#FocusFuture

# The 7Ds for Sustainability

**Debt** IN DEPTH

Decarbonisation
Defence
Democracy
Demography
De-risking Globalisation
Digitalisation

Wilfried
Martens Centre
for European Studies

# The 7Ds for Sustainability - Debt in Depth

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April 2024

## Credits

The Wilfried Martens Centre for European Studies is the political foundation and think tank of the European People's Party, dedicated to the promotion of Christian Democrat, conservative and like-minded political values.

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Assistant Editors: Sara Pini, Senior Research Officer & Theo Larue, Editorial and Publications Officer
Cover design: Gëzim Lezha, Brand and Visual Communications Officer
External editing: Communicative English bvba
Typesetting: Victoria Agency
Printed in Belgium by INNI Group

This publication receives funding from the European Parliament.

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# Table of acronyms

| | |
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| BRRD | Bank Recovery and Resolution Directive |
| CMDI | Framework for Bank Crisis Management and National Deposit Guarantee Schemes |
| ECA | European Court of Auditors |
| ECB | European Central Bank |
| EPBO | European Parliament Budget Office |
| ESM | European Stability Mechanism |
| ETS | Emissions Trading Scheme |
| GNI | Gross National Income |
| MFF | Multi-Annual Financial Framework |
| MS | Member State |
| NGEU | Next Generation EU |
| OECD | Organisation for Economic Cooperation and Development |
| SGP | Stability and Growth Pact |
| TPI | Transmission Protection Instrument |
| VAT | Value added Tax |

# Introduction

**Klaus Welle and Eoin Drea**

Debt is a question of dose. Too much, and you lose your political independence and sovereignty. Too little, and you might miss out on the possibility and necessity of building infrastructure that facilitates future development.

Keynes taught us that there are situations in which price and interest signals do not work and, as a result, the state is the only actor able to step in temporarily and stabilise the economy—and with it, the political system. A hard lesson was learned in the 1930s. It inspired us during Covid, when the economy threatened to come to a standstill. But debt was put on the EU's balance sheet without corresponding own resources for the Union to finance and repay it. In addition, no proper parliamentary oversight of debt at the EU level was introduced.

Unfortunately, we have now entered a period of vulgar Keynesianism: increasing the debt-to-GDP ratio in crisis times and in good times as well. The consequence is a debt-to-GDP ratio of about 90% in the eurozone and around 100% in the UK and the US. If this trend continues, it will not be very long before a debt crisis reoccurs and the independence of our political decision-making is threatened, together with the cohesion of the EU.

China and Japan are no exception to this trend. Japan has already demonstrated how ageing societies, with correspondingly meagre growth, can enter into decades of exploding debt. China's debt is largely out of control, especially on the local and regional level, for which the central state will ultimately have to take responsibility. This accumulation of debt was partially driven by the end of a property building boom and significant over-capacity in many sectors of the economy. This has resulted in Chinese debt levels no longer being accompanied by a sustainable growth model.

The situation is further aggravated by the fact that public investments have become unavoidable in digital infrastructure, defence and decarbonisation, and to alleviate the financial burdens of unfavourable demographics. De-risking from China will add to the burden. The time of imported deflation that was the consequence of hundreds of millions of Chinese workers being integrated into the global market for the first time seems to be over.

During the eurozone crisis, we learned that cutting expenditure on its own is not the answer, because the potential reduction in debt can be largely offset by a significant reduction in GDP as well. Any successful strategy will therefore have to focus on growth and productivity-enhancing strategies at the same time.

In 2023, the Martens Centre published its *7Ds for Sustainability* strategy document. This text comprised 175 proposals for the next legislature to future-proof EU policy in the areas of debt, decarbonisation, defence, democracy, demography, de-risking globalisation, and digitalisation. Sustainability was chosen as the guiding principle to ensure that the policies reconcile the needs of both the present and the future, and systematically include the interests of the next generations.

The *7Ds* document has already inspired reflection on what to do over the next five years. These discussions are based on Christian Democrat and conservative thinking and the available in-house expertise of the Martens Centre. For the next phase of intense discussions about the programme to be implemented during the 2024–9 legislature, the Martens Centre has invited renowned external experts to put forward their own, more extensive proposals based on the original document, thereby deepening the available expertise. It is hoped that these proposals, published at the beginning of April 2024, will help to clarify the way forward at a critical juncture, when the European Parliament, the European Commission and the European Council are negotiating on and finalising their strategic priorities.

