ofce

Policy brief 138

2024

28 october

ECONOMIC GOVERNANCE IN THE NEXT EU LEGISLATURE
What agenda for fiscal and monetary policy?

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Summary

The last fifteen years have seen a succession of crises which have put European integration to the test and polarized the political landscape.

After the serious errors made in managing the sovereign debt crisis, the widening divergences between European countries, and the sluggish growth that followed, European decision-makers reacted with altogether greater efficiency to the crisis born of the pandemic. At the cost of mounting debt, national fiscal policies supported jobs, household incomes and corporate solvency by providing aid during the periods of forced inactivity. In the meantime, the European Central Bank (ECB) set up securities purchase programmes and provided backing for the banking sector to alleviate pressure on the financial and sovereign debt markets. Finally, the European Commission arranged soft loan programmes to support government spending that targeted the sectors hit hardest by the pandemic (health care and the labour market). These efforts were crowned with success and largely explain the economic rebound following the lockdowns.

The responsiveness of the European authorities, surprising given the inertia shown during previous crises, carried over into the medium– and long-term orientation embodied both in the Next Generation EU (NGEU) programme of investment in the ecological and digital transitions as well as in the tool put in place by the ECB to avoid widening spreads and protect member states' public finances, the Transmission Protection Instrument (TPI).

This *Policy brief* takes a broadly positive view of the policies and institutional developments implemented over the past four years: the European Union (EU) and the eurozone have managed to bounce back from the crisis and embark on a long-term investment programme which, despite its inevitable shortcomings, is succeeding in meeting its goals. But the EU has also had its share of failures. The disappointment of the European Stability Mechanism's (ESM) dedicated credit line for healthcare expenditure demonstrates the need to reorganize the assistance provided by European institutions to member states. Above all, resistance to a perennization of the NGEU programme or, more generally, to the creation of borrowing and spending capacity at European level, coupled with a very disappointing reform of the Stability and Growth Pact, continues to pose the problem of creating the fiscal space to meet the EU's future needs, whether in terms of industrial and transition policies, macroeconomic stabilization, or the provision of global public goods such as health care and education. Finally, the nature of the inflationary shock has shown that macroeconomic and structural policies need to be coordinated to cope with multidimensional shocks, which raises the question of the anachronistic nature of the ECB's single mandate on price stability.

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These considerations lead us to make the following recommendations:

- Review the ECB's mandate to include an employment objective, to adapt it to the role the Eurozone central bank has recently had (and will likely have in the future), which goes far beyond simply controlling inflation;
- Pursue the debate on the creation of fiscal space, especially as national excessive deficit procedures are set to intensify. If the fiscal space cannot be created at European level, given the lack of appetite for further integration (made all the more obvious by the recent European election results), it seems unavoidable that EU countries reopen the discussion on the reform of the fiscal rule in the direction of protecting public investment;
- Finally, the numerous programmes of financial assistance to member states should be reorganized and consolidated into a single facility, as has already been proposed in the past.

The last months of 2024 are characterized by three major events, likely to shape the European policy landscape in the next years. The first is the somewhat laborious formation of the von der Leyen second cabinet, that reflects the substantial continuity in the distribution of seats in the European Parliament after last June's elections. Like in the previous legislature, it will continue to be difficult to find a majority; what's more, given the expansion of the European People's Party (EPP) group compared with the previous mandate, the poor electoral performance of the Renew group and a relative decline in the weight of the Socialists & Democrats group, progress in European integration and the creation of tools strengthening solidarity between member states will likely stall. This will undoubtedly have an impact, at least in the short-term, on the direction of European economic policies. The second event is the presentation of budget laws by EU governments that, to different degrees, all reveal the will to set, as the first priority, fiscal consolidation and the reduction of public debt. The 60 bn euros budget cut of the newly installed Barnier government is the most striking example, but other countries are aiming at similar efforts. This is in part, but not only, because, after the suspension of 2020, the EU fiscal rules came back into force (in a reformed version).

The third relevant event is the publication of the Draghi (2024) report on productivity that, last September, has highlighted a completely different set of priorities. The report's starting point is the diagnosis of an increasingly evident growth gap that has been opening between the EU and its main competitors (mainly the US and China). A gap that the former ECB president rightly attributes to a chronic stagnation of productivity growth, for large and small countries alike. Furthermore, the team working to the report has emphasized the fact that closing the growth and productivity gap requires a wide spectrum of policies: the report highlights the need for reforms enabling a better working of markets and the full exploitation of the large scale of the European economy. These reforms go from the deepening of the single market (on which the Letta report also insists) to better organize financial markets (competing the capital market union), to the streamlining and reorganization of the different layers of regulation that have piled up in a somewhat disorderly manner over the past year and that, today, are drag on growth. But the report does not stop here and is unambiguous about the fact that market enabling reforms are far from enough. It is in fact impossible to imagine that the digital and green transition and making up for the lost ground in terms of productivity and growth can be implemented without massive investment. The team working on the Draghi report quantified these resources in around 800 billion euros per year (around 5% of EU GDP), of which more than half would have to come from public investment. While it may seem obvious among academics and EU scholars who have been working on the ecological transition, (e.g., Baccianti, 2022) this clear call for the mobilization of new resources as a complement to other instruments is an important step forward for EU policy makers.

Taken together, the complex political equilibrium emerged from the EU elections, the turn towards fiscal consolidation, and the Draghi Report, give a rather precise idea of the contradictions that characterize the current phase of EU policy making. The need to catch up with our competitors and become leader of the structural transformation ahead (Cerniglia and Saraceno 2024) clashes with the consolidation of public finances of member states and with the almost inexistent political space for the creation of some form of fiscal capacity at the EU level.

This *Policy brief* will detail the policy choices and the institutional innovations that characterized the last legislature of the European Parliament and will assess the needs (and the political feasibility) of further institutional change to equip the European Union with the instruments to successfully complete the transitions and restore productivity and growth.

The last five years have seen a great deal of institutional progress. This contrasts with the situation in the previous ten years (2009-2019). Since 2020, the European Union member states and institutions have reacted swiftly and flexibly to the challenges posed by the health, economic and financial crises. First, they revived the use of economic policies and bypassing the fiscal austerity policies that prevailed after the so-called sovereign debt crisis (2010-2014). Secondly, the member states and European institutions developed tools to strengthen financial solidarity between member states, through joint debt issuance and innovative monetary policies. Finally, the sustainability of public debt, at the heart of the European fiscal framework, is now being considered in conjunction with the digital and ecological transitions, in order to help boost Europe's potential GDP. To achieve this, the policy levels have been intertwined: the national level for debt sustainability, with Community oversight, and the European level for the financing of the two transitions, with investment plans that nevertheless kept emanating from the States themselves.

