RETHINKING THE POLICYMAKING IN THE EMU: THE INSTITUTIONAL SOCIAL RESPONSIBILITY AND THE FISCAL REFORM ACT
Matteo Laruffa, LUISS Guido Carli University

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Abstract

The purpose of this paper is to answer to the following research questions: How has European economic governance changed during the years of crisis (2007-2013)? What is the impact of constrained government budgets and their automatic mechanisms of policy-making?

The first part of the paper describes the effects of the reforms of the European fiscal discipline implemented to date. It analyses the institutional design of the European economic governance, the principles of the European Semester, the trade-off between rules and politics, their effects on social responsibilities of the EU, and political participation/representation. Part two discusses four main paradoxes of the current model of governance and their impact on effectiveness of policies, conditions of democracy, well-being of person (in terms of socio-economic conditions and political rights), and equality of member states. The third part challenges the quantitative parameters of finance in the Fiscal Compact and lays out some proposals to move towards a different governance which does not tie the hands of policy-makers unconditionally. Finally, the last part of the paper illustrates some proposals for improving the quality of the model of governance with the Fiscal Reform act and a new policy analysis model based on the principles of the Institutional social responsibility. The conclusion summarizes some analytical indications concerning the consequences of the reforms on the European democracies in terms of representation, political rights, policy effectiveness, and social contract.

KEYWORDS: European economic governance, Fiscal Reform Act, Institutional social responsibility

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Introduction

Almost all the advanced countries of the world have strengthened their economic performances in the last years and some of them launched equality-oriented policies in order to better connect their citizens to the benefits of growth. However, for reasons that this paper will discuss, the European economy has not yet seen a significant recovery. Important resources - including the labor market - remain underutilized and human capital goes to waste. In this way, the entire society, not only the economy, discovers itself ever poorer and less capable to build a future of shared prosperity.

The long depression of the European economy reveals a number of weaknesses in the institutional design and the burden of problems that are not just cyclical, but rather structural. After having analyzed the effects of the fiscal rules approved in order to thwart the crisis, it is time to reflect on whether the EMU (Economic Monetary Union) is on the right track and if the European economy is on a more stable footing.

Even if the measures adopted until today contained the catastrophic domino effect of the economic downturn, the current fiscal discipline, mainly reshaped during the crisis, is revealing itself as the catalyst of stagnation. The new fiscal discipline was established under a narrow vision of the function and the role that fiscal policy can play in order to launch an effective anti-crisis strategy, guide the economy towards recovery, and promote sustainable growth.

The crisis teaches us that today the principle “without reform, there can be no recovery” has the same importance for both the Member States and the EMU as a whole. As recently said by Guntram B. Wolff and André Sapir: “Problem solving in a monetary union cannot only be about putting one’s house in order; it must also be about putting the common house in order.” The paper offers a pragmatic interpretation of the fiscal rules of the EMU so as to set out an alternative model of economic governance which can keep the economy in a healthy growth rate. We should treasure Tommaso Padoa-Schioppa’s advice when he said: “The Union is a dynamic process which is not completed yet. And it does need to be completed.”

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3 Padoa-Schioppa Tommaso, Speech to the National Assembly of the Republic of Serbia, Belgrade, 16 December 2009.
This research will be useful not only as a theoretical exercise, but also in order to consider measures to help the EMU to flourish again.

1. The flaw in the European responses to the crisis

The euro crisis was triggered by two dynamics both related to countries specific aspects and the EMU institutional structure. Firstly, the doubts about fiscal sustainability of the Member States due to the original ineffective common discipline which would have taken deficit and debt trajectories under control. Indeed, the decision-making process established by the Stability and Growth Pact (SGP) did not prevent the deterioration of national public finances: “Clearly, the rule-based framework for fiscal policy created by the Excessive Deficit Procedure and the Stability and Growth Pact was insufficient to prevent a debt crisis despite its emphasis on keeping public sector deficits low and strengthening forward-looking budgetary planning.”

Secondly, the risks of financial instability and sovereign-bank interdependence within the Eurozone. According to Silvia Merler and Jean Pisani-Ferry: “the strong interdependence between banking and sovereign crisis has emerged as a salient feature of Euro area crisis.”

The impact of the financial crisis on the banking sector forced some governments to act in order to avoid the collapse of the financial system with different policy interventions whose costs increased the already high levels of deficit and debt. These critical dynamics compromised the economic performance of those Member States where a gradual long-term erosion of competitiveness continued since the end of the Nineties, with structurally low growth in a downward economic spiral. Interests rates for many governments bonds soon became unsustainable and, since these bonds were held by other European countries and their banks, uncertainty and instability extended to the EU as a whole.

At the end of the Nineties, the capacity of the EMU to withstand negative macroeconomic and financial shocks was already identified as a major challenge for the success of the Euro. The financial crisis was considered by Martin Feldstein “a severe test of the Euro’s ability to survive than any that it faced during its first ten years.

In early 2010, it became clear that “the Economic and Monetary Union lacked the appropriate institutional structures, procedures, rules, and instruments to effectively face the sovereign debt crisis.” Indeed, the crisis struck at a time when the EU was in “an incomplete stage of its construction” said Tommaso Padoa-Schioppa. The financial panic and the large and persistent downturn of the European economy showed some specific structural problems of the EMU as a model of governance without effective crisis management systems.

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Erik Jones, Dan Kelemen, and Sophie Meunier propose a failing forward argument to explain how the European integration proceeds in order to describe the effect of the intergovernmental bargaining which forces Member States with diverse preferences to settle on lowest common denominator solutions. Therefore, the condition of incompleteness allows that the forces of the crisis could unleash all the unresolved problems of the European economic governance.10

Particularly noteworthy is the fact that the limits imposed by the Fiscal Compact on national public finances have been approved in a framework which is inadequate to avoid the negative counterproductive effects that – rebus sic stantibus – the fiscal consolidation can produce in time of crisis on the economic recovery, the sustainability of public finances and standards of social cohesion. The adoption of this type of fiscal rules happened in a model of economic governance that is still lacking of a central budget for common countercyclical action and a common fiscal policy.

Because of the absence of a European fiscal policy which could substitute the empty space left by the national public investments and expenditures, the procyclical fiscal policies adopted by a large number of Member States have had negative effects on the EU as a whole.11

The balanced budget rule approved by almost all the Member States, the new centralized automatic mechanisms of policymaking and strengthened corrective procedures in cases of excessive deficit and debt, have forced governments to procyclical expenditure cuts in the pursuit of consolidation, although in times of crisis and without any common fiscal intervention, which could counterbalance the effects of national restrictive policies in an economic slowdown.

At the same time, in the existing model of economic governance, monetary policy alone cannot organically face the actual situation of crisis by ensuring the necessary stabilization. Cœuré Benoît clarifies “if inefficiencies are high and the economy adjusts more slowly, fiscal policies need to be more expansionary.”12

With reference to the substantial effects of fiscal policy, in his analysis on fiscal measures and the crisis, David Romer showed that: “when monetary policy does not respond, conventional fiscal stimulus is effective.”13

The following sections provide a brief overview of the reforms of the fiscal discipline of the EMU, with more emphasis on the new fiscal discipline of the EMU, the effects of austerity and the risks of long term stagnation.

**The fiscal discipline of the EMU**

In addressing the situation, some institutional innovations and reforms of the EMU’s rules have been introduced so as to achieve a stronger fiscal discipline, with the aim to limit the risks of a model of governance characterized by ineffective enforcement mechanism of fiscal discipline, incomplete financial integration, and ambiguous fiscal-monetary policy mix. In this framework, the European

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10 Erik Jones, R. Daniel Kelemen, Sophie Meunier, Failing Forward? The Euro Crisis and the Incomplete Nature of European Integration, Comparative Political Studies December, 2015.


12 Cœuré Benoît, Lamfalussy was right: independence and interdependence in a monetary union, at Lamfalussy Lecture Conference organised by Magyar Nemzeti Bank in Budapest, 2 February 2015.

