

# **The EU's fiscal framework: Reform proposals of the European Fiscal Board**

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Bank of Italy Webinar  
The EU fiscal governance framework: headed for the future  
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## **EU fiscal rules:**

Status quo and EFB proposals

## **Central fiscal capacity:**

Status quo and EFB proposals

# EFB proposal for SGP reform: the status quo

## Anchor $\neq$ Goal

Achieve medium-term budgetary objective (MTO):  
country-specific targets, net of cyclical factors and one-offs

## 3 operational rules

2 for deficit reduction

- Structural budget balance (since 2005)
- Expenditure benchmark (since 2011)

1 for the reduction of the debt-to-GDP ratio (since 2011)

## 2 reference values/thresholds

3% of GDP for general government deficit

60% of GDP for gross general government debt

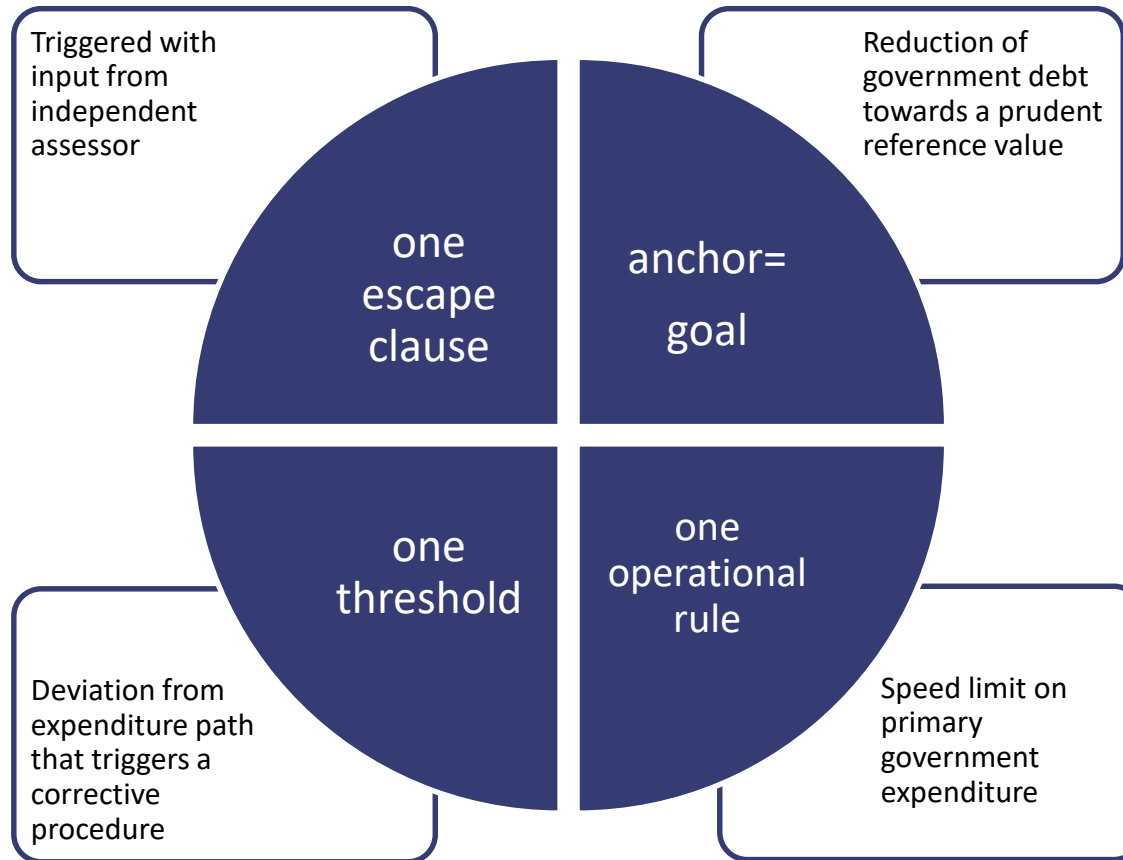
## Many flexibility provisions

Structural reforms, investment, unusual events, severe economic downturn, margin of discretion etc.

