



The future of the EU fiscal governance

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Outline

- 1. Key changes of EMU's fiscal architecture since the crisis**
- 2. Assessment of the current EU fiscal framework**
- 3. The future of EU fiscal governance (including the 6 December package)**

Fiscal policy in EMU: an evolving view

**Conventional view
on fiscal policies in
EMU – pre crisis**



**"Put own house
in order..."**

- Rules to tame deficit bias in absence of national exchange rate policy
- Automatic stabilisers: let them play
- Risk of debt monetisation dominates monetary-fiscal relations
- Low spillovers because of offsetting monetary policy reaction
- Threat of financial sanctions helps discipline governments
- Negative coordination suffices

**Revising the role of
fiscal policy in EMU
– post crisis**



**"...and strengthen
the joint
foundation"**

- Discretionary fiscal policy needed in case of large shocks
- High multipliers and spillovers when monetary policy is constrained
- Aggregate fiscal stance and differentiated fiscal space matter
- Sovereign-banks nexus
- Institutions / rules / markets
- Links fiscal policies/ structural reforms
- Difficult to sanction sovereign states

Institutional changes in EMU since 2011

| Challenge | Measure taken to address the challenge | Measure in greater detail | Application |
|--|--|--|-------------------|
| Conventional view on fiscal policies in EMU – pre-crisis | Stronger SGP | <ul style="list-style-type: none"> • Introduction of expenditure rule, debt benchmark (<i>6-P</i>) and balanced budget rule (<i>TSCG</i>) • Possibility of imposing earlier/more gradual sanctions (<i>6-P</i>) • Surveillance of DBPs (<i>2-P</i>) | ✓ |
| | National fiscal frameworks | <ul style="list-style-type: none"> • Mandatory min. requirements at the national level) (<i>6-P</i>) | ✓ |
| | Macro surveillance | <ul style="list-style-type: none"> • Prevention/correction of macroeconomic imbalances via the introduction of the new Macroeconomic Imbalance Procedure (<i>MIP</i>) (<i>6-P</i>) | being implemented |
| Revising the role of fiscal policy in EMU – post-crisis | Crisis resolution mechanism | <ul style="list-style-type: none"> • European Stability Mechanism (<i>ESM</i>) | ✓ |
| | Better articulation of fiscal rules | <ul style="list-style-type: none"> • More flexibility in applying the rules • Euro area fiscal stance | ✓ |
| | Breaking sovereign/banks nexus | <ul style="list-style-type: none"> • Banking Union • Capital Markets Union | to be completed |

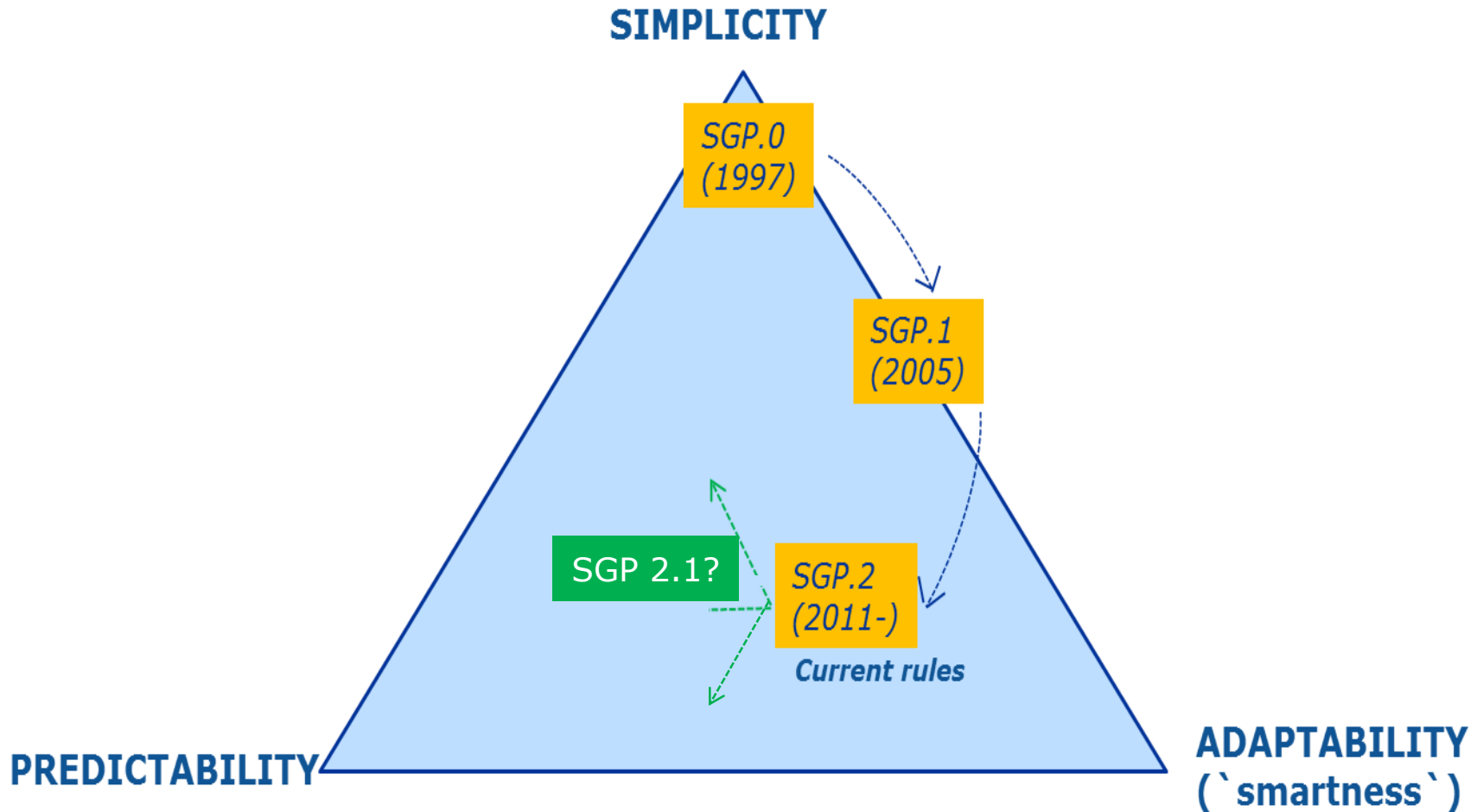
Note: Key reforms steps taken in the area of fiscal and macroeconomic policies are shown in italics in brackets, namely 6-Pack (6-P), Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), 2-Pack (2-P).

