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Abstract

The present paper highlights the imbalances that have characterized the Eurozone during the crisis. The contribution focuses on the issue of current account imbalances and the factors that caused them. It also examines the banking union as an important step toward a better management of the Eurozone financial imbalances. Furthermore, the paper discusses and assesses the policies, especially monetary policy, implemented in the Eurozone, stressing the limits of the strategy pursued by the European authorities. The main purpose of the paper is to point out possible solutions in order to correct the imbalances and discuss changes in Eurozone policies.

Keywords: imbalances, current account balance, monetary and fiscal policies, banking union

JEL Classification: E50, E58, E62, F30, F45, 052

1. Introduction

The present paper highlights the imbalances that have characterized the Eurozone during its long crisis. The contribution focuses on the issue of current account imbalances and the factors that caused them. It also examines the banking union as an important step toward a better management of the Eurozone financial imbalances. Furthermore, the paper discusses and assesses the policies, especially monetary policy, implemented in the Eurozone, stressing the limits of the strategy pursued by the European authorities. The main purpose of the paper is to point out possible solutions in order to correct the imbalances and discuss changes in Eurozone policies. The ultimate goal is to have a more balanced and integrated Euro zone which is able to pursue stability, less divergence and political credibility.

2. Policies, institutional flaws and the crisis in the Eurozone

Before the crisis, the governance in the Eurozone was based on a fiscal policy which remained at national level, although constrained by the Growth and Stability Pact. At the same time, national authorities were deprived of the exchange-rate instrument and national discretion over last resort lending for macroeconomic management. The ECB was and still is an independent EU official institution, in charge of handling the single currency and the monetary policy with the narrow remit of ensuring price stability[1]. Consequently, monetary policy has resulted to be independent from fiscal policy. In addition, the ECB did not monitor the banking sector, since bank regulation and resolution, as well as the regulation of financial markets, were left to national governments. Although in the years before the crisis the increasing integration of Eurozone financial markets determined a growth in capital flows and banking − an increase that undermined the ability of some member states to backstop their national banking system −, there was no strategy in terms of harmonization of rules and surveillance of the financial sector in the EMU (Schilirò, 2017). The EMU lacked a developed surveillance framework to track and correct the imbalances in financial markets, sovereign debts, and competitiveness (European Commission, 2017). Thus, the stabilizers that existed at the national level prior to the start of EMU were stripped away from member states without being transposed at the monetary union level. This left the member states unable to deal with the coming national disturbances (De Grauwe, 2013). At the same time, financial deepening reached a certain level within the monetary union, due the concurrent progress of financial integration and financial sector growth, and it left the Eurozone facing a *policy trilemma*.

[1]Article 127(1) of TFEU.

As Obstfeld (2013, p.3) explained, the following three conditions cannot be maintained simultaneously: (1) cross-border financial integration, (2) financial stability, and (3) national fiscal independence[2]. The growth of the balance-sheets in the banking system is a related aspect of financial deepening that gave rise to the "doom loop", linking the solvency of banks to that of the sovereign debt (Obstfeld, 2013). Tabellini (2015, p.1) observes that: "in order to preserve financial integration and avoid future crisis", the trilemma implies the need of "adequate common fiscal resources to cope with both systemic banking crisis and sovereign debt runs". On the institutional side, the rules laid down in Maastricht and imposed on the Eurozone member countries were intended to preserve the system, not to favour political integration and social cohesion among those countries (Mody, 2015). But this form of institutional framework revealed its flaws. In fact, it encouraged the accumulation of lasting imbalances at the expense of the Eurozone's weaker countries and determined a widespread dissatisfaction towards the single currency and its system of rules (Schilirò, 2017). The crisis emphasized the inadequacy of the governance in the Eurozone, and the single currency was put at risk. Actually, the European monetary union has been characterized by a complex institutional system where the intergovernmental decision-making system has dominated the so-called Community method (i.e. the co-legislative decision-making system), posing a problem of legitimacy. Even more so, the intergovernmental decision-making system has caused direct clashes between national governments. Thus, there is a need for a change in the political approach of EMU governance (De Grauwe, 2010). But this change also requires a reshaping of the institutional framework, so that the Eurozone can aim at stability, cohesion and development on a lasting basis. However, this new approach needs the strengthening of the euro governance at supranational level on a solid legal basis. This, in turn, would require substantial changes to the European treaties, which represent the real challenge, even though such changes are unlikely to be achieved in a short time (Schilirò, 2014; Schilirò; 2017).

