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Fiscal austerity and monetary largesse: the EU's constitutional and ideological straitjacket

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1.Introduction

This chapter argues that the combination of the European economic and monetary constitution with neoliberal ideology is – or was, until the arrival of the COVID-19 pandemic – hindering the necessary move towards a more sustainable economy. Neoliberalism insists that the role of the state should be strictly limited to creating the conditions which will allow individuals to interact and allocate resources through market transactions.[1] Spending by the state must be reined in because fiscal policy will 'almost surely make matters worse',[2] by interfering with the market's efficient allocation of resources, creating uncertainty and generating inflation.[3] Central banks should be independent,[4] and conduct monetary policy with an exclusive focus on ensuring price stability, as opposed to wider goals such as full employment.[5] Labour should be weakened, particularly in its collective dimension,[6] and financial markets should be structured to ensure that corporations prioritise the shareholder interest.[7] The EU Treaties conform to these neoliberal prescriptions by imposing fiscal spending limits on

[1] D. Harvey, *A Brief History of Neoliberalism* (Oxford University Press, 2005) pp. 64-5; P. Mirowski, *Never Let a Serious Crisis go to Waste* (Verso Books, 2013) pp. 53-8;.

[2] M. Friedman, *Capitalism and Freedom* (University of Chicago Press, 1962), Chapter Five.

[3] M. Blyth, *Austerity: The History of a Dangerous Idea* (OUP, 2015) pp. 155-6.

[4] See for example, R.J. Barro and D.B. Gordon, 'Rules, Discretion and Reputation in a Model of Monetary Policy' (1983) 12 *Journal of Monetary Economics* 101-121, arguing for enforced monetary policy commitments to prevent inflation shocks; K. Rogoff, 'The Optimal Degree of Commitment to an Intermediate Monetary Target' (1985) 100 *Quarterly Journal of Economics* 1169, arguing that conservatives, who 'place a greater weight on inflation stabilization relative to unemployment stabilization', should be appointed to head central banks.

[5] M. Friedman, 'The Role of Monetary Policy' (1968) 58 *American Economic Review* 1 at 12-13. On the evolution of central bank mandates see D. Cobham, 'The Past, Present, and Future of Central Banking' (2012) 28 *Oxford Review of Economic Policy* 729.

[6] Friedman ibid at 8-9.

[7] T. Palley, 'Europe's crisis without end: the consequences of neoliberalism run amok' (2013) *Macroeconomic Policy Institute Working Paper* 111 at 5. Friedman's work was highly influential in disseminating ideas about shareholder primacy which were being developed in neoclassical economics at the time. See for example Friedman, *Capitalism and Freedom,* p. 112; M. Friedman, 'The Social Responsibility of Business is to Increase its Profits', *New York Times Magazine*, 13 September, 1970 p. 17

Member State governments, and giving national central banks and the European Central Bank (ECB) a clear, single mandate to ensure price stability.

After the global financial crisis of 2008, public sector debt ballooned. Some of this additional debt resulted from automatic stabilisers triggered by the recession and discretionary Keynesian fiscal policies pursued in the immediate aftermath of the crisis. However, much of the debt was transferred from the private sector. Member States had to borrow money to finance their bailouts of financial institutions, whilst loans made before the crisis by private sector financial institutions to private borrowers in the periphery were gradually moved onto the balance sheets of the ECB and the national central banks (and in the case of Greece, the International Monetary Fund), further adding to the indebtedness of the peripheral Member States. The neoliberal policy response to public debt is that it must be cut, and this was reinforced by a number of politically-driven changes to EU law in 2011, which sought to activate the ineffective Stability and Growth Pact.

With further fiscal policy (that is, public spending) ruled out, the primary policy response to the financial crisis was monetary policy. Central banks conducted conventional monetary policy in line with neoliberal prescriptions, that is with great largesse, slashing interest rates to close to zero. They also launched unconventional monetary policies that probed the outer limits of their powers, actions that were accommodated by the Court of Justice of the European Union (CJEU). The net effect is that unelected central banks can intervene in financial markets to protect financial institutions and to boost asset prices, but elected governments are not permitted to intervene in the real economy to protect citizens and create more reliable demand.[8]

This combination of fiscal austerity and monetary largesse led to a number of undesirable consequences, including: an ever greater polarisation of wealth distribution as asset prices rose but real wages were stagnant or falling; and increased fragility of private sector balance sheets, as households stopped deleveraging and went into debt to sustain consumption and purchase property and financial assets, smaller companies found it difficult to borrow from banks, but large listed corporations, under pressure from the shareholder primacy corporate governance system, took advantage of enormous liquidity and historic low long-term interest rates to borrow money through bond issuance, using the proceeds to finance dividends and repurchase shares. At the same time, a variety of national, supranational and international pressures have operated to force indebted states to cut expenditures on welfare and other social services.

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[8] J.P. Watkins, 'Quantitative Easing as a Means of Reducing Unemployment: A New Version of Trickle Down Economics' (2014) 48 *Journal of Economic Issues* 431-440; T. Palley, 'Quantitative Easing: A Keynesian Critique' (2011) 70 *Investigación Económica* 69 at 84.

None of this suggests that the EU's economy was operating in a sustainable manner before the COVID-19 pandemic struck in 2020. A sustainable economy may provisionally be defined as one in which the financial system is governed so as to produce stability; in which the wealth generated is distributed so that all people have sufficient income to meet their present essential consumption needs and lead satisfying lives without going into debt and prejudicing future consumption[9]; and in which sufficient resources are available to the state to provide public goods and social services for all.[10]

After the pandemic hit Europe in March 2020, the European Union institutions implemented a range of far-reaching and coordinated fiscal and monetary policy measures intended to protect individuals and businesses and to stabilise and stimulate the economy in the face of the losses and other disruptions both triggered by the virus itself and arising out of the associated political responses, such as mandatory business closures and lockdowns. The actions taken in response to this state of emergency demonstrates that, if the political will is there, there is scope for the EU to intervene significantly in its economy in order to make it more sustainable. The question remains, however: once the pandemic recedes over the horizon of history, will the EU revert to its straitjacket, imposing (even more) fiscal austerity to deal with the new (enlarged) debt burdens at both EU and Member State level, whilst reverting to exclusive reliance on monetary policy to stimulate the economy? Or might the pandemic demonstrate that other policy choices are possible, and might a new form of political solidarity emerge in its aftermath, leading to a greater pooling of fiscal sovereignty and, in turn, a more sustainable economy?

The chapter proceeds as follows. The next section looks at the constitutional limitations on Member State fiscal spending, showing how more conventional Keynesian responses to the aftermath of the financial crisis were ruled out by legally binding instruments. The third section explores the scope of monetary policy available to the ECB and national central banks, and the ways in which monetary policy has been used in the aftermath of the financial crisis. This shows that constitutional limits on fiscal spending effectively forced central banks into unconventional monetary policy actions in order to deal with the crisis. The almost exclusive reliance on monetary policy to stimulate the economy has produced a number of pathologies, which have made the economy far less sustainable. These are examined in the fourth section. The fifth section then looks at the way in which the EU responded to the COVID-19 emergency, uncharacteristically releasing itself from its straitjacket, at least temporarily and as an emergency measure. The conclusion then asks whether these recent developments indicate

[9] See e.g. M. Common and C. Perrings, 'Towards an Ecological Economics of Sustainability' (1992) 6 *Ecological Economics* 7 at 9.

