European Fiscal Board

Annual Report 2021

10 November 2021

Macroeconomic and fiscal developments in 2020

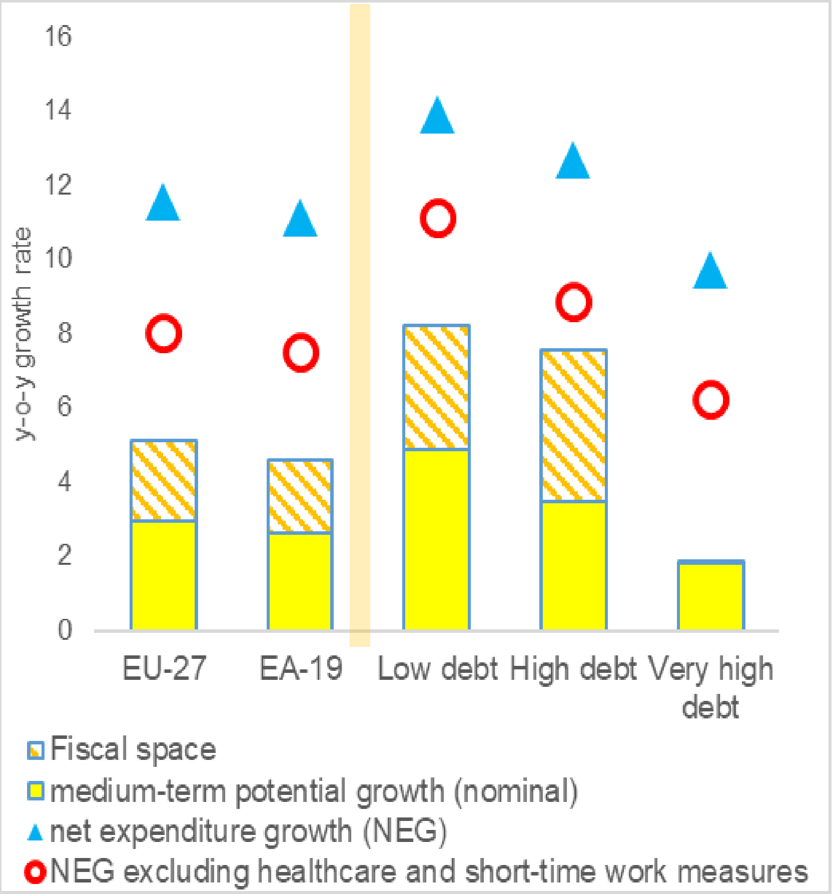
Sharp recession

- **Growth nosedived,** employ-ment held up relatively well.
- **Symmetric** external shock, but **asymmetric** impact on countries (yoy GDP growth rates in the range of +3.5 and – 11%).

Fiscal performance

- EU **deficit increased by some 6 ½ %** of GDP (on the back of large expenditure increases), **debt by ca. 13 % of GDP**.
- **Countries with fiscal space** were able to put it to good use in 2020.
- **Further divergences in fiscal positions:** high-debt countries recorded more pronounced debt increases, mainly due to a stronger drop of GDP.

Net expenditure growth in 2020 (country groups by fiscal positions)