3.Current account imbalances

Economists have focused on different aspects of the Eurozone crisis. This section focuses on current account imbalances. Today, there is a broad consensus among economists that it was a mistake to concentrate primarily on fiscal aspects. Alessandrini *et al.* (2014), for instance, through empirical evidence, highlight that fiscal imbalances of Southern countries have certainly contributed to exacerbate the Eurozone fragility, but the latter cannot be interpreted only as the result of fiscal indiscipline. These authors, instead, give greater importance to market liquidity in times of uncertainty that suggests a shift from a fiscal to a balance-of-payments crisis, which is in turn driven by labor productivity differentials between north and south. Fiscal stance, indeed, plays an important role because its spillover effects can be massive, but it is also necessary to look at what happens to competitiveness, current account balances and credit cycles. Several economists highlight with different modes the current account imbalances, the cross-border capital flows, and the divergence in competitiveness as the core issue of the crisis in the Eurozone economy (Holinski *et al*., 2010; Werner-Sinn and Wollmershaeuser, 2011; Merler and Pisani-Ferry, 2012; Werner Sinn and Valentinyi, 2013; Cour-Thimann, 2013; Higgins and Klitgaard, 2014; Alessandrini *et al.*, 2014; Baldwin, Beck, *et al.* 2015; De Grauwe, 2015). Baldwin, Beck *et al*. (2015), particularly, searching for a consensus view of the crisis narrative, argue that the real culprits were the large intra-Eurozone capital flows that emerged in the decade before the crisis. According to their view, a balance of payments crisis became a public debt crisis, due to the sudden stop of capital flows that raised concerns about the viability of banks and governments in nations dependent on foreign lending, while slowing growth produced increasing public debt ratios.

Even though among the economists there is a large consensus on the fact that peripheral countries built up very large current account deficits and external debts, the discussion is about the causes. Competitiveness, particularly, is at the heart of the debate. De Grauwe (2013) argues that the countries of Southern Europe have not only supported greater costs but they have been hampered in their ability to stabilize their economy in the event of asymmetrical shocks. This happened because their loss of competitiveness was attributed by the European authorities to the policy mistakes of the government of the peripheral countries. Thus, this loss justified the need for fiscal austerity and structural reforms. In particular, internal devaluation, which included nominal wage cuts, was considered the key point to restore competitiveness as a medium-long term policy.

[2] Obstfeld (2013) observed that a country reliant mainly on its own fiscal resources will likely sacrifice financial integration as well stability, as it is true in the Eurozone, because markets will then assess financial risks along national lines.

