the TPI, it has rightly been pointed out (Buiter, 2022) that the mechanism is opaque in places and actually overlaps with the OMT program.

The new Monetary Tightening (MT) tools also are characterized by rigidities during a recession, particularly with regards to the changes made in the conditions banks must meet to access Targeted Longer-Term Refinancing Operations (TLTRO).

3. Banks: an important factor of resilience

The two financial crises of 2008 and 2011-12 had a serious impact on the real economy and on commercial banks, leading to a surge in impaired credits that peaked in Europe and in Italy at the end of 2015. Banks subject to ECB oversight recorded between 2015 and 2016 credit impairments totaling €1 trillion.

A successful phase of de-risking followed that benefited from macroeconomic policies, heightened supervision by banking authorities plus the realization on the part of banks that they had to improve the quality of their balance sheets. In practical terms, de-risking involved addressing the problems facing households and firms also with loan moratoria and public-loan guarantee programs. The market in impaired credits that followed enabled risk redistribution and more efficiency in bringing the credits to market (SCOPE, 2022).

However, with the onset of the recession and the downgrade in ratings of some countries, particularly Italy, things have begun to change and an uneven picture is emerging. Although the ratio of non-performing loans (NPLs) is set to increase in many countries, a banking crisis and a worsening in credit quality is unlikely in Europe and Italy. Euro area banks had by mid-2022

[5] As will be discussed in paragraph 4, the problems facing the Plan highlight the risks of financial fragmentation in the euro area linked to on one hand low degrees of substitutability between various countries' government bonds and on the other the shortage of commonly held risk-free assets.

recorded encouragingly robust capital and liquidity metrics. Headline data for Italy are in fact very good: CET1 15%; LR 5.6% & LCR 168%; NPL 1.9%.

Nonetheless, an excessively tough monetary stance risks negatively impacting incomes of households and businesses with knock-on effects for banks.

The ECB's 50-basis point hike in July 2022 was followed by further increases of 75 and 50 basis points on 27th October and 15th December, respectively. Worringly, President Lagarde announced the possibility of more rises 'at several more meetings'.

According to the timeline announced by Lagarde herself, the ECB will conclude its investigation phase on the digital euro in 2023 and the European Commission will present its proposal for the legislative framework. The risks of crowding out banks a digital euro implies are well known and the launch of a digital system in the euro area requires considerable caution with regard to both timing and method (Savona, 2021; Masera, 2022).

The tightening of monetary policy and the inevitable uncertainty of its effects on incomes and prices poses threats in terms of equity, inclusion and social stability as a whole, particularly for households and small and medium-sized businesses (Phelps, 2022; Paganetto, 2022b) with potential negative spillovers for the systemic stability of the banking system.

In Europe as in Italy, a review of state aid and the possibility for more public-backed loans cannot be ruled out. The granting of further credit restructuring and moratoria requires structural changes, albeit gradual, regarding time horizons and the nature of spending, whether current or long-term 'reproductive' investment (see paragraph 6). Basel 3 capital requirements should also be revised to avoid excessive provisioning (Patuelli and Sabatini, 2022).

4. Fiscal Policy: NGEU and RRF

EU financial support in the form of NextGenerationEU and the Recovery and Resilience facility are a cornerstone in improving long-term sustainable productivity and development that generate new job opportunities for women and young people, and reduce geographical inequalities in the face of the challenges posed by digital transformation, the environment, energy transition and demographic decline. The successful carrying out and completion of these projects requires connecting and supporting sound public and private investments, particularly in infrastructure in the broadest sense, and in human capital.

In the event of supply-side shocks, structural changes in energy prices and the geopolitical order, support for growth goes hand-in-hand with structural reform.

In Italy, the most important of these concern the justice system, taxation, competition, public procurement, land registry, concessions, excessive bureaucracy. The Draghi government addressed the need to remove structural inefficiencies and red tape that have contributed to the chronic underperformance of the Italian economy. The current Meloni government is faced with carrying out these reforms.

NGEU and RRF were developed in response to Covid-19 and its aftermath (Gennaro and Masera Eds, 2020). As we have seen, the SGP was put on hold in March 2020 at the onset of the pandemic, with the NGEU's being approved in July of the same year, to be followed by the national plans within the RRF.

Suspension of the SGP was extended until the end of 2023. The NGEU-RRF mechanism is a significant step towards the creation of an innovative European institutional framework. Formally, however, it is a temporary instrument that does not envisage automatic forms of fiscal stabilization country-by-country.

