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Abstract

The European Monetary Union is characterized by a crisis of governance, this has become more evident with the crisis of the euro which has shown the weaknesses of the European institutions and stressed the heterogeneity of member countries.
The global financial crisis struck the euro area very severely because it coincided with the lack of appropriate policy tools to manage the crisis and with a period of weak political leadership which have made crisis management even harder. Europe needs to build the institutions of its monetary union to avoid similar crises in the future. But it is necessary a greater European integration, with a central fiscal entity at European level which requires a transfer of sovereignty from the individual Member States. This contribution first discusses the issue concerning rules and discretion in the governance of the euro. In the following section it describes the euro crisis and examines the remedies put in place, noting that despite the statements and the efforts of the European authorities the confidence in the euro is diminishing. Thus the exit of Greece from the euro or even the breakdown of the single currency has become a hypothesis discussed more frequently among economists, politicians, central bankers and businessmen. The last section of the work focuses on what's wrong in the governance of the euro and examines the institutional aspects and the economic policy issues suggesting that the European integration serves to ensure the European citizens independence and protect their historical freedom, but also to influence and thus affect the choices from which may depend the future prosperity of European nations involved.

Introduction.

The European Monetary Union is characterized by a crisis of governance, this has become more evident with the crisis of the euro which has shown the weaknesses of the European institutions and stressed the heterogeneity of member countries; a heterogeneity – according to Martin Feldstein (2011) – that includes not only economic structures but also fiscal traditions and social attitudes.
The members of the European Monetary Union are independent states which have given up their own currencies in favor of a joint currency, the euro. Stability of the euro can be assured if the economies of the member states tend to be similar in competitiveness, economic growth and fiscal policies. Otherwise imbalances between these countries tend to occur, create tensions in the currency area and, in the end, endanger the currency union, as Mundell (1961) had already maintained. In any case, since its inception the European Monetary Union has shown a preference for a political approach to decisions to admit a country as a member of the euro area instead of looking exclusively to its economic fundamentals.
Undoubtedly, the global financial crisis struck the euro area severely because it coincided with the lack of appropriate policy tools to manage the crisis and with a period of weak political leadership which have made crisis management even harder.
Barry Eichengreen (2009) has correctly underlined the need for Europe to build out the institutions of its monetary union that can avoid similar crises in the future, because the economic governance of the European Monetary Union has remained incomplete and weak.
But apart from building the appropriate institutions and complete the architecture of the system, it is necessary a greater European integration, which inevitably has a political character. However, the European integration serves to ensure the European citizens – at a time when only the giants make the law and have political power and wealth – that they can enjoy independence and protect their historical freedom, but also to influence and thus affect the choices from which may depend the future prosperity of European nations involved.

Keywords: Euro, crisis of governance, European integration , European institutions, economic policies
JEL classification: F15, F33, F34, F36, F43, O52.

This contribution first discusses the issue concerning rules and discretion in the governance of the euro. In the following section it describes the euro crisis and examines the remedies put in place, noting that despite the statements and the efforts of the European authorities the confidence in the euro is diminishing. Thus the exit of Greece from the euro or even the breakdown of the single currency has become a hypothesis discussed more frequently among economists, politicians, central bankers and businessmen. The last section of the work focuses on what's wrong in the governance of the euro and examines the institutional aspects and the changes required and the economic policy issues. All the proposals demand a stronger European political integration where the European institutions are able to implement the economic policy for the entire euro area.