# Ensuring the Sustainability of Public Finances

Jürgen Matthes

Current debt levels in the eurozone are well above the 60% ceiling set out in the Treaty of Maastricht under the Stability and Growth Pact (SGP). Those member states that did not use the better times between 2015 and 2019 to build fiscal buffers for the next downturn are now burdened with rather high public debt levels. While public spending requirements are large in view of the green and digital transitions, economic growth will be slower in the coming years and interest rates are likely to remain higher for some time in the aftermath of the temporary surge in inflation. Under these circumstances, public debt levels could increase further into dangerous territory should an overly lax fiscal policy be adopted.

Ensuring the public debt sustainability of the EU and its member states is a prerequisite for the continued success of the wider European integration process. It is also a vitally important element in maintaining market confidence in the euro and in the ability of individual member states to meet their financial commitments. The return of a euro debt crisis would endanger not only macroeconomic stability but also the EU's aims of prosperity, the green transition and open strategic autonomy.

For the European People's Party, it is thus critical to ensure that debt sustainability is placed at the heart of the revised eurozone governance framework. Politically, the objectives should be to balance a credible, effective and consistent fiscal framework with a longer-term sense of ownership in the national capitals. The European People's Party must also draw clear lessons from the decade of economic crises. Most notably, increasing economic growth is a key pathway to reducing debt levels over the medium term.

The table below lists nine recommendations aimed at achieving a sound fiscal future for the EU. These are based on the following two observations. First, the (ongoing) reforms of the euro area fiscal governance framework and of the SGP offer new opportunities. However, depending on how these reforms are implemented, they could also pose new risks linked to debt sustainability. Green and digital spending must be weighed against risks to market confidence as higher expenditures tend to increase public debts. Second, to achieve the right balance and to strengthen incentives for sound fiscal policy management at the national level, adjustments need to be made in the way policymaking is shared between the member states and the EU, as well as among the EU's institutions. In particular, the European Central Bank (ECB) is overly exposed as a lender of last resort to governments. Its continuous presence in sovereign debt markets could reduce the willingness of member states to sufficiently take into account the need for a stability-oriented fiscal policy.

| | Programme 1 | Programme 2 | Programme 3 |
|---|---|---|---|
| | **Empowering good fiscal governance at national level** | **Defending an independent eurozone monetary policy** | **Simplifying and depoliticising EU-level economic governance** |
| **Project 1** | Responsibility for keeping fiscal policy sustainable rests with member states. EU institutions should not interfere with these national responsibilities so that governments can clearly discern how lax fiscal policies can result in a loss of market confidence. | Raise interest rates accordingly if inflation increases, no matter how this affects the debt sustainability of highly indebted member states. The ECB's decisions must not be concerned with fiscal implications regardless of the political pressure. Its independence is key to guaranteeing price stability. | Depoliticise and simplify the SGP, for example by giving more power to independent institutions such as national fiscal councils or the European Fiscal Board. Too often the euro area's fiscal governance has been influenced by political instead of economic considerations. |
| **Project 2** | Joint borrowing by the EU interferes with the connection between national fiscal policies and market confidence. Raise EU debts only in exceptional circumstances. There is no need for a NextGenerationEU 2.0 or other common funds financed by EU debts on a regular basis. Prioritise making the best of the NGEU funds, which are still plentifully available. | Exercise caution in ECB actions to protect governments from a loss of market confidence. In cases where unsound national policies contribute to a loss of market confidence, the ECB should only intervene if the respective country agrees to an ESM programme with reform conditions (as is provided for by the Outright Monetary Transaction programme). | The SGP reform renders public debt sustainability more central to fiscal policy guidance. The European Commission should manage the SGP soundly and not make decisions influenced by political pressures. |
| **Project 3** | As a lender of last resort, the ESM has been sidelined in recent years because of allegations that it interfered unduly with national sovereignty. A pending ESM reform would change this and introduce an ESM programme without any reform conditions for countries with sound economic policies. All member states should ratify this reform. The new ESM programme could also be the key condition for the use of the TPI. | Use the democratically legitimised ESM to decide about the soundness of a member state's economic policies and thus its eligibility for the TPI. For euro states with sound economic policies, the ECB's TPI allows sovereign bond purchases to contain unwarranted interest rate hikes. | The SGP reform aims to change the pattern that governments often fail to build fiscal buffers in good times to avoid excessive spending cuts in bad times. New expenditure ceilings will be introduced that are derived from medium-term instead of short-term growth performance. National governments should heed these ceilings so that fiscal buffers can grow in good times. |