The institutional advances outlined in this document form a four-dimensional architecture: crisis management, business cycle management, financial solidarity and long-term sustainability. It is in the light of these four dimensions that we can take stock of the institutional progress made over the last five years and propose several avenues for reform.

These institutional advances took place in the face of an unprecedented crisis – the Covid-19 pandemic, which began in Italy in January-February 2020.While the pandemic was initially dealt with by the EU member states, the EU quickly put in place common instruments that, while temporary in nature, also – and this is undoubtedly an important point to remember – were consistent with a long-term orientation for common economic policies. We review below the temporary initiatives of the European Central Bank (ECB) (with, principally, the creation of the Pandemic Emergency Purchase Programme, PEPP) and those of the European Stability Mechanism (ESM) and the European Commission to facilitate the financing of public spending on healthcare and unemployment benefits during the crisis. We will then look back at the ECB's longer-term initiatives, with the introduction of a permanent tool to improve the monetary policy transmission channels (the Transmission Protection Instrument, TPI), and at those of the EU Commission and the Council, with the Next Generation EU (NGEU) programme and the Recovery and Resilience Facility (RRF). While NGEU and RRF are temporary, their operating arrangements extend from 2021 to 2026. Can the TPI and the NGEU, in conjunction with the new fiscal rule, ensure the EU's economic stability, solidarity and sustainability beyond extreme events such as a pandemic?

The pandemic did not disprove the famous adage that "Europe will be forged in crises and will be the sum of the solutions adopted for those crises" (Jean Monnet). Even in the wake of the revision of national fiscal rules as part of the Stability and Growth Pact (SGP) and of the ECB's strategy review, however, the European fiscal and monetary institutional framework does not encourage much optimism: on one side national fiscal policies are still led to focus primarily on the reduction of public debt, at the risk of triggering economic instability; on the other side, in the absence of treaty changes, the ECB is still bound by its primary objective of price stability. At the same time, the NGEU has not fully demonstrated its ability to meet the goals it has been assigned of stability, solidarity and sustainability. We will discuss below why that is the case.

As we have seen with the energy crisis, without greater coordination of economic policies, divergences can reappear and weaken the European economy[1]. In our conclusion, we propose several ways to improve European economic governance.

1. Economic policies at the bedside of the European economy

The EU has been widely criticized for its generalized fiscal austerity policies during the sovereign debt crisis and for having let the ECB alone to keep the single currency afloat "whatever it takes" from 2012 onwards, and especially after 2015 when the ECB launched its massive public debt buybacks. The spring of 2020 has reshuffled the deck. As if the mistakes of previous years were remembered and corrected, European policymakers acted quickly and decisively to counter the pandemic, by coordinating their efforts, marking a turning point in the macroeconomic management of the eurozone (Saraceno, 2021; Creel *et al.*, 2021a). The long list of acronyms (their definitions are given below) that follows bears witness to the policies implemented in 2020: in chronological order, extension of the PSPP, creation of the PEPP and PELTRO, suspension of the SGP, creation of the ESM's pandemic line, SURE, the NGEU and the RRF. These were to be followed in 2022 by the creation of the TPI, before the reform of the SGP in 2024.

Crisis management: Covid and the other "whatever it takes"

Member states on the front line

In 2020, the first barrier against the pandemic was erected by the governments of the member states[2], which was inevitable in the absence of a European federal government. In addition to dealing with the health emergency, the states injected resources into the economy to support business liquidity, limit the fall in labour income and provide guarantees to allow continued access to credit to the productive sector. The effect of these measures on public finances was immediate; debts and deficits rose considerably in 2020, but also in 2021[3], with rare exceptions (in 2022 the public finances continued to deteriorate, but this time in relation to the effort to combat

1. See the recently published OFCE *Policy briefs* on this subject: Bock *et al.* (2024) and Aurissergues *et al.* (2024).

2. Until October 2021, the IMF maintained a description of national budgetary and fiscal measures implemented during the pandemic. *The data is available online in Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic*.

3. According to the IMF (see previous note), Germany, Spain, France and Italy have respectively increased spending and foregone tax revenue to counteract the effects of the pandemic, to the tune of 15.3%, 8.4%, 9.6% and 10.9% of their GDP between January 2020 and September 2021. This does not take into account business support measures such as guaranteed loans, which have no direct effect on public finances.

inflation). This colossal effort by European governments has nevertheless paid off, as income and employment have fallen in every country by far less than GDP.

The ECB to the rescue

European institutions have supported the efforts of the member countries. The ECB opened a protective umbrella by extending its purchases of government bonds under the Public Sector Purchase Programme (PSPP, created in 2015) by 120 billion euros on 12 March 2020, and then by launching a new government bond purchase programme on 19 March 2020, the PEPP (Pandemic Emergency Purchase Program) with an initial purchase envelope of 750 billion euros (the amount was revised upwards twice, bringing the total to 1,850 billion euros). The ECB also renewed its long-term liquidity operations for banks, creating Pandemic Emergency Longer-Term Refinancing Operations (PELTROs), with negative interest rates of -0.25%. This helped reduce market interest rates (already low due to the very large amount of savings available), making debt more sustainable (Creel *et al.*, 2021b).

At the end of April 2024, the outstanding securities held by the Eurosystem amounted to 2,300 billion euros under the PSPP and 1,600 billion euros under the PEPP. The total (consolidated) value of the Eurosystem's balance sheet stood at just under 7,000 billion euros at the end of 2023, an amount that has tripled since January 2015, when the then-ECB President Mario Draghi announced the launching of the PSPP.

First initiatives by the European Commission and the European Stability Mechanism

After activating the suspension clause of the Stability and Growth Pact (SGP) to enable governments to cope with the pandemic without having to pursue pro-cyclical policies, European institutions were also quick to put in place financial assistance tools to support the member states' efforts in two sectors hit particularly hard by the pandemic and by the lockdowns: the labour market and health care. In both cases European institutions were supposed to borrow on favourable terms and then remit the funds to member countries at an interest rate that, for some of them, was below the market rate. These funds were to be used to finance public expenditure linked to the labour market (unemployment insurance, part-time work, active policies to get people back to work, etc.) or to the healthcare sector (purchase of artificial respirators, masks, tests, vaccines, intensive care beds, etc.).

