

## Eurozone: The Year of the Review

The European Commission just released its review of the eurozone's fiscal rules, kickstarting a process of possible changes to the framework. With both monetary and fiscal policies under review, 2020 could become a year of overhaul for the eurozone. The emphasis is on 'could'



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In the eurozone, a year of review is upon us; a review of the monetary union's basic economic rules and guidelines, a review of the eurozone's fiscal rules, and a review of the European Central Bank's monetary policy strategy.

Today, the European Commission demonstrated that fiscal policy can sometimes be ahead of monetary policy. The EC presented the outcomes of its own review of the eurozone's fiscal rules. Since the start of the monetary union, the fiscal rules have been bent, adjusted and reformed. Discussions and controversies on the eurozone's fiscal rules are even older than the eurozone itself. Remember that even the 'holy' 3%-deficit and 60%-debt norm were not the result of any economic analysis but rather the result of pragmatism and the economic reality in the early 1990s. However, no reform of the last 20 years has managed to solve the underlying question, and

often source of conflicts between governments, of how growth-supportive fiscal policy in the eurozone should actually be.

## European Commission presents review of fiscal rules

Not surprisingly, the European Commission found in its review that the fiscal rules have “contributed, among other factors, to the gradual strengthening of EU economies and strong job creation recorded in recent years. However, the EC also concluded that the fiscal stance has “frequently been pro-cyclical” and that the “composition of public finances has not become more growth-friendly and national governments have revealed their preference for increasing current expenditure rather than protecting investment”. Finally, the EC found that the fiscal rules have become less transparent. Looking ahead, the EC will now launch a debate with several stakeholders, similar to the ECB’s intentions, to discuss possible changes to the eurozone’s fiscal rules. Major issues in this debate will be how to integrate the Green Deal, digital transition and structurally lower growth into the fiscal framework, while at the same time making the framework less complex.

## Main items in the upcoming fiscal debate

It is an open secret in this upcoming debate that the most important issue is how to increase investment in the eurozone, particularly as monetary policy has more or less reached the lowered bound. As is the case with the ECB’s review, the mandate, meaning the deficit and debt limits, will not be touched. As the ECB will probably look into new definitions of price stability, the European Commission will try to push for a simplification of the rules and more focus on investment. The big question is whether this will work. Looking back at the history of the eurozone’s fiscal rules shows that they were very simple at the beginning but were complicated to allow for more flexibility and have now become too complex. Just think of the use of output gaps, structural deficits, medium-term objectives or other metrics. In our view, a way forward could be to focus more on actual expenditures, possibly also making room for green and digital investments. Regarding the enforcement of rules, it would be interesting to see whether the European Commission could eventually push countries to implement fiscal stimulus as much as it can push them to correct excessive deficits. In any case, let’s not forget that no matter what the fiscal rules look like, their ultimate success will always depend on eurozone members willingness to comply with them.

## The Year of Review but not necessarily the Year of Overhaul

The year 2020 seems to be one in which no stone in eurozone policymaking will be left unturned. It is a once in a lifetime opportunity to at least question whether the policies of the past are the right policies for the coming years, facing challenges from climate change, digital transition and demographics. It is also an opportunity to discuss the policy mix in the eurozone, which in recent years has been heavily reliant on monetary policy. However, we warn against too much enthusiasm. A year of overhaul does not automatically mean that anything substantial will actually change.

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