
REFOCUSING THE EUROPEAN FISCAL FRAMEWORK

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**Reforming Europe's Fiscal Framework –
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Fiscal rules should...

...target fiscal aggregates which

- are under direct control of governments,
- can be forecast reliably, and
- are prone to only minor revisions

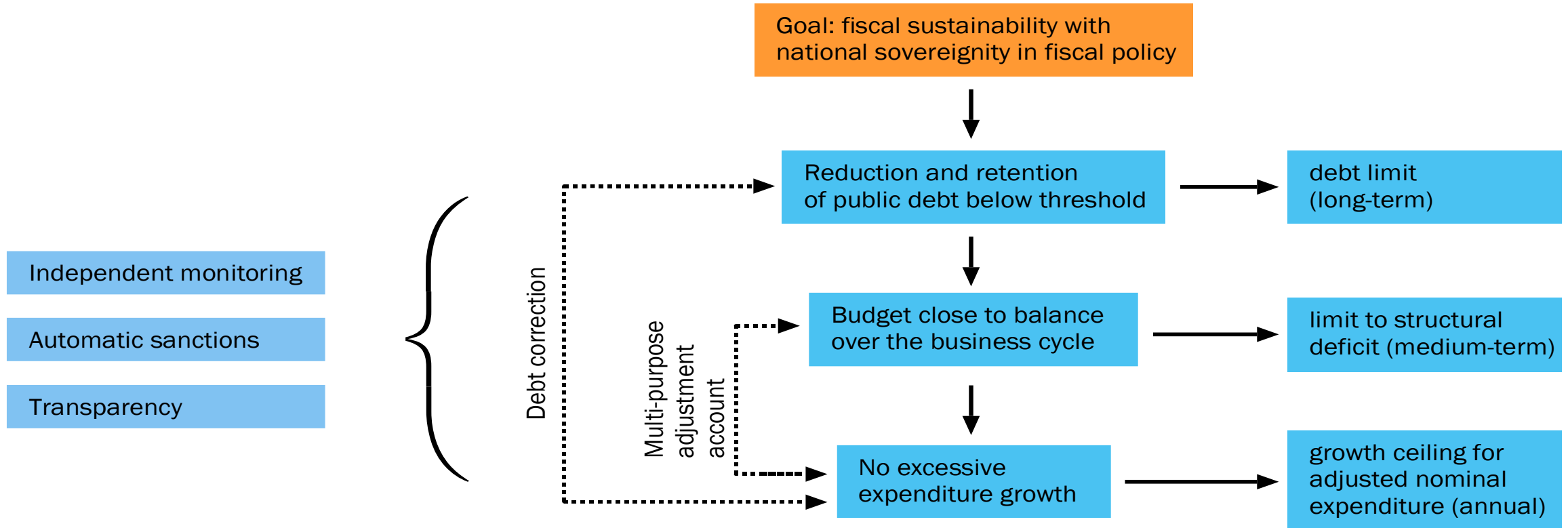
... not limit automatic stabilisers, i.e., prevent pro-cyclicality in fiscal policy

... ensure reduction of debt to GDP ratios over a reasonable time horizon

... be associated with high political costs for non-compliance, through

- transparency vis-à-vis the public and media
- quasi-automatic and noticeable sanctions