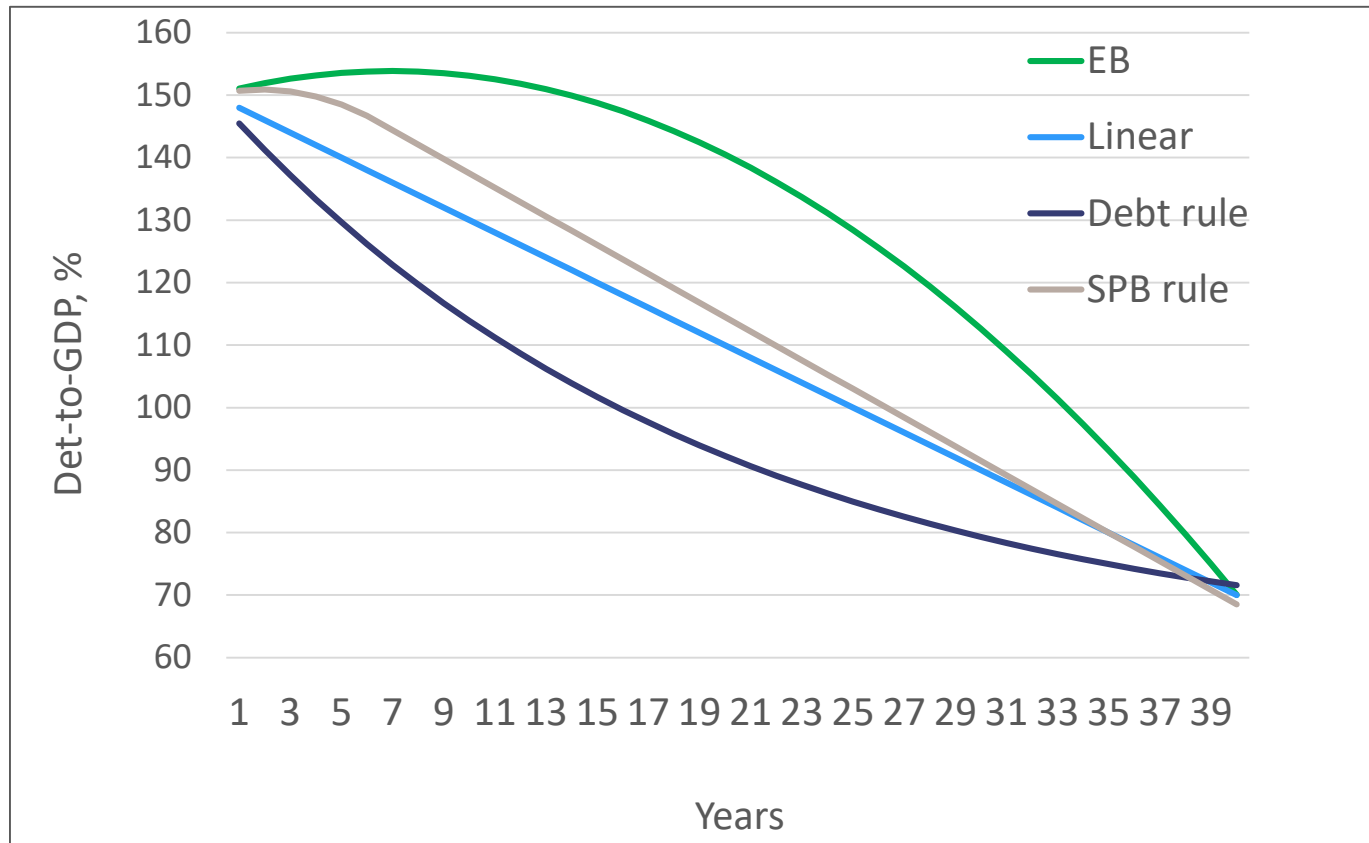
## Sources of complexity in the public debate:

- MTO is the anchor but not ultimate goal
- MTO is expressed in structural terms involving real-time output gap
- High frequency of assessments involving update of output gap estimates with possible adjustments to guidance
- Several operational rules offering conflicting signals and allowing for cherry-picking