# Ensuring Financial Stability

**Fredrik N. G. Andersson and Lars Jonung**

Following the Great Financial Crisis of 2008–9, financial stability has emerged as an important policy priority in the EU. New tools for enhancing financial stability have been devised, alongside the establishment of new institutions: in particular, the European Systemic Risk Board was founded in 2010. The European Central Bank has assumed a major role in fostering financial stability. The current EU framework for safeguarding financial stability is built upon two main pillars: the evaluation of macroeconomic risks and the enactment of macroprudential stabilisation policies. These are coupled with enhanced oversight and assessment of micro-level risks and the conduct of individual financial institutions.

Despite notable improvements in the financial stability infrastructure since the Great Financial Crisis, potential vulnerabilities persist across three key dimensions: avoiding crises, preparing for crises and digitalising the financial system. Crisis avoidance is predicated on ensuring financial crises like that which commenced in 2008 never occur again. Therefore, it is crucial to place more emphasis on fostering economic growth, that is, aligning the EU's growth performance with that of leading high-income economies. Merely regulating the volume of credit cannot single-handedly limit all aggregate macroeconomic financial risks. Growth reform that spurs future growth is an essential, albeit indirect, measure to prevent future financial crises.

The Great Financial Crisis exposed significant vulnerabilities in the euro area's crisis preparedness, particularly the absence of mechanisms for coordinating fiscal policy and for sharing fiscal costs. However, coordinating and sharing fiscal responsibilities alone are inadequate to prevent a sovereign debt crisis from causing financial turmoil. Maintaining a low debt burden before a crisis is vital since this allows governments to substantially increase debt to bolster the financial system and the real economy during and immediately after the crisis. Effective crisis preparedness necessitates reducing euro-area debt in the near future to levels that can accommodate such significant increases without triggering a fiscal crisis. Current debt levels should thus be reduced to create sufficient fiscal space to successfully counteract a future financial crisis.

In the near future the financial system is poised for significant transformation driven by new digital technologies, including artificial intelligence. This development will introduce novel methods for assessing risks and investment opportunities, as well as new financial products. Actors such as Big Tech companies and new fintech companies will enter and transform the financial system to an extent unknown today. With this, new risks will emerge that require vigilant monitoring by financial regulators. For example, there may be a shift towards a financial system increasingly reliant on peer-to-peer and peer-to-business lending, where new as well as old financial institutions act as intermediaries.

| | Programme 1 | Programme 2 | Programme 3 |
|---|---|---|---|
| | **Avoiding crises** | **Preparing for crises** | **Digitalising the financial system** |
| **Project 1** | Ensure that regulation and supervision are adequate to handle the new landscape that has emerged through recent technological advancements and the growth of the fintech sector. The principle of 'same activity, same risk, same rules' must be applied to all EU regulatory and supervisory actions in these areas. | Ensure that current regulatory frameworks for crisis management, such as BRRD, are kept up to date with changes in the financial system brought about by technological advancements. | Ensure a robust implementation of existing supervisory mechanisms, including the Basel Accords, which set international standards for bank capital adequacy, stress testing and liquidity requirements. |
| **Project 2** | Deepen the EU's single market in capital. Move ahead with the consolidation of the EU's stock exchanges, clearing houses and national securities laws to unlock more liquid pools of capital. Growth reforms that spur future growth are an essential, albeit indirect, measure to prevent future financial crises. | Reduce current debt levels in the euro area to create fiscal space sufficient to successfully counteract a future financial crisis. The Maastricht budget criteria should remain the relevant guidelines in this regard. | Develop new EU-level mechanisms for managing risks in a financial system increasingly reliant on peer-to-peer and peer-to-business lending, where new as well as old financial institutions will function as intermediaries. |
| **Project 3** | All EU legislative proposals should be fully costed by an independent, non-partisan EPBO. This office would produce a cost estimate for every bill that is approved by a full committee of the Parliament. This tool would allow policymakers to avoid future budgetary crises more successfully. | Implement the framework for bank crisis management and national deposit guarantee schemes (the CMDI framework). The Banking Union aims to ensure that banks are robust and able to withstand any future financial crises. However, it remains incomplete, and this reduces the EU's crisis preparedness. | Coordinate EU and US regulation to create a level playing field and to bring into alignment the frameworks for competition and control on both sides of the Atlantic. The remit of the Trade and Technology Council should be expanded to include the digitalisation of the financial system. Financial regulation requires international cooperation. |