Remaining vulnerabilities

- ***Have the financial sovereign doom loops been sufficiently severed?***
 - Banking union not completed yet
 - ***Will the revised governance framework be effectively implemented?***
 - Limits to the application of rules/peer pressure on democratically elected governments
 - ***Has EMU the capacity to withstand the next large shock?***
 - ESM remains entirely dependent on national Treasuries and slow decision-making
 - No tool for smoothing large asymmetric shocks and managing the euro area fiscal stance when needed
 - ***Is the appropriate fiscal stance at the EA level being achieved?***
 - Bottom-up coordination does not work
- ***Sustaining euro area falls too much on the shoulders of the ECB***
- ***Missing piece: minimum fiscal capacity to secure macroeconomic and financial stability***

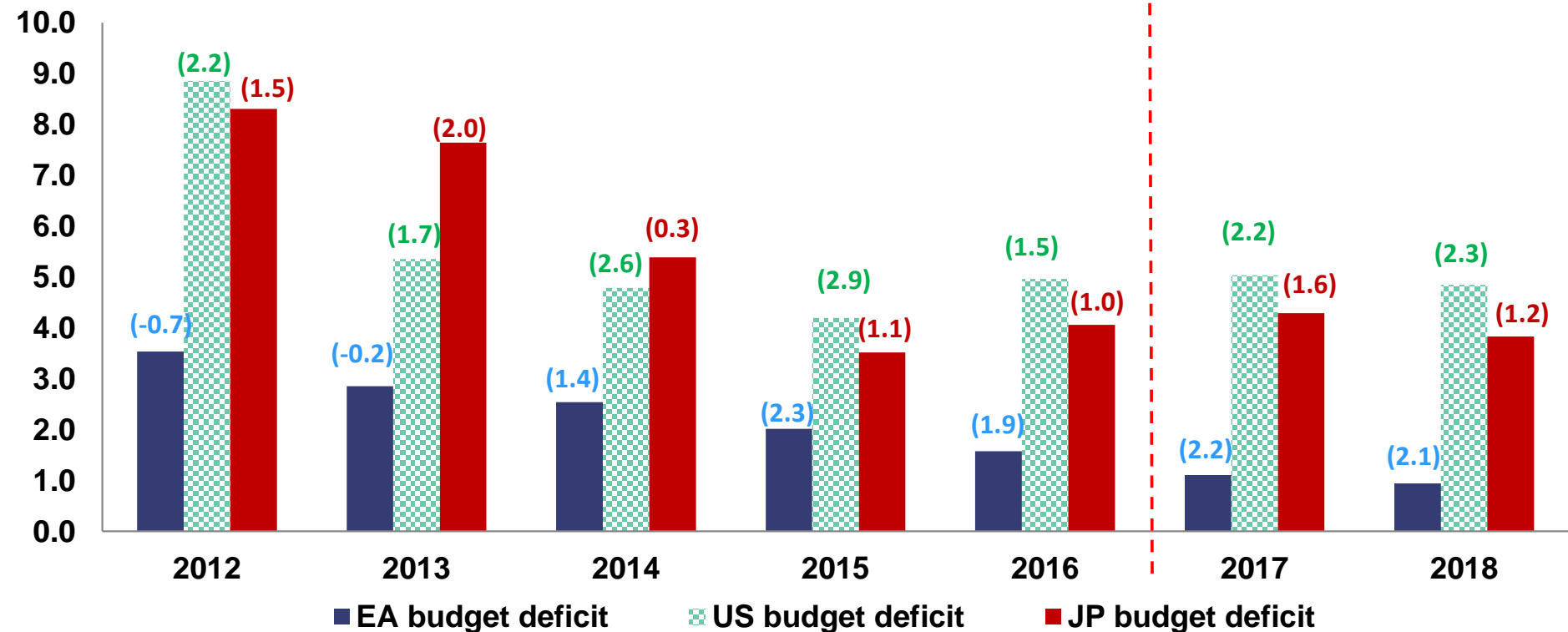
*The rules have evolved to respond to economic developments... ..
but at the cost of increased complexity*

Inherent trade-offs in design of a fiscal framework



Have the rules ensured sound fiscal positions?

