European Economic Governance after the Eurozone and COVID-19 Crises

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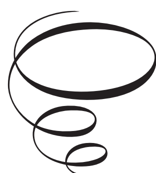
Edited by

Ioannis Papadopoulos

Cambridge Scholars Publishing



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ABOUT THE JEAN MONNET CENTRE OF EXCELLENCE

In the present book, the Jean Monnet Centre of Excellence "Research on Crucial Issues of European Integration" of the University of Macedonia presents the results of two scientific conferences and a roundtable discussion, as well as the research carried out within the framework of the Centre's 2nd Research Axis entitled "European Economic Governance", under the direction of its thematic coordinator, Associate Professor Ioannis Papadopoulos.

The Jean Monnet Centre of Excellence "Research on Crucial Issues of European Integration" was established in 2015 after having been selected for co-funding by the ERASMUS+ Jean Monnet Action Programme. It was hosted within the Institute of International Relations and European Integration (IDEA) of the Department of International and European Studies at the University of Macedonia (Greece) directed by the Head of the Department, Professor Ilias Kouskouvelis.

The main purpose of the Centre was to conduct research on topical and crucial issues of European integration in five research axes: a) The European Union in the International System: Security and Defence; b) European Economic Governance; c) The Development of the European Union; d) Constitutional Values, Rights and Citizenship in the European Union; and e) Research, Education and Youth Policies in the European Union. Each axis had three research projects. Overall, 38 researchers participated in the 15 research projects from the University of Macedonia, from the Aristotle University of Thessaloniki, as well as from other universities and research centres in Greece and abroad. The Centre organised 18 conferences and roundtable discussions on the above topics, as well as research visits abroad by the researchers, e.g. in the European Central Bank and the European Securities and Markets Authority.

The Centre also organised 3 summer academies on the EU Area of Freedom, Security and Justice, a seminar and a webinar on hate speech,

and established the “Observatory of EU Constitutional Values”, with its main aim being to report and comment on relevant EU legislation and case law.

As academic coordinator, I would like to thank everyone, the distinguished speakers and contributors in this volume, and all those who supported the Centre of Excellence in organising the conferences and events. Most of all, I would like to thank Professor Aristidis Bitzenis for hosting our roundtable discussions and panels in the framework of the annual International Conference for International Business (ICIB) of the University of Macedonia, in which Prof. Bitzenis serves as Academic Coordinator and Assoc. Professor Papadopoulos serves as member of the organising committee.

I would like to express my appreciation for, and acknowledge, the voluntary work of: a) the interns at the Jean Monnet Centre of Excellence, i.e., students from the Department of International and European Studies of the University of Macedonia, the Law School, and the Department of Political Sciences of the Aristotle University of Thessaloniki, who were selected to assist in compiling this volume, to conduct relevant research, and to prepare the notebooks of the 2nd Research Axis that are posted on our website “jmcexcellence.uom.gr” (in alphabetical order): Maria Kilinkaridou, Fotis Kokkinis, Panagiotis Moumtsidis, Aggeliki Roussou, Evlampia Stogianni, and Kornilia Vikelidou. Dr. Vikelidou also prepared a lexicon of the relevant terms; b) the undergraduate students (in alphabetical order) Aliki Chapsanidou and Christos Zois, who reviewed the transcripts of certain presentations in order to assist the contributors in the preparation of their chapters; and c) the undergraduate student Despoina Damianidou and the postgraduate student Antonia Koumpoti (experts and interns/researchers of the Centre for Research on Democracy and Law, directed by Assoc. Prof. Papadopoulos), for assisting in checking the use of the Chicago referencing system and in correcting the text format.

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None of this would have been possible without the Erasmus+/Jean Monnet Action co-funding arrangements, which contributed significantly to the extroversion and cross-fertilisation of our research.

Thessaloniki, October 29, 2021

Despoina Anagnostopoulou
Associate Professor
Department of International and European Studies
Jean Monnet Chair
Former Academic Coordinator of the Jean Monnet Centre of Excellence
University of Macedonia

INTRODUCTION

THE CHALLENGE OF THE COVID-19 PANDEMIC FOR EUROPEAN ECONOMIC GOVERNANCE

IOANNIS PAPADOPOULOS*

Increasing structural divergences in Europe due to the pandemic

The Covid-19 health crisis came as a tremendous shock to the world, and to the European Union (hereinafter EU) more particularly, only a few years after the Eurozone crisis. The fact is that EU member states were not affected to the same degree, at least in terms of the economic impact, by the Covid-19 crisis; on the contrary, the asymmetrical nature of this crisis confirmed the already existing disequilibrium between them. The most evident source of this asymmetry is that the southern countries of the EU (Portugal, Spain, Italy, Malta, Greece and Cyprus) are very dependent on tourism, which is one of the sectors that were most hit by the Covid-19 pandemic. But that is only the tip of the iceberg. More profoundly, the pandemic exacerbated the old structural differences in the economic growth models between the South and the North of Europe. The South mostly relies on internal demand and the services sector, whereas the North on exports and a robust industrial basis. Yet it so happens that the Covid-19 pandemic, by its nature, struck services much more than industry, because the services sector is to an important extent dependent on the interpersonal element, which was put in brackets due to the confinement measures.

