Joint Workshop by the Fiscal Affairs Department and the Europe Office of the IMF

The Future of Rules-Based Fiscal Policy

On April 29, the Fiscal Affairs Department and the IMF Offices in Europe organized a workshop on the future of rules-based fiscal policy in Europe (see program below). Participants from EU member states finance ministries, central banks, independent fiscal institutions, academia, and EU institutions discussed recent experiences and developments in the design and implementation of fiscal policy rules. The workshop consisted of three thematic sessions and one concluding panel.

The first session asked whether EU fiscal governance had become too complex to work. All participants acknowledged the extraordinary complexity of EU fiscal rules. Their lack of clarity to the general public and even policymakers complicates compliance, while frequent changes on the basis of unclear, or largely political, parameters sap their credibility. Yet, some saw that complexity as inherent to EU fiscal governance, given the lack of a fiscal mandate for EU institutions and the desire to maintain sufficient flexibility in fiscal management. Contingent fiscal rules are quite widespread, including outside the EU, and a careful design of their parameters can help limit moral hazard risks. Recent research shows that strong fiscal rules helped maintain consumer confidence after announcements of unexpected fiscal consolidation. Several steps have been undertaken to strengthen national ownership of EU fiscal rules and increase familiarity with technical concepts such as structural balances, but it is still too early to assess whether these measures will alleviate concerns related to the complexity of the framework. Some participants from member states suggested that if complexity is unavoidable, then much greater transparency and consistency in the implementation of the rules is required.

The second session discussed options for reforming the EU fiscal framework. A "rule of thumb" proposal would use the fiscal effort (defined on the basis of the gap to a debt-stabilizing primary balance, adjusted for economic conditions) as operational target and general government gross debt as long-term fiscal anchor. This simple rule could provide a prescriptive benchmark to assess the adequacy of fiscal policy in EU countries and would actually suggest a more even fiscal effort over time than current EU rules. The audience was generally supportive of the proposal, including the move toward more normative fiscal guidance, with benchmarks adjusted according to macroeconomic conditions rather than absolute limits. An even simpler form, using a spending growth limit anchored in a normative debt path, could foster further political accountability.

In the third session, discussions revolved around the viability of rules-based fiscal policy. It seems under threat from austerity fatigue, very low interest rates, overly complex design, a lack of national ownership, and a fading collective memory of fiscal crisis, among others. Some participants noted that the EU fiscal framework was moving towards greater discretion in implementation. Simpler rules, although easier to monitor, may also be more vulnerable to political pressure from member states, as seen in the past with the first version of the Stability and Growth Pact. A more credible no-bailout clause, stronger financial market signals, and an EU-level fiscal council, tasked with independent monitoring, or even oversight, of compliance with the rules, could restore the framework's credibility. However, outside a new crisis-driven momentum, such as in the case of a disorderly Grexit, these options were seen only as a medium-term possibility.

Participants' views on the benefits of an EU-wide fiscal council differed. Some argued that national fiscal councils had only just been set up and should be allowed to start operating first before drawing conclusions. Though there could be merit in closer cooperation among the national entities, a common fiscal council would merely add to the complexity of EU fiscal governance. By contrast, other participants felt that it would be helpful to have a group of (non-political) experts reviewing the implementation of rules.

In the concluding session, panelists drew lessons for EU fiscal governance going forward. Several ideas shaped the discussions:

- The EU is essentially faced with two options to ensure sound fiscal governance: moving toward a genuine fiscal union and centralizing decision-making powers at the EU level, or strengthening enforcement powers over existing rules.

- The immediate priority is to make an imperfect system work as well as possible. The system's design reflects multiple constraints, and successive reforms inevitably tend "over-specify" its architecture. Treaty-imposed limits on national policies also limit the scope for radical changes. Against this background, rather than reforming existing institutions or creating new ones, such as an independent EU-wide fiscal council, the near term focus should be on improving compliance. In the long term, more radical changes would be desirable, but this requires political will and democratic legitimacy.

- If a full-fledged fiscal union is off the table, a system of "fiscal federalism by exception" could be envisaged, enabling EU authorities to intervene in national fiscal policy in case of serious infractions to the common rules. The institutional set-up of such a system could be similar to that of the Eurosystem, with a governing council and Parliamentary approval of its decisions.