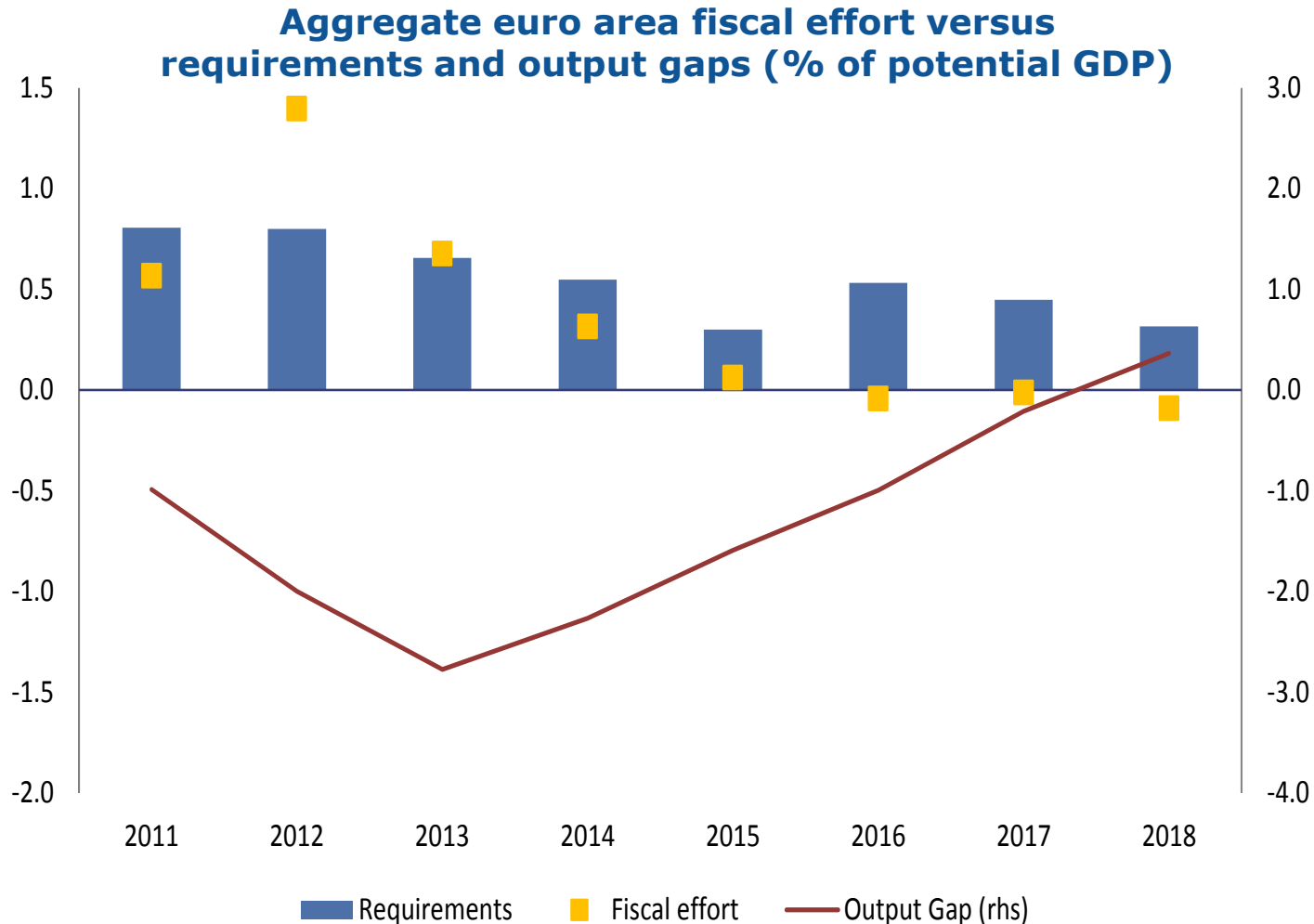
Aggregate budget deficit in the euro area fell from over 6% of GDP in 2010 to below 1% in 2018, much lower than US/Japan



Note: Figures between brackets above the columns represent real GDP growth rates

Have the rules ensured sound fiscal positions?