But even the industrial products produced in the South are more mid-range market than in the North; the South has no real presence in the

* Associate Professor and Director, Centre for Research on Democracy and Law, Department of International and European Studies, University of Macedonia (Thessaloniki, Greece).

Artificial Intelligence sector yet, which seems to be the driving force behind the new, fourth, wave of industrialisation (known as "Industry 4.0") currently unfolding. Moreover, the institutions in the South tend to be weaker and less impervious to partisan pressures than in the North; this inevitably produces less efficiency in public services. Finally, the education and training systems of the Northern countries are better adapted to the needs of the market and closely fit the local and regional productive fabric, as is the case of the famous "dual learning" system in Germany, which revolves around the industrial enterprises of the country and is flexible enough to stick to the changes in international demand (Bosch 2010).

The cause of this structural divergence can be traced back to the first two industrial revolutions between the mid-18th and the beginning of the 20th centuries, when industrial plants were primarily concentrated in the area between the Northern Sea and the north of Italy, leaving outside the periphery of the continent. The fundamental lack of territorial cohesion in Europe is due foremost to economic history (Crescenzi et al. 2020). This is the reason for the establishment of EU cohesion policy in the end of the 1980s. Nevertheless, the creation of the euro area accentuated the pattern of divergence, since the removal of the foreign exchange risk directed more resources towards the specialised structures of production, i.e., services in the South and industry in the North. The austerity policies that took hold after the eruption of the Eurozone crisis stressed even more the fundamental structural divergence between the South and the North. The heterogeneity of the euro area became entrenched, even though the internal devaluation measures, the reforms that promoted competitiveness, and the extremely accommodating monetary policy of the European Central Bank (hereinafter ECB) had gradually allowed the South to recover by the mid-2010s despite the grave problems in the policy mix that was adopted and the generally low institutional quality of the involved countries (Pelagidis & Moutsopoulos 2021).

The Covid-19 pandemic made its deleterious appearance shortly after the Eurozone crisis had started to heal. Only this time, the response of the EU was of a completely different nature than in the 2010s. An impressive array of fiscal and monetary policy instruments was mobilised to counteract the pandemic shock and to restore confidence in a time of panic. The foundations of a true Transfer Union made their appearance with the 750 billion euro EU Recovery Plan, the launching of a form of jointly issued debt (Eurobonds) for the very first time in the history of European integration, and the creation of new own resources for the EU budget. A federal-type Fiscal Union has thus been watermarked. We can

notice it when we take a comprehensive look at the full panoply of measures that the European institutions decided to espouse in the midst of the worst crisis since World War II.

Conditions for optimism

Consequently, there is reason to be optimistic despite the ravages of the Covid-19 pandemic. Compared to the Eurozone crisis in the 2010s, this new challenge has brought about a breakthrough in the European economic governance with innovative financial tools and new procedures for their use. And it seems by now that even though there will be negative economic consequences from this pandemic crisis, these will be shallower and more short-lived than the wounds that the Eurozone crisis left behind.[1] Contrary to the double —public and current account— deficit that we had witnessed just before the outbreak of the Eurozone crisis, the situation now is very different: we never experienced a downfall in aggregate demand, since public deficit spending by the EU member states after the suspension of the Stability and Growth Pact in 2020 has been compensated by surplus savings of households and businesses.[2] This state of affairs prefigures a situation in which private sector expenditure will rise at the same time that the public sector will start spending less to support the economy. There is, thus, a sort of internal equilibrium that will certainly smooth the transition to normality, provided that state aid will not be withdrawn abruptly for the sake of fiscal consolidation, as had happened during the Eurozone crisis in 2011.

The European Commission confirms this perspective. In its Spring 2021 Economic Forecast, the Commission projects that the EU economy will expand by 4.2% in 2021 and by 4.4% in 2022, after a contraction of 6.1% in 2020, and also that public investment, as a proportion of GDP, is set to reach its highest level in more than a decade in 2022, and that this will be driven by the Recovery and Resilience Facility, the key instrument at the heart of the EU initiative NextGenerationEU (EC 2021). In such circumstances, all EU member states should see their economies return to pre-crisis levels by the end of 2022. Yet, the ratio of public debt to GDP is

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[1] A recent International Monetary Fund working paper has estimated that there will be significant negative impacts in economic performance and income distribution, as well as an increase in poverty until 2025, but only if more effective policy responses than those in the past are not adopted (Emmerling et al. 2021).

