

Fiscal is local: EU standards for national fiscal frameworks

Xavier Debrun

National Bank of Belgium,

European Fiscal Board,

University of Louvain, School of Economics

Based on joint work with Wolf Reuter. Usual disclaimers apply

A few points on the context

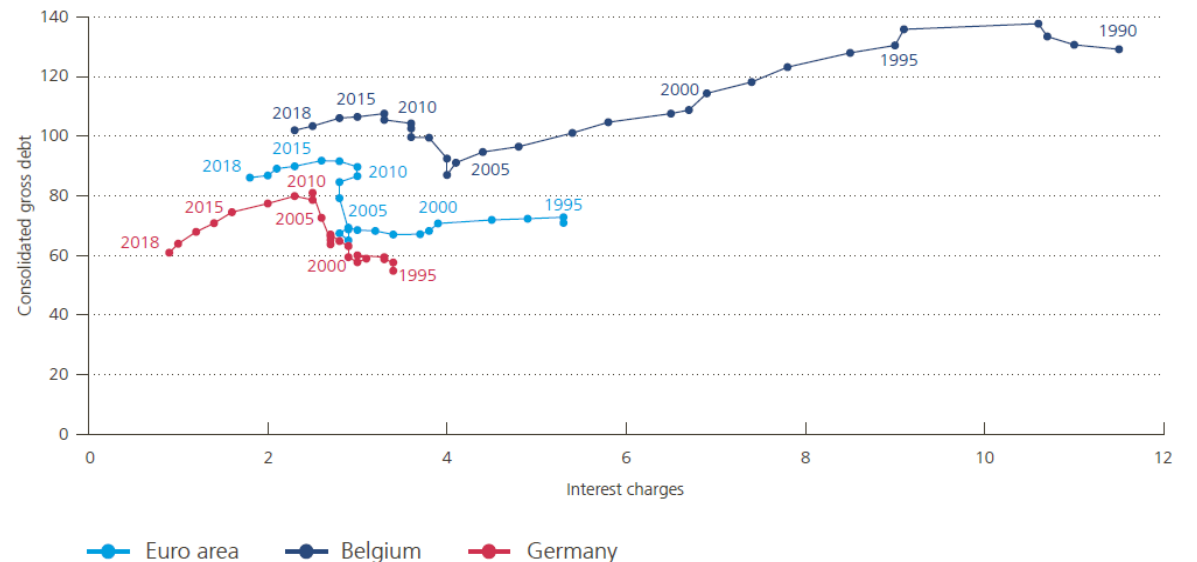
- After a good start (i.e. experts' apparent convergence on simpler rules based on a single debt anchor and expenditure ceilings, need to abandon unobservables), the debate on EU fiscal governance seems to be slipping again in the direction of intelligent design (green golden rules and the like,...). **This is the wrong direction: clarity of purpose and ownership are essential for enforcement or self-compliance.**
- To get back on the right track, we need to remember:
 - Fiscal responsibility is a constraint, not a choice. You cannot choose to ignore your public debt trajectory.
 - Policymakers face frictions → Fiscal discretion must be constrained by rules and independent institutions.
 - **One cannot delegate fiscal policy and one should not overplay the role of IFIs → one must live with rules, like it or not.**
 - **Rules are not a substitute for good fiscal policy → they define the perimeter → politicians are elected to make hard choices (butter vs. guns) → budgets must reflect those priorities.**
 - Are rules effective? Qualified yes but not through enforcement → Importance of reputational costs and broad public ownership:
 - **Complex rules never work → simple and well understood by the public → basis 4 reputational effects.**
 - **Any form of enforcement must be close to where fiscal legitimacy sits.**

Today's challenges

- Negative R-G:
 - Defining debt sustainability is even more elusive than usual.
 - Since the euro exists, debt affordability has improved regardless of the debt level.
 - Risk: undue focus on debt affordability (observable, unlike sustainability), which could change quickly.
- Multiple and massive pressures on public finances:
 - Old ones: ageing,...
 - New ones: climate change,... taking defense a bit more seriously → or should these be European public goods?
- Hard choices are back and uncertainties are huge:
 - Regardless of the transition path to a new and happy steady state (decarbonized, inclusive, etc...), fiscal responsibility is a must → need a fiscal anchor because unmoored fiscal policy is very risky, and we just do not need another source of risk right now.

Interest charges have fallen continuously since 1990

(changes in the public debt and interest charges, in % of GDP)



Focus on national rules

- Motivation:
 - Designing fiscal rules is hard (simplicity-flexibility-enforceability trilemma) → even more so in a heterogenous fiscal landscape (one size does not fit all).
 - Enforcement must be close to where legitimate fiscal choices are made.
 - **Coordination ≠ centralization.** National policy rules serving the same objective (debt sustainability, stabilization) can deliver adequate **fiscal policy coordination in the EU.**
 - At the EU level: hybrid reforms help free the overall reform process from strictly national considerations as tailoring occurs “locally.”

Focus on national rules

- Guiding principles of our hybrid reform proposal:
 - (1) accept a lexicographic ordering of objectives: debt sustainability is existential, so it comes first;
 - (2) do not come in the way of automatic fiscal stabilizers;
 - (3) facilitate enforcement and/or nurture self-compliance (IFIs boosting reputational costs).
- EU and national rules are complements, not substitutes:
 - Debt sustainability should be the shared aim of national and supranational fiscal frameworks, with **supranational provisions remaining the ultimate backstop against gross fiscal errors.**
 - Without prejudice to debt sustainability, the room for short-term flexibility should reflect national preferences and needs.
 - Enforcement should, in the first instance, be set by national processes reflecting specific political and institutional features.
- Simplicity?
 - A consistent set of national frameworks internalizing the public good nature of debt sustainability should be simpler than a supranational arrangement trying to accommodate a diverse fiscal landscape.

Focus on national rules

- **Primary reliance on national fiscal frameworks meeting clear EU-level standards.**
 - New Directive on national fiscal frameworks should be the legal instrument to ensure that national arrangements can credibly meet the EU-wide aim of debt sustainability. **Existing national fiscal rules are uneven and need serious vetting.**
- **Only countries unable or unwilling** to adopt an adequate national rules-based fiscal framework would be subject to the reformed preventive arm of the SGP.
 - Agreement on streamlining those EU rules and beefing up their enforceability — e.g. along the lines proposed by EFB (2020) — would be easier if countries had the option to opt out and design a national framework that suits them better.
- **The Excessive Deficit Procedure in the context of a streamlined SGP would remain the ultimate backstop against gross fiscal errors.**
 - Markets and citizens should remain confident that unjustified or persistent violations of the deficit reference value of 3% of GDP would ultimately entail material costs—reputational and political if not pecuniary—for non-compliant governments.