However, the choice of the financial vehicle was different for the two sectors. For labour market related policies, a new mechanism called SURE was introduced (temporary Support to mitigate Unemployment Risks in an Emergency), endowed with 100 billion euros. For healthcare spending, a special credit line of up to 2% of GDP, or around 240 billion euros, was created within the already existing ESM, established in 2012 to ensure the stability of the eurozone by coming to the rescue of countries in difficulty on the financial markets. This choice was criticized at the time, because the ESM did not seem suited to financial assistance intended to promote solidarity. The decision to use the ESM was justified by the urgent need to channel funds as quickly as possible to healthcare systems on the brink of collapse, which was supposed to benefit from the utilization of an existing financial vehicle; for labour markets the creation of the new SURE mechanism was supposed to take effect more gradually. In fact, the opposite has happened: SURE was implemented almost immediately, and between 2021 and 2022 it disbursed 98 of the 100 billion euros endowed to it, while no country used the ESM's pandemic credit line. We will come back to the reasons for this failure later.

Sustainability and solidarity: Looking to the long term

European institutions did more than just support member states' efforts during the pandemic. They also looked at possible instruments to be put in place to facilitate recovery from the pandemic and to take advantage of the shock to relaunch the ecological and digital transition, while securing public finances' sustainability. The results of this effort are the Next Generation EU programme and the monetary policy Transmission Protection Instrument.

Next Generation EU, an undeniable step forward

In July 2020, the EU adopted an ambitious financing programme entitled Next Generation EU (NGEU). It combines a Recovery and Resilience Facility (RRF), for which the first payments were made as early as summer 2021, with other financial mechanisms (React-EU), with a combined budget of 750 billion euros in constant 2018 prices. This programme comes on top of the 1,100 billion in the EU's multiannual budget, ultimately providing member states with 1,850 billion euros over seven years.[4]

4. See Cerniglia, *et al.* (2021). For the French recovery plan, see Plane and Saraceno (2021).

The NGEU has a number of innovative features: firstly, the issuance of large stock of common debt (750 billion, or 5% of EU GDP), which since 2021 and up to 2026 is financing a vast programme of investment and reforms designed to channel the recovery towards the EU's long-term objectives (ecological transition, digitization, social and territorial cohesion); secondly, the allocation of resources to member states according to the needs generated by the pandemic, rather than the usual EU budget allocation formulas. The debt incurred by the EU will be repaid between 2028 and 2058, *a priori* through additional own resources (tax on financial transactions, carbon border adjustment mechanism, tax on plastic packaging, tax on multinationals) or else by increases in national contributions to the EU budget.

The NGEU programme is by no means an "Hamiltonian moment", a founding act of a federal Europe. The common debt is temporary and the EU does not take over existing national debts; moreover, just over half of the RRF, NGEU's main facility, involves loans, which are attractive only to countries that face high interest rates on financial markets; furthermore, the additional own resources are for the moment no more than a wish list: with the exception of the "plastic tax", there is no consensus on the other taxes. What is more, the investment programmes included in the NGEU will remain national and do not have an explicitly pan-European dimension. It was therefore good news that, as part of the programme, the Commission laid down strict guidelines for the design of national plans (a sort of "good conditionalities") that aim at ensuring both the overall coherence of national strategies and greater efficiency in the provision of common public goods.

Despite these limitations, the NGEU programme, and in particular the RRF, represented a turning point in the process of European integration, as for the first time it introduced a strong dose of solidarity between countries. Firstly, by issuing common debt, the so-called virtuous countries facilitated access to lower interest rates for countries with less favourable financing conditions for their public debts. Secondly – and this is undoubtedly the most innovative element in terms of financial solidarity – part of the RRF's funds were distributed in the form of grants, to the benefit of those countries that suffered most from the pandemic (and which were already weakened after the "lost decade" of the sovereign debt crisis). In short, the NGEU programme introduced for the first time a partial mutualization of debts and significant risk sharing. This constituted an implicit recognition of the fact that, in the event of major shocks, a joint response is more effective than a fragmented reaction. What makes the NGEU programme even more significant is the stance taken by Germany, which until then had been vehemently opposed to any risk-sharing mechanism. In 2020, it inspired and pushed forward the programme.

Protecting the transmission of monetary policy: A little-known tool

The ECB discontinued its net bond purchases under the PEPP in March 2022, then under the PSPP in June 2022, so as to conduct only reinvestment operations of securities previously acquired and reaching maturity, to keep its stock of bonds constant. However, since March 2023, the ECB has been carrying out partial reinvestment operations, which have reduced the stock of securities acquired under the PSPP on the Eurosystem's balance sheet. Moreover, from July 2024 until at least the end of the year, the ECB will reduce its stock of securities held under the PSPP by an average of 7.5 billion euros per month. The increase in key rates in July 2022 has therefore been accompanied for just over a year by *quantitative tightening* (QT), as opposed to *quantitative easing* (QE).

The usefulness of this reorientation of monetary policy to curb inflation will doubtlessly be debated for some time to come,[5] but it should not obscure an innovation introduced into the ECB's financing operations. In July 2022, the ECB Governing Council adopted a new instrument to protect the transmission of monetary policy, known as the Transmission Protection Instrument (TPI). Its stated aim is to ensure the uniform transmission of the single monetary policy between eurozone member states, so that the price stability objective assigned to it by the Treaty on the Functioning of the EU (TFEU) is better respected. Ultimately, the aim is to avoid a new episode of rising spreads on 10-year interest rates on public debt between member states that are not justified by proven deviations from fiscal discipline or by heterogeneity in the economic conditions prevailing in the member states (such as an acceleration in inflation in one member state but not in the others).

Activation of the TPI is conditional on the member state's compliance with the European fiscal framework, and in particular on the fact that it is not subject to an excessive deficit procedure and that there are no macroeconomic imbalances.[6] The TPI is used to purchase the securities (primarily public debt, although private debt is not excluded) of a member state whose financing conditions have deteriorated unjustifiably. These purchases are to be temporary in nature, so as not to place a long-term burden on the Eurosystem's balance sheet and interfere with the ECB's general monetary policy stance.

5. See the preliminary analysis by Blot and Creel (2022) and, more recently, the work carried out by Ben Bernanke and Olivier Blanchard with several central bank teams (Bernanke and Blanchard, 2024), which highlights the sources of inflation, and therefore their more or less sensitive nature to the rise in key rates: policy rates weigh on demand but have relatively little effect on supply factors such as energy prices or supply chain disruptions.

6. The macroeconomic imbalance scoreboard comprises 14 indicators. See https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/macroeconomic-imbalance-procedure/scoreboard_en

2. Have the recent European economic policies been effective?

NGEU, ESM, SURE, PSPP, PEPP, TPI: Once again the EU is a producer of acronyms. But what lessons can be drawn from the use of these different levers to ensure better crisis management, greater solidarity and sustainability, and enhanced economic stability?

