The fiscal responsibility pillar in AGS 2015

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Overview

- Definition of ‘fiscal responsibility’ in AGS 2015
- Critique I: fiscal consolidation as a policy priority in spite of evidence about its negative role in the current crisis
- Critique II: negligence of aggregate macroeconomic considerations esp. in EZ
- Policy implications

Fiscal responsibiltiy: AGS2015 definition

- ‘The **growth in government debt must be reversed**[1] **in the years to come** in line with the Member States’ obligations under the Stability and Growth Pact**’**
- Combination of responsible fiscal policies **and** economic growth:
  - First, the **pace of fiscal adjustment should be differentiated according to the fiscal challenges** faced by different Member States.
  - Second, the **composition** of fiscal strategies needs to be designed in a growth-friendly manner: expenditure cuts vs. tax hikes; investment vs. consumption spending

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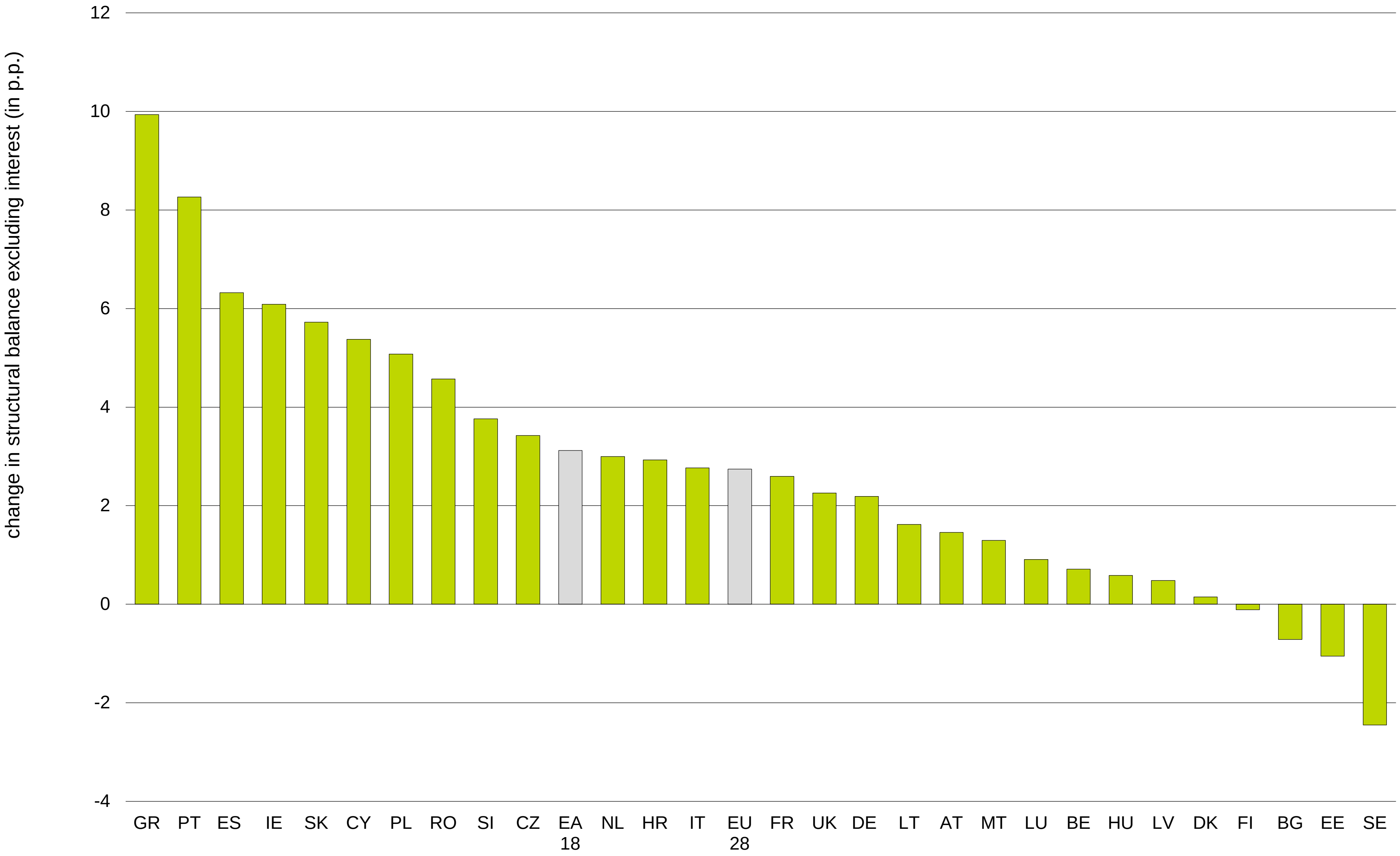
Fiscal responsibility: misinterpreting the evidence?