2. Rules and discretion in the governance of the euro.

The governance of the euro has been characterized by the centralization of monetary policy and by decentralization of fiscal policy. The advent of the single currency has involved the transfer of monetary sovereignty to the European Central Bank (ECB). The ECB has in any case a limited liability and a very narrow remit, which is to look after the stability of the euro. In order to fulfill the maintenance of stability of prices, the Maastricht Treaty, signed in 1992, has given to the ECB a complete institutional independence[1]. This institutional independence is, according to mainstream economic theory (e.g. Barro and Gordon,1983), a prerequisite to ensure the credibility of monetary policy (Schilirò, 2006).
Thus the peculiar feature of the setting of the European Monetary Union is that in the face of a single monetary policy, which is established at the level of the euro area as a whole, the fiscal policy remains under the direct responsibility of individual member states and is, therefore, inevitably fragmented. In fact, the EMU has followed an original design: it has a common currency, the euro, but does not have a federal budget and a major form of integrated financial supervision. This because the Maastricht Treaty has embodied a conscious political choice *not* to create a fully-fledged economic union to accompany monetary union, thus creating a fundamental asymmetry in the institutional structure (Schilirò, 2002, 2006). For this Eichengreen and von Hagen (1996) argued that EMU is an incomplete system, as it is based on a monetary union without fiscal union.
It is well known that due to strong economic heterogeneity among member states of the European Monetary Union being formed, the Maastricht Treaty made the participation of a country into the European Monetary Union to a sufficient degree of convergence, compared to other countries, of certain financial and fiscal criteria (Schilirò, 2002). Actually the Maastricht criteria constrained governments in few aspects of heterogeneity only. More specifically, the sovereign debt of a country should not be more than 60 percent of its GDP and the annual increase in debt should not exceed 3 percent of GDP. In addition, the inflation rate should not be higher than that of the three most stable countries by more than 1.5 percent, the yield to maturity of long term-government bonds should not exceed that of the three most stable countries by more than 2 percent and the country should have been a member of the European Currency System for at least two years without devaluation of its currency. Of course, the creation of the single currency has led to the loss of exchange rate flexibility.
Another essential rule of this institutional setting was the no-bailout clause, so that a member state in heavy financial difficulty or with liquidity problems could not be helped by other member states or by the European Central Bank. This no-bailout clause, which precludes the sharing of liability for government debt across Member States, has beeen codified in Art. 125 of the Treaty on the functioning of the European Union (TFEU)[2] and by Art. 104, which rules out that national central

[1] The independence of ECB derives from Art. 282 of the EU Treaty (see Official Journal of the European Union, 2010)
[2] However, Art. 122 provides an exception to this clause. When a member state is in difficulties or is seriously threatened by natural disasters or exceptional occurrences beyond its control, on a proposal from the Commission, the

banks or the ECB provide direct credit to public authorities, defined in a comprehensive sense. Once a country has joined the EMU, the two essential criteria became the 3 percent criterion regarding the deficit and the sovereign debt criterion[3]. Furthermore, to establish specific constraints to individual member states and precise rules that restrict the actions of the national governments in addition to the fiscal criteria of the Maastricht Treaty, it was introduced the Stability and Growth Pact[4], which would have further limited the discretionary action of the member states of European Monetary Union. But in the subsequent revision of the Pact in 2005 the strictness of the 3% limit and the time frame for correcting excessive deficits were relaxed, while procedural deadlines were extended (Schilirò, 2006). This revison of the Pact have shown the operative difficulties to reconcile strict and flexible rules.

Yet, the European monitoring mechanism focused itself exclusively on sovereign indebtedness, whereas other warning signals like wage increases, international competitiveness, etc. were ignored. This was probably due to the prevailing conviction that the convergence between national economies would be enforced by the market mechanism and by European directives which then would homogenize laws of the member states.

The theoretical foundations that have justified the presence of specific criteria of fiscal discipline in the design of the EMU are not strictly related to the theoretical paradigm of optimum currency areas (Mundell, 1961). An important aspect concerns the fact that the existence of independent monetary policy authority from political power is a necessary and sufficient condition to ensure stable prices, but that this condition is actually strictly related to the behavior of fiscal authorities. Thus, to avoid problems of *fiscal dominance* or avoid adverse effects on the price level of potentially expansive fiscal policy is necessary to introduce a discipline with strong ties in the conduct of fiscal policy (Schilirò, 2006, 2011). Another aspect, already highlighted by Tabellini and Alesina (1990), concerns the opportunistic behavior of democratic governments elected in office that, following fiscal policies inconsistent and shortsighted, might prefer to leave excessive deficit to potential successors who will come to power, thus creating imbalances in debt policies among member countries of the EMU. Such opportunistic behavior makes it hard for the ECB to ensure stability. The Stability and Growth Pact has been designed just to ensure a supranational budgetary discipline, and that short-sighted and opportunistic behaviors of the member States sould be avoided or otherwise sanctioned. On the other side, Krogstrup and Wyplosz (2010) pointed out that although theoretically supra-national rules are welfare improving relative to merely national regimes, they cannot fully eliminate the deficit bias, which calls for strong national rules in addition to the supra-national ones. Yet the literature argues that the effectiveness of fiscal rules with respect to fiscal performance is not assured (von Hagen and Eichengreen, 1996). Some authors, for instance Ayuso-i- Casals *et al*. (2009), have shown that such effectiveness depend on the mechanisms established to enforce conformity with the rule and on the type of rule. Others, in particular Buti *et al*. (2007), have shown fiscal rules to be effective, but also to lead to significant creative accounting aimed at their circumvention.