The NGEU, SURE and ESM pandemic line: The anatomy of two successes and one failure

NGEU investment plans are in process, and the funds allocated are still far from having all been disbursed. At the start of 2024, only Croatia, Spain, France and Italy had received more than half of their grant funding. Italy stood alone in terms of loan disbursements as the only country to have reached the symbolic 50% mark. In contrast, Spain, which is eligible for 83 billion euros in loans, chose to apply for them only in 2023, and as a result has so far received only 340 million. At the EU level, only 37% of allocated funds had been disbursed until the start of 2024, i.e. 42% of the allocated grants and 31% of the allocated loans. The disbursement forecasts communicated by the European Commission at the end of May 2020 implied that by the end of 2023, 45% of grants and 67% of loans would have been disbursed. Two lessons can be drawn from these figures. First, most loans were not requested. The low level of interest rates on European public debts, before they rose again in 2022, undoubtedly contributed to this lack of appetite for funds allocated at a quite similar rate, and which required meeting numerous "milestones" at EU level. Second, and more important, the program suffered from a fundamental ambiguity as of its purposes. NGEU should never have been aimed at ensuring the EU's macroeconomic stability: the "stimulus" arm, the "recovery" part of the Recovery and Resilience Fund, has always been incompatible with the very gradual pace of actual funding, notably via subsidies, more than half of which were due to be paid out from 2024, i.e. four years after the pandemic and the economic crisis it engendered.

It may seem premature to take stock of the NGEU, given that many investments are still to be realized. In its mid-term assessment of the NGEU, published in February 2024 (European Commission, 2024), the Commission was particularly pleased with the choice of method: the disbursements of funds under the NGEU are in fact conditional on compliance with numerous milestones, including, for example, calls for tender prior to the financing of investment projects. This performance obligation – milestones have to be met before investments can be made – was hailed as an undeniable success: European funding is more transparent, and the performance obligation makes it easier to identify the added value of such funding, notably by combating windfall effects when member states use European funds to finance projects they had already planned to carry out. When it comes to the actual impact of NGEU, the European Commission relies on *ex-ante* impact studies. On the basis of simulations using EU macroeconomic models, the European Commission (2024) estimates that by 2026, taking into account updated loan requests and the profile of investment spending by country, the use of NGEU funds should increase real EU GDP by 1.4% compared to a situation without a common European policy. For the record, the multiplier effects calculated range from 1 in the short term to 6 in the long term (see Pfeiffer, Varga and in 't Veld, 2023). The NGEU's effects should be more marked in countries with per capita incomes below the European average (Bulgaria, Greece) or hit harder by the pandemic (Spain, Italy). In addition, the simultaneous use of all the allocated funds would produce additional spillover effects that could account for up to a third of the NGEU's expected impact on EU GDP.

The NGEU's expected impacts on the main beneficiary country, Italy, are currently the subject of debate. Boeri and Perotti (2024) focus mainly on the bottleneck effect of European funds allocated to Italy, which are not being used due to a lack of the time and administrative resources to manage them. Italy has a problem absorbing European funds. They need to be smoothed out over time, so that they can be used effectively to finance investments and hopefully generate growth; alternatively, the authors claim, Italy should renegotiate its plan and give up some of the loans. For their part, Giavazzi and Goretti (2024) point to the NGEU's successes in Italy, particularly in accelerating reform. The NGEU has, for instance, been associated with an improvement in the Italian judicial system. Furthermore, in terms of the milestones mentioned above, the transparency requirements of calls for tender have significantly reduced the risk of corruption. Giavazzi and Goretti also mention that the water and electricity utilities have been rationalized since the deployment of European funds.

Creel and Kaiser (2024) seek to get around the problem of the impossibility of evaluating NGEU *in the process* by attributing the multiplier effects of past national fiscal policies to the expected effects of NGEU loans. The advantage of European loans over national financing of capital expenditure is fairly limited: it depends on the spread between the European interest rate and the national interest rate, i.e. a few basis points. Apart from situations where there are wide spreads between member states, this difference is very small. Conversely, NGEU subsidies make a real difference: in the short and medium term, beneficiary countries do not directly pay interest on the debts they have contracted. The expected multiplier effect of European subsidies should therefore be higher than that of loans. By calculating the multiplier effects for past national fiscal policies, one can therefore expect to determine a lower limit on the *ex-post* effects of NGEU, if the loans and subsidies are actually used. In France, this lower limit would be on the order of 0.5 after one year; it would be 0.7 in Italy after three years; and it would be zero in Germany. In the Italian debate discussed below, the balance would therefore tip towards the (more optimistic) side of Giavazzi and Goretti: the NGEU would have a real positive effect in Italy, as a complement to ongoing reforms. Creel and Kaiser (2024) also show that the multiplier effect is higher in Italy and Germany (but not in France) if fiscal policy intervenes during an economic slowdown. The multipliers are then close to those found by the European Commission: equal to 2 in Germany after one year and 4 in Italy after three years.

Over and above its impact on long-term GDP, and hence on the sustainability of European public finances, NGEU has helped to strengthen financial solidarity through its innovative allocations, joint debt issuance and risk-sharing. In terms of crisis management, NGEU has served as a signal to put a halt to speculative movements on European debts, as evidenced by the fall in spreads since the announcement in May 2020 of the joint Franco-German initiative leading to its adoption. In terms of macroeconomic management, NGEU has little in common with a stimulus fund though: since the pace of funding peaks after four years, it is impossible to expect any immediate effect on the European economy.

Let us return now to the other two fiscal tools used to mitigate the economic and social costs of the pandemic. These two tools, SURE and the ESM's pandemic credit line, have had very different fates. SURE, the fund set up to support governments in their efforts to preserve labour markets, was very well received, and almost all of the 100 billion euros earmarked for it have been allocated and disbursed. The ESM's pandemic line, intended to support efforts in the healthcare sector, remained unused. The reason for this must be sought in the choice of financial vehicle: the ESM had been created in the wake of the Greek crisis to prevent the public finance problems of a single member state from undermining the single currency (which is also why the ESM is set up by an intergovernmental treaty reserved exclusively for eurozone countries). This is why in 2012 the ESM was grafted onto the regulatory framework for the financial supervision of member states, the "two-pack" and the "six-pack", giving the institutions a power to interfere (the famous "enhanced surveillance") that still makes using the ESM risky (a country resorting to it could be put under surveillance). The pandemic line softened the conditions for accessing the credit line, but did not change the nature of the ESM.

SURE's success, on the other hand, stems from its drafting under the provisions of Article 122 of the TFEU, which regulates European solidarity in the event of exceptional events such as an earthquake, or the 2020 pandemic. Article 122 stipulates that the EU may provide financial assistance to countries affected by natural disasters. This assistance is therefore naturally aimed at supporting the country in difficulty and not, as in the case of the ESM, at preserving the financial stability of the creditors.