De Grauwe underlines that the first best policy would have been for the debtor countries to reduce and for the creditor countries to increase spending. Thus, the necessary austerity imposed on the Southern European countries could have been offset by demand stimulus in the Northern European countries. This proposal of symmetric rebalancing, that is to say, surplus countries need to make converse macroeconomic adjustments by stimulating demand (for instance, through tax cuts, wage rise and investment) is also shared by Posen (2010), Mody (2015), Dodig and Herr (2015), Onaran and Stockhammer (2016), and other economists, but unfortunately it has been dismissed by the European authorities. Dodig and Herr (2015), in particular, highlight that European institutions seem not to have understood that the EMU is a monetary union without sufficient institutional integration. In addition, they underline that the absence of the central bank's explicit commitment to be a lender of last resort for the governments undermined the credibility in the liquidity and solvency of individual member states. This, in turn, made the deficit countries vulnerable to sudden stops of capital inflows and panic in financial markets. Wyplosz (2013) emphasizes the importance of domestic demand and disagrees with the view that the lack of competitiveness of the deficit countries is mainly due to excessive increase in wages and prices. Essentially, he argues that the loss of competitiveness in these countries was a mere reflection of the increase in demand, determined in turn by a loose monetary policy, not the cause of the current account imbalances. Comunale and Hessel (2014), applying the idea of Wyplosz to the data, provide an eclectic view. They suggest that the link between credit and current accounts has been very important in the Eurozone crisis. By introducing the so-called financial cycle, which is mainly driven by credit and house price growth, Comunale and Hessel (2014) show that domestic demand fluctuations at the frequency of the financial cycle are the main driver of current account dynamics, whereas changes in competitiveness play only a minor role. Thus, these authors call for more emphasis on credit growth and macro prudential policy, in addition to the current attention for competitiveness and structural reforms.

Another view is provided by Matthes and Iara (2016). They observe that, though downward rigidities (i.e. insufficient adjustment during recessions) of wages are still considered a rooted problem of Eurozone, notably in its southern European members, “the Eurozone debt crisis immensely increased reform pressures” (Matthes and Iara, 2016, p.20). Consequently, relatively wide-ranging structural reforms in labour and product markets have been taken in most stressed EMU countries (OECD, 2015). These reforms have raised wage flexibility and have thus also reduced downward rigidities (Anderton and Bonthuis, 2015; ECB, 2016), especially because wage rigidities are closely related to the rigidity of regulations[3]. Moreover, Verdugo (2016) provides evidence for Italy, Spain, and Portugal where wages appear to be considerably less rigid than usually depicted. Furthermore, he points out that in eight major Eurozone countries real wages are nearly as responsive to the economic cycle (unemployment) as in the United States and that their responsiveness has further increased during the crisis. Unger (2016) focuses, instead, on credit factors. This author, through an empirical investigation of the relation between domestic credit developments and the current account balance, shows that flows of bank loans to the non-financial private sector are a significant determinant of the current account. Finally, Picek and Schröder (2017) partly criticize the internal devaluation solution, but, at the same time, they consider the view that Northern Europe and in particular Germany should run expansionary policies in the common European interest as misleading. These authors by running simulations of current account rebalancing scenarios in the Eurozone, based on a closed multi-country input-output model, suggest that the spillover effects of domestic demand booms in the Northern surplus countries are non-negligible, but not large. This result implies that although the spillover effects cannot on their own create a meaningful upswing in the former Southern deficit countries, however an expansion from the Northern countries can create the necessary policy space for a domestic demand-driven expansion in the deficit countries by relaxing the balance of payments constraint. In conclusion, this literature seems to suggest, despite the concerns and the view of the European authorities, that wage increases or downward rigidities in the Eurozone do not appear very significant, and that the loss of competitiveness is not the only key determinant of current account imbalances.

[3] This is especially relevant for reforms taken in the wage bargaining systems which should allow to better align wages with cyclical conditions, productivity developments, and the needs of smaller companies.

Anyway, while several Eurozone countries built up external deficits in the period of global financial crisis (2008-2009) and during the euro crisis (2010-2015), others recorded significant surpluses (e.g. Germany, Austria, Luxembourg, Netherlands) (Eurostat, 2016)[4]. After 2013, some countries, especially those in the periphery of the Eurozone that recorded large pre-crisis deficits, had experienced significant diminishing external imbalances (e.g. Ireland, Spain, Portugal, Slovenia)[5]. The reasons were probably associated with the spike in real interest rates, the stabilization of domestic demand and growth contraction, improvements in relative cost and prices, and, lastly, the decline of oil prices (ECB, 2015). Esposito and Messori (2016) also show that the elimination or the drastically reduction of current account deficits of peripheral countries, in particular since the end of 2014, is a result which is more dependent on the contraction of their GDP and relative reduction in their average real wages than on productivity increases in their economies. All this confirms the key role of domestic demand and austerity measures.