In some member states, particularly in Italy, there is widespread belief that NGEU-RRF is a permanent instrument paving the way to create a true common European public debt.

The EC, when in 2022 approving the continued suspension of the SGP, stressed the need for high debt/GDP countries (Greece, Italy, Cyprus) to taper current national public spending to below potential growth levels in line with the policy message that investment and reform were the keys for continued and long-lasting recovery.

These issues were at times the subject of confused debate at the European level that failed to take account of how they inevitably tied in with the Donohoe Plan, examined by euro area finance ministers in course of discussions on sovereign debt and deposit insurance reforms. In fact, the proper completion of the Banking Union, overcoming the errors and shortcomings of the past (Rossano, 2022), represents a fundamental part of the consolidation of the euro area.

Paschal Donohoe, the Irish Finance Minister, in Spring 2022 went as far as to state optimistically that

“it is now or never for an EU banking union”.

However, during the informal meeting of the Eurogroup held in Versailles on 10th and 11th March 2022, profound differences emerged particularly on the question of banks’ exposure to national sovereign debt and the European Deposit Insurance Scheme (EDIS). These issues were the subject of the so-called ‘Donohoe Work Plan’, an attempt to overcome existing differences. The Plan failed to get acceptance particularly due to Germany’s insistence on not wanting any debate about the possibility of a commonly guaranteed European deposit insurance scheme (Lindner, 2022).

5. Reforming Stability & Growth Pact: Some Policy Considerations

The SGP is due to come back into force in 2024 following a wide-ranging review by the European Commission (EC, 2022c; Buti, 2022). The present fiscal framework based on a distinction between preventive and corrective arms, presents a range of problems that are correctly identified and in part addressed on the basis of the proposals drawn up.

Apart from the key issue relating to the creation of a common European public debt (see para. 6), the main problems lie in a series of factors: complex indicators and rules, a rigid and restrictive reduction foreseen by the 1/20 rule (applying to countries with debt levels above the 60% target determines that these countries have to reduce their debt-to-GDP ratio by at least 1/20th of the difference between their current debt/GDP ratio and the 60% target every year), pro-cyclical distortion both in positive and negative phases, unrealistic incentives for reform and fostering ‘good investments’, uneven corporate governance in national public debt management.

Although the Maastricht thresholds for debt (60% debt/GDP) and deficit (3% deficit/GDP) would remain, each Member State could adopt its own plan for reducing debt in a period ranging from four to seven years, with the opportunity to extend the adjustment period. The 1/20th rule is to be dropped and the rules followed by the Commission in its annual assessment simplified. Nevertheless, a Member State’s failure to reduce debt levels means possibly losing out on European funds, including those foreseen by the Recovery and Resilience Facility.

No 'golden rules' for investments in the green and digital economy or human and social capital have been made. States have to present national debt reduction plans and their individual debt status – substantial, moderate or low – will be taken into account. In essence, each State with a debt/GDP level over 60% will have to present a debt restructuring plan to be assessed by the Commission and approved by the Council. The Commission is responsible for monitoring the implementation of the plans and States must present annual updates on the implementation process. Failure to carry out these plans will result in penalties.

Although I cannot provide here an exhaustive analysis of the European Commission's review of the SGP, the steps taken so far represent important improvements to the existing framework without however modifying the basic structure. I remain convinced that the framework will keep its deflationary bias as long as it continues with the, I believe, obsolete 60% debt/GDP ratio. Far better would be a 100% benchmark.

As already seen, the proposed scheme is not holistic as it does not address, in particular, the issues raised and so far unresolved in the Donohoe Plan. This will inevitably heighten the differences between the so-called virtuous countries and those highly indebted ones. A further criticism is the acceptance of sustainable debt models that implicitly presume the transversality condition.

A model imbued with fiscal discipline and debt sustainability may require a different approach based on the principle of a common European public debt and a sharp distinction between reproductive public investments and other types of public spending. I will discuss this in the next paragraph.

6. A PROPOSAL FOR INSTITUTIONAL AND POLITICAL CHANGE: COMMON DEBT AND CURRENCY

The complex linkages between political and fiscal union are necessarily part of any analysis of public debt. Many policy makers, both in the EU and the IMF – the latter the so-called 'Washington Consensus'[6] – have argued that public debt is an inevitable burden for future generations. This position is founded on the 'intertemporal dynamic efficiency model', i.e. public

[6] For a critical analysis of the Washington Consensus, see for instance Serra and Stigliz (2008).

debt at time t must be covered by the current net value of primary balances[7]. In this way, purported Ponzi games cannot be sustained and balance constraints are 'well defined'[8]. This intertemporal efficiency model posits that r (real interest rate on public debt) will be higher than g (real GDP). Long periods in the past have disproved this theory, such as in the 1900s and 2000s, but nonetheless it continues to be adopted mainly on the grounds of its alleged internal cohesion rather than for its power to represent economic reality[9].