In short, SURE was an instrument tailored to the needs it was intended to meet, a vehicle for European solidarity with the countries hit by Covid. The ESM is an instrument created to ensure financial stability. The choice to redirect the ESM towards a new purpose – "health" – without fundamentally changing its conditionality explains the failure of the pandemic line (Mangia and Saraceno, 2020).

The success of SURE raises the question of whether its logic can be replicated to cope with other shocks. For example, SURE was mooted as a model when Commissioners Breton and Gentiloni (2022) put forward the proposal to create a common tool to cope with soaring energy prices. As part of a possible reorganization of Europe's financial assistance system (see below), a credit line based on solidarity in the face of external shocks (e.g. Article 122) could have its place.

The PSPP and PEPP: Complementary rather than substitutes

As we saw above, starting in spring 2020, the PSPP and the PEPP coexisted. However, the two programmes were very similar in terms of their modus operandi: they consisted of purchases of the same government bonds from the same counterparty institutions: eligible commercial banks (or "primary dealers"). The most notable difference between the two programmes concerned the distribution in the balance sheet between purchases of securities by issuing country: purchases of government bonds under the PSPP had to be made following the capital keys, meaning purchasing bonds in proportion to each member state's share in the ECB's capital (the ECB therefore acquired more German than Italian government bonds, as Germany's share in the ECB's capital is greater than Italy's); the PEPP instead innovated by allowing temporary deviations from the capital keys, so that in the short term the ECB could e.g. purchase more Italian debt than its share of the ECB's capital. The PSPP was therefore not designed to alter interest rate spreads in the eurozone, whereas the PEPP was.

This difference between the PSPP and PEPP in the implementation of public bond purchases ended up being mostly on paper. In practice, the ECB has in most cases respected the capital key for its PEPP purchases. The PSPP and PEPP therefore appeared to be substitutes, raising the question of their coexistence: why have two similar programmes rather than just one?

In reality, these two programmes had different intermediate objectives, while the main goal remained to ensure price stability: the PSPP was launched in 2015 to combat the downward drift of inflation expectations away from the 2% target, while the PEPP was launched in 2020 to reduce interest rate spreads. It appears that, at least in the short term, and therefore when the spreads were at their worst, the ECB was able to push these spreads downwards as long as it communicated this intermediate objective and gave itself the flexibility needed to deviate from the usual capital keys (Hubert *et al.*, 2024).

The PEPP has been an effective crisis management tool, promoting the sustainability of Europe's public finances by lowering interest rates on public debt of most fragile countries, while combating the risks of financial fragmentation. Above all, by reducing spreads the ECB has ensured that its monetary policy was transmitted more uniformly to all eurozone member states. Once the PEPP was discontinued, the TPI became its natural substitute: in the event of any heterogeneous transmission of the ECB's monetary policy (e.g. diverging sovereign rates following monetary tightening), the TPI could be applied.

The TPI: Too much conditionality?

The TPI's conditionality is obviously reminiscent of the approach of the Outright Monetary Transactions (OMT) purchase programme. A few weeks after his vibrant “whatever it takes” plea, in July 2012 (“The ECB is ready to do whatever it takes to preserve the euro, and believe me, that will be enough”), Mario Draghi, then ECB President, announced the creation of a programme of unlimited bond purchases up to a maturity of three years. The OMT thus replaced and extended the previous programme known under the acronym SMP (Securities Market Programme). Activation of the OMT is conditional: the ECB triggers its purchases if, and only if, a member state is placed under an ESM programme and is pursuing, for example, a macro-economic adjustment programme. As we have seen, the conditionality of the TPI is different, as it relates to compliance with current European criteria on macroeconomic and public finance imbalances. However, the difference remains quite subtle, insofar as structural adjustment plans rarely overlook the need for fiscal consolidation.

To date, after almost two years in existence, the TPI shares another peculiarity with the OMT: it has never been triggered. These instruments, which can be used but never have been, undoubtedly have served primarily as insurance for governments and as a signal to financial markets. While the ECB still does not officially have the status of lender of last resort, it now does have many of its attributes.

The Eurosystem’s losses: A measured risk

Unconventional policies (in the eurozone, mostly the PSPP and PEPP) have contributed to a considerable increase in banks' excess reserves with the central bank. Past monetary policies have therefore also had a positive impact on banking stability, by reducing, all other things being equal, the risk on commercial banks’ assets. However, these excess reserves are remunerated and contribute to losses of the Eurosystem and so can be interpreted as subsidies to banks. This raises questions about the proper allocation of resources between different sectors of the economy (see De Grauwe and Yi, 2022). Do Eurosystem losses pose a significant risk to the eurozone?

The normalization of the ECB’s monetary policy from summer 2022 onwards has led to a significant fall in Eurosystem profits and, at end 2022, to losses for, e.g. the Bundesbank and Banque de France. As a result of the interest-rate hike introduced to curb inflation, the reserves accumulated by commercial banks with the ECB have been better remunerated (they are paid mainly at the marginal deposit facility rate, which turned positive again in July 2022, and before the recent decreases, had hit 4%): in the worst-case scenario, the mounting central bank losses could require recapitalization by the member states, imposing a cost to taxpayers. Nevertheless, we're a long way from that.

There are several factors to bear in mind when considering such a risk. Firstly, some recent studies emphasize the link between inflation, rising interest rates and the value of debt: raising interest rates following inflation would reduce the price of outstanding bonds, and therefore *de facto* the value of debt held in central bank assets (Cecchetti and Hilscher, 2024). The losses generated by a fall in the value of central bank debt would de facto materialize only in the case of an actual sale of the debt at this lower price. The central bank may very well decide to hold its debt until maturity and to provision its losses, anticipating that the key rates will fall again: the two operations – the actual, effective sale, or refinancing – will then not have the same discounted value. The risk of a loss on assets held by the ECB and the Eurosystem is thus limited. The ECB holds government bonds at their nominal value (i.e., their value at the time of purchase, Humann, Mitchener and Monnet, 2023) and not at their market value; moreover, the ECB states that it holds its securities until maturity and that any reduction in its balance sheet is handled not by selling the securities it holds, but by cutting back on new purchases.

Secondly, the rules for sharing the Eurosystem’s losses (and profits) between eurozone member states are highly codified and considerably limit risk-sharing with regard to the actual holdings of government bonds. A default on a member state's debt would have little *direct* impact on the Eurosystem or the other member states. Of every 100 euros of debt acquired by the Eurosystem, 80 euros are in fact national debt held by the national central banks, and only 20 euros are shared in some way: 10 euros are shared between the national central banks and 10 euros are held by the ECB itself. Given that 80% of the stock of public debt held is not shared, the Eurosystem’s holding of public debt is above all a national problem.