Framework of the GCEE proposal

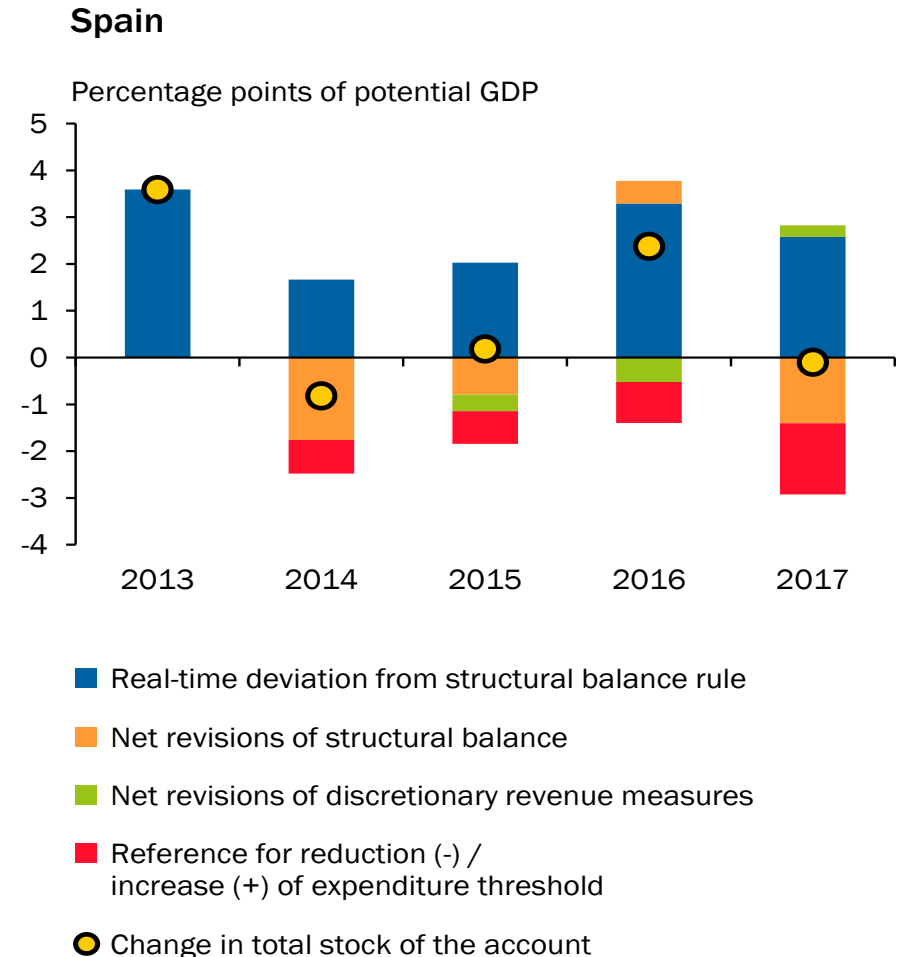


Annual target: Constraining growth of expenditures

- Nominal government expenditure growth
 - Excluding cyclical unemployment expenditures
 - Excluding interest expenditures
- Advantages:
 - Directly influenced by governments
 - Largely independent from the business cycle
 - Forecast errors are substantially smaller
 - Largely acyclical, i.e, automatic stabilisers are free to work

Medium term: limit to structural deficit

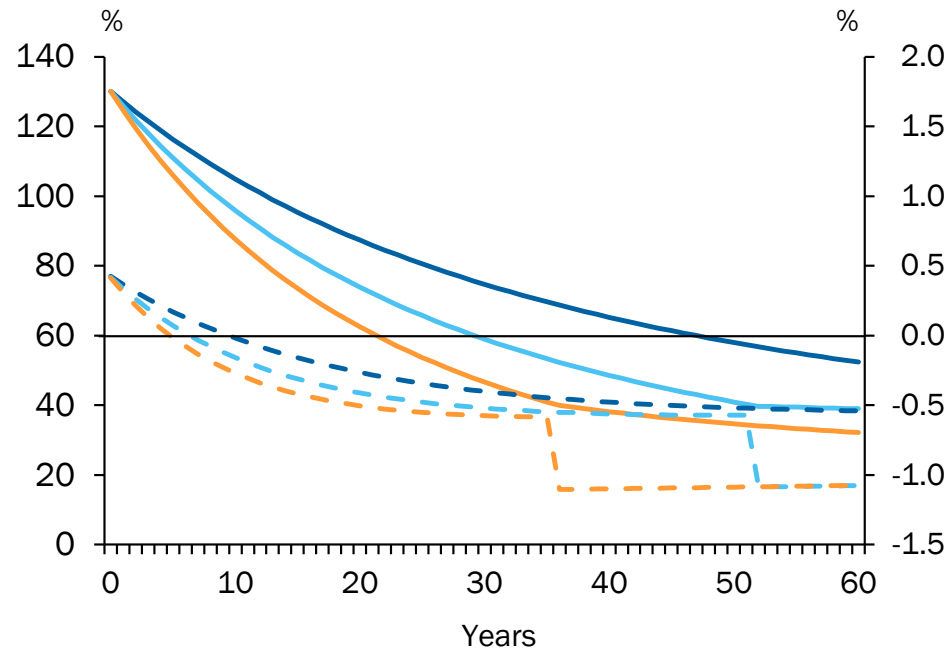
Need for a multi-purpose adjustment account



