Towards a progressive EMU fiscal governance

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Overview

- Background
- Current fiscal governance – main shortcomings
- Our 4 general principles for the next EMU fiscal governance reform
  - A much more active and prominent role for fiscal policy
  - “Safer” government bonds
  - More and better coordination to foster sustainable wellbeing; between
    - Fiscal and other economic, social and environmental policies
    - Member states
  - More democratic participation and scrutiny
- Outlook
Background

- TUREC in Brussels (September 2017): scenario of a major Economic Governance reform before European Elections
- Some catchphrases: six- & two-pack, flexibility, Completing EMU, eurozone Budget, European Semester, SDGs, zero interest rates, Eurobonds
- Idea of a progressive intervention, focused on fiscal policy fostering sustainable wellbeing instead of austerity
- General principles to cover the increasing number of reform proposals;
- for each principle, however, we include examples of how to address these principles, ranging from fundamental to pragmatic proposals
Fiscal policy: main tool to foster well-being

Magic Polygon of well-being oriented economic policy

- fairly distributed material well-being
- quality of life
- financial stability
- price stability
- full employment and decent jobs
- ecological sustainability
- stable public sector activity
- balanced external economic relations

Current fiscal governance – main shortcomings

- Restrictive and pro-cyclical fiscal rules (although possibility for national monetary and exchange rate policy is lost in EMU)
- Carrot and stick principle to cut public spending and restrict national policies via financial markets
- Further restrictions on national economic policy by European Semester focused on structural reforms, structural tax competition, etc.
- Hardly any attempt to coordinate national policies to achieve certain aggregate EMU outcomes (like an expansive fiscal stance)
- Few opportunities for democratic participation and scrutiny (especially in the Eurogroup)
Principle 1: a much more active and prominent role for fiscal policy

- National fiscal policies matter -> enable them to perform their role
- The scope is threefold:
  - there should be more leeway to strengthen economic and social stabilisation, especially in times of crisis
  - public investment should be given preference (for example by a golden rule of public investment)
  - leeway to tackle asymmetries (e.g. by an EMU fiscal capacity for public investment and common goods, financed by common resources)
- Ambitious reform would replace fiscal rules by standards, such as coordinated prudent economic policy not detrimental to other countries
public investment: the need for the golden rule

Net public investment (in % of GDP)

Source: European Commission (Nov. 2019).
# Short-term options for more fiscal leeway

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<thead>
<tr>
<th>Goal</th>
<th>Measures</th>
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<tbody>
<tr>
<td>Cyclical stabilisation (ex ante)</td>
<td>(1) implement better methods of cyclical adjustment</td>
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<td>(2) use a realistic fiscal multiplier in budgetary analysis <em>ex ante</em>, especially for public investment</td>
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<td>Cyclical stabilisation (ex post in crisis)</td>
<td>(3) increase flexibility for cyclical conditions</td>
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<td>(4) use the exception ‘in case of a severe economic downturn’</td>
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<td>(5) use balanced-budget-multiplier</td>
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<td>(6) create a euro area stabilisation instrument</td>
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<td>Strengthening public investment</td>
<td>(7) allow for temporary investment programmes (similar to EFSI)</td>
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<td>(8) interpret certain temporary investment programmes as ‘structural reforms’</td>
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Principle 2: “Safer” government bonds

- EMU member states should be able again to issue safe sovereign bonds (at an interest rate below the rate of growth)
- Public debt guaranteed by the ECB should be restricted to countries agreeing to submit their economic policies to a coordination process, which should always reach an agreement
- Threat: discussed obligation for banks to consider gov. bonds as risky
- Pragmatic step: minimum safety net (via ECB and ESM)
Principle 3: more and better coordination

- Good fiscal policy is part of a broader multi-level governance framework aiming for overarching goals like wellbeing or sustainable progress.
- From a macroeconomic point of view, priority for aggregate demand.
- Coordination processes as the European Semester should aim at them.
- Fiscal policy must be treated functional within this framework.
- Tax harmonisation is needed to stabilise public revenues.
- An integrated scoreboard of economic, social and environmental indicators within a reformed Eu. Semester might be a first pragmatic step.
Principle 4: democratic participation & scrutiny

- ‘democratic conditionality’ for further reforms: parliamentary control
- Some kind of EMU parliament co-deciding on all aspects of euro-zone economic decision-making
- Positions of each minister within the Eurogroup should be made public
- A more transparent Eurogroup Working Group
- Serious instead of current formal involvement of social partners
- No predominant status of fiscal rules
Outlook: fiscal governance reforms ahead?

- While the Commission (and the ‘economic mainstream’) has become more open to progressive reforms, the ‘Hanseatic League’ is blocking.

- Six- and Two-Pack review scheduled for January could reopen the debate.

- Likely result: Better but still restrictive reformed fiscal rules, more leeway for ‘green public investment’, a stronger role for the European Parliament (& Social Partners?) on an informal basis and more progressive narratives (SDGs, Wellbeing Economy, Social Pillar) within the European Semester.

- The announced ‘Conference on the Future of Europe’ and the ‘European Green Deal’ as opportunities for further progressive reforms?