What Blanchard gets wrong: The puzzling persistence of managerialism in EU fiscal governance

The Covid-19 pandemic has prompted renewed debate over the architecture of Europe's Economic and Monetary Union. **Marco Dani, Dario Guarascio, Joana Mendes, Agustin José Menéndez, Harm Schepel** *and* **Mike Wilkinson** *respond to a recent proposal to overhaul the EU's current fiscal framework. They argue that while the EU's fiscal rules should undoubtedly be reformed, a more radical solution is required that puts democratic politics at the heart of the EU's fiscal governance.*

When, after the onset of the Covid-19 pandemic, the EU's finance ministers decided to trigger the "general escape clause" of the Stability and Growth Pact (SGP), they expressed a "full commitment" to the SGP. Even if temporarily suspended, it seemed beyond the pale, politically and legally, to doubt that Economic and Monetary Union (EMU) would return to its normal functioning. Almost one year later, in an ever-uncertain economic context, it is clear that the suspension will not be lifted until the end of 2022. Indeed, the prevailing opinion seems to be that the present rules have proven inadequate, and that the time has come to seriously rethink the architecture of EMU.

The debate on how to reform the SGP now starts in earnest. In a recent reform proposal, Olivier Blanchard, Alvaro Leandro and Jeromin Zettelmeyer developed a radical critique of current EU fiscal rules. The latter are regarded as obsolete because they were designed to achieve low debt levels in an environment of "normal" (i.e. positive) interest rates, while the post Covid-reality is going to be one of high debt levels and very low if not negative interest rates.

Blanchard and his co-authors further argue that the EU fiscal framework is too complex and ineffective: the rules are exceedingly detailed, and too hard to enforce. EU institutions have been very reluctant to apply the financial sanctions that render the rules "credible". Under such circumstances, nothing less than a Copernican revolution is required: rather than persisting with a mix of hard rules and soft formal enforcement, they suggest shifting to a system that relies on softer rules ('standards') and more credible enforcement.

Their proposal revolves around four elements. First, an EU institutional framework for fiscal policy allowing member states to pursue their chosen fiscal policy, subject only to the limits necessary to secure debt sustainability. Second, fiscal standards to be fleshed out in more concrete guidelines formulated on the basis of a specific formula to calculate debt sustainability: the so-called "Stochastic Debt Sustainability Analysis" (SDSA). Third, a system of surveillance focused on the size of the deficit, without the possibility for EU authorities to question single items in national budgets. And finally, a system of enforcement, entrusted to either the European Council or a specialised chamber of the European Court of Justice. Either way, the task of the adjudicator would be to prevent a nationally approved budget in breach of EU standards from becoming binding law.

At first sight, Blanchard et al.'s proposal seems to be in strong discontinuity with the economic rigidity and austerity of the past. It sets out to reconcile EU coordination of national fiscal policies with their democratic determination. That would depart from the status quo, in which Treaty norms pre-empt the democratic space within which member states can pursue alternative courses of action. The proposal is, in addition, designed to reduce the risk of forcing specific measures, be they expansionary or austerity-driven, on recalcitrant member states.

The devil, however, is in the details. First, while Blanchard and his co-authors avoid relying on a whole series of "constructed" numerical rules, such as the structural deficit, which are at the core of the present SGP, debt sustainability is far from a neutral variable. Contrary to what they assume, the choice of debt sustainability assigns central importance to a concept, the output gap, which is only apparently technical.

In other words, accepting the centrality of debt sustainability in European governance means accepting that public decisions that affect aggregate demand only make sense as a means of correcting transitory market failures, and not as a means to foster structural change. Public decisions that could address the structural and technological asymmetries that account for the divergences within the Eurozone, not least between the Eurozone core (largely the North) and its periphery (largely the South) are excluded from this logic. This casts serious doubt on the capacity of their proposal to recreate the space for a genuinely discretionary fiscal policy (thus subject to the normal run of democratic contestation) and, by the same token, to reduce economic instability and the risk of new crises.

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Our second concern (linked to the first) pertains to their proposed method. Blanchard et al. present SDSA as the tool to calculate debt sustainability. Yet, predictions based on the SDSA would again – as in the case of the European Commission's estimation of the structural deficit based on the output gap – be biased by a supply-side and backward-looking approach disregarding key structural and demand-side factors likely to affect long-term growth and debt dynamics. As a result, fiscal impulses risk being constrained by a mistaken conceptualisation of the economy and by an inbuilt penalisation of economies that, at the time of the "sustainability evaluation", are underutilising their production capacity.