Thirdly, estimates of Eurosystem losses resulting from the now high remuneration of bank reserves are quite modest. The Eurosystem losses calculated by Belhocine, Vir Bhatia and Frie (2023) are on the order of 0.4% of GDP and are very temporary. The Eurosystem’s positive profits during the years since 2008 are not really being interrupted by two years of losses, in 2023 and 2024. This is also the observation of Bell *et al* (2023). Nevertheless, the losses, however limited or temporary, ultimately mean fewer fiscal resources for eurozone member states. What's more, they come at an inopportune time, when national fiscal rules (see below) and a period of fiscal consolidation are likely beginning.

3. What else?

The global financial crisis reignited the debate on the respective roles of the state and the market in the economy in both ensuring growth convergence and absorbing business cycle fluctuations; and many economists today have no problem recognizing a macroeconomic role for monetary and (especially) fiscal policies: part of the burden of making economic adjustments to deal with shocks or structural changes affecting growth must necessarily rest on the shoulders of public policy. A case in point is the United States, a monetary union relying on market flexibility and on the mobility of labour and capital in which, however, macroeconomic policies play a central role not only in times of crisis but also in regulating the economy in normal times (Alcidi, D'Imperio and Thirion, 2017). The pandemic made it clear that only the mutual insurance mechanisms typical of a federal state could guarantee macroeconomic stability and growth by operating in concert with (and sometimes in place of) market adjustments. The situation in the eurozone is very different. The only European “federal” institution in existence today, the ECB, would need to be accompanied by an overhaul of national and European fiscal policies with the objective of relieving the central bank of some of the burden it has had to bear on its own up to now. First, as recently highlighted by the Draghi report, the ecological and digital transitions will require active industrial policies and massive investment in the future, a large part of it public investment (Cerniglia and Saraceno, 2022). Furthermore, it is unfortunately plausible that the coming years will be marked by persistent geopolitical instability and waves of global shocks, which will require economic policy to play a stabilizing role.

This raises the challenge of equipping the European Union and its member states with the tools they need to implement social and industrial policies. Last but not least, the numerous crises of recent years have revived the debate on the impact of fiscal policy on economic activity. Studies on the size of the fiscal multipliers have multiplied,[7] and it is now accepted that their size is generally much larger than previously thought, and that they are more effective when the economy is in crisis (see e.g., Creel, Heyer and Plane, 2011).

7. For a review of the literature on multipliers, see Gechert and Rannenberg (2018) and Deleidi, Iafrate and Levrero (2023).

Making the ECB's monetary policy less restrictive

Since 2012, with Mario Draghi's "whatever it takes", the ECB has actively participated in the eurozone's stabilization efforts, sometimes forced to intervene against its will and beyond its formal mandate by the inertia of the fiscal authorities (Saraceno, 2016). The PSPP and PEPP programmes, the OMT and the TPI were all set up within the existing normative framework, which postulates that "The primary objective of the European System of Central Banks, hereinafter referred to as the 'ESCB', shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union" (Article 127(1) TFEU). All the successive interventions to support the financial system and counter soaring spreads have been justified by the threats to price stability posed by financial instability and by the risk of the eurozone's dissolution (notably in 2012). So, while it would be an exaggeration to claim that the normative framework has constrained the ECB, it is certainly true that it has forced it into acrobatics in its communications and some stubborn ambiguity in its actions. Not to mention the fact that legal risks arise when the ECB acts at the boundaries of its mandate, as demonstrated by the various attempts to challenge its actions before the German Constitutional Court in Karlsruhe and the European Court of Justice.

The constrained flexibility of the ECB's activity raises the question of modifying its mandate to bring the principles and practices of the last decade into line. When revising its strategy in 2021, the ECB adopted a symmetric inflation objective around the 2% target, abandoning the definition of price stability as "inflation rate below, but close to, 2%". Although the soaring inflation in 2021-2023 still makes it impossible to assess the impact of this change "in normal times", it was a major step forward, as it removed an implicit deflationary bias of the ECB mandate.

The ECB also indicated that policies such as QE were now an integral part of its monetary policy toolbox in the event of crises. At the same review, the ECB also abandoned the monetary aggregate targets. The ECB's monetary and financial analysis is now aimed at shedding light on monetary policy transmission channels and potential financial risks, rather than at detecting risks to price stability of the growth of money supply. This is a technical point, and in the past the money growth target has often been ignored without too much concern. However, it is symbolically important, given that the emphasis on monetary growth is a legacy of a monetarist period during which it was believed that a tight link between prices and the quantity of money existed, which implied leaving the task of controlling inflation to the central bank alone. Today, the ECB joins other central banks in recognizing that the link between inflation and the volume of money in circulation is tenuous, and that monetary and fiscal policies must cooperate to bring inflation down to desired levels. It would therefore be desirable for the subject of the central bank's mandate to be put on the table as part of the discussions on reforming the European institutions.

There are certainly strong arguments for introducing a dual mandate (employment and price stability) for the ECB, as is the case with the US Federal Reserve (Blot *et al.*, 2014). Once we accept that inflation is not necessarily a monetary phenomenon (Creel *et al.*, 2024a; Saraceno, 2023) and that the central bank participates in the policy mix alongside other policies (industrial and fiscal), then limiting the ECB's mandate to inflation alone can no longer be fully justified. Furthermore, as long as European countries do not endow themselves with a central fiscal capacity (see below), giving the ECB the task of implementing countercyclical policies against common shocks would make its stabilization policies more effective. Finally, a dual mandate would reveal the trade-offs and political aspects of monetary policy, dispelling the technocratic illusion of optimal inflation-targeting rules (Islam and Saraceno, 2015).

A discussion should also be engaged on the ECB's inflation target (Blot and Saraceno, 2024). The 2% target may have seemed reasonable during the long period of great moderation (1990s-2008), when stable GDP growth was accompanied by limited fluctuations in the inflation rate. However, this period of apparent macroeconomic stability concealed growing imbalances, such as a chronic tendency towards excess savings and, consequently, increasingly low neutral real interest rates.

In 2008 we entered a new phase in which imbalances have come to the fore and macroeconomic shocks have become more pronounced. Against a backdrop of stronger instability, central banks may find themselves having to cut interest rates significantly. If these rates are initially moderate, the risk of reaching the effective lower bound is larger. This is the situation in which the Federal Reserve and the ECB found themselves throughout the 2010s. A higher inflation target would make it possible to have higher interest rates in normal times and provide greater scope for lowering them when necessary. This additional leeway could prove invaluable in the likely event of greater macroeconomic and geopolitical instability in the years ahead. According to the revised estimates by Holston, Laubach and Williams (2023), the neutral real rate in the eurozone currently stands at -0.7%, suggesting an optimal inflation target of 2.8% (see Andrade *et al.*, 2021). Furthermore, the recent discussion about the non-monetary causes of inflation points to the central bank's relative loss of control on the inflation rate. Monetary policy alone is not capable of precisely targeting changes in the inflation rate, which has multiple causes. Acknowledging that monetary policy is not almighty in controlling inflation has two consequences. Firstly, coordination of monetary and fiscal policies becomes paramount in trying to hit the target. Secondly, given that the central bank is not omnipotent in combating a phenomenon that depends on other causes, it may be more reasonable to target an inflation range of rather than a level. Short of the introduction of a dual mandate, a range would also allow the ECB room to arbitrate between the objective of price stability and other secondary objectives such as growth.