- Four components
 - Deviations from structural balance rule
 - Revisions of structural balance
 - Estimation errors of discretionary revenues
 - Short-term deviations between actual and budgeted expenditures
- Net inflows of one year reduced proportionally in each of the subsequent years
- Keeping structural balance rule in line with rules in national and EU regulation,
 - But address problem with real-time estimation

Long-term target: Debt correction

Debt-to-GDP ratio in $t=0$: 130%
Debt correction 1/75



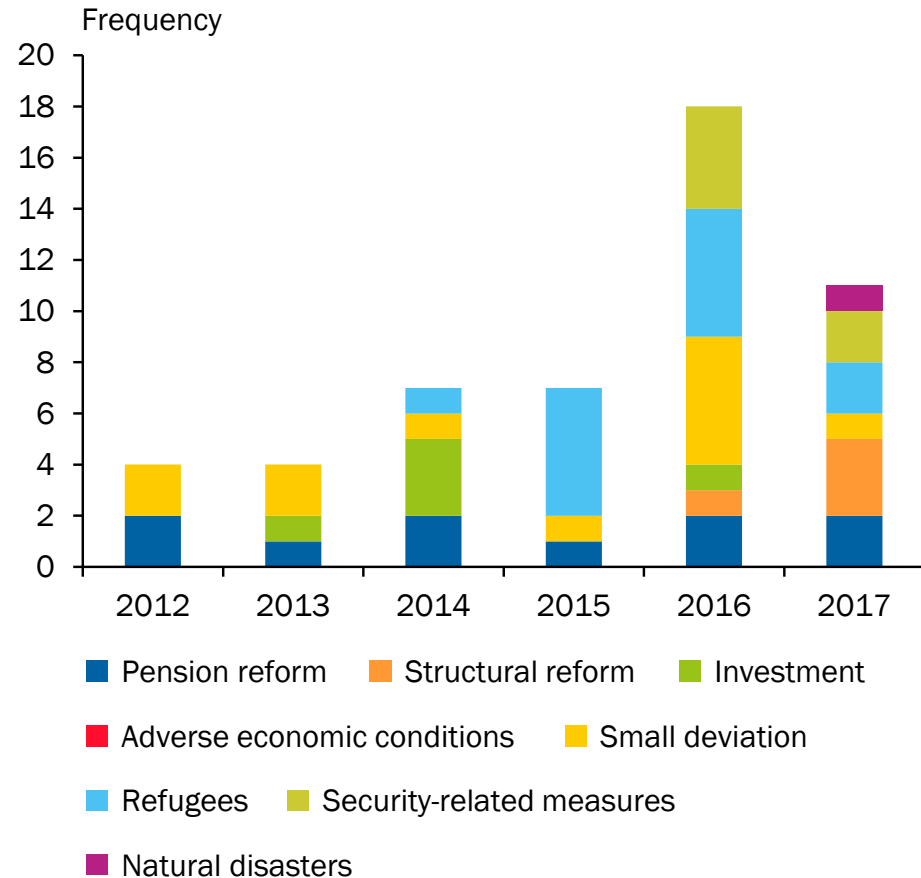
Debt ratio for different growth rates of nominal GDP:

— 2% — 3% — 4%

- Markdown relative to difference between present debt to GDP ratio and long-term limit
- Supports faster convergence to lower debt levels

Exemptions and sanctions

Frequency of exemptions granted in the SGP



Sources: European Commission, own calculations

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- No exemptions and only two escape clauses
 - Natural disasters
 - Exceptionally severe economic crises (decision based on set of economic indicators)
- Increase political costs of non-compliance
 - Increase in transparency
 - Strengthening of national and European fiscal councils
 - Less discretion in imposition of sanctions

Implementation

- Builds on elements that already exist today
- Procedures and specifications causing complexity not enshrined in treaties
- regulations and guidelines by European Commission or Council of the EU can be changed more easily