Central Bank maintained and respected its mandate in the commitment to save the single currency, even if its policy-decisions faced two large obstacles: ineffective fiscal discipline and financial crisis. The period 2010-2014 represents a phase of unprecedented institutional changes, which reshaped both the old convergence criteria adopted in Maastricht and their procedures (art 104.1, TFEU), in order to strengthen the control over national fiscal and budgetary policies at the supranational level. The European economic governance has been reformed many times by the EU Legislation and rules adopted by Member States outside the EU Law. These reforms have reduced the discretionary capacities of policy-making of Member States and considerably increased the formulation, guidance and monitoring functions of the EU institutions with reference to fiscal policies and national budgets. Following the early literature on the institutionalisation of the EU and a more focused approach based on historical institutionalism, this phase of reform has been interpreted by some scholars as a new critical juncture of the European integration or as a step change, which establishes new institutional structures and affects the future for considerable time to come in terms of political strategies, outcomes and preferences.

The reform of the European economic governance started with the adoption of the following legislative packages, more known as Six Pack (November 2011), which codified and institutionalized the European Semester:

- Regulation (EU) No 1173/2011: on the effective enforcement of budgetary surveillance in the Euro area, which imposes sanctions in the form of interest-bearing deposits or non-interest-bearing deposits for significant divergences of the budgetary position;
- Regulation (EU) No 1174/2011: on the conferral of new powers to the Council of the EU in order to guarantee the effective correction of excessive macroeconomic imbalances in the Euro area;
- Regulation (EU) No 1175/2011: on the strengthening of the multilateral surveillance of budgetary positions and economic policies in order to prevent excessive government deficits. The Regulation provides that the Commission and the Council assess and monitor the implementation of national stability or convergence programs;
- Regulation (EU) No 1176/2011: it sets up an alert mechanism in order to facilitate preemptive identification of imbalances and give to the Commission new powers of surveillance over Member States’ corrective action plans;

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These rules work together with those ones of the Treaty on Stability, Coordination and Governance (TSCG), also called Fiscal Compact, which entered into force on 1 January 2013 as an international self-standing legal framework super-imposed on the EU law. The Fiscal Compact restores a new common rule-based fiscal discipline for 25 Member States with the following institutional innovations and rules:

- A new balanced-budget rule has been incorporated into national law: The rule states that structural budget deficits may not exceed 0.5% of GDP for states with a debt-to-GDP ratio exceeding 60%, or at most 1.0% of GDP for states with debt levels within the limit of the 60%.
- It requires the implementation of budget limits in the national legal systems by writing them into laws and constitutions. If significant deviations are observed from the balanced-budget rule, correction mechanisms are triggered automatically. Finally, the European Court of Justice has the power to verify the incorporation of this rule into national laws;
- Reinforced excessive deficit procedure for Euro area Member States: If the European Commission observes that a country has exceeded maximum reference value for the excessive deficit procedure, the euro country will adopt the European Commission’s proposals and recommendations unless a qualified majority of euro countries - not including the country concerned - are opposed. At the same time, the Treaty establishes that “Such correction mechanism shall fully respect the prerogatives of national Parliaments.” (art. 2, TSCG);
- New conditions for financial assistance: Countries will be eligible for financial assistance from the European Stability Mechanism only if they have ratified the Fiscal Compact.

The Fiscal Compact emerges among the reforms of the European economic governance as a turning point in the evolution of the EMU. Hughes Hallett and Svend Jensen in 2012 emphasized why fiscal rules embodied in the Stability and Growth Pact did not effectively promote the aim of sustainable public finances. While, according to Jeffrey Frankel carefully noted that the final aim of the Fiscal Compact was “to fix Europe’s long-term fiscal problem, which since the date of the Euro’s inception has been evident in the failure of the Stability and Growth Pact.”

In May 2013, the common budgetary timeline has been strengthened and the Commission’s powers of ex-ante examination of draft budgets have been increased by two legislatives acts, usually called Two Pack, which completed that phase of reform of the economic governance. The Two Pack (Regulation (EU) No 473/2013, Regulation (EU) No 472/2013) provides new rules for ex-ante surveillance procedures by the Commission on national budgets of the Euro area Member States.

Marco Buti and Nicolas Carnot observed that this last reform would tighten further the links between the European Semester and national processes underpinning finance laws within the EMU.

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The current European Semester is the integration of the rules of these three reforms into a single cycle of coordination and control of Member States’ fiscal policies and national budgets. As Francesco Costamagna suggests, these legislative interventions and the principles enshrined in the Fiscal Compact complete the European Semester, they improve its functions, reorder different strains of EU policy surveillance and enforcement mechanisms into a single institutional process.\textsuperscript{20} Today, the European Semester is a yearly cycle of budgetary, macro-economic and structural policy coordination, aimed at ensuring the consistency between national fiscal policies of Member States. Under the firm conviction that the Eurozone cannot afford to come back to imprudent fiscal policies, these rules establish a “more intrusive central fiscal surveillance regime”\textsuperscript{21} based on the dual principle of national fiscal responsibility and centralized coordination of policy-making processes.

**The procedures of the European semester**

The current process involves the key role of the following institutional actors: national governments, European Commission, Council of the EU, European Council and European Parliament. The functions of each institution are here listed in a chronological order as established by the European Semester.

The role of national governments is limited to the functions:
- to prepare and submit National Reform Programs and Stability and Convergence Programs to the Commission (April);
- to prepare and submit to the Commission draft budgetary plans (October);
- to adequate their draft budgetary plans to the opinions presented by the European Commission in order to comply with the obligations of the Stability and Growth Pact (November);
- to submit the draft budgetary plans to national parliaments (November).

The main functions of the European Commission are:
- to develop the Annual Growth Survey (in January);
- to propose country-specific recommendations (CSRs), assess National Reform Programs and budgetary policies presented by national governments (May, June);
- to control over the compliance of draft budgetary plans with the Stability and Growth Pact, and prepare opinions on the draft budgetary plans (November).

The Council of the EU discusses the Commission’s opinions on draft budgets (December). It adopts Euro area recommendations and the country specific recommendations (July). The European Council endorses the final Country Specific Recommendations (July).

The role of the European Parliament is limited to discuss the Annual Growth Survey by the European Commission (in January and February).

The European Commission has more power than the other institutional actors in this decision-making process, because it assesses national policies as a technical institution, indicates the necessary


\textsuperscript{21} Schlosser Pierre, The expansion of fiscal surveillance in EMU: an actor-centric analysis, European University Institute, paper presented at the conference “Five Years of Crisis - Lessons Learned and Paths towards a Resilient European Monetary Union” at the University of Trier, 9-10 October 2014, p. 2.
corrections in form of recommendations for national governments and sends them to the Council, which formally adopts them, and to the European Council, which endorses them.

According to the current rules of the economic governance of the EMU, all the Euro Member States have to take the necessary measures to comply with the indications proposed by the European Commission. The only hypothesis where one of the Euro member state can avoid the European Commission’s opinion on budgetary plans is if the Council of the EU allows it with a reverse qualified majority voting procedure. Otherwise, as established by the Fiscal Compact (Art. 8) a new and stronger enforcement mechanism will impose the “necessary measures” to the Member State:

ARTICLE 8

1. The European Commission is invited to present in due time to the Contracting Parties a report on the provisions adopted by each of them in compliance with Article 3(2). If the European Commission, after having given the Contracting Party concerned the opportunity to submit its observations, concludes in its report that such Contracting Party has failed to comply with Article 3(2), the matter will be brought to the Court of Justice of the European Union by one or more Contracting Parties. Where a Contracting Party considers, independently of the Commission’s report, that another Contracting Party has failed to comply with Article 3(2), it may also bring the matter to the Court of Justice. In both cases, the judgment of the Court of Justice shall be binding on the parties to the proceedings, which shall take the necessary measures to comply with the judgment within a period to be decided by the Court of Justice.

The adoption of national debt brakes in the form of a balanced-budget rule, an ex-ante coordination of Member States’ budgetary and fiscal policies, new policy-making processes and automatic correction mechanisms of national public finances have placed more emphasis on the expenditure control which allowed the emergence of a centralized institutional process based on the role of the European Commission. Its functions have been enlarged to those ones of formulation and evaluation of fiscal policies and control over national budgets. For example, the European Semester provides that national governments present their draft budgets to the European Commission every year, before the text is debated and approved by national parliaments. As established by ART. 7 (2) of the Regulation EU No 473/2013: “The Commission has three weeks to ask for changes in the national budgets.”

