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Fiscal policy coordination: a necessary step for the Eurozone recovery

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On January 21st, 2015, the austerity-based monetary regime of the Eurozone (EZ) was officially abandoned as the European Central Bank (ECB) launched its Quantitative Easing (QE) programme of sovereign bond purchases on secondary markets. The European Court of Justice's attorney general has certified that the QE programme is not in breach of EZ Treaties, but it certainly challenges the established interpretation regarding the latitude of the ECB's room for manoeuvre within its mandate. In November 2014 the newly appointed European Commission launched an investment programme, the most significant impact of which is the message that, in principle, there can be a common pool of resources for governments to spend off the books of the Excessive Deficit Procedure. Also, the "flexibility" issue - raised by Italy and France regarding the timing and extent of application of the fiscal-compact rules on public deficit and public debt reduction - is no longer taboo, with a few steps in that direction. And, of course, a major political change took place in Greece that is affecting the whole of Europe.

These seeds of regime shift emerge from the overwhelming pressure of economic, social and political crises all across Europe, a widening divergence of policy strategies with major partners and official institutions outside the EZ, and the rapid decline in support for the austerity doctrine from leading academic schools outside the "German block".

Is the European austerity doctrine dead, and can we forget about it? Not quite. We all understand that a fast boost to economic activity in the EZ cannot only come from QE plus sparse domestic fiscal stimuli, given the narrow fiscal room for manoeuvre to which each government is constrained by the Fiscal Compact or, indeed, by investors. As argued by President Draghi at Jackson Hole, the path towards a satisfactory recovery in the EZ can only be initiated by *fiscal and monetary coordination at EZ level*, and this fiscal stimulus can only be *coordinated across countries via Brussels*. This view calls into question the design of the EZ's economic governance, of which the austerity doctrine remains one of the pillars.

What can, and should, genuine reformers do? As in any high politics operation, a unique combination of vision, determination and brinkmanship is needed. First, genuine reformers should nurture mutual trust making clear that the proposed reform to will not be a tricky system of bypassing fiscal responsibilities, sovereignty limitations, and economic reforms that are necessary to live and prosper in Europe and in the euro. Second, the "democratic deficit" of European institutions at large should be taken very seriously: fiscal policy cannot and should not be delegated to technocratic entities or to pseudo-fixed rules. Fully fledged political and fiscal federalism can be shown to Pareto-dominate other institutional arrangements in a monetary union with labour mobility and asymmetric shocks.[1] However, under current political constraints, the United States of Europe may well be a mirage, capable of entrapping the EZ in a dangerous *status quo*. What is urgently needed is an *effective system of protection and stabilization against large economic and financial boom-bust cycles* skilfully articulated at the national and super national levels along the following lines.

1. Complete redesign of the fiscal regulation system: a) substitution of the “country-by-country” approach with a system oriented towards coordination of fiscal policies; b) removal of the apparatus of fixed rules imposed on fiscal budgets,in favour of direct monitoring of the long-term sustainability of public debt; c) flexibility of long-term fiscal plans in relation to the business cycle, domestically and EU-wide, under peer monitoring and coordination; d) transfer of a few national fiscal competences (e.g. supranational infrastructural investments, automatic stabilizers, such as unemployment benefits) to the Union’s budget, under the control of the European Parliament. This may be the germ of a real fiscal union.

2. Institution of a newly conceived “Ecofin 2.0”, a board of national fiscal authorities with a clear mandate to implement the new fiscal rules and coordinate EU-wide fiscal policy with a view to stabilising the aggregate business cycle *vis-à-vis* the monetary policy stance of the ECB. The board should also have a clear and transparent agenda and a system of majority voting. This does not guarantee that the divergent policy interests of the German block with the rest of the EZ will be overcome, but that, as happened with the ECB architecture, negotiations will be not be predetermined under the shield of fixed rules and alternative views stand a chance of being heard or acted upon.

3. Realignment of the ECB statutes and scope of competences in line with those of standard central banks in developed countries (remove prohibitions that are not enforceable when they may endanger the stability of the system).

Last but not least, genuine reformers will need the credible determination to present all other players with a clear-cut alternative: either a serious reform is begun here and now, with all the necessary ingredients, those which the *South* dislikes as well as those which the *North* dislikes, or everyone will have to take their own share of responsibility for saying ‘No’ to genuine European economic and monetary union.

[1] Baglioni A., Boitani A., Bordignon M. (2015), “Labor Mobility and Fiscal Policy in a Currency Union”, *CESifo Working Paper No. 5159*, January 2015