Pro-cyclical stance in bad times

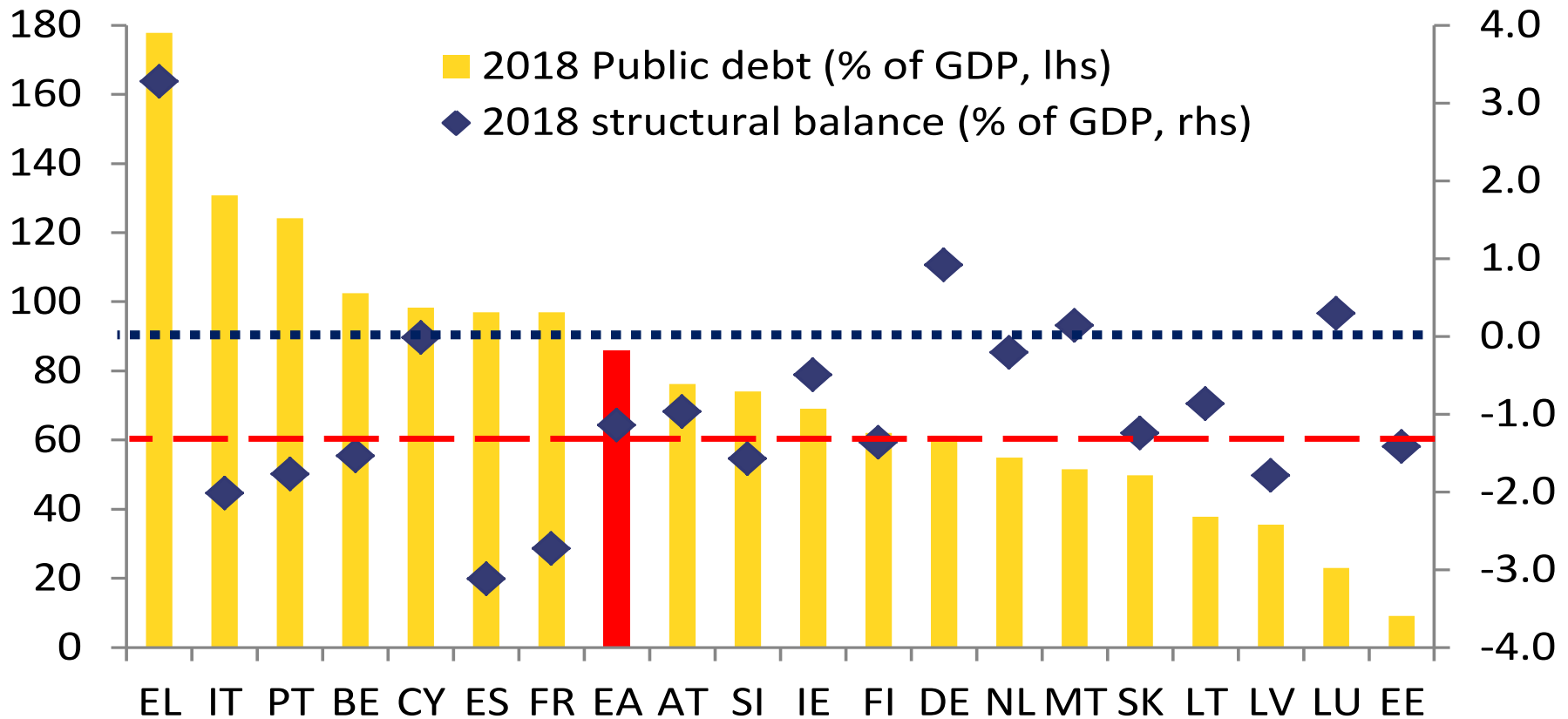


Source: European Commission autumn forecast 2017

Have the rules ensured sound fiscal positions?

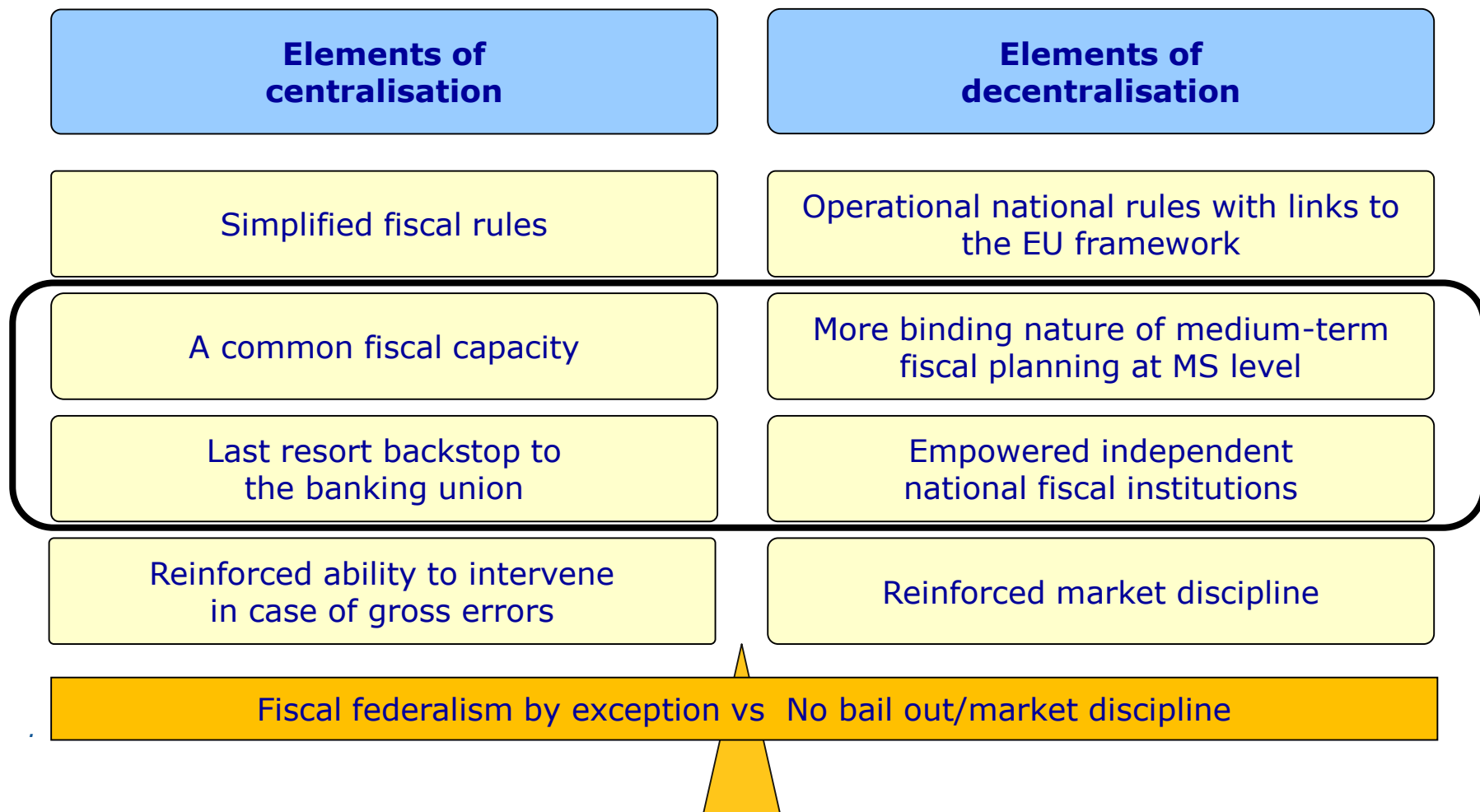
Large divergences in fiscal positions between Member States