## The stylised basic structure (2<sup>nd</sup> generation fiscal rules)



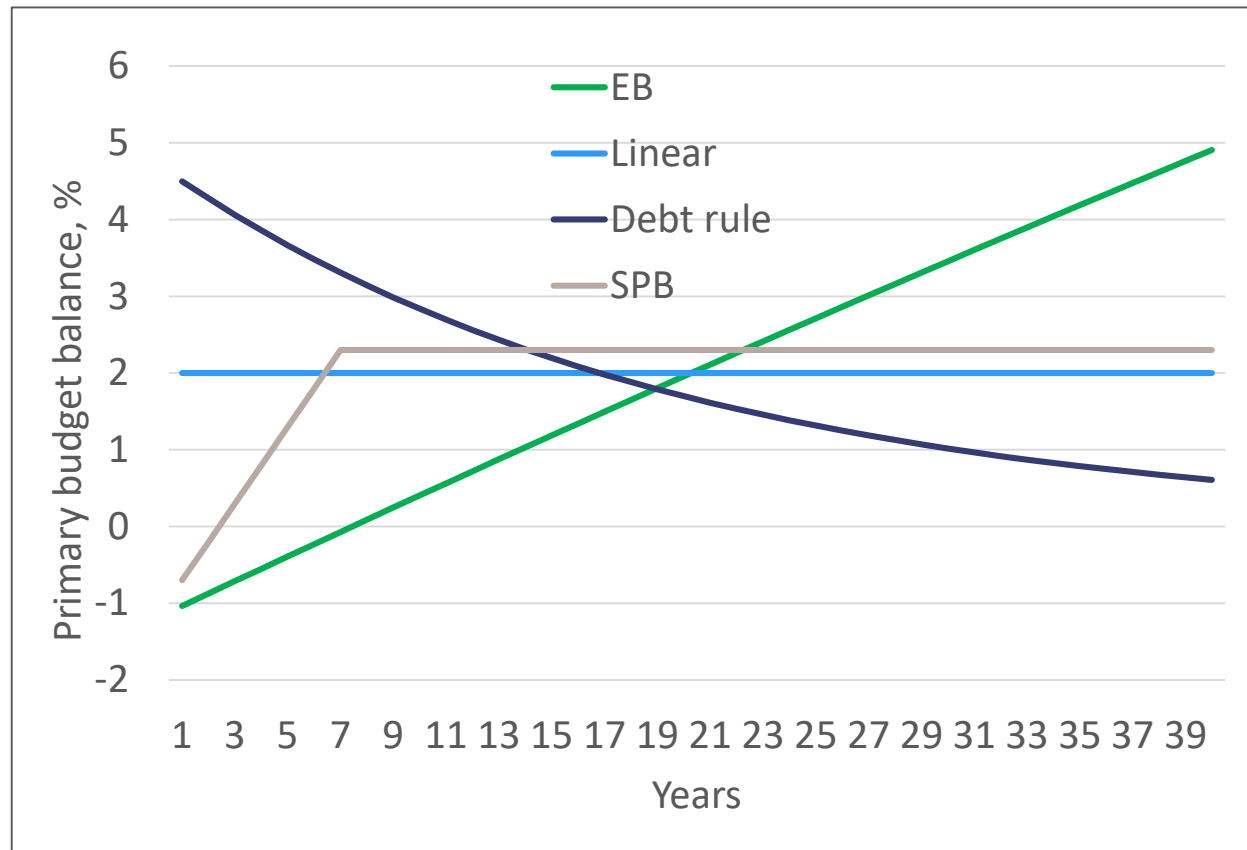
# Advantages and challenges of simplified SGP



$d_0 = 150\%$   $i_t = 5$   $yp_t = 5$

- EB: speed limit on primary expenditure ( $g=5-0.35$ ),  $d=70$  in 40 years
- Debt rule:  $1/20*(d_{t-1} - 60)$ , yields  $d=70$  in 40 years
- Linear debt reduction:  $d_t - d_{t-1} = (d_0 - 60)/40$
- SPB:  $pb_t - pb_{t-1} = 0.5$  until  $pb$  yields  $d=70$  in 40 years