Thank you

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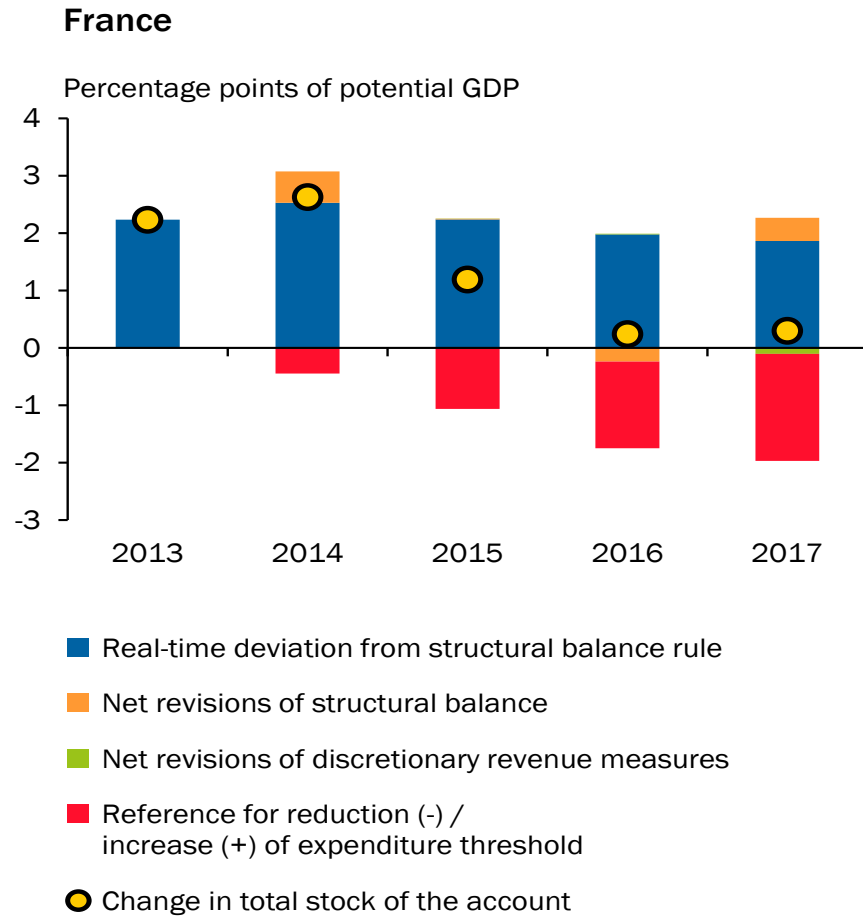
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Backup

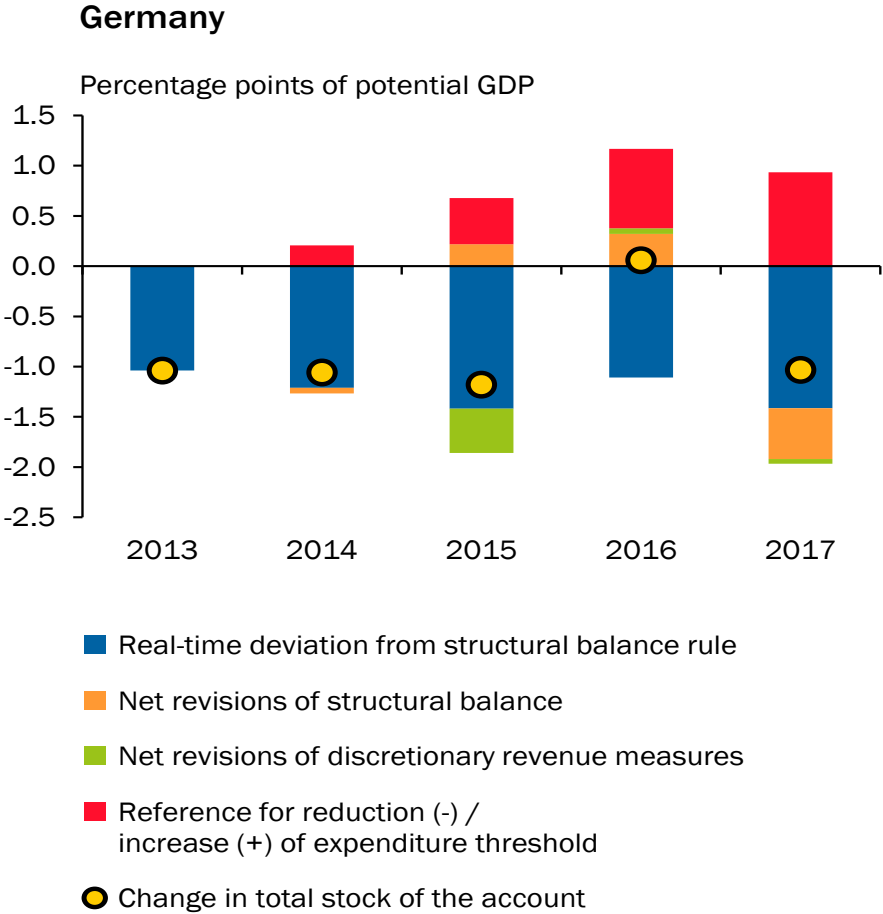
Multi-purpose adjustment account (France)