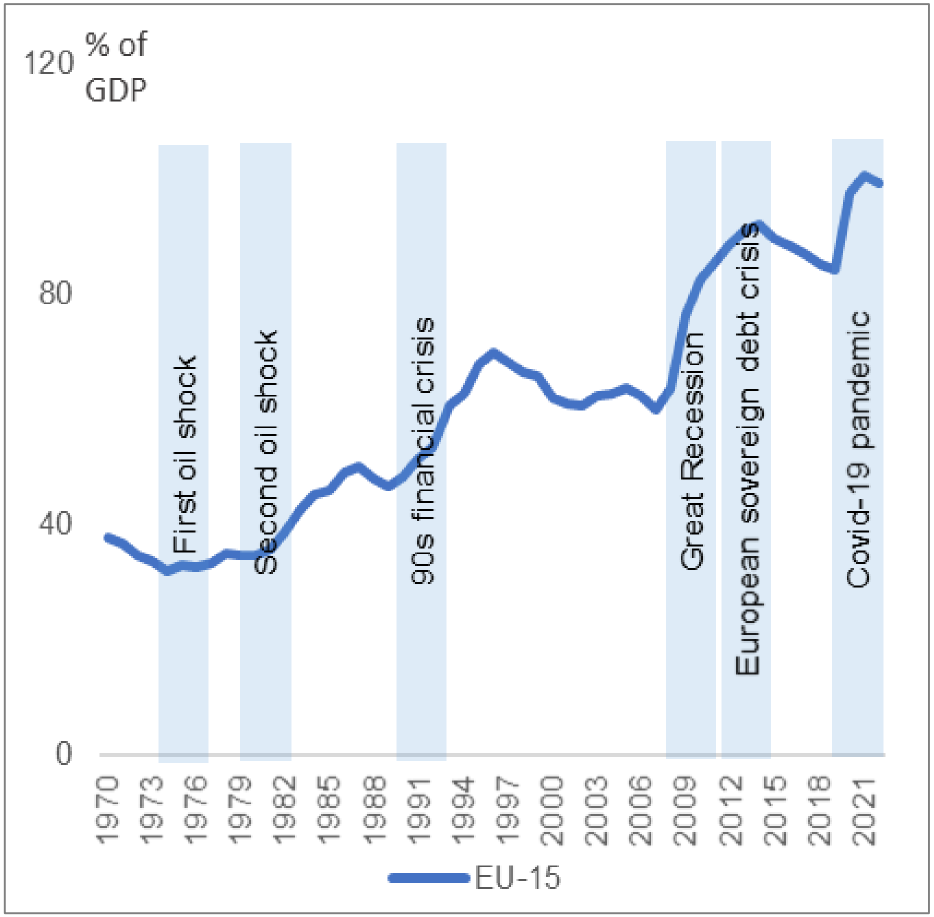


SGP IMPLEMENTATION IN EXTRAORDINARY TIMES

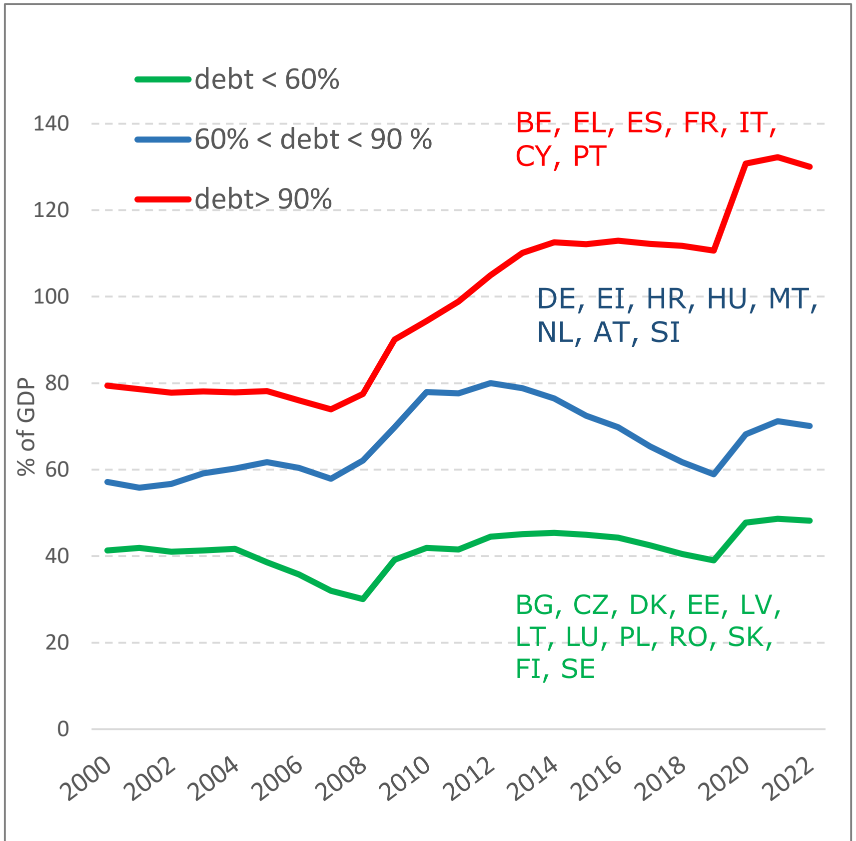
- Economic case for using extra flexibility foreseen in the event of a **severe economic downturn is indisputable**. However, its treatment as a **general waiver** gave rise **to diverging interpretations and uncertainties.**
    - Common understanding in public: **rules are suspended**. Official communication: **rules are not suspended**.
- **No EDP** was opened for established cases of non-compliance **on account of 'high uncertainty'**.
    - Decision to take no decision was based on **political considerations, not SGP provisions or precedents.**
    - Rather than imposing frontloaded consolidation, EDPs could be **multi-annual framework to anchor expectations** (with the possibility to update in light of new events).