As regards the movement of capital between the Eurozone countries during the sovereign debt crisis, capital flows aggravated the difficulties of the peripheral countries since they did not target the more productive sectors, in many cases feeding real estate bubbles. Some peripheral countries, given their large external debts, could not finance their deficits through capital inflows, since a sudden stop in the inflow of private capital was determined by a loss in creditors' confidence regarding the solvency of these countries (Merler and Pisani-Ferry, 2012)[6]. This sudden stop required macroeconomic rebalancing and appropriate policies to improve competitiveness. The adjustment process was cushioned by the single monetary policy through harmonized short-term interest rates. Moreover, the ECB offered liquidity assistance measures (i.e. liquidity-providing credit operations, outright transactions, etc.) and through TARGET2 − the payment infrastructure of the Eurosystem −, financed the current account deficits of the peripheral countries (Schilirò, 2013). Since imbalances were mainly addressed through internal devaluation, deficit countries have tried to restore international competitiveness by aggressively reducing labour costs, coupled with fiscal consolidation, in order to lower their product prices[7]. The overall short-term effect of this internal devaluation and austerity measures has been to weaken domestic demand. Given the lack of an offsetting increase in external demand of surplus countries undertaking a reflationary stimulus, these measures have undermined economic growth and, hence, the public finances of the deficit countries. To restore competitiveness, it would be convenient to implement productivity-enhancing reforms that improve long-term economic prospects, as suggested by Estrada, Galì and Lopez-Salido (2013), Posen and Ubide (2014), Bini Smaghi (2015). Unfortunately, Eurozone member countries have taken the benefits of the single currency for granted without acknowledging their shared responsibility, so the ECB's monetary policy had to bridge the shortcomings of member states.

Another possible strategy to overcome the current account imbalances and problems of competitiveness in the Eurozone without first reducing nominal wages is that suggested in Carfì and Schilirò (2014). According to this view, based on a game theory model, it would be convenient for the Eurozone member countries to follow a *co-petitive strategy* based on the simultaneous interplay of cooperation and competition, where the different countries agree to cooperate regarding to some key variables (e.g. exports, foreign direct investments) in order to provide a win-win solution that is good for everyone and for the whole monetary union[8]. More specifically, the group of surplus countries of the Eurozone could contribute to re-balance its trade surplus with respect to deficit countries and, in addition, the surplus countries should provide a certain amount of foreign direct (innovative) investments to improve the competitiveness of the countries of Eurozone, which are in a particular economic difficulty, as is the case of Greece (Carfì and Schilirò, 2014).

[4] The current account balance is the sum of the balances of trade (in goods and services), primary income (dividends and interests on foreign investments plus salaries paid to/received by non-residents) and secondary income (remittances to/by foreign workers and contributions to EU institutions).

[5] At the same time, the divergence between the countries in the Eurozone has enlarged. This evidence has casted doubts on the effectiveness of the Macroeconomic Imbalance Procedure introduced in 2011 with 'six-pack' legislation to obtain greater macroeconomic surveillance.

[6] Merler and Pisani-Ferry (2012), through an empirical analysis of these sudden stops in the euro area, stressed the role the balance of payment crisis.

[7] Sometimes, as in the case of Greece, wages went down but prices did not, because of lack of competition in the economy.

[8] In more detail, Carfì and Schilirò's analytical model (2014) proposes a framework characterized by a cooperative bi-strategy based on two shared variables: export and FDI. The solutions offered in such co-petitive model aim at enlarging the amount of total payoff and sharing it fairly.