This approach, which underpins Europe's SGP and balanced-budget objectives, does not distinguish between government current account spending and net returns over time on government infrastructure investments. In even more general terms, the dynamic relations between real interest rates, economic productivity and growth[10] are not taken into consideration.

Intertemporal efficiency has often been adopted by policy makers, who integrated it into contexts of stochastic general economic equilibrium based on dynamic optimization employed by both firms and households (see e.g., EC, 2022a). As indicated, econometric testing of these models and the resulting forecasts are generally based on hypotheses of measurable probability and of stationarity of the economic variables analyzed.

These mainstream models ignore the dynamic connection between real interest rates and growth rates, accounting for the marginal productivity of capital. The linkages are however evident in the neo-classical production function model developed by Solow (1956). With a production function with constant returns to scale and labor augmenting technological progress, the rate of interest rises with growth and decreases with the rate of saving.

Conventional economic and political models contributed to further and unwarranted support for the debt burden argument and the adoption in Europe of the SGP despite Domar's (1993) cogent arguments to the contrary.

The issue has recently been the subject of some reassessment that has recognized the need to analyze the impulses underlying the level and dynamics of interest rate differentials (r-g). Four key non-independent factors have in past years played a part in depressing real interest rates

[7] The primary balance is the difference between a government's revenues and its non-interest expenditure.
[8] Debrun *et al.* (2019).
[9] As shown by Bernanke and Reinhart (2004) and Blanchard (2019).
[10] For an exhaustive analysis see for example Bergeaud *et al.* (2019).

even more than GDP rates: decline in total factor productivity, falling birth rates, a savings glut and, from December 2009 until June 2022, monetary policy.

There is increasing acceptance that a distinction must be made between reproductive and deadweight government deficits. This taxonomy has illustrious precedents, particularly Arrow and Kurtz (1970) and more recently work by economists and statisticians at the IMF, the World Bank and ISTAT, who have stressed the importance of this distinction[11].

As we have seen, the NGEU represents an important step in the construction of an innovative European institutional framework that views real public debt not as a burden, but as a positive legacy for future generations.

I propose (Masera, 2021) a model that integrates the NGEU model as part of a permanent economic institutional setting and rigorous review of the SGP that goes beyond its deflationary bias. Common real debt would be funded through the creation of an EU Reproductive Infrastructure Security (EURIS) backed by productive assets and their real returns. EURIS securities would include debt, equity and hybrid instruments, with the bonds satisfying triple-A rating criteria. The accumulation of good infrastructure, understood in its broadest sense, plus the funding instruments proposed, based on established market and PPP forms to incentivize the crowding in of private investments, would represent the foundation for resilient growth. Additionally, it would offer a solution to the debt problem without requiring a fiscal straitjacket.

I am not suggesting that European Monetary Union member countries adopt a traditional golden rule on public investments at a national level, but instead develop new infrastructure projects put forward by single States and scrutinized and monitored jointly. Capital account spendings would in principle be characterized by economic returns (MPK) higher both than GDP growth rates and bond yields ($PMK>g>r$). The projects selected would have a benefit-cost ratio exceeding one and would be accompanied by appropriate segregation of market returns. The European Investment Bank, the world's largest and most efficient public investment bank, could market the launch of operations.

The need for the permanent and rigorous management of public finances, particularly in the area of current expenditure and revenues, would be assured by the adoption of a system that

[11] For an overview of the literature, see Masera (2021).

allowed deficits only for investments jointly monitored by the EC. Temporary deficits would of course be allowed to address both exceptional circumstances and cyclical trends through the creation of a common automatic fiscal stabilization capacity.

This stabilization capacity would be flanked by a fundamental institutional change: the EMU would be transformed into a Political, Monetary and Fiscal Union along the lines of a blueprint for a concentric Europe (figure 1). The proposal draws together the strands present in past initiatives such as the Three Communities (politics, defense, coal and steel) of the founding fathers and the Paris Treaty of 1951, contributions by Delors (1993), President Mitterrand and Chancellor Kohl (Kohl and Mitterrand, 1990), and more recently the Five Presidents' Report (2015) and President Macron (2018).