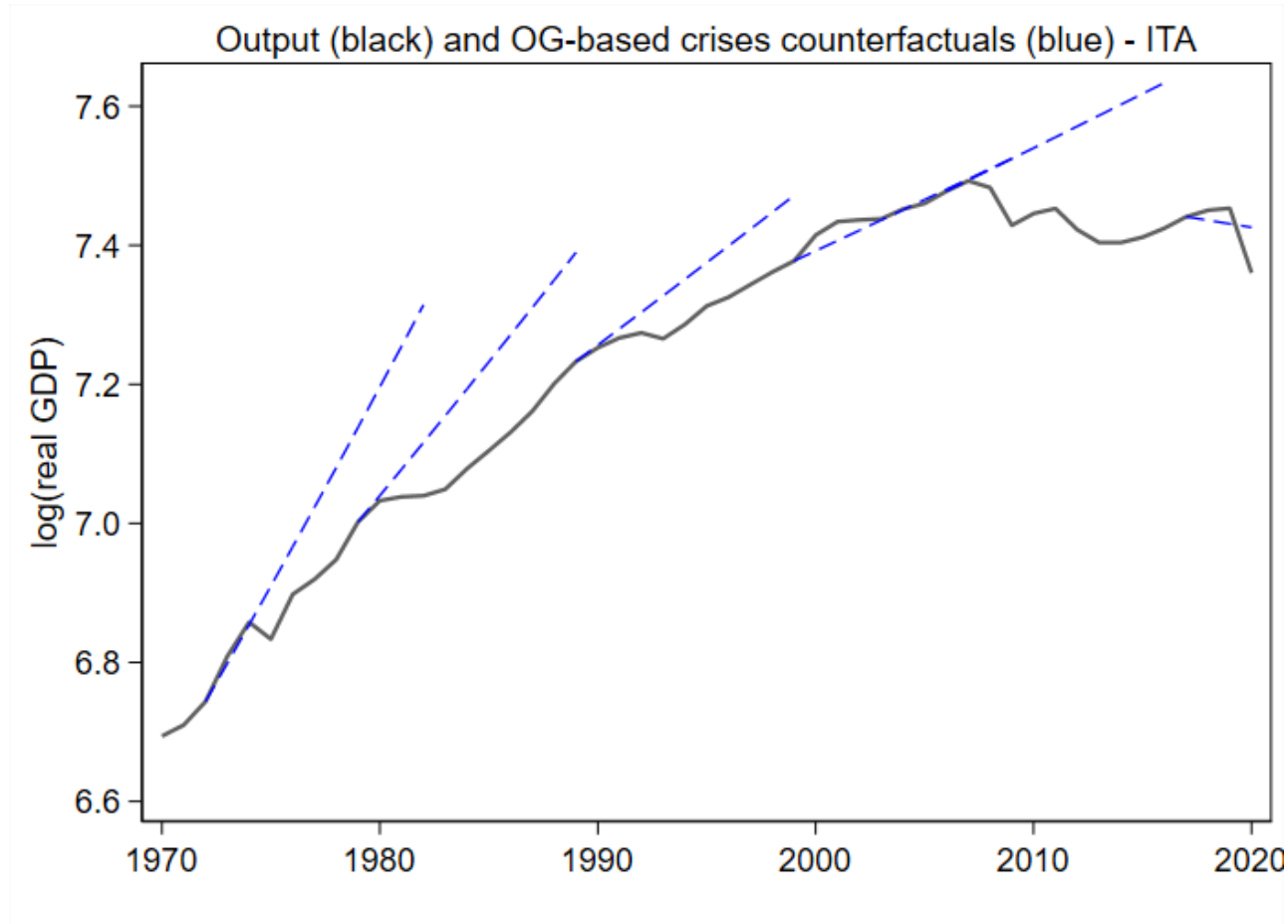
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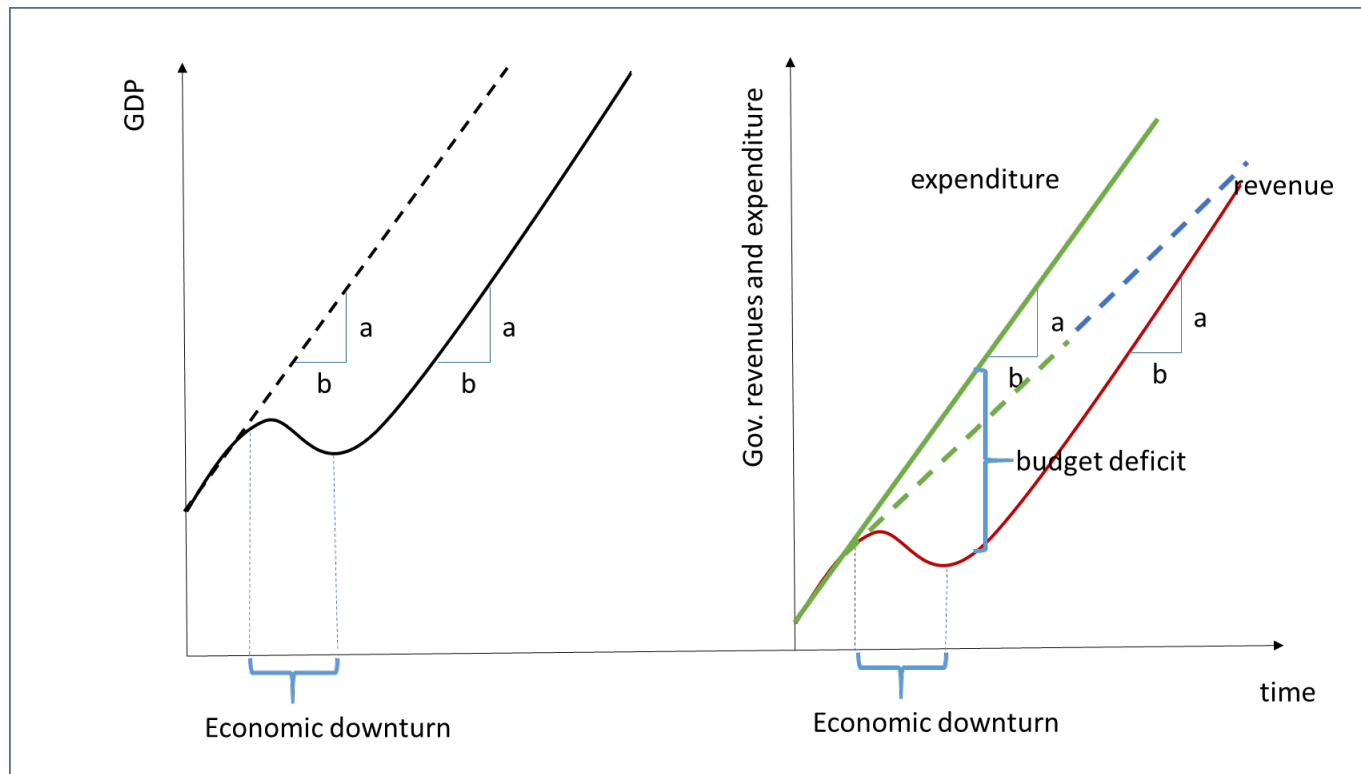
# Advantages and challenges of simplified SGP