Of course, one of the criticisms levelled against a band within which inflation could fluctuate is that it is less precise, which could undermine the central bank's credibility. But the credibility argument can be used the other way round. How credible is a central bank that almost systematically misses its target?

Recovering fiscal space

The disappointing reform of the Stability and Growth Pact

After three years of virtual inaction and a few months of frenetic negotiations, in December 2023 the European Finance Ministers finally reached an agreement to reform the Stability and Growth Pact, which had been suspended in 2020 during the pandemic. The new rules took effect upon ratification by the European Parliament in April 2024, and it was not long before the European Commission recommended (on 19 June 2024) the opening of excessive deficit procedures against seven EU member states, including Belgium, France and Italy, for government deficits in excess of 3% of GDP.

The previous Pact, introduced in 1997, came in for almost universal criticism. Firstly, because it was baroque and based on a plethora of indicators, some of which were arbitrary and difficult to calculate; secondly, because its emphasis on identical annual targets for all countries meant that it was geared towards short-term discipline, with the effect of being pro-cyclical; and thirdly, because it discouraged public investment, a particularly acute problem at a time when European countries were embarking on the ecological and digital transitions. Above all, the old Pact was a product of the dominant worldview of the 1990s, which envisaged reducing the State's role in the economy, inter alia by tying the hands of fiscal policies with restrictive rules, in order to give more room to supposedly efficient markets.

That world has never existed, and after the multiple crises that have plagued the world economy since 2008, economists and political decision-makers seemed to have noticed this too. The 2008 crisis, the calamitous management of the euro crisis, the pandemic and, last but not least, inflation, have shown that there can be no macroeconomic stability and growth without stabilization policies, without adequate levels of global public goods such as health and education, and without industrial policies and public investment in the ecological and digital transitions – in short, without an active role for the State in the economy.

This newfound role for macroeconomic policies explains the decision to launch the Stability and Growth Pact reform ward in 2020. The reformed rule, it was widely believed at the time, was supposed to foster a radical change in approach in focusing on restoring fiscal space for governments to pursue short and long term objectives (while, of course, ensuring the sustainability of public finances). This change in philosophy was at least partially reflected in the reform proposal presented by the European Commission in 2022, which while not devoid of shortcomings, was a radical step forward. The rule proposed by the Commission abandoned single annual targets in favour of medium-term plans designed and owned by countries in agreement with the Commission, within a framework that guaranteed debt sustainability and some (still not enough) protection for public investment.

In short, at the heart of the framework proposed by the Commission was a probabilistic analysis of debt sustainability that took into account country-specific characteristics and radical (and therefore inevitable) uncertainty over the various determinants of debt dynamics. By its very nature, this type of analysis is imperfect and dependent on several assumptions (and therefore, in a way, on the political preferences of those who make them), but it certainly represents a significant step forward compared to the previous idea that the only measure of sustainability was debt reduction. In the Commission's proposal, the analysis of sustainability would then have served as the basis for a multi-annual adjustment process, prepared in consultation with the member state, with the deliberately unquantified objective of placing the country on a reasonable debt reduction trajectory. In the case of major investment and reform plans, countries could also have negotiated an extension of the adjustment period (from four to seven years).

The negotiation process yielded a very different outcome. The new rule maintains the Commission proposal's framework, but *de facto* transforms it into an empty shell. On paper, the multi-annual plans and the investment protection still exist. But a group of countries led by Germany succeeded in imposing a plethora of complex safeguard clauses that will be triggered in the event of a deviation from the agreed plans towards excessive debt or deficit (i.e. almost always and for almost everyone) and which, whatever the plans agreed with the Commission, amount to imposing the same annual numerical constraints for everyone. For example, a country whose debt exceeds 90% of GDP must reduce the ratio by at least one point per year on average, regardless of any other consideration; short-term one-size-fits-all objectives, therefore, are present in the reformed Pact as much as they were in the old one. Furthermore, the new system is baroque and extremely complex (perhaps even more so than the old system); like the old one it features problematic indicators such as the structural balance, which is difficult to calculate and has in the past been the subject of exhausting negotiations between the Commission and member states. It is not easy to understand, even for insiders, how this web of constraints will end up being applied. What is clear is that, in practice, it makes the multi-annual and country-specific plans redundant. As in the old Pact, in short, the seven member states subject to an excessive deficit procedure in July 2024 will all have to reduce their structural deficit by 0.5% of GDP per year until their total deficit falls below 3% of GDP. Above all, the change in philosophy (the creation of fiscal space in a framework ensuring debt sustainability) that was the greatest merit of the Commission's proposal has been completely nullified: debt reduction remains the principle inspiring the framework that governs countries' fiscal policies, and it is no coincidence that all the so-called "frugal" governments are delighted that the new rules will be more effective than the old ones in ensuring fiscal discipline, at the risk of inducing fairly widespread fiscal consolidation and insufficient resources devoted to public investment and industrial policies.

Central fiscal capacity: A realistic prospect?

With a reformed fiscal rule that is scaringly similar to the old one, one should hope that the fiscal space that individual countries will lack will be created at the supranational level. The Next Generation EU programme could be the embryo of a fully-fledged European fiscal capacity. Only the success of the NGEU could pave the way for discussion of the next step, the creation of a permanent fiscal capacity. It would not be the first time that temporary instruments have acted as icebreakers, leading to institutional innovations. Next Generation EU has some of the characteristics of a federal ministry of finance: its ability to borrow, a capacity (in the making) to finance itself with own resources, an allocation of resources that combines the needs of individual states with the pursuit of common goals such as the ecological transition and digitization. Equipping the eurozone with such an instrument would considerably reduce the market pressure on member states, as well as their ability to act opportunistically, so feared by the so-called frugal countries. Buti, Coloccia and Messori (2023) argue convincingly that endowing the EU with a central fiscal capacity would enable macroeconomic stabilization and the financing of European public goods more effectively and at lower cost than through national policies.

However, for Next Generation EU to become a Hamiltonian moment, a foundational step in the construction of a federal treasury, much remains to be done. Firstly, there must be political consensus on the creation of own resources. Secondly, the member states need a future agreement on boosting investment in truly European public goods. Finally, the challenge will be to channel resources towards effective projects. Unfortunately, the mounting delays in the implementation of national recovery and resilience plans (NRRPs), of which the Italian example is emblematic, leave little room for optimism.

