

O que há de novo no quadro fiscal europeu em discussão?

What is new in the European fiscal framework under discussion?

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Resumo: A situação fiscal da Europa tem sido objeto de discussão devido à sua incapacidade de garantir índices de endividamento específicos e instrumentos adequados para lidar com eventos imprevistos. Os membros não conseguiram cumprir tanto as regras preventivas quanto corretivas. Em geral, as regras fiscais rígidas mostraram-se ineficazes na aplicação do cumprimento. Em vez disso, as discussões recentes evoluíram para favorecer parâmetros de médio prazo mais flexíveis, simples e específicos para cada país na condução da política fiscal. Este artigo apresentará os principais argumentos contra o atual quadro e a discussão recente sobre possíveis melhorias.

Palavras-chave: política fiscal, quadro fiscal europeu.

Abstract: The European fiscal framework has been under discussion because it was unable to guarantee targeted debt ratios and adequate instruments to deal with unanticipated events. Members failed to comply with both preventive and corrective rules. Overall, rigid fiscal rules have proven to be ineffective in enforcing compliance. Instead, recent discussions evolved to favour more flexible, simple, and country-specific medium-term parameters for conducting fiscal policy. This article will present the main arguments against the current framework and

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the recent discussion about possible improvements.

Key-words: fiscal policy, european fiscal framework

Introduction

Fiscal rules are instruments to constrain government activities by imposing limits on selected aggregates such as public debt, expenditures, revenues and budget balance. The rules are supposed to guarantee the long-term sustainability of public finance and short-term macroeconomic stabilization. In a monetary union, specialists add one more argument to motivate the adoption of fiscal rules: the risk of spillovers among other members. That is, the negative impact indebted countries can have on others (Darvas, 2018). But 30 years after the Maastricht Treaty, have these goals been achieved?

There seems to be a consensus that the European fiscal framework has failed to ensure moderate debt ratios and enough instruments for economic stabilization. In a 2017 Deutsche Bundesbank report, the institution discusses key points from EU rules and some results. They pointed out that the current framework comprises two parts. The first is the preventive arm, which concerns a structurally balanced budget's medium-term objective (MTO). The other is the corrective arm, underpinned by two reference values: the 3% GDP deficit and the 60% GDP debt ratio. In the corrective arm, the one-twentieth debt reduction rule aims to reduce annually the debt ratio of countries over the 60% criterion. Also, if the Commission concludes that a member has an excessive deficit, the structural deficit-GDP ratio must be reduced by at least 0,5%.

However, despite having preventive and corrective rules, the institution lists many cases of non-compliance. For example, the 3% GDP deficit ceiling has been violated 109 times, with 13 times lasting longer than three or more consecutive years. Regarding the 60% debt ratio, only Estonia, Luxembourg, Latvia, Lithuania and Slovakia complied with the EU-rule the entire time. On the other hand, Belgium, Greece, Italy and Austria have never respected the limit. Also, the MTO was seldom observed.

Failure to comply with Maastricht ceilings is associated with overwhelming complexity due to repeated Stability Global Pact (SGP) amendments. "Now, it is impossible to understand their implementation" (Deutsche Bundesbank, 2017). In addition, exceptions are not well defined, opening room for excessive discretion. Lack of transparency on

decisions is another issue often raised. But overall, the literature emphasizes the low effectiveness of the set of rules despite the various modifications made over the years.

Such findings reveal that the set of rigid fiscal rules resulted in massive infringement instead of enforcing compliance. Especially in the aftermath of the pandemic crisis, discussions about fiscal frameworks are now focusing on medium-term parameters, as flexibility in the conduction of fiscal policy has been proven again imperative.

The IMF (2022) indicates that lessons of the past decades have shown that rules should allow governments to react to shocks, particularly when monetary policy is near the zero lower bound, and that fiscal policy should be an instrument to support economic growth. In addition, the downward trend in long-term interest rates raises doubt about debt limits and tight anchors to conduct fiscal policies.

With respect to the EU fiscal framework, Blanchard, Leandro, and Zettelmeyer (2021) remind us that even the successive amendments to deal with unpredictable events did not prevent damage to public investment. Furthermore, the framework hampered the support to navigate the Global Financial Crisis.

For these reasons, there have been recent discussions about an adequate new framework for the EU, which we shall present below. We focus on three works that bring different but complementary insights. Also, Table 1 summarizes other proposals.

2. A fiscal standard approach

In a more bold approach, Blanchard, Leandro and Zettelmeyer (2021) suggest abandoning fiscal rules as we know it. Instead, countries should be concerned with standards, a qualitative perspective that provides a combination of debt sustainability analysis with room for some judgment.

First, they argue that the widespread idea that rules should be simple is attractive but not feasible due to the different realities of countries. In this sense, "no quantitative rule can hope to come close to fitting the diversity of possible country-time situations" (p. 198). Also, they discuss how the set of a debt limit is likely to be country and time specific, which is precisely the opposite of the common invariant ceilings of the EU fiscal framework.