Scarring after major economic downturns is recurring feature

Source: Larch, M, P Claeys, W van der Wielen (2022) Scarring effects of major economic downturns: the role of fiscal policy and government investment, EFB conference 2022

# Advantages and challenges of simplified SGP



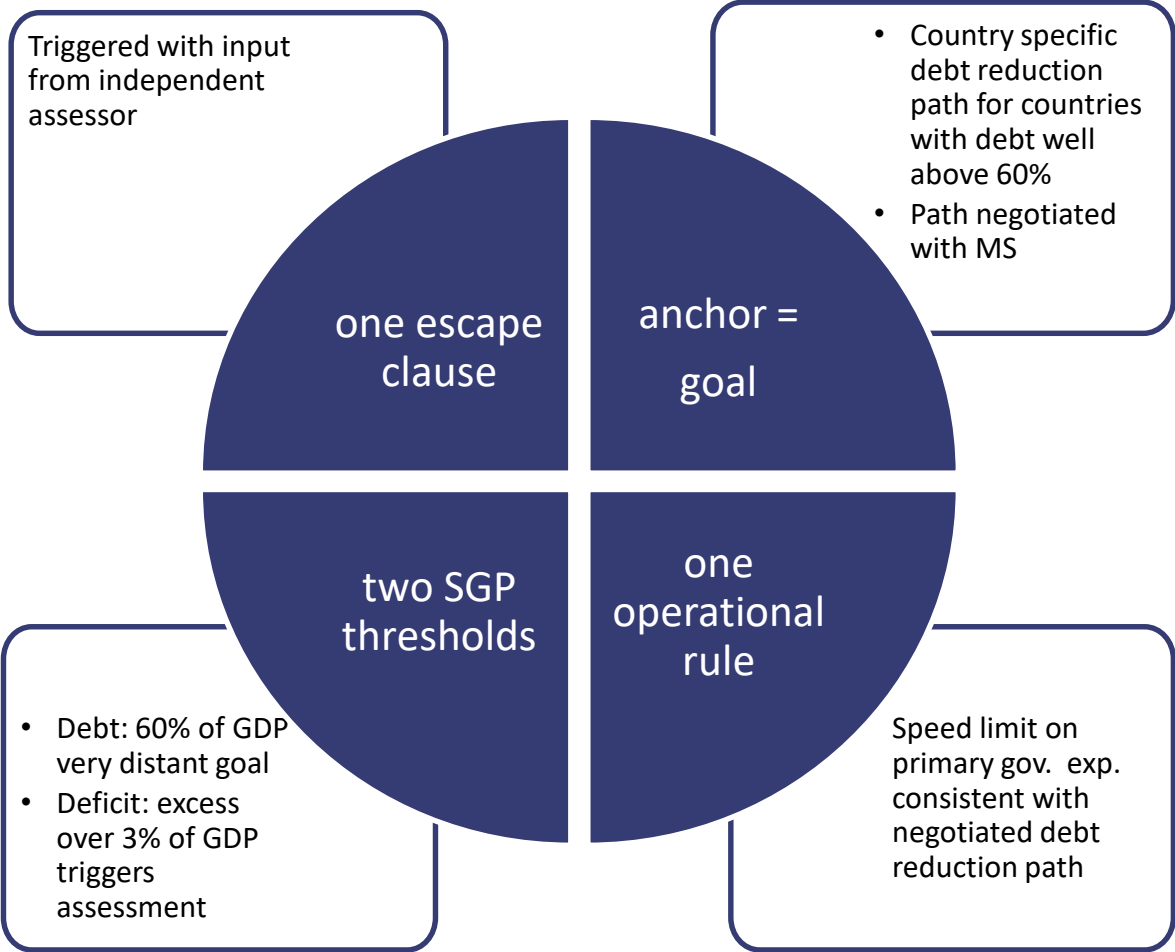
Solution to level problem: (i) update benchmark every 3-4; (ii) safety margin

Examples of safety margins: 'Zalm rule' in the NL, UK Treasury in 1980s and 1990s