# Growth and Fairness

**Eoin Drea**

The social market economic model is not just about growth statistics, debt levels and employment figures. At its heart, it is about people. It is about guaranteeing equal opportunities for everyone. Free competition, free enterprise and wealth creation are balanced with a guarantee of solidarity with those members of society who cannot help themselves or who find themselves in need of additional support. This is a pragmatic approach which positions personal choice and responsibility as key guiding principles.

However, events since the Great Financial Crisis in 2008 have highlighted that economic uncertainty can feed feelings of exclusion and disillusionment. As levels of economic growth slow more and more, Europeans are feeling insecure about their economic prospects. Digitalisation, the casualisation of employment and the increased cost of living are all contributing to this feeling of precariousness. These are widely held feelings, notwithstanding historically low levels of unemployment across the EU.

Such worries are exacerbating societal divides, particularly between younger people and the older generations, who possess the majority of European wealth. Increasingly, the EU's climate change ambitions are also widening tensions between many rural and urban areas.

Growth and fairness have always been mainstays of the social market economic model. To ensure that these principles remain at the forefront of policymaking, it is essential that the EU reinvigorates the single market as the most important driver of jobs and growth in Europe. Critical to this process is placing the single market at the core of EU policymaking. The creation of a first vice-president of the Commission for the single market and trade would underpin the EU's competitiveness and growth agendas.

In addition, the social market economy model must be modernised to reflect the realities of working life for tens of millions of European families. Taxation on earned income must not act as an impediment to innovation, social mobility and self-improvement. Issues such as childcare, mental health support and access to basic social security protections are essential in increasingly flexible societies. Access to critical public services—such as health and education—must never be determined by geographic location.

Underlying a modernised social market economic model is the concept of tax fairness for all. In an increasingly globalised world, this will ensure that every global business contributes its fair share, regardless of size or domicile.

| | Programme 1 | Programme 2 | Programme 3 |
|---|---|---|---|
| | **Reinvigorating the single market, which drives jobs and growth** | **Making work pay** | **Developing an inclusive social market economic model** |
| **Project 1** | Merge the portfolios of the European Commissioners for the internal market and for trade, and reclassify this role as first vice-president of the Commission. This enlarged portfolio should be supported by a designated Directorate-General for the single market, which is the basis of the EU's global prominence. | Reduce the burden of national income taxes (by increasing the income levels at which higher income tax rates apply). Europe's middle-income workers are pessimistic about their future economic prospects. Reducing income taxes is important to allow them greater control over their financial well-being. Further expansion of the EU budget must not result in higher taxes on workers' incomes. | Develop a more ambitious EU strategy on mental health which specifically sets out cross-border measures to provide support, advice and treatment for citizens of all ages. This has become particularly pressing because digitalisation and the Covid-19 pandemic have brought about a huge increase in the number of Europeans suffering mental health issues. |
| **Project 2** | Restore competitiveness to ensure the future of the single market. Every new EU legal act, policy programme or strategy should undergo a comprehensive competitiveness check under the direction of the first vice-president for the single market and trade. This check must be carried out free from all political considerations. | Support national childcare models to give every type of European family the widest range of work–life balance options. The socio-economic benefits of affordable and accessible models of childcare are well established. They are drivers of social mobility, gender equality, economic growth and social inclusion, particularly in disadvantaged areas. | Establish an EU health and education corps to place professionals such as family doctors, teachers and community nurses in underserved rural areas. Such postings would be for a fixed period and in return for financial support for training. Rural areas are Europe's heartlands. Yet, many of them are suffering a shortage of basic public services, including health and education professionals. |
| **Project 3** | Ensure that every new legislative initiative is accompanied by a detailed regulatory impact assessment, verified by the Regulatory Scrutiny Board. This assessment must be updated (as required) across all EU institutions. | Lead the development of a business tax system in Europe which ensures every company contributes its fair share, regardless of size or domicile. This is essential for social fairness. Support and expedite the ongoing OECD process in this area on a global level. | The lack of access to affordable, secure, long-term housing is worsening divisions in society, reducing social mobility and widening the wealth gap between generations. It is also a key factor fuelling young people's disenchantment with politics. While housing policy must remain a national competence, the EIB should significantly expand its existing social and affordable housing financing programmes. |