Moreover, even if a political space for introducing a European fiscal capacity could be carved out, creating a centralized capacity to tax and spend while remaining accountable to the electorate at the national level would require a complex process of creating the necessary checks and balances (e.g., involving the European Parliament in the definition and in the monitoring of investment projects) to ensure that no new democratic deficit emerges.

Reorganizing assistance to the member countries

While waiting (in vain?) for the eventual success of Next Generation EU to open up the political space for a common fiscal capacity, there is an urgent need to reorganize the Union's financial assistance instruments, which have become increasingly "vague" and confused over the years. A note from the Delors Institute (Guttenberg, 2020) starts from the observation that the Covid crisis has created a political demand for solidarity and stabilization mechanisms; the author proposes repatriating the ESM (currently governed by an intergovernmental treaty between eurozone countries) within the perimeter of the EU and consolidating it with the plethora of other existing assistance instruments: SURE, the loan allocations of the Recovery and Resilience Facility, the Bank Resolution Fund, and the Balance of Payments Support Fund. All these elements could be combined into a single facility capable of opening credit lines differentiated by purpose and access conditions, and which could be activated and deactivated as required. The ESM itself could then evolve into a European Debt Agency (Amato and Saraceno 2022) to coordinate and, in the case of joint projects such as Next Generation EU, centralize the management of national debts. In particular, it could become the issuer of a safe asset that would enable better management of European debt, and facilitate the deepening of a unified eurozone financial market.

4. Conclusion

Economic governance moved forward

The European Union has been slow to reconsider the ban on the utilization of fiscal policy that it inherited from the first decade of the euro and from the calamitous management of the sovereign debt crisis. The Covid-19 pandemic, an exogenous shock *par excellence*, acted as a catalyst for the EU, prompting its member states and institutions to take vigorous action against the pandemic and the socio-economic consequences of the social distancing policies implemented to fight it. Despite a few mistakes at the very start of the pandemic, when the principles on which the EU is founded – the four freedoms – were somewhat trampled, the EU's member states and institutions quickly managed to cooperate effectively.

They have done so in particular through what will remain the major institutional innovation of recent years, namely the creation of the Next Generation EU programme. Even if we are a long way from the federal leap evoked by the frequent reference to a "Hamiltonian moment", the NGEU should not be underestimated. Its positive effects have already begun to be felt, and the shortcomings that emerged, notably the delays in implementation and some clumsiness in the procedures for monitoring and disbursement, can be used to better prepare the future major European investment plans.

In addition, the tools developed by the ECB helped stem the financial crisis that the pandemic was producing and contributed to the sustainability of member states' debts at the height of the crisis.

The European Union member states have numerous needs for financing, both for macroeconomic stabilization after the many shocks they have experienced and to ensure the ecological transition. This raises the question of how fiscal and monetary policy should be linked and how the different levels of fiscal policy – national and European – should be coordinated.

The reform of the Stability and Growth Pact has failed to live up to the promise of the European Commission's initial proposal. National fiscal policies are still straitjacketed in a tight web of limits and safeguards; the result is that member states' governments will not have the means to match their ambitions in term of reindustrialization, investment and industrial policies for the transition. Given the current budget deficits in a number of countries, such as Belgium, France and Italy, excessive deficit procedures will very quickly force the implementation of tight fiscal policies. This will hit the European economy at a very difficult moment, amidst geopolitical tensions and a race to the decarbonation of the economy that it is losing to its competitors.

What can be done during the next legislature of the European Parliament?

The reform of the Stability and Growth Pact was seen by some observers as a prerequisite for a far-reaching reform of the European budget, securing the perpetuation of Next Generation EU and the creation of a central fiscal capacity (with a federal budget charged with ensuring macro-economic stabilization objectives). The safeguard clauses belatedly introduced in the new version of the Pact speak volumes about member states' lack of appetite for such an evolution. As for the long-term future of the NGEU, this is difficult to imagine without treaty changes (Allemand *et al.*, 2023). At the very least, the creation of an agency or fund for European public investment could serve to steer and control common investment projects and drastically reduce the risk of duplication of national plans. Focused on climate issues, such a fund could cover part of the annual needs, estimated at around 2.5% of European GDP (Creel *et al.*, 2024b).

In view of the recent political difficulties encountered, it seems logical to reopen discussions on reforming the Stability and Growth Pact. There is no need to wait for the results of the tight fiscal policies that will be implemented starting already in 2025: their deleterious effects on growth are certain, as demonstrated by the long list of economic studies devoted to the multiplier effects of fiscal policy (see footnote 7). The process of reform of the Pact started in 2020, i.e. before the pandemic and before inflation, with the rise in public deficits and debts to which they contributed. It is not possible to carry on as if public finances were at the levels of 2019; it is unrealistic and masochist to have the objective to return, however gradually, to the levels of the public deficits and debts that prevailed in 1991 and when natural interest rates were 4 or 5 points larger than today. Said it differently, it is unreasonable to maintain the public debt target at 60% of GDP after public debts have risen dramatically when it is not at all easy to attribute the cause to one or another spendthrift government. That is the advantage of a pandemic – at least there is one! – no one can be held individually responsible. The shock generated is therefore exogenous. Given the financing requirements for the ecological transition, to which we must now add the financing requirements for defense, given the levels of debt reached, and given the lack of political will in favour of a common fiscal policy, implementing the new Pact will require budget cuts in the areas of health and education. This is certainly not optimal if we are to avoid falling behind our competitors (most notably the United States) (Bock *et al.*, 2024; Aurissergues *et al.*, 2024).

Unfortunately, the fiscal consolidation that is about to be enacted has every chance of taking effect amidst weak growth. Thus, as difficult as it might seem, given that the new rule has just been agreed upon, it seems unavoidable that the discussion resumes with a view to establishing a new rule allowing truly counter-cyclical policies. At the same time, rerouting the various financial assistance instruments into a single financing facility would rationalize aid and ensure greater debt sustainability.

Last, but not least, let us not forget the ECB. Admittedly, its pragmatism has enabled it to adapt its actions to the changing context, considerably extending the panoply of its monetary policy instruments, and even sometimes reinterpreting its mandate, by adopting a symmetric inflation target since 2021. But rather than expecting much from the ECB, either to stabilize the European economy or to promote its greening, it would undoubtedly be useful if, in addition to a discussion on fiscal space there was further dialogue about the objectives assigned to an independent central bank by the member states, and a clearer mandate were established, or at least one more in line with monetary practices. With a dual mandate, the ECB's actions would more readily correspond with its statutes.

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