

EMU after the Crisis: Key Challenges

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Abstract: *After the financial crisis and the sovereign debt crisis and following some important reforms in fiscal policy accompanying also the start of banking union there is the need to complete EMU through convergence and social cohesion, more integration in financial sector, better fiscal governance and supervision and more cooperation between institutions. The 5 presidents Report mentions the principal steps necessary to complete the Economic Union and to support the Monetary Union. Single currency and Monetary Union are facing severe challenges now and in the next future due to serious financial difficulties in Southern Europe and troubles in the Italian and German banking sectors. The capital flight from Southern Europe into Northern Europe has imposed massive interventions of ECB. Italian Banks, especially Banca Monte dei Paschi, cannot be supported by state through bail out due to Single Resolution Mechanism of banking union. A great economist like Joseph Stiglitz suggested some important and useful measures for a proper functioning of single currency and Monetary Union.*

Key Words: *economic union, monetary union, single currency, financial union, banking union, fiscal union, convergence, crisis, debt, deficit, governance*

JEL Classification: *E 52, E 58, F 36, G01, H 30, H 62, H 63*

1. Introduction

The global financial crisis which started in USA in 2007/2008 was followed by the euro area sovereign debt crisis which had a deep impact on EU's economic growth and macro-financial stability, the most affected country being Greece. Despite some important reforms in fiscal field, EMU seemed the most hit part of EU, due to the fragmentation of financial markets combined with the vicious circle between banks and sovereigns and different fiscal policies associated with macroeconomic imbalances and great policy mistakes and market failures. After the crisis, some important challenges confronted the EMU, like low potential growth, large macroeconomic imbalances in some MS, weak adjustment capacity, insufficient fiscal consolidation in good times and a supervisory capacity not keeping pace with financial integration (Robert Kuenzel and Eric Ruscher, 2013). To have a better coordination of policies and to deepen the economic integration by completing EMU, a banking union as a part of a larger financial union and a fiscal union are taken into consideration together with more political integration. Brexit shock and uncertainties in both banking sector and political spectrum may raise some questions regarding the future of monetary union and even of the EU. It is evident that financial stability must prevail in the face of price stability (targeting the inflation), vicious circle between banks and states should be broken, macroeconomic imbalances such as external imbalances, house price or credit developments have to be prevented and counteracted, a strong enforcement of SGP rules must be provided.

2. Report of the 5 presidents: Completing Europe's Economic and Monetary Union

It was a direct result of Euro Summit of October 2014 asking for a closer coordination of economic policies within EMU by developing mechanisms for this coordination, convergence and solidarity, and also for better economic governance. The report prepared by 5 presidents (EC, Euro Summit, Eurogroup, ECB, EP) reflects their opinions, exchange of ideas, intense discussions with MS and civil society, content of previous similar reports. A deeper EMU involves transparency, preserving the integrity of the Single Market and completing the four fundamental freedoms, strengthening the elements needed to boost economic union.

A. The Nature of a Deep, Genuine and Fair Economic and Monetary Union

There is no doubt that the financial and economic crisis led to the explosion of fiscal deficits and public debts in the euro area also affecting the project of the monetary union. Further steps are needed to complete EMU in order to achieve a balanced economic growth and price stability and also a competitive social market economy. Currently, Euro adoption is a political and economic project but for its full success is necessary for the MS to: a) to better prevent crises by means of a high quality governance at European and national level, sustainable fiscal and economic policies, and fair and efficient public administrations; b) to respond effectively to any economic shock by means of fiscal buffers and risk-sharing achieved through integrated financial and capital markets. Significant divergence across the euro area in fiscal policy creates fragility for the whole Union and progress is needed towards a genuine Economic Union, based on common structural features, towards a Financial Union, based on a Banking Union and a Capital Markets Union, insuring the integrity of euro and risk-sharing with the private sector, towards a Fiscal Union, meant to provide fiscal sustainability and fiscal stabilization, towards a Political Union, based on democratic accountability, legitimacy and institutional strengthening.