Regarding the sanctions in case of violation of the debt criteria, the implicit assumption of the Maastricht Treaty appears to be that the sanctions are sufficient to force states back on a trajectory satisfying the Maastricht criteria, although there was a weak enforcement mechanism, even in the Stability and Growth Pact[5]. The weakness of the Pact was due, however, to its weak enforcement

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Council of the Heads of the national governments may grant financial assistance to the member state under certain conditions. This clause is a way to make enter the political discretion in a crisis resolution.

[3] If new debt is likely to exceed 3 percent of GDP, then the European Commission issues an early warning. If it actually exceeds 3 percent, then the Commission starts a deficit procedure. (For more details see Schilirò, 2006).

[4] The Pact was established by the Resolution of the European Council held in Amsterdam on 17 June 1997. Later in the EU Council in Brussels on 22 and 23 March 2005 the Stability and Growth Pact was amended (Schilirò, 2006).

[5] The 2005 reform of the Stability and Growth Pact has increased the degree of discretion of the national governments of the euro members, since it implicitly accepted to tolerate possible fiscal deficits systematically higher in all countries of the euro area, but it also undermined the role of institutions.

provisions (ECB, 2008). Just consider that the provision of a qualified majority was required in the ECOFIN Council in order to approve further procedural steps. So countries with excessive deficits retained the right to vote and needed only a few additional countries – prospective deficit countries among them – to block such steps.
In a monetary union such the EMU is obvious that coordination problems arise among member states, since these member States are independent states that must decide about their wage and labor market policy, their industrial policy, the monitoring of their banking system, etc. The coordination is doomed to be ineffective if there are conflicts of interest among the States, thus leading to imperfections in internal coordination. Actually, the institutional framework of the EMU is based on decentralised policymaking, soft coordination and an insufficiently stringent enforcement of common rules. So the institutional framework established in the European monetary union has given the national policy a wide range of discretion, despite the Maastricth criteria and the Stability and Growth Pact. For instance, wage and price increases can be much higher in one state relative to the others. Another case is that a State may run a strong currency account deficit. Furthermore, the issue of monitoring by capital markets is never mentioned in the Maastricht Treaty. Therefore, if a State has a bad debt rating, no political action needs to be taken. Lastly, the issue of financial stability was not included in the governance of the euro, while all the emphasis has been placed by the ECB with regard to price stability.

3. The crisis of the euro and the remedies put in place.

In 2007, when the global financial crisis broke, the European Monetary Union had already deprived member governments of the monetary and exchange-rate instruments of macroeconomic management and, through the Stability Pact, it also tried to constrain the adoption of fiscal instruments. But since the euro area was not an optimal currency area, the imposition of one-size-fits-all ECB interest rates produced asymmetric impulses in EMU economies, with effects above-average or below-average in terms of rates of growth and inflation. In particular, the economies of the "GIPS" (Greece, Ireland, Portugal and Spain), taking advantage of very low real interest rates, have spent and lived beyond their means by accumulating private and/or public debt and running large current account deficits. In fact they have relied on state spending to drive growth, so they have recorded high deficit/GDP ratio and rising public debt, in addition "GIPS" countries have fueled credit-financed economic growth and employment, but also rapid increases in unit labor costs that reduced export competitiveness (Baldwin *et al.*, 2010; Schilirò, 2011). The resulting rise of current-account deficits was accommodated by equally rising capital inflows from investors in surplus economies leading to rising external debts accumulated primarily in the private sector. As a consequence, the economies of the "GIPS" were becoming extremely vulnerable to potential disturbances in international financial markets that might induce capital flight – followed by potential liquidity and solvency crises.
This has created deep concerns about the fiscal sustainability and the credibility of whole euro area, especially because the GDP in the euro area has been growing much less than budget deficit and public debt, in fact over 2011, GDP increased only by 1.4 per cent.
Table 1 shows that the average value of deficit/GDP ratio for the whole eurozone was 6.0 per cent in 2010 double than the 3 per cent fixed in the Maastricht Treaty , whereas the average value of debt/GDP was 86.1 per cent, much higher than the 60 per cent benchmark.
In particular, Greece has accumulated a huge sovereign debt, mainly due to public finance mismanagement[6], so that its financial exposition prevented the Greeek government to find capital in the financial markets, therefore Greece has become at risk of sovereign default. Also Ireland has become at risk because of the large private debt due to the mismanagement of its banks, thus the country cannot find finance in the markets. Portugal was the third country of the euro area with an