[10] S. Anand and A. Sen, 'Human Development and Economic Sustainability' (2000) 28 *World Development* 2029 at 2030-2.

a change in approach on the part of the EU, heralding a shift to a new, more economically sustainable system of allocating economic resources, or whether a return to the constitutional and ideological straitjacket beckons. We fear it will be the latter, leaving economic sustainability as far away as ever.

2. The constitutional limits on fiscal spending

The Treaty on the Functioning of the European Union (TFEU) leaves fiscal spending largely in the hands of the Member States but provides for monetary policy to be determined at supranational level, at least for members of the Eurozone. Since national budget deficits could undermine financial and monetary stability, Member States' fiscal policies were 'placed within an agreed macroeconomic framework and [made] subject to binding procedures and rules'.[11] These provisions use a combination of market forces and legal rules to place significant limitations on the ability of Member State governments to stimulate their economies through public spending. First, there are treaty provisions intended to ensure that fiscal spending does not become a problem in the first place. Article 120 TFEU requires Member States to coordinate their 'economic' (i.e., fiscal or public spending) policies. More detailed rules are found in the Stability and Growth Pact (SGP). Article 121 TFEU puts in place a multilateral surveillance procedure to ensure that Member States comply with guidelines laid down. Article 126(1) TFEU imposes an obligation on Member States to 'avoid excessive government deficits' (that is, borrowing in order to spend more than they received in taxes). Sub-articles (2)-(14) of Article 126 then establish a supranational process which ultimately allows the Council to require a Member State to reduce an excessive deficit. A deficit is excessive for the purposes of Article 126 if it amounts to 3 percent of GDP, whilst public debt is excessive if it exceeds 60 percent of GDP.[12] The Article 126 procedure will be triggered by a Member State crossing these thresholds unless the ratio of debt to GDP has either declined substantially and continuously and reached a level that comes close to the reference value, or the excess is 'only exceptional and temporary'.[13] Second, these processes operate against the backdrop of rules intended to ensure that market forces operate to constrain Member State public spending. Article 123(1) TFEU prohibits central banks from providing credit to, and purchasing bonds directly from, Member State governments, so that governments have to fund their deficits by borrowing on the bond market. Article 125 TFEU complements Article 123 by prohibiting bailouts of Member States by the EU or other Member States, confirming to markets (at least until the advent of unconventional monetary policies, discussed below) that there would be no interference by Member States or the EU with the borrowing rates charged to Member States by the market.

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[11] See Committee for the Study of Economic and Monetary Union, *Report on the Economic and Monetary Union in the European Community* (17 April 1989) (the 'Delors Report') at 20.
[12] Protocol (No 12) on the Excessive Deficit Procedure OJ L 115/279-80, 9 May 2008.
[13] Art 126(2) TFEU.

The SGP came into force in 1999, and for the first couple of years, only a handful of peripheral Member States were in breach, but in 2004, both France and Germany failed to bring their deficits within 3 percent of GDP. However, action by the Council was blocked by France, Germany, Italy and the UK, a decision which the CJEU subsequently ruled unlawful.[14] The SGP was then ignored in wholesale fashion when deficits ballooned as Member States intervened in their economies to bail out banks, stabilize the financial system and stimulate their economies, with the Commission also coordinating an emergency stimulus package of Euro 200bn claimed to be 'in full respect of the Stability and Growth Pact' and intended to 'restore business and consumer confidence'.[15]

In May 2010, with the financial sector fully bailed out with public funds and supported by guarantees, neoliberal orthodoxy was restored, with the Commission launching a proposal for new regulation to ensure that the SGP was adhered to in the future.[16] Enforcement of the Article 126 excessive deficit procedure has now been reinforced by the 'six-pack' (consisting of five regulations and a directive[17]), adopted under Article 136 TFEU in November 2011, which gives each Member State a medium-term budgetary objective, from which they must not deviate significantly, and makes detailed provision for enforcement against Member States which are not reducing debt sufficiently quickly towards the 60 percent threshold.[18]

Finally, there is the Treaty on Stability, Coordination and Governance, also known as the 'Fiscal Compact', which reaffirms the need for a 'balanced budget rule' to 'safeguard the stability of the Euro area as a whole'.[19] This intergovernmental agreement was agreed and signed by 25 Member States in 2012 (the UK and Czech Republic did not sign), and has been in force since January 2013, running in parallel with the SGP. The Fiscal Compact requires the budgets of signatory governments to be

[14] For the early history of the SGP, see J. Fischer, L. Jonung and M. Larch, '101 Proposals to reform the Stability and Growth Pact. Why so many? A Survey', *European Commission Directorate-General for Economic and Financial Affairs Economic Papers*, No 267, December 2006 at 6-10.
[15] *European Economic Recovery Plan*, COM(2008) 800 final, 26 November 2008. See further L. Schuknecht, P. Moutot, P. Rother and J. Stark, 'The Stability and Growth Pact: Crisis and Reform', *European Central Bank Occasional Paper Series No 129*, September 2011 at 11.
[16] See EU economic governance: the Commission delivers a comprehensive package of legislative measures, IP/10/1199, Brussels, 29 September 2010.
[17] See Regulations 1173-1177/2011 and Directive 2011/85/EU, OJ L 306, 23 November 2011.
[18] Commission, 'EU Economic governance "Six-Pack" enters into force', MEMO/11/898, 12 December 2011 (https://ec.europa.eu/commission/presscorner/detail/en/MEMO_11_898). In 2019, Italy was in dispute with the European Commission about its deficit, with the Commission deciding, in light of Italy's commitment to adopt measures to bring it into line with the SGP, not to propose to the Council to open an Excessive Deficit Procedure: see European Commission Press Release, 3 July 2019, http://europa.eu/rapid/press-release_IP-19-3569_en.htm.
[19] See preamble to Treaty on Stability, Coordination and Governance.

balanced or in surplus, and to converge on the medium-term objective set in the SGP.[20] Member State signatories are required to create binding and permanent national budgetary rules, preferably at constitutional level, under threat of sanction from the CJEU. Sanctions will be imposed automatically where Member States deviate from the SGP,[21] although 'temporary deviations'[22] are permitted, provided that they do not 'endanger fiscal sustainability in the medium-term', in 'exceptional circumstances' where there is 'an unusual event outside the control of the Contracting Party concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn as set out in the revised Stability and Growth Pact'.[23] The TSCG was then integrated into EU law by the so-called 'Two-Pack', a pair of regulations which provide rules for euro area Member States in the corrective arm of the SGP and for enhanced oversight of national budgets of euro area Member States that are threatened with financial difficulties.[24]

The TSCG purports to contribute to the EU's objectives of 'sustainable growth, employment, competitiveness and social cohesion'.[25] However, it is difficult to see how it can possibly achieve this. These provisions entrench fiscal austerity, and effectively prevent counter-cyclical Keynesian demand management policies, at least for those signatories whose debt is above 60 percent of GDP (which in 2017 encompassed 14 out of the 25 signatories, a figure which had been reduced to 11 by 2019, as a number of Member States ran budget surpluses[26]). The result is declining welfare and social service provision, increasing economic insecurity and fewer opportunities for citizens in indebted Member States. These constraints on government spending mean that growth in many Member States will be heavily dependent on either renewed borrowing by the private sector or an improved net trade position. The former is undesirable, given high existing household and corporate debt levels, while the latter looks unlikely at present with globalisation in retreat (and, as we will see at the end of this chapter, is likely to depend upon increasing competitiveness by cutting labour costs).

