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Economic Intelligence

Up-to-the-Minute Analysis from
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'Whatever It Takes'
Why Urgent Fiscal Policy Action is Key to Eurozone Success

In recent years, monetary policy has taken on an increasing – and increasingly solitary – role as the dominant macroeconomic policy tool.[1] While fiscal policy has stood on the sidelines, most particularly in Europe, the European Central Bank (ECB) has been called upon to pull out of its hat one instrument after another in the pursuit of its stabilisation role.[2] Negative interest rates, massive asset purchases, forward guidance – indeed "whatever it takes" in the celebrated expression of former ECB President Mario Draghi – the arsenal of tools has been creatively expanded and deployed, spawning increasingly "unconventional" monetary policy. At the same time, it is widely recognised that prolonged and anticipated monetary accommodation generates its own downsides in terms of excess risk-taking and asset-market overvaluation. Investors' expectation that they can rely on monetary stimulus in the face of any adversity is a dangerous premise, as evidenced by recent stock market gyrations.

Even so, many observers are still looking with anticipation to the ongoing review of the ECB's instruments, with faith placed in President Christine Lagarde's boldness to pull more rabbits out of the hat.[3] There seem to be many more "memos" of advice emanating from think tanks and directed to Frankfurt than to the masters of fiscal policy. Such appeals are misdirected.

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[1] **Economic Intelligence** is a series of up-to-the-minute policy briefs from Alessandro Leipold, chief economist of the Lisbon Council and former acting director of the International Monetary Fund's European Department and later executive director for Italy, Greece, Portugal, Malta, Albania and San Marino. Special thanks to Cécile Bergmans, Paul Hofheinz, Chrysoula Mitta, David Osimo and Viorica Spac.
[2] See especially Mohamed El-Erian, *The Only Game in Town: Central Banks, Instability, and Avoiding the Next Collapse* (New York: Random House, 2016).
[3] European Central Bank, "ECB Launches Review of its Monetary Policy Strategy," 23 January 2020. https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200123~3b8d9fc08d.en.html

The ECB is not where the action is. Having fired everything from pop guns to bazookas, the ECB is low on ammunition. Even unconventional monetary policy is exhausted, with little or no dry powder left. Past recessions have generally required rate cuts of around five percentage points – a margin unavailable today. There is thus broad agreement that in the case of a pronounced euro area downturn monetary policy would be unable to cushion the cycle.[4] Even the ECB's carefully worded pledge on 02 March 2020 "to take appropriate and targeted measures, as necessary and commensurate with the underlying risks" was suggestive of its limited range of options.[5]

As European Union finance ministers and heads of state gather in Brussels on 16-17 March and 26-27 March to discuss the worsening economic picture and the fallout from the COVID-19 virus, they need to recognise that, **in the face of severe downside risks, the primary countercyclical instrument in Europe today has to be fiscal policy: it is its turn to take on the "whatever-it-takes" mantle.** Put simply, Christine Lagarde is not the one who can save Europe now. That task currently falls to European finance ministers themselves and to Paolo Gentiloni, European commissioner for the economy.

What's more, the situation – correctly assessed – presents as much opportunity as challenge. Concretely, **the current environment of "low interest rates for long" makes for fiscal policy optimality.** In the words of Philip R. Lane, member of the executive board and chief economist of the ECB, "the macroeconomic impact of fiscal policy is particularly strong in an environment in which inflationary pressures are muted and the expected interest rate path is not very steep."[6] Similarly, Olivier Blanchard and Larry Summers argue in a recent paper that "this environment of low rates should be seen as a regime change, in which fiscal policy will have to play a major and likely dominant role in stabilization policy. It requires a fundamental reconsideration of discretionary fiscal policy and of automatic stabilizers and fiscal rules… In a world where monetary policy cannot assume responsibility for stabilization policy, there is a strong need for fiscal policy to address stabilization issues."[7]

However, "looking for new central bank tools will remain an intellectually interesting exercise but ultimately a futile one if the context is not changed." See Mohamed El-Erian, "Central Banks Seek an Edge in a Game They Can't Win," *Bloomberg*, 25 February 2020. https://www.bloomberg.com/opinion/articles/2020-02-25/central-banks-seek-an-edge-in-a-game-they-can-t-win