[6] Greece have reported incorrectly the data on government finances, which have aggravated concerns.

high deficit, for whom the access to liquidity in financial markets was denied. These countries were forced to seek financial support. Lastly, Spain (like Ireland) is now suffering the most serious recession, since its real estate bubble is deflating with the related problems that ramify through the financial systems, while its budget deficit has greatly worsened. In this situation international capital markets reacted by demanding higher risk premiums for continuing holding public debt of "GIPS", but also of Italy, so the bond spreads have shot up.
Growing current account imbalances were recorded between the countries of North and South of the euro area over time (Holinski et al. 2010). The crisis, actually, has exposed flaws in the peer review process which put disproportionate emphasis on fiscal discipline at the expense of equally relevant criteria such as current account deficits.
The problem of current account imbalances between the "GIIPS" (Greece, Ireland, Italy, Portugal and Spain), that is the countries with strong deficit of current accounts, on one side and Germany and other surplus countries, on the other, has been recently stressed and criticized by Werner-Sinn and Wollmershaeuser (2011)[7].

Table 1. Government Balance and Debt in Euro Area Coutries in 2010

	Deficit/GDP	Debt/GDP
Belgium	-4.1	96.8
Germany	-3.4	83.2
Ireland	-32.4	96.2
Greece	-10.5	142.8
Spain	-9.2	60.1
France	-7.0	81.7
Italy	-4.6	119.0
Luxembourg	-1.7	18.4
Netherlands	-5.4	62.7
Austria	-4.6	72.3
Portugal	-9.1	93.0
Finland	-2.5	48.4
Euro area	-6.0	86.1

Source: Eurostat (2011)

The debt crisis of the euro area has highlighted that the euro system lacks the mechanism to resolve the crisis. In addition, the crisis has led to a more robust pursuit of the national interest, which usually comes to the fore in times of crisis. At the same time the bail-out clause (Art. 125 TFEU), devised to instil market discipline on policymakers through differentiated risk assessment in sovereign debt markets, proved to be ineffective and far from reality since the countries, although opposed to the bailouts, have been forced by events to accomplish them. But the debt crisis has also pointed out, according to Paul De Grauwe, that "there is no mechanism to ensure convergence of members' competitive positions and thus to prevent major trade imbalance. This stems from the fact that economic policies (spending and taxation, social policies, wage policies, etc.) remain firmly in the hands of the member governments and members do not coordinate such policies". Moreover, "there is no mechanism to resolve crises caused by these imbalances and divergent competitive

[7] They argue that ECB and the European System of Central Banks has played a huge and improper role as lender of last resort to the banks of the euro area, in particular those of the countries with a current account deficits, since the crisis in the euro area has become above all a balance of payments crisis.

positions. Consequently, Eurozone crisis management is ad hoc, time-consuming, and hindered by a lack of credibility." (De Grauwe, 2010).
The crisis of the euro also showed the weaknesses of the banking system in the euro area. The banks demonstrated not to be strong enough, but they are at the same time interconnected with the sovereign debts. The fragility of banks and its interconnectedness with the debt crisis created severe macroeconomic problems, and also the risk of failure of banks in several countries of the euro area. Thus a pressing need has become to ensure the euro area a unique system of banking supervision and coordination[8]. In short, the governance of the euro area revealed the lack of a coordinated banking policy, which is crucial for crisis management.
In order to establish a new institutional framework to manage the crisis of the "GIIPS" but also and more generally the crisis of the euro, the European institutions have taken several decisions during 2010 and 2011. First, in Spring 2010, the EU together with the IMF have decided a program of financial aids to help Greece since the country was on the verge of insolvency. To overcome the no bail-out clause the European Council approved the financial aids in the form of "coordinated bilateral loans" at non-discounted interest rates[9].
Second, ECB adopted an important measure, called "securities market programme" (SMP) by which ECB decided to buy government debt of fiscally challenged countries; in this way the ECB purchases government bonds, in secondary markets, in order to provide liquidity to alleviate pressures from sovereign debt risk [10]. Also the member banks of the European System of Central Banks started buying government debt. This measure aimed at improving liquidity, reducing volatility in the financial markets so to reduce the spreads on the sovereign bonds[11]. The SMP was mainly active during 2 periods. The first started after the ECB Governing Council meeting on May 14, 2010 and lasted until the week of July 9 2010. The second period began the week of August 15, 2011 and at the end of 2011 was still underway.
Third, another very important decision to shape a new institutional framework to manage the crises was taken on May 9, 2010 when the 27 Member States of European Union agreed to create a comprehensive rescue package, a legal instrument aimed at ensuring financial stability in Europe: the European Financial Stability Facility (EFSF), a Luxembourg-registered company owned by Euro Area Member States, that has become operative in August 2010 and started to give credits to countries in financial difficulties[12]. But EFSF can also intervene in the debt primary and secondary markets; in particular, the intervention in the secondary market will be only on the basis of an ECB analysis recognising the existence of exceptional financial market circumstances and risks to financial stability. The ESFF is devised in the form of a special purpose vehicle that will sell bonds and use the money it raises to make loans to eurozone nations in need. In practice the EFSF may issue bonds or other debt on the market in order to accumulate funds with whom to lend to countries in the eurozone economic difficulties, recapitalising banks, or buying government bonds. EFSF is backed by guarantee commitments from the euro area Member States (in proportion to their paid-in capital to the European Central Bank) for a total of €780 billion and has a lending