In order to build the four interrelated unions were designed short and long term measures organised in two consecutive stages: *Stage 1* between 1 July 2015 and 30 June 2017 (**deepening by doing**), the aim is to boost competitiveness and structural convergence, to complete the Financial Union, to achieve and maintain responsible fiscal policies at national and euro area level, and to enhance democratic accountability; *Stage 2* between 30 June 2017 and December 2025 (**completing EMU**), aiming at increasing the convergence process by using a set of commonly agreed benchmarks for convergence as an essential condition to participate in a shock absorption mechanism, *Stage 3 (Final)* at the latest by 2025, when a deep and genuine EMU will provide economic stability and social prosperity and will offer a positive example for non-euro states to join EMU.

B. Towards Economic Union - Convergence, Prosperity and Social Cohesion

Convergence between MS and convergence within European societies seem to be essential for a true Economic Union but they are difficult to attain with different economic policies although there is a common monetary policy. Presently, in the EU there is a monetary union but not a fiscal one as no large scale fiscal transfers between MS are made and the labour mobility is limited. Convergence may be achieved with high levels of growth and employment but also requires a deepening of the Single Market. It should be noted that sustainable convergence involves structural reforms meant to modernize the economies, to enhance the efficiency of labour and product markets while creating stronger public institutions. On short term (*Stage 1*) it is foreseen a convergence towards the best performance and practices in EU targeting a better governance and achieving resilient economic structures within Eurozone. On medium term (*Stage 2*) the convergence will be based on commonly agreed legal standards and after that a shock absorption mechanism will be set up.

Different pacts, as Euro Plus Pact, and EU law in the field may support the progress towards a union of convergence, growth and jobs, that should be implemented in *Stage 1* and is based on four pillars: the creation of a system of Competitiveness Authorities (CA) in euro area, a strengthened implementation of the Macroeconomic Imbalance Procedure, a greater focus on employment and social performance and on stronger coordination of economic policies within a revamped European Semester. A national body in charge of tracking performance and policies in the field of competitiveness was recommended for each MS of euro area. These bodies or entities will assess the dynamics of wages compared to labour productivity, progress made with economic reforms for enhancing the competitiveness, role played by the institutions and policies in supporting productive firms. Within this euro area system of CA, European Commission would coordinate the actions of national authorities on an annual basis and should then take into account the outcome of this coordination when it decides on steps under the European Semester, in particular for its Annual Growth Survey and for decisions to be taken under the Macroeconomic Imbalance Procedure (MIP), including the activation of the Excessive Imbalance Procedure. The Macroeconomic Imbalance Procedure (MIP), a part of the European Semester, represents the annual cycle of reporting and surveillance of EU and national economic policies and is a tool or a device to prevent and correct imbalances, for instance to prevent real estate bubbles, or to detect a current account deficit (an external one), or the loss of competitiveness, rising levels of private and public debt, and a lack of investment.

Labour markets and welfare systems need to function well, while the first ones should promote a high level of employment and be able to absorb shocks without generating excessive unemployment. Adequate education, an effective social protection system, reform of pension and health systems are also needed. A

deeper integration of national labour markets is required by facilitating geographic and professional mobility, including through better recognition of qualifications.

Steps have been taken to simplify and strengthen the European Semester: a greater focus was put on priority reforms, on accountability of MS for achieving their commitments, on better integrating the euro area and the national dimensions, on establishing a clear long-term vision.

On medium term (*Stage 2*) the convergence process involves adopting common standards focused primarily on labour markets, competitiveness, business environment and public administrations, as well as certain aspects of tax policy (e.g. corporate tax base). Country-Specific Recommendations and MIP may be used for monitoring the progress towards these standards. A deep scientific analysis is needed for adopting specific standards and indicators, as flexicurity - combining security and flexibility of working force on labour market.