[4] A recent paper from the Peterson Institute for International Economics argued that central banks are "not quite" out of ammunition to fight a recession but added that the ECB "has no easily available ammunition left. It has set the policy rate about as low as is likely to be helpful. It has also pushed yields on the safest long-term bonds about as low as practical." See Joseph E. Gagnon and Christopher G. Collins, "Are Central Banks Out of Ammunition to Fight a Recession? Not Quite," *Peterson Institute for International Economics*, November 2019. https://www.piie.com/publications/policy-briefs/are-central-banks-out-ammunition-fight-recession-not-quite

[5] European Central Bank, "Statement by the President of the ECB," 02 March 2020. https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200302~f2f6113f52.en.html

[6] Philip R. Lane, "The Monetary Policy Toolbox: Evidence from the Euro Area: Keynote Speech at the 2020 U.S. Monetary Policy Forum," 21 February 2020. https://www.ecb.europa.eu/pub/conferences/html/20191219_4th_fiscal_policy_conference.en.html

[7] Olivier Blanchard and Lawrence H. Summers, "Automatic Stabilizers in a Low-Rate Environment," *Peterson Institute for International Economics*, February 2020.

How can this be translated into action in the euro area in 2020?

We propose a five-point package. See the box on page 4 for a summary and the more detailed discussion that begins on page 7.

Discuss, Defer, Delay…A European Habit

The economic outlook has darkened markedly. The Organisation for Economic Cooperation and Development (OECD) sounded a clear alarm in the March 2020 *Interim Outlook*, in which it lowered world growth projections by one-half of a percentage point under its central (more benign) scenario.[8] OECD Chief Economist Laurence Boone minced no words: "The world economy is in its most precarious position since the global financial crisis."[9] For the euro area, this follows dismal growth figures for the fourth quarter of 2019, which fell short of even highly diminished expectations.[10] The area recorded the lowest quarterly growth rate since 2013 and its major economies either flatlined (Germany) or contracted (France and Italy). The euro-wide economy was thus teetering on the brink of recession even before any coronavirus impact.

Despite such gathering clouds, Europe's deliberations have lacked any sense of urgency. While the new European Commission has commendably attempted to instil fresh momentum on a variety of fronts, at the political (ministerial) level the prevailing approach has lacked ambition and remains that of "business as usual." For example, with fiscal policy now effectively the only game in town, the European Council recommendation on the economic policy for the euro area is content with an area-wide fiscal stance expected to be

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https://www.piie.com/system/files/documents/pb20-2.pdf
See also Olivier Blanchard, "Revisiting the EU Fiscal Framework in an Era of Low Interest Rates," Keynote Speech at Fourth ECB Biennial Conference on Fiscal Policy and EMU Governance, 19-20 December 2019.
https://www.ecb.europa.eu/pub/conferences/html/20191219_4th_fiscal_policy_conference.en.html

[8] Organisation for Economic Co-operation and Development, *OECD Economic Outlook: Interim Report*, 02 March 2020.
https://www.oecd-ilibrary.org/docserver/7969896b-en.pdf?expires=1583179181&id=id&accname=guest&checksum=A9EC8FA42080FB15635A75B53945AFF3
Economist Kenneth Rogoff sounded a similar warning: "The odds of a global recession have risen dramatically, much more than conventional forecasts by investors and international institutions care to acknowledge." See Kenneth Rogoff, "That 1970s Feeling," *Project Syndicate*, 02 March 2020.
https://www.project-syndicate.org/commentary/next-global-recession-hits-the-supply-side-by-kenneth-rogoff-2020-03?utm_source=project-syndicate.org&utm_medium=email&utm_campaign=authnote&

[9] Ibid.

[10] Eurostat, "GDP and Employment Flash Estimates for the Fourth Quarter of 2019," 14 February 2020.
https://ec.europa.eu/eurostat/documents/2995521/10159400/2-14022020-AP-EN.pdf/f9d9764c-bd84-e8f9-90b1-24b12ecee7a4

"broadly neutral" to at most "slightly expansionary" in 2020-21.[11] Similarly, a "business-as-usual" approach is reflected in the standard recommendation of "full respect of the stability

The Urgency of Now: Five Key Steps

The primary macroeconomic policy instrument in Europe today has to be fiscal policy.

- Monetary policy accommodation has run out of ammunition and potency and has downsides.
- The deployment of fiscal policy enjoys an optimal setting: one of "low-interest-rates-for-long."
- There are pressing investment needs: green economy, digitalisation, infrastructure.

