First Workshop by the European Fiscal Board

Independent Fiscal Institutions in the EU Fiscal Framework

Concluding remarks

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Outline

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Reforming Fiscal Rules - the Expenditure Benchmark

- **Barnes and Casey examine whether the Expenditure Benchmark (EB) can play a useful role in a future EU Fiscal Framework**

- **They show that the pro-cyclicality of the estimates of potential output underpinning the EB raises doubts about its suitability to ensure effective economic stabilisation**

- **<u>Other potential issues</u>:**
  1. **Treatment of investment**
  2. **Unemployment-related spending**
  3. **“ratchet effect”**

- **Best available (but imperfect) estimates of potential output projections should be at the centre of fiscal policy, with the design of the fiscal rules recognising their uncertainty**

- **<u>Possible policy solutions</u>: revisions to the EU Commonly Agreed Methodology (CAM) for estimating potential output <u>or</u> alternative methods to better capture the cycle endorsed by IFI <u>or</u> Rainy Day Funds to correct for pro-cyclicality of the rules**

Reforming domestic fiscal frameworks I – Sweden

- **Swedish fiscal framework contributed to a sharp fall in the debt-to-GDP ratio. It includes: (i) *expenditure ceiling*, (ii) *surplus target*, (iii) *fiscal council*, (iv) *debt anchor***

- **Authors' recommendation: attention should shift from budget surplus of 1/3 percent of GDP over the business cycle for the general gov't to maintaining a stable debt-to-GDP ratio of 25% of GDP (+/- 5 pp.); current debt anchor of 35% is considered too high**

- **20-30% of GDP as a desirable range of the debt level to maintain sustainable public finances in case of major economic shock that would lead to massive increase in the debt level**

- **Fiscal framework has an important role to play in contributing towards consumption smoothing during major shocks**

- **Fiscal Policy Council (established in 2007) has advised gov't in the past to engage in counter-cyclical fiscal policy by spending and borrowing *more* than it was willing to do**

Reforming domestic fiscal frameworks II – Spain

- **Interplay between rules and IFIs need to be reinforced to unlock full potential of the domestic fiscal frameworks**

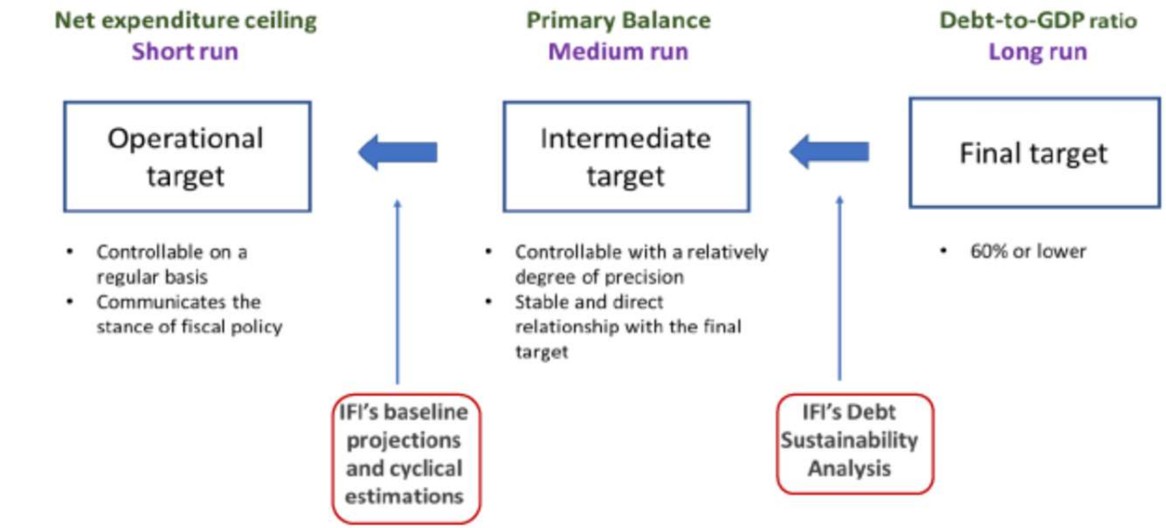
- **Two main pillars of the proposal:**

  1. **Focus on debt sustainability**
     - **Debt reduction features prominently**
     - **Intermediate target (primary balance)**
     - **Short-term operational instrument (nominal expenditure)**