C. Towards Financial Union - Integrated Finance for an Integrated Economy

An Economic Union must be fully sustained by a complete Financial Union they both are complementary and mutually reinforcing. A monetary union involves a common monetary policy but also an anti-crisis support on behalf of a banking union with a single bank supervision mechanism, a single bank resolution mechanism and a single deposit insurance system. The first two were implemented, the second only partially, but for completing the Financial Union one needs to launch a common deposit insurance scheme for Banking Union and the Capital Markets Union. But setting up the Single Resolution Fund and also a European Deposit Insurance Scheme (EDIS) implies some time and some financial efforts. Attention must be paid to potential new risks developing in the banking sector, including risks related to the shadow banking sector, and they have to be detected by existing structures like macro-prudential institutions, the European Systemic Risk Board (ESRB) and ECB, also it should be reviewed the treatment of bank exposures to sovereign debt, for example by setting large exposure limits. A Capital Markets Union will ensure more diversified sources of finance and will strengthen cross-border risk-sharing through deepening integration of bond and equity markets.

D. Towards Fiscal Union - an Integrated Framework for Sound and Integrated Fiscal Policies

Unsustainable fiscal policies may affect price stability in the Economic Union but may also harm financial stability by creating contagion between MS and financial fragmentation. National fiscal policies are important for having a sustainable public debt and effective fiscal automatic stabilisers for counteracting economic shocks. What happens at national level may affect the whole euro area. In order to resist to very severe crises it is necessary to create a euro area-wide fiscal stabilisation function in the longer term built on previous steps related to a significant degree of economic convergence, financial integration and further coordination and pooling of decision making on national budgets. The common EU fiscal governance framework should be reinforced after the improvements made following the crisis with the aim to prevent budgetary imbalances, to focus on debt developments and on better enforcement mechanisms. We now have an ample ex ante coordination of annual budgets of euro area MS and an enhancement of the surveillance for those experiencing financial difficulties, but MS must comply with stricter rules brought by the 'Six-Pack', the 'Two-Pack' and the Treaty on Stability, Coordination and Governance.

An advisory European Fiscal Board was suggested for coordinating and complementing the national fiscal councils that have been set up in the context of the EU Directive on budgetary frameworks. Establishing an automatic stabilisation mechanism at the euro area level would improve the cushioning of large macroeconomic shocks and make EMU overall more resilient to external shocks. The European Fund for Strategic Investments may support the stabilisation function and contribute to the development of specific projects. Stabilisation function must avoid permanent transfers between countries or transfers in one direction, it should not undermine the incentives for sound fiscal policy-making at the national level and the incentives to address national structural weaknesses; it should be consistent with the existing EU fiscal framework and with procedures for the coordination of economic policies; it should not be an instrument for crisis management replacing the European Stability Mechanism (ESM) but it must target the improvement of the overall economic resilience of EMU and individual euro area countries by preventing crises and future interventions by the European Stability Mechanism.

E. Democratic Accountability, Legitimacy and Institutional Strengthening

More dialogue, greater mutual trust and a stronger capacity to act collectively are needed at the level of European institutions. Linked to European Semester there are 'Economic dialogues' between the European Parliament and other European institutions. A new form of inter-parliamentary cooperation was established within the European Parliamentary Week, organised by the European Parliament in cooperation with national

Parliaments. European Commission has to cooperate with EP and national Parliaments having an effective interaction in the case of Country-Specific Recommendations and annual budgetary procedures. EU and the euro area must be better represented in the international financial institutions. Several intergovernmental arrangements created during the crisis need to be integrated into the legal framework of the European Union and this refers to the Treaty on Stability, Coordination and Governance, the Euro Plus Pact, the agreement on the Single Resolution Fund and the European Stability Mechanism. The presidency of Eurogroup should be reinforced for a greater role of this institution. The Stability and Growth Pact is seen as the main instrument for providing strong fiscal rules and stability. A genuine EMU will require more collectively decisions and a future euro area treasury.