It is thus time for fiscal policy to take on the "whatever-it-takes" mantle. The end-March European Council, in the midst of mounting concerns about the outlook, needs to deliver a decisive response, comprising five key steps:

1) **Embrace countercyclical fiscal stimulus centered on investment**. In finalizing the euro area-wide recommendations, the European Council needs to move away from viewing a "neutral" or "slightly expansionary" fiscal stance in 2020-21 as appropriate and embrace a clearly supportive stance.

2) **Accelerate revision of the fiscal rules**. To provide institutional support to the shift in fiscal stance, the European Council needs to adopt two immediate decisions: a) a declaration that the coronavirus epidemic is such as to trigger the "exceptional circumstances" clause under the stability and growth pact, and b) approval of a "greening" of the rules.

3) **Use the 2020 European Semester to enhance the quality of member states' public finances.** The focus needs to shift from short-term considerations around yearly budgets toward achieving sustainable economic growth for future generations.

4) **Agree the financing mechanism for the Budgetary Instrument for Convergence and Competitiveness.** Despite the lack of a stabilisation function in its design, this budgetary instrument could play a role in driving crucial investment in areas such as green growth, technology adoption and intra-European convergence.

5) **Launch a European unemployment benefit reinsurance scheme.** This powerful idea, first aired in the 1990s, could serve as an important automatic stabilizer – helping to stimulate flagging economies and providing more stability to the system at large.

and growth pact" (SGP) – even repeated twice in the same paragraph of the euro area recommendations, and again several times in the annual growth strategy (AGS).[12]

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[11] European Commission, *Council Recommendation on the Economic Policy of the Euro Area,* 18 February 2020.
https://data.consilium.europa.eu/doc/document/ST-5822-2020-INIT/en/pdf

When 'Business as Usual' Becomes the Usual Business…

Despite a looming recession, the official response has been characterized by deferment and a "business-as-usual" approach.

- The 2020 European Semester documents lack any sense of urgency. The euro area recommendations are content with a "broadly neutral to slightly expansionary" area-wide fiscal stance in 2020-21.

- While the flaws of the current fiscal framework are widely recognised, its review is to take a full year. In the interim, the mantra remains that of "full respect of the stability and growth pact."

- A possible cushioning tool, the Budgetary Instrument for Competitiveness and Convergence (BICC), has been emasculated to the point of irrelevance for stabilisation purposes.

- Work on a European unemployment benefit reinsurance scheme, that could have a countercyclical role, is on the slow burner.

- The next seven-year budget (the multiannual financial framework) lacks ambition and discussions are mired in yesteryear's concepts of "net" beneficiaries and contributors. The new European green deal financing is largely a rebranding of funds reshuffled from various existing programmes.

The 2020 European Semester is marching on as a mere formal exercise on automatic pilot, without any ambition of *ex ante* coordination (its original rationale). The procedure is unfolding mechanically through its calendar, in a routine fashion and largely detached from ongoing developments. Thus, for example, there is basically no difference between the European Commission's original draft of the euro area recommendations, presented in mid-December 2019, and the text adopted by the Council of Ministers in mid-February 2020.[13] In the intervening two months, however, the outbreak and spread of the coronavirus has drastically depressed the outlook. The only reaction in the revised text of the Council of Ministers recommendation was the addition of an anodyne and self-evident phrase: "… if downside risks were to materialize… member states should stand ready to coordinate

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[12] The AGS is the document setting out key goals for 2020. See European Commission, *Annual Sustainable Growth Strategy 2020*, 17 December 2019.
https://eur-lex.europa.eu/legalcontent/EN/TXT/?qid=1578392227719&uri=CELEX%3A52019DC0650

[13] Compare European Commission, *Recommendation for a Council Recommendation on the Economic Policy of the Euro Area*, 17 December 2019 with European Commission, *op. cit.*, 18 February 2020.
https://ec.europa.eu/info/sites/info/files/2020-european-semester-euro-area-recommendation_en.pdf

policies in the eurogroup." That this platitude was touted as a sign of responsiveness and progress is testament to the fundamental lack of ambition.