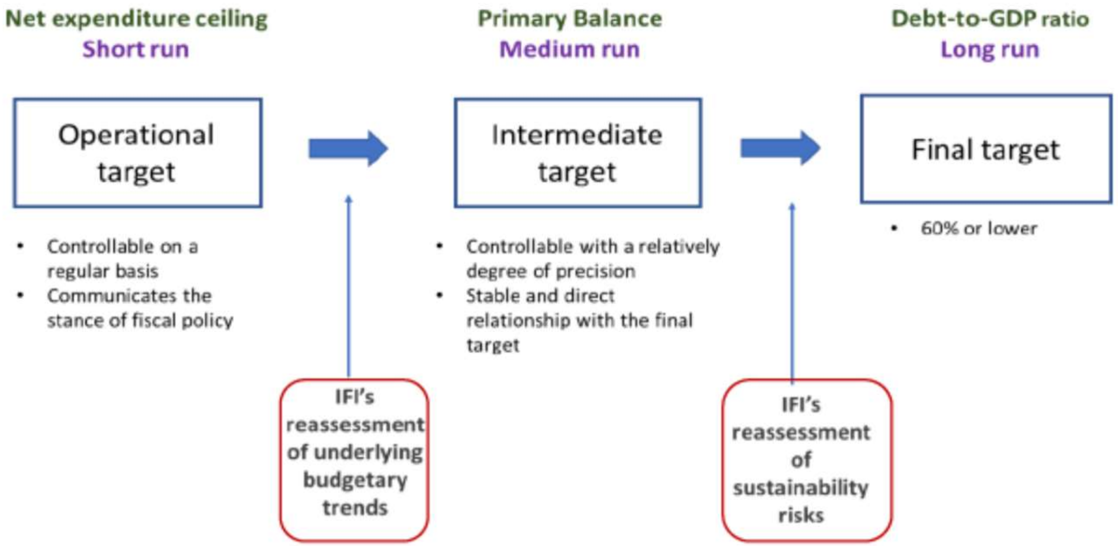
  2. **Strengthened role for AIReF**
     - **Limit areas of discretion (assessment of the cyclical situation or the no-policy-change projections for the primary balance)**

- **Fosters local ownership, fiscal transparency, consistency and anchors fiscal expectations**

Determining fiscal stance ex ante (every four years)



Assessing internal consistency ex post (every four years)



Source:AIReF

Fiscal discipline: from theory to practice

1. ***Ex ante* solvency condition**: **public debt should not be 'too large' relative to GDP over the very long run**
   => no numerical debt target but rule for desirable path for gross public debt level over the long run (NZ model)

2. **'Gulliver syndrome': tying the gov't with a thousand knots**
   ⇒ Inconsistent targets; enables cherry-picking; undermines legitimacy => need for simplification

3. **Fiscal rules should include an enforcement procedure**

4. **IFIs can play the role of '*referee*' interpreting the margin for flexibility. They should:**
   (i) perform *ex ante* & *ex post* assessment of rules compliance
   (ii) produce forecasts for budget computation (involvement in the budgetary preparation process)
   (iii) evaluate assumptions underpinning the budget

5. **Democratic legitimacy requires decentralization of fiscal rule making, with a strong monitoring role of national fiscal councils ; EFB would oversee their work and monitor countries adhering to their own framework**

IFIs in the EU – Is Coordination Required?

- '*Transparency-reputation-market-discipline nexus*' not a panacea against unsustainable fiscal policy

- Effective communication key to boost signal-to-noise ratio; presence in the public debate cannot be taken for granted

- Two types of coordination failures:
    1. Insufficient harmonization of IFIs' objectives, functions & capacities
       => ***minimum standards*** needed
    2. Public disagreements between COM & national IFIs
       => ***vertical* information sharing** (via MoUs; role of EFB?)
       => ***horizontal* information sharing** among IFIs (Network of EU IFIs)

- In the case of EU IFIs soft forms of coordination needed

- Enhanced role for the EFB?

Sharing best practice: expanding the IFI toolbox

- **Previous election campaign promises posed risks to fiscal sustainability**

- **Latvian Fiscal Discipline Council started a '*fiscal discipline survey*' (i.e. impact assessment of different proposed policy measures) for the first time in the run-up to the October 2018 election (inspired by Dutch CPB's costing of party manifestoes)**

- **Allows political parties to credibly commit to fiscally prudent policies before the election & binds them *ex post* + encourages more specific party programmes regarding the revenue side**

- **Resource-intensive task that can contribute towards levelling the playing field for a fair party competition (reduces incumbency advantage) BUT only 6 out of 16 parties submitted the excel questionnaire**

- **CPB's costing of election manifestoes in 2017 entailed 1165 policy measures from 11 political parties**
- **2/3 of voters consider CPB's calculations important & 20% said it helped with their choice at the ballot box**

Thank you for your attention

https://ec.europa.eu/european-fiscal-board

EFB Proposal for a new fiscal framework

CURRENT SGP	NEW FISCAL RULES
TWO FISCAL ANCHORS: → Maintain balanced budget over the cycle, with deficit ceiling at 3% → Reduce debt to 60%	**ONE FISCAL ANCHOR:** → Reduce debt to 60%
FOUR FISCAL REQUIREMENTS: → Structural budget balance → Nominal budget balance → Net expenditure growth → Short-term debt dynamics	**ONE FISCAL REQUIREMENT:** → Net expenditure growth
MANY FLEXIBILITY PROVISIONS: → Fiscal adjustment modulated over the cycle → Flexibility clauses: investment, structural reforms → Several escape clauses covering different contingencies: economic downturn, unusual events	**ONE ESCAPE CLAUSE :** → Covering different contingencies (economic downturn, unusual events)
SURVEILLANCE: → Annual surveillance cycle	**LESS INVASIVE SURVEILLANCE:** → 3-year surveillance cycle
GOVERNANCE: → Commission and Council	**UPGRADED GOVERNANCE:** → Commission and Council → Independent bodies to produce economic assessment including for escape clause

EFB Proposal for a new fiscal framework (fits on one page!)