- Reduction of public debt/GDP ratio through lower deficits/higher surpluses put on same (if not higher) priority and time-horizon as restoring recovery in output growth
- Yet, fiscal efforts since 2010 have been largely responsible for continued recession
- Study by Gechert et al. (2015) suggests that fiscal consolidation in Europe led to 7.7% lower GDP by 2013 compared to a baseline scenario
- Have not delivered lower spreads (ECB did from 2012 with OMT-'whatever it takes' statement)
- Have not reduced debt/GDP ratios

Figure 1.9. Fiscal policy stance in the EU, 2010-2014



Source: own calculations using AMECO data (UBLGBPS).

Evolution of fiscal austerity in the EU and EA18, 2010-2016 (f)

Source: AMECO (series: UBLGBPS)

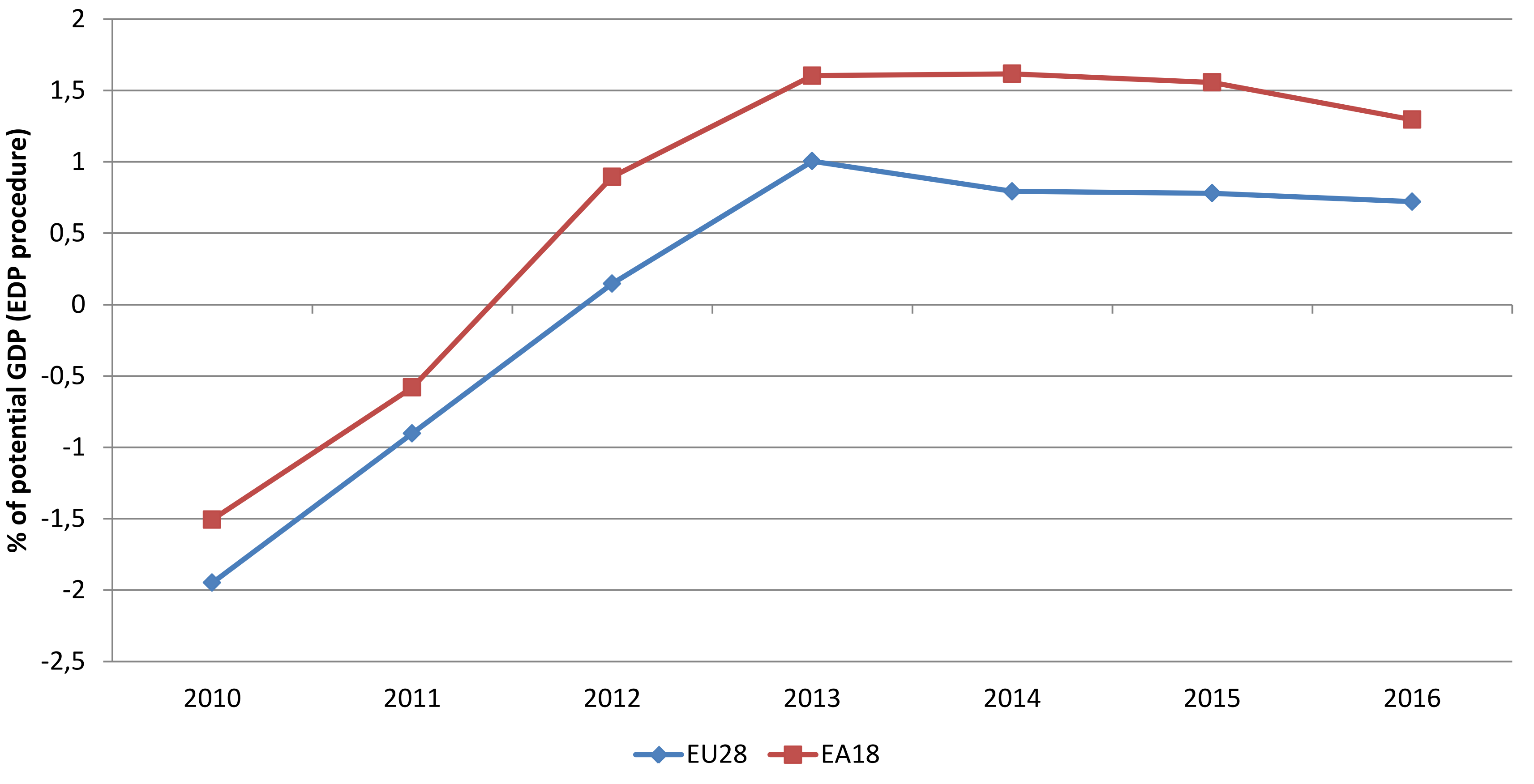
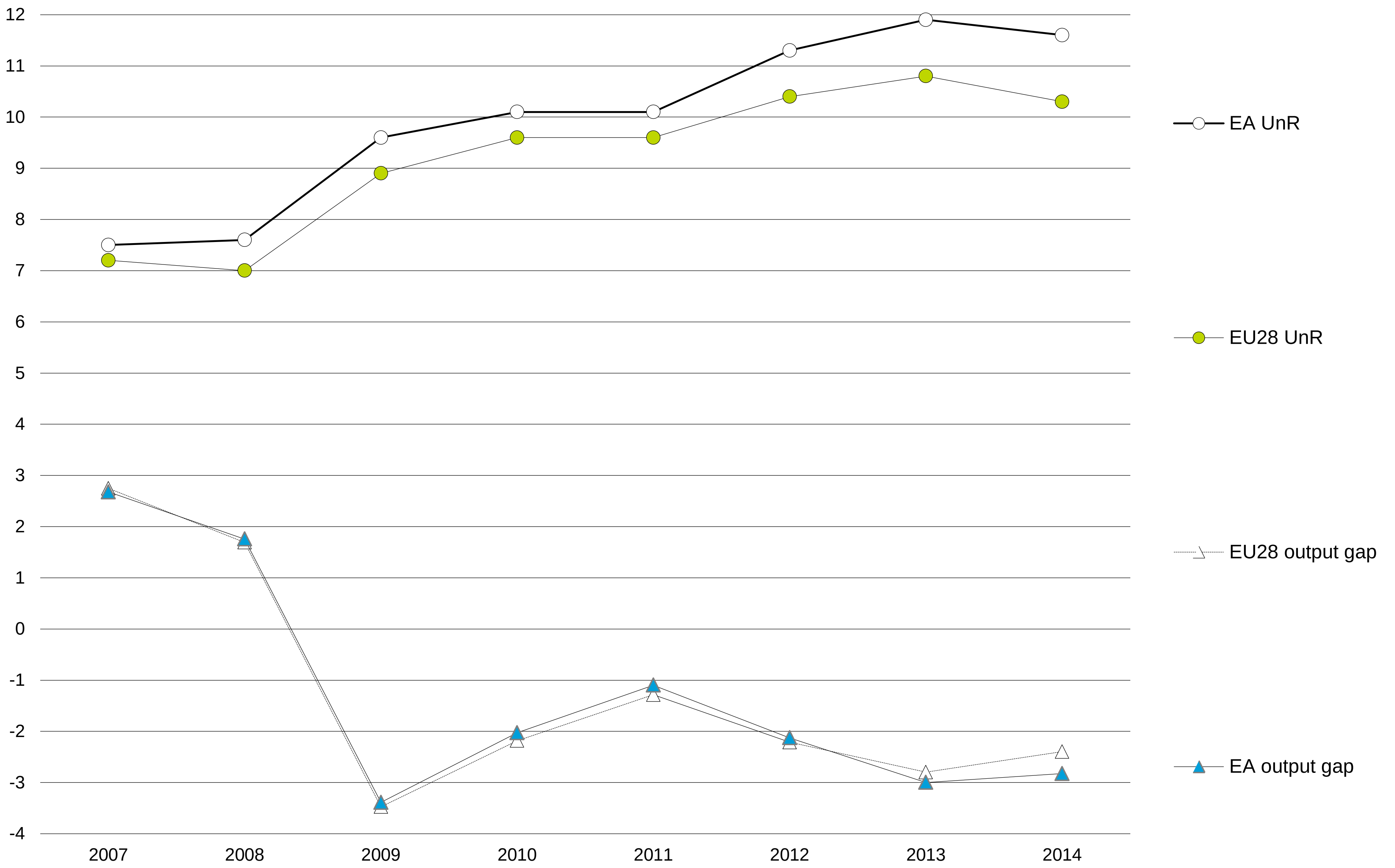
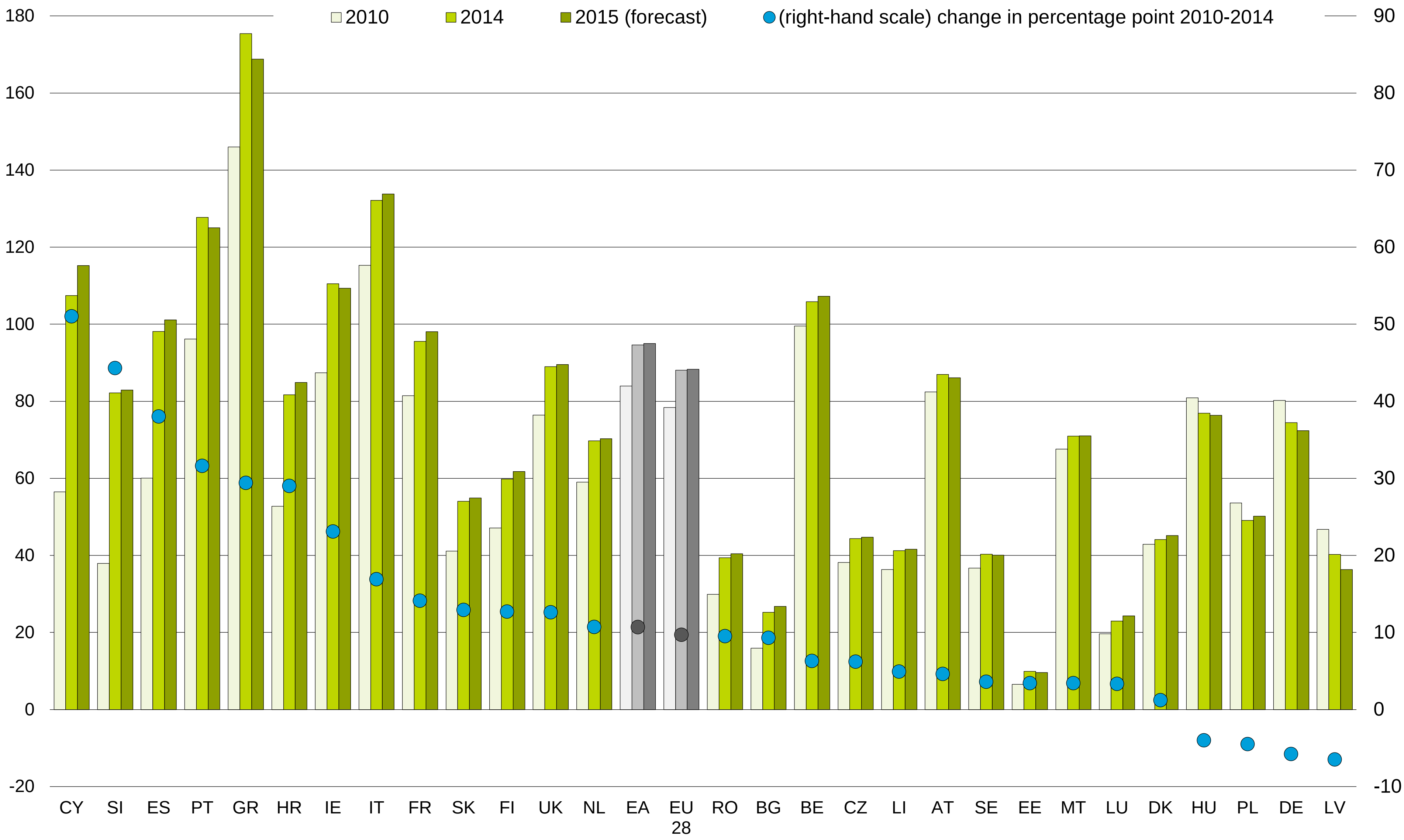