Public debt levels (% GDP) and structural budget balance (% GDP)

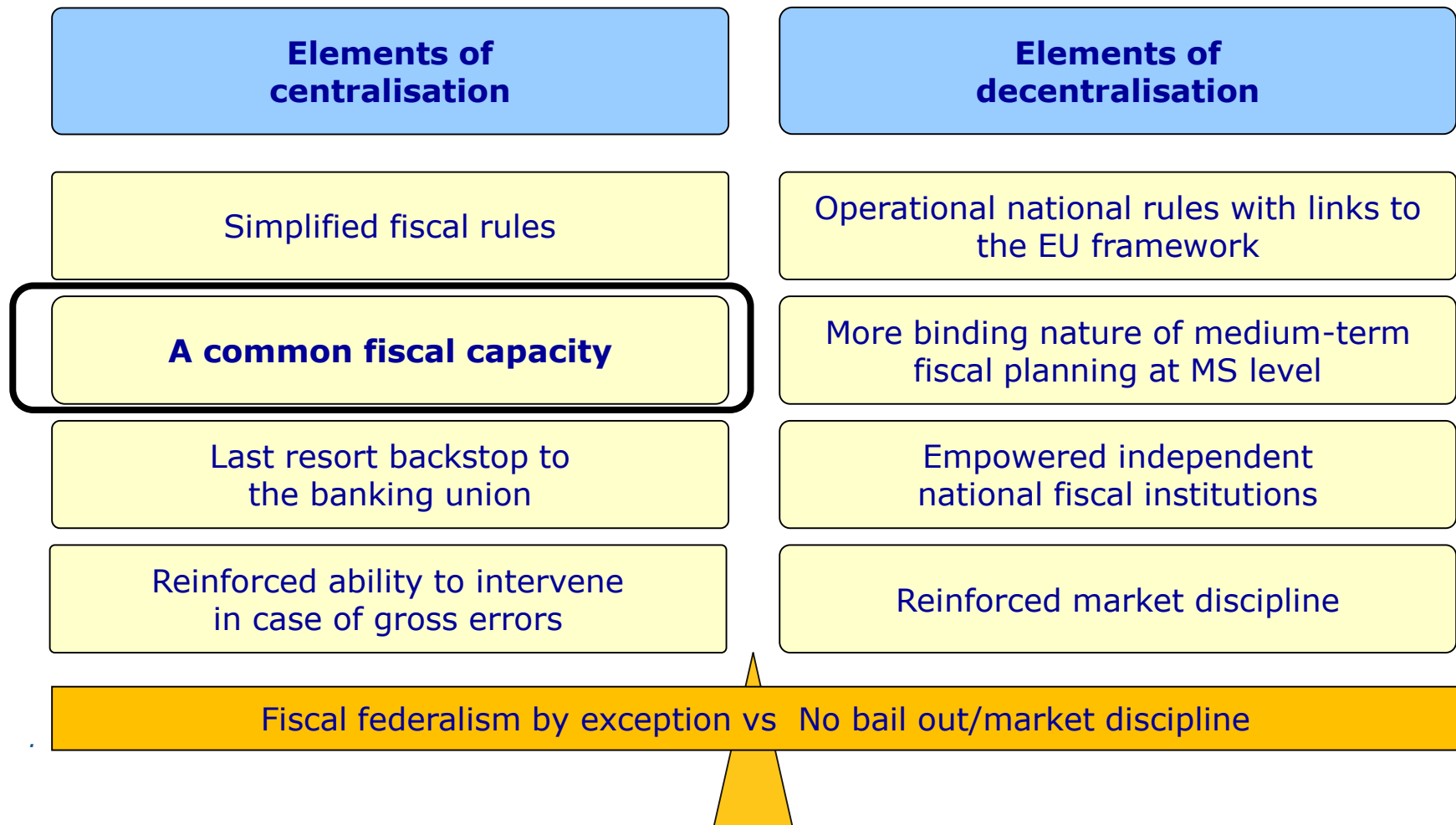


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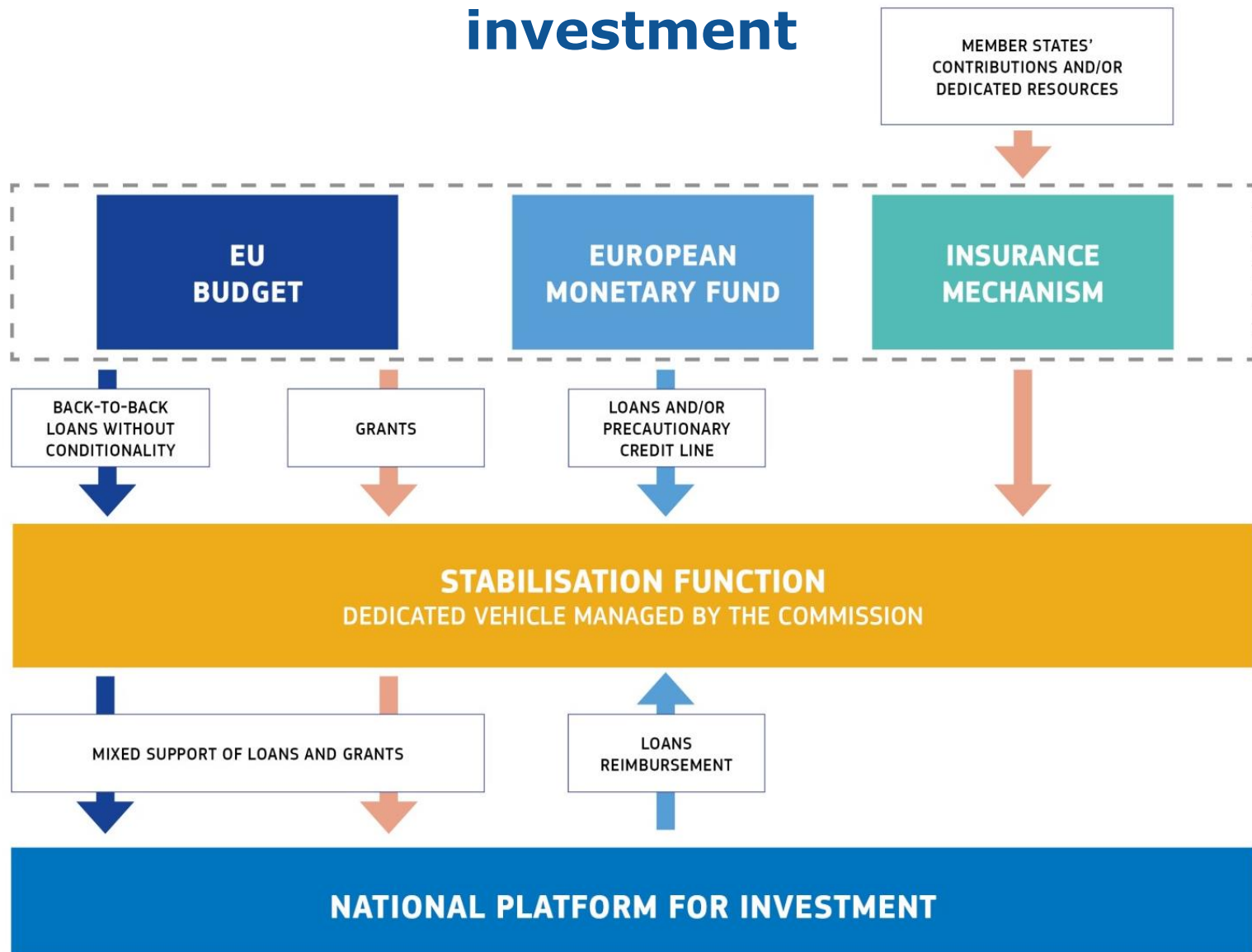
Which future? Searching for the right balance



