Q. Today we have discussed in detail the EU fiscal framework, both its strong points and its weaknesses were highlighted. We have also examined a number of proposals for reform. Until a few months ago a sense of urgency accompanied all these proposals. But I am not sure that this is still the case. The war in Ukraine and its economic and social consequences have perhaps changed our priorities? ***I would like to ask our panelists to share with us their thoughts on the importance of a reform of the EU fiscal framework for the future of Europe. Is it essential for the efficient working of EMU - or even for its survival - or is it something that after all can wait - given current circumstances? Is it possible or desirable to identify aspects of the framework that can and should be reformed earlier than others?***

The need for a fiscal framework – consisting of fiscal rules – was acknowledged by the architects of EMU as the project began concretely to take shape, in the seminal Delors report. In particular, the relevant contribution (due to Alexander Lamfalussy) highlighted that fiscal discipline in a monetary union was a matter of common interest and the alternative to fiscal rules, namely, market discipline, was unlikely to work, as its operation would be too disorderly and disruptive, as market alternates between phases of irrational exuberance and irrational gloom (interestingly, Lamfalussy almost t uniquely among the members of the Delors committee, which consisted essentially of central bank governors, had actual experience of the working of market from the markets' participants perspective).

However unsatisfactory our experience with fiscal rules in EMU, the lesson of the Delors report stands. In particular, the unviability of market discipline has been confirmed by the evolution of the position of the European Central Bank regarding the occurrence of disorderly movements in public debt markets: from a position that one may call of benign (some would say malign) neglect in the early phase of the euro area crisis, to the current position, according to which 'unwarranted' movements in public debt markets with – inevitable, I would say – consequences for the transmission of monetary policy - may require central bank intervention, where compliance with the EU fiscal framework is set to play a central role in judging the nature – unwarranted o warranted – of the market movement.

If a working fiscal framework is essential for a working EMU and the fiscal framework that we have inherited from the euro area crisis has not delivered as expected in important respects, should the reform be undertaken now or can it wait? In answering this question is important to distinguish the important from the urgent. The reform is certainly important – as confirmed by the attention devoted to it not only by the European Commission but also other institutions, the ECB and the IMF, a number of Member States and economists and think-tanks. Views can differ and do differ concerning the timeline of the reform. Admittedly, since the eruption of the COVID-19 pandemic and more recently with the unprecedented geopolitical tensions shaking Europe including a destabilizing economic fallout, the case for rule-based fiscal policy may look weak: however good the fiscal rules one might have in place, the current situation is one in which robust escape clauses would be called for. This is not to say, however, that the reflection on the reform of EU fiscal rules should not move from the stage of general debate to that of discussing more concrete orientations for the future. It is the institutional task of the Commission to put forward such orientations and the Commission has considered that the time has come. At the same time, the horizon for the implementation of the reform, specifically, in terms of legislative proposal remains open, not least because, even if the Commission were to follow quickly its forthcoming orientations with specific legislative proposals, the prospects for their adoption within the terms of the current Parliament – bearing in mind the role of Parliament as co-legislator - look uncertain.

In this connection, some aspects of currently applicable fiscal rules may call for more urgent revision than others. To give some examples: after the eventual deactivation of the General Escape Clause, which has effectively suspended the normal operation of the rules of the Stability and Growth Pact, one can hardly expect any effective application of the so-called debt-reduction benchmark aka 1/20 rule) , which anyway has never resulted in opening of excessive deficit procedures, nor, when it comes to the so-called preventive arm of the Stability and Growth Pact, a return to the so-called 'matrix' of required annual adjustments toward the medium-term objective of balance or in surplus of structural terms. In turn, these references effectively falling in abeyance would imply that only the 3% of GDP deficit threshold would be left in place as a ‘hard’ reference for Member States’ fiscal policies. This is not a situation that one may wish to persist, in particular, having regard to the risks posed by the unprecedentedly high level of debt on some Member states. One should find therefore ways to imaginatively implement the new orientations, assuming that debate evince a sufficient consensus, by way of interpretation, even before a legislative reform can be brought to fruition. A relatively low-hanging fruit, in terms of legislative reform, may be a revision of the current directive national budgetary framework, in particular, with a view to strengthening the provisions on medium-term budgetary frameworks and independent fiscal institutions.

Whether we push forward with the reform in the near term or we opt for defining a path towards it, possibly dependent on the developments in Ukraine, ***how could (and should) a realistic “landing zone” look like****?*

Three issues stand out, which a landing zone should satisfactorily address: simplification, ownership, enforcement.

Simplification is arguably the only aspect of reform, on which all the participants to the debate on the future of fiscal rules agree. Simplification however has many dimensions. One is that of indicators. There seems to be an emerging consensus on the superiority of expenditure net of discretionary revenue measures as operational rule, especially in terms of allowing the playing of automatic stabilizers and making governments responsible for outcomes they can deliver. In turn, operational rules need an objective, providing the anchor for their calibration. A widespread view is that the anchor should be expressed in terms of a debt target . However, the debt target is effectively meant to be a proxy for debt sustainability . In turn, debt sustainability is a prevailingly directional as opposed to level concept. This suggests anchoring the expenditure rule directly in a debt sustainability objective, that is, ensuring beyond certain debt level a robustly declining debt trajectory over the medium term, so as to eventually eliminate situations of high risk. In turn, a greater focus on ‘gross errors’, where the sustainability is potentially at stake, would imply a considerable simplification of surveillance.

Another aspect of reform that has gained increasing attention is that of national ownership. Rules anchored in a broad sustainability objective would inherently allow for more leeway in pursuing national priorities subject to the respect of sustainability requirement. A medium-term orientation in the implementation of the expenditure rule, namely, constraining yearly budgets, would address the usual time consistency issues that are bound to arise in national fiscal policy making. To preserve the ex ante multilateral dimension of surveillance, Member States would be given commonly agreed references on the limits of acceptable expenditure paths.

In terms of enforcement, the procedure that has proved to work, namely, the deficit-based EDP, should be preserved. The debt-based EDP, which as never been activated, should be repurposed, essentially to enforce the required expenditure path for Member States presenting a situation of high risk. The toolbox of sanctions would need revising, in particular, to acknowledge the unviability of macroeconomically material sanctions, and promote the reputational dimension.