We will see in the next section that reducing interest rates so as to boost borrowing and spending by the private sector is one of the aims of unconventional monetary policy. However, where growth is driven by borrowing, it is unlikely to be sustainable because these new private sector debts must be

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[20] This is subject to a permissible structural deficit of 0.5% (Art 3(1)(a)), whilst signatories whose general government debt is below 60% of GDP and is considered sustainable in the long-term can run a structural deficit of up to 1% of GDP (Art 3(1)(d)).
[21] Art 3(1)(e).
[22] Art 3(1)(c).
[23] Art 3(3)(b).
[24] See Regulations 472/2013, OJ L 140/1, 27 May 2013 and 473/2013, OJ L 140/11, 27 May 2013.
[25] Art 1(1).
[26] Eurostat, *Government finance statistics*, April 2018 and October 2020 (for more details see http://ec.europa.eu/eurostat/statistics-explained/index.php/Government_finance_statistics#Government_debt).

repaid in the future. We will then see in Section 5 that the SGP has been temporarily suspended through activation of the general escape clause contained in both the 'six pack' and 'two pack' in order to give Member States – at least temporarily – more fiscal leeway to address the economic and social consequences of the COVID-19 pandemic.

3. The breadth of monetary policy

With fiscal policy massively circumscribed by the TFEU and associated instruments, monetary policy was the only way to stimulate European economies after the financial crisis. This section shows that the ECB and Bank of England (BoE) have pushed their powers to their legal limits in an effort to reduce long term interest rates and inflate asset prices, in the hope that this will stimulate borrowing and spending by the private sector.

In line with the neoliberal prescriptions, both the BoE and the ECB are given a mandate to maintain price stability.[27] In the UK, the BoE has, since independence, been given a symmetrical target of '2 per cent as measured by the 12-month increase in the Consumer Prices Index',[28] and is required to conduct monetary policy so as to target this level. In the EU, the National Central Banks (NCBs) of the Member States and the European Central Bank (ECB) together constitute the European System of Central Banks (ESCB). The ESCB's 'primary objective is maintain price stability', but, as long as this primary objective is not prejudiced, it should also contribute to achieving the EU's wider goals as set out in Article 2 TFEU. One of the 'basic tasks' to be carried out through the ESCB is to 'define and implement the monetary policy of the Union'.[29] The ECB's Governing Council 'formulate[s] the monetary policy of the Union including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB' and to 'establish the necessary guidelines for their implementation.'[30] However, the monetary policy of the EU is 'conducted' by the Eurosystem, which consists of the ECB and the NCBs of the Member States which have adopted the Euro.[31]

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[27] See s11(a) of the Bank of England Act 1998 and Article 2 of Protocol (No 4) on the Statute of the European System of Central Banks and of The European Central Bank, OJ C 326/230, 26 October 2012.

[28] s12(1) of the Bank of England Act 1998 requires the Treasury to specify annually a single inflation target. For the latest specification, see letter from Chancellor of the Exchequer to Governor of the Bank of England dated 29 October 2018, available online at www.bankofengland.co.uk/letter/2018/mpc-remit-october-2018.

[29] Art 127(2) TFEU and Article 3 of Protocol No 4.

[30] Article 12.1, emphasis added.

[31] Art 282(1) TFEU.

The principal mechanism used by central banks to hit their inflation target is control over interest rates. Both the BoE's monetary policy committee and the ECB's Governing Council set overnight interest rates at the level they consider appropriate in order for inflation to hit their target. Both the ECB and the BoE reduced interest rates dramatically in the aftermath of the financial crisis. The BoE reduced interest rates from 5.75 percent in July 2007 to 0.5 percent in March 2009. They dipped to 0.25 percent between August 2016 and October 2017, and currently stand at 0.75 percent. The ECB cut its refinancing rate from 3.75 percent in October 2008 to 1 percent in May 2009. It subsequently raised the rate as high as 1.5 percent in July 2011, but started cutting again in November 2011, with the refinancing rate hitting zero in March 2016, and they have remained there ever since. The ECB deposit rate is even lower, currently -0.40 percent.[32]

Once set, the central bank has to ensure that the interest rate applies to lending and borrowing in the overnight market. Where private banks need access to liquidity in the form of reserves, they normally borrow them from other private banks overnight. Reserves are liabilities of the central bank, held in private banks' accounts at the central bank, and used to clear interbank liabilities. The central bank only enters the market and supplies reserves where, due to shortage of reserves or other disruptions, the interbank overnight rate exceeds the base rate set by the central bank. In this situation, the central bank has to add reserves to the system in order to drive down their price, and it does this by purchasing bonds from private banks, crediting those banks' accounts with reserves. Likewise, if there is a surplus of reserves in the system, the cost of borrowing will fall below base rate, and the central bank will sell bonds in order to drain reserves from the interbank market. These activities are referred to as 'open market operations' (OMO), and they are a normal aspect of monetary policy.[33]

Once interest rates hit their 'lower bound', further cuts to stimulate the economy are difficult, although five central banks (Eurozone, Japan, Sweden, Denmark and Switzerland) have been experimenting with negative interest rates for a number of years. This dilemma led central banks to engage in unconventional monetary policy, commonly referred to as quantitative easing (QE). The use of large scale asset purchases by the central bank to stimulate the economy was advocated by Friedman and Schwartz in 1963.[34] The policy was first deployed by the Bank of Japan from 2001-2006,

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[32] Whereas the refinancing rate is the rate at which the ECB provides liquidity to the system, the deposit rate is more relevant, given the vast amount of excess reserves currently in the system (see discussion on the next two pages).

[33] See Art 18 of the ECB Statute and Art 123(1) TFEU, which implicitly allows secondary market purchases, provided they are compatible with the other provisions of the Treaty. For the BoE's OMO see Bank of England, *The Framework for the Bank of England's Operations in the Sterling Money Markets* (June 2012) at 5.

[34] M. Friedman and A. Schwartz, 'Money and Business Cycles' (1963) 45 *The Review of Economics and Statistics* 32-64, although it appears that Keynes, in his *Treatise on Money*, was the first economist to recognise that central banks could stimulate the economy by intensifying their use of OMOs, albeit with doubts as to its

whilst the US Federal Reserve launched a large QE programme in November 2008, initially focusing on the purchase of mortgage-backed securities, and later extending to government bonds.[35] In 2009, the BoE responded to the financial crisis by purchasing £200bn of government bonds between March and November 2009, another £175bn between October 2011 and July 2012, and most recently a further £60bn of government bonds and £10bn of corporate bonds in August 2016 following the Brexit referendum.

The ECB eventually launched its QE programme in January 2015, with the Eurosystem purchasing €60bn per month of securities issued by the European institutions and the Member States, a programme which continued until December 2018.[36] In March 2016, the programme was increased to €80bn per month, and was extended to include investment grade corporate bonds issued by non-bank corporations.[37] Overall, 20 percent of the assets purchased would be subject to loss-sharing in the event of a default or a loss when the QE programme is unwound.[38] The remaining 80 percent of the securities are purchased by NCBs on their home market in proportion to the ECB's capital key, ensuring that there will be no loss sharing.[39] In effect, this means that the German central bank will purchase almost 18 percent of the remaining bonds, whilst France will purchase 14.2 percent. Greek and Cypriot bonds were originally excluded on the basis that they were not investment grade, although Cyprus was granted a waiver during the time its bailout programme was ongoing.

