



# **Fiscal policy in EMU: an evolving view**

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# Outline

- 1. Key changes of EMU's fiscal architecture since the crisis**
- 2. What is still missing to ensure a viable fiscal framework for the euro area?**
- 3. Concluding remarks**

## Fiscal policy in EMU: an evolving view

**Conventional view  
on fiscal policies in  
EMU – pre crisis**



**"Put own house  
in order..."**

- Rules to tame deficit bias in absence of national exchange rate policy
- Automatic stabilisers: let them play
- Risk of debt monetisation dominates monetary-fiscal relations
- Low spillovers because of offsetting monetary policy reaction
- Negative coordination suffices

**Revising the role of  
fiscal policy in EMU  
– post crisis**



**"...and strengthen  
the joint  
foundation"**

- Discretionary fiscal policy needed in case of large shocks
- High multipliers and spillovers when monetary policy is constrained
- Aggregate fiscal stance and differentiated fiscal space matter
- Sovereign-banks nexus
- Institutions vs. rules vs. markets
- Links fiscal policies/ structural reforms
- Difficult to sanction sovereign states

# Institutional changes in EMU since 2011

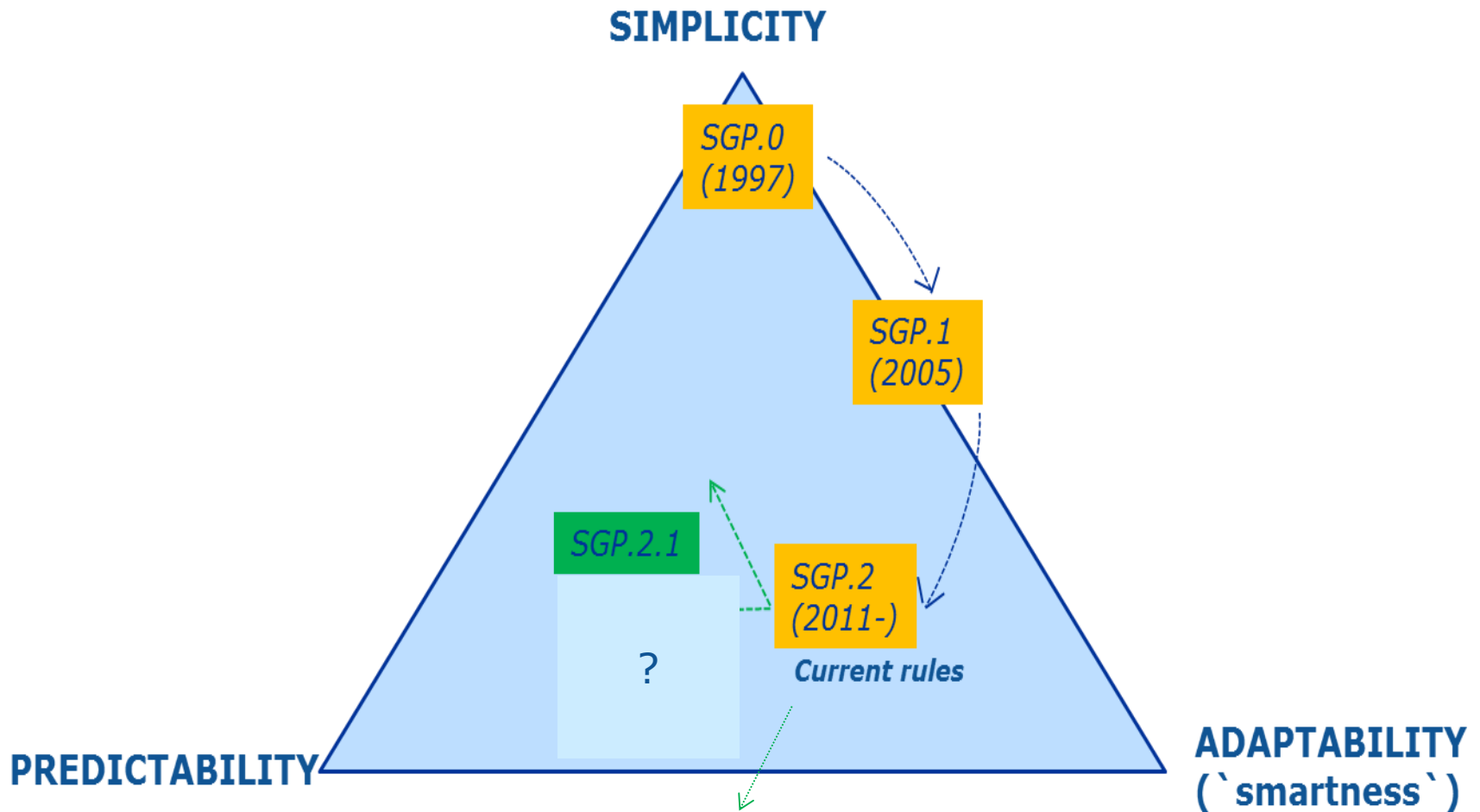
Challenge	Measure taken to address the challenge	Measure in greater detail	Application