[2] Indeed, in America the recession caused by the Covid-19 pandemic only lasted two months, which makes it the shortest US recession on record (NBER 2021).

forecast to peak at 94% this year before decreasing slightly in 2022, while aggregate general government deficit is set to rise by about half a percentage point to 7.5% of GDP in the EU this year before halving to just below 4% by 2022 (EC 2021).

The European Commission prudently notes that "[t]he risks surrounding the GDP forecast are high and will remain so as long as the pandemic hangs over the economy. On the epidemiological front, developments concerning the pandemic and the efficiency and effectiveness of vaccination programmes could turn out better or worse than assumed in the central scenario of this forecast. On the economic side, this forecast may underestimate the propensity of households to spend, or, on the opposite, consumers' desire to maintain high levels of precautionary savings. […] Another risk to the outlook is the timing of policy support withdrawal, which if premature could jeopardise the recovery. On the downside, the impact of corporate distress on the labour market and the financial sector could prove worse than anticipated" (EC 2021). In truth, even though the epidemiological and macroeconomic conditions play a very important role as to the future direction of the European economy, the American Recovery Plan instigated by President Joe Biden highlights the potential that could be unleashed also in Europe if the EU —or at least the Eurozone— shared a stronger common approach to fiscal policies, as the Chief Economist of the ECB Philip Lane says in an interview for the French journal *Le Monde* (Albert & Charrel 2021). In the United States of America (hereinafter US), there has been little doubt as to the capacity of the federal state to finance public deficits of any size. If a full-blown Fiscal Union had been established in the EU by now, the economic actors —and foremost the governments that will have to borrow to finance their national recovery and investment plans— would have been less apprehensive about the economic outlook.

To the advancement of a Fiscal Union, we could also add the establishment of a common European Industrial Policy, which would place emphasis on building clusters of innovation and joint technology initiatives at European level for the promotion of investments in cutting-edge sectors such as the hydrogen economy or the manufacturing of electrical batteries. With the Covid-19 health crisis, it became evident that the European industry stakeholders —industrial enterprises, research institutions and educational systems, corporate finance, national and regional governments— should collaborate more closely so as to restructure the supply and logistic chains and to bring productive plants closer to the product users. In some strategic sectors it is of good economic logic to

construct European industrial champions capable of withstanding international competition and of providing security of supply to the Europeans, especially in troubled times such as these. In summary, a more coherent and demanding European fiscal framework together with a dedicated European industrial policy could turn out to be the real game changers for European economic governance and for the process of European integration more broadly.

Structure of the book

The title of this collective volume refers to the economic governance of the EU after the economic crisis of 2007-08 and during the Covid-19 pandemic crisis, and to the challenge of sustainability in its growth model.

The chapters are organised in four parts. The first part of the book *Where is Europe heading?* contains ideas on the future of Europe and on the reorganisation of European economic governance from two renowned European economists, Michel Aglietta and Karl Aiginger. The second part *EU Fiscal and Monetary Union* analyses the two basic policy tools used by the EU to tackle the subsequent Eurozone and Covid-19 pandemic crises, i.e., the Stability and Growth Pact and the EU Recovery Initiative, commonly known as “NextGenerationEU”. The third part *EU Banking Union* discusses several legal aspects of the EU Banking Union —notably the combination and balancing of various EU competences with member states’ powers—, a case study on the implementation and shortfalls of the EU Banking Union, and a possible structural reform of the banking sector both in the US and in the EU aiming towards some form of separation between commercial and investment banking. The fourth and last part of the book *The Legal and Economic Dimension of Credit Rating Agencies* critically examines Credit Rating Agencies (hereinafter CRAs), especially their legal dimension and their efficiency as tools of economic prediction, develops some thoughts on the impact of credit rates on the efficiency and resilience of the economy, and expounds an alternative model of Independent Credit Rating Agencies (hereinafter ICRAs).

The opening chapter of the first part is an across-the-board interview of the French economist *Michel Aglietta*, Professor Emeritus at the University of Paris X Nanterre and scientific advisor to CEPII and to France Stratégie, by the editor Ioannis Papadopoulos. Professor Aglietta explains why he thinks the Stability and Growth Pact is not sufficient and capable of leading to a real Fiscal Union in Europe, since it was not

designed with foresight. The source of the problem is that the disruption of the growth regime of financial capitalism that we are experiencing after 2008 has not been well understood. The endogenous dynamic of finance expresses a logic of momentum and radical uncertainty, whereas the neoclassical conception of efficiency, which is the basic macroeconomic assumption in Western countries, eliminates temporality and uncertainty. According to Aglietta, the most fundamental element that needs to be put in place is a common European long-term investment and industrial policy. This policy must be founded on the presupposition that the new growth regime is a new form of globalisation based on common goods such as the climate. It is the idea of European added value that will help us define a long-term investment programme by transforming finance. We need a restructuring of the European budget on the fiscal revenue side, with new own resources related to the European common goods, particularly a tax on digital data, a tax on financial transactions, and a carbon tax. The new EU budget, and the common investment and industrial policy that it will support, can play a countercyclical stabilisation role and at the same time create a sense of European belonging for the citizens.