QE operates through central bank purchases of large quantities of financial assets from the private sector, using newly created reserves. The central bank's balance sheet expands, with the bonds as an asset, and the reserves as a liability. The sellers of bonds may be private banks, which hold them on their balance sheets as safe, highly liquid assets, but for the most part, private banks act as conduits through which pension funds, insurance companies and other holders of bonds sell their holdings to

effectiveness: see J. Kregel, 'Was Keynes's Monetary Policy *À Outrance* in the *Treatise* a Forerunner of ZIRP and QE? Did He Change his Mind in the *General Theory*?' Levy Economics Institute of Bard College Policy Note 2011/4 (2011).

[35] See Federal Open Market Committee statement, 18 March 2009 (available at www.federalreserve.gov/newsevents/pressreleases/monetary20090318a.htm).

[36] See Account of the monetary policy meeting of the Governing Council of the European Central Bank, 21-22 January 2015 (available at www.ecb.europa.eu/press/accounts/2015/html/mg150219.en.html).

[37] See ECB Press Release, 'Monetary Policy Decisions', 10 March 2016 (available at www.ecb.europa.eu/press/pr/date/2016/html/pr160310.en.html).

[38] Under Art 33.2 of Protocol 4 to the TEU and TFEU, any losses made by the ECB are set off against the general reserve fund, and then against income accruing in proportion to their shareholdings to the NCBs from their performance of the ESCB's monetary policy function. The Protocol is silent on the question of recapitalisation, but presumably if the ECB makes losses which exceed this income, the capital will be written down, and Member States will be required to recapitalise the ECB in line with their shareholdings.

[39] Public sector purchase programme (PSPP) - Questions & answers (www.ecb.europa.eu/mopo/implement/omt/html/pspp-qa.en.html). The ECB's current capital subscription key can be found at www.ecb.europa.eu/ecb/orga/capital/html/index.en.html.

the central bank. When a private or institutional investor sells its bonds to the central bank, the central bank adds reserves to that investor's bank's account at the central bank, and the investor's bank credits the investor's account with a deposit, which they can either hold on to, or (more likely) use to purchase other financial assets.

The principal effect of QE is to raise asset prices. It raises the price of government bonds, and therefore lowers the yield (the effective interest rate) on those bonds. It also raises the price of other assets (such as corporate equities and bonds), as those who sold their bonds to the central bank rebalance their portfolios by purchasing other assets which they consider to be more efficient substitutes for government bonds than a deposit in a bank account.[40] House prices too are considerably higher than they would have been in the absence of QE.[41] These higher asset prices are expected to produce a number of effects on the economy.[42]

First of all, higher asset prices and lower yields should reduce 'the cost of borrowing for households and companies leading to higher consumption and investment spending', and give companies working capital, allowing them to maintain output, increasing employment and consumer spending.[43] This first channel depends on households and companies having access to – and demanding – credit in the first place.[44] Whilst larger companies can access capital markets directly by issuing bonds, households and smaller companies depend on bank lending. Smaller companies may indirectly benefit through effects on the supply chain and (unless they are net importers) because QE also causes a depreciation in the currency, potentially leading to greater external demand. However, households remain entirely dependent upon banks passing on the lower cost of funding to them.[45]

Second, higher asset prices create a wealth effect, so this should boost the spending of asset holders. Through this channel, there is more consumption activity as asset holders liquidate or borrow against

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[40] See M. Joyce, N. McLaren and C. Young, 'Quantitative Easing in the United Kingdom: Evidence from Financial Markets on QE1 and QE2' (2012) 28 *Oxford Review of Economic Policy* 671 at 693.

[41] The BoE estimates that, without QE, 'real equity prices and real house prices in 2014 would have been 25% and 22% lower respectively than they actually were': see P. Bunn, A. Pugh and C. Yeates, 'The distributional impact of monetary policy easing in the UK between 2008 and 2014', *Bank of England Staff Working Paper No 720*, March 2018 at 8.

[42] For a more detailed explanation of these mechanisms, see J. Benford, S. Berry, K. Nikolov and C. Young, 'Quantitative Easing' (2009) *Bank of England Quarterly Bulletin* 90.

[43] Ibid at 93.

[44] A collapse in the demand for – rather than supply of – credit presents considerable difficulties for monetary policy. The experience of Japan in the 1990s showed that in the case of a balance sheet recession where the asset side of the balance sheet collapses, firms and individuals will attempt to avoid bankruptcy by continuing to pay off loans but given their technically insolvent position will have no demand for new credit: see R. Koo, *The Holy Grail of Macroeconomics: Lessons from Japan's Great Recession* (Wiley, 2008).

[45] C. Bowdler and A. Radia, 'Unconventional Monetary Policy: the Assessment' (2012) 28 *Oxford Review of Economic Policy* 603 at 611-2.

higher priced assets to finance spending. However, the BoE recognised that there is considerable uncertainty surrounding this channel, as it depends on whether households believe the increase in asset prices will persist; if they do not, they may hold the wealth as a precautionary buffer against income shocks rather than spend it.[46]

Third, following QE, private banks have more central bank reserves (assets) and more customer deposits (liabilities). Since 'the banking system would be holding a higher level of reserves in aggregate', this 'might cause it to increase its lending to companies and households.'[47] Banks do not lend out reserves to their customers.[48] However, they need reserves when customers withdraw or transfer their deposits, so increasing their reserves means 'they should be more willing to hold a higher stock of illiquid assets in the form of loans as they have the funds to cope with the potentially higher level of payments activity'.[49] In other words, banks might be more willing to expand their balance sheets, creating deposits (liabilities repayable on demand) in return for customer promises to repay in the future (illiquid assets). However, researchers at the BoE recognised that this channel 'may be impaired, at least in the near term' because of 'the financial stresses that banks are currently facing'.[50] However, they added that, even if banks do not actually increase their lending, the extra reserves should lower the interbank borrowing rate, allowing banks which face outflows of deposits to finance them more cheaply.[51]

Finally, by demonstrating that the central bank will 'do whatever it takes to meet the inflation target', QE can affect the inflation expectations of private actors, leading firms to set higher prices, raising inflation directly, and perhaps leading to perceptions of an improved economic outlook, and therefore confidence.[52] There may also be 'policy signalling effects', as asset purchases may lead 'market participants to expect policy rates to remain low for longer'.[53]

Unconventional monetary policies push central banks very close to the limits of their powers. In raising bond prices and lowering yields (making borrowing cheaper), QE certainly has the effect of reducing the cost to Member States of financing their debt, and therefore comes very close to being unlawful economic (fiscal) policy on the part of the ECB, and unlawful finance of a deficit under Article 123(1)

[46] Benford et al above n42 at 99.
[47] See BoE MPC minutes, 4 and 5 March 2009, para 31.
[48] M McLeay, A Radia and R Thomas, 'Money creation in the modern economy', (2014) *Bank of England Quarterly Bulletin* (Q1) 14 at 17.
[49] Benford et al above n42 at 93.
[50] Ibid at 97.
[51] Ibid at 94.
[52] Ibid at 95.
[53] M. Joyce, M. Tong and R. Woods, 'The United Kingdom's Quantitative Easing Policy: Design, Operation and Impact' (2011) *Bank of England Quarterly Bulletin* 200 at 201.

TFEU. However, this argument was implicitly rejected by the CJEU when it examined the legality of the ECB's July 2012 Outright Monetary Transactions (OMT) programme, a programme which has not been activated to date. Faced with soaring yields on bonds issued by peripheral Member States, the ECB announced that the Eurosystem would use its OMO power to purchase Member State bonds in secondary markets. There were no ex ante quantitative limits on these purchases, but access to the OMT would be restricted to Member States which have access to bond markets and are participating in a Eurozone macroeconomic adjustment programme. The simple fact that the ECB stood ready to buy bonds if yields crept back up (and prices dropped) had the effect of keeping prices higher and yields at lower levels.