Sources: European Commission, Project FIRSTRUN, own calculations

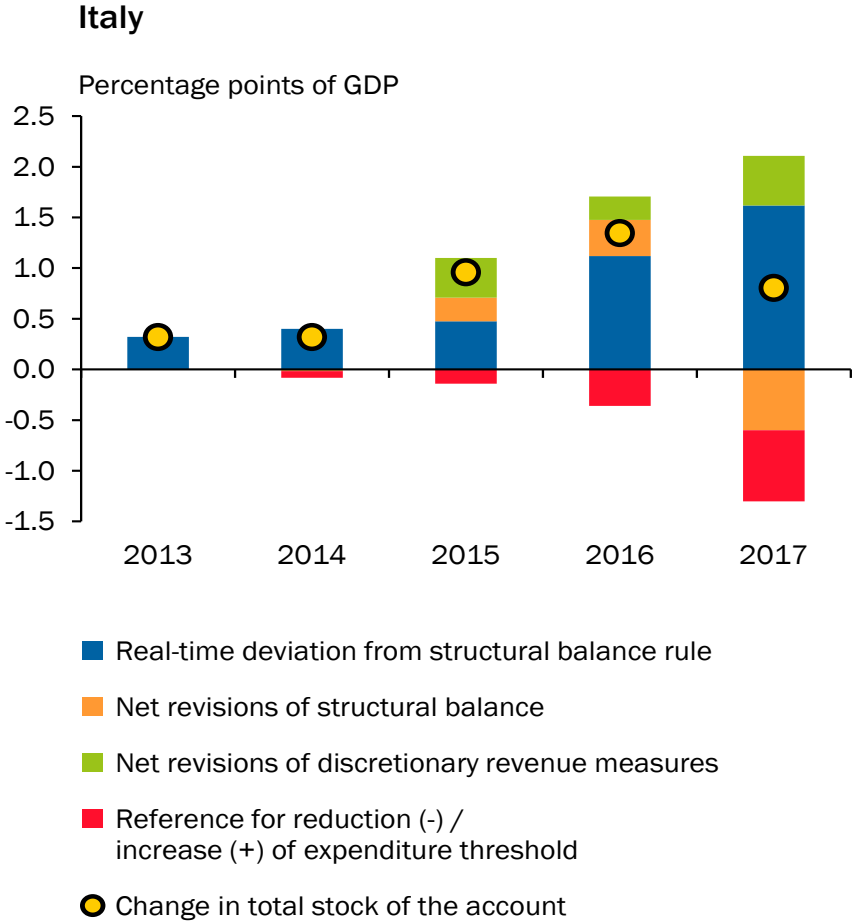
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Multi-purpose adjustment account (Germany)



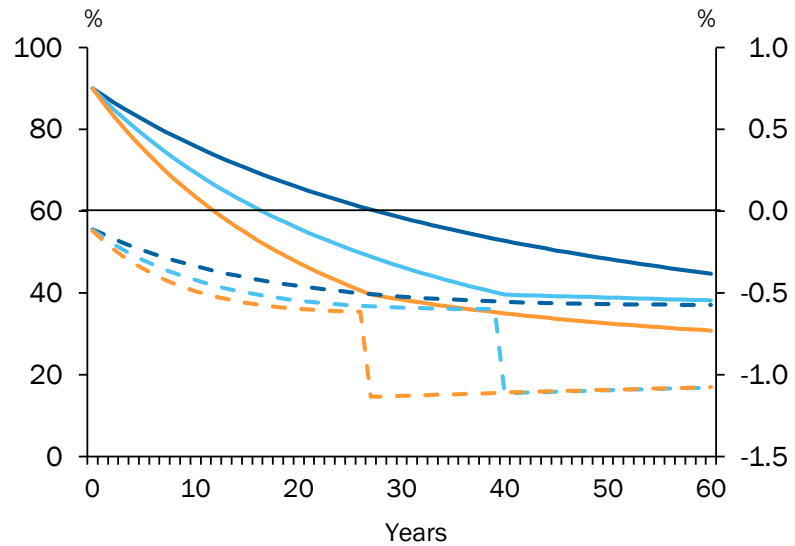
Sources: European Commission, Project FIRSTRUN, own calculations