# EFB proposal for SGP reform: evolution

## Adapted basic structure



### Surveillance

Focus on outcomes over medium term

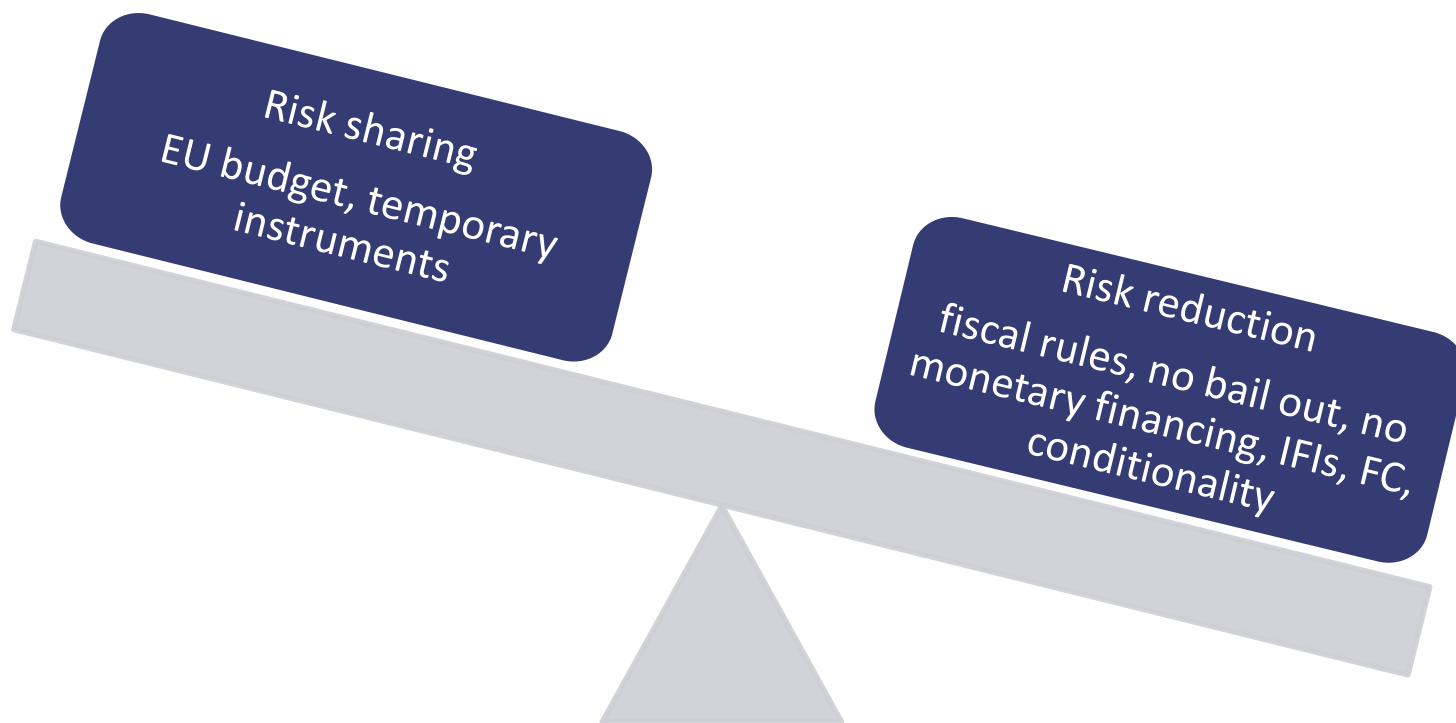
#### National monitoring

- provided there is strong national framework (e.g. MTBF, IFI)

#### EU surveillance

- If national framework is not strong
- In the event of 'gross errors'

## Economic and Monetary Union (status quo)



## Central fiscal