Michel Aglietta also expounds his conception of a public-private partnership financial system. Such a system needs to promote a European network of national promotional banks. It also needs to encourage the issuance of European bonds linked to low-carbon investments, which are capable of boosting production and income in the long run. Aglietta explains the price mechanism that can lead to carbon neutrality. In a context in which deflationary pressures must be prevented from turning into stagnation equilibrium, the European Central Bank's mission must change; since money is a fundamental public good that is global and climate is a global public good, we need a money-climate link. Structural change can come from new incentives induced by the evolution of consumption patterns. Furthermore, a new European paradigm needs to avoid restrictive fiscal policies and to impose some countercyclical action for the euro area as a whole. This will need an institutional reform comprising a European finance minister and democratic control of the European economic governance. Finally, Aglietta reflects on Europe's demographic deficit as a long-term structural challenge that can pave the way for an understanding of social protection as a universal right of citizenship.

The second chapter of the first part has been written by *Karl Aiginger*, Director of the Policy Crossover Centre Vienna-Brussels and

Professor Emeritus of Economics at the Viennese University of Economics and Business (WU Wien). It contains an all-embracing vision for a stronger and larger Europe, lighthouse of sustainable growth and reforms mentor for its vicinity. In Aiginger's view, the European unification project has met with tremendous success, but it also faces problems on the road to the future. The increasingly irrational competitive advantage of the US dollar has to be addressed by a new European strategy, part of which would be the issuance of European safe bonds and the denomination of more international contracts in euros so as to enhance European economic power in the globalising world. The author argues that it is extremely important to develop synergies between public sector reforms and an improved European budget, climate policy, and stimulus packages to counteract the crisis.

In this context, he carves out four basic policy choices that may determine strategies for the Union and its member states: a high road strategy focusing on innovation and skills, raising energy or resource productivity, and fostering new firms and technologies, instead of seeking low costs only; a counterstrategy against populism that rejects pessimism and the narrative that everything was better in the past by placing emphasis on future-oriented reforms; a boost for energy efficiency and a shift of energy use from fossil fuels to clean energy; and a future-oriented industrial policy driven by societal goals such as climate change, health, poverty prevention, and the reduction of inequality. Professor Aiginger also develops some interesting ideas on the improvement of European governance: a combination of top-down common goals set by the EU and bottom-up preferences and innovations pursued by member states; a streamlining of EU decisions; a strengthening of European financial stability; and a delegation of decision-making on migration to regions or cities as well as a combination of the acceptance for migrants with financial incentives.

He also argues forcefully in favour of both an enlargement of the EU to the Western Balkans and a European outward strategy striving for new partnerships with its dynamic yet unstable neighbourhood, especially with Africa. Southern Europe can serve as a bridge to the southern and eastern non-European neighbours and can make Europe as a whole stronger and more capable of shaping globalisation in a responsible, welfare-increasing way. Putting everything into perspective, Professor Aiginger maintains that the European Green Deal, accompanied by a Social Europe that leaves no person or region behind, can provide a new narrative that will mobilise European citizens, and concludes with some

intriguing ideas on how to combine measures to limit climate change and inequality with the large stimulus programmes due to Covid-19.

The second part of the book opens with a chapter by *Dimitrios Skiadas*, Professor at the University of Macedonia. The chapter focuses on a more technical aspect of the establishment of a Fiscal Union within the EU, namely the importance of the Excessive Deficit Procedure (hereinafter EDP) under the current fiscal governance scheme of the Economic and Monetary Union (hereinafter EMU) as a means of safeguarding and improving the coordination of the national economic policies of the EU member states. The author first presents the basic rationale of the Stability and Growth Pact (hereinafter SGP) as well as the controversies as to its legal nature and economic efficacy. He then develops the central part of the chapter, which is devoted to the European Court of Auditors' (hereinafter ECA) proposals to tackle the weaknesses of the SGP's functioning that have been diagnosed during the Eurozone financial crisis. The main problem identified by the ECA is the underperformance of the European Commission in its mission to monitor the implementation of the SGP preventive arm —as it was reinforced by the establishment of a Macroeconomic Imbalance Procedure in 2011— and to ensure the interaction of the latter with the SGP corrective arm.