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[8] A first step, but still insufficient, was the creation of the European Banking Authority (EBA) by the European Parliament and the Council of 24 November 2010.
[9] Actually the interest rate paid on the loans to Greece (loans approved by the European Council in April 2010) by the Members States was 5 per cent, lower than the 7 per cent demanded by the markets.
[10] To sterilize this move the ECB conducts liquidity absorbing operations of the same magnitude. In fact, the ECB is buying risky assets issued by a fiscally troubled governement of the eurozone and, via its sterilization operations, selling its claims on banks, which is equivalent of selling new assets. A move that has been viewed by some economists and financial analists as an improper risk transfer.
[11] The creation of the SMP was closely related to the Greek debt crisis, but then it was helpful for sovereign debts of Spain and Italy.
[12] The EFSF has been used to help the governments of Greece, Ireland and Portugal. The Fund bases its rules of the crisis management regime on the principles and procedures of the "IMF doctrine". The EFSF operates in case of unstainable fiscal policies and sovereign debt crises.

capacity of €440 billion[13]. The bonds also will be backed by guarantees given by the European Commission representing the whole EU and the IMF(that can provide loans up to a maximum of 250 billion euros). The EFSF will sell debt only after an aid request is made by a country. In 2011 the EFSF issued securities for about 18.0 billion and granted loans to Ireland and Portugal, respectively, for 7.6 and 6.9 billion. The EFSF has also issued € 35 billion of bonds for the activation of the scheme repurchase designed to support the quality of securities issued or fully guaranteed from Greece. The EFSF is tasked to provide emergency financing until 2013 (Schilirò, 2011). At the same in 2013 it should become operative the European Stability Mechanism (ESM) a permanent organization that will provide financial assistance to members of the euro area in financial difficulty (European Council, 2011b), replacing the existing temporary funding programmes such as EFSF and EFSM (the European Financial Stabilization Mechanism). The agreement reached by the leaders of the euro area concerning the EFSF was a typical political compromise. Unfortunately, compromise could not necessarily work in a debt crisis. There are, in essence, two ways to solve a debt crisis: through a bail-out or through default. The leaders of the euro area got itself an arrangement that represents only an emergency facility and constitutes a scarsely credible intermediate solution between bail-out and default[14].

On 16 December 2010 the European Council agreed an amendment to Article 136 of the TFEU[15] that says: “The member states whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.” Later, on 11 July 2011 the European Stability Mechanism itself has been established by a treaty among the Member States of the euro area: the *Treaty Establishing the European Stability Mechanism*. The European Stability Mechanism becomes an intergovernmental organization under public international law, located in Luxembourg. It would be led by a Board of Governors. Each Member States would appoint a governor and the board would either be chaired by the President of the Euro Group or by a separate elected chair from amongst the governors themselves[16]. There is a disagreement among member States concerning the funding of ESM, since for the rescue of three countries Greece, Ireland and Portugal over two years of crisis between 2010 and 2011, euro area countries (Germany above all) have had to intervene for a total of 273 billion euros, plus other 130 billion for the second loan to Athens. However, the worsening of the crisis of the euro, the risk that Greece could leave the euro area, seem to influence a decision to bring forward to 2012 the birth of the ESM, but nothing looks taken for granted.