# Own Resources

**Alain Lamassoure**

The discrepancy between the responsibilities conferred upon the EU and its financial means has for too long been the black hole of the European debate. Treaty after treaty, crisis after crisis, the EU has grown into a formidable normative power. Worried by this development, experts from other continents lament the 'Brussels effect', whereby Europe's competitors might be forced to adopt the same standards, thus making the European model contagious.

And still, inexplicably, this giant has not only feet made of clay but tiny ones: like a giant sequoia with bonsai roots. For the last 30 years the common EU budget has been stuck at 1% of EU gross national income. As a result, the ambitions of the European Council have long been murkily funded by a tangle of various new intergovernmental funds that have escaped parliamentary control, resounding commitments deprived of specific timetables, the reselling of previous grandiloquent announcements, and often by inextricable blends of grants, loans, guarantees and promises.

In 2020 the great disruption by the virus-driven crisis was a game-changer. The European Recovery Programme, five times higher than the annual budget, was funded by European borrowing and fresh EU own resources to be specified at a later date. This programme was announced as being an exceptional response, and it was meant to save national budgets from a once-in-century crisis, not to fund EU policies. But a short while later the war in Ukraine intervened, with the prospect of a further, up-ending enlargement of the EU, while global warming was getting worse. As a result, the gap between the sum of European commitments and the EU budget level has become abysmal and politically unaffordable.

Therefore, the time has come for a complete overhaul of the system, based on simple, clear and democratic principles. In particular, there are three principles which are at the core of the European People's Party philosophy.

The first is that of democratic consistency: European decisions taken democratically must be funded democratically by European resources. The second is the principle of subsidiarity. It means that every public task must be entrusted at the most relevant level, not the lowest or the highest. Thus devised, the EU budget must not be a burden for national finances but rather represent a more efficient transfer of national tasks and costs to the EU level. The last is the principle of constancy. Whatever the choice in the distribution of roles, the transfer of competences and means to another level should not result in an increase in overall spending or overall taxation: all other things being equal, Europe must be built on constant costs.

| | Programme 1 | Programme 2 | Programme 3 |
|---|---|---|---|
| | **Ensuring democratic consistency** | **Implementing real subsidiarity: EU policy = EU funding** | **Ensuring constancy and debt optimisation** |
| **Project 1** | Measure *ex ante* net savings made at the national level in return for new action at the EU level. No European agencies should be created without comparing the advantages and costs of action at the national or European level. | Adopt a fully transparent and democratic budget procedure: 'no taxation without representation' at the EU level. | Harmonise the key concepts and rules of public accounting in the EU to secure transparency and fairness between member states. |
| **Project 2** | Transfer national staff and financial means to the EU in line with transferred competences. | Create new EU own resources linked to the single market and EU competences: a value-added tax, an ETS and other 'green' taxes, and harmonised profit taxes that fully apply to multinational digital companies. | Reserve all projects financed by European loans for member states and guarantee such projects by means of existing taxes. As long as these guarantees are not established, every member state incorporates its share of the common debt in its national debt. |
| **Project 3** | Supervision of spending by national parliaments and European Parliament, along with the national and European Courts of Auditors (including controlling existing duplications in procedures, red tape and staff). | Compensate for every tax rise or additional financial expenditure by a reduction in another tax or at another level. | Only policies that generate measurable financial, economic or environmental profits and that are duly specified in the MFF should qualify for EU borrowing. |

# Public Sector Reform

Adriaan Schout

The quality of our public sectors at the national and EU levels is a cornerstone of debt sustainability. It has an impact on the confidence of financial markets, economic growth, the ease of doing business and the quality of the rule of law (broadly defined). Moreover, it determines whether countries can deliver on EU agreements and maintain the confidence of other member states.

