Should EMU’s fiscal framework be reformed and if so, how?

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The Maastricht fiscal framework

• **EU fiscal rules**: de facto “constrained discretion”

• **Focus on sustainability/stability:**
  – Avoidance of excessive deficits, focus on gross errors
  – No initial concern for cyclicality
  – Sanctions, but political process ≠ classical infringement procedures

• **No bail out rule**: hope in market discipline and TINA
The SGP history: searching for the right mix

SGP 1.0  
• Focus on stability  
• Simple rules, gross errors  

SGP 2.0  
• More 'cyclically proofed' rules: Structural balance, MTOs  
• Flexibility for pension reforms  

SGP 3.0: Six pack, Two pack, Fiscal Compact  
• 'Exhaustive' rules (debt rule, exp. rule)  
• Automaticity: RQMV, correction mechanism  
• 'Ownership': national frameworks  

Recent evolution:  
• Flexibility for reforms, investment  
• More emphasis on stabilisation, aggregate stance  

Maastricht Treaty  
SGP reforms reflecting an evolving view of fiscal policy in EMU

Conventional view on fiscal policies in EMU – pre crisis

"Put own house in order..."

- Rules to tame deficit bias in absence of national exchange rate policy
- Automatic stabilisers: let them play
- Risk of debt monetisation dominates monetary-fiscal relations
- Low spillovers because of offsetting monetary policy reaction
- Threat of financial sanctions helps discipline governments
- Negative coordination suffices

Revising the role of fiscal policy in EMU – post crisis

"...and strengthen the joint foundation"

- Discretionary fiscal policy needed in case of large shocks
- High multipliers and spillovers when monetary policy is constrained
- Aggregate fiscal stance and differentiated fiscal space matter
- Sovereign-banks nexus
- Institutions / rules / markets
- Links fiscal policies/ structural reforms
- Difficult to sanction sovereign states
Overall assessment of the SGP experience

• A glass half-filled?
  – SGP partially disciplined policies
  – EA position sound overall but fragilities in some MS
  – Some pro-cyclical tendencies
  – From multilateral to bilateral surveillance mode

• Unsolved issues
  – Limited enforcement mechanisms
  – No tool for influencing aggregate stance
  – QPF underrated

• Political economy not evolving favourably
  – Erosion of consensus, polarisation of views
Components of a minimum fiscal union balanced with elements of decentralisation

Elements of centralisation
- Simplified fiscal rules
- Common fiscal capacity
- Reinforced ability to intervene in case of gross errors

Elements of decentralisation
- National rules nested with EU rules
- Some strengthening of national fiscal institutions
- Reinforced market discipline

Full fiscal federalism
- No EU rules
The SGP trilemma

Efficacy optimum not yet achieved...
Some conclusions

• The latest incarnation of fiscal framework has given considerably more weight to growth concerns

• For the medium-term, there are three conceivable avenues:
  (1) Make the best use of the present framework
  (2) Improve the fiscal rules
  (3) Take steps towards fiscal union

• The steps are non-exclusive, even complementary:
  – In the short term a credible implementation of current framework is critical to rebuild trust
  – Combining simplified rules with common stabilisation capacity would be a promising arrangement
Thank you