

Why Italy should spell the end of Europe's fiscal rules

Eoin Drea

HERE WE GO AGAIN. WITH SLOWING GROWTH, INCREASING DEBT AND AN UNCERTAIN GLOBAL ENVIRONMENT, ITALY FACES ANOTHER BUDGETARY CRISIS IN 2019. ONCE AGAIN ROME WILL FACE BRUSSELS IN A BATTLE FOR FISCAL SOVEREIGNTY. THE RESULT? EITHER ANOTHER POLITICAL FUDGE OR THE END OF EUROPE'S CURRENT FISCAL RULES AS A CREDIBLE POLICY TOOL. THIS *IN BRIEF* ARGUES THAT THERE IS AN ALTERNATIVE TO ENGAGING IN REPEATED POLITICAL ARGUMENTS ABOUT EXISTING FISCAL RULES. RATHER, THE EU SHOULD RECOGNISE THE FUNDAMENTAL WEAKNESSES IN THE GOVERNANCE OF THE EUROZONE. A MOVE TOWARDS A MORE DECENTRALISED MONETARY UNION BASED ON THE CONCEPTS OF NATIONAL FISCAL AUTONOMY AND A CREDIBLE NO-BAILOUT RULE IS NOW ESSENTIAL. ONLY THEN WILL THE EUROZONE HAVE A REALISTIC CHANCE OF LONG-TERM SURVIVAL.

Commissioner Pierre Moscovici in a recent [defence](#) of the European Commission's interpretation of the Euro's fiscal rules argued correctly that more "political ownership" in the Euro's member states is a key objective of his approach. An objective that is better achieved through a flexible interpretation of the rules and a constructive "dialogue" between Brussels and national capitals. Only in this way, he argues, can true accountability be achieved.

While accountability and transparency are important elements in any monetary union, they are far from the most important consideration. Flexible application by Brussels of "binding" fiscal rules will not induce greater fiscal discipline in member states nor inspire greater market confidence in the Euro. In fact, it

continues to do the opposite. The situation now exists where every national budgetary plan, irrespective of its impact on deficits or debt levels, is up for discussion in Brussels. It's a populist's dream.

Consider the example of Italy's first budget proposed by its ruling populist parties in late 2018 – late night, closed door discussions in Brussels are hardly the mechanisms to deliver accountability and transparency. Is the Italian budget any more sustainable because the European Commission forced them to delay some measures that make for better headline statistics this year, rather than next? This ad-hoc approach ensures the Euro muddles on, but it is neither sustainable nor desirable in the longer term. It's like sticking a plaster on a broken leg.

This kicking the can down the road approach is about to come to an abrupt end. Italy is now entering a perfect storm. Anaemic growth – the latest European Commission [forecast](#) of just 0.2% growth in 2019 will result in a budget deficit well in excess of 3%. Even new monetary theory can't save a country that is barely growing, requiring real structural surgery and with a debt burden now exceeding 130% of GDP.

The division in Italy's government – between those who favour the implementation of a flat tax (that will cost the Italian state tens of billions of euros in lost revenue) and those that favour dramatic increases in the minimum wage worsen the already fragile situation. The last thing the Eurozone needs is more late-night meetings, fudging numbers, pretending that Europe's fiscal rules are maintaining discipline. That

could be the final disaster for Italy, and for the Euro.

Although unlikely, even the sudden conversion of the Commission to the rigid (and non-political) implementation of the existing rules would no longer be useful. Such a move will achieve nothing more than allowing Italy's governing parties to speak of Brussels dictates swamping the will of the populist masses. Such a confrontation will achieve nothing more than ensuring the Populist Playbook 101 – with a stagnant economy, blame the EU – gains more traction than should be the case.

Unfortunately, Commissioner Moscovici's approach is further proof that the most important lesson of the turmoil since 2007 has not been understood. Namely, the best way to safeguard the Euro is not to create a pointlessly small Eurozone budget (perhaps 1% of GDP) or obsess about mythical debt levels, rather it is to ensure that the ultimate responsibility for fiscal discipline should rest where the power for drawing up and implementing the budget actually lies. And this will remain the prerogative of national states for the foreseeable future.

In this context the decentralisation of fiscal authority to member states should become the core element of Eurozone governance. The finalisation of a complete Banking Union (including a common deposit insurance scheme) should be the first small step in re-implementing the “no bailout clause” so carelessly ignored by European institutions over the last decades. What the Eurozone really needs is a return to the basic principles of sound economic governance. A complete Banking Union, supported by more integrated financial markets and a more developed Capital Markets Union, are the best initial steps that should be taken in order to safeguard the long-term viability of the Eurozone.

But what if a member state like Italy or Greece decides to run a 10% budget deficit to fund massive welfare spending increases? Wouldn't this destabilise the Euro and ultimately lead to contagion? No, not if both national capitals and the financial markets understand that the no bailout mechanism is politically accepted and legally enshrined at both European and national level. European Commission officials need to look more closely at the historic development of the US Federal Reserve system (a working decentralised monetary union that is now over century old)

rather than focussing entirely on an [economic theory](#) from the 1960s.

Fiscal discipline – or more specifically, fiscal sustainability – is vital to the success of any monetary union. National and European blueprints exist for best-practice fiscal discipline arrangements. A model based on a government making public spending and taxation decisions supported by an independent fiscal council. This independent council would assess how the budgetary choices of the government impact on fiscal discipline. National frameworks would be certified at European level by an impartial body.

Politically, the current approach is fuelling populism in member states by allowing national politicians to continually blame Brussels for every austerity measure, for every broken electoral promise and for every slowdown in economic activity. Trips to Brussels to “battle” the Commission about national budget plans are becoming a regular feature of Eurozone life. Eventually, however, a populist or avowedly anti-European national leader will arise that will call Europe's bluff. And, as narrowly avoided with Ireland, Portugal, Greece, Spain and Cyprus before, the ultimate cost of the resulting economic crisis may well be the disintegration of the Eurozone.

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