GOVERNMENT DEBT- A RISING TREND, RATCHETED UP IN CRISIS

The aggregate view since 1970



A bit more detail since 2000



Note: Countries are grouped based on their average debt levels in 2011-2019.

The relaunch of the economic governance review

- The EFB **welcomes** both the **relaunch of the review** and the declared ambition to "***build consensus well in time for 2023***"

- Reforming the fiscal framework **remains a superior approach** to new discretionary and hard-to-predict tweaks in the implementation of the existing rule book

- Reforming in time would **serve the interests both of Member States** keen to avoid further erosion of a rules-based system and of those willing to exploit flexibility

- Less predictable fiscal policies make **repricing of risks by financial markets** more likely

SUSTAINABILITY RISKS IN THE POST-PANDEMIC ENVIRONMENT

- **Risks to sustainability may seem remote** in the nearer term; debt servicing costs are likely to remain favourable relative to the growth of nominal income - though less so than in the recent past - and the ECB helps to dampen unwarranted market upsets

- Still **debt reduction strategies** should be formulated in EU countries with very high debt, both to preserve an ability to respond in future crises and to **protect themselves and their EU partners** against potentially existential risks of financial spill-overs

- Has this risk become so difficult to quantify that only standards for fiscal behaviour can be envisaged? Should the **reference values in the Treaty be revised** upwards? We understand the arguments, but believe **less radical steps would be adequate**

THE EFB REFORM AGENDA - UPDATE AND SIMPLIFICATION

- Beyond retaining the primary objective of sustainability, the **EFB’s agenda for update and simplification** is shaped the by pre-pandemic experience of excessive short-term focus, reliance on unobservable indicators and worsening compliance and back-loading

