



Independent Authority  
*for* Fiscal Responsibility

## **Towards a third-generation of fiscal rules in the EU?**

**Madrid, 19 April 2018**  
**AIReF Workshop on Fiscal Rules**

## Preliminary remarks on IMF contribution

- ❑ **Extremely useful paper:** comprehensive overview on FR - recent trends, economic rationale, empirical evidence effort, weakness of current FR and ideas for future reforms
  
- ❑ **Most of the views and in particular IMF desirable features for FR shared.** In fact, at least at EU level there is an emerging consensus on:
  - the need for a new reform
  - some of the elements of the reform
  
- ❑ I will thus mainly adopt **an EU perspective** that in fact frame national FR and thus the Spanish one (to be dealt with in next session)

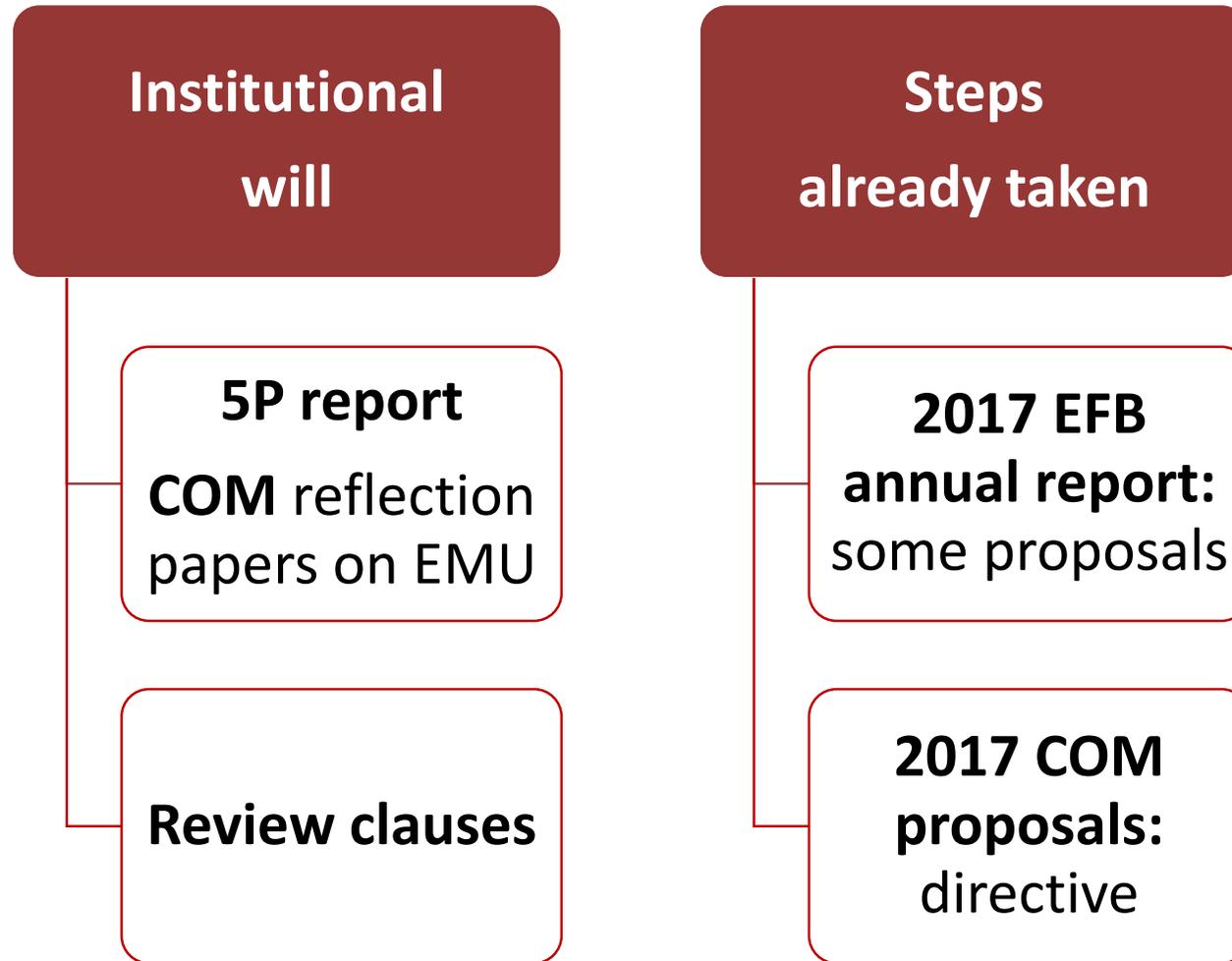


**Need for reform in the EU: towards a 3<sup>rd</sup> generation of rules?**

**IMF 3 guiding principles**

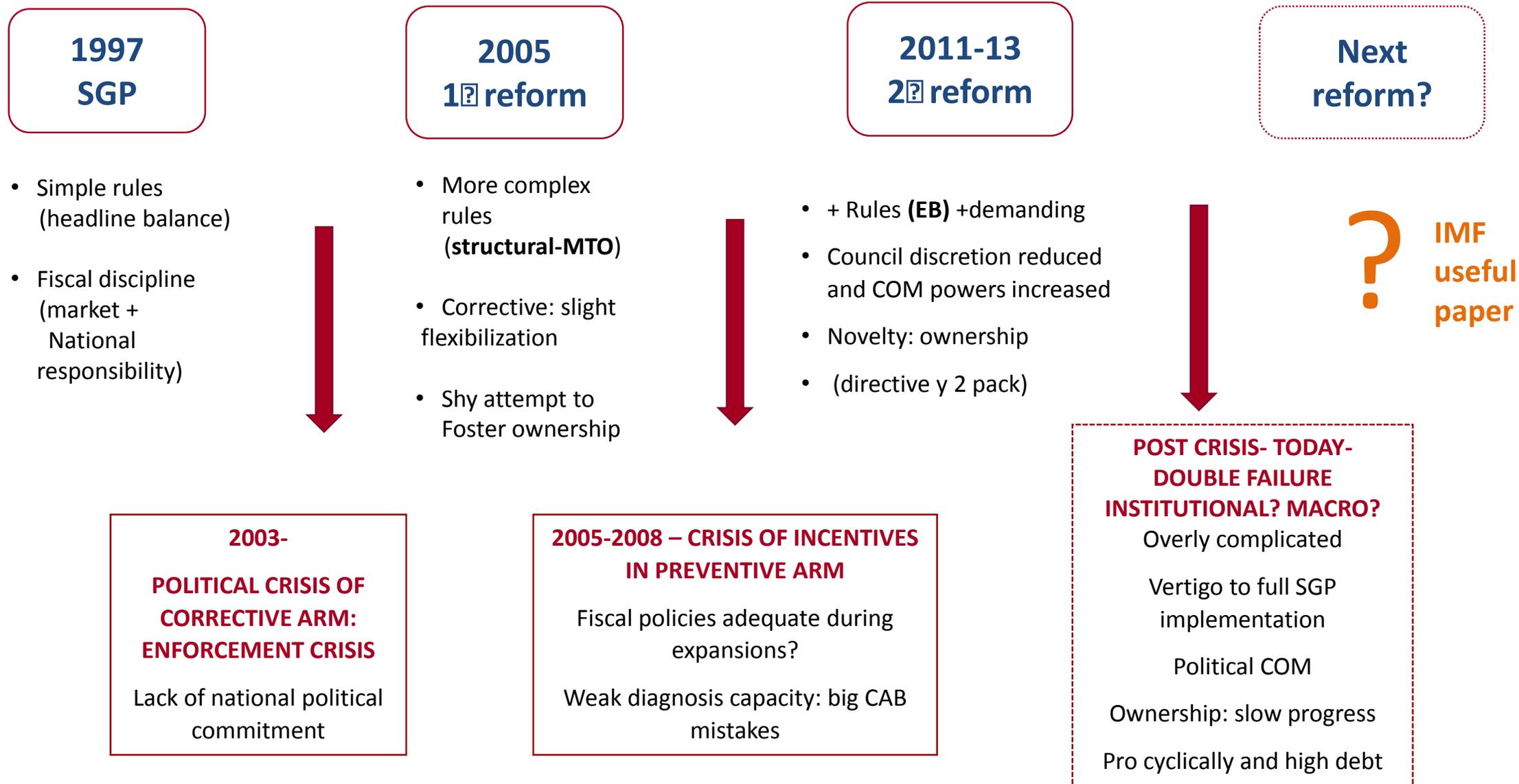
**Final reflections: additional principles,  
some questions**