Simply put, Blanchard et al. present the assessment of debt sustainability the way Fiorello La Guardia regarded cleaning the streets in NYC: there is no Democratic or Republican way to go about it. Yet, the experience of the past has taught us that debt sustainability is a terrain exposed to legitimate political debate and, indeed, to political conflict. If calculating debt sustainability is by no means a neutral exercise, institutional design should not aim simply at imposing and implementing the "right" policy or method, but at institutionalising and mediating that conflict. In other words, the decision on the determination of the proper level of debt cannot but be political in nature and should be left to political institutions (in the EU context, the ECOFIN and the European Parliament) to decide.

This leads us to our third concern. The focal point of the proposal is debt sustainability. No matter how debt might be regulated, the Covid-19 pandemic has reminded us that central banks have a key role as buyers of last resort of public debt. The ECB itself has acknowledged that its expanded role is set to continue if the uncoordinated implosion of the Eurozone is to be avoided in the mid run.

These developments are overlooked in Blanchard et al.'s proposal. Implicit in the debt sustainability discussion appears to be the idea of a return to the "old normal" in which the ECB is prevented from intervening to secure, *de facto* if not *de jure,* the sustainability of debt, and fiscal assistance is offered only through the European Stability Mechanism (ESM). Were this to be the case, the proposal would lose most of its appeal. The operation of the ESM precludes the very space for political action that Blanchard et al.'s proposal purportedly opens.

Finally, the appeal of the infringement procedure in Blanchard et al.'s proposal rests largely on the fact that it relies on the authority of the Court of Justice of the EU (CJEU). The attraction of this proposal, they argue, is the impartiality of the adjudicator and its ability to develop the meaning of the softer rules that would be put in place and, hence, facilitate its enforcement. However, the infringement procedure in which the CJEU is the ultimate umpire is by no means a matter of impartially settling a breach of legal norms by judicial means. The judicial phase is preceded by an entirely discretionary process, fully in the hands of a diplomatic-like procedure between the member states concerned and the Commission.

The Court has fiercely protected this space of negotiation between Commission and national officials, precluding any possibility of challenging fundamental discretionary decisions made by the Commission. This is the core of the infringement procedure, and it remains mostly in the shade. The Court has repeatedly refused to overturn decisions foreclosing access to documents, with the aim to protect the spirit of "trust" that must prevail in bilateral negotiations. The sensitive nature of fiscal decisions is an unlikely field for change in this regard. If the purpose of assigning the CJEU as adjudicator is to prevent national budgetary measures from becoming binding law, as Blanchard et al. suggest, this will not come about as a result of judicial intervention. The Court can only apply monetary sanctions, in case the member state concerned does not remedy an infringement verified by the Court.

Perhaps even more decisively, we doubt that a specialised chamber of the CJEU would be well-suited to embark on the difficult evaluations implied in SDSA or its equivalents. If a hard case reaches the Court, the judges would either have to defer to the technical discretion of the executive bodies to whom the Treaties and the EU legislation have entrusted competence in the matter, or would place themselves in the very uncomfortable frontline of adjudicating matters that were once the preserve of democratic institutions.

Overall, the very idea that the Court or another independent institution could and should develop a coherent set of precedents on fiscal policy fails to convince. Fiscal policy is a highly salient policy domain attracting a high degree of political contestation, in which the exercise of political judgment is simply inescapable. Not by chance, judicial review of fiscal measures is almost invariably conducted by constitutional adjudicators on the basis of the lightest standards of review.

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In Blanchard et al.'s proposal, by contrast, the CJEU would be given the last word at the end of heated political discussions. For all of the skills of the judges sitting in the newly established special Chamber, we fear that their decisions would be almost invariably tarnished by an amplified version of the counter-majoritarian dilemma. By contrast, what is needed is enforcement of those measures by political institutions accountable for their decisions.

So far, EU fiscal rules have been treated like Hammurabi's Code, written to last eternally. In this respect, Blanchard et al.'s proposal marks a cultural change. Still, it seems to us that there are very good reasons to embrace the matter in full, and be more daring. As the Covid-19 pandemic has proven again, fiscal policy is a decisive field that simply does not lend itself to managerial regulation and technocratic steering.

Instead of cloaking discretion, wrapping it up in legal norms or legal standards combined with contestable numerical indicators produced through tools such as SDSA, we need to frame it in the only way which is at the same time feasible and legitimate: democratic politics. We are conscious that this will immediately trigger fundamental questions regarding the political and social legitimacy of European institutions, which appear both perennial and enmeshed in their very structure. This is not, however, a time to avoid fundamental questions, but to tackle them. To keep on muddling through is most likely the safest way to the uncontrolled implosion of the Eurozone, in the medium or long-run.

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