On other fronts, **when agreement cannot be reached even on the lowest common denominator, the default "solution" is that of endless deferment**. The words uttered by President of the European Council Charles Michel after the collapse of the latest marathon discussions on the next seven-year budget – "we need more time" – could be the epitaph of many key European Union initiatives.[14] To cite just three examples:

- Banking Union is in the deep freeze. In the words of *Financial Times*, "hopes of striking a grand bargain over the eurozone's banking union project are in tatters."[15] Divisions on its essential component – a European deposit insurance scheme (EDIS) – remain profound. The problem, in typical dilatory manner, is kicked aside to a committee, with the creation of "a high-level working group to work on *a roadmap for beginning political negotiations*" on EDIS (our emphasis). That this should be the state of play after years of discussions is disheartening.

- The sad tale of the Budgetary Instrument for Convergence and Competitiveness (BICC) is equally revealing. In its original conception, the instrument was to serve as an ambitious common eurozone budget, large enough to smoothen asymmetric economic shocks within the monetary union and function as an important area-wide stabilisation tool. The need for such a tool has been widely argued elsewhere and will not be rehearsed here.[16] Ministers however ruled out any stabilisation function in June 2019, opting instead for a fund aimed solely at structural reform and in an amount far too small to act as a shock absorber. The European Commission, the ECB and the European Fiscal Board have all lamented this outcome; in the words of the latter: "Such a [central fiscal] capacity would, in our view, have been desirable for both sharing and reducing risk… [and] alleviating the problems of sustainability in vulnerable member states."[17] Even the current unambitious project is stalling: the eurogroup meeting of 17 February 2020 was unable to agree on the instrument's financing, particularly on the need for an intergovernmental agreement (IGA) to top up its meagre resources from the yet-to-be-agreed multi-annual budget. In an

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[14] European Council, "Remarks by President Charles Michel After the Special Meeting of the European Council on 20-21 February 2020," 21 February 2020.
https://www.consilium.europa.eu/en/press/press-releases/2020/02/21/remarks-by-president-charles-michel-after-the-special-meeting-of-the-european-council-on-20-21-february-2020/
[15] Mehreen Kahn and Guy Chazan, "Weakened Scholz Puts Brakes on Eurozone Reform," *Financial Times*, 04 December 2019.
https://www.ft.com/content/a0b6c866-163b-11ea-8d73-6303645ac406
[16] See Marco Buti and Nicolas Carnot, "The Case for a Central Fiscal Capacity in EMU," *Vox*, 07 December 2018;
https://voxeu.org/article/case-central-fiscal-capacity-emu
and Nathaniel Arnold, Bergljot Barkbu, Elif Ture, Hou Wang and Jiaxiong Yao, *A Central Fiscal Stabilization Capacity for the Euro Area* (Washington: International Monetary Fund, 2018).
https://www.imf.org/~/media/Files/Publications/SDN/2018/SDN1803.ashx
[17] European Fiscal Board, *Assessment of EU Fiscal Rules* (Brussels: European Commission, 2019).
https://ec.europa.eu/info/sites/info/files/2019-09-10-assessment-of-eu-fiscal-rules_en.pdf

unusual move, it threw the issue back into the lap of the European Council, where it risks further delay.[18] At the same time, consideration of a potentially potent stabilisation tool – a European unemployment benefit reinsurance scheme – has yet to begin in earnest.

- The limits of the current fiscal rules enshrined in the stability and growth pact and subsequent "packs" and "compacts" have long been recognised. The need for reassessment has been evident for some time, and indeed the 2011 reform of the stability and growth pact instituted regular reviews. The European Commission published such a review in early February 2020.[19] But any action has been delayed until after a public "consultation," to last through the first half of 2020, followed by another six months of "reflection," during which the European Commission will take "into consideration the views of stakeholders and complete its reflections on possible future steps." This will take us to end-2020, and then political deliberations – unlikely to be rapid – will ensue, making for a truly protracted timetable.

Time for Fiscal Policy to Do 'Whatever-it-Takes'

How can fiscal policy take on the "whatever-it-takes" mantle? We propose a five-point programme to be launched at the 16-17 March ministerial meetings and finalised at the 26-27 March European Council. Deliberations at these meetings need to reflect the urgency of action and embrace the five measures proposed below and summarised on page 4:

1) A clear shift to a concerted countercyclical fiscal stimulus centered on investment;
2) An acceleration in the revision of the fiscal rules;
3) An enhanced focus on the quality of public finances;
4) An agreement on the financing of the Budgetary Instrument for Convergence and Competitiveness;
5) A decisive launch of work on a European unemployment benefit reinsurance scheme.