# Consensus on the need for reform in the EU: SGP reform already in the agenda



*Proposals by 2019? Time horizon of reforms 2020-2025*

# Why? Existing EU fiscal framework: a double failure



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**Final reflections: additional principles,  
some questions**

# 1. A holistic approach to rules-based fiscal frameworks

Not perfectly addressed in the EU .....

## □ Review clauses indeed foreseen in EU legislation:

### ❖ 2018:

- Fiscal Compact integration in EU legislation: proposal
- 2011 Directive on fiscal framework – by December
- ECOFIN agreement on SGP flexibility – by June

### ❖ 2019- December:

- 6 pack regulations: preventive (1466) y corrective (1467)
- 2 pack regulation: DBPs (473)



**But not a clear sequencing**

**Without an integral view: reluctance to adopt proposals such as  
2017 December Directive**

# 1. A holistic approach to rules-based fiscal frameworks

.....but consensus emerging around IMF elements: anchoring/parsimony/consistency

## a) Anchoring: debt anchor + operational rules

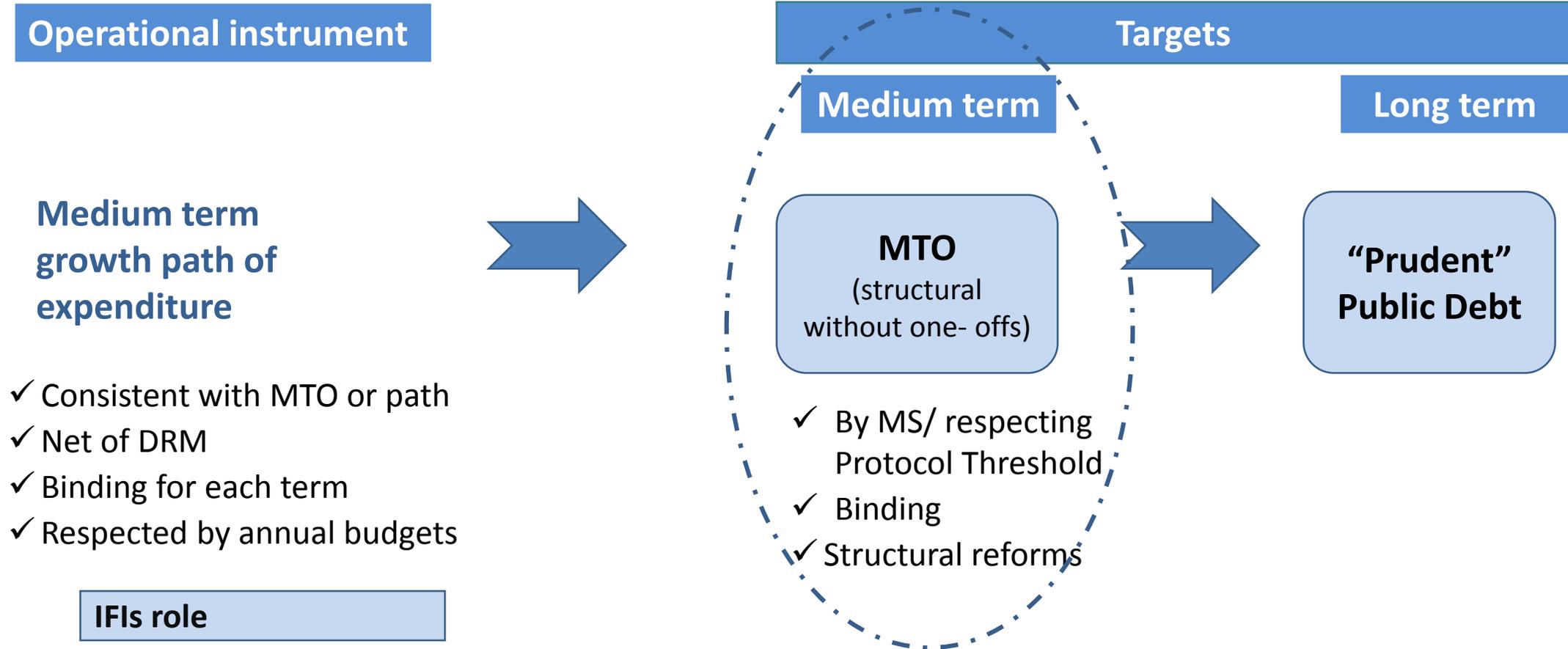
- Stabilization and sustainability hard to be addressed simultaneously
- Public debt right anchor for long-term
- Operational rule annually binding
- **COM (next slide) and AIReF share these general features but some differences with respect to IMF:**
  - Net debt: too demanding indicator. Gross debt
  - An intermediate objective for the medium-term: [MTO \(COM\)](#) vs PB (AIReF)