Conventional view on fiscal policies in EMU – pre-crisis	<b>Stronger SGP</b>	<ul style="list-style-type: none"> <li>• Introduction of expenditure rule, debt benchmark (<i>6-P</i>) and balanced budget rule (<i>TSCG</i>)</li> <li>• Possibility of imposing earlier/more gradual sanctions (<i>6-P</i>)</li> <li>• Surveillance of DBPs (<i>2-P</i>)</li> </ul>	✓
	<b>National fiscal frameworks</b>	<ul style="list-style-type: none"> <li>• Mandatory min. requirements at the national level) (<i>6-P</i>)</li> </ul>	✓
	<b>Macro surveillance</b>	<ul style="list-style-type: none"> <li>• Prevention/correction of macroeconomic imbalances via the introduction of the new Macroeconomic Imbalance Procedure (<i>MIP</i>) (<i>6-P</i>)</li> </ul>	being implemented
Revising the role of fiscal policy in EMU – post-crisis	<b>Crisis resolution mechanism</b>	<ul style="list-style-type: none"> <li>• European Stability Mechanism (<i>ESM</i>)</li> </ul>	✓
	<b>Better articulation of fiscal rules</b>	<ul style="list-style-type: none"> <li>• More flexibility in applying the rules</li> <li>• Euro area fiscal stance</li> </ul>	✓
	<b>Breaking sovereign/banks nexus</b>	<ul style="list-style-type: none"> <li>• Banking Union</li> <li>• Capital Markets Union</li> </ul>	to be completed