As the main conclusions that could be drawn from the Report of the 5 presidents one may mention the principal steps necessary to complete EMU at the latest by 2025 and an ambitious and pragmatic roadmap. The report offered a clear sense of direction for Europe's EMU which is essential for citizens and economic actors, and also for their confidence in the single currency. The implementation of the first steps was not so easy and the prospects for the later steps are not very encouraging and we can see that translating the proposals made into actions will require a strong political will and commitment of the Member States and EU institutions.

3. Requirements regarding the future of Monetary Union and of the single currency

For **Nouriel Roubini** after Brexit there are many signs of huge concerns especially for the Eurozone. Firstly, if the divorce between Great Britain and EU will become prolonged and difficult, economic growth and markets will suffer, and if Scotland and Northern Ireland would leave the UK then Catalonia may exert high pressures for its independence from Spain. And without Britain, for Denmark and Sweden, who have not intended to join the Eurozone, there is great concern that they will become second hand members of the EU, which may cause them to take the "Exit scenario" into account. Upcoming elections (from France, Germany and Netherlands) and referenda in some Member States will take place on a minefield created by Brexit. Currently, Italy seems the weak link in the euro area, as economic growth is anaemic, banks have 350 billion euros in debt and desperately need capital and fiscal targets agreed with the EU are difficult to achieve without triggering another recession. In addition Matteo Renzi is in total disagreement with Angela Merkel on bail in, which could attract a huge run of capital. If Renzi fails to resolve these difficulties then Movimento 5 Stelle (5 Stars Movement), an anti-European party, who stated recently in local elections, could come to power starting next year. Italy has a public debt of 2,000 billion euro or 135% of GDP, making Greece one less danger for the stability of the euro area. But budget deficits haunt many Eurozone countries, which have exceeded the 3% of GDP threshold, which Romania must observe it strictly. Therefore Brussels has given up to penalties (fines), even they were set at symbolic levels. Deliberate violations of Stability and Growth Pact represent, in addition to defiance of Brussels, an exacerbation of the economic problems, with effects that may go to the disappearance of the euro currency.

Lüder Gerken (2015), head of the Centre for European Policy in Freiburg believes that the Stability and Growth Pact would be exposed to arbitrary political decisions. It requires a common European treasury, in addition to an economic and fiscal policy. A thorny issue is that fiscal policies are totally different in concept in Member States and even the establishment of a EU treasury would not change anything. The European Union had always been a transfer union in that it sought to strike a balance between winners and losers of common market.

Until the completion of the national elections, the EU is unlikely to take steps to complete the monetary union by introducing risk sharing and accelerating structural reforms to speed up the process of economic convergence. Given the slow pace of reforms (and aging of population), growth potential remains a low one, while current real growth is a quite moderate recovery of cyclical type but anyway threatened by post-Brexit risks and uncertainties. At the same time, great deficits and debts, and the rules of the euro area, constrain the use of fiscal policy to stimulate economic growth, while the European Central Bank may reach the limits of effectiveness of its unconventional monetary policy (quantitative easing) to support economic recovery. According to **Lucian Croitoru** (2016), in addition to raising the inflation target over 2% per year, giving up the overregulation generated in the last 6-7 years and the illusion of positive effects of quantitative easing, the use of fiscal policy should be extended and accepted larger budget deficits until the exit phase of stagnation/insufficient growth and negative interest rates. Whereas the constraints of Stability and Growth Pact are high in respect of budget deficit and public debt one might consider the views of Joseph Stiglitz (2015) on a

fairer redistribution of income between capital and labour that would stimulate private consumer demand and help out of the liquidity trap and deflation.