The public sector is continuously being reformed as new challenges emerge and as lessons are learned when new policies are implemented. These reforms are susceptible to prevailing trends. They have to be maintained so that quality standards are not sacrificed due to day-to-day socio-economic pressures or current fashions. Good governance requires stability—which, in turn, needs to be safeguarded by dedicated policy units and procedures at all levels of government. Complaints about 'bureaucracy' or 'too much regulation' miss the point that it is quality that matters.

The EU needs to prioritise the quality of institutions as an area of mutual concern with member states. The quality of the EU's multilevel public sector is influenced by the cultures of the member states. Here lies one of the EU's sensitive dilemmas: there is not merely one set of public sector practices. Rather than agreeing common quality standards and mutual control, the EU Treaties assume loyal cooperation from the member states and underline the respect for existing public-sector traditions.

As we move towards 75 years of European integration and cooperation, the question that needs to be addressed is, what level of common standards for member states can be set and supervised? Essential generic standards include transparency, and the independence of information gathering and monitoring. These requirements create national ownership and public respect for (EU) policy.

Distinctions between the reform of the national public sectors and that of their European level counterpart raises a typical EU dilemma: reforming the public sector at EU level alone is bound to have a limited effect.

Impact assessments and the implementation and enforcement of EU policies cannot be carried out by the member states on their own. It is necessary to have European networks and independent European management agencies that can work out both EU policies and procedures for independent inspections.

| | Programme 1 | Programme 2 | Programme 3 |
|---|---|---|---|
| | **Building on the EU level: themes & experience** | **Developing multilevel interdependence** | **Establishing national-level preconditions** |
| **Project 1** | Focus during the next Commission on core themes, including transparency, impact assessments and the role of EU agencies. In 2026 it will be 25 years since the White Paper *European Governance* was published after the fall of the Santer Commission. | The themes in the 2001 White Paper also demand parallel reconsiderations at the national level, e.g. what is the state of transparency at the national level and how have independent agencies been accepted at the national level? A quick look at the EU semester and the functioning of the EU budget indicates that major gaps persist at the national level. Yet, much progress has been achieved in other areas. It is high time for cross-sectoral learning. | Develop and then make public a ranking of EU and national budgets based on the quality of spending. National reforms affect the functioning of the EU. In particular, it is important that the quality of spending, at both the EU and national levels, is understood. |
| **Project 2** | Re-examine the level of harmonisation with a view to allowing the member states more flexibility. Similarly, demands for new EU funds should acknowledge that limited fiscal space is left at the Union level. | Develop economic convergence, which is a key requirement for the sustainability of EMU. Some countries have had persistent problems with convergence; others have performed remarkably well. Yet, new worries over convergence have arisen since some countries are sliding back while others need to move beyond catch-up growth. The next Commission should carefully select the national institutions whose quality needs to prioritised to ensure economic growth. | The material available displays wide differences in the quality of legislation at the national levels. This raises questions about the ability of national institutions to supervise the quality of national legislation (from impact assessments to quality control). The next Commission should add a general assessment of the quality of legislation to broaden awareness at national level. |
| **Project 3** | Give priority to enforcement, the required institution of checks and balances, and the delineation of appropriate roles for the Commission. These areas have been neglected for a long time. | Expand and strengthen the powers of the ECA and especially of its national counterparts to ensure that EU financial failures have meaningful consequences. EU spending as a shared responsibility has been the object of 25 years of frustration. Many reports by the ECA, among others, have pointed out the weaknesses in EU spending. | Subject deregulation to regular scrutiny. Some member states have had active deregulation policies. In light of new (EU) commitments, the viability of national quality needs to be revisited and experience gained from deregulation should be discussed. |

# About the Authors

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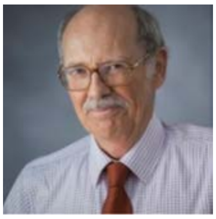

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**Adriaan Schout** is a Senior Research Fellow at Clingendael. His work combines research and consultancy on European governance questions for national and European institutions. He has worked on projects addressing issues relating to the EU Presidency, EU integration and improving EU regulation, amongst others. Prior to joining Clingendael, he served as an independent expert in the field of EU governance for the European Economic and Social Committee and for the European Commission's Directorate-General for Research. He is an Honorary Fellow of the Centre for Social and Economic Research on the Global Environment at the University of East Anglia, UK. He graduated from Groningen with a master's degree in Economics and completed his Ph.D. in Political Science at Leiden University.

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