Michael W. Bauer and Stefan Becker noted that “as the rules for Member States are growing ever stricter, the EU’s executive plays a pivotal role in enforcing them. While its agenda-setting power has been curbed during the crisis, it continues to formulate policy, and more importantly its role in implementation has grown substantially. It now covers a much broader scope of policies and is, in some cases, equipped with stronger competences.”

Before the introduction of the European Semester, the policy-making involved more the national institutions than the European ones. The fiscal policy-making process has been radically changed in both the formulation of fiscal policy and the adoption of annual budget. Even the nature of the process has been changed, because the introduction of the European Semester moved the decision-making

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process from the national level to the European level of governance and radically restricted the role of national parliament.

Under the current European rules there is not one single government which can reject the measures that the European Commission describes in the opinions on draft budgets and in the country specific recommendations. According to Bieber Roland, the common denominator of those acts is a reduction of Member States’ competence in matter of general economic policy and a resulting transfer to the European Union. In a few words, in the new economic governance “the top down control over fiscal policies has vertically expanded from the EMU level, in a feedback loop, to the domestic level.”

**Fiscal consolidation**

Even if the final aim of fiscal consolidation, as enshrined in the Fiscal Compact, is to help the Member States to put “out of control” budgets on a pace of adjustment and to secure their medium and long-term sustainability. Many doubts emerged about these new rules and their effects. Some experts criticized the fiscal targets as not realistic for many countries and argue that the slow or negative growth could re-ignite the financial instability.

The austerity measures adopted by every Member State had an external impact on the other States with negative effects on growth resulting from domestic fiscal consolidation can be exacerbated when several countries consolidate simultaneously.

With reference to the transmission mechanisms of the external effects of domestic fiscal consolidation policies, the researches by Shafik Hebous and Tom Zimmerman give us important analytical indications about the impact on domestic output resulting from fiscal contractions in foreign countries. Their results explain that the European Member States show significant reactions to foreign fiscal consolidation actions and “these cross-border effects of fiscal consolidation become significant after the EMU.”

Moreover, it has been observed that “when all countries consolidate simultaneously, the drag on domestic growth is stronger than if a country consolidates alone.”

Therefore, the effects on other Member States are due to the lower domestic activity and demand, which can reduce the demand for foreign goods.

As expected by some experts, the collective austerity hampered growth and investment in the Eurozone as a whole, thus making compliance with fiscal rules even harder. Stefan Collignon wrote:

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24 Schlosser Pierre, The expansion of fiscal surveillance in EMU: an actor-centric analysis, European University Institute, paper presented at the conference “Five Years of Crisis - Lessons Learned and Paths towards a Resilient European Monetary Union” at the University of Trier, 2014, p. 30.
29 *Ivi.*
“The focus on imposing fiscal consolidation and balanced structural deficits on each and every Member State prevents the Euro area from using fiscal policy as a proper policy tool, by which aggregate demand is efficiently adapted to the potential growth path of euro area output. As a consequence, aggregate demand is not sufficient to stimulate investment and return GDP to pre-crisis levels.”

Since 2010, European countries have implemented restrictive fiscal policies in order to reduce budget deficits, with highly negative fiscal impulses. From 2011 to 2013 fiscal policy in the Eurozone was pro-cyclical, while in 2014 fiscal policy was flat and did not counteract the continuing deterioration of the economy. As the Independent Annual Growth Survey 2016 states, the recovery is weak and reduction of unemployment is too low: “At the current pace of reduction, the 2007 pre-crisis rate of unemployment would not be reached again before 2022.”

There is a wide consensus on the risks of a long term stagnation for the Eurozone. Particularly noteworthy is the scenario offered by the OECD in the report “Escaping the Stagnation Trap: Policy Options for the Euro Area and Japan.”

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<th>Escaping the Stagnation Trap: Policy Options for the Euro Area and Japan (OECD, 2015)</th>
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<td>“the Euro area’s GDP per capita is not expected to reach back its 2007 level before 2017 at the earliest.”</td>
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<td>“In the area as a whole, the crisis-related hit to potential output has been significant and the fall in the neutral interest rate implies that the decline in interest rates to close to zero may not be giving sufficient stimulus. Actual and potential growth dynamics have been mediocre and slack remains large, especially in labour markets. Investment and confidence are low and intra-EU trade remains very weak. The stagnation features have been particularly strong in the vulnerable countries.”</td>
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This is clearer if we compare the EMU and the United States. GDP per head is still below its 2007 level in the EMU, whereas the US economy has undergone a significant recovery.

Indeed, the comparison with non-EU economies raises the question on the endogenous factors, which contribute to the weakness of the economy of the Eurozone in particular.

The combination of unconventional monetary policies, financial backstops, new budgetary rules and national structural reforms has not been enough to conduct the EU to a new cycle of growth. In the perspective of a secular stagnation, budgetary constraints can trigger a vicious circle where weak demand undermines potential growth (e.g. via a deterioration of the capital stock, structural unemployment and higher inequality) and weak potential growth further reduces demand (e.g. by discouraging capacity-expanding investment). As explained by Hansen Alvin ten years after the outset of the Great Depression: “This is the essence of secular stagnation – sick recoveries which die

33 OECD, Escaping the stagnation trap: policy options for the Euro Area and Japan, January 2015, p. 5.
34 Ibid.
37 OECD, Escaping the stagnation trap: policy options for the Euro Area and Japan, January 2015, p. 2.
in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable core of unemployment.38
This suggests that one of the main problems of the European economic governance lies in its fiscal framework which reveals itself completely ineffective in facing the three main challenges of the European economy: high debt, high unemployment and weak growth.

Even if the European Commission approved the investment plan for Europe, in order to unlock additional investment over three years, its effects is still weak. The so-called Junker plan seems too limited and not enough for an economic system which suffers from an investment gap estimated at around €200-300 billion per year.39 This perspective is more troubling if the Junker plan is compared with the American Recovery and Reinvestment Act adopted by the Obama administration in 2009, which injected more than $800 billion into the US economy until 2013.
Finally, poor economic performances have a strong and negative social impact. With reference to the social conditions of the European Member States, it might be useful to summarize some of the key findings of the Social Justice in the EU - Index Report 2015.40

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<th>Social Justice in the EU – Index Report 2015</th>
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<td>Nearly one-quarter of EU citizens (24.6%) are currently regarded as being at-risk-of poverty or social exclusion (approximately 122 million people)</td>
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<td>The gap between the northern European countries and the crisis-battered southern European countries remains enormous</td>
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<tr>
<td>While the EU-wide share of children at-risk-of poverty or social exclusion has increased since 2007, the share of older people at-risk-of poverty or social exclusion declined in the same period</td>
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Hence the necessity to analyze in depth the existing fiscal discipline so as to identify its problems and to outline some proposals for a growth-oriented economic governance. A simple analysis of the current fiscal discipline is necessary in order to explain why the EMU’s future is fraught with risks and uncertainty.

2. The unresolved problems of the European fiscal discipline

This section describes how these reforms directly changed the policy priorities of the EMU and its decision-making. On the one hand, the policy goals are now based on a primary aim, namely fiscal consolidation, with specific priorities (i.e. deficit and debt ceilings) and universal targets in terms of quantitative criteria. On the other hand, the new decision-making processes are less discretionary, because of new automatisms, and more technical, due to the growing powers of independent

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institutions. With knowledge on these aspects, it should be fairly easy to identify the unresolved problems of the European fiscal discipline.