Fourth, again in March 2011 the European Council (2011a) agreed on a new plan, named the ‘Pact for the Euro’, which tries to design a new governance of the EMU and to achieve a better economic policy coordination for leading to a higher degree of convergence. The plan was advocated by the French and German governments and it is firstly designed as a more stringent successor to the Stability and Growth Pact, which has not been implemented consistently. In fact the ‘Pact for the Euro’ constitutes an attempt to give new and effective national budgetary rules. Actually the Pact has come out with four broad strategic goals along with more specific strategies for addressing these goals. The four goals are: fostering competitiveness, fostering employment, contributing to the sustainability of public finances, reinforcing financial stability. So this ‘Pact’ contains crisis management and resolution principles and procedures, that did not exist before, but also a wider economic policy framework to the Member States of the euro area. While the ‘Pact’ comes with

[13] EFSF has been assigned the best possible credit rating by Moody’s (Aaa) and Fitch Ratings (AAA). EFSF has been assigned a AA+ rating by Standard & Poor’s. The capacity of EFSF of achieving these “good” ratings depends on *overcollateralization* (that is by a shared assumption about the distribution of possible otcomes), which takes the form of guarantees by other eurozone countries. However, only France and Germany have a rating of AAA.

[14] To deepen the technical aspects of the financial rescue mechanisms and their ineffective solutions see Schilirò (2011).

[15] The amendement will not come into force until it has been ratified by each member state according to their respective constitutional requirements, and cannot come into force until 1 January 2013.

[16] European Council (2011).

specific strategies, these are not seen as compulsory, the choice of the specific policy actions necessary to achieve the common objectives remains under the responsibility of each country. The aims and strategies of the 'Pact' are to be updated yearly with the following procedure: each year participating Member States will agree at the highest level on a set of concrete actions to be achieved within 12 months.

A positive aspect included in this new economic policy framework is the recognition that not all crises are rooted in a lack of budgetary discipline. It is now agreed that financial stability and macroeconomic stability also matter. Yet several questions remain open, as for instance the true capacity and the will of each Member State to adopt the necessary measure to fulfill the requirements of the 'Pact', thus it remains an agreement on principles without a real enforcement. Daniel Gros (2011) correctly pointed out that the 'Pact' contains a list of desirable policy goals but no means to implement them. In particular, the employment and competitiveness goals remain too vague, and are not really embedded in a framework which is clearly oriented to growth. As Darvas, Pisany-Ferry and Sapir (2011) have argued a success of any program to evercome a debt crisis is conditioned by the capacity of a country (like Greece) to meet the fiscal adjustment targets and also by the ability of the country's economy of triggering the growth, since without stimulating growth any fiscal consolidation program will not succeed[17].

Finally, it is well known that the ECB has the restricted mandate of look after to price stability in the euro area and has not the possibility of printing money to help the member countries in financial difficulties, so that it cannot be a lender of last resort as the Federal Reserve in the United States. However, in December 2011 ECB has launched a *Long Term Refinancing Operation* (LTRO), a program of making low-interest loans with a term of 3 years (36 months) and 1 per cent interest to European banks accepting loans from the portfolio of the banks as collateral[18]. This is an unconventional measure taken by ECB to offset the lack of liquidity that has occurred in the credit market.

Despite the quite frequent meetings of the European Council in 2010 and 2011 (the Heads of the Government of the euro area made 13 meetings over the two years) and the three Euro Summits (one in 2010 and two in 2011),which produced the set of decisions above cited, the confidence in the euro is diminishing, because the markets and many observers (economists, opinion makers, businessmen, etc.) have the feeling that the European authorities still do not have governance mechanisms capable of making important decisions and also implementing them. Moreover, the single currency, that should force the countries of the euro area to respond to the crisis in a unitary manner, has created, on the opposite, a situation in which all countries seem unwilling to act. Thus the hypothesis of breaking the euro has become real, despite the constant reassuring statements of European authorities (European Council, 2011c, 2011d), that deny this hypothesis.

In the next section I examine the institutional aspects and the economic policy issues that have determined the crisis of the governance of the euro area.

4. What's wrong in the governance of the euro: institutional aspects and economic policy issues.

The euro area is characterized by a crisis of governance. This is caused by many factors, but an important role has been played by the European authorities, who have pursued a strategy of small

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[17] Greece is an economy which is recession since four years and the fiscal consolidation does not seem to lead the country on a virtuous path that allows the economy to get out of debt crisis and absence of growth.