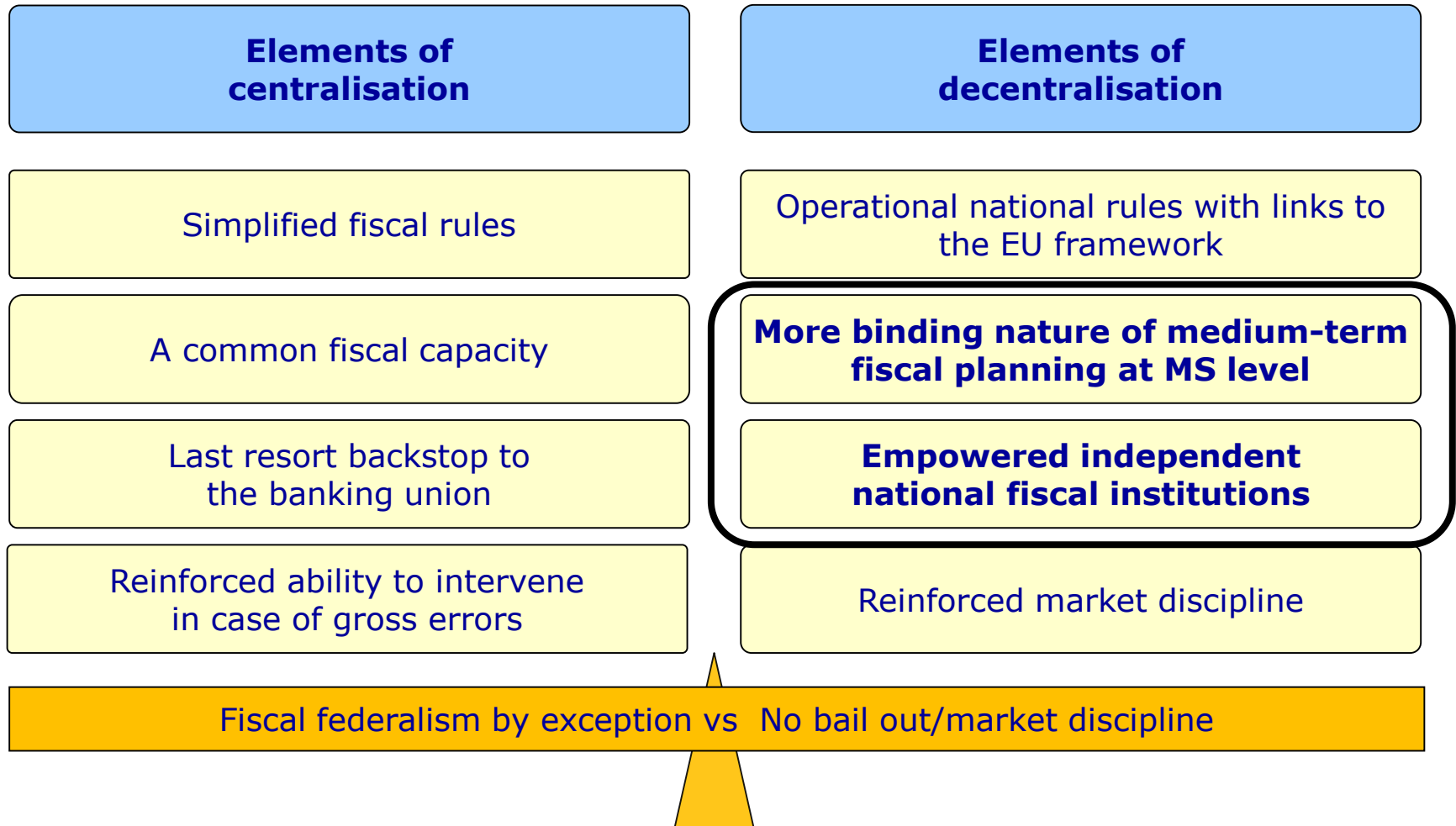
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