The first of these steps – **a clear shift to a concerted stimulus** – is squarely part of the next European Council's agenda, charged with adopting the final, political version of the recommendations on euro area economic policy. Contrary to past practice, this should not be a mere pro forma rubber-stamping of the tepid text handed down by the February Council of Ministers. In the present circumstances, it would be complacent to the extreme to be content with a "broadly neutral" or only "slightly expansionary" area-wide fiscal stance in

[18] European Council, *Eurogroup Report on a Possible Inter-Governmental Agreement for the Budgetary Instrument for Convergence and Competitiveness,* 17 February 2020. https://www.consilium.europa.eu/en/press/press-releases/2020/02/17/eurogroup-report-on-a-possible-inter-governmental-agreement-for-the-budgetary-instrument-for-convergence-and-competitiveness/
[19] European Commission, *Economic Governance Review*, 05 February 2020. https://ec.europa.eu/info/sites/info/files/economy-finance/com_2020_55_en.pdf

both 2020 and 2021. In the current conjuncture, **the European Council should embrace a clearly expansionary fiscal stance as appropriate for the euro area as a whole.** The current draft before the heads of state and government recognises that "in case of a worsening outlook, achieving a supportive fiscal stance at the aggregate level that focuses on productive spending… is important to sustain growth in the short term."[20] The outlook has unmistakably worsened, and this passage needs to be translated into action. With some of the surplus countries flirting with recession (notably Germany), the long-standing calls on them to expand acquire greater relevance and urgency. There will of course be objections to this prescription. A particular objection advanced at the current conjuncture is that fiscal policy cannot cure a negative supply shock caused by a virus. Indeed, fiscal policy is not equipped to address the effects of plant closures, transport disruptions and supply chain breakdowns. But it can fund key measures required to fight the epidemic, including a strengthening of the health system, the hiring of personnel and the purchases and stockpiling of medical supplies and equipment. There is a demand dimension to the shock as well, which fiscal stimulus is well-placed to address by providing an alternative source of demand. Indeed, government spending is the only growth component (consumption, investment, net exports) not dented by the epidemic, nor by the fear and uncertainty it generates.[21]

The second recommended step would buttress the shift to fiscal stimulus by providing it with the necessary institutional backing. The European Council should agree **an acceleration in the revision of the economic governance framework and the fiscal rules.** As observed in a *Financial Times* editorial already in August 2019: "Reforming Europe's fiscal rules has rarely been more urgent… Indeed, the long-term survival of the euro may depend on it."[22] Against this urgency, the envisaged lengthy periods of "consultations" and "reflection" would lead to European Commission proposals only by end-2020, with political discussions to follow. In short, no change would be operational in time even for the 2021 European Semester cycle. Given the rich literature and ample research already undertaken on the shortcomings of the rules and possible ways forward, there is no need for such a protracted timetable. Indeed, most studies converge on advising a single fiscal anchor (e.g., the public debt-to-GDP ratio) and a single operational target (e.g., an expenditure growth rule).[23]

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[20] European Commission, *op. cit.*, 18 February 2020.
[21] In the United States, the role of fiscal support has been recognised in the $8.3 billion [€7.4 billion] emergency coronavirus package enacted on 06 March 2020. This followed a 50 basis point emergency interest rate reduction from the U.S. Federal Reserve on 03 March 2020.
[22] *Financial Times*, "Europe Needs a Stronger Anchor for Fiscal Policy," *Financial Times*, 28 August 2019.
https://www.ft.com/content/c01693a6-c8c7-11e9-a1f4-3669401ba76f
[23] The European Fiscal Board itself provided rich input in its August 2019 report on the subject: European Fiscal Board, *Assessment of EU Fiscal Rules* (Brussels: European Commission, August 2019).
https://ec.europa.eu/info/sites/info/files/2019-09-10-assessment-of-eu-fiscal-rules_en.pdf
In addition, both the IMF and think tanks have contributed ample suggestions for improvement. See IMF, "Reforming Fiscal Governance in the European Union," (Washington: IMF, 2015);
https://www.imf.org/external/pubs/ft/sdn/2015/sdn1509.pdf
and Zsolt Darvas, Martin Philippe and Ra Xavier, "European Fiscal Rules Require a Major Overhaul," *Bruegel,* October 2018.
https://www.bruegel.org/wp-content/uploads/2018/10/PC-18_2018.pdf