Regarding the other proposals, the authors summarize the ideas in two key points: a) replacing the complex existing rules for a straightforward expenditure rule in line with a defined anchor, and b) measures to improve enforcement. In their view, the proposals may

represent progress compared to the current framework. Nevertheless, they are likely too loose or tight, which would require other rules, increasing complexity.

Even though the trade-off between the complexity of assessing many unpredictable situations and the simplicity of summarizing them in one rule is an important debate, Blanchard, Leandro and Zettelmeyer (2021) state that the main argument to abolish fiscal rules is the inability of economists to define "any rule that gets the trade-offs right ex-ante, even when given a free hand in making the rules as complex as desired" (p. 215). They argue that instead of anticipating the trade-off between debt limits and output stabilization, their alternative fiscal standard proposal addresses it continuously in light of current information. For them, setting rules or standards are similar ways of controlling government behaviour, with the latter having the advantage of being able to be country-specific.

The major issue with the fiscal standard is determining the parameters that define good performance. In this sense, the authors sustain the need for "criteria, procedures, and methods that describe how to apply them" (p. 217). The primary tool would be the stochastic debt sustainability analysis (SDSA), which gives various debt-ratios paths based on the forecast of key indicators such as primary balance, interest rates, growth and maturity structure of the debt. In short, an adequate fiscal standard would open room for any fiscal policy as long as the debt crisis risk is dismissed.

3. Focusing on implementation and enforcement

EU fiscal framework failed to address both debt ratio constraints and macroeconomic stabilization. According to the IMF (2022), this happened mainly due to deficiencies in the national implementation of the rules. That is, they have not been followed. Also, the institution highlights the short-term focus on yearly budgets rather than medium-term plans as an additional pressure on debt accumulation. Finally, they criticize the weak enforcement of the EU framework.

So, in light of these facts and in compliance with the European stability pact, the IMF suggests a fiscal reform based on three cornerstones. Preview proposals inspire the work that gives special attention to implementation.

First, there should be a set of risk-based EU-level fiscal rules. The rules must connect the short-term budgetary guidance with the medium-term risk evaluation, here identified as a debt sustainability analysis (DSA). The DSA works as an anchor to guide the operational level. In addition, a new and independent European Fiscal Council (EFC) would develop a

common methodology to avoid discrepancies among members. This methodology "would leave some room for judgment but constrain such judgment by using quantitative indicators" (p.11). Indebted countries should adopt expenditure ceilings as the operational national rule to achieve the medium-term objective. These ceilings would minimize procyclicality since lower revenues would not require spending cuts. Also, the current 3 per cent deficit and 60 per cent debt rules would remain in the new framework as reference values.

The second pillar suggested by the IMF (2022) addresses the framework's credibility by strengthening national institutions and guaranteeing enforcement. In the proposal, independent national fiscal councils (NFC) would be key in endorsing macroeconomic projections, DSA and fiscal risks. NFC would also be responsible for linking fiscal planning and the budgeting process. The power of the new framework would be enhanced by providing mandates, resources and independence. Also, an independent European fiscal council (EFC) would be essential to ensure coordination of NFCs and to determine the DSA methodology. So, while there is agreement about DSA implementation compared with the standard approach, it is important go further on implementation and enforcement tools.

Finally, the third pillar suggests an EU Fiscal Capacity (FCEU) to provide common public goods and reinforce macroeconomic stabilization. The proposal emphasizes the increasing demand for joint action in some areas, such as green transition and common security. However, the decision about the cost-sharing arrangement is confined to political choices.

4. European Commission (2023): legislative proposals

The package addresses a series of shortcomings of the current framework, especially concerning the effectiveness of the rules in containing debt ratios and smoothing shocks. For this, "the orientations envisaged a stronger national ownership, a simplified framework and a move towards a greater medium-term focus, combined with stronger and more coherent enforcement" (EU, 2023b, p.2).

The claimed objectives of the reform are a) simplifying legislation, b) clarifying provisions, c) strengthening national institutions, d) promoting medium-term guidance, and e) improving the quality of public finance. The core is the concept of debt sustainability, which aims to respect members' specific challenges and realities. So, the Commission has presented legislative proposals to reform the EU fiscal framework to achieve this goal.

First, the package replaces the preventive arm, the structurally balanced budget medium-term objective, for a medium-term fiscal orientation anchored in country-specific debt challenges. In this sense, fiscal policy should converge to medium-term debt positions determined for each member and respecting their particularities. As for this change, it is crucial to remember how unreliable the structural balance is.

Darvas (2021) discussed how alterations in estimated potential outputs and, thus, output gaps changed structural balance positions, which have a central role in the EU framework. For example, in late 2019, estimations for France's structural balance suggested the country had achieved some fiscal effort between 2014 and 2018. However, new assessments in late 2020 revealed the opposite, indicating a more significant structural deficit that implied a French fiscal stimulus over the same period. He points out the methodological reasons for such findings, which suggests procyclicality in estimates of potential output leading to successive revisions of structural balances. Therefore, replacing the preventive arm is progress compared to the up-to-date unreliable index.