Quantitative parameters for deficit and debt ceilings

For the sake of brevity, the next paragraphs elaborate the following argument: that the fiscal discipline is more focused on quantitative parameters with strong negative effects in terms of the efficacy of fiscal policies. In this perspective, the main aim of these paragraphs is to catch the core element of the current fiscal rules: an approach founded on deficit and debt ceilings without any other policy priorities. The European fiscal discipline revealed the paradoxical nature of an approach only aimed to fiscal consolidation, which does not consider other aspects of the economy, which are related to growth and unemployment:

- Universal quantitative parameters do not consider “that there is no “one-size-fits-all” optimal austerity program: the higher is the accumulated level of debt, the less aggressive the optimal program should be (in terms of both the debt target to reach and timing)”\(^4\)\(^1\) and, as demonstrated by the OECD, within a fiscal framework based on a quantitative approach “inappropriate fiscal rules, such as simple balanced budget rules, can be destabilizing.”\(^4\)\(^2\)
- These rules do not consider the essential relations between fiscal policy, economic fluctuations, long term economic trends and social changes. The fiscal discipline of the EMU represents an economic constitution with the pretension to bind the European economic governance to automatic mechanisms of fiscal correction made by specific “quantitative” budget limits and prearranged timing, which ignores the socio-economic transformations. Rules cannot crystallize the institutions and their actions, nor they can force them to follow the same policy priorities and quantitative parameters indifferently from the changes that occur in the European society and its economy.
- Basically, a given fiscal strategy that works today could not exactly work in a different framework of socio-economic variables tomorrow. For example, rules for fiscal consolidation are effective during periods of growth but they do not work in periods of crisis, when they can worsen the economic performance and have high negative social effects. Furthermore, recent theoretical explanations support that “when the shocks are persistent, the ex-ante optimal rule is no longer sequentially optimal.”\(^4\)\(^3\) This means that rules will be always imperfect, because not all circumstances that affect public finances can be anticipated or predicted by them. At the same time, the preferences of the current policymakers would no longer coincide with those of the European society in the future. Therefore, an economic constitution should not bind future generations to a particular approach to the economy without room for flexibility.

\(^4\) Battaglini Marco, Political Economy of Debt and Growth, Department of Economics, Princeton University, December 2014, p. 33.
\(^4\) OECD, Counter-cyclical economic policy, OECD Economics Department Policy Notes, No. 1, May 2010, p. 3.
• The current European fiscal discipline is not able to achieve the basic functions of the fiscal policy aimed to avoid economic fluctuations and to promote economic stability with measures for growth and development. Pursuing fiscal consolidation in a phase of economic crisis means reducing growth, a reduction of the GDP reduces government revenue, hence it can increase the deficit and the debt-to-GDP ratios continue to rise. In this way, if adopted in a time of crisis, the overall results of measures for fiscal consolidation instead of reducing deficits and debts may lead to the opposite result. According to Olivier Blanchard: “Those forces pulling growth down in advanced economies are fiscal consolidation and a still-weak financial system.”44 On the one hand, austerity cannot be applied in a recession without triggering a downward growth spiral. On the other hand, historical evidence show that the most effective way to cut deficits is “to combine deficit reduction with rapid economic growth, which generates more revenue.”45

• The common fiscal rules created strong pro-cyclical effects46 and did not limit or shorten the economic downturn. Indeed, the attempt to reduce discretion in the policymaking processes related to fiscal policy has prevented that the fiscal policy could play the role of pivotal element of macroeconomic stability.

These factors have been particularly relevant in the measures adopted for the crisis in Greece and Portugal. As the IMF stresses: “for both Greece and Portugal, the nominal deficit ceiling was frequently revised in the course of the program, often in tandem with GDP, which contracted more than anticipated. The latter was tantamount to disallowing the operation of automatic stabilizers, thus aggravating the procyclicality of the fiscal stance, which in turn widened the nominal deficit and exacerbated the contraction—a self-defeating approach, much like the case of a dog chasing its own tail.”47 In the words used in the IMF’s paper: “From this perspective, program implementation was in some instances harmful to growth and, as a corollary, inimical to debt sustainability.”48 In a few words, there is a danger of a self-reinforcing process and vicious cycle.

**Governance of rules**

There are at least three relevant aspects related to the design of procedures, fiscal rules and their impact on the resilience of the institutions:

1. the Treaty on Stability, Coordination and Governance offers an example of legally binding rules which allow strong and weak states to regularize their asymmetric relations in the Union;

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44 Blanchard Olivier, in World Economic Outlook, International Monetary Fund, October 2012, p. XVI.
48 Ivi.
2. Detailed rules have several problems, because given bounded rationality and the pervasive uncertainty in which institutions operate, they can never construct rules that anticipate every contingency;

3. Uncertainty makes precision less desirable as well as less attainable.

If it is true, the first consequence of the new decision-making processes is that, although rules should avoid arbitrary exercise of political power, they should not limit the use of discretionary power. That is to say, rules cannot undermine the capacities, functions and powers of the institutions to cope with surprises and disturbances through forward-looking policy-making. In order to deal with an unknown future, it might be better to have not less but rather more alternative policy responses and to improve the resilience of an institutional system rather than limit it with automatisms that can paralyze the institutions. As recently noted by the Independent Evaluation Office of the International Monetary Fund (2016), with reference to the lessons from the crisis management adopted for the Greek crisis in 2010: “Program design must factor in uncertainty regarding both data and economic knowledge and staff should be encouraged to produce policy analyses based on a range of alternative assumptions.”

In this process of reform new implementation tasks have been conferred to the European Commission in order to exercise an ex-ante and ex-post control on public finances based on simple quantitative indicators for decisions concerning public expenditure. The reduction of discretion at the national level with stronger budgetary rules, and the emergence of new automatisms in the policy-making at the supranational level, reflect an approach “intended to promote fiscal discipline by “tying the hands” of policy makers in order to constrain decisions about spending and revenue programs.”

This evolution of the European economic governance is the result of the growing importance given to ordoliberalism, as the school of economic thought which has shaped the fiscal reforms of these years: “the strengthening of the rules on public deficits and their sanctioning are indications of a strong influence on the EU decision-makers stemming from an ordoliberal configuration of thought.”

With reference to the influence of ordoliberalism over the European economic governance, Sebastian Dullien and Ulrike Guérot explain that “ordoliberalism opposes intervention into the normal course of the economy. For example, it rejects the use of expansionary fiscal and monetary policies to stabilize the business cycle in a recession.” Under the conviction that these rules could substitute new institutions with full powers and a justified room for manoeuvre, whatever type of countercyclical fiscal policy has been limited, with significant negative social consequences and effects on the economic performances. In effect, the evolution of the rules adopted for the reform of the fiscal discipline of the EMU created an erosion of the discretion of sovereign powers trough rigid rules and quantitative parameters, ex-ante conditionality and timing.

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In their model of economic policy, the Nobel laureate Thomas Sargent and Neil Wallace consider that monetary policy should obey to a simple rule, because “such a rule has the happy characteristic that in any given set of circumstances, the optimal setting for policy is unique.” Following the academic debate over the years, the same conclusion is not appropriate for the fiscal policy. Simply put, the policy that is optimal today cannot be optimal tomorrow. For example, the Nobel laureate Christopher Sims explains that “under the current rules none of the Member States in the EMU can make the kind of expansionary fiscal commitment needed to exit a liquidity trap.” Therefore, the fiscal rules of the EMU can limit, rather than improve, the crisis management capacity of the institutions, both at the national and supranational level. The effects of this new limits to the institutional capacity of governments can engender a growing political crisis in terms of lack of trust and legitimation. According to Jurgen Habermas (1975): “If governmental crisis management fails, it lags behind programmatic demands that it has placed on itself. The penalty for this failure is withdrawal of legitimation. Thus, the scope for action contracts precisely at those moments in which it needs to be drastically expanded.”

The uncertain and risky environment requires institutional agility and flexibility. For example, flexibility cannot be fully eliminated and it is desirable in many cases, as – for example – to accommodate exogenous shocks with automatic stabilizers. Flexibility is desirable and sometimes essential in order to engage in legitimate countercyclical policies which pursued policy priorities at the service of citizens: “Fiscal rules cannot substitute for political will, which means that public understanding of and support for the rules are critical. In other words, legitimacy of the rules is key to success.”

This model of governance has crystallized both the decision making and the capacity of the EU in many policy issues (for example fiscal and budgetary policies) by establishing a governance insensitive to people’s problems due to the supremacy of rules over politics. Following the same policy priorities and quantitative parameters -indifferently from the changes that occur in the European society and its economy - this institutional stasis creates a problem concerning both the functioning of the European governance and the quality of the European democracy. As Fritz W. Scharpf (2011) highlights, the crisis has undermined the economic and fiscal viability of some EMU Member States and frustrated political demands and expectations to an extent that may yet transform the economic crisis into a crisis of democratic legitimation.