While an acceleration of the economic governance review would be welcome, it would not in itself contribute to addressing current risks. To this end, the upcoming European Council should give two important, immediate signals. First, a declaration that the coronavirus epidemic is such as to trigger the **"exceptional circumstances" clause under the stability and growth pact**, and that member countries' 2020-21 fiscal plans will be evaluated in this light. The epidemic clearly meets the definition of "exceptional circumstances" which allow for flexibility under the stability and growth pact in the case of exogenous events outside the control of national policymakers that impact on government budgets.[24] The eurogroup conference call of 04 March 2020 alluded to possible recourse to this clause, but was also very guarded in recalling all the guardrails circumscribing its use.[25] Greater boldness will be needed. Second, to accompany the ambitious European green deal, the European Council should agree on a **"greening" of the fiscal rules**, via an easing of the rules to free up investment on environmentally-friendly projects. This could take the form of a "green golden rule," i.e., a revision of the stability and growth pact's investment clause to explicitly allow financing of green investments that mitigate or adapt to climate change.[26] This would also be aligned with the shift in the focus of the European Semester toward "an instrument that integrates the United Nations Sustainable Development Goals."[27]

As a third step, the European Council should signal an **enhanced emphasis on the quality of public finances** in the implementation of the European Semester going forward.[28] In essence, this means moving away from the pre-eminent focus on numerical targets

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Finally, there have been multiple conferences and workshops on the issue, including most recently one organized by the European Commission "Fiscal Rules in Europe: Design and Enforcement," 28 January 2020;
https://ec.europa.eu/info/sites/info/files/economyfinance/agenda_ecfin_workshop_on_fiscal_rules.pdf
and another by the European Fiscal Board, "Rethinking the European Fiscal Framework," 28 February 2020.
https://ec.europa.eu/info/sites/info/files/efb-conference-programme_en.pdf

24 Specifically, "an unusual event outside of the member state's control and with a major impact on its public finances." See European Commission, *Vade Mecum on the Stability and Growth Pact 2019 Edition* (Brussels: European Commission, 2019).
https://ec.europa.eu/info/sites/info/files/economy-finance/ip101_en.pdf

25 Notably the targeted and temporary nature of the measures; see European Council, *op.cit.*, 04 March 2020.

26 For a detailed proposal, see Grégory Claeys, "The European Green Deal Needs a Reformed Fiscal Framework," *Bruegel*, 10 December 2019.
https://www.bruegel.org/2019/12/the-european-green-deal-needs-a-reformed-fiscal-framework/

27 As per Ursula von der Leyen, *Mission Letter to Commissioner Paolo Gentiloni*, 10 September 2019.
https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-paolo-gentiloni_en.pdf

28 The Lisbon Council examined this topic in depth at **The 2018 Euro Summit** with the aim of laying the groundwork for a broader, more sustained period of policy-making attention to the issue. This has partly ensued, as evidenced in the new European Commission's priorities; also, the European Fiscal Board dedicated an entire chapter to the quality of public finances in its 2019 assessment of the EU fiscal rules. On the subject, see Alessandro Leipold, "Why the Quality of Public Finance Matters for Europe," *Lisbon Council*, 21 January 2019.
https://lisboncouncil.net//index.php?option=com_downloads&id=1434https://lisboncouncil.net//index.php?option=com_downloads&id=1434

(nitpicking on decimal points of the nominal and structural deficit ratios to GDP) in favour of the composition of expenditure and taxation. With each of these magnitudes approaching 50% of gross domestic product in most member states, they are clearly of greater import than the minuscule difference between the two. Put simply, composition – i.e., the underlying quality of a country's public finances – matters more for growth than the deficit. This is particularly relevant to avoid that investment spending continues to decline, especially in light of the substantial additional investments needed to modernise infrastructure, make the European Union's economy climate-neutral by 2050 and promote the digital transition. Both the European Commission and the European Fiscal Board have identified the lack of attention to the quality of public finances as a weakness in the present framework.

Fourth, the European Council should rise to the challenge kicked upstairs by the eurogroup of February 2020 and **make progress on agreement on the financing of the Budgetary Instrument for Convergence and Competitiveness**. It could, at the very least, declare political agreement on the need for additional contributions in the context of the BICC, and charge the eurogroup to take this further.[29] As noted, the BICC as currently envisaged is a far cry from the central fiscal stabilisation tool originally envisaged, to the point that a number of analysts believe it would be better to scrap it altogether and begin anew.[30] While sharing the critique, we would favour accepting this instrument for what it is – an additional investment vehicle – while pressing to move forward with another recommended stabilisation tool.