The legality of OMT was referred to the CJEU by the German Federal Constitutional Court, [54] which had concluded that 'it is likely' that OMT 'is not covered by the mandate of the European Central Bank'[55] and 'is likely to violate' the Article 123(1) prohibition on monetary finance,[56] even if no bonds are actually purchased.[57] In its decision,[58] the CJEU ruled that both in objective and form, OMT was a monetary policy measure within the ECB's powers. Its ultimate objective was to ensure the ability of ESCB to guarantee price stability in line with its mandate by safeguarding 'the singleness of monetary policy' and ensuring that the ECB is able transmit monetary policy throughout the eurozone.[59] In form, OMT amounted to a threat of large scale OMOs, which are recognised as an instrument of monetary policy under the ECB Protocol.[60] Any indirect effects on the 'stability of the Euro area', which is a matter of economic policy, would not suffice to make OMT unlawful.[61] Nor did OMT contravene Art 123(1), because it contained sufficient safeguards to ensure that that Article's objective, namely 'encourag[ing] the Member States to follow a sound budgetary policy', is not circumvented.[62]

QE differs from OMT in a number of respects, including that precise details of its scope were announced in advance and that it would result in huge increases in base money and liquidity. The ECB's decision to launch a QE programme was referred to the CJEU by the German Federal

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[54] Bundesverfassungsgericht, 2 BvR 2728/13 vom 14.1.2014, Absatz Nr. (1-105). An English translation is available online at www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2014/01/rs20140114_2bvr272813en.html. For further discussion of this decision, see C. Gerner-Beuerle et al, 'Law Meets Economics in the German Federal Constitutional Court: Outright Monetary Transactions on Trial' (2014) 15 *German Law Journal* 281.

[55] Ibid, para 69.

[56] Ibid, para 84.

[57] Ibid, para 93.

[58] Judgment of 16 June 2015, *Gauwiler and others v Deutscher Bundestag*, C-62/14, EU:C:2015:400.

[59] paras 47-50.

[60] Ibid, para 54.

[61] Ibid, para 52.

[62] Ibid, paras 100-2.

Constitutional Court in July 2017.[63] Given the deferential approach of its OMT decision, it was unsurprising that the CJEU ultimately confirmed that the ECB was not acting illegally. As with OMT, indirect effects on economic stability did not turn a monetary policy measure into a measure of economic policy.[64] Perhaps most importantly, the programme was 'not selective', meaning it would 'have an impact on financial conditions across the whole of the euro area and will not meet the specific financing needs of certain Member States of that area'.[65] Uncertainty about future bond purchases meant that its impact on the need for 'sound budgetary policy' would be limited.[66] Nor was the programme disproportionate to its goal of raising inflation, and if such measures were unlawful, this 'might — in particular in the context of an economic crisis entailing a risk of deflation — represent an insurmountable obstacle to its accomplishing the task assigned to it by primary law'.[67] Finally, the programme was subject to safeguards in terms of loss-sharing, as discussed above.[68] If losses do occur, they are likely to arise at the level of NCBs when they unwind their bond purchases, potentially requiring the relevant national treasury to indemnify its central bank (discussed further in the next section).

Overall, then, central bankers have a far broader discretion in terms of how they conduct monetary policy than national treasuries have in relation to fiscal policy. This serves to underline the extent to which the EU's monetary and economic constitution complies with neoliberal policy prescriptions, and poses a serious threat to the sustainability of the EU's economy.

4. The pathological effects of exclusive reliance on monetary policy

The significant legal restrictions on expansionary fiscal policy contrast starkly with the light policing of monetary policy by the courts. In line with the neoliberal prescription, apart from the first year or two after the financial crisis, monetary policy has been the only permissible way to stimulate economies.

A number of observations can be made about the effects of QE. Most of the focus in this section is on the UK, where the QE programme has been running for longer, and so there is more evidence about its consequences.

[63] Judgment of 11 December 2018, *Weiss and others*, C-493/17, EU:C:2018:1000
[64] ibid, paras 63-64.
[65] ibid, para 82.
[66] ibid, para 132.
[67] ibid, para 67.
[68] ibid, paras 94-95.

First, QE blurs the lines between fiscal and monetary policy,[69] because central banks receive either explicit or implicit backing from their treasuries. The BoE has an explicit indemnity for losses arising from its QE programme from the UK Treasury,[70] and interest payments on bonds held by the central bank are remitted to the Treasury,[71] effectively relieving the treasury of the obligation to pay interest on the bonds which are held by the central bank. These circular flows of money show that, whilst formally independent, the Bank of England is not entirely separate, because it is financing the Treasury's operations. Similarly, whilst the vast majority of any losses resulting from Eurozone QE are likely to fall on the national central banks, which are explicitly or implicitly backstopped against losses by national treasuries, the ECB might have to be recapitalised by the Eurozone Member States in line with their shareholdings in the event that it makes losses on its purchases which exceed its reserves. Payment by a national treasury under an indemnity would amount to public spending.[72] As such it must comply with the SGP, although it would presumably be considered an 'exceptional circumstance' outside the control of the Member State in question, given that the ECB required NCBs to purchase bonds. Whilst the possibility of such backdoor fiscal spending was not at issue before the CJEU when it considered QE, allowing it merely to note that any economic policy effects were 'indirect' and therefore insufficient to impugn the programme,[73] it does serve to highlight the wider discretion available to unelected central bankers than to elected politicians.

Second, QE in the UK may have headed off a far worse downturn,[74] but at the price of further exacerbating inequality,[75] an aspect of monetary policy which was little discussed before the crisis.[76] As it was intended to, QE has driven up the prices of financial and non-financial assets, such as houses,[77] benefitting households which hold those assets.[78] This has primarily boosted the wealth of

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[69] J. Green and S. Lavery, 'The Regressive Recovery: Distribution, Inequality and State Power in Britain's Post-Crisis Political Economy' (2015) 20(6) *New Political Economy* 894 at 906-7.

[70] See letter dated 29 January 2009 from the Chancellor of the Exchequer to the Governor of the Bank of England available online at http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk/d/ck_letter_boe290109.pdf.

[71] See letter dated 9 November 2012 from the Chancellor of the Exchequer to the Governor of the Bank of England available online at www.hm-treasury.gov.uk/d/chx_letter_091112.pdf.

[72] Cobham above n5 at 741-2.

[73] *Weiss and others*, para 63.

[74] C. Martin and C. Milas, 'Quantitative Easing: A Sceptical Survey' (2012) 28 *Oxford Review of Economic Policy* 750.

[75] The Bank of England claimed that the UK's Gini co-efficient is lower than it would have been in the absence of QE, although it also recognised that wealthiest households and those around retirement age benefitted the most: see Bunn et al, above n41.

[76] See G. Epstein, 'Central Banks as Agents of Economic Development' *U Mass Amherst Political Economy Research Institute Working Paper No 104*, September 2005 at 5-6.

[77] Bank of England, The Distributional Effects of Asset Purchases' (2012) Q3 Quarterly Bulletin 254-66 at 258.

