Fiscal Delegation In A Monetary Union: Instrument Assignment And Stabilization Properties

Discussion of Basso and Costain (2017)

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Disclaimer: The views expressed do not necessarily correspond to the views of the ESM.

Interesting paper

… that contributes to the debate on how to achieve fiscal discipline in the EMU by

⇒ **analysing different institutional frameworks** for conducting fiscal policy (FP) in a MU

[planner, status quo MU, national states, fiscal authority(-ies), federal government]

⇒ **comparing** them in terms of

- ⇒ their success in addressing deficit bias/stabilising public debt
- ⇒ welfare implications
- ⇒ stabilisation properties (in response to public demand shock)

⇒ showing **benefits of delegating one of fiscal instruments** to an independent, unelected, debt-averse Fiscal Authority (FA), either at national or union level

⇒ providing a **discussion on policy implications**

Outline of discussion

- Key assumptions and mechanisms
- Some comments
- Simulation results
- Policy implications

Key assumptions and mechanisms in the model

- Reduced form macro model with dynamic games btw policy makers [CB, G, Gj, Fj, F]

- Key assumptions delivering outcomes in main scenarios

⇒ **Status quo MU scenario [CB, Gj]:**

CB that cannot commit, gov'ts are impatient, disregard the effects of own debt on union interest rate and on MP => **inflation and deficit bias**

⇒ **FA compared to MU [CB, Gj, Fj or F]:**

FA more patient than local gov'ts, debt averse and if union-wide, internalizes the effect of debt on interest rate and on MP

⇒ **FG compared to MU [CB, G]:**

FG impatient, not debt averse by mandate, internalizes effects of debt levels on interest rates and MP, but fails to optimize the spending because no local information

Some comments on assumptions

- How the results change if central bank was **committed**? And if it did not care about the gov’t spending?

- Take into account **sovereign risk** that would be priced in by the markets - gov’ts would become debt averse and symmetry breaks down; model of MU fits early EMU, but not crisis period

- Add **asymmetry** across countries in shocks or in debt levels (where some countries would need more austerity)?

- Shock to government spending bliss point - other ways of modelling?

Results: Moving from status quo to fiscal delegation

Simulations:

- **Delegation of debt**
  - ⇒ SS: large reduction in debt, inflation and tax burdens and higher welfare
  - ⇒ Stabilisation: reduces the welfare cost of fluctuations, greater austerity on impact is compensated with large welfare gains

- **Delegation of tax instrument** delivers **similar benefits**, but
  - ⇒ SS: FA is less effective in reducing inflation and debt, welfare roughly comparable
  - ⇒ Stabilisation: austerity implies larger decrease in output

- Very similar outcome for **national vs union-wide FA** (union wide slightly better in terms of SS debt)

Results: Moving from status quo MU to federal government

Simulations:

- **Federal government controlling debt** (and determining spending)
  - SS: lower debt and higher welfare compared to *status quo* MU, higher debt than with FA, lower welfare
  - Stabilisation: comparable or more costly than in *status quo* MU **(!)**

Policy implications for debate on fiscal sustainability

- Fiscal delegation could be a viable way to enhance/replace the **system of rules** with a **system of institutions**

- The transition to a new system would result in significant debt reduction – solution to debt overhang

- **What kind of fiscal delegation?**
  - Independent, non political, with a clear mandate - would it work if within EC?
  - Ideally a union wide FA, but even national FA big improvement – less intrusive, more acceptable option politically, but possible coordination issues
  - Debt delegation better results but tax delegation easier to implement; European treasury?

- Sustainability vs stabilisation

Conclusion

- A very topical and interesting paper
- Analyses a rich set of options
- Important policy conclusions
- Some assumptions could be more realistic - further research

Thank you!

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