Specifically, and as a fifth step, the end-March European Council should **decisively launch work on the European unemployment benefit reinsurance scheme.** Properly designed, such a scheme could effectively work as the much-needed area-wide countercyclical tool. The idea has been around since at least the 1975 Marjolin Report, which argued that "a community initiative in the unemployment field is particularly opportune, for it will have beneficial effects on the economy and society as a whole."[31] Almost 50 years later, its creation is now an integral part of the new European Commission's programme. President von der Leyen's mission letter to European Commissioner Paolo Gentiloni thus charges him to "lead work on the design of a European unemployment benefit reinsurance scheme to protect our citizens and reduce the pressure on public finances during external shocks,

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[29] The eurogroup's report noted: "There are different views on the need for additional contributions in the context of the BICC. Should there be a political decision to do so, an IGA [inter-governmental agreement], a treaty of international public law, or other forms of coordination, of political nature that are not reflected in international law obligations, could be used." European Council, *Eurogroup Report on a Possible Inter-Governmental Agreement for the Budgetary Instrument for Convergence and Competitiveness*, 17 February 2020. https://www.consilium.europa.eu/en/press/press-releases/2020/02/17/eurogroup-report-on-a-possible-inter-governmental-agreement-for-the-budgetary-instrument-for-convergence-and-competitiveness/

[30] Among these, see the Twitter feeds of Lucas Guttenburg (Jacques Delors Centre), Jacob Kirkegaard (Peterson Institute for International Economics), Jean Pisani-Ferry (Bruegel), Silvia Merler (Algebris Policy and Research Forum) and Shahin Vallée (German Council on Foreign Relations).

[31] Commission of the European Communities, *Report of the Study Group Economic and Monetary Union 1980* (Brussels: Commission of the European Communities, 1975). https://ec.europa.eu/archives/emu_history/documentation/chapter7/19750308en57reportstudygroup.pdf

working closely with the commissioner for jobs" (i.e., European Commissioner Nicolas Schmit).[32] In his testimony to the European Parliament, Commissioner Gentiloni stressed that the scheme "remains a key element for completing the architecture of the EMU." Here, too, there has been extensive work on the desirable design of such a scheme, with recognition of the economic and political constraints that would need to be observed.[33] In essence, the design features should be such as to ensure that there are no permanent transfers between member states, that support is provided in a timely fashion and only in cases of significant shocks and that it not engender moral hazard. These are not insurmountable constraints and several proposals have been put forth that attempt to satisfy them. It is now time to bring these proposals to the table and reach agreement, kick starting this process now.

The current juncture recalls another situation invoked by Mario Draghi in his speech at the Jackson Hole Symposium in the summer of 2014, when he warned that "the risks of 'doing too little' outweigh those of 'doing too much.'"[34] In fact, there is currently no risk of overdoing it in Europe. Laurence Boone, chief economist at the OECD, and Marco Buti, now head of cabinet for European Commissioner Paolo Gentiloni, put it aptly in October 2019: "While the benefits of a more supportive fiscal policy already appear sizeable at the current juncture, depending on how events unfold, the failure to act could result in snowballing negative effects going much beyond those captured in the usual simulations... In these circumstances, the costs of too little stimulus in a worsening economy are likely to outweigh the costs of too much stimulus should a more favourable scenario materialise. The large compounded downward risks call for a risk-based approach to fiscal policy, with more pre-emptive rather than reactive policy action."[35]

May the heads of state and government bear this admonition in mind and move along the five steps advocated in this Economic Intelligence note when they meet as the European Council in Brussels on 26-27 March 2020. These steps could address the current conjuncture's clear and present danger of a significant slowdown, or possibly a recession, in the absence of a sufficient fiscal response. Amid much uncertainty, there is indeed only one clear question: not whether there will be an economic slump, but only how severe and long it will be. Such prospects call for decisive action and leadership.

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35 Laurence Boone and Marco Buti, "Right Here, Right Now: The Quest for a More Balanced Policy Mix," *Vox*, 18 October 2019. https://voxeu.org/article/right-here-right-now-quest-more-balanced-policy-mix

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