FOREWORD

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This volume brings together the papers presented at the Banca d'Italia workshop held in Perugia from 9 to 11 April 2015.

In Europe, the euro-area sovereign debt crisis had spurred the implementation of structural reforms as well as fiscal consolidation efforts in several Member states. Sovereign bond yields lowered significantly in many countries and reached very low levels across the area, reflecting also more responsible and credible fiscal plans. The recovery progressed, though at low pace. Against this background, it was felt that it could be the right time to re-discuss fiscal policy in a longer-term perspective. This assessment, taking also into account the experience non-European countries, was the first objective of the workshop. The second one was to examine how the European fiscal framework – whose level of complexity has increased over time – could be made simpler, more consistent and enforceable.

Session 1 was mainly devoted to inequality: its roots, its consequences in terms of political instability, its relationship with fiscal choices. The first paper of the Session studies the effects of fiscal consolidation on inequality. Using a sample of 17 OECD countries over the last 30 years the authors show that consolidation episodes, measured by changes in the cyclically adjusted primary balance or identified by the narrative approach, increase income inequality in the order of 0.2-1 per cent over the short and medium term. Using a very large database containing both developed and emerging markets, the second paper provides evidence that inequality, as measured by the Gini index, has increased over time and that the key driving factor behind this dynamics has not been the declining labor share of income but the strong increase in wage inequality. Going beyond the standard *GDP per capita* measure of material well-being, the third paper studies welfare inequality, measured by the expected discounted sum of future consumption plans, at the global level. The authors show that, starting from the '80s, there is evidence of polarization across world population, with a share of countries "trapped" at medium-low levels of welfare. The analysis also shows that in the future such pattern could persist and the trend of reducing inequality observed over the 1960-2011 period could be stopped and even reversed. The fourth study examines the relationship between inequality and government crises, finding that the latter are likely to rise when inequality increases. The authors also find that expansionary (and increasing expansionary) fiscal stimuli may contribute to reduce political instability. The following paper presents an overview of wealth distribution and asset-based taxation in the EU, provides a range of arguments in favour of asset-based taxation and discusses design and implementation issues. The last study of Session 1 computes the "marginal cost of homeownership" for France, Italy, Spain and UK, showing significant differences across countries and, within countries, across income deciles. As a function of income, such cost is broadly constant in France and it decreases in the other countries.

In the fiscal adjustment process following the sovereign debt crisis most European countries reduced public investments. The first two papers in Session 2 investigate to what extent this cut has been detrimental for growth. The first study presents updated and systematic estimates of public capital stock in advanced economies and, using a recursive VAR analysis, finds no evidence about higher productivity of public capital in recent years; the results does not suggest, therefore, that there is a general lack of public investment. The second paper finds that the effects of higher public investment on growth, investigated on the basis of its effect on private investment, are time- and country-specific. The clearer evidence concerns France, where increases of public investment

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generally trigger increases of private investment. The third study uses a spatial Computable General Equilibrium model to evaluate ex ante the impact on growth in EU countries of four expenditures items (Human capital, R&D, Aid to Private Sector, and Infrastructure) considered by the EU Cohesion policy 2014-20. These expenditure are assumed to affect a set of parameters including factor productivity and transport costs that determine the model outcome.

Session 3 deals with two important policy issues: the fiscal effects of low inflation and the impact on welfare of mandatory pension savings. The first paper analyses the impact of an unanticipated disinflation shock on the primary balance and the debt-to-GDP ratio for a set of selected EU countries (Austria, France, Germany, Greece and Italy). Country specific features are found to play an important role; in general, the effects on the debt ratio tends to be stronger and more persistent, given the denominator effect. The second paper studies the effects of a major reform in Israel: the introduction of mandatory pension contributions. Results suggest that the program forced low-income to save too much, early in their working lives and that, concerning the incidence of the contribution, 5 years after the latter was introduced, wages of its target population were reduced by nearly the full amount of the increase in employers' contributions.

The works included in the last session identify possible reforms of the European fiscal framework in order to make it more transparent and efficient. The first study looks at possible improvements in fiscal indicators, both for the headline deficit – to avoid creative accounting – and for the structural deficit, based on international best practices. Moreover, the paper argues that a more decentralized fiscal framework is desirable, as country-specific circumstances can be taken into account by local fiscal councils. At the central level, only compliance to minimum standards would be monitored, avoiding yearly fine-tuning of fiscal policies. The second paper presents options for simplifying the EU fiscal governance framework while enhancing its overall effectiveness. Options are evaluated on the basis of model-based simulations and of additional considerations. It is argued that moving to a two-pillar approach with a single fiscal anchor the public debt ratio) and a single operational target (an expenditure rule) would be particularly effective in stabilizing output and in meeting the dual objective of providing operational guidance to policymakers and achieving transparency.

The panel discussion, at the end of the conference, examined the EU fiscal rules and possible ways forward. The views set forth by Lucio Pench and Fabrizio Saccomanni were often close. They both recognized the complexity of the current set of rules and agreed on its main cause: the lack of a fully legitimated central authority and insufficient trust among member states. They both stressed that improving the institutional design was a precondition for simplifying rules and indicated the need to introduce an "authoritative referee" in the system. While Pench discussed possible ways of flanking the Commission with a body possessing "strictly operational independence from politics" and a "mandate restricted to fiscal surveillance", Saccomanni examined a bolder institutional change: separating fiscal surveillance from the other activities of the European Commission and creating a specific institution with that task.

Banca d'Italia is grateful to the institutions that contributed to the success of the initiative, to the experts who provided research papers and to all who came to Perugia to take part in the discussion.

This volume extends the analysis of fiscal policy issues carried out in the previous workshops, which were devoted to *Indicators of Structural Budget Balances* (1998), *Fiscal Sustainability* (2000), *Fiscal Rules* (2001), *The Impact of Fiscal Policy* (2002), *Tax Policy* (2003), *Public Debt* (2004), *Public Expenditure* (2005), *Fiscal Indicators* (2006), *Fiscal Policy: Current Issues and Challenges* (2007), *Fiscal Sustainability: Analytical Developments and Emerging Policy Issues* (2008), *Pension Reform, Fiscal Policy and Economic Performance* (2009), *Fiscal Policy: Lessons from the Crisis* (2010), *Rules and Institutions for Sound Fiscal Policy after the Crisis* (2011), *Fiscal Policy and Growth* (2012), *Fiscal Policy and Macroeconomic Imbalances* (2013) and *Public Finances Today: Lessons Learned and Challenges Ahead* (2014).