[78] Joyce, McLaren and Young above n40 at 696-7. In contrast, research by McKinsey suggests that, in the UK, 'household wealth may have increased by $1.1 trillion as a result of ultra-low interest rates, with an estimated

the top 5 percent of households, which hold 40 percent of financial assets, but has also skewed distribution of benefits towards those aged over 45, who hold close to 80 percent of financial assets. At the same time, rates payable on the stock of loans and deposits have fallen, benefitting debtors but disadvantaging those who hold their savings in deposit accounts.[79] Yet politicians, under the influence of neoliberal ideology, have not sought to counter these regressive distributional effects of QE through changes to progressive taxation and redistributive fiscal spending, whilst central bankers, aware of the distributive effects of their emergency actions, have called on politicians to take such steps, albeit with relatively little publicity and even less effect.[80]

Third, in line with the doubts expressed by both Minsky and Keynes,[81] there is little evidence that QE has produced effects on the real economy, and it has been argued that 'QE, by itself, is not strong enough to spark an economic recovery.'[82] Event studies suggest that 'QE has a sizeable impact on corporate bond rates',[83] but that 'QE does not appear to have affected interest rates facing small and medium enterprises and households.'[84] Whilst the yields on corporate bonds may have fallen, relatively few UK listed companies raise debt finance on the bond market and so are able to take advantage of its low, long-term interest rates.[85] Larger companies appear to have been taking advantage of low bond yields to resume their pre-crisis pattern of issuing bonds and buying back their shares. While corporate bond issuance has been buoyant, smaller companies, as well as those with more volatile earnings, are struggling to obtain finance.[86] Likewise, in the Eurozone, where bank

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89 percent coming from housing, 10 percent from bonds, and 2 percent from equity.' See McKinsey Global Institute, 'QE and ultra-low interest rates: distributional effects and risks', November 2013 at 32.

[79] BoE above n77 at 258-9.

[80] The Governor of the BoE, Mark Carney, in his 2016 Report to the Treasury Committee simply noted that 'Trade and fiscal policy continued to drag on growth' (see www.bankofengland.co.uk/-/media/boe/files/about/people/mark-carney/mark-carney-annual-report-2016). Similarly, the President of the ECB, Mario Draghi, has emphasised the limits of monetary policy, but has also noted that, under the regulatory constraints discussed above, 'current fiscal space to support growth is limited' in many euro area Member States and that 'we should avoid the fiscal rules being stretched to a point where they lose credibility': see M Draghi, Introductory Remarks at the Portuguese Council of State, Lisbon, 7 April 2016 (www.bis.org/review/r160408a.htm).

[81] See H. Minsky, 'Comments on Friedman's and Schwartz' Money and the Business Cycles' (1963) 45 *The Review of Economics and Statistics* 64 at 69-70. For Keynes, see above n34.

[82] Martin and Milas above n74 at 762. In its 2015 Annual Report, the Bank of International Settlements concluded at 20 that 'the evidence suggests that central banks have been very successful in influencing financial markets and financial risk-taking but less so in boosting risk-taking in the real economy and hence output'.

[83] Martin and Milas ibid at 757.

[84] Martin and Milas ibid at 758.

[85] In 2010, 141 public non-financial corporations had issued both bonds and equity to the public, while a further 116 issued only bonds: see A Pattani and G Vera, 'Going public: UK companies' use of capital markets' (2011) *Bank of England Quarterly Bulletin* Q4 319 at 322.

[86] Bank of England data shows that lending to SMEs declined in most of the years post crisis and in 2018 remained slightly negative after two years of positive but weak growth: see

lending is the dominant source of corporate finance, SMEs face greater difficulty than larger firms in obtaining bank finance, with considerable divergences between Member States.[87] This is regressive both in terms of sustainability and innovation, and in terms of employment, as smaller companies are the main drivers of employment growth in the EU.[88] The effect of QE on employment is more uncertain. The UK's headline unemployment rate was impressive, falling from over 8 percent in 2010-11 to 5.7 percent in October 2014[89] and even dipping below 4 percent in January 2019. Between 2010 and 2014, most Eurozone Member States had higher unemployment rates, and also saw a considerable increase in involuntary part-time unemployment.[90] Whether or not QE prevented more unemployment in the UK, it appears to have done nothing to prevent falling real wages in the UK between 2010 and 2013: by 2013, real wages were down by 8.5 percent from their 2009 level.[91] This was in marked contrast to most countries (including the Eurozone, where QE had not yet been launched) where downwards wage adjustments slowed after 2011.[92] The more important driver was surely the UK's neoliberal-inspired flexible labour market policies and shareholder primacy corporate governance system.[93]

With the monetary stimulus not reaching the economy either through increased borrowing and investment by most corporations, or through higher wages, any stimulatory effect of QE on the real economy has had to operate through the wealth effect channel, with asset owners increasing their borrowings and spending in response to rising asset prices. It seems plausible, then, to argue that QE amounts to little more than a continuation of the 'financialised demand strategy'[94] that prevailed before the crisis, which, against a backdrop of wage stagnation, relied on rising asset prices and private rather than public debt to stimulate demand in the economy.[95] Yet, relying on QE to produce a wealth

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www.bankofengland.co.uk/statistics/visual-summaries/businesses-finance-raised. See also www.ukfinance.org.uk/wp-content/uploads/2018/10/SME-Finance-Where-are-we-nowV4.pdf.

[87] ECB, 'Survey on the Access to Finance of Enterprises in the euro area – October 2018 to March 2019', May 2019, para 4.2.

[88] 'Small and medium-sized enterprises - Key for delivering more growth and jobs. A mid-term review of Modern SME policy' (COM (2007) 592 final, 4 October 2007) at 3.

[89] ONS Labour Market Statistics, February 2015.

[90] OECD, *Employment Outlook 2018* at 24 and 35-37.

[91] ONS, *Real wages down by 8.5% since 2009*, 5 April 2013.

[92] 'How does the United Kingdom compare?', OECD Employment Outlook, September 2014.

[93] For discussion of the 'neoliberal box' in which lower income households are trapped by the abandonment of full employment policies, small government, labour market flexibility and globalization see T. Palley, 'Financialization: What It Is and Why It Matters' (2007) *Levy Economics Institute of Bard College Working Paper No 525* at 22.

[94] Green and Lavery above n69 at 6

[95] Bhaduri terms this 'a vulgar version of Keynesian demand management' which revolves around stimulating the economy with liquidity to save financial institutions and in the hope that 'this will also revive aggregate demand sufficiently to save not only banks but also the real economy'. A. Bhaduri, 'What remains of the Theory of Demand Management in a Globalizing World?' (2014) *Levy Economics Institute Public Policy Brief* No 130.

effect is likely to be less effective than conventional Keynesian fiscal stimulus, because increased inequality puts downwards pressure on demand, as 'poorer income groups have higher marginal propensities to consume.'[96] It may also lay the groundwork for financial instability if lower income households resume borrowing to fund consumption,[97] whilst higher income households and institutional investors take more speculative financial positions in a search for yield.[98] Finally, it is hard to see how interest rates can normalise because the ongoing rise in private debt levels, encouraged by low interest rates both before and since the financial crisis, is likely to require the continuation of zero interest rates and QE to prevent a major economic downturn.[99]

5. The EU's Fiscal and Monetary Policy Response to the COVID-19 Pandemic

Everything changed – at least temporarily – when the pandemic hit Europe in March 2020. Fiscal policy became very expansionary, and this was complemented by the European Central Bank engaging in QE and lowering interest rates. Whilst the EU's response touched many areas beyond fiscal and monetary policy,[100] it is on those policies that we will focus here.