Besides replacing the MTO, the reform amends the corrective arm of the framework by abandoning the one-twentieth rule. By imposing an annual reduction of one-twentieth of the excess over the 60 per cent debt, the member might face an unreasonable consolidation, which could burden economic activity disproportionately. For this reason, the reformed framework requires corrections of deviations from a net expenditure path. The national level sets the expenditure rule, consistent with a 'plausibly downward path' when debt is about 60 per cent. The current 3 per cent GDP deficit criterion and the 60 per cent debt ratio remain reference values to guide the medium-term debt orientation and the operational short-term expenditure rule. For countries violating these limits, the EU Commission will guide their expenditure path.

According to Darvas (2023), seven countries (Belgium, France, Italy, Poland, Romania, Slovakia and Spain) are expected to breach the reference values in 2024 and 2025. Also, Austria, Croatia, Cyprus, Finland, Germany, Greece, Hungary, Portugal and Slovenia are likely to remain with a lower than 3 per cent budget deficit but higher than 60 per cent public debt. The remaining eleven countries (Bulgaria, Czechia, Denmark, Estonia, Ireland, Latvia, Lithuania, Luxembourg, Malta, Netherlands and Sweden) are projected to meet the 3% GDP deficit criterion and the 60% debt ratio.

Regarding institutional improvements, the package includes clarifying the IFIs role in the surveillance of the EU fiscal framework at the national level, preparing and endorsing budgetary forecasts, and validating sustainability analysis and policy impacts.

5. The spirit of the new framework: final remarks

The concept of debt sustainability is the core of the proposals, in line with a more medium-term approach to fiscal analysis. There seems to be a consensus that fiscal policy must be flexible to deal with unpredictable events. Instead of trying to anticipate these events, the framework should leave room for country-specific situations and allow gradual adjustments.

In addition, a simple operational and national expenditure rule must guide the short-term conduction of fiscal policy following the medium-term country-specific debt criterion. The idea of an expenditure path involves decreasing procyclicality whilst guaranteeing debt sustainability.

Strengthening national institutions and increasing transparency are also key factors in recent discussions to ensure enforcement. It derives from the observation that the current framework has failed to produce the intended results due to non-compliance. On the other hand, improvement in fiscal cooperation has been recognized as an important political subject left outside of the fiscal rules agenda.

Table 1 – Recent Proposals for Reform of the EU Fiscal Rules

Source/study	Rule proposal	3 percent of GDP deficit ceiling	60 percent of GDP debt limit	Escape clause	Green golden rule	Common fiscal instrument
Arnold, Balakrishnan, Barkbu, Davoodi et al. (2022)	Expenditure ceilings consistent with a zero or positive overall fiscal balance over the medium term for high-risk countries. For countries that are not high risk but have debt above 60 percent of GDP, expenditure ceilings consistent with an anchor based on the overall balance that—while not necessarily zero or positive—leads to declining debt over the medium term.	Yes	Yes	Yes	No	Yes, for stabilization and common public goods (e.g., climate investment, energy security, defense R&D, pandemic preparation)
EFB (2021)	Long run debt ceiling, with intermediate country-specific medium-term targets. Expenditure rule as operational target, and no explicit debt reduction rule.	Yes	Yes	Yes	No	Yes, for stabilization
ESM (2021)	Annual debt correction of 1/20th when debt above 100 percent of GDP (acting as an anchor)	Yes	Modify to 100 percent	Yes	No	Yes, for stabilization, investment, and crisis resolution
Giavazzi, Guerrieri, Lorenzoni, and Weymuller (2021) and D'Amico et. al., (2022)	Medium-term debt targets (10 years), with different speed of adjustment depending on purpose of debt, which helps provide counter cyclicity. Multi-year ceiling on primary spending, net of automatic stabilizers, and spending-for-the future EU public goods". The ceiling is revised every three years but the economy must meet the medium-term debt target in 10 years.	No	Yes	Yes	Yes	Yes, a common fund to acquire pandemic and crisis-related debt
Netherlands-Spain Joint Proposal	Expenditure rule with country-specific medium-term fiscal plans to make the rules more comprehensible, easier to enforce and more countercyclical	Yes	Yes	Yes	No	EU-financed investment in public goods in strategic areas, especially climate change mitigation
Martin, Pisani-Ferry, and Ragot (2021)	Country-specific medium-term debt targets (assessed by the domestic independent fiscal institution on the basis of a common methodology, monitored by the EFB, and endorsed (or rejected) by the relevant EU bodies) based on a DSA and implemented through 5 year primary expenditure growth ceilings	No	No	Yes	No	Yes, for stabilization and investment
Blanchard, Leandro, and Zettelmeyer (2021)	Abandon quantitative rules in favor of qualitative standards and use stochastic DSAs to assess debt sustainability, with the pace of debt reduction depending on the monetary policy stance	No	No	Yes	No	Yes, under certain conditions
European Commission (2023)	Medium-term debt target, with operational expenditure rule consistent with debt sustainability	Yes	Yes	Yes	No	Yes, under certain conditions

Source: IMF (2022) adapted

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