Box 4

THE REFORM OF THE FISCAL SURVEILLANCE FRAMEWORK IN EUROPE

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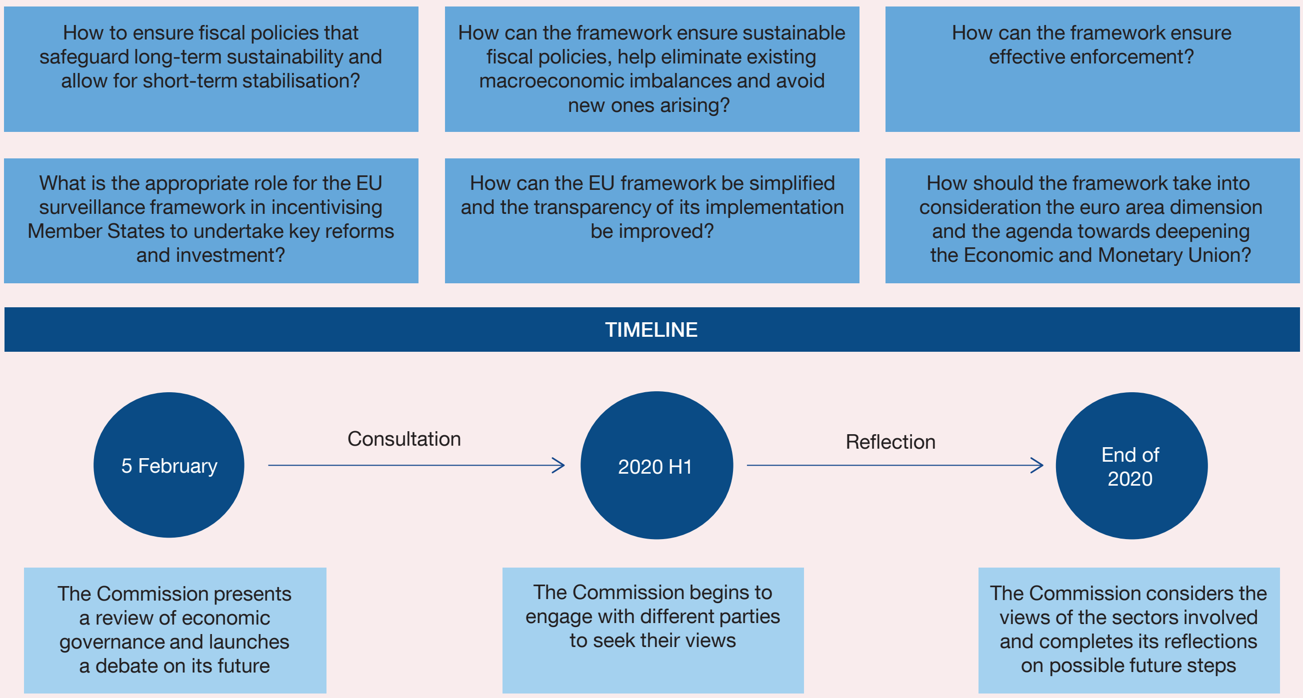
On 5 February the European Commission announced the start of the review of the economic governance framework for the European Union (EU). It further offered an assessment of the effectiveness of the current surveillance framework.[1] Figure 1 shows the main phases and characteristics of the review. The first phase of the process will involve an extensive public consultation, running to mid-2020, in which all European institutions, the Member States and civil society will participate. The Commission will give itself until end-2020 to assess the opinions received, reflect on the steps to be taken and submit, if appropriate, a formal proposal for reform.

The EU's economic governance framework has undergone numerous changes since its inception, progressively adapting to the new requirements arising during the European construction process. In its initial design, the framework was chiefly geared to preventing the effects of excessive budgetary imbalances on financial stability in a monetary union. The 2005 reform sought to add some flexibility with a view to being able to address adverse cyclical situations. Following the 2008 economic and financial crisis, the focus moved once more to the risks that high levels of public debt entail for euro area economic and financial stability. Against this background, the latest "six-pack" and "two-pack" legislative reforms were implemented in 2011 and 2013, respectively. These introduced elements to strengthen the sustainability of public finances, to add flexibility to fiscal rules and to improve the Member States' budgetary processes. In addition, surveillance was extended beyond the fiscal domain to address macroeconomic imbalances from a broader perspective (under the Macroeconomic Imbalances Procedure), and a macroeconomic oversight procedure was set in place for those countries receiving financial assistance. These changes were integrated into the European Semester, the framework conceived to coordinate economic policies at the European level and to

Figure 1
REFORM STAGES AND MAIN AREAS OF DEBATE



SOURCE: European Commission.

