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Jackson Hole, Draghi and the Governments' Turn

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In the run-up to Jackson Hole, the international media tended to portray the debuts of Janet Yellen and Mario Draghi in almost sporting terms. Accepting this journalistic stretch, one can safely say that, as to clarity of message, the contest was "won" by the head of the ECB. Yellen's speech was in fact difficult to decipher, often tending to run with the hare and hunt with the hounds. Each passage that seemed to presage a labor market recovery was followed by another playing it down. Little in the way of forward guidance, therefore, from the Fed.

Mario Draghi, for his part, was crystal clear, calling unequivocally for a strengthened accommodative stance. He explicitly pointed to the asymmetry of current risks in the eurozone, with the risks of "doing too little" outweighing those of "doing too much." So why, one could legitimately ask, is the start of euro area quantitative easing – widely seen as essential to averting a Japanese-style lost decade – continuously postponed? For sure, there are well-known limitations to the effectiveness of QE in Europe, but Draghi's speech appeared to embody another design as well. In order to overcome strong political opposition to the instrument, Draghi seemed to use QE as a bargaining chip to obtain much-needed structural reforms – without which any liquidity injection would in any case have little effect ("No amount of fiscal or monetary accommodation can compensate for the necessary structural reforms in the euro area"). This could turn out to be a smart political move to spur governments. But at the risk of "doing too little," or at least "too late." To the many reasons to implement structural reforms, one can now also add that of paving the way for further ECB action.

The main novelties of Draghi's speech lie however beyond the domain of monetary policy, and concern three main points. First, the unprecedented invitation to make better use of the existing flexibility within the Stability Pact rules. Second, the recommendation to strengthen the coordination of national fiscal policies. And third, the clear-cut support for a large EU public investment program, as proposed by the incoming President of the European Commission, Jean-Claude Juncker.

Among these, the proposal with the slimmest chances is that of a stronger coordination of the different national fiscal stances. As noted by Alessandro Merli in Il Sole 24 Ore of August 23, this is another way of saying that countries that have budgetary margins, such as Germany, should exploit them. Such advice has been pressed for many years, including by the IMF and the OECD, to absolutely no avail. Indeed, the strengthened process of EU surveillance, known as the European Semester, was itself supposed to improve the ex ante coordination of fiscal policies. In practice, it has been used solely to pressure individual states, rather than to aim for an overall fiscal stance aligned to the cyclical needs of the euro area – as advocated by Draghi at Jackson Hole.

Juncker's proposal for a large investment program may fare somewhat better. But this is certainly not the first time that hefty investment plans for strategic projects in Europe are floated, and some skepticism seems advisable. Such investments require in any case a long gestation period, and will certainly not help lift the euro area from its current stagnation any time soon.

The point of greatest interest is Draghi's invitation to make better use of the flexibility existing within current SGP rules. It steps right into the current debate and positions the ECB on the side of those who, such as the government of Matteo Renzi in Italy, are strongly pressing the issue. The problem is that this "best-use" line has for some time now been part of the official mantra of EU summits – without however any agreement on its precise meaning or, much less, any concrete application. Such language can be found word-for-word in the conclusions of the Ecofin Council of last July. Similar concepts have been around for even longer, but again devoid of content. Thus, for example, the conclusions of the European Council of March 2013 (Mario Monti was still in government) already stressed "the necessity of differentiated growth-friendly fiscal consolidation," was open to "short-term targeted measures to boost growth," and recalled "the possibilities offered by the EU's existing fiscal framework to balance productive investment needs with fiscal discipline objectives."

The gap between declarations and actions is a dispiriting European ritual. It is high time to bridge this void. The special EU summit of end-August will be entirely taken up by the remaining top job appointments. One has to therefore look to the informal Ecofin in Milan, on September 13, to finally give substance to the notion of "flexibility-within-the-rules," thus allowing an agreed – and consequently non-controversial – application in individual country's budget plans, starting with the update of Italy's Stability Program (the so-called DEF). In the face of a sharp deterioration in the eurozone's economic situation, to continue to speak of "flexibility" in empty terms would be gravely irresponsible. It would be a case of "doing nothing," clearly much worse than "doing too little" and, of course, well removed from "doing too much."

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