Figure 2.3. Unemployment rate and output gap in the EU28 and EA



Source: AMECO, ZUTN, AVGDGP.

Figure 1.5. Gross public debt/GDP ratios, 2010-2015 in the EU



Source: own calculations using AMECO data (UDGG).

Gross public debt/GDP ratios (%), EU, 2010, 2012, 2014

(Source: AMECO(series: UDGG))

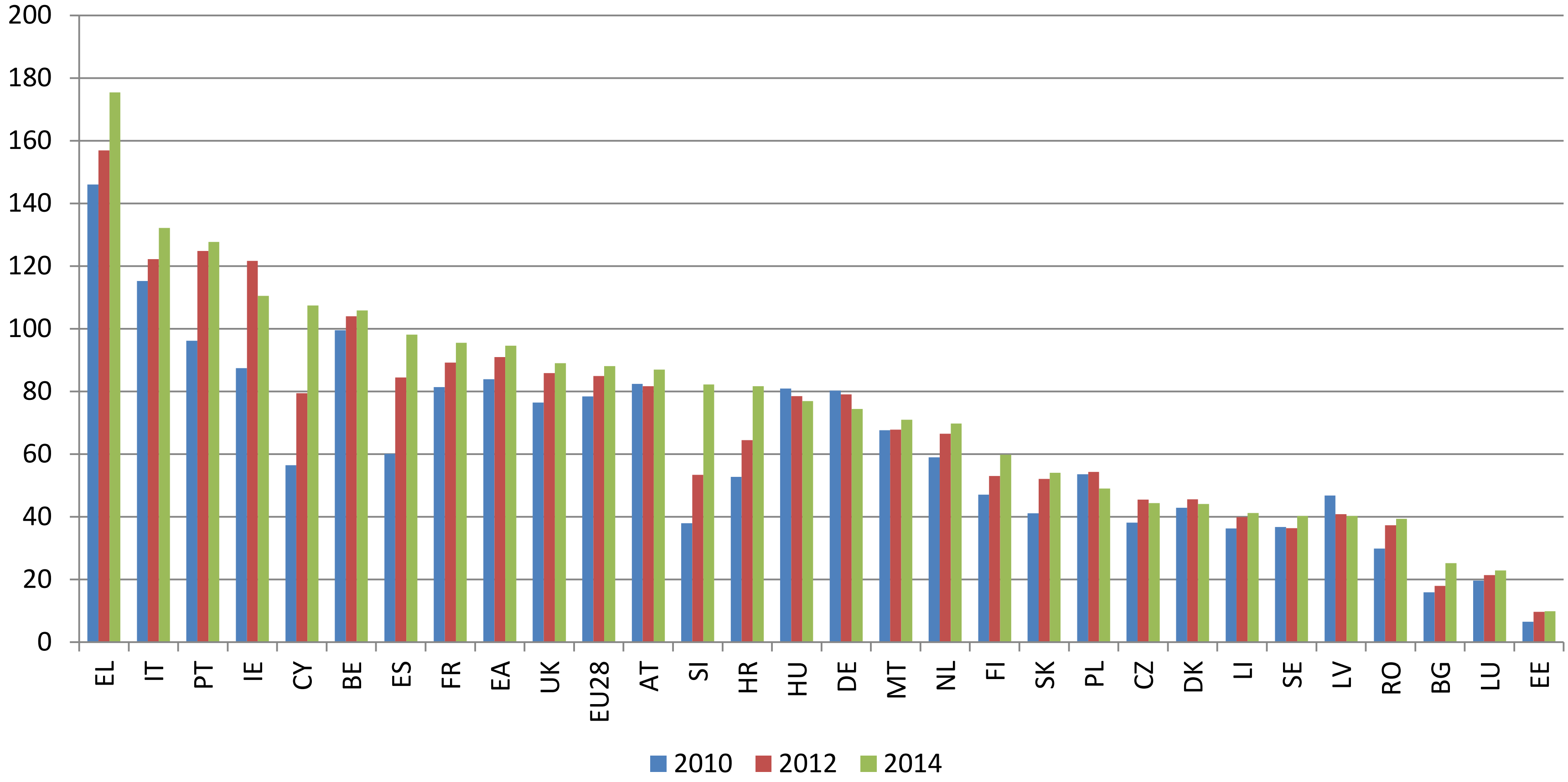
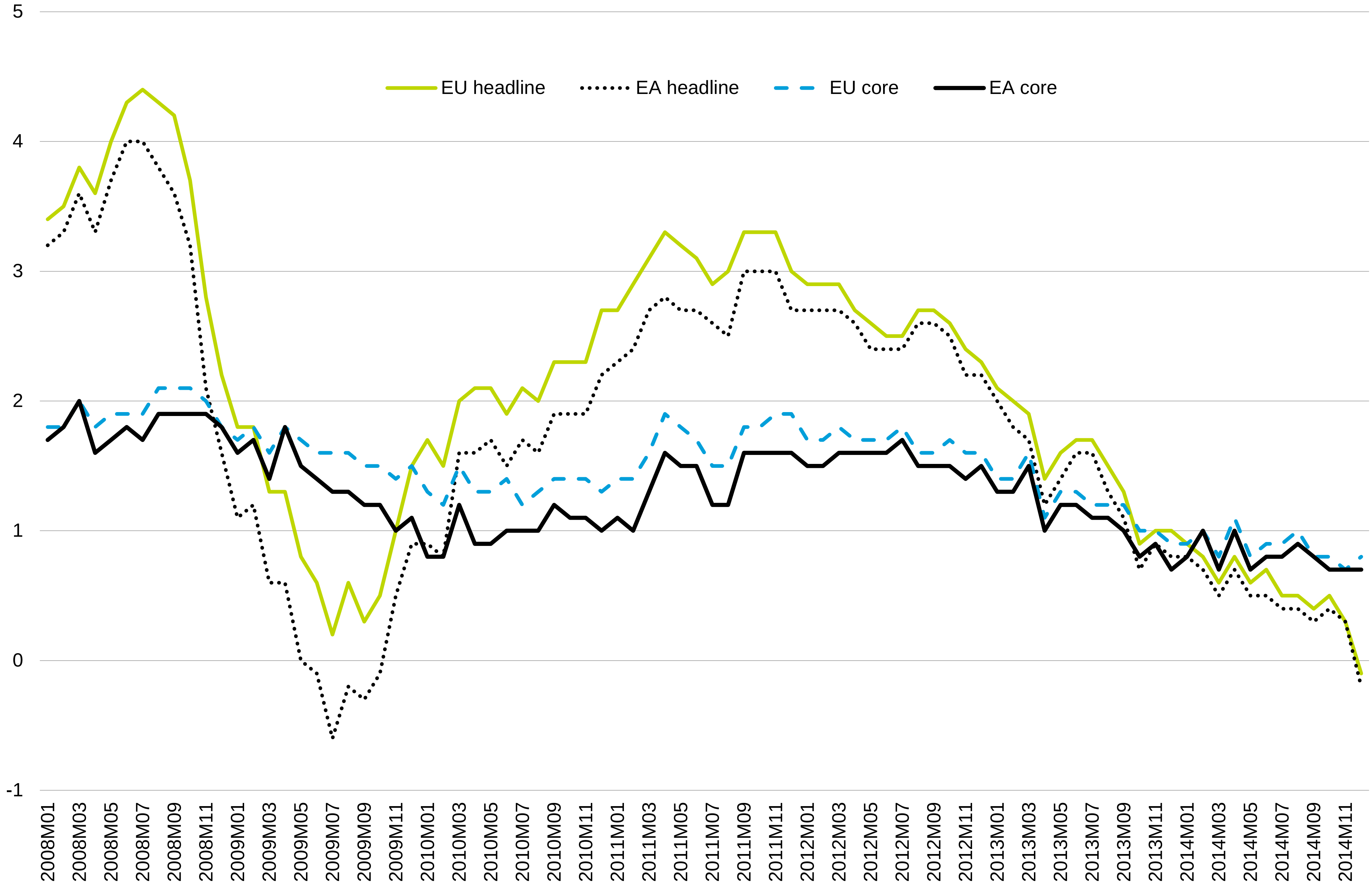