As a consequence, the credibility of the SGP has been seriously undermined, sending thus an implicit political message to the EU member states that they should not be overly concerned neither with their slow pace of convergence to their medium-term fiscal objectives nor with their capacity to tackle another recession in the future. A complementary problem identified by the ECA is that the examination of data by Eurostat does not adequately assess EU member states' control systems, thus leaving them leeway to get around the fiscal and macroeconomic standards set up by the reformed SGP. In a broad way, more transparency and clarity are needed, since the SGP mechanisms have become more complicated due to the several strata of reforms that have been adopted. Overall, if the EDP is to be the instrument for enforcing the fiscal rules decided by the EU in the course of eventually establishing a Fiscal Union, the improvement of its use is imperative.

The second chapter of the second part has been written by *Ioannis Papadopoulos*, Associate Professor at the University of Macedonia and Director of the Centre for Research on Democracy and Law. The chapter concerns the EU Recovery Initiative, commonly known as "NextGenerationEU", that was adopted in the midst of the Covid-19

pandemic. Under the pressure of an unprecedented health and economic crisis, the EU established an innovative EU Recovery Instrument (hereinafter EURI) —official name of the initiative— as a dedicated instrument designed to tackle the adverse effects of the pandemic crisis and to support investment, speed up the recovery, strengthen cohesion among member states, and reinforce the long-term growth potential by focusing on the green and digital transition of the European economy.

This chapter first recounts the path towards a difficult European coordination in front of a crisis both symmetrical and asymmetrical, and presents a narrative of the events and the basic points of the discussion that accompanied the endorsement of NextGenerationEU, which it considers as a game changer for Europe. It then goes on to analyse five aspects of the initiative that stand out: the massive use of a form of Eurobonds; the onset of a Transfer Union; the substantial redistributive effects of the EURI; the National Recovery and Resilience Plans as guarantees of good governance; and the necessary expansion of the EU's own resources. The author proceeds to a thorough critical presentation of the Recovery and Resilience Facility, which was received positively both by the main European actors themselves and by scholars, and surely is the centrepiece of the EU fiscal policy response to the Covid-19 pandemic crisis. The main thesis of the chapter is that the NextGenerationEU initiative seems to be a European success story, since it has created a European budgetary capacity and new own resources, it has opened the way for direct transfers at unprecedented amounts, and most importantly, it has provided Europe with a strategic sense of orientation for the future.

The third part opens with a chapter by *Iosif Ktenidis*, Associate Professor at the Aristotle University of Thessaloniki, on the legal aspects of the Banking Union. The author argues that the legal novelty of the Banking Union is that its gradual establishment has required an extraordinary combination and balancing of various EU competences, in different policy areas, with member states' powers, and that this legal exercise resulted in the introduction of different legal instruments that, when examined together, constitute the Banking Union as a unique cross-policy legal structure. Ktenidis shows convincingly, by a combined reading of the Treaty and of relevant case-law, that in the area of prudential supervision (the Single Supervisory Mechanism, hereinafter SSM, which is the first pillar of the Banking Union), the EU does not have a monetary, but rather an internal market competence shared with the member states. He also shows that the Treaty has established a bridge between monetary policy, the internal market, and the stability of the

financial system (which is an economic policy objective), and that implementing powers in the area of prudential supervision have been exceptionally conferred on the ECB.

As to the second pillar of the Banking Union (the Single Resolution Mechanism, hereinafter SRM), this is interwoven with, and supplements, banking supervision, since the latter can never rule out the possibility of failure of individual credit institutions; in such case, resort to a set of credible resolution tools is crucial so as to guarantee the continuity of the failing institution's critical financial and economic functions. Therefore, the centralisation of supervisory tasks at the EU level necessitates also a centralisation of resolution procedures for the institutions subject to the ECB's supervision. The author retraces the appropriate internal market legal basis for the establishment of the SRM, analyses the normative differences between the SRM and the SSM Regulations, and explains the reason for the limited role of the ECB in the SRM. He shows that the SRM is not only a mechanism of the EU internal market; it also serves the economic policy objective of financial stability, since its operation should release member states' economic policies and EU coordinating economic powers from the task of addressing the problems of bank failures that have not been prevented by the operation of the SSM. Ktenidis concludes by pointing out the importance of the internal market not only as an autonomous EU objective, but also as an instrument which serves the objectives of the EMU. Indeed, as the Eurozone crisis showed, the introduction of the EMU necessitated the remobilisation of EU internal market powers in the banking activity in order to avoid fragmentation of the internal market attributable to EMU asymmetries.