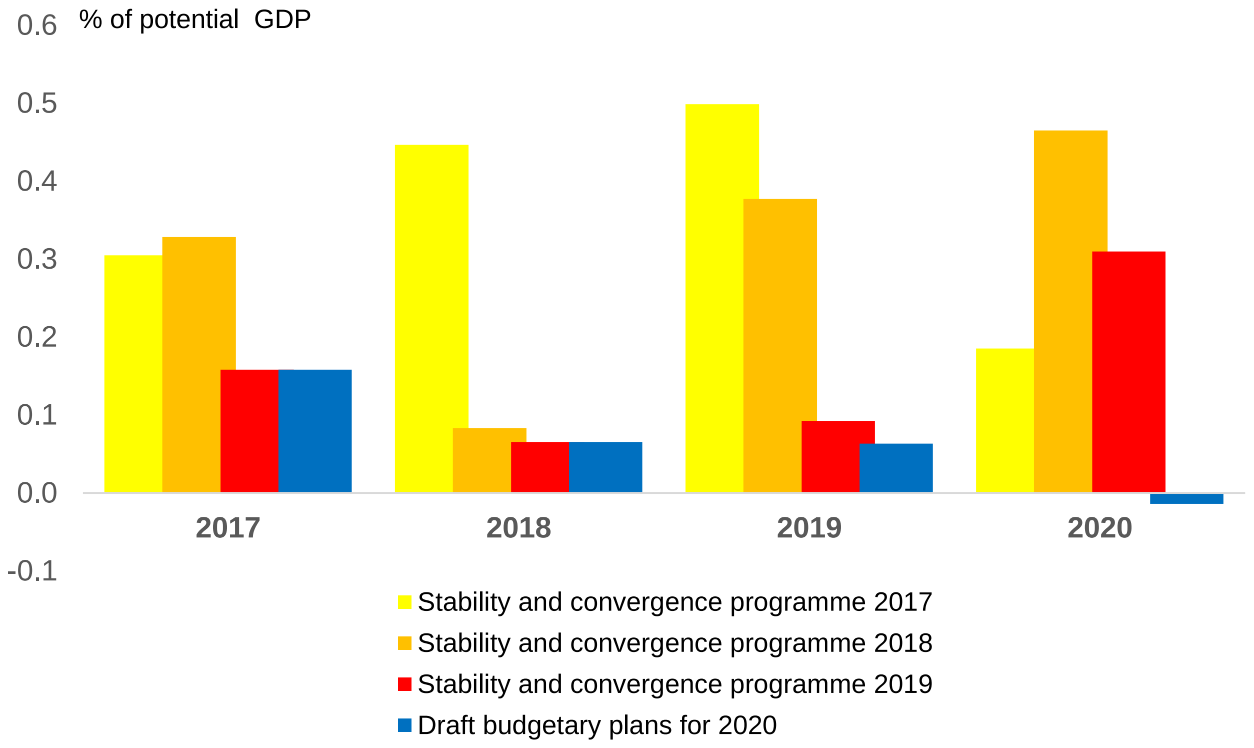
- Our **proposed SGP reform**, advanced since 2018-19, seems even more relevant now: to underpin sustainability, update the concept, and roll back overambition

  - set numerical targets for debt reduction in very high debt countries, at a **moderate and differentiated pace**,
  - implement through a **single, observable indicator, an expenditure benchmark**,
  - with one escape clause invoked **on the basis of independent economic analysis**

- The **3% threshold for the headline deficit should be maintained as a backstop** in containing debt dynamics and as a trigger for the EDP for all Member States