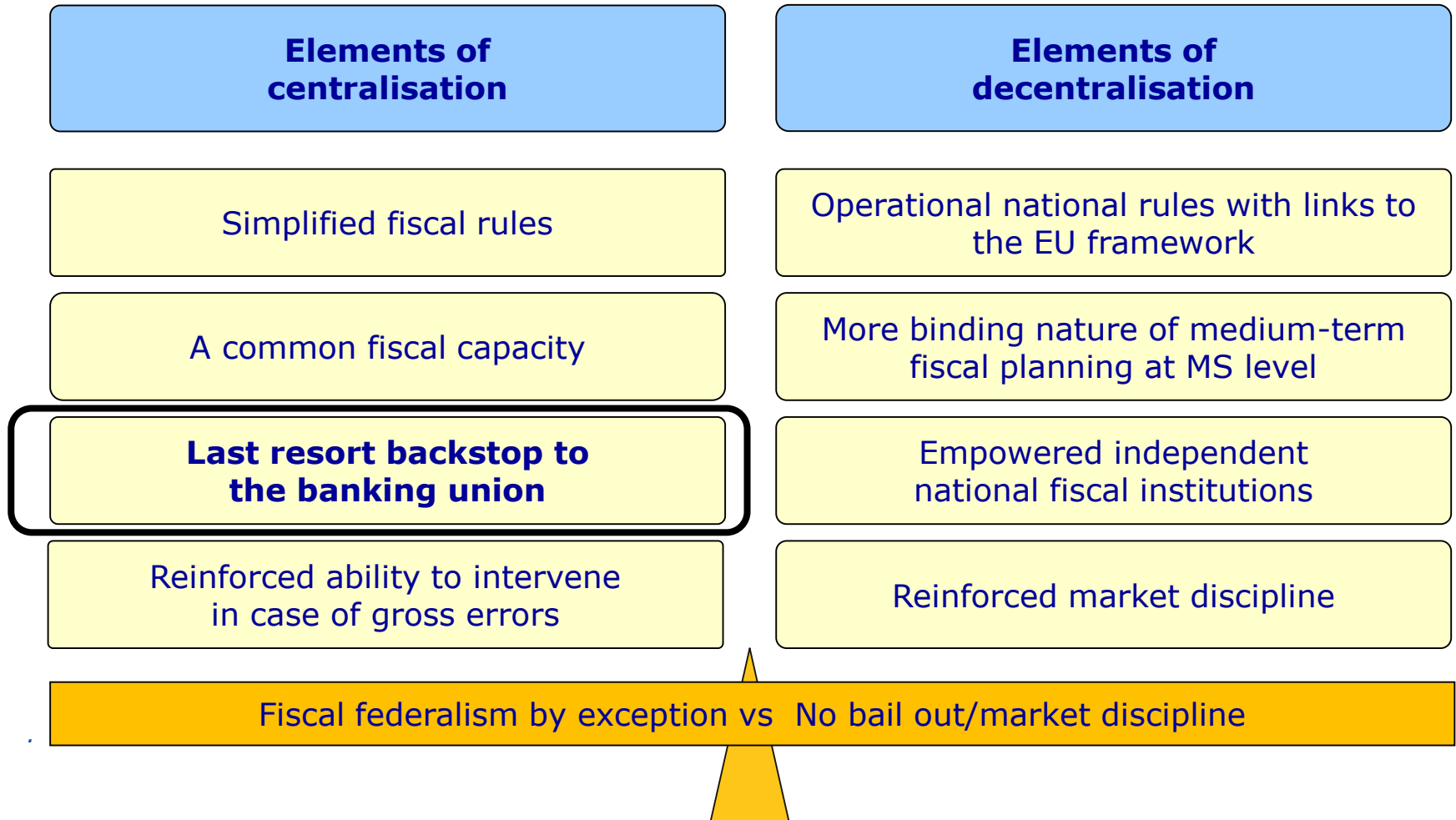
A European stabilisation function in support of investment