capacity

**Purpose:** Stabilisation and allocation

**Trigger:** Predefined macro development + independent assessment

**Main focus:** Growth enhancing expenditure and strategic investment with EU dimension

**Conditionality:** Access linked to compliance with EU fiscal rules (?)

## Add-on to EU budget

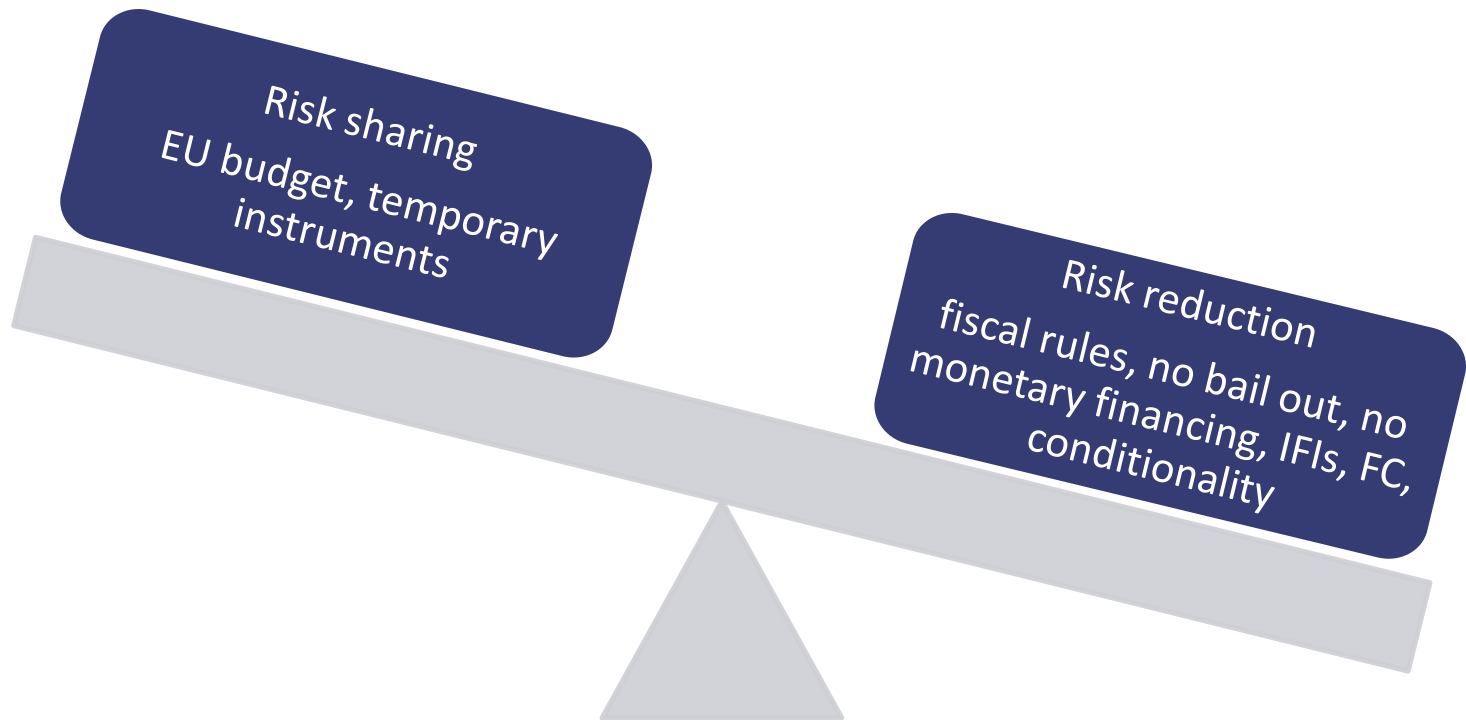
**Purpose:** Protect and foster government investment and EU public goods