1 Community regulations require the European Commission to conduct an economic governance framework review every five years, and to submit a report on the implementation of the existing legislation.

steer the structural reforms necessary at the national level.

According to the Commission, the essential aim of the review under way is to strengthen the effectiveness of its oversight. It is mindful that the current macroeconomic environment, marked by low potential growth, population ageing and low interest rates, is very different from that of previous reforms. At the same time, the EU has to respond to new challenges, such as digitalisation and climate change (as seen with the European Green Pact).

The consultation addresses various issues: the means of ensuring compliance with accountable fiscal policies, increasing the transparency, flexibility and simplicity of the rules; the review of the macroeconomic imbalances procedure; increased incentives for investment and for structural reform; and enhanced economic policy coordination and the deepening of EMU.

The assessment conducted by the Commission notes both the strengths and weaknesses of the current framework. As regards strengths, the Commission highlights the fact that the latest legislative reforms have reinforced the policy oversight framework, providing for the correction of economic imbalances and, specifically, the reduction of excessive budget deficits. At the same time, the Commission indicates the momentum given to ongoing economic convergence in the EU and greater economic policy coordination. Further, mention is made of the creation of independent fiscal institutions and of enhanced national budgetary processes and medium-term fiscal planning procedures.

However, the Commission also recognises in its assessment certain areas for improvement. Firstly, it notes that the ongoing incremental reform of the fiscal framework has led to greater complexity, with diverse procedures and numerous rules. Admittedly, this design sought to make the framework more flexible and adaptable. But it may also have deterred ownership of the fiscal rules (see Chart 1), while reducing transparency and hampering communication.

Additionally, the Member States' fiscal policies have retained some procyclical bias, as illustrated in Chart 2 The Commission expresses particular concern over the lack of discipline in expansionary phases, during which countries have not sufficiently rebuilt their fiscal buffers. Such behaviour, according to the Commission, is expected to have restricted the capacity of the framework to coordinate national fiscal policies, with appropriate cross-country differentiation, and to attain a suitable fiscal stance for the euro area as a whole.

The Commission also highlights the persistence of high levels of public debt in some countries, which are in turn far from meeting their medium-term fiscal targets (see Chart 3), while their reform-geared momentum appears to have slackened.

Finally, another area for improvement is the quality of public finances. This covers both the composition of public spending and revenue, and their capacity to support growth and social inclusion. In this respect, the Commission stresses that public investment is the spending component that traditionally bears a high proportion of the adjustment in fiscal consolidation processes (see Chart 4), which underscores the importance of protecting this spending component in the design of the fiscal surveillance framework.

The Commission's analysis shares many of the concerns voiced by experts and international institutions. These refer to the need for a comprehensive review of the framework that reduces its complexity, enhances compliance and contributes to the design of countercyclical fiscal policies and to the sustainability of public finances.[2] In this connection, the review is timely and necessary. Moreover, it should be an integral part of the ongoing deepening and strengthening of EMU. In particular, the proposals envisaged should be completed with other elements that help enhance fiscal policy design and coordination at the European level, such as the introduction of a central fiscal capacity that reinforces the stabilising role of fiscal policy.

2 For an exhaustive review see, inter alia Andrle, M., J. Bluedorn, L. Eyraud, T. Kinda, P. Koeva Brooks, G. Schwartz and A. Weber (2015) "Reforming Fiscal Governance in the European Union" IMF Staff Discussion Note 15/09, May; Banco de España (2017), Annual Report 2016, Chapter 4, "Fiscal policy in the euro area"; Kamps, C., N. Leiner-Killinger (2019) "Taking stock of the functioning of the EU fiscal rules and options for reform" ECB Occasional Paper, No. 231, August, and European Fiscal Board (2019), "Assessment of EU fiscal rules with a focus on the six and two-pack legislation", August.