Roubini does not seem so pessimistic as he was before and thinks that it is unlikely that the euro and EU to suddenly disintegrate, many of the risks they face now are in a not very dangerous phase, and the disintegration process may be of course avoided by a political vision that balances the need for greater integration with the desire to have a certain degree of national autonomy and sovereignty over a range of issues. But finding ways of integration that are democratic and politically acceptable is a pressing need and turmoil of economic policy led to an unstable equilibrium, that can inevitable produce the collapse of the EU and euro area and given the many risks and challenges confronting EU it is an urgent need of a new vision on its future.

Joseph Stiglitz (2016) believes that Europe is moving towards a "*cataclysmic event*" that could lead to a collapse of the euro and the end of the European project as we know it, because the single European currency could inevitably cease at a time in the future unless drastic measures are taken. There would be a growing hostility against the euro, to which one may unfortunately add a widespread hostility to the whole European project and to liberal values. Well defined consensus, that Europe is not working, will probably be explained by the dysfunctions of euro zone and the need to abandon the euro zone and single currency with the continuation or not of the European project.

Stiglitz believes that referendum to be organized by Renzi in Italy in November is quite risky based on the results of the referendum from Great Britain. Italy has a low productivity, a history of missing growth targets and has registered counter-performances as against the rest of Europe in the recent years. Because the Italian banking sector has a lot of bad loans the government forced bank managers, insurers and investors to place 5 billion euro into a bailout fund, Atalante, for the weakest banks from the country. Stiglitz believes that bail in cannot be a viable solution in Italy, i.e. shareholders and big depositors of commercial banks can not save them from bankruptcy. In October 2016 Joseph Stiglitz believed that Italy and other countries will exit the euro zone in the coming years and that the culprits for Europe's economic problems are the austerity policies promoted by Germany.

According to Stiglitz, after the 2008 financial crisis euro member countries behaved more modest than MS outside the euro area and more modest than the US, which was the crisis epicentre. Countries like Greece are in a deep recession, and Member States that have performed better, were more efficient economically, as Germany did, have done so on the backs of others, especially those from Southern Europe. Now Germany blames the victims, showing the waste made by Greece and other countries' debts and deficits. Spain and Ireland had still budget surpluses and a small debt to GDP before the euro crisis. So the crisis has appreciably increased deficits and debts, not vice versa. Deficit fetish is only one possible explanation, other would be that welfare state and excessive protectionist measures on the labour market caused the crisis. But some of the most advanced countries in Europe, like Sweden and Norway, have the strongest welfare state and best protected labour markets. Many of the countries that currently have significant difficulties performed very well - above the European average - before the introduction of the euro, and their decline is not the result of a sudden change in labour legislation or in real work of population, but only in monetary arrangements.

It could be also blamed the macroeconomic management provided by European leaders, who could conceive and implement better policies. Ineffective policies like austerity, but also so-called (erroneously) structural reforms that increase inequality and thus weaken overall demand and growth potential have worsened economic and social situation. But the euro was based on a political agreement, the German had a dominant voice. Another reason for the poor performance of the Eurozone is the critique stance of the political right on Eurocrats that imposed rules preventing innovation, but this criticism is flawed because Eurocrats, as well labour legislation or the welfare state, have not suddenly changed in 1999, with giving up exchange rates, or in 2008 when the crisis began. For Stiglitz what matters most is the standard of living, quality of life and any comparison between Western Europe and China is enlightening. Another explanation remains: one may blame the single currency, not policies and structures in certain states because the euro was defective at its birth and neither the best politicians nor the best economists in the world could make it work properly.