The second chapter of the third part has been written by *Ioannis Papadopoulos*, Associate Professor at the University of Macedonia and Director of the Centre for Research on Democracy and Law, *Apostolos Kiohos*, Associate Professor at the University of Macedonia, and *Nikolaos Stoupos*, Post-Doctoral Research Fellow at the University of Macedonia, and concerns the EU's effort to restructure its banking sector by introducing a type of separation between commercial and investment banking so as to minimise risks to financial stability from Too-Big-To-Fail phenomena. The authors first make a comparative assessment of the European Commission's policy scenarios concerning the scope and strength of the proposed structural separation between commercial and investment banking. They then propose a reading of the available materials that is alternative to the Commission's, the preferred models of

which are either an enhanced functional separation (Subsidiarisation model) or a light ownership separation (Volcker Rule).

By placing emphasis on the reduction of moral hazard and of capital and resources misallocation, balanced against the losses in economies of scope, the authors tentatively conclude in favour of a very strong ownership separation (the Glass-Steagall model), that was meant to function as a prophylactic measure against the structural tendency towards excessive security loans and over-investment in securities of all kinds, produced by the integration of commercial and investment activities under one single banking group. This tentative conclusion is then closely tested against an extensive analysis of the original purposes of the Glass-Steagall Act in the US and of the problems brought about by a series of legislative interpretations over the years, which shows that both the original Glass-Steagall model and the subsequent Volcker Rule that took hold in the US were proven quite impracticable, since they were riddled with many definitional and practical conundrums.

This leads the authors to shift the perspective by examining a new model of structural banking reform based on the regulation of traders' pecuniary motivation in their specialised labour market, instead of threatening integrated banking groups with sanctions for lack of compliance with a ban on risky investment activities (most notably proprietary trading). In plain language, this new model would concern traders' compensation arrangements: if a trader were to engage in any kind of proprietary trading activities, he would not be allowed to participate in any profits made from this trade. The chapter concludes that as a matter of public policy, such a model seems preferable for a future EU structural banking reform since it does not rely on complicated supervisory and corrective requirements, but rather on rational motivational mechanisms underlying traders' risky behaviour and on the capacity of banking management to be incentivised by policy signals.

The third chapter of the third part has been written by Dr. *Kornilia Vikelidou* (University of Macedonia), and presents a case study on the EU Banking Union: the Italian Bank Monte dei Paschi di Siena (hereinafter BMPS) and its big capital shortfalls. This chapter critically examines the extent to which the ongoing situation of this bank interacts with the implementation and the progress concerning the still incomplete Banking Union framework. The aim of the chapter is to provide an insight into the extent to which the Banking Union framework has been implemented

so far, to shed light on the missing elements, and to draw some tentative conclusions.

The main issue, as was exemplified in the BMPS case, was the unwillingness of resolution authorities to impose a bail-in, i.e., losses on shareholders, creditors and uninsured depositors of non-viable banks, since this would provoke chain reactions that the Italian political system could not manage: the fear of a potential panic made taxpayers' help seem safer than the implementation of a bail-in, even though this cannot be a long-term solution and raises serious issues of moral hazard. The case of BMPS is considered to be the first big test of how the Banking Union functions in practice. What the case study shows is that the two already established pillars of the Banking Union, i.e., the SSM and the SRM, have still not been effective enough to build the necessary confidence that would make participating countries more receptive regarding the implementation of the new banking resolution tools. Furthermore, the case of BMPS has shed light on the inefficiency of the key supervisory tools at the EU level to prevent the development of new non-performing loans. This chapter attempts to advance some proposals that could make a positive contribution to EU policies towards an effective Banking Union. The main conclusion is that the establishment of a European Deposit Insurance Scheme (EDIS) as the third pillar of the Banking Union, and of a fiscal backstop under the Banking Union framework, are an indispensable complement to moving supervision to the ECB, since these mechanisms would ensure the stability of the new integrated European banking system. It is thus clear that further harmonisation is needed at EU level through an adequate legal framework in order for viable debt to remain serviced and non-viable debt to get timely resolved, and also in order to prevent diverging national requirements from annulling the rules needed for the effectiveness and completion of the Banking Union.

The EU Banking Union is also the theme of the final chapter of the third part written by Dr. *Martha Kavvatha*, Attorney at law with the Bank of Greece. More specifically, the author analyses the complicated legal relation between the ECB and the so-called National Competent Authorities (hereinafter NCAs) regarding prudential supervision of Significant credit Institutions (hereinafter SIs) and Less Significant credit Institutions (hereinafter LSIs), and expounds the tasks and powers of the Bank of Greece (hereinafter BoG) in its quality as NCA and in correlation to those conferred on the ECB. The functioning of the SSM relies on the obligation of cooperation in good faith and of exchange of information between the European (ECB) and the national (NCAs) levels of supervision. The SSM,

established in the aftermath of the financial crisis, results in a transfer of powers from national competent authorities to an EU institution (namely the ECB) in relation to banking supervision. The centralisation of decision-making at the European level is indisputable: the ECB remains ultimately responsible for the effective and consistent functioning of the entire mechanism and holds, to this end, important coordinating powers. Thus, micro-prudential supervision of SIs falls within the remit of the ECB. However, the NCAs retain important tasks and powers, while cooperation and coordination between the national and the European levels is deemed crucial for the fulfilment of the objectives of the SSM. Thus, the micro-prudential supervision of LSIs falls under the direct supervision of the BoG, and in exercising its tasks in relation to SIs established in Greece, the ECB cooperates closely with the BoG because EU law acknowledges the important and long-established expertise of national supervisors in the supervision of credit institutions within their territory, and their economic, organisational and cultural specificities.