[18] In particular, on December 21 2011, the ECB has placed an auction with about 489.19 billion euros expiring on January 29, 2015 (and early payment option in a year) at an audience of 523 bidders in Europe. The rate of supply of liquidity was fixed on the reference 1 per cent and was expanded the range of assets that European banks could put as collateral for these loans. This LTRO is primarily designed to provide greater bank liquidity, but it should also lower sovereign yields since euro area countries can use their own sovereign debt as collateral, which, in turn, increases demand for the bonds and lowers yields.

steps and not short times in the management of the crisis of the euro area. But now that the times of the economy and financial markets have become even more fast it is necessary to think about a different method. From this consideration it follows that the timing of the policy and its procedures, at European level but also at the level of the individual Member States, are too long compared to those of the economy and the markets. Moreover, there were two ways to proceed in the face of crisis: muddling through or adopting radical solutions. The European institutions have preferred to follow the first, thus following their traditional way of proceeding. In addition, the new governance of the euro, which is laboriously carried out by the European institutions and by the individual Member States, takes time; however, the path has been characterized by the statements of the European authorities that are often contradictory and contribute to uncertainty. This behavior has caused negative reactions in the markets and makes more difficult to resolve the crisis.

The European authorities showed instability in their decisions. At first they were very patient in financial terms, after too they became too much demanding with financial discipline. At the same time all the countries of the euro area seem unwilling to act against the crisis. The virtuous members States do not want to pay for those in difficulty, while the weaker countries are certainly not pleased with the sacrifices that Europe asks.

The crisis also revealed some new facts about the governance of the euro area. Firstly, a greater intrusion of European institutions (European Council, Ecofin, Eurogroup, ECB) in the lives of citizens of the Member States. Secondly, the crisis has caused the de-commissioning of the European Union: in fact, the European Council decides on its own the political and economic strategies without answering before the Commission and the European Parliament. Another aspect of the emptying of the role of the Commission is represented by the fact that the Commission counts less while France and Germany are more influential. Thus, it has been established a kind of duopoly in the European governance. The France-Germany duopoly that has characterized the management of this crisis in the euro area has, *de facto*, changed the rules of governance[19].

A governance of the euro area that is effective, requires that the member states should adopt a coherent strategy made of three steps: coordination, decisions and actions. Coordination problems obviously arise among member states of a currency union, however a policy in which there is a high degree of coordination is crucial in the governance of the euro. But coordination must be followed by appropriate decisions where the cooperative attitude should prevail. Actions are also necessary, otherwise decisions remain wishes without effects, consequently, effective mechanisms of enforcement of decisions are needed.

Unfortunately the EU is a hybrid system, on some issues the governments of various countries are willing to accept the decisions at European level, on the other they claim national sovereignty.

The institutional framework of the European Monetary Union, in particular, appeared, since its inception, clearly incomplete and inadequate. Examples of inadequacy of the institutional architecture are: the relationship between the Member States of the euro area and the EU institutions is unclearly defined, because of the strong interests of the Member States. Thus, national interests still prevail over the interest of Europe and within the European institutions. But also important problems are the mismatch between the growing number of policies decided by the European Union and the policies carried out at national level, and also the lack of a effective policy at European level that is able to decide on economic issues and to implement them. These problems create an unstable environment and negative consequences, which have become more evident in the euro crisis.

And yet, it looks awkward the position of the ten Member States of non-euro area, who sit in the European Council but do not express themselves on the issues concerning the euro area. Although

[19] One consequence of this duopoly could lead to a change of governance of the ECB, where the vote of the governors should be weighted by their GDP, this implies a shift from democratic governance to management based on the credit strength of the member countries.

