European Fiscal Board

Annual Report 2021

10 November 2021
Macroeconomic and fiscal developments in 2020

Sharp recession

- **Growth nosedived**, employment held up relatively well.

- **Symmetric** external shock, but **asymmetric** impact on countries (yoy GDP growth rates in the range of +3.5 and –11%).

Fiscal performance

- **EU deficit increased by some 6½ %** of GDP (on the back of large expenditure increases), **debt by ca. 13 % of GDP**.

- **Countries with fiscal space** were able to put it to good use in 2020.

- **Further divergences in fiscal positions**: high-debt countries recorded more pronounced debt increases, mainly due to a stronger drop of GDP.

![Net expenditure growth in 2020 (country groups by fiscal positions)](image-url)
SGP IMPLEMENTATION IN EXTRAORDINARY TIMES

• Economic case for using extra flexibility foreseen in the event of a severe economic downturn is indisputable. However, its treatment as a general waiver gave rise to diverging interpretations and uncertainties.
  
  • Common understanding in public: rules are suspended. Official communication: rules are not suspended.

• No EDP was opened for established cases of non-compliance on account of ‘high uncertainty’.
  
  • Decision to take no decision was based on political considerations, not SGP provisions or precedents.

• Rather than imposing frontloaded consolidation, EDPs could be multi-annual framework to anchor expectations (with the possibility to update in light of new events).
GOVERNMENT DEBT- A RISING TREND, RATCHETED UP IN CRISIS

The aggregate view since 1970

A bit more detail since 2000

Note: Countries are grouped based on their average debt levels in 2011-2019.
• The EFB welcomes both the relaunch of the review and the declared ambition to “build consensus well in time for 2023”

• Reforming the fiscal framework remains a superior approach to new discretionary and hard-to-predict tweaks in the implementation of the existing rule book

• Reforming in time would serve the interests both of Member States keen to avoid further erosion of a rules-based system and of those willing to exploit flexibility

• Less predictable fiscal policies make repricing of risks by financial markets more likely
• **Risks to sustainability may seem remote** in the nearer term; debt servicing costs are likely to remain favourable relative to the growth of nominal income - though less so than in the recent past - and the ECB helps to dampen unwarranted market upsets.

• **Still debt reduction strategies** should be formulated in EU countries with very high debt, both to preserve an ability to respond in future crises and to **protect themselves and their EU partners** against potentially existential risks of financial spill-overs.

• Has this risk become so difficult to quantify that only standards for fiscal behaviour can be envisaged? Should the **reference values in the Treaty be revised** upwards? We understand the arguments, but believe **less radical steps would be adequate**.
Beyond retaining the primary objective of sustainability, the EFB’s agenda for update and simplification is shaped by pre-pandemic experience of excessive short-term focus, reliance on unobservable indicators and worsening compliance and back-loading.

Our proposed SGP reform, advanced since 2018-19, seems even more relevant now: to underpin sustainability, update the concept, and roll back overambition.

- set numerical targets for debt reduction in very high debt countries, at a moderate and differentiated pace,
- implement through a single, observable indicator, an expenditure benchmark,
- with one escape clause invoked on the basis of independent economic analysis

The 3% threshold for the headline deficit should be maintained as a backstop in containing debt dynamics and as a trigger for the EDP for all Member States.
Backloading of necessary adjustment continued to be a persistent pattern prior to the Covid-19 crisis, especially in high debt countries (weighted average for euro area countries not at their MTO in 2017)

Changes in the structural budget balance as recalculated by the Commission based on national plans. Euro area countries not at MTO in 2017: AT, BE, ES, FI, FR, IE, IT, LV, PT, SI, SK.
Fiscal policies in pre-pandemic years

- Countries with high or very high debt-to-GDP ratios spent in excess of the recommended limits.

- Another illustration of the notorious problem of the EU fiscal framework: some Member States do not succeed in taking advantage of favourable economic conditions.
COMPLEMENTING AN UPDATED AND SIMPLER SGP WITH LONG-TERM REFORMS

- Recap: **Three central elements in SGP update**, complemented by a central fiscal capacity for stabilisation and targeted joint budgetary provisions for EU common public goods.

- **Return to existing rules to be avoided**
• The joint initiatives of 2020 – RRF and SURE – have impressively, but temporarily, filled the two main longer-term gaps in EU economic governance by
  - supporting the provision of EU common goods through assuring room for growth-enhancing public expenditures, and
  - providing elements of macroeconomic stabilisation

• Agreeing on how these essential features could be replaced – at the latest when/if the RRF comes to an end in 2026 – should not be long postponed
• Assuring a continuing **provision of EU public goods through the EU budget**, possibly enlarged by dedicated national envelopes, would to the EFB seem preferable to **creating more flexibility** in the implementation of fiscal rules.

• Finding the proper **balance between national ownership and EU perspectives** will remain a permanent challenge.
• **National IFIs have played a useful** role in improving fiscal transparency and improving the macroeconomic and budgetary forecasts on which fiscal policies are based

• Many **IFIIs are extending their range of activities**; input into the evaluation of the sustainability of public finances will be particularly welcome

• However, the EFB sees **limits for the governance reform process to rely on significant decentralization** in the monitoring of compliance with EU fiscal rules

• **The role of the Commission and of the Council** in monitoring fiscal and economic performance, respectively in formulating recommendations, **can not be delegated**
Thank you for your attention

Visit the EFB at:
https://ec.europa.eu/european-fiscal-board