As to macro-prudential supervision aimed at addressing systemic risks, the ECB shares powers with the NCAs, which remain primarily responsible for the application of macro-prudential tools in their jurisdictions. Finally, a good example of the complicated delineation of powers between the European and the national levels explained by the author are the enforcement and sanctioning powers: the ECB retains such powers only regarding SIs, while the BoG not only remains competent for sanctions vis-à-vis LSIs, but also reserves important sanctioning powers in regard to SIs as well, but only following a request of the ECB. The general conclusion is that of a unique institutional set-up of the SSM, in which the NCAs formally retain certain powers, which nonetheless can no longer be autonomously exercised for the purpose of carrying out tasks that have been attributed to the ECB.

The fourth and last part of the book opens with a chapter by *Periklis Gogas*, Professor at the Democritus University of Thrace, *Theophilos Papadimitriou*, Professor at the Democritus University of Thrace, *Athanasia Dimitriadou*, PhD Candidate, University of Derby, and *Anna Agrapetidou*, PhD, Democritus University of Thrace, expounding an alternative model of ICRAs. The chapter presents the history and evolution of CRAs. In the years following the US stock market crash in 1929, we have been seeing a growing reliance of investors and other markets participants on CRAs' ratings, to such a point that they have become the quasi-official arbitrators of credit risk throughout the global financial system. But after the 2008 financial crisis, CRAs have faced

intense criticism, obviously because they failed to signal financial (default) risk. The basic structural problem underlying the CRAs' operation is the inherent conflict of interest due to the "issuer-pays system", since CRAs are paid by the issuers of the debt instruments, and they therefore have a strong incentive to assign the highest possible ratings. This structural problem is complemented by the relatively loose regulatory oversight from government agencies.

In recent years, new regulations, the abundance of economic and financial data, and the availability of powerful new methodologies and inexpensive computing power, have brought us to a new era of ratings that can be produced by non-market, not-for-profit ICRAs, which can either compete with CRAs or be used as an auxiliary risk-gauging mechanism by market participants. The authors show that these independent ratings are free from the problems inherent in traditional CRAs. They then present two relevant forecasting models with their methodologies, one for bank credit ratings and one for bank failures. These models, based only on quantitative and publicly available information, can be used by an ICRA to assign credit risk ratings to banking institutions and/or produce probabilities of default, with a very good overall accuracy level. The authors conclude that since public disclosure is now mandatory for transparency reasons, ICRAs must come into play. ICRAs do not suffer from the issuer-payer conflict of interest, they come with full transparency in the ratings procedure, they increase competition, thus minimising the oligopolistic power of the existing CRAs in information gathering and processing, and they are subject to market discipline or market rewards depending on the accuracy and fairness of the ratings they provide.

The second chapter of the fourth part, written by *Despoina Anagnostopoulou*, Associate Professor at the University of Macedonia, and Dr. *Kornilia Vikelidou* (University of Macedonia), contains a legal analysis and evaluation of the EU regulatory framework on CRAs in order to assess its role in the restoration of market confidence and the enhancement of investor protection. Everybody recognises that the ratings of CRAs play an important role in credit assessment. However, their use should not be mechanistic nor lessen a debtor's responsibility to ensure that its credit exposures are based on sound risk assessments. The chapter first presents the development of the EU regulatory framework on CRAs since 2009, which established the European Securities and Markets Authority (hereinafter ESMA) as supervisor and attempted to reduce the regulatory role of CRAs by obliging financial institutions to make their own credit risk assessments. It then proceeds to an evaluation of the EU

regulatory framework in its multiple facets: registration and quality of the rating process, conflicts of interests, and rules on transparency. The supervision of registered CRAs by ESMA is explained in its details.