THE PROBLEMATIC BACK-LOADING OF STRUCTURAL ADJUSTMENT

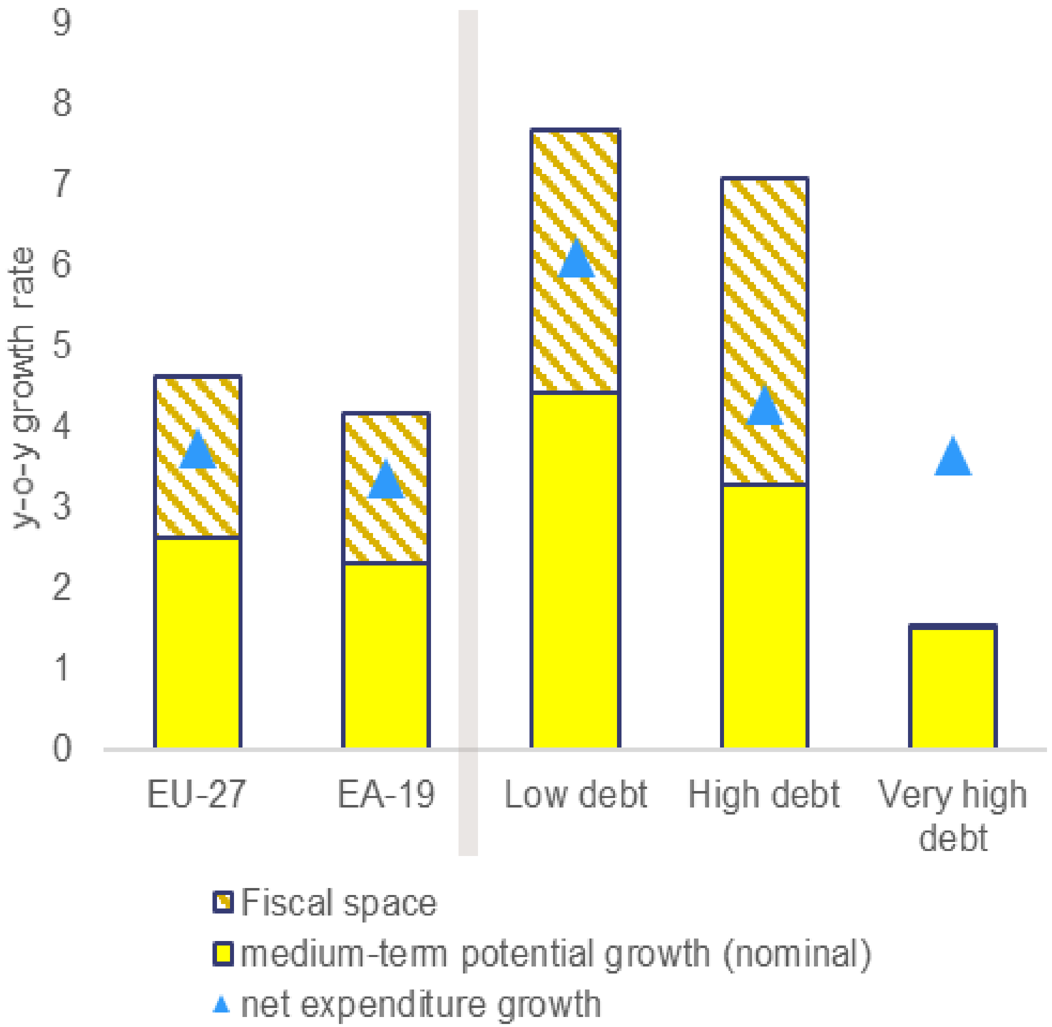
Backloading of necessary adjustment continued to be a persistent pattern prior to the Covid-19 crisis, especially in high debt countries (*weighted average for euro area countries not at their MTO in 2017*)



Changes in the structural budget balance as recalculated by the Commission based on national plans. Euro area countries not at MTO in 2017: AT, BE, ES, FI, FR, IE, IT, LV, PT, SI, SK.