**b) Parsimony: it makes sense.** Particularly, once FCs exist.

## c) Consistency and adequate calibration

- **COM proposals** - allows FC assess calibration of MTO and expenditure path. Consistency searched in current setting but:
  - Macro consistency lost
  - Complexity has hindered deficit/debt connection
- **AIReF:** EU debt threshold given **while fiscal effort is calibrated** to meet the medium-term objective and meet desirable properties in terms of output maximization

## Example: 2017 December COM proposal



1. Assessing targets **adequacy**: MTO and expenditure path.
2. **Monitor compliance**, included risk of significant deviation
3. **Exceptional circumstances**
4. In the event of observed significant deviation call on the activation of **correction mechanism**

## 2. Simpler flexibility

### IMF timid?

- ❑ **Agreeing on need for escape clauses** for unforeseeable events: FC role
- ❑ **Agreeing on factoring in the cycle** in a simple way but IMF too confident in the possibility to overcome CAB limitations. **Too much credit to FC**
  - Clear rationale for CAB but no consensus on methodologies (statistical?)
  - Practical implementation problems limit CAB effectiveness
    - Ex ante: imperfect fiscal policy guidance (ES example)
    - Ex post: lack of transparency and discretionary assessment
- ❑ **COM and AReF: bet for expenditure indicators as main operational guidance**
  - Avoid SB measures even when defined in changes (instead of levels)
  - Identification of fiscal effort by the IFI (difference between the objective and IFIs estimates) to be translated into an EB

### 3. Improving enforcement mechanisms

#### □ IMF points 2 potential avenues:

- positive incentives: not much details. Any suggestions?
- reputational costs: need for strong FC