*Note: Key reforms steps taken in the area of fiscal and macroeconomic policies are shown in italics in brackets, namely 6-Pack (6-P), Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), 2-Pack (2-P).*

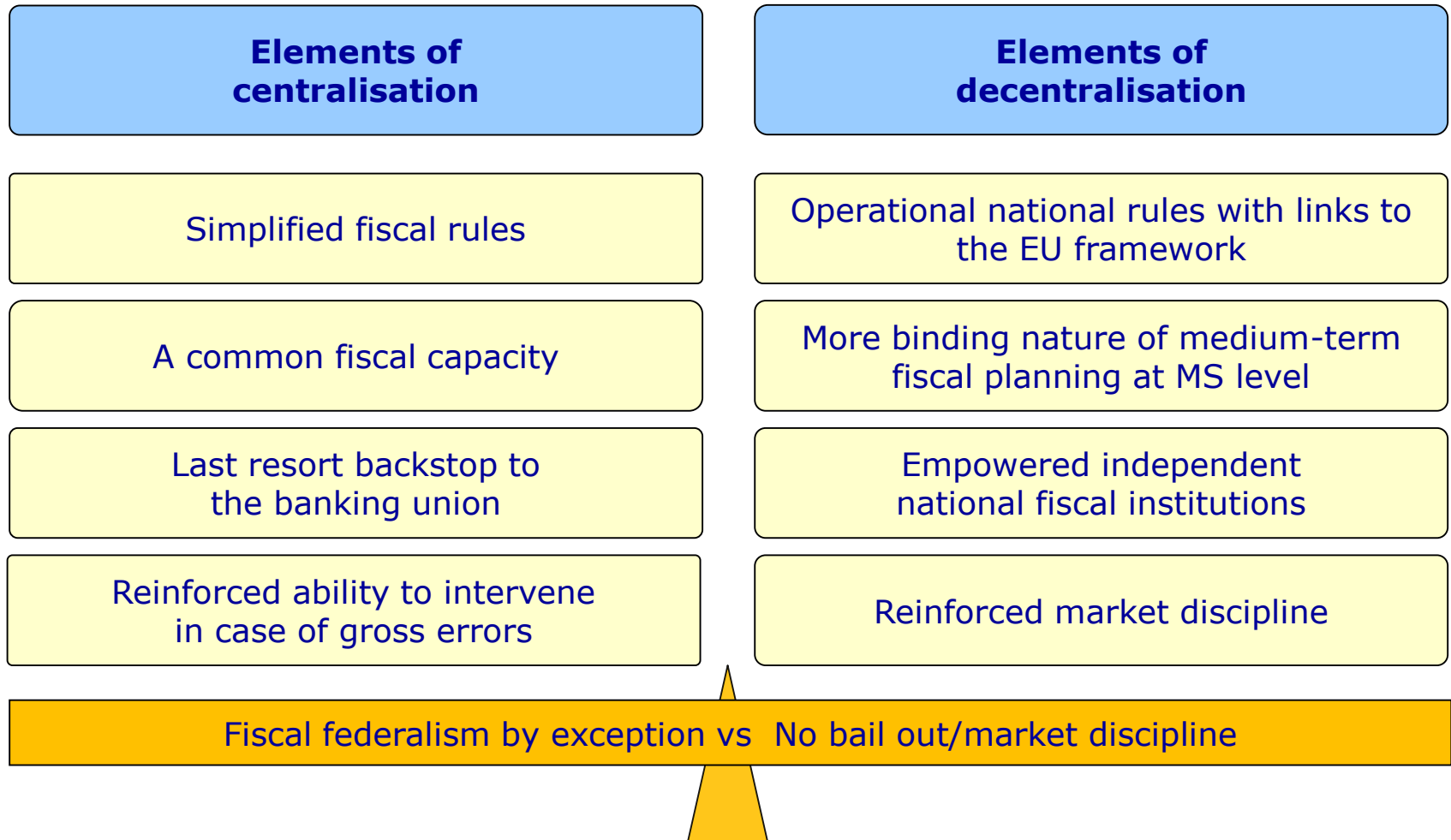
## Remaining vulnerabilities

- ***Have the financial sovereign doom loops been sufficiently severed?***
    - Banking union not completed yet
    - Exposure of national financial sectors to sovereigns remains high
  - ***Will the revised governance framework be effectively implemented?***
    - Limits to the application of rules/peer pressure on democratically elected governments
  - ***Has EMU the capacity to withstand the next large shock?***
    - ESM remains entirely dependent on national Treasuries and slow decision-making
    - No tool for smoothing asymmetric shocks and managing the euro area fiscal stance when needed
  - ***Is the appropriate fiscal stance at the EA level being achieved?***
    - Bottom-up coordination does not work
- ***Sustaining euro area falls too much on the shoulders of the ECB***
- ***Missing piece: minimum fiscal capacity to secure macroeconomic and financial stability***

## Inherent trade-offs in design of a fiscal framework



# Which future? Searching for the right balance



→ Essential to conceive the different elements of the framework together

## Conclusions

- The crisis revealed fault lines in original EMU design and steps have been taken to breach those
- The present set-up remains vulnerable to shocks and leaves too heavy responsibilities on the ECB
- Find right balance between EU and national levels, and between rules, institutions and market discipline
- Reforms have to pass the political, economic and market stability test: sequencing is key
- EMU package in December



**Thank you very much for your attention**