With national governments ordering businesses to close, it was viewed as imperative to use fiscal policy to support the economy in ways that would not be contemplated in an ordinary recession. Countries such as France, Germany and Italy added between 4.9 percent and 8.3 percent of GDP by

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[96] Ibid at 7.

[97] Bank of England MPC member Jan Vlieghe highlighted this concern in a September 2017 speech, noting that the deleveraging of UK household balance sheets that started in 2010 appeared to end in 2016 (see J Vlieghe, 'Real interest rates and risk', speech at Business Economists' Annual Conference, London, 15 September 2017 available at www.bankofengland.co.uk/-/media/boe/files/speech/2017/real-interest-rates-and-risk.pdf). On the drivers of increasing household debt to finance consumption, see R. Bellofiore, J. Halevi and M. Passarella, 'Minsky in the "New" Capitalism: the New Clothes of the Financial Instability Hypothesis' in D.B. Papadimitriou and L.R. Wray (eds), *The Elgar Companion to Hyman Minsky* (Elgar, 2010) at 92-8.

[98] E Stockhammer, 'Rising inequality as a cause of the present crisis' (2015) 39 *Cambridge Journal of Economics* 935.

[99] In its 2015 Annual Report at 8, the BIS suggests that low interest rates may not be conducive to sustainable and balanced global expansion, and that with 'too much debt, too little growth and excessively low interest rates… low rates beget lower rates.'.

[100] See for example the adoption by the Commission of a Temporary Framework to enable Member States to use the full flexibility foreseen under State aid rules to support the economy in the context of the COVID-19 outbreak: Commission Communication, 'Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak', C(2020) 1863 final, 19 March 2020.

way of additional spending,[101] and a range of other measures such as equity injections, loans and asset purchases were also witnessed.[102] At EU level, a further 3.8 percent of GDP (EUR 427.8bn) in additional spending had been committed under a variety of programmes by early September 2020,[103] including the Corona Response Investment Initiative and the Recovery and Resilience Facility. The latter, agreed in July 2020 is composed of up to EUR 312.5bn in grants (as well as up to EUR 360bn in loans) to Member States. Member States should prepare recovery and resilience plans setting out a coherent package of reforms and investments to be implemented by 2026, of which at least 37 percent of expenditure should be related to green investments and reforms.[104] These loans and grants are financed by the European Commission issuing bonds, the first time the EU has agreed to issue supranational debt instruments in response to an economic crisis. The Commission was authorised to do so by the Council under Art 122 TFEU.[105] Borrowing costs are low, given the EU's high credit rating, and the borrowings will either be rolled over and refinanced or paid back, either from Member State repayments of loans made to them, or, in the case of grants, out of the revenue sources in the EU's budget, including customs duties, Member State VAT contributions and other Member State contributions. [106] The effect of this is that the cost of the EUR 312.5bn of grants issued to Member States will be spread among the Member States in proportion to their contribution to the EU budget; as Art 122 TFEU puts it, the action is taken 'in a spirit of solidarity between Member States'.

The European Council also approved the issue of up to EUR 100bn in social bonds under the SURE Regulation,[107] the proceeds of which will support 18 Member States with loans to finance public expenditure to preserve employment. By December 2020, EUR 39.5bn of the approved SURE bonds had been issued.[108]

As for monetary policy, the ECB was supportive, buying much of the newly issued debt, as it announced a EUR 750bn extension of its QE programme. The Pandemic Emergency Purchase

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[101] IMF, Fiscal Monitor, Database of Country Fiscal Measures in Response to the COVID-19 Pandemic, October 2020 at 19 (available at www.imf.org/en/Publications/FM/Issues/2020/09/30/october-2020-fiscal-monitor).

[102] Ibid.

[103] Ibid at 2.

[104] European Commission, *Recovery and Resilience Facility* (https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en).

[105] *Q&A : Next Generation EU - Legal Construction*, QANDA/20/1024, https://ec.europa.eu/commission/presscorner/detail/en/QANDA_20_1024.

[106] European Commission, *Recovery plan for Europe* (https://ec.europa.eu/info/strategy/recovery-plan-europe_en).

[107] Council Regulation (EU) 2020/672 of 19 May 2020 on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak, OJ L 159/1, 20 May 2020.

[108] European Commission, Investor Presentation, December 2020 (https://ec.europa.eu/info/sites/info/files/about_the_european_commission/eu_budget/investor_presentation_21122020.pdf).

Programme (PEPP) includes all asset categories eligible under the existing Asset Purchase Programme (APP).[109] In addition, euro area banks were temporarily permitted to exclude their exposures to their central bank from their leverage ratio calculation[110] and the banking system was supported with additional liquidity in the form of Pandemic Emergency Long Term Repo Operations (PELTRO).[111]

However, perhaps the most significant development was the suspension, in March 2020, of the Stability and Growth Pact, which until then had been the primary instrument by which fiscal discipline was imposed on Member States. The Commission and Council agreed to activate the general escape clause, which was introduced as part of the 'Six-Pack' in 2011 in the aftermath of the financial crisis. [112] That clause applies to both the preventive and corrective arms of the SGP in the event of a 'severe economic downturn for the euro area or the Union as a whole'. Member States in the preventive arm may be permitted 'temporarily to depart from the adjustment path towards the medium-term budgetary objective… provided that this does not endanger fiscal sustainability in the medium term',[113] whilst recommendations and notices given to Member States in the corrective arm may be revised, allowing them to adopt a revised fiscal trajectory.[114] The effect of this is that the 'budgetary impact of the measures taken in response to the outbreak will be excluded from the Commission's assessments of compliance with the Stability and Growth Pact.'[115]

In essence, then, the suspension of the SGP means that the additional debt issued by Member States to finance their response to the pandemic will not be taken into account in assessing whether their deficits breach the SGP. As to what should be done when the crisis has passed, it has been noted by two ECB researchers that, once the Member States' 'economies have sufficiently recovered, the important fiscal support provided during the crisis will need to be withdrawn and government debt must be reduced.'[116] It is worth noting, however, that the Recommendations issued to Member States

[109] Decision of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17), OJ L 91/1, 25 March 2020.
[110] Decision on the temporary exclusion of certain exposures to central banks from the total exposure measure in view of the COVID-19 pandemic (ECB/2020/44), OJ L 305/30, 21 September 2020.
[111] European Central Bank, ECB extends pandemic emergency longer-term financing operations, Press Release, 10 December 2020, www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr201210~8acfa5026f.en.html.
[112] Commission, 'Communication on the activation of the general escape clause of the Stability and Growth Pact', COM(2020) 123 final, 20 March 2020; Council, 'Statement of EU ministers of finance on the Stability and Growth Pact in light of the COVID-19 crisis', 23 March 2020 (www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/#).
[113] Art 9(1) of Regulation 1466/97 as amended.
[114] Arts 3(5) and 5(3) of Regulation 1467/97 as amended.
[115] COM(2020) 123 final, 20 March 2020.
[116] S Hauptmeier and N Leiner-Killinger, 'Reflections on the Stability and Growth Pact's Preventive Arm in Light of the COVID-19 Crisis' (2020) 55(5) *Intereconomics Review of European Economic Policy* 296.

in the preventive arm of the SGP state that they should resume a focus on 'achieving prudent medium-term fiscal positions', at least 'when economic conditions allow'.[117] The European Fiscal Board, an independent body which advises the Commission, reported in July 2020 that 'activation of the general escape clause of the SGP was fully justified; but it should have included indications on (and conditions for) exit or review… Clarity should be offered in due course, ideally by spring 2021.'[118] A more comprehensive review of the SGP was launched by the Commission in February 2020, noting both the danger of changes in market sentiment towards heavily indebted Member States, and that, with interest rates having hit their effective lower bound, 'the appropriate role of fiscal and economic policy in macroeconomic stabilisation should be assessed'. [119] However, the review was put on hold after the onset of the pandemic, and will probably restart later in 2021. Whilst it is currently unclear how far and how quickly Member States will be required to reduce their pandemic-related debt, it seems clear form the documents discussed above that this is not a permanent change and a reduction will ultimately be required, entailing some combination of fiscal austerity and tax increases. Whilst the balance between these two is a political question for Member States, neoliberal ideology would privilege cuts to public spending above tax increases. If Member States' political choices follow neoliberal ideology then this will further undermine economic sustainability in the EU.

