

Proposals to reform fiscal rules in the Eurozone

A joint statement of the French and German Economic Councils

Proposals to reform the Eurozone are on the agenda again. The French Council of Economic Analysis and the German Council of Economic Experts welcome this renewed interest by governments. The fiscal framework of the Eurozone has, however, so far not been at the core of the political discussions. Members of both Councils have just independently published two proposals for ambitious reforms of the European fiscal rules¹. Their main results were presented and discussed at a workshop at Bruegel on September 12. While they are not identical, the two contributions converge on the need to markedly simplify the fiscal framework and to redesign fiscal rules with a focus on a public expenditure rule.

Our common starting point is that existing fiscal rules have failed on several dimensions: i) they are overly complex, non-transparent and prone to measurement errors; ii) many European countries have failed to reduce public debt levels suggesting that the rules were not stringent enough in good times; iii) they have generated pro-cyclical fiscal policy as governments did not leave enough space towards the limits set by the rules, such that in bad times, too many governments had to conduct a fiscal adjustment. We recognize that the reforms introduced after the Great Recession attempted to strengthen European fiscal rules and reduce their pro-cyclical nature but this was done at the cost of making fiscal rules non-transparent.

Without changing the treaty, both proposals recommend to reform the existing fiscal framework. A common element is an expenditure rule which follows one guiding principle: nominal expenditures should not grow faster than long-term nominal income. Moreover, they should grow at a slower pace in countries with excessive levels of debt. Although our proposals differ in some respects, in particular regarding the enforcement mechanisms and the detailed institutional framework, both consider this type of expenditure rule to have many advantages: i) it is simpler and more operational than the current rules; ii) it allows automatic stabilizers to work better (we also both propose to exclude parts of unemployment expenditures from the rule); iii) different countries can choose different levels of public spending since the rule tolerates discretionary changes in taxes as long as these are coherent with debt sustainability. We also both recommend to strengthen the independence of fiscal councils and their role as effective watchdogs.

We recommend that the fiscal framework should be at the core of the agenda of reforms for the Eurozone. We recognize that this is no easy task but we hope our proposals can help structure the discussions.

¹ French Council of Economic Analysis, European fiscal rules require a major overhaul, by Z. Darvas, Ph. Martin and X. Ragot. German Council of Economic Experts, Refocusing the European fiscal framework, by L.P. Feld, Ch.M. Schmidt, I. Schnabel and V. Wieland.