Multi-purpose adjustment account (Italy)



Sources: European Commission, Project FIRSTRUN, own calculations

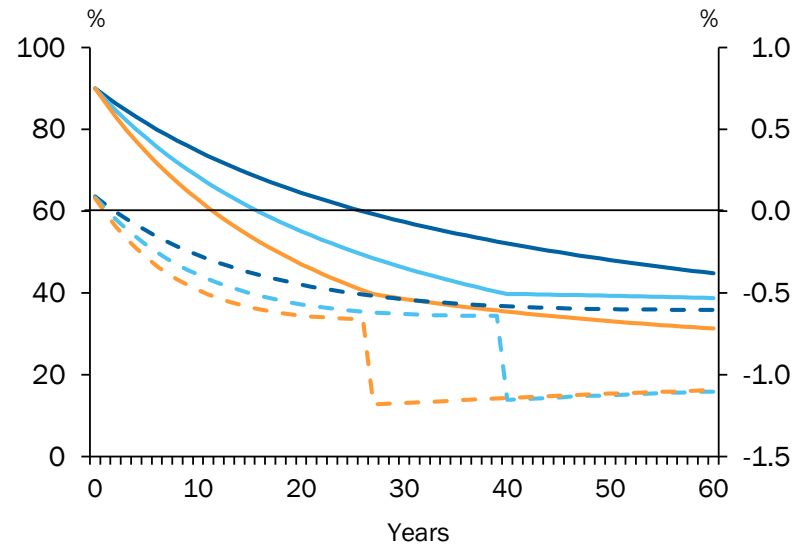
Debt-to-GDP ratio in t=0: 90%
Debt correction 1/75



Debt ratio for different growth rates of nominal GDP:

— 2% — 3% — 4%

Debt correction 1/50

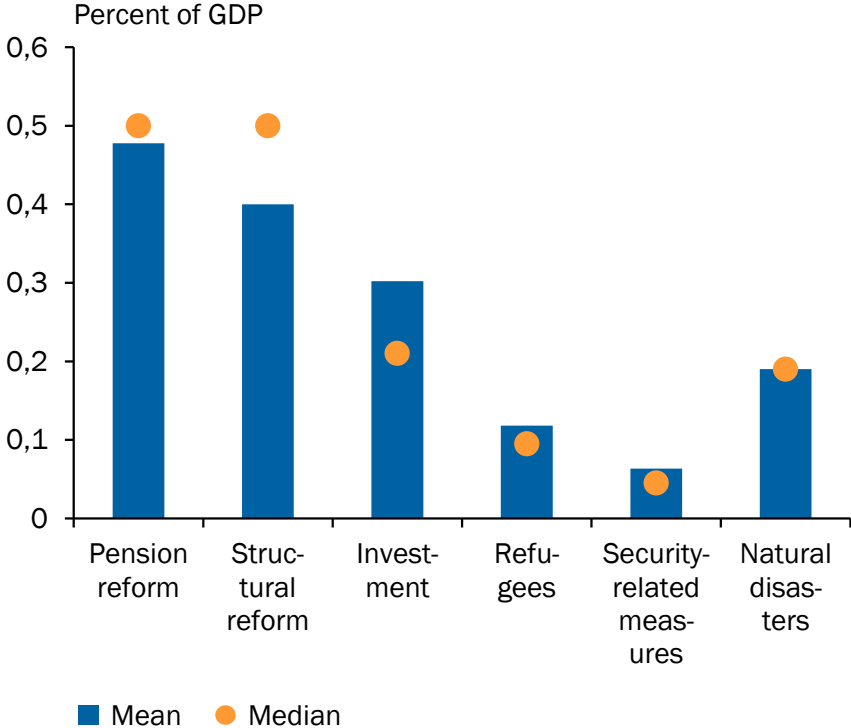


Budget balance for different growth rates of nominal GDP (right hand scale):

- - - 2% - - - 3% - - - 4%

Exemptions

Average size of the exemptions granted in the SGP



Sources: European Commission, own calculations