5.2 An alternative European fiscal policy strategy

5.2.1 Implementing the Golden Rule to strengthen public investment and safeguard it in the medium term

The shortcomings of the EU Commission's strategy demonstrated in the previous section suggest that there is certainly a major role to play for the Golden Rule of public investment in Europe. Unlike proposals to provide more leeway for fiscal policy in general, it provides particular support for public investment as a key to short and long term growth. And unlike the Juncker-Plan to boost public or (publically supported) investment through investment funds it provides a direct boost to public investment on the national level and does not have to rely on highly insecure shifting and leveraging of public funds on the European level in the hope of finding private investors at times when business confidence is extremely low.

In fact, if the Golden Investment Rule had been newly introduced, say in 2014, this could have provided a considerable upward shift in public investment with a corresponding push for aggregate demand in the individual member states and the European economy as a whole. This can be illustrated by looking at table 2. Countries with negative net investment, whose investment had suffered from fiscal restraint could have started increasing their investment towards the pre-crisis level or at least the threshold value of 1 or 1.5 per cent of GDP. Countries with traditionally low public investment (like Germany and to a lesser extent Austria) could have started a major investment initiative. And countries with already high public investment could have used the additional leeway for other stimulus measures if cyclical conditions suggested it.

Even without additional investment, those countries with positive net investment would also have improved their budgetary position, i.e. they would have moved closer to their MTO or the 3 per cent reference value of the excessive deficit procedure which would immediately (slightly) reduce consolidation pressures and allow for a less restrictive consolidation path. As the positive stimulus from higher investment will most probably lead to strong multiplier effects under the present conditions, the ensuing upswing would bring countries even closer to their respective deficit and debt targets potentially creating further leeway. However, the immediate positive one-time fiscal stimulus through the introduction should not be overestimated. If all Euro area countries immediately adjusted their public investment to the pre-crisis level the average positive fiscal stance for the Euro area would be 0.8 per cent of GDP. If in addition Germany very substantially increased its net investment by 1 per cent of GDP the overall fiscal stance for the Euro area would be slightly above 1 per cent of GDP. Realistically, for this to happen, some adjustment time of two or three years would be necessary. Introducing the Golden Investment Rule would then realistically at least achieve the stimulus dimension that the Investment for Europe Plan strives for while at the same time increasing the long term growth potential of the European economy.

One essential question is whether the introduction of the Golden Rule proposed in this study would be compatible with current EU law or whether a change of Council regulations or the Treaty would be necessary. With respect to the old Treaty Blanchard and Giavazzi (2004: 15) argued that the old Art. 104.3 would have allowed implementing the Golden Rule without any treaty changes by changing the corresponding Council regulations, because it stated that in the report to be prepared by the Commission it should also be taken into account whether the government deficit exceeded government investment expenditure. However, since 2008 Art 2 (3) of Protocol No. 12 about the excessive deficit procedure annexed to the Treaty states that investment is to be understood as gross investment. Therefore a permanent interpretation as net investment would probably be difficult to justify. In the end, this is a juridical question that is difficult to answer from an economist's point of view. The change of the Council regulation deemed necessary, however, would still require unanimous consent within the Council.

For some time the introduction of the Golden Rule for public investment could probably be approximated even without any changes in the current institutional framework, if the European Commission and the European Council were willing to more actively use the interpretational leeway within this framework (see table 3 for an overview of measures). Actually, the clarification as to the interpretation of the Pact that the Commission has just given can already be seen as illustrating steps in that direction.

At least additional net investment could be justified if it came in the form of a temporary investment programme, analogous to the way the Commission interprets contributions to the EFSI. Additionally or alternatively, it may be possible to treat an investment programme as structural reform that temporarily allows for deviations from MTO or the adjustment path towards it. As to the 'investment clause' it should be possible to implement it as a 'small-scale Golden Rule' under these conditions. Reference to adverse cyclical conditions might help to increase leeway even further, although this could create the danger of a stop-and-go investment policy, if cyclical conditions improve as can be expected under an investment programme. Finally, recourse to the exceptional clause of a severe downturn in the Euro area or the EU could be had in order to justify slowing down the consolidation path and allowing for additional investment spending. All of this could further be supported if realistically high multiplier values were used in assessing the budgetary impact of additional investment, which may not be significantly negative or even positive. This would mean that such additional investment could be irrelevant at least under the excessive deficit procedure as it would not (or hardly not) increase the deficit. Reconsideration of the EU Commission's method of cyclical adjustment – e.g. to be more in line with the OECD method and results – may create further leeway as it might increase the cyclical part of the budget deficit thus reducing the structural deficit (Truger 2014).

Some or all of the mentioned interpretational leeway could be used to push up public investment on the level that would be consistent with a Golden Rule in the medium term. However, the permanent recourse to exceptional circumstances which would be necessary to permit permanent use of the rule for public investment in general would most probably overstretch the interpretational leeway inherent in the current framework. Therefore, in order to solidly implement the Golden Rule on the EU level a permanent change in the institutional fiscal framework would be adequate and most probably also necessary from a legal perspective.

Such a change could be adopted as primary law in the form of an 'Investment Protocol' that would be annexed to the Treaty under the simplified revisions procedure of Art.48 of the Lisbon treaty (see table 3). On the member states' level further legal changes would be required if following the fiscal compact there were other legal provisions put in place that would prevent a reinterpretation of the budget balance as net of net spending on public investment. This would for example clearly be the case under the German debt brake.[10]

5.2.2 A European Investment Programme and an expansionary overall fiscal stance to spark off the recovery

As discussed in the previous section, the implementation of the Golden Rule of investment would probably take some time until the necessary political and legal steps could be completed. It should therefore mainly be seen as a fiscal policy framework focused on safeguarding public investment in the medium term, and not so much as a readily available instrument for providing the – urgently needed – boost to the European economy in the short run. Because the Juncker-Plan will not be able to provide this boost in

[10] See Burret and Schnellenbach (2014) for an overview of the state of implementation of the fiscal compact in the different signatory member states.