EU Fiscal Governance and Institutional Change

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EU Fiscal Governance
Questions about current state

- Can the current system of EU fiscal governance discourage government deficit bias and ensure long term debt sustainability?
- Can it do the above while leaving room for countercyclical policy?
- What reforms would be desirable?

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Questions that need to be answered first

- Are the targets/rules adequately constructed?
- Are there measurement issues?
- Is primary evidence/statistics of appropriate, harmonized quality?
- Are the rules monitored, applied and enforced?
- Are roles/responsibilities in fiscal governance optimally allocated?
- Are conditions in other policy areas and in markets appropriate and supportive?

EU Fiscal Governance
Overall assessment

- Progress has been made since the crisis: Six Pack, Fiscal Compact, Two Pack
- Weaknesses of the system=> not a steady state
  - The set of rules is complex (affects application, communication)
  - Measurement of unobserved decision variables is a problem (e.g., output gap, structural fiscal balance)
  - Statistics (relevant for the construction of variables used in making policy decisions) may be of variable quality across Member States

EU Fiscal Governance
Overall Assessment

- Weaknesses of the system (continued)
  - Application and enforcement of the rules face significant risks:
    - Persistence of various escape clauses
    - Discretion by Commission (need for rigorous application of rules and pursuit of targets despite significant political pressures)
    - Monitoring and decisions by peers (incentive structures may not be conducive to fully applying/enforcing the rules)
    - Difficulty to enforce sanctions in crisis situations
    - Still not enough built-in automaticity in enforcement of rules
    - Reliance on national responsibility/political will for applying rules
    - Potentially slow processes of fiscal adjustment; adverse debt/fiscal sustainability implications

EU Fiscal Governance
Overall Assessment

- Weaknesses of the system (continued)
  - Allocation of roles and responsibilities in union fiscal governance unfinished and contradictory
    - No significant union budget, with spending on services and investment, taxing authority and capacity to issue debt
    - Countercyclical policy remains with Member States
    - Banking system responsibility (including for recapitalization) remains national

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Overall Assessment

- Weaknesses of system (continued)
  - Conditions in other policy areas and markets are unsupportive
    - Full banking union is lacking
    - Banks are too tied to national governments/national government financing
    - Capital markets are not fully integrated and developed

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Aspects of a steady state for the Union

- Member States commit to the Union by giving up areas of sovereignty: “Getting both feet inside the door”
  - Large parts of fiscal spending and taxation (previously by Member States) now at the center, leading to significant Union budget
  - Responsibility for countercyclical policy at the center (Union budget), taking away that responsibility from MS budgets
  - Responsibility for bank recapitalization at the center (Union budget) breaking the link with MS budgets and governance
  - Single bank supervision, bank resolution, deposit insurance
  - Responsibility for European Statistics at the center: European Statistical System now an integrated organization, in the form of an independent authority responsible for <u>all</u> European Statistics
  - Unified capital market, under the responsibility of the center
  - Simple budget rules for MS budgets; the market disciplines

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Interim first steps towards steady state

- Simplify the fiscal rules/targets as much as possible, emphasizing an adequate debt criterion to support fiscal sustainability
- Address as much as possible measurement issues (e.g., use additional explanatory variables for estimating unobservable output gap)
- Move boldly to fewer escape clauses, less room for discretion, more automaticity (including for sanctions)
- Assign compilation of most important European statistics used for policy decisions to an integrated European Statistical System structure carved out of National Statistical Institutes and Eurostat
- Complete single bank supervision and resolution; make progress on deposit insurance and on unified capital market

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The new European Statistical System in the steady state

- The new ESS will be a fundamental reference point for the policy side, as well as the markets and the public, producing all European statistics so that they are:
  - of assured and harmonized quality
  - timely and punctually provided
  - produced efficiently and cost effectively
  - highly accessible with full transparency
  - rapidly responding in a fully coordinated manner to evolving user needs

EU Fiscal Governance

The new European Statistical System in the steady state

- The new ESS will generate value and save resources by reconstructing its business chain and investing collectively in innovation
- integrate/share production and dissemination of statistics

=> significant economies of scale while avoiding discrepancies in the quality of statistical output and services between different countries/regions in Europe

EU Fiscal Governance

The new European Statistical System in the steady state

- Sharing of human and financial resources as well as of confidential microdata will be fundamental aspects of the operation of the new ESS
- The National Statistical Institutes will become **European Statistical Institutes**—the branches of a single organization, which will be an independent authority, fully outside policy structures
- The above ways of doing business will be accompanied by a corresponding evolved legal framework and governance structure for the ESS