**Design:**

- National buckets in EU budget
- Funds to be used domestically within given time period
- Funds go to general EU budget if not used by Member State

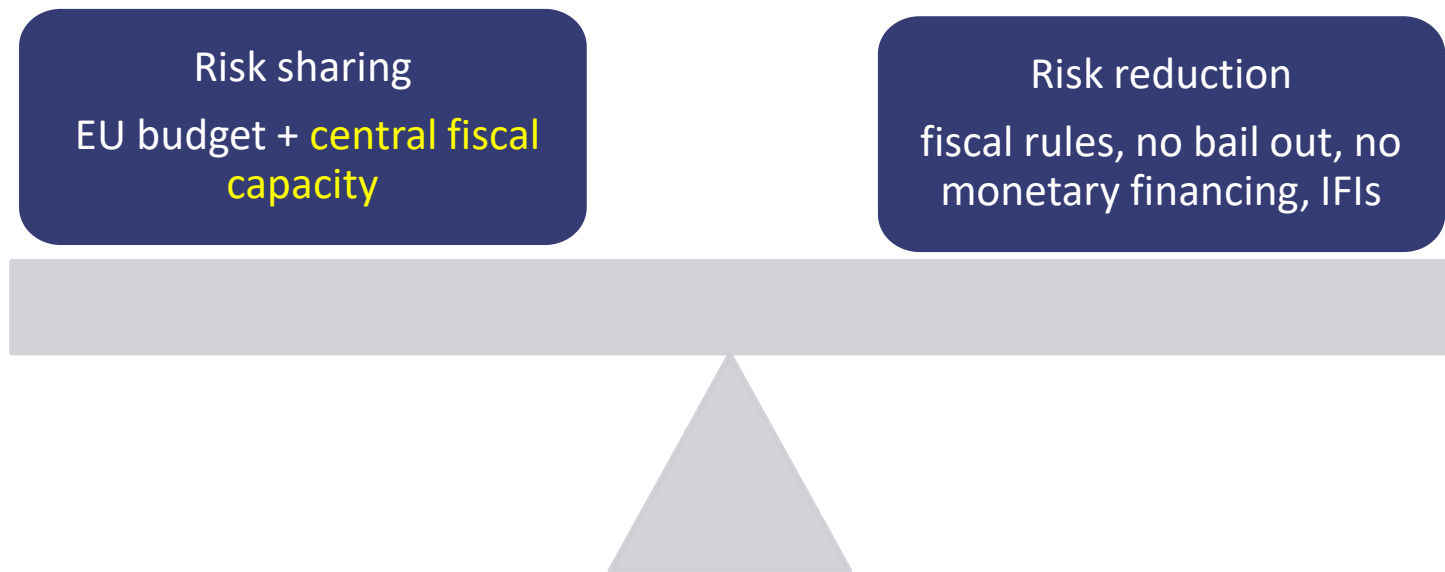
# Advantages and challenges of EFB proposal for CFC

## Economic and Monetary Union (status quo)



# Advantages and challenges of EFB proposal for CFC

## Economic and Monetary Union (as it should be)



# Advantages and challenges of EFB proposal for CFC



- CFC would close important gap in current EMU architecture
- Predicament well known for more than ½ a century
- Economies of scale, positive externalities
- Why no or very little movement?
- Moral hazard: ex-ante conditionality vs time consistency
- Distribution of risks across MS not random
- Risk sharing at EU level without proper political representation and accountability

**Thanks for your time!**

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