#### IMF view on more radical proposals?

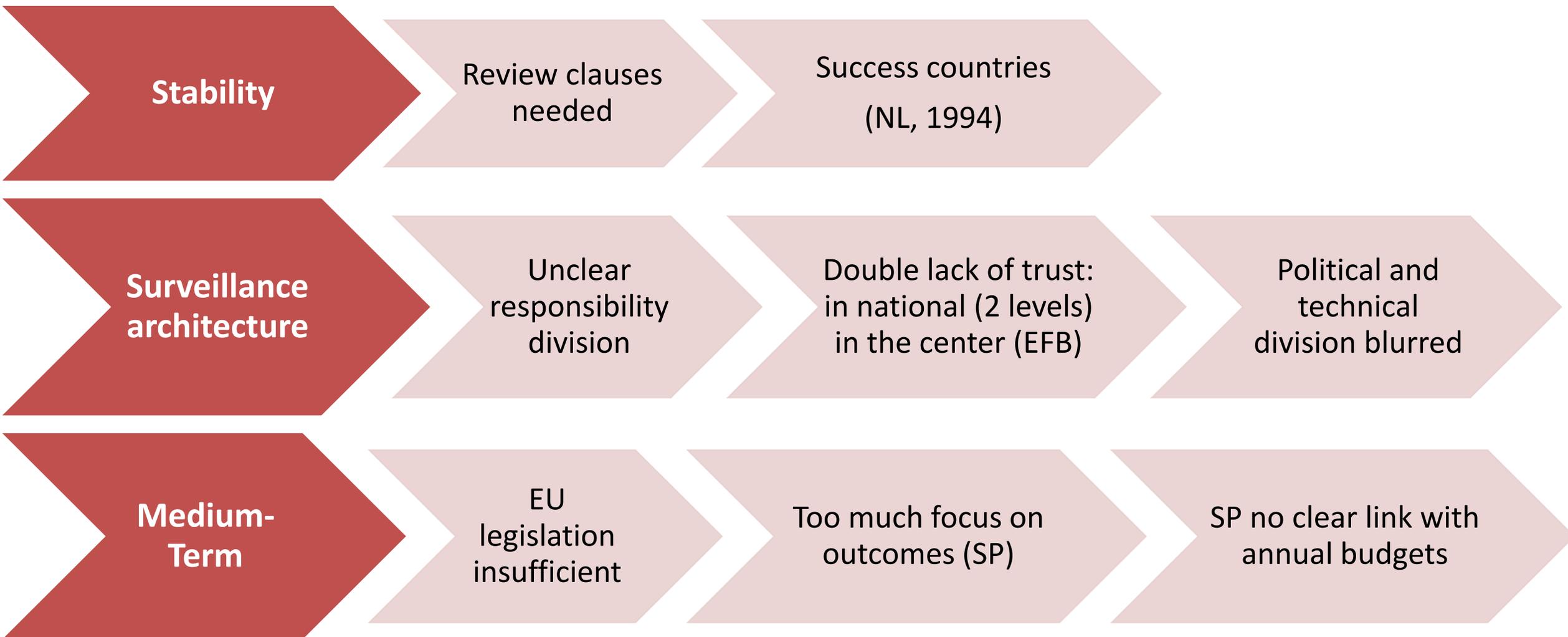
- Court
  - Some amendment legislative capacity to FC
  - Junior bonds
  - Automatism sanctions
- Too slow surveillance cycle (source of pro cyclical): need to reinforce preventive actions. Ex ante tools to be more decisively used (DBP, SGP, Autonomous recommendation)

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# 1. Three missing elements in IMF reflections



***A holistic approach to go beyond Fiscal Rules and focus on Fiscal Frameworks  
(in particular, interplay Fiscal Councils and Fiscal Rules)***

## 2. Some questions on empirical evidence

### □ Empirical evidence: IMF papers very fiscal rules supportive:

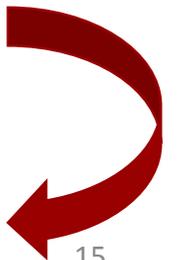
- Design matters
- Non compliance does not imply ineffectiveness (magnet effect)
- Calibrating is relevant

### □ Empirical evidence on EU raises some issues:

- EDP costly (higher spreads): several explanations. In general, this points to EDP failure. But it should act as an incentive to avoid EDP (no need for sanctions?)
- EDP success? Exits but with less than expected effort
- Not only preventive arm has failed (building up buffers). EDP also to be revisited

## Concluding remarks on IMF contribution

- ❑ Extremely useful paper
- ❑ Most of the views and in particular IMF desirable features for FR shared
- ❑ From an EU perspective:
  - ❑ An **integral approach** makes full sense and even there is a **need to go a bit further** and widen its scope by considering additional dimensions. Interplay rules and councils, whole architecture (EU and national), medium-term approach.
  - ❑ A clear anchor and hierarchy across rules and time consistency are absolutely necessary. **IMF principles seem reasonable to follow** (resemble the way monetary policy is conducted)
  - ❑ Some doubts on the ability to overcome well know **limitations of CAB.**



# Some questions and potential issues of discussion for the IMF and audience

## On IMF principles

- ❑ **Anchoring:**
  - Net debt?
  - Country specific debt thresholds?
  - Need for intermediate objective?
- ❑ **Simpler flexibility**
  - CAB still valid?
- ❑ **Enforcement mechanisms**
  - Suggestions for incentives?
  - View on more radical proposals?

## On IMF empirical evidence

- ❑ **EDP evidence in the EU**
  - How do you explain it?

## Additional guiding principles?

- Stability
- Surveillance architecture (FC role)
- Medium term approach



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