A common debt implies a fiscal union of euro countries with a corresponding change in the political institutional framework and a move towards a concentric model built around the eurozone as illustrated in Figure 1 below.

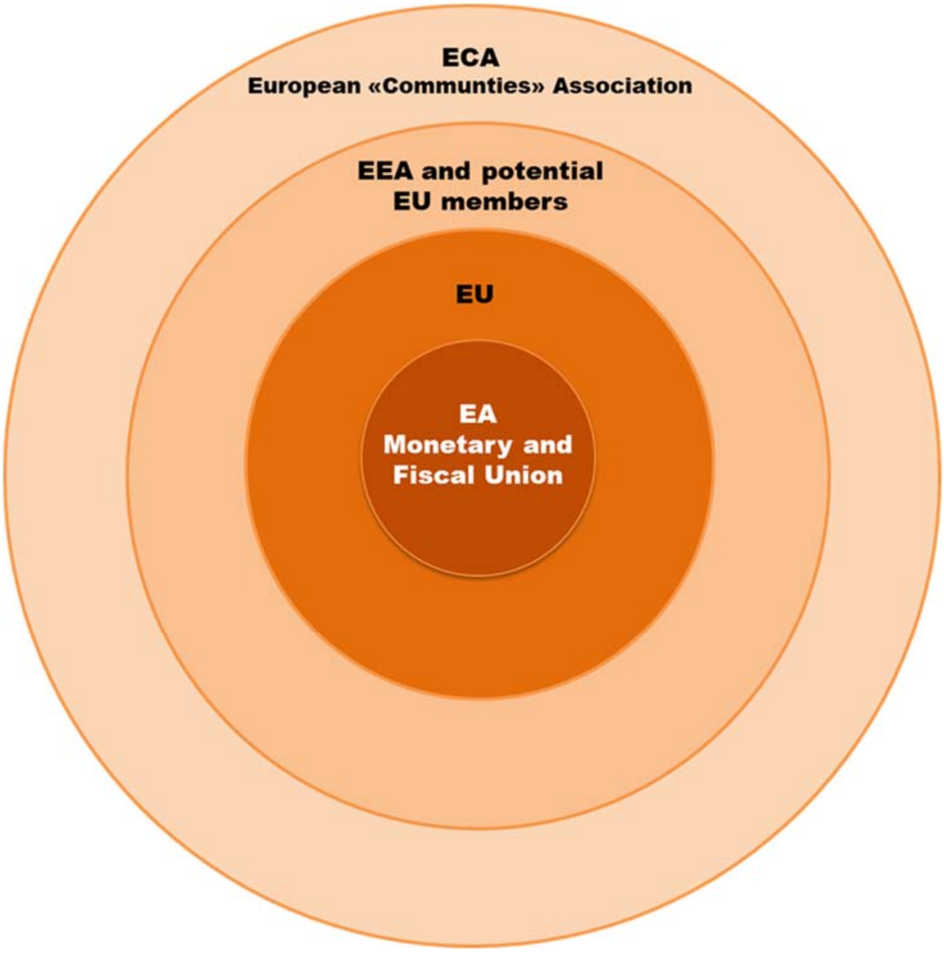
7. Conclusion

I have discussed a series of distinct but inextricably linked issues – political, legal, economic, financial – that are involved in the construction and reform of the European institutional architecture. The approach proposed addresses new challenges whilst recognizing the lessons from the past. Primarily, political union requires consolidating monetary union through the creation of a common public debt on the condition that this is exclusively reproductive, i.e. investments destined for tangible and intangible infrastructure. The fiscal constraint would consist in a balanced budget, related to the level of non-productive (deadweight) spending for each country, flanked by a common fiscal stabilization capacity.

In parallel, the EMU would become a Political, Monetary and Fiscal Union along the lines of Europe's founding fathers and the Blueprint for a concentric and open Europe.

The hurdle of 'a currency without a state' can only be overcome by the full implementation of the Banking Union. The absence of this fundamental linkage weakens the institutional architecture and propagates political and financial fragmentation in a world already characterized by radical uncertainty.

FIGURE 1 - *Concentric Europe: a Blueprint*



Acronyms:

ECA = European "Communities" Association

EEA = European Economic Area

EU = European Union

EA = Euro Area (or Eurozone)

Source: Author's adaptation from Macron (2018).

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