3.Banking union and monetary policy to counter the financial crisis

During the crisis, relevant decisions were taken by the European authorities in order to stabilize the economies of the peripheral countries and the single currency. Thus, if we look at the evolution of governance in the Eurozone and consider the policies implemented during the years from the start of the euro crisis we face a changed environment. The ECB, after some attempts to support financial stability and improve the monetary transmission mechanism with limited effects, on 26 July 2012in the midst of a dramatic moment for the single currency announced, that the central bank "is ready to do whatever it takes to preserve the euro" moving in the direction of becoming a normal central bank (Eichengreen and Wyplosz, 2016). Therefore, in September 2012, the ECB announced the purchasing programme Outright Monetary Transactions (OMT), a non-standard measure of monetary policy to purchase, in secondary sovereign bond markets and under strict conditions, bonds issued by Eurozone member states. This was an example of a centralized provision of backstop facilities for sovereign debt markets. The OMT, although not tested, did work, mainly through the expectation channel, proving to be sufficient to contain the sovereign credit risk premia. Following these changes in order to make the Eurozone countries less divergent in terms of competitiveness, the doctrine of European authorities has been that national governments of member states should promote market competition, and to pursue fiscal discipline and supply-side reforms (Schilirò, 2014). Apart from the new fiscal regime (i.e. the "six-pack" and the 'two-pack' legislation, as well as the Fiscal Compact)[9], the heads of state or government of EU countries and the European authorities agreed to create a Banking Union with the aim of constructing a more resilient system. Actually, the Banking Union is an important pillar of the new governance; it allows the transfer of banking sector policy from national to European level. Eichengreen and Wyplosz (2016) observes that banking system stability constitutes a Eurozone-wide public good, which provides strongly increased returns. In fact, it is a major achievement since one of the main goals of the Banking Union is to break the connection between banks and sovereign debt (the "doom loop"). This nexus caused a steep increase in the refinancing cost of public debts in deeply indebted countries, reducing their anti-cycle fiscal capacity. The first step towards the Banking Union was the establishment of a Single Supervisory Mechanism (SSM) under Article 127 of the Lisbon Treaty. The SSM, which became operational in November 2014, locates the Supervisory Board within the European Central Bank (ECB), which assumes fundamental supervisory responsibilities for all banks in the Eurozone[10]. The SSM has already intervened to enhance the public good of financial stability, and more generally by pressing the banks it supervises to reduce home bias in their sovereign bond portfolios (Eichengreen and Wyplosz, 2016). A second fundamental step was the creation of a Single Resolution Mechanism (SRM) for banks in the Eurozone countries. In case of bank failures, the SRM would provide appropriate solutions through rescue or liquidation[11]. Moreover, the Bank Recovery and Resolution Directive (BRRD) − Directive 2014/59/EU – was introduced by the European Parliament and the Council to provide a common mechanism[12] for resolving bank failures in all the countries of the European Union, preventing the use of taxpayer money in bank bailouts in Europe, since it imposes a bail-in from the private sector. Thus, a single EU authority would have the powers to protect taxpayers from bank failures, ensuring the overall stability and transparency of the financial system in the Eurozone. However, in this agreement of Banking Union, common European regulators and national regulators coexist. Unfortunately, Banking Union remains unfinished, since it should encompass a centralized deposit insurance. In fact, the absence of deposit insurance can threaten confidence and financial stability throughout the monetary union (Eichengreen and Wyplosz, 2016, p.26). A European Deposit Insurance Guarantee Scheme should constitute the 'third leg' of the Banking Union, but despite the European Commission's proposal[13], several member states, including Germany, have expressed their opposition to the European Commission's plan. But a complete Banking Union with a mutualization of deposit insurance would also require some form of fiscal capacity (Pisani-Ferry and Wolff, 2012; Obstfeld, 2013; Véron, 2015).

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[9] European Commission (2017).

[10] Colliard (2014) has studied the optimal architecture of the single supervision mechanism (SSM) and argues there is a conflict of objectives between local and joint supervisors.

[11] The centralized decision making is built around a Single Resolution Board. Colon and Cotter (2015) provide an empirical analysis on SRM for European banks.