such decisions influence as well the non euro area members. There is, therefore, a problem of transparency and legitimacy in the decision process at institutional level (Schilirò, 2011).
I firmly believe that a set of policy measures should be taken to enable the euro area to survive. First, an immediate and credible program to deal with excessive sovereign debt and achieve debt sustainability particularly in the economies of the PIIGS, since the creation of EFSF or of ESM do not appear in the current state a convincing answer to solve the problem. Moreover, the eurobonds may be not the correct solution to the sovereign debt crisis since they tend to solve the problem through the socialization of the debt[20]. Instead it is more appropriate to adopt a policy, based on coordination, to overcome the dysfunctional politics across the Member States and to avoid the negative external effects of the macroeconomic imbalances. This policy, aiming at the creation of a fiscal union in the euro area, should offer reciprocal insurance to Member Sates and reduce income volatility within the region, so to affect the root of the problem. In any case, it is necessary a far more aggressive plan to reduce budget deficits with binding fiscal rules for the Member States, that even the 'Pact for the Euro' does not guarantee, therefore it is required the introduction of mechanisms that credibly achieve medium-term fiscal sustainability. But it is very crucial, make the economies of the "PIIGS" more competitive in the near future with structural reforms that are framed or bound at EU level. In fact – as Kirkegaard (2011) also emphasized – "without improving external competitiveness and, at the same time, increasing exports/reducing imports, the euro area periphery will not be able to restore domestic economic growth during their prolonged period of fiscal consolidation". Of course, a supportive monetary policy from the ECB is needed, while the ECB should become *de jure* or *de facto* a lender of last resort with respect to the governments and the banks. This wider role of the ECB will allow a more strong and effective monetary policy and economic policy of the euro area on the whole. Furthermore, it is very important the good health of the banking system, since many European banks still have in their balance sheet too many "toxic assets" and risky sovereign bonds. Lastly, an institutional change must implemented, that reduces the instability in the financial sector.
I also believe that, since the euro area have shown during its crisis strong macroeconomic imbalances, it can be helpful to envisage a new economic policy strategy. To avoid that the euro area becomes a transfer union, Carfì and Schilirò (2010, 2011, 2012) have suggested a policy strategy based on coopetition. First, they have pointed out the primary role of competitiveness in determining growth and the relation between competitiveness and macroeconomic imbalances. Carfì and Schilirò have argued that to overcome macroeconomic imbalances it is necessary a medium term strategy for competitiveness and growth, based on innovative investments and a process of structural change of the production system (Schilirò, 2008). Within this broad strategy, current account imbalances, in particular, can be addressed through a coopetitive strategy, which implies a cooperative attitude aiming at growth among the member countries of the euro area, despite their divergent interests. The coopetitive strategy will provide a *win-win solution* to the actors of the game and can constitute a new macroeconomic policy tool to help solving the imbalances problems and contribute to overcome the economic crisis in a medium-run perspective.
The euro area is therefore characterized by strong imbalances, and the governance of the euro appears inadequate to address these imbalances. The experience of the current crisis where every Member State fights alone against its disequilibrium in sovereign debt or in current account demonstrates the failure of this policy strategy. The coopetitive strategy is a viable and effective way to overcome the isolation of individual countries before the crisis. However, a more stable and comprehensive solution for the governance of the euro area requires a deep change at institutional level. This change of governance demands a greater European integration, with a central fiscal entity at European level which requires a transfer of sovereignty from the individual Member States and the European Central Bank that becomes lender of last resort. But also a different relationship between the member countries of the euro zone that, barring the duopoly France and Germany and,

[20] Although the "Blue Bond" proposed by Delpla and von Weizsäcker (2011) is a sensible proposal.

de facto, the German leadership, give to the Commission the role of coordinator and of third party, return to the European institutions such ECB, Ecofin, Eurogroup their proper and independent role and give to the European Parliament its centrality.

Conclusions.

The euro crisis has made the pessimism regarding the euro area more prevalent. For over two years European authorities and political leaders have promised to do whatever it is needed to save the euro area, but problems remain unsolved and solutions seem quite far.The euro area is currently in recession with high unemployment and strong macroeconomic imbalances between the various Member States. Moreover, the prolonged stand-off over the rescue plan for Greece, the corresponding risk of a sovereign default which could spread to Portugal, Spain and Ireland and the financial difficulties of Italy have definetely brought a gloomy picture of the European currency union. All this, in turn, highlighted the profound weaknesses in the governance of the euro area, the uncertainties of the European authorities, and posed the issue of German leadership.
In this work I have analyzed the institutional framework of the euro area, discussing the issue of the rules and of the discretion in the governance of the euro. I have also examined the remedies put in place by the European authorities to overcome the crisis and their flaws. The last section of the work has focused on institutional aspects of the governance of the euro and on economic policy issues that the crisis in the euro area have stressed, suggesting some basic outline for the new institutional architecture and feasable economic policy solutions. These solutions imply a more strong European political integration where the European institutions coordinate and are capable of implementing the economic policy for the whole euro area, with a central fiscal entity at European level and the European Central Bank that becomes lender of last resort. Only in this way it is possible to restore credibility in the euro area, create a stable macroeconomic environment, stimulate the economic growth so to overcome this long and hard crisis.

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