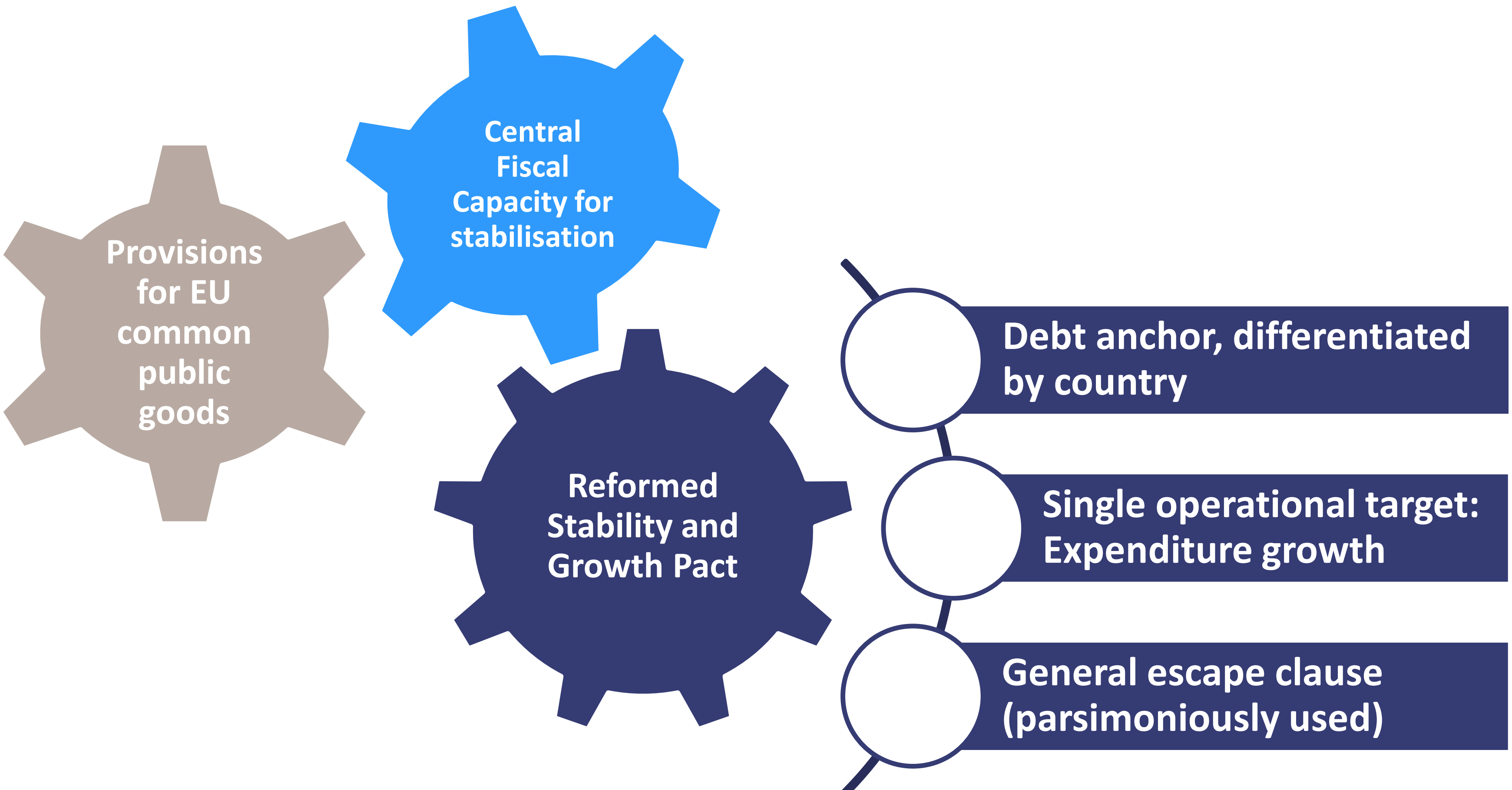
Fiscal policies in pre-pandemic years

Net expenditure growth in 2017-19 (country groups by fiscal positions)



- Countries with high or very high debt-to-GDP ratios **spent in excess** of the recommended limits.
- Another illustration of the notorious problem of the EU fiscal framework: **some Member States do not succeed in taking advantage** of favourable economic conditions.

- Recap: **Three central elements in SGP update,** complemented by a central fiscal capacity for stabilisation and targeted joint budgetary provisions for EU common public goods**.**
- **Return to existing rules to be avoided**



- The **joint initiatives of 2020** – RRF and SURE – have impressively, but temporarily, filled the two main longer-term gaps in EU economic governance by
    - **supporting the provision of EU common goods** through assuring room for growth-enhancing public expenditures, and
    - providing elements of **macroeconomic stabilisation**
- Agreeing on how these essential features could be replaced – at the latest when/if the RRF comes to an end in 2026 – **should not be long postponed**

THE LONGER-RUN AGENDA (CONTINUED)

- Assuring a continuing **provision of EU public goods through the EU budget**, possibly enlarged by dedicated national envelopes, would to the EFB seem preferable to **creating more flexibility** in the implementation of fiscal rules

- Finding the proper **balance between national ownership and EU perspectives** will remain a permanent challenge

THE EFB REFORM AGENDA - SYNERGIES BETWEEN NATIONAL AND EU POLICIES

- **National IFIs have played a useful** role in improving fiscal transparency and improving the macroeconomic and budgetary forecasts on which fiscal policies are based
- Many **IFIs are extending their range of activities**; input into the evaluation of the sustainability of public finances will be particularly welcome
- However, the EFB sees **limits for the governance reform process to rely on significant decentralization** in the monitoring of compliance with EU fiscal rules
- **The role of the Commission and of the Council** in monitoring fiscal and economic performance, respectively in formulating recommendations, **can not be delegated**

Thank you for your attention

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