As Wolfgang Streeck stresses, there is a serious difficulty for member states in mediating and find a balance between fiscal consolidation imperatives and social responsibility of their policies and institutional actions. The parameters of fiscal consolidation introduced in the years of the economic crisis clash with citizens’ rights. Recently, he denounced the non-economic deficits existing in the EU, which are related to its political and social dimension. According to Streeck there is not simply

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a democratic deficit but also a deficit of social-sensitivity due to the conflict between a “technocratic
hubris” and the decision-making processes concerning the economic governance. The EU lives in a
condition of prisoner of its own wrong and arbitrarily set up of fiscal target.58

The unresolved problems of the fiscal discipline of the EMU

This rule-based approach to the policy-making has negative effects on the legitimacy of the decisions,
but also on the economic, social and political conditions of the EU. Finally, there is a negative impact
also on the integration process. It has been possible to identify five main paradoxes created by the
reforms of the complex set of rules, policies and institutional practices that constitute the economic
governance of the EMU:

1. policy paradox: flexible decision-making process and discretionary powers are the preconditions
for a resilient model of governance. They create the institutional capacity to approve different
economic policies for different socio-economic circumstances and cope with both external and
internal changes. That is to say that the institutions can deal with unexpected problems. As established
by the Fiscal Compact, the new rules put an end to the possibility of autonomous national fiscal
policies and force them under automatic mechanisms for fiscal consolidation in order to balance the
budget. Hence, they do not consider specific policy decisions for growth and employment. It should
be considered that: “Fiscal rules cannot substitute for political will, which means that public
understanding of and support for the rules are critical. In other words, legitimacy of the rules is key
to success.”59

With reference to the effect on the integration process, these reforms did not introduce a higher level
of convergence. Indeed, higher convergence depends not on the processes but on the outcomes of the
processes. As already mentioned before, this quantitative approach does not consider that there is no
“one-size-fits-all” optimal economic program for different countries. The Independent Annual
Growth Survey 2016 a negative scenario: “EA aggregate public debt would decrease to 65% GDP in
2035 but country specific evolutions are diverse. Some countries (Germany, Ireland, Portugal) are
overshooting the 60% ratio, suggesting that they have some fiscal space, whereas others (France,
Italy, Spain, Belgium) do need further fiscal consolidation to bring their debt to GDP ratio back to
60%.”60

The new European fiscal discipline prescribes not just same priorities for the policymaking, but also
tools and strategies of the policies to be adopted by Member States. The data in terms of sustainability
of public finances (public debt/GDP) show how this dual approach, which considers both objectives
and tools for Member States’ budgets, is undermining the convergence between Member States,

58 Wolfgang Streeck The Rise of the European Consolidation State MPIfG Discussion Paper 15/1 Max-Planck-Institut
für Gesellschaftsforschung, 2015.
59 Bergman Michael, Hutchison Michael M. and Svend E. Hougard Jensen, Do Sound Public Finances Require Fiscal
Rules or is Market Pressure Enough?, European Commission Directorate - General for Economic and Financial Affairs,
European Economy, Economic Papers 489, p. 6.
rather than improving it. Different socio-economic conditions between Member States, requires not similar, but different policies for achieving the same policy goal.

2. economic paradox: fiscal consolidation can reduce growth and worsen the economic performance, make the objectives of sound public finances unrealistic and unfeasible, carry negative social impact and compromise future horizons of development. It means that the current fiscal framework reflects the illusion that it is possible to face the challenges of high unemployment and high debt without growth-promoting policies. That is to say that the European leaders who adopted these rules did not consider that weak demand undermines potential growth (e.g. via a deterioration of the capital stock, structural unemployment and higher inequality) and weak potential growth further reduces demand. In some Member States this rule-based approach can create a vicious cycle. As expected by some experts, the collective austerity hampered growth and investment in the Eurozone as a whole, thus making compliance with fiscal rules even harder. It is an increase in the level of GDP and revenue that allows governments to avoid to resort to ever higher level of deficit. Public finances will never be sustainable without economic growth. If the EU needs rules for its fiscal policies, they should prioritize growth, because growth contributes to budget sustainability in whatever economic conditions (also when there is high debt and deficit). Contrary to the features of the current fiscal discipline, the design of fiscal rules should be “based on asymmetric behavior along the cycle.” Moreover, these rules can create problems also in good times, because they prevent high but responsible levels of deficits and debt also when the economic growth allows to the Member States to pay back high level of debt. Therefore, they impose dramatic restrictions during periods of crisis and unjustified restrictions during periods of growth.

3. social paradox: As enshrined in Article 3.3 of the Treaty on EU, among the Union’s objectives there are those ones of “a highly competitive social market economy, aiming at full employment and social progress.” It also establishes that the EU “shall combat social exclusion and discrimination, and shall promote social justice and protection.”

While, under article 9 of the Treaty on the Functioning of the EU: “In defining and implementing its policies and activities, the Union shall take into account requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion.” Finally, as the Court of Justice recognizes in a number of recent rulings grouped in the Laval/Viking jurisprudence, the Union “has not only an economic but a social purpose.” Henceforth, there are specific duties of the EU related to full employment and social progress which cannot be ignored. On the one hand, the policymaking of the EU should take into account the objectives of high level of employment, adequate social protection and the fight against social

61 OECD, Escaping the stagnation trap: policy options for the Euro Area and Japan, January 2015, p. 2.
63 Strawczynski Michel, Optimal design of new generation Fiscal Rules: coping with the business cycle and discretionary tax reductions, Hebrew University of Jerusalem, September 2014, p. 5.
65 Ivi.
66 Ivi.
67 European Court of Justice, Case C-438/05 Viking line, 2007, and Case C-341/05 Laval un Partneri, 2007.
exclusion and inequalities. On the other hand, this fiscal discipline may have a strong negative impact on unemployment, because “fiscal retrenchment amid weak private demand would lead to chronically high unemployment”68 and “there has been widespread and growing concern that measures designed to lift economies out of recession were failing, not only to fulfill their primary goal, i.e. contribute to economic recovery, and damaging rights which have been recognized as inalienable and which should not have been limited by financial arguments.”69

Nevertheless, as recently reported: “The mainstream response to failing economies was cuts in spending and savings in budgets. With areas such as pensions, healthcare and education, which were eating up to 70% of GDP in some countries, these areas were the first ones to be affected by emerging politics of austerity.”70 The fiscal discipline and its budgetary rules should orient the economic policies to the socio-economic responsibilities of the EU at the service of necessities of citizens. On the contrary, until today: “the policies imposed in the crisis countries have been growth reducing and socially unjust.”71 Under the current circumstances, a fiscal discipline shaped by quantitative rules of budget constraints does not allow the use of fiscal policy as an active instrument for pursuing specific socio-economic responsibilities of the European Union.

As Franco Gallo highlights “at present, social and fiscal policies appears to have stagnated, leaving a disappointing record in terms of concrete results.”72 The finalité économique related to the control on deficit and debt of Member States cannot be pursued against the finalité sociale related to social cohesion and employment. The overriding concern is for the social responsibilities of the European Union and its Member States. The current fiscal discipline cannot responsibly offer a solution to the high social and economic costs that millions of Europeans are paying due to the policy mistakes of austerity measures. Finally, the first social policy in times of crisis is aimed at provide effective solidarity in terms of vertical equity, which implies unequal treatment of people in different ranks. It is the criteria which policy-makers should follow in order to do more for helping people who have less, while today the European measures and policies consider solidarity a help based on conditionality. In a few words, the European solidarity asks to those people who have less, to make more sacrifices. Commenting the political consequences of this status-quo, Stefan Collignon affirms: “The policy framework in the euro area is therefore inefficient in welfare terms. In the long run, this inefficiency will undermine the legitimacy of European integration.”73

4. political paradox: Under the new fiscal discipline, the European institutions are less responsive to citizens' interests because there has not been a parallel increase of citizens’ participation in the decision-making processes, in order to balance the centralization of powers of control and coordination: “the 6 Pack, the Fiscal Compact and the Two Pack, have proven to be key legislative

68 Sachs Jeffrey D., Paul Krugman and the Obama Recovery, Project Syndicate, 5 January 2015.
70 Ibidem, p.11.
72 Gallo Franco, Social Justice and Fiscal Justice with the prospect of Completion of European Unification, Altiero Spinelli Lecture, Centro Studi sul Federalismo, Torino, 12 December 2013, p. 7.
steps in the reinforcement, expansion and vertical institutionalization of a fiscal surveillance regime in Europe.”