Special attention is given to competition issues raised by the oligopoly of the so-called “Big Three” CRAs (Moody’s, S&P, and Fitch), which constitutes a risk for financial stability: both the US and the EU authorities have investigated probable concerted practices and abuse of dominant position in the market, but these have proven difficult to confirm in the EU case. As to the possible civil liability of CRAs because of mishandled ratings, the authors depict the rise of the willingness to treat CRAs like other gatekeepers, e.g., banks, accountants, and lawyers, after the 2008 financial crisis, since reputational capital by itself does not seem to provide sufficient incentives for accurate ratings. In the EU, even though the CRA Regulation opened the possibility of claims against CRAs both by the issuers (contracting parties) and by the investors (third parties) in relation to infringements of the Regulation committed intentionally or with gross negligence, EU law refers all relevant aspects of civil law damage claims to the national laws; since there is a wide diversity of civil liability regimes in the member states, the authors are of the opinion that harmonisation is needed.

The authors conclude that although the EU regulatory framework constitutes a significant first step towards mitigating the adverse influence that CRAs were found to have, hardly can this regime be considered effective enough to satisfy the aim of independent, objective, and adequate quality ratings. The emerging Banking Union and Capital Markets Union could mitigate the pro-cyclical impact of credit ratings, while enhancing vigorous competition in a level playing field.

The last chapter of the fourth part, written by *Emmanouil Vlachogiannis*, First Vice-President of the Thessaloniki Chamber of Commerce and Industry, is an economic analysis of the contribution of credit ratings to market efficiency and/or resilience. In neoclassical economics, where the idea of equilibrium price is all-important, credit ratings are supposed to improve market efficiency by allowing supply and demand to define interest rates and to incorporate the underlying risks in the sense that they provide investors with information about the credibility of bonds. The chapter investigates the validity of this neoclassical assumption. In order to do this, the author examines the microeconomic conditions under which credit ratings are produced. Credit ratings are costly endeavours. In the case of sovereign debt, the source of financial

compensation for CRAs is unknown. The temptation to manipulate credit rating outcomes is inherent in this system of privately produced, “condensed or compiled” information, which is broadcasted and made available to the general public. The author assumes that investors form their expectations around a statistical measure of the past that might be a median or an average of default risks, and also that when credit ratings suggest that the default risk is below the median, debt with lower interest rates will be issued, and on the contrary, when credit ratings suggest that the default risk is above the median, funding can be attracted under only significantly higher interest rates.

The consequence is that credit ratings, which aim to be an instrument of information, rather transform themselves into instruments of giving bonuses or maluses, and therefore inevitably spell a kind of political judgment. If we visualise these assumptions in a traditional market setting with supply (the willingness of investors to engage in funding with varying amounts regarding interest rates) and demand (the need of debtors for funds in varying amounts, depending on interest rates) curves and we suppose that a perceived supply curve intersects with the perceived demand curve in a price/quantity point that corresponds to the median default risk, we will notice that the elasticity of both supply and demand will increase due to credit ratings. That might be a problem for market efficiency, as both curves will intersect and create a new equilibrium, where interest rates will reflect increasing risk intolerance as market participants become more informed. The result is that interest rates will not always correspond to risk, so market efficiency, i.e., a stable relation between interest rates and inherent risks, is questioned. As to the impact of credit ratings on market resilience, experience has shown that the latter will receive a severe blow when bond markets with settings prone to divergence are confronted with contracting liquidity. And the fact that credit ratings try to anticipate market reactions aggravates the problem. Overall, credit ratings seem to contribute to an unintended instability of financial markets instead of improving market resilience. This is not a Pareto Efficient Equilibrium world; this is a Minsky Financial Market Instability world.

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PART A:

WHERE IS EUROPE HEADING?

CHAPTER 1

INTERVIEW WITH MICHEL AGLIETTA: THE CHALLENGES FACING THE EU IN FRONT OF THE CHANGES IN CAPITALISM

Ioannis Papadopoulos: Good morning.

Michel Aglietta: Good morning.

Ioannis Papadopoulos: So, I'm very happy, delighted even, to be with you at the CEPII (Centre d'études prospective et d'informations internationales) in Paris, where you also happen to have your office. First of all, I would like you to formally introduce yourself to us, and then we will start discussing the Fiscal Union.

Michel Aglietta: I am Michel Aglietta. I am professor emeritus at the University of Paris X Nanterre, and I am also a scientific advisor to the international economics research organisation called CEPII and to France Stratégie, the former Commissariat du plan (Plan Commission), which is somewhat of a public body of foresight for the French economy and its position vis-à-vis Europe and the world.

Ioannis Papadopoulos: So, we're going to try to talk about the Fiscal Union first. I will ask you a few questions, then you will position yourself freely, and afterwards the discussion can take us elsewhere. I don't want you to feel constrained to follow any strict conversation guidelines. You can also talk about growth issues, which I know are dear to you since I follow your work.

So, the first question is quite broad, of course. In your opinion, and considering its macroeconomic assumptions, is the Stability and Growth Pact an institutional framework that is sufficient and capable of leading us to a real Fiscal Union in Europe, in the European Union, or rather, in the euro area? Is this the case or not?