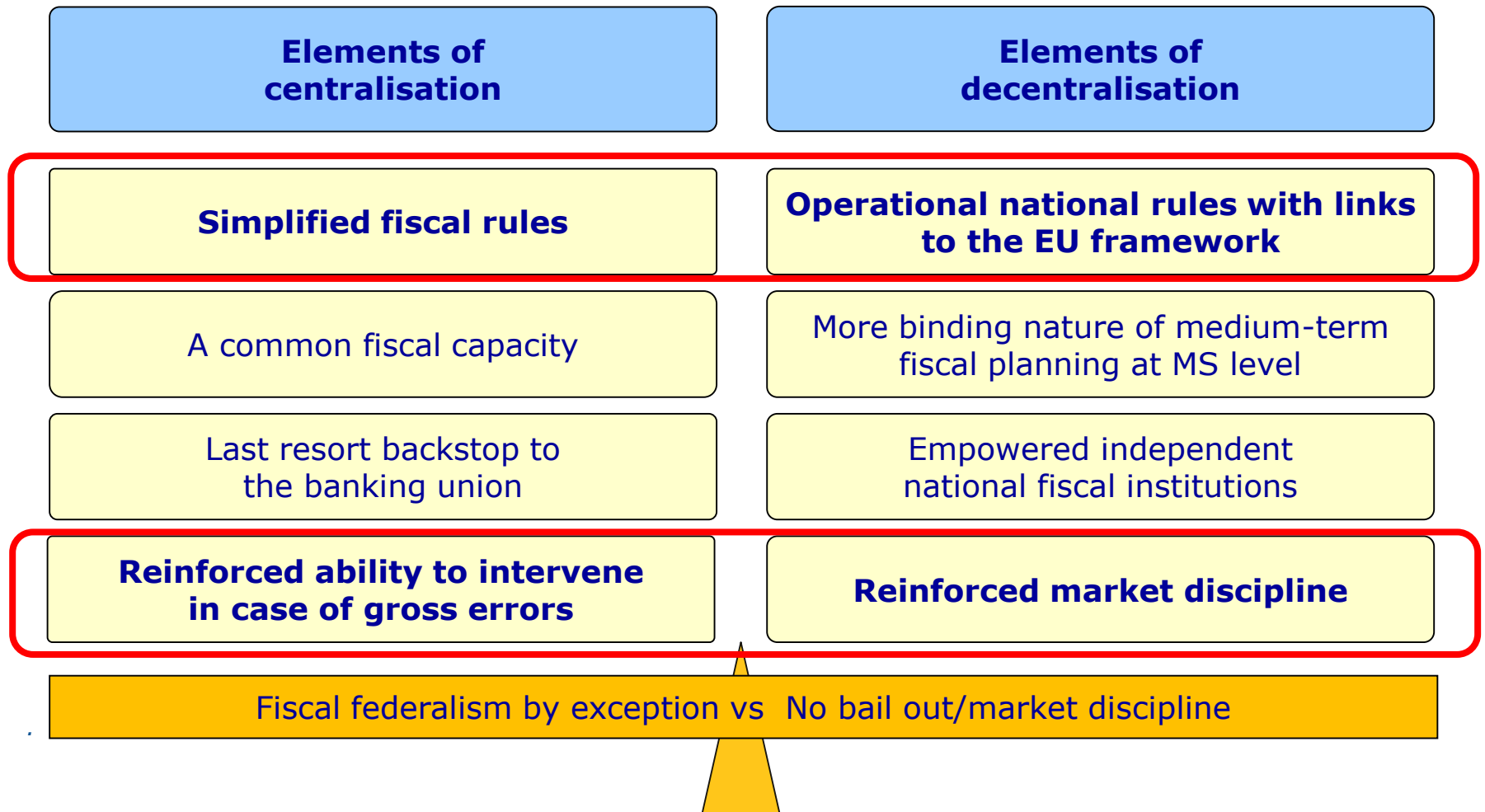
Which future? Searching for the right balance



Which future? Searching for the right balance



Which future? Searching for the right balance



Conclusions

- The crisis revealed fault lines in original EMU design and steps have been taken to breach those
- The present set-up remains vulnerable to shocks and leaves too heavy responsibilities on the ECB
- Find right balance between EU and national levels, and between rules, institutions and market discipline
- Reforms have to pass the political, economic and market stability test: sequencing is key but challenging
- 6 December 2017 package: Roadmap for deepening EMU: "fix the roof when the sun is shining"

Thank you very much for your attention