6. **Conclusion**

In the Eurozone, as a result of the financial crisis and long before the COVID-19 pandemic, the economic and social situation in heavily indebted 'peripheral' Member States such as Greece, Italy and Spain appeared unsustainable. Similarly, growing inequality within Member States was driving the emergence of populist governments, a dynamic which was creating serious political tensions within the EU. Indeed, one need look no further than the UK, where the rampant inequality created by 40 years of neoliberalism has been further exacerbated, first by the distributional consequences of QE

[117] See for example 'Recommendation for a COUNCIL RECOMMENDATION on the 2020 National Reform Programme of France and delivering a Council opinion on the 2020 Convergence Programme of France', ST 8183/20 - COM(2020) 510 final, 8 June 2020. Equivalent Recommendations were made to all Member States that are in the preventive arm: see European Parliament Briefing, 'Implementation of the Stability and Growth Pact under pandemic times' Economic Governance Support Unit (EGOV) PE 659.618 - November 2020.

[118] European Fiscal Board, 'Assessment of the fiscal stance appropriate for the euro area in 2021', 1 July 2020 at 6. For further discussion of post-crisis ways forward, including considerations relating to transitionary arrangements, see European Parliament, 'When and how to deactivate the SGP general escape clause?' Economic Governance Support Unit (EGOV), Directorate-General for Internal Policies, PE 651.378, November 2020 available at www.europarl.europa.eu/RegData/etudes/IDAN/2020/651378/IPOL_IDA(2020)651378_EN.pdf.

[119] European Commission, 'Economic Governance Review', COM(2020) 55 final, 5 February 2020 at 5-6.

and fiscal austerity in the aftermath of the global financial crisis, and second by the pandemic.[120] Indeed, fiscal austerity and the inequality it deepened appears to have played an important role in the outcome of the UK's 2016 referendum on membership of the EU.[121]

Heavily indebted members of the eurozone do not have the 'luxury' of depreciating their currency against their intra-EU trading partners, nor do they have control over interest rates and unconventional monetary policy, so they cannot unilaterally decide to stimulate their economy in this way. They also face very significant constraints on fiscal policy as a result of the SGP. As a result, if they want to improve economic growth, they will have to engage in unilateral structural adjustment (a euphemism primarily referring to reducing the power of labour). But if this also reduces the income of labour, this will further weaken domestic demand, further undermining economic sustainability and also potentially creating political instability.

As for what should be done, the Bank for International Settlements rightly noted the need to 'replace the debt-fuelled growth model that has acted as a political and social substitute for productivity-enhancing reforms… Monetary policy, overburdened for far too long, must be part of the answer, but it cannot be the whole answer.'[122] However, its prescription for reform was straight out of the neoliberal playbook, emphasising 'improving the flexibility of product and labour markets,[123] providing an environment conducive to entrepreneurship and innovation, and boosting labour force participation.'[124] In other words, further structural adjustment, and with it, further social dislocation.

Others have been calling for more far-reaching reform ever since the financial crisis, with researchers at the IMF in 2013 calling for increased fiscal risk-sharing[125] and a banking union within the Eurozone[126] to address the structural imbalances. A 2018 IMF paper noted that the lack of fiscal union was an ongoing vulnerability which 'presents an existential risk that policymakers should not ignore', [127] although in the same year others at the IMF noted that 'progress towards "more Europe", including in the fiscal domain, stalled as the [financial] crisis ebbed'. However, everything changed when the

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[120] See Institute for Fiscal Studies, 'Covid-19: the impacts of the pandemic on inequality' Briefing Note, 11 June 2020, available at www.ifs.org.uk/publications/14879.
[121] See for example T Fetzer, 'Did austerity cause Brexit?' (2018) *University of Warwick Department of Economics Working Paper No 1170*.
[122] BIS Annual Report 2015 at 9.
[123] A key part of Palley's 'neoliberal box': above n93 at 22.
[124] BIS Annual Report at 18.
[125] C. Allard et al, 'Toward a Fiscal Union for the Euro Area', IMF Staff Discussion Note, September 2013, SDN/13/09.
[126] R. Goyal et al, 'A Banking Union for the Euro Area', IMF Staff Discussion Note, February 2013, SDN/13/01.
[127] H Berger, G Dell'Ariccia and M Obstfeld, 'Revisiting the Economic Case for Fiscal Union in the Euro Area', IMF Departmental Paper No 18/03 (available at www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2018/02/20/Revisiting-the-Economic-Case-for-Fiscal-Union-in-the-Euro-Area-45611).

pandemic hit in 2020 and the policy playbook was, at least temporarily, replaced by something more sensible.

The EU's willingness to use emergency measures to allow fiscal policy to offset shortages in demand comes at a time when the international institutions appear to be reversing their long-standing support for neoliberalism. The IMF suggested in 2016 that neoliberalism may have been 'oversold' on the basis that it has 'increased inequality', which in turn undermines the 'sustainability of growth'.[128] Similarly, the OECD recognises that widening income inequalities significantly curb economic growth; that tax and transfer policies do not harm growth if they are well designed and implemented; and that countries should support lifelong skills development and learning.[129] Whilst this apparent change of approach is to be welcomed, this chapter has shown that there are significant legal, political and ideological barriers to change. Sawyer, who calls for significant income transfers between Member States (of the kind subsequently – but exceptionally – witnessed in the response to the COVID-19 pandemic) and a supranational social security system, admits that his recommendations are 'very far removed from the present policy positions, and remote from what could be viewed as politically feasible'.[130] Whilst the pandemic has provided a space in which policies aimed at economic sustainability could be deployed on a temporary basis, it is clear that the intention of the European institutions is to return to the previous regime in due course, if not as soon as possible, and it is to be expected that there will be pressure for debt reduction once the disruption is behind us. The (limited) fiscal integration embodied in the grant component of the 2020 Recovery and Resilience Facility shows what can be done where there is political will. However, economic sustainability will require the EU to go much further than time-limited measures taken in a state of emergency. It is clear that, without constitutional change, whether loosening the constraints on public debt or providing for continuous fiscal transfers as required between Member States, and without an ideological shift away from neoliberalism, sustainable growth within the EU will remain elusive. At present, such change looks politically implausible, yet a failure to address these issues creates the very unwelcome risk that the EU itself may break apart.

[128] J.D. Ostry et al, 'Neoliberalism: Oversold?' (2016) *Finance & Development* 38.

[129] OECD, 'Does income inequality hurt economic growth?', Focus on Inequality and Growth, December 2014.

[130] M. Sawyer, 'Alternative Economic Policies for the Economic and Monetary Union' (2013) 32 *Contributions to Political Economy* 11 at 11.