- Home-grown constraints on fiscal policy can greatly improve compliance with EU rules. However, their establishment is not rewarded at the EU level; and the uneven enforcement of EU rules actually undermines incentives for member states to build their own system of EU-compatible fiscal governance.

Overall, there was a sense among the panel that at the current juncture, scarce political capital should not be wasted on reforming the still relatively new EU fiscal framework, but rather be spent on more pressing issues, such as completing the banking and capital market unions, which would in itself contribute to reducing fiscal risks.

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8:30-9:00 am	**Registration** (Coffee)
9:00-9:15 am	**Introductory remarks:** *J. Franks (Director, Europe Office, IMF)* *M. Guerguil (Deputy Director, Fiscal Affairs Department, IMF)*
9:15-10:45 am	**The Second Generation of Fiscal Rules: Too Complex to Work?** The session will take stock of the experience with the so-called "second-generation" fiscal rules, which make constraints on relevant fiscal aggregates contingent on the business cycle and other policies. What are the main features of the new national-level fiscal rules in the EU? How have countries dealt with the methodological challenges of cyclical adjustment and the definition of one-offs? How have these rules been made operational? In particular, have PFM systems been adapted to better implement those rules, notably by the introduction of medium-term frameworks? To what extent have other policies—especially structural policies—been taken into account in the design of the rules? *Chair: M. Guerguil* *Presentation: G. Mourre (Head of Unit, DG ECFIN, European Commission)* *Discussant : R. Beetsma (Professor, University of Amsterdam)*
10:45-11:00 am	Coffee break
11:00-12:30 pm	**Flexible and Operational Rules: Exploring Reform Options** How can we circumvent methodological complexities and excessive "numerology" that can come with contingent rules, while preserving flexibility? What is the scope for so-called "rules of thumb" that would prescribe a certain policy path rather than prohibit outcomes beyond certain limits? How could they be articulated with the existing rules-based fiscal framework? Does the experience with expenditure rules justify the focus of the current policy debate on those rules? *Chair: L. Pench (Director, Fiscal Policy, DG ECFIN, European Commission)* *Presentation: N. Carnot (Adviser, DG ECFIN, European Commission)* *Discussant: X. Debrun (Deputy Division Chief, Fiscal Affairs Department, IMF)*
12:30-1:45 pm	Lunch, **Address** by *R. Beetsma*
1:45-3:15 pm	**The Long View: Fiscal Anchors, Policy Frameworks and Growth** The session will discuss (i) the main features of a desirable fiscal trajectory over the longer term, (ii) effective ways to achieve it, and (iii) the potential implications of such a trajectory for long-term growth. Specific questions include: What is an appropriate long-term anchor for fiscal policy? How far beyond the public debt level can we go without jeopardizing simplicity; and in particular can we and should we incorporate fiscal risks in the definition of the anchor? What are the broad contours of an institutional framework able to credibly link the anchor to the policy trajectory? What are the potential effects of improved fiscal behavior on long-term growth? *Chair: B. Barkbu (Deputy Resident Representative to the European Union, IMF)* *Presentation: L. Jonung (Professor , University of Lund)* *Discussant: P. Rother (Chief Economic Analyst, European Commission)*
3:15-3:30 pm	Coffee break
3:30-5:00 pm	**What Future for Rules-Based Fiscal Policy?** Panelists will wrap up the policy lessons of the day focusing on 3 questions: (i) Can we realistically patch up second-generation rules? (ii) Should we move away from legally-binding rules and towards more prescriptive rules/benchmarks with a comply-or-explain obligation? (iii) Can we conceive a more encompassing policy framework that would foster a better coordination of fiscal, structural and even monetary policies? *Chair: M. Guerguil* *Panelists: C. Alcidi (Head of Economic Policy, Center for European Policy Studies), C. Kamps (Head of Section, Fiscal Surveillance, ECB), L. Pench, H. Schuiling (Director General of the Budget, Netherlands), G. Wolff (Director, Bruegel).*
5:00-5:15 pm	**Concluding remarks:** *M. Guerguil.*