FISCAL GOVERNANCE AT THE EUROPEAN LEVEL

Comments on R. Beetsma and C. Kamps

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Consensus in several areas

- Assessment of existing situation
  - SGP framework has not guaranteed appropriate fiscal stance in EA
  - Externalities of national fiscal policies not internalized
  - Automatic stabilizers alone not enough in post-crisis period

- Problems in improving risk sharing
  - Potential inconsistency with SGP/Fiscal Compact
  - No central fiscal capacity exist
  - Conflicting interest with national objectives (e.g., overheating, national fiscal rules)
Comment 1: Output gap estimation

• Difficulty of output gap estimation is acknowledged, but fundamental issue
  • Focus and consensus on fiscal stance in EA in 2017/8, but not at individual country level, such as for Germany
  • EC estimate for Germany is controversial (e.g., accounting for refugees in potential GDP)

• Structural deficit estimates for Germany for year 2017
  • EC (May): 0.3
  • CEE (Mar): -0.3
  • OECD (Jun): -0.7
EC output gap estimate for Germany

Spring projection

% of potential output
Comment 2: Complexity of Rules

- Fiscal rules have become increasingly complex
  - trade off between short-term stabilization and long-term fiscal sustainability
  - CPB graph
- Designing rules that also regulate how fiscal space can be used are likely to be even more complex
- Fiscal rules must be understood by policymakers and citizens (at least in a rough sense)
Complexity of budgetary rules in EU

The number of pages of European budgetary rules in relevant publications has increased, substantially, over the last years.

CPB, Macro Economic Outlook 2016, p.18
Comment 3: Risk sharing channels

- Amount of risk sharing in Eurozone in 2007-14 about half compared to US (Milano/Reichlin, 2017)
- Channels differ as well:
  - Role of factor mobility and financial integration much higher in US; is there more potential in Europe?
  - In Eurozone most smoothing comes from existing centralized public institutions such as ESFS, ESFM, ESM
Figure 2. Risk sharing in the Eurozone, before and after the recession

Figure 3. Risk sharing in US, before and after the recession
Comment 4: EMU fiscal capacity

• What are the constraints: country or political/ideological differences?
  • Survey of members of national parliaments in France and Germany 2016
  • Nationality matters, but party effect dominates quantitatively!
Figure 3: Average Preferences in Regard to Selected EMU Reform Proposals

Source: Own calculations. The graph displays the country-specific averages of individual responses of German and French MPs, which are weighted by the inverse probability of age, gender, fraction in parliament, parliament and membership to ruling party in the respective country to gain representativeness of answers to overall population of MPs. The answers to the related questions are based on a scale ranging from -4 ("Disagree") via 0 ("Undecided") to +4 ("Agree"), respectively (see Appendix A2).
Figure 7: Average Preferences Regarding Selected EMU Reform Proposals by Political Group

- **EPP (European People’s Party group)**
  - Higher investment: 2.03
  - Flexible labour markets: -1.71
  - EMU-UI: -1.73
  - Eurobonds: -1.25
  - ECB QE: -0.28

- **S&D (Progressive Alliance of Socialists and Democrats)**
  - Higher investment: 2.92
  - Flexible labour markets: 2.08
  - EMU-UI: 0.89
  - Eurobonds: 2.11
  - ECB QE: 1.83

Source: Own calculations. The graph displays the respective averages of individual responses of German and French national MPs with respect to (hypothetical) membership to political groups of the European Parliament. The averages are weighted by the inverse probability of age, gender, parliament and membership to ruling party in the respective country to gain representativeness of answers to overall population of MPs. The answers to the related questions are based on a scale ranging from -4 (“Disagree”) via 0 (“Undecided”) to +4 (“Agree”), respectively (see Appendix A2).
Conclusion

• Risk sharing through modified fiscal rules seems difficult:
  • too complex in many dimensions
• Fiscal capacity at Euro Area level more appealing, but
  • country and party preferences speak against this
  • danger of moral hazard and permanent fiscal transfers
• In absence of refined rules and central fiscal capacity, other channels of risk sharing must be used or improved
  • factor mobility, financial integration and existing centralized institutions
National cleavage

Q3: ECB asset purchase
Q4: Fiscal compact
Q5: Tax policy
Q6: EUI
Q7: Eurobonds

France
Germany
Partisan cleavage

Q3: ECB asset purchase
Q4: Fiscal compact
Q5: Tax policy
Q6: EUI
Q7: Eurobonds

S&D EPP