



# ***Reforming Europe's fiscal framework***

## ***Discussion***

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- Lars P. Feld, Christoph M. Schmidt, Isabel Schnabel, Volker Wieland (FSSW)

*"Refocusing the European Fiscal Framework"*

Zsolt Darvas, Philippe Martin, Xavier Ragot (DMR)

*"Refocusing the European Fiscal Framework"*

- Important similarities reflecting evolution of reflection on fiscal rules...
- ... and differences highlighting important (and unresolved) issues in functioning of fiscal rules, notably at supranational level
- Synthetic assessment best carried out under two angles:
  - Design
  - Implementation

# A 'state-of-the-art' fiscal rule

## FSSW

## DMR

### Debt anchor

Calibration of the intermediate objective reflects the choice of the debt anchor

- Gross debt ratio, 60% debt goal
- Debt reduction pace: fixed rule

- Gross debt ratio, 60% debt goal
- Debt reduction pace: more freedom of choice

### Intermediate objective

Headline balance OR structural balance

- Starting position  $<$  Intermediate Objective  
→ Requirement to adjust towards objective
- Starting position  $\geq$  Intermediate Objective  
→ Requirement to avoid deviation from objective

- Structural balance equal or close to balance ('over-determination?')

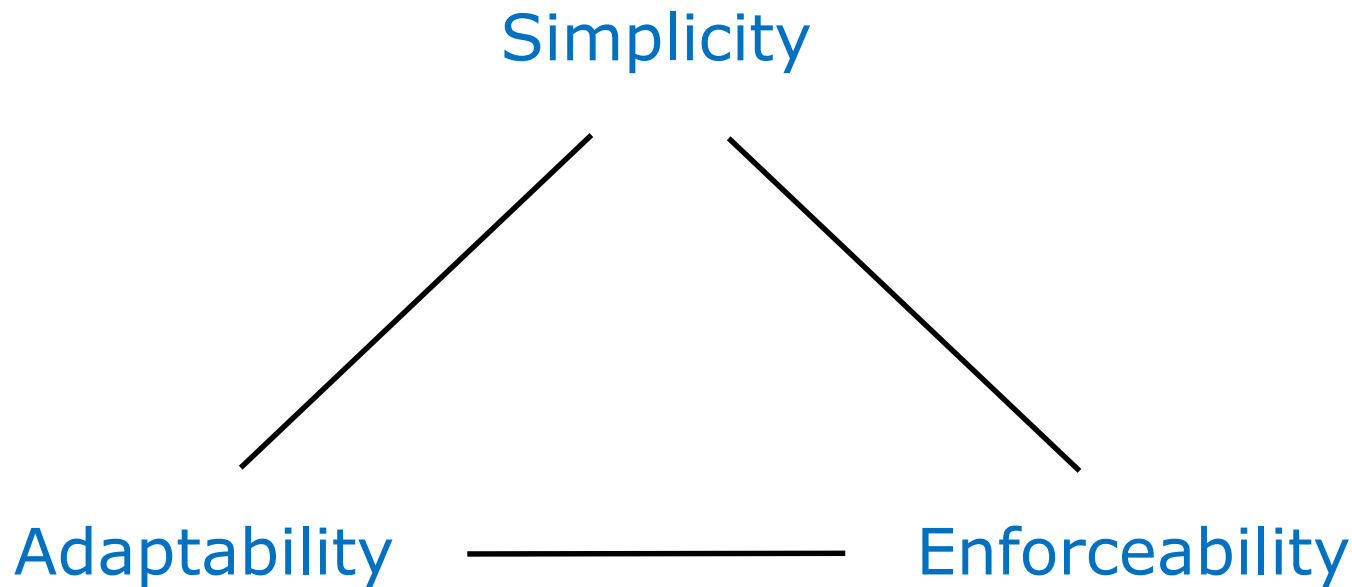
- ?

### Operational instrument (annual compliance)

Expenditure growth (net of revenue measures)

- Annual update of instrument (pro-cyclical behaviour?)
- Alternative approach: multi-annual binding targets/ceilings over legislature

# A trilemma for EU fiscal rules



- Is high reliance on numerical algorithms compatible with simple rules?
- Can rules be 'automatically' enforced in time consistent manner?
- Fiscal councils: shifting locus of political haggling rather than outcomes?

# Conclusion

- The two proposals go in the right direction and echo COM's and DG ECFIN's ideas and initiatives (including recent proposal for the incorporation of the Fiscal Compact into EU law)
- The proposals may be less simple in practice than they pretend (potential conflict between expenditure rule and other rules that are maintained such as MTO and 3%, consideration of structural reforms...)
- Their implementation would face issues that are underplayed (too much automaticity in bad times [FSSW], too much discretion at other times [DMR])
- The proposed Directive arguably offers a set of more refined trade-offs between automaticity and flexibility, EU level and national level, technical expertise and political decision



# Additional slides

# Integrating the Fiscal Compact into EU law

## *Proposed Council Directive for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States*

- Incorporates the Fiscal Compact into EU law by focusing on its underlying objective: **convergence to prudent levels of public debt**
- Complements and reinforces the SGP (no weakening of current EU rules)

<i>Immediate benefits</i>	<i>Long-term benefits</i>
Lower risk of duplications and conflicts between EU framework and intergov't arrangements	<ul style="list-style-type: none"><li>- More effective monitoring and enforcement of fiscal rules at EU and national level</li><li>- Strengthened national fiscal frameworks and domestic ownership</li></ul>

- Main features:
  - **(national) medium-term objective** in terms of structural balance, geared towards prudent gov't debt level + correction mechanism for significant deviations
  - **medium-term expenditure path** (net of discretionary revenue measures) set for the entire legislature when new gov't takes office, binding on annual budgets
  - key role for **national fiscal councils** in setting the above parameters and monitoring compliance with them (including 'comply-or-justify' principle)
- Applicable to euro area Member States, with 'opt-in' clause for the others

# Fiscal Compact Directive in the context of the EU fiscal framework

	SGP 3.0	FISCAL COMPACT	DIRECTIVE	SGP 4.0
OVERARCHING GOAL	"Sustainability of public finances"	"Sound public finances"	Satisfactory pace of debt reduction (w.r.t. 60% threshold)	?
MEDIUM TERM OBJECTIVE	<b>"Close to balance or in surplus" (<math>\geq -1</math>)</b>	"close to balance" ( $\geq -0.5$ )	Medium term objective consistent with the debt reduction objective (no numerical value)	?
MEDIUM TERM CONSTRAINT	SCPs (not binding over medium term)	Calendar of convergence (not binding)	<b>Binding multiannual expenditure path (or other binding annual target)</b>	?
CORRECTION MECHANISM	Significant Deviation Procedure	National correction mechanism	National correction mechanism	?
INDEPENDENT MONITORING	-	IFI	Strengthened IFI	?