The single currency has deprived the MS of the monetary union of the most important adjustment mechanism - the exchange rate. The response to asymmetric shocks and differences in productivity level would have to materialize in adjustments of the real exchange rate, which means that prices at the periphery of the eurozone would have to fall relative to those in Germany and Northern Europe. But given Germany's obsession with price stability and keeping inflation at a very low level, the adjustment could take place through deflation

elsewhere, which meant high unemployment and weakening of trade unions; the poorest countries in the euro zone, particularly workers in these countries, have borne the greatest burden of readjustment. In this way the policy of encouraging convergence between the euro area countries failed miserably, with increasing disparities between countries and within them. This system can not function properly in the long term, and the single currency will be viable only if it will change the rules of the euro zone and the institutions. In Stiglitz's view it is still necessary:

- 1) to abandon the convergence criterion, which requires budget deficits below 3% of GDP;
- 2) to replace austerity with a growth strategy, supported by solidarity funds for stabilisation;
- 3) to give up a system prone to crisis, in which countries must borrow in a currency that is not under their control, and to introduce bonds issued by euro area or a similar mechanism;
- 4) to amend the mandate of the European Central Bank, which focuses only on inflation, unlike the US Federal Reserve, which has in view the unemployment, growth and economic stability;
- 5) to create the insurance pools to stop bleeding of euros in poor countries and to create the components of a "banking union" (largely completed);
- 6) to encourage rather than to prohibit industrial policies that provide Eurozone laggards a chance to catch the leaders (a reindustrialization policy was initiated).

Stiglitz believes these changes are minor ones, but they can not be taken due to lack of political will of decision-makers, who do not understand that the current situation is not sustainable in the medium and long term. The monetary union was meant to ensure prosperity and accelerate the integration but it had the opposite effect. Stiglitz said: *If European leaders can not or do not want to take the hard decisions, European voters will do for them - the leaders could not even be happy when they see the results.*

In his latest book launched in France in September 2016 and entitled *"The Euro: How a Common Currency Threatens the Future of Europe"*, Stiglitz argues that there were errors since the origin of the euro, since Europeans *"put the cart before the horse"* by launching single currency, without having the necessary institutions to manage it, and the single currency deprives states of two of the most important tools for adjustment: the exchange rate and interest rate. A solution envisaged by Joseph Stiglitz (2016) is the exit of Germany from the euro zone, which would make other countries more competitive, thanks to devaluation of the euro, but if this is not adopted Stiglitz recommends an amicably divorce and creating *"two or three currency areas"* pending the establishment of the necessary institutions. For Stiglitz is obvious that Greece, Portugal, Italy, Spain should not have to adopt the euro and now they should leave the euro zone.

At the informal meeting from 9 to 10 September 2016 in Bratislava, ECOFIN discussed issues related to evaluation of the first year of the European Fund for Strategic Investments (EFSI), the fight against tax evasion and consolidation of EU investment. They discussed issues related to creating a function of macroeconomic stabilisation for Eurozone in *Stage 2* (post 2017) by establishing the elements of a fiscal union, Slovak presidency presenting the following possibilities: an European Scheme for Unemployment Insurance, a Stabilisation Fund for Ailing States, a Joint Investment Fund. Not resisting well to shocks EMU needs structural reforms and tax compliance for promoting convergence and confidence between Member States, but also avoiding moral hazard and permanent transfers. However there are very significant differences, especially between countries in the euro area and those outside it, and between euro zone members on how to absorb symmetrical and asymmetrical shocks, while a larger Community budget or a fiscal union is a long term project, difficult to achieve and requiring the participation and non-members of the euro zone (Prisecaru, 2016).

4. Recent negative developments in the European banking sector and in the Eurozone

Troubles and systemic imbalances in the banking sector have aggravated in the last 2 years when banks like Deutsche Bank, Commerzbank, Monte dei Paschi and other German, Italian and Spanish banks have experienced major difficulties in terms of losses and debts. The main problem is represented by the situation of TARGET-2 and its imbalances at the National Central Banks of the Eurosystem that reflect the capital flight from Southern Europe into Northern Europe, mainly in Germany, not related to the trade balance deficit, as Spain and Italy have managed to reduce their trade balance deficits. TARGET-2 is a clearing system which allows commercial banks in Europe to conduct payment transactions in the euro. After the crisis in the euro area, commercial banks have stopped lending each other money and the compensation has to be provided by the European Central Bank. But a lot of capital was going from Spain and Italy to Germany, Luxembourg, the Netherlands and Finland, imposing massive interventions of ECB. These huge imbalances highlight the great

tensions existing in the Economic and Monetary Union (EMU), the need for macroeconomic balances to be restored, to re-establish the trust in banking systems, and to strengthen the institutional foundations of EMU.

