

New life for an old framework:



Goal

EU fiscal framework suffers from numerous problems

Our goal is to recommend a major revision which:

Would lead to marked improvement of the framework

Possible without EU Treaty revision

Problems with the EU fiscal framework (1)



Complexity, transparency, predictability, consistency across countries and time, weak ownership

Weak compliance and enforcement

Dependence on unobserved variables (output gap and structural balance)

Frequently leading to pro-cyclical fiscal policy

Not allowing repeated fiscal stimulus when a recession lingers for years

Problems with the EU fiscal framework (2)



In case of hysteresis effects, pro-cyclical tightening in a recession can undermine the growth potential

Not protecting the quality of public spending

Not restrain fiscal policies in good times, leading to vulnerable fiscal position

Too much emphasis on annual, rather than longer-term performance indicators

Public expenditures are under the direct control of governments, while the structural balance is not

Certainly, European fiscal rules are not
the only culprit for fiscal misbehaviour



Growing consensus on expenditure rules in the literature



Carnot (2014), Andrieu *et al* (2015), Claeys *et al* (2016), Benassy-Quéré *et al* (2018), Feld *et al* (2018), Darvas *et al* (2018) and OECD (2018), European Fiscal Board (2019), Darvas and Anderson (2020), among

made reform proposals

The gist of these proposals is the same:

a properly designed expenditure rule as the main operational target which is linked to an appropriate medium-term public debt level target and underpinned by a proper institutional setup



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Our recommendation for the EU fiscal framework (1)

Anchor: five-year ahead or seven-year ahead debt ratio change objective

Operational target: multi-year ahead ceilings for public expenditure corrected for discretionary unemployment expenditure, interest expenditure and discretionary revenue changes, while public investment is treated as discussed in the next point

The ceiling for the operational target should be compatible with the debt ratio objective

Public investment: an asymmetric golden rule



Our recommendation for the EU fiscal framework (2)

Institutional framework:

Strengthened independent national fiscal councils

Establishment of a European Fiscal Council (similarly to ECB Governing Council),

Commission remains the institution that proposes recommendations to the Council of Ministers for adoption

Financial sanctions: to be replaced with various instruments related to surveillance, positive incentives, market discipline and increased political cost of non-compliance

A single general escape clause (applicable country by country)

Thank you for your attention

Paper available at:

<https://www.bruegel.org/2020/10/new-life-for-an-old-framework-redesigning-the-european-unions-expenditure-and-golden-fiscal-rules/>