[12] Since 1 January 2015 all member states have to apply a single rulebook for the resolution of banks and large investment firms, as prescribed by the Bank Recovery and Resolution Directive under the supervision of the European Banking Authority.

[13] On 24 November 2015 the European Commission made a legislative proposal introducing a European Deposit Insurance Scheme (EDIS) as a further step to a fully-fledged Banking Union.

Therefore, a true Banking Union should sit within some type of fiscal union, but understood in a limited sense and targeted at a specific financial problem associated with monetary union, not the centralization of fiscal functions at the level of the Eurozone (Eichengreen and Wyplosz, 2016). Otherwise, given the current setup of the banking rules, the bank-sovereign vicious circle, which has been correctly identified as a key factor of instability, cannot be eliminated (Véron, 2015). In January 2015, the ECB confirmed its new role of a normal central bank in contrasting the crisis with its (unconventional) monetary policy by deciding a programme of quantitative easing (QE). The programme started on 9 March 2015 and it was named the Public-Sector Purchase Program (PSPP). The decision came after the ECB's core target of inflation, "close to but under 2%", was found to be far from the current state of inflation in the Eurozone. In fact, the Eurozone has officially been in deflation since January 2015. The QE programme committed the ECB to buying a certain amount of assets per month until September 2016[14]. Later in December 2015, the ECB decided to extend the QE programme until March 2017, (in February 2017 there was a further extension until December 2017), since core inflation in the Eurozone was still below 1% and financial volatility high. With the QE, the main purposes of ECB are to stimulate lending, encourage investments, and to increase inflation expectations to the target of (nearly) 2%. Of course, the ECB's sole objective is the defence of price stability, and not even to support growth. Therefore, in the decision taken by the ECB there is not an explicit link between low growth and new monetary stimulus, but rather one between deflation and monetary easing (Schilirò, 2017). In practice, QE operates essentially through the portfolio channel by changing the mix of securities in the market, but also through the expectation channel. The empirical literature has widely demonstrated that central bank asset purchase has had economically significant effects, at least on governments bond yields[15]. There is also some worry that the flood of cash created by QE fuels asset bubbles and encourages reckless financial behaviour. In general, the lower yields and the lower long-term interest rates have somehow determined a positive effect on the economy; but the impact of QE on the economy is difficult to measure (Joyce *et al*., 2012). However, Wieladek and Pascual (2016) find that the effect of ECB QE is roughly 2/3 times smaller than in the UK/US, but that in absence of the first round of ECB QE, real GDP and core CPI in the Eurozone would have been 1.3% and 0.9% lower, respectively[16]. In addition, during 2016, the unconventional monetary policy and the lower exchange rate of the euro have been conducive to enhancing the competitiveness of eurozone products outside the region, especially those member states which are strongly dependent on markets outside the Eurozone. The trade surplus has expanded significantly showing that the Eurozone economy is continuing to recover. There is also evidence that the unconventional monetary policy by ECB has had positive international spillovers on non-euro countries in Europe (Horvath and Voslarova, 2017). Among the negative effects of QE, in particular, there is the asset shortages, less enthusiasm for structural reform by member states, risks of financial bubbles. The experience of QE in the US, UK and Japan suggests that to emerge from a profound crisis, like the one experienced in the Eurozone, monetary policy is not enough. What is needed is a balanced combination of monetary and fiscal policy (Posen, Ubide, 2014; Bini Smaghi, 2015; IMF, 2016). In conclusion, the unconventional monetary policy by the ECB have not only increased its balance sheet, but also expanded its role, becoming more and more a normal central bank. The QE has only had clear-cut effects on stimulating financial markets, while more time is needed to evaluate the effectiveness of QE. But, the benefits of large-scale asset purchases outweigh their potential risks in terms of financial stability as Clayes and Leandro (2016) point out. On the whole, unconventional monetary policy has been important for the Eurozone economy, even if the effects of such monetary policy are still matter of debate among the economists. Indeed, the ECB has played a decisive role through its monetary policy to lead the Eurozone economy out of the crisis. But monetary policy can only be effective if structural problems in the Eurozone are tackled at the root. This is a matter of responsibility for national governments, which are called upon to engage more (e.g. consolidation of public finances, productivity improvements, enhancing competitiveness, strengthening of growth potential), whereas at European level more political efforts are needed. Although structural reforms to improve competitiveness are important, major emphasis should be given to innovation, improvement in human capital and growth-promoting investment.