Big differences between different economies of euro zone make extremely difficult any monetary policy of ECB, interest rates may be too high or too low depending on the specificity of respective economy. Different options for supporting banks, as bail out or bail in, are forbidden because there is a unified monetary policy and a banking union, and also a need for inseparable fiscal and monetary policies. In the euro area ECB had to provide liquidity in a traditional way through longer-term refinancing operations that did not work and ECB was forced to launch an unconventional monetary policy: quantitative easing.

For GEFIRA Foundation it is the design of the Eurozone that makes the European Central Bank's actions ineffective. If there is a lack of trust in the banking sector, then the banks do not lend money to each other any more, it is the National Central Bank that has to provide temporarily some cheap money and offer the government (fiscal authorities) time to solve the underlying solvency problems, but the euro area does not have this important mechanism. Governments may rescue a bank by financing a bail-out operation or nationalizing some banks or may impose new rules adapted to local circumstances. National governments may use some measures for supporting the banking system like mandatory conversion of foreign currency mortgages into local currency mortgages, temporary moratorium on foreclosures and repossessions if people fall behind on their payments, outsourcing national electronic payment system to commercial banks etc. In the euro area there are no fiscal authorities and no single fiscal policy, so the problems of banking system may be solved only by monetary authorities and the liquidity provided by ECB plays an essential role in this respect.

In the summer of 2016 it was obvious the critical situation of Italian banking sector, mirrored by the amount of nonperforming loans (NPLs) at around 200 billion euros, or around 8% of total loans but another €60 billion worth of loans could soon be pushed into NPL status. The third-largest bank by assets in Italy, Banca Monte dei Paschi, founded in 1472, was asked by ECB to cut its gross nonperforming loan exposure from €46.9 billion in 2015 to €4.6 billion by 2018. The great problems of Italian banks, especially of BMP, are related mainly to their solvency and there are concerns about a potential conflict between Italian government and European Commission over new restrictions on government bailouts of the financial sector. Due to the Single Resolution Mechanism within the banking union the national governments from euro zone cannot use the bail out procedure (public money, state aid) for rescuing bankrupt banks which may use only bail in procedure (money of shareholders and depositors). After the financial crisis Italy failed to restructure its banks and the financial sector's difficulties have been exacerbated by a sluggish economic growth, and one could see low yields of Italian government bonds and banks bonds, and also falling interest rates, which badly affected the situation of banks. The solution selected by Italian government has involved the money from private sector and state-backed institutions, including a privately backed bailout fund called Atlante (€5 billion). Decision makers from Italy must agree on a plan to recapitalize Italian banks and protect small investors in bank bonds. If an agreement on bail out fails then Italian voters may bring to power the 5 Star Movement, which has called for a referendum on euro zone membership.

5. Conclusion

More financial and fiscal integration under the form of banking union, capital markets union and a fiscal macroeconomic stabilization mechanism are considered the best solution for a further progress of EMU. National governments should look not only at the deficits and debts but on their expenditures and incomes regarding the removal of public waste and combating firmly the tax evasion. A new European financial institution and a large EU budget (a treasury) may be two possible solutions for the deepening of integration within EMU. To exit from liquidity trap and deflation trap it is needed a better distribution of income between capital and labour which may support the recovery in consumer demand and economic growth in Europe. Austerity policy must be replaced by other policies targeting the reindustrialization of EU, regional development, green energies, research and innovation. A better and closer institutional cooperation between European institutions and between them and national institutions for strengthening EU governance and for providing more democratic accountability, legitimacy and institutional performance is imperiously required.

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