These policy-making processes are not competence of a representative political institutions with a direct responsibility to the citizens. For example, “the ‘reverse majority’ leaves the problem of ‘unenforceable’ fiscal rules unresolved for large Member States and re-enforces the democratic deficit unless the role of the European Parliament is significantly strengthened.”

The process of reform has substituted the democratic policymaking of representative political institutions into a bureaucratic machinery made by automatisms of rules and supervisions of technical independent institutions. These processes reduce the role of representative politics, the accountability and participation to the decision-making of the European economic governance and made the institutions less responsible to the citizens. Issues of accountability and transparency raised with reference to the crisis management mechanisms developed and used until today.

It is still unresolved the question that Jacques Delors defines as that one of “the tensions between government by rules, and government by politics.” There is a control exercised by rules over the European citizens rather than a control by the European citizens over rules and policies. Hence, these reforms impose a de facto limit to the political rights of citizens. In a few words, there is a pre-electoral definition of policy goals and a pre-political surveillance of policy-making. Indeed, the current model of governance is not legitimate in front of the constituencies and it does not meet one of the basic principles of democracy, which is the right of citizens to contribute to the decision-making process of institutions. Kai Guthmann and Klaus Armingeon (2014) describe this pre-electoral definition of policy as follows: “these policies have only rarely been the outcome of domestic democratic procedures of will-formation and decision-making (in fact, they have been in the UK and some considerable extent also Latvia, which explains part of the conundrum), but were imposed on national political systems by external actors and developments.”

This paradox is more relevant if we consider the notion of legitimacy as reconceptualised by Sandra Kröger and Richard Bellamy (2016), which uses the explanation of two-level game proposed by Putnam (1998). Namely, following Kröger and Bellamy’s reconceptualization: “the legitimacy of EU level decisions rests on their satisfying the normative logic of a two-level game whereby they must be acceptable not just to the contracting national executives but also to the respective demoi they claim to represent. From this perspective, negotiators must treat each other with mutual respect as representatives of their citizens; appreciating that the legitimacy of their decisions depends on their retaining the on-going, democratic support of all their different peoples.”

Adopting the above-

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74 Schlosser Pierre, The expansion of fiscal surveillance in EMU: an actor-centric analysis, European University Institute, paper presented at the conference “Five Years of Crisis - Lessons Learned and Paths towards a Resilient European Monetary Union”, University of Trier, 9-10 October 2014, p. 30.
75 Aiginger K., Cramme O., Ederer S., Liddle R., Thillaye R., Reconciling the short and the long run: governance reforms to solve the crisis and beyond; European Policy Brief No. 1, 2012, p. 4.
80 Sandra Kröger and Richard Bellamy, Beyond a Constraining Dissensus: The Role of National Parliaments in Domesticating and Normalising the Politicization of European Integration, 2016, p. 5.
mentioned concept of legitimacy of EU level decisions, as based on the normative logic of a two-level game, this analysis offers an alternative perspective to what has been argued by Scharpf (2003) about the legitimacy of the EU system, which is based on output legitimacy (i.e. through the benefits provided by the common policies) rather than through input legitimacy (i.e. through the election of the decision makers).\textsuperscript{81} Indeed, it does not depend just on the outcomes of the EU institutions, but it basically depends on the role of “representative institutions” in the decision-making processes at every level of governance. Accordingly, the legitimacy of EU level decisions, depends on a dual standard: “These decisions must reflect the consent of each of the demos to whom they apply and they must not undermine the capacity for those demos to give or withdraw that consent.”\textsuperscript{82}

5. institutional paradox: In order to manage the euro crisis, the European economic governance has been radically reformed with unprecedented institutional mechanisms, which represent an unexpected political development of the European integration after the Lisbon Treaty. Although this first shift from national to supranational level of decision making might be seen a step forward in the process of integration, as the progressive Europeanization of governing functions, the main features of this shift create negative consequences for the conditions of the European integration and its democracies. The crux of the matter is not the direction towards a more integrated model of governance, rather than how this phase of the integration happened. Indeed, the reforms of the economic governance of the EMU entail the transition of powers from political to independent-technical institutions. That is to say, less accountability and responsiveness of the decision making. Moreover, functions, powers and roles of institutions, both nationals and supranational, have been transformed by a new equilibrium between politics and rules in favour of the latter. It implies less discretion and legitimacy of decision making. Finally, the last political development of the European integration is moving the EMU towards a model of governance which reflects the condition of unbalanced system of powers where the principle of equality of the Member States is not fully respected. In a few words, the new status quo resembles the passage from the condition of equality of Member States to the condition of supremacy of a small group of states, with more substantial powers for the latter. The institutional paradox explains also the crisis of democracy in many European countries. As said by Guthmann and Armingeon (2014): “Citizens should have realized that their democratic institutions were no longer able to effectively formulate their own economic and social policies, and this ought to have led them to withdraw their support from a clearly under-performing political system.”\textsuperscript{83}

3. Repairing and completing the fiscal discipline

If the first parts of the paper explain the reforms of the European economic governance and its main paradoxes, the last part illustrates how to reform the fiscal rules of the EMU in order to overcome the crisis and reorient its policy-making to growth and social priorities. The decision to support a policy

\textsuperscript{81} Fritz W. Scharpf, Problem-Solving Effectiveness and Democratic Accountability in the EU, MPIfG Working Paper 03/1, Max Planck Institute for the Study of Societies, 2003.

\textsuperscript{82} Sandra Kröger and Richard Bellamy, Beyond a Constraining Dissensus: The Role of National Parliaments in Domesticating and Normalising the Politicization of European Integration, 2016, p. 8.

of prioritizing the consolidation rather than growth, during the deepest recession after the 1929-33 crises, reflects the absence of a long run perspective for the EU and a myopic approach to the economic challenge.

The root of problems in the European economic governance lies in the institutional arrangements of the common fiscal discipline. As Guntram Wolff and André Sapir affirm “the Euro area has two features that have been particularly responsible for the crisis and for the difficulty of resolving it: major economic (and also political and social) differences between countries resulting in some cases in failed policies, and the euro area’s inadequate economic governance.”\(^{84}\)

The European economy will be subject to a structural vulnerability until when the common fiscal discipline will not be reformed. With reference to this issue, Joseph Stiglitz argues that: “What Europe needs more than structural reform within member countries is reform of the structure of the Eurozone itself, and a reversal of austerity policies, which have failed time and again to reignite economic growth. Those who thought that the euro could not survive have been repeatedly proven wrong. But the critics have been right about one thing: unless the structure of the Eurozone is reformed, and austerity reversed, Europe will not recover.”\(^{85}\)

**The Fiscal Reform Act**

In order to change the fiscal discipline of the EMU, this paper describes the proposal of the Fiscal Reform Act. It should complete the automatic mechanism of policymaking already provided by the fiscal rules established during the crisis, which do not consider pro-growth measures. The proposal is based on a pragmatic approach to the institutional development of new functions, powers and functions of models of governance. Indeed, the literature is mainly focused on theoretical and formal aspects, without considering that the distance between theory and practice is not always so short, and that rules cannot predict everything.

The Fiscal Reform Act should establish a dual mandate of fiscal discipline in order to re-orient the European economic governance towards two taxonomies of policy objectives:

- Higher Employment-to-population ratio: policies to reach sustainable recovery and return to normal output in time of economic crisis. The European institutions should be responsible for approving and financing policies to overcome prolonged recessions and reduce unemployment. These policies require the gradual formation of a central budget of the EMU, which the European institutions would be able to use it autonomously from Member States. In 1969 Peter Kenen already affirmed that a monetary union required a fiscal capability to support Member States when they experience economic downturns.\(^{86}\) These European policies of intervention (EPI) would be proposed and implemented by the Commission with the approval by the European Parliament. The final aim of the European policies would be to overcome prolonged recessions and reduce unemployment.