[14] See Claeys, Leandro and Mandra (2015) for details of ECB's QE.

[15]The effects on the sovereign bonds of Italy and Spain since the start of the QE have been very clear and positive. There is instead less consensus on the transmission channels linking asset purchases with asset prices (Joyce *et al.*, 2012).

[16]These authors find that the policy is mostly transmitted through the portfolio balance, signaling, exchange rate and credit easing channels. The uncertainty channel does not seem to operate in the case of the ECB's QE.

European authorities should pursue a forward-looking economic policy that reduces in equalities among the member countries, creating also more opportunity for the young people, in order to favour less divergence and growth. At present, the European Commission is softening austerity constraints applying more flexibility, with the precise aim of contrasting pro-cyclical policies and favouring investment (European Commission, 2016), leaving several Southern countries of Eurozone (e.g. Italy, France, Greece, Portugal and Spain) space to boost their economies, while ECB has expanded and extended the QE programme until the end of 2017, so growth has come back in the Eurozone and improvements in several economic and financial indicators are good signs. But macroeconomic imbalances within the Eurozone are still present and the problem of Greece has not been entirely resolved. In conclusion, in this section, we have stressed the need of financial stability thatrequires appropriate monetary and fiscal policies and the correct institutional design. Therefore, a complete banking union is an important part of this institutional design, whichwould require that the ECB's lender of last resort role for banks should remain a regular feature of EMU in order to enhance its resilience (Obstfeld, 2013; Schilirò, 2014). Moreover, the banking union would require at least some centralized fiscal capacity (Pisani-Ferry, Wolff, 2012; Obstfeld, 2013; Véron, 2015). But this can be obtained without a complete fiscal union. In fact, a complete fiscal union is a problematic goal to achieve at present, and it is also unnecessary to complete the Banking Union as Eichengreen and Wyplosz (2016) point out.

Conclusions

This paper has examined the imbalances and assessed the policies of Eurozone during the crisis, underlining the flaws of the institutional framework. Imbalances have been analyzed with a focus on current account balances, banking union and monetary policy. A key point that emerged in the analysis is that competitiveness is not the main determinant of current account imbalances, but domestic demand and credit flows are other major factors. Moreover, there is evidence in the literature that increases in wages and downward rigidities of wages have lost their weight during the Eurozone crisis and are not the main cause of the loss of competitiveness in the peripheral countries of the Eurozone. In addition, a proposal of a strategy based on co-petition that aims to help the exports of countries with deficits in current account and provide them with FDI can be the more effective solution in restoring the current account imbalances. Another important point that emerged from the analysis is that completion of the banking union is linked to some form of fiscal union, but this poses the question of democratic legitimacy of the European institutions. Furthermore, the paper has discussed proposals of new policies that would require changes in the European treaties. In conclusion, even though at present the Eurozone is experiencinga virtuous cycle, it needs to continue reforming its architecture and adapt its policies, since several crucial issues remain to get a more accomplished EMU, namely: the simplification of rules and the transparency of institutions, more flexibility in the common policies, a greater coordination of fiscal policy at Eurozone level, and political legitimacy. A new political effort is needed to bring Europe towards a path of increasing integration. The Eurozone needs a budget that can afford three specific functions: large-scale investments, financial assistance in emergencies, and countercyclical macro transfers. At present, the European Commission and the Eurozone institutions seem more aware of the need of pursuing a new phase of greater integration and stability. Therefore, Eurozone with the right reforms can become a monetary union characterized by less divergence, more stability and, above all, political credibility.

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