

Jean Pisani Ferry writes: Central bankers are often proud to be boring. Not Mario Draghi. Two years ago, in July 2012, Draghi, the president of the European Central Bank, took everyone by surprise by announcing that he would do “whatever it takes” to save the euro. The effect was dramatic. This August, he used the annual gathering of top central bankers in Jackson Hole, Wyoming, to drop another bomb.

Draghi’s speech this time was more analytical but no less bold. First, he took a side in the ongoing debate about the appropriate policy response to the eurozone’s current stagnation. He emphasized that, along with structural reforms, support for aggregate demand is needed, and that the risk of doing too little in this respect clearly exceeded the risk of doing too much.

Second, he confirmed that the ECB was ready to do its part to boost aggregate demand, and mentioned asset purchases, or quantitative easing, as a necessary tool in a context in which inflation expectations have declined below the official 2% target.

Third, and to the surprise of most, Draghi added that there was scope for a more expansionary fiscal stance in the eurozone as a whole. For the first time, he expressed the view that the eurozone had suffered from the lower availability and effectiveness of fiscal policy relative to the United States, the United Kingdom, and Japan. He attributed this not to pre-existing high public debts, but to the fact that the ECB could not act as a backstop for government funding and spare fiscal authorities the loss of market confidence. Moreover, he called for a discussion among euro members of the eurozone’s overall fiscal stance.

Draghi broke three taboos at once. First, he based his reasoning on the heterodox notion of a policy mix combining monetary and fiscal measures. Second, he explicitly mentioned the aggregate fiscal stance, whereas Europe has always looked at the fiscal situation exclusively on a country-by-country basis. Third, his claim that preventing the ECB from acting as a lender of last resort imposes a high price – making governments vulnerable and reducing their fiscal space – contradicts the tenet that the central bank must not provide support to government borrowing.

The fact that Draghi chose to confront the orthodoxy at a moment when the ECB needs support for its own initiatives is indicative of his concern over the economic situation in the eurozone. His message is that the policy system as it currently works is not suited to the challenges that Europe faces, and that further policy and institutional changes are necessary.

The issue now is whether – and, if so, how – conceptual boldness will translate into policy action. There is less and less doubt regarding the benefits of outright asset purchases by the ECB. What was long regarded as too unconventional to be contemplated has gradually become a matter of consensus. It will be operationally difficult, because the ECB, unlike the Federal Reserve, cannot rely on a unified, liquid bond market, and its effectiveness remains uncertain. But it will most likely take place.

At the same time, there is little doubt that fiscal policy will fall short of Draghi's wishes. There is no agreement in Europe on the concept of a common fiscal stance, and the backstop that the ECB could provide to sovereigns can be offered only to countries that commit themselves to a negotiated set of policies. Even this conditional support within the framework of the ECB's so-called outright monetary transactions (OMT) program has been opposed by Germany's Bundesbank and constitutional court.

Draghi's initiative on this front should thus be interpreted not only as a call for action, but also – and perhaps even more so – as a call for reflection on the future approach to eurozone policymaking. The question is this: How can the eurozone define and implement a common fiscal policy without having a common budget?

International experience shows that voluntary coordination is of little help. What happened in 2009 was a rare exception; shocks like that which followed the Lehman Brothers bankruptcy – sudden, strongly adverse, and highly symmetric – come once in decades. At the time, all countries faced essentially the same issue, and all shared the same concern that the global economy could slide into a depression.

Europe's problem today, though serious, is different: a significant subset of countries does not have fiscal space to act and would therefore be unable to support demand. And, though Germany is doing much better than anyone else and has fiscal space, it does not wish to use it to benefit its neighbors.

If joint fiscal action is to be undertaken, a specific mechanism would

be needed to trigger it. One could think of a joint decision procedure that would, under certain conditions, require budget laws to be approved by the national parliament and a majority of partner countries (or the European Parliament).

Or one could think of a mechanism inspired by the “tradable deficits permits” imagined by Alessandra Casella of Columbia University. In this scenario, countries would be allocated a deficit permit consistent with the desired aggregate stance, but would be free to trade them; a country willing to post a lower deficit thus could cede its permit to another one willing to post a higher deficit. In this way, the aggregate stance could be achieved while accommodating national preferences. Any mechanism of this sort raises a host of questions. But the fact that the official in charge of the euro is raising the issue indicates that the common currency’s architecture remains in flux.

A few months ago, the consensus was that the time for redesigning the euro had passed, and that the eurozone would have to live with the architecture inherited from its crisis-driven reforms. Not anymore. It may take time before agreement is reached and decisions are made, but the discussion is bound to resume. That is good news.

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