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85 Stiglitz Joseph, Europe's economic madness cannot continue, Project Syndicate, 8 January 2015.
Lower Debt-to-GDP ratio: measures to reach a sustainable consolidation for dealing with high public debt in time of economic growth. When the rate of economic growth and employment-to-population indicate scenarios of long-term progress, national measures should be implemented by Member States in order to reduce their debts. The final aim of the national policies of consolidation (NPC) is the creation of strategies for minimizing deficits and reducing more debt.

The institutional innovations for the EPI would improve the crisis management capacities of the EMU, and both the effectiveness and legitimacy of its economic policies with a direct involvement of the European Parliament as the only representative institutions that can monitor over the measures implemented by the Commission. At the same time, the debate between the Commission and the Parliament, would eventually be the first true political dynamic which can resemble the idea of a political union.

The proposal of the Fiscal Reform Act is inspired by Nicholas Kaldor (1978), when he commented the perspective of the EMU by saying: “It requires the creation of a Community Government and Parliament which takes over the responsibility for at least the major part of the expenditure now provided by national governments.”87 According to Kaldor: “The Community’s present plan on the other hand is like the house which “divided against itself cannot stand”. Monetary union and Community control over budgets will prevent a member country from pursuing full employment policies on its own-from taking steps to offset any sharp decline in the level of its production and employment, but without the benefit of a strong Community government which would shield its inhabitants from its worst consequences.”88

This forward looking fiscal guidance can offer a wide range of alternatives of policy-making under the principle of the symmetry over the cycle of the economic policies. As the IMF notes, one of the lessons from the euro crisis experience is that both “in the design of the scale and time-path of the fiscal adjustment it is necessary to avoid insofar as possible an excessively procyclical stance.”89

Under the Fiscal Reform Act, there would be a different model of governance, which gives to policy-makers the room for manoeuvre to decide beyond the trade-off between output growth and fiscal stability: “on one hand, they would like to implement measures to increase output and employment, but on the other hand, the deterioration of public finances forces them to stick to fixed rules.”90

The “policy switch” can determine which of the two mechanisms of policy-making should be used in order to realize the appropriate fiscal policy within a medium term budget framework. The automatic policy switch can ensure the necessary trade-off between commitment and flexibility in a dynamic self-control setting so as to improve the conduct of fiscal policies throughout the cycle by enforcing tighter policies in good times and providing additional leeway for cushioning downturns with the transition from an automatic policy-making to a resilient policy-making.

With the adoption of the Fiscal Reform Act, the European institutions and the Member States can work out of the limits of fiscal consolidation with the aim to stimulate a genuine growth during economic slowdown. As argued by the OECD (2016): “The application of the EU Stability and Growth Pact should be modified to allow for a more supportive fiscal stance, for example by

90 Bianchi Carluccio, Menegatti Mario, Rules versus Discretion in Fiscal Policy, Quaderni di Dipartimento, Università degli studi di Pavia, July 2007.
excluding net investment spending from fiscal rules and more generally developing a coherent approach for using discretion in applying fiscal rules.”

Therefore, fiscal consolidation for sound public finances should not be excluded from the European economic governance – and the principle of sound public finances “as a credible commitment to medium-term consolidation should be part of any serious counteracting fiscal policy programme” – but it can be pursued in time of growth without risks of negative socio-economic consequences. These pro-growth rules can be seen as the other half of the current fiscal regime which is mainly made by the provisions of the Treaty on Stability, Coordination and Governance and does not contemplate alternative priorities or fiscal policy objectives for the recovery during crises. Even if the traditional neoclassical growth model does not consider fiscal policy as able to impact on the long-term growth rate of the economy: “several extensions of the neoclassical growth theory have considered public expenditure and taxation as playing a crucial role in determining long-term economic growth. Moreover, government expenditure in public infrastructure and in research and development are also important factors for growth.”

Hence, the necessity to consider reasonable public expenditure essential to growth. With growth, high-debt States can reduce it and those States with a high growth rate can avoid to get into debt. It means to put forward, in the long-term perspective, the commitment of consolidation already started at the beginning of the sovereign debt crisis. At the same time, it means to establish a common fiscal policy for the Eurozone which should seek to strike an adequate balance between tackling historically-high debt levels and supporting the economic recovery. The two objectives of recovery and consolidation can coexist and the full realization of one of them does not compromise the other. A new fiscal policy framework requires not only a credible commitment to long-run debt sustainability and specific counter-cyclical instruments, but it needs also an institution supporting these aims for the primary objectives of reinvigorating growth and boosting job creation. It is important to have a clear institutional framework which governs the interaction between the two mechanisms of policy-making and a more complete discipline with social goals. This is also claimed by Daniel Schraad-Tischler in the Social Justice in the EU - Index Report 2015: “Both member-state and the EU-level policymakers must take seriously the fact that more social justice can promote growth. In recent years, a number of studies on this issue (e.g. OECD 2015, Ostry et al. 2014) have found that increasing levels of inequality in incomes and opportunities have a negative impact on long-term economic growth. The EU therefore needs an integrated long-term strategy that supports this potential positive-sum relationship. In the future, it will be important that – as announced by the new Commission – social indicators be given a greater weight in the context of macroeconomic-coordination processes at the European level.”

They are also crucial for the future and should not be cynically considered as a waste of money, because its returns are not immediately tangible as in the case of investments in infrastructures, but they can significantly contribute to growth. Social policies impact on competitiveness and represent a long-term investment. A recent study by the OECD (2014) shows “income inequality has a sizeable

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and statistically significant negative impact on growth, and that redistributive policies achieving greater equality in disposable income has no adverse growth consequences. Moreover, it suggests that it is inequality at the bottom of the distribution that hampers growth. Additional analysis based on OECD PIAAC data suggests that one key channel through which inequality negatively affects economic performance is through lowering investment opportunities (particularly in education) of the poorer segments of the population.°95

Hence the active social policies can contrast inequalities and stop their negative impact on growth. This is particularly noteworthy in the current conditions of the EU: “in most European Union countries, per capita GDP is less than it was before the crisis. A lost half-decade is quickly turning into a whole one. Behind the cold statistics, lives are being ruined, dreams are being dashed, and families are falling apart (or not being formed) as stagnation - depression in some places - runs on year after year.”°96 Specific margin of flexibility, even if under a central control over fiscal policies, can help the European economic governance to face negative economic trends in a framework characterized by uncertainty: “Deciding the appropriate policy in the face of an economic disturbance is complicated by pervasive uncertainties. Uncertainties may concern the structure of the economy and the nature of the shocks hitting the economy as well as how policy choices affect the economy.”°97

In line with these proposals, the budgetary and fiscal rule-based setup in the Eurozone needs a political institution, namely a representative and legitimized one, to help to make a step forward in the integration process with an evolution from a complex set of rules, policies and procedures of automatic control, to an institution which can work within its mandate with a room for manoeuvre for extraordinary socio-economic circumstances and the exercise of the specific function to take fiscal policy decisions. In order to ensure both legitimacy and accountability of its actions, it ought to be strictly accountable to an elected body. The involvement of the European Parliament can solve the lack of democratic legitimacy of the current governance, which delegates budget discipline to automatic mechanisms of policy-making, and put these automatisms under the control of a representative political institution. The EU needs a new institutional order based on a more effective involvement of citizens into the decision-making process on the firm conviction that “public discussion is a vehicle of social change and economic progress.”°98

The adoption of the above exposed proposals can achieve the organization of the fiscal-monetary policy mix that was already indicated in 2003 by the first President of the European Central Bank, Willem F. Duisenberg: “Monetary policy-makers should be responsible for price stability and fiscal policy-makers should keep public finances sound with a view to providing the best contribution to enlarging the growth potential of the economy.”°99

The introduction of the Fiscal Reform Act can represent another step toward the complete realization of the long-run process of institution building of the EMU and the adoption of economic policies which promote the social responsibilities of the EU. According to the former President of the Italian Republic, Carlo A. Ciampi: “The aim of European Union institution-building should be to make

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°96 Stiglitz Joseph, Europe’s economic madness cannot continue, Project Syndicate, 8 January 2015.
°97 OECD, Counter-cyclical economic policy, OECD Economics Department Policy Notes, No. 1, May 2010, p. 2.
available the entire panoply of instruments for governing the economy, whether budgetary, revenue-related or those linked to tangible and intangible elements. Europe needs to foster an economic governance capable of promoting income growth, a more equitable distribution thereof and better employment opportunities.”

