EU Fiscal Governance and Institutional Change

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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?
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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
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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
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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 all 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
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.
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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.