Box 4

THE REFORM OF THE FISCAL SURVEILLANCE FRAMEWORK IN EUROPE (cont'd)

Chart 1
COMPLIANCE WITH DEFICIT AND DEBT RULES (a)

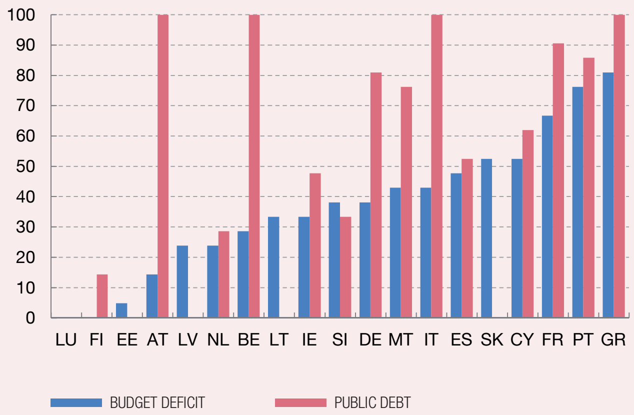


Chart 2
STRUCTURAL BALANCE AND OUTPUT GAP IN EURO AREA COUNTRIES (b)

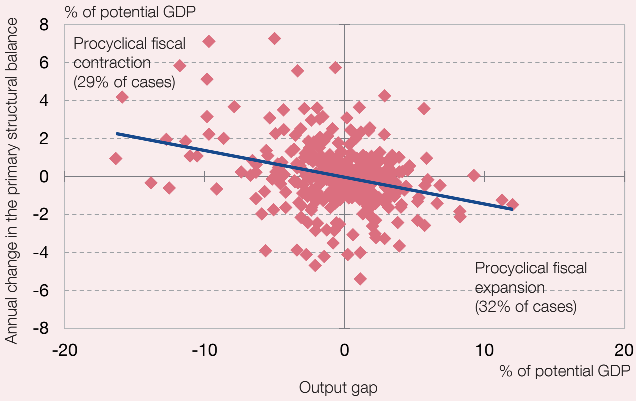


Chart 3
DEBT AND STRUCTURAL BALANCE IN EURO AREA COUNTRIES
2021. Commission forecasts

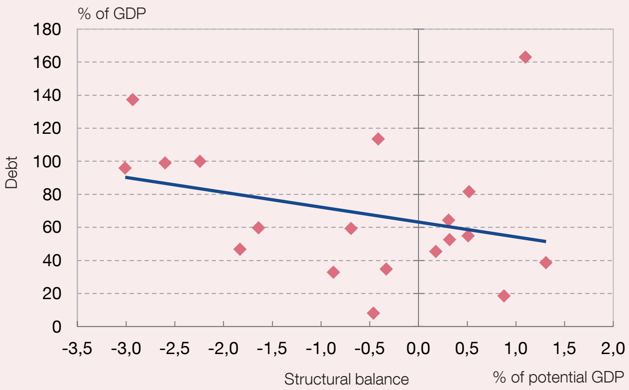
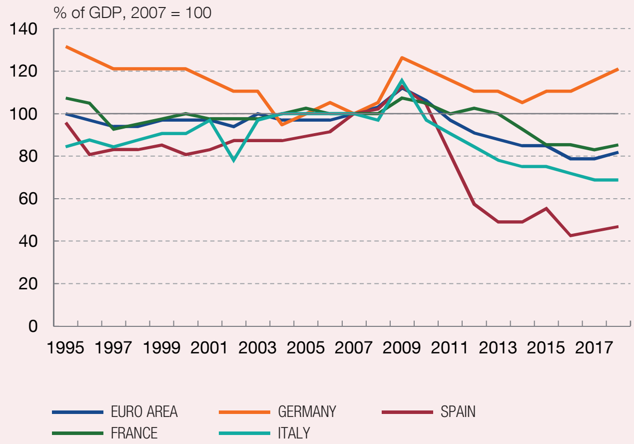


Chart 4
PUBLIC INVESTMENT



SOURCES: European Commission and Eurostat.

a Percentage (%) of years between 1999 and 2019 in which budget deficits exceeded 3% of GDP and public debt exceeded 60% of GDP.
b The scatter plot contains values of variables between 1999 and 2018.