The Institutional Social Responsibility

The root of these problems seems to be the lack of any criteria of social responsibility at any level of the policymaking related to the economic decisions. The theoretical bases of this idea of filling the gap of the economic discipline and the policymaking are basically expressed in the following argument: “Because improving the lives of individuals is the primary goal of social policy, the goals here are a priori political goods, unlike the goals of economic policy.” Accordingly, the crux of the matter here is not if the economic policy has an effect on the social dimension, but which effect to expect the economic policy would produce on the social dimension. This example of an existing model of economic governance demonstrates that institutions, politicians and policymakers usually decide economic policies as these policies would be part of a bubble keeping their effects out of the life of the people, the social welfare and level of well-being.

The post-ethical condition of public policies and policy analysis exists where there is not an evaluation of the ethical consequences of the actions and also the intentions of the actions are not directly justifiable by ethical arguments. For example, the decision to impose a path of fiscal consolidation made of deficit and debt limits is not more ethical that any alternative policy option aimed at the same purpose of fiscal sustainability.

Behind this argument there are different cultural approaches which sustain the primacy of moral and social interests over the economic ones and more in details it means to recognize the moral and social responsibility of the economic actions whatever their scope and author is, if it is at the micro level of the private business or the macro level of public policy, if it is by a single person or company, or by an institution or policymaker. The normative approach that is considered here finds its roots in the Catholic Social Teaching, and as many other exhortations its moral principles will be seeds of the development of theoretical and practical tools for policy analysis, policymaking processes and institutional goals. Indeed, although other normative frameworks exist, this is one of the most consistent and long-time developed.

During the last century the Popes wrote memorable pages for emphasizing the ethical principles that should lead the economy, and partially some of these principles have been adopted since when two years after the Great Depression, Pope Pio XI published the famous encyclical letter Quadragesimo anno (1931). The most important principles with reference to the issue of this article are following listed:

- integral human development. As Pope Paul VI wrote in 1967: “The development We speak of here cannot be restricted to economic growth alone. To be authentic, it must be well rounded; it must foster

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100 Carlo A. Ciampi, Speech for the celebrations of the 10th Anniversary of the European Central Bank and the European System of Central Banks, 2008.

the development of each man and of the whole man”102 and he stressed that the ideal model is that of an economic order designed for the welfare of the human person;103 - ethical principles for the economy. In the view proposed by the Catholic Social Teaching, human activities are under an ordering ethics that shapes social processes, structures and institutions, as well as their goals in a frame which is people-centered: “man is the source, the center, and the purpose of all economic and social life.”104 As Benedict XVI stressed: “The economy needs ethics in order to function correctly - not any ethics whatsoever, but an ethics which is people-centred.”105 This principle can also be called economic personalism or economic humanism. The first approach is based on Jacques Maritain’s view of the person applied to economic philosophy, theory and policy; the second one is based on Wilhelm Röpke’s idea of an “economic humanism”, which means an economic order which respects and promotes the dignity of human life.106

How to translate these principles in action? How to make of them the central tenet of the new public policies in the economy?

Even if policy tools evolve usually differently from their original ideas, it would be not so complex or inappropriate to invite the institutional and political actors, at local, national and international level, to promote a normative and theoretical vision of the economy in the form of a “Social Political Economy” completing the idea of “Social Market Economy”. This parallel was already proposed by Alexander von Rüstow, who developed a certain concept of social policy, which he calls “vital policy or Vitalpolitik”: “Vital policy would complement the institutional order of the market.”107

Indeed, this seems to be the gap in the existing rules and models of functioning of the economy, which is governed as any decision or policy would produce social effect or as they would not require any social responsibility by the decision makers, whatever they would be politicians or technocrats. Under these circumstances, the social market economy can be fully realized only if there is also a social political economy, within a balanced share of social responsibility on the side of the market and that one of the policymaking.

Filling the gap in this discipline would require the consensus of politicians and policymakers, nonetheless, the main pressure over the institutional system is coming from non-political and non-governmental organizations and intellectuals promoting a social reform of the European Union. While the EU institutions since October 2017 are working on a new Proposal for an Interinstitutional Proclamation on the European Pillar of Social Rights, that will repeat the main rules of the European legal order for social rights and issues currently unheeded, more concrete proposals are made by universities, think-tanks and other non-institutional actors. Particularly noteworthy is the idea of the Social Inclusion Monitor Europe (SIM), which will be used to assess and formulate concrete recommendations for policy reforms in individual member states and the EU as a whole. This project by the Bertelsmann Foundation is aimed to provide new instruments and policy tools for economic policy and social justice.108 This is just one of many examples of the possible measures and instruments which can improve the quality of the economic policymaking and make its processes more sensitive to people’s problems and responsive to social changes.

103 Ibidem, n. 86.
107 Ibidem, p. 143.
An alternative proposal might be here outlined. For example, that one of the notion of Institutional Social Responsibility, which could be one of many persistent attempts to stop the shift of policy analysis from pure economic quantitative variables to their social meaning and impact, and make possible there can be a reverse shift of the focus of policymaking from simple fiscal quantitative parameters to economic policies written to pursue specific social purposes. This is important if we assume the argument provided by the Catholic Social Teaching and here summarized: “To the extent that economics is a science of human choice, its principles must be grounded in human social reality and not merely in mathematical formulas that work in the sense of producing generally correct predictions.”

More practically, it would be possible to affirm the following rules:
- the institutions recognize as principle of their action the social responsibility of every public policy,
- every public policy has to be adopted by decision-making processes entailing a social impact assessment;
- the social purposes of the institutional actions and public policies related to health, housing, education, and income prevail over the other purposes.

The above-mentioned four sectors of public policies: health, housing, education, and income have been considered as those ones that the academic literature has recognized as the most important. Following these three rules it could be possible to institute a monitoring tool for the policy analysis and the assessment of policy purposes and means. That is to say providing an index of Institutional Social Responsibility with specific indicators to deliver a conceptually cohesive research on the level of social responsibility of policies and the purposes of decision-making processes. This would be designed in order to regularly observe and empirically measure the social responsibility of local, national and international institutions as well as both the technical and the political ones. The multidimensional index would measure the differences between economic policies actually adopted by the institutions and alternative economic policies that would be required in order to achieve a minimum level so social protection. This kind of assessment of institutions, policies and their impacts is necessary for converting the current and future models of economic governance towards policies of social justice for the integral development of the person.

**Conclusion**

The final goal of this reform is the project of an institutional framework which can clearly show the interactions between monetary and fiscal policy in the EMU, keep the economy in a healthy growth rate, strengthen social cohesion, promote social progress and equity, make the economic governance more resilient and prepared to prevent future crisis. As Joseph Stiglitz says: “in most European Union countries, per capita GDP is less than it was before the crisis. A lost half-decade is quickly turning into a whole one. Behind the cold statistics, lives are being ruined, dreams are being dashed, and

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families are falling apart (or not being formed) as stagnation - depression in some places - runs on year after year.”

In this new season of global uncertainty, a reform of the fiscal discipline aimed to establish a resilient model of governance – made by flexible policymaking processes ready to adequate themselves to changing circumstances – can be the only way to overcome the status quo and resolve the paradoxes of the current fiscal rules. The EU needs a far-sighted strategy to lift the European economy out of the risks of the long-term stagnation and to improve the socio-economic conditions of the EU.

The EU seems still unable to overcome the legacies of the crisis and the recovery is so feeble and slow. It needs a long-term and far-sighted strategy to lift the European economy out of a crisis that has gone on too long.

Matteo Laruffa

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