Figure 1.6. Headline and core inflation rates, EU and euro area, 2008 MO1-2014 MO12



Source: Eurostat (prc_hicp_manr).

Fiscal responsibility: neglecting the big picture

- Aggregate fiscal stance and broader macroeconomic conditions largely neglected fiscal responsibilty among objectives
- Very low inflation/deflation and virtually zero nominal interest rates due to prolonged weak demand→ monetary policy not much traction-uncertain QE effects
- Under current circumstances: fiscal policy is The tool to stabilise EU/EZ economy
- Yet, average EU and esp. EZ fiscal stance still too tight given output gap,
- Rules do not force some member states to run more expansionary fiscal policy with same rigour as they enforce fiscal consolidation on others

Policy implications

- In the absence of federal fiscal policy, some fiscal rules are necessary in the EU
- In the medium-to-long term the most effective way for ensuring sustainable public finances is output growth, not fiscal austerity, esp. when the latter undermines the former
- The content and interpretation/implementation of the rules should allow not only for national adjustments to shocks but also **enforce national stances** that deliver an appropriate ***aggregate*** fiscal stance in the EZ/EU, esp. when it comes to running larger deficits/smaller surpluses
- With interest rates at virtually zero, a negative output gap and the economy at the brink of deflation, fiscal policy is the main tool that can effectively restart the EU/EZ economy and it should be allowed to do so.

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