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SUERF 60

The European Money and Finance Forum

Monetary policy in uncertain times: Towards robustness and resilience

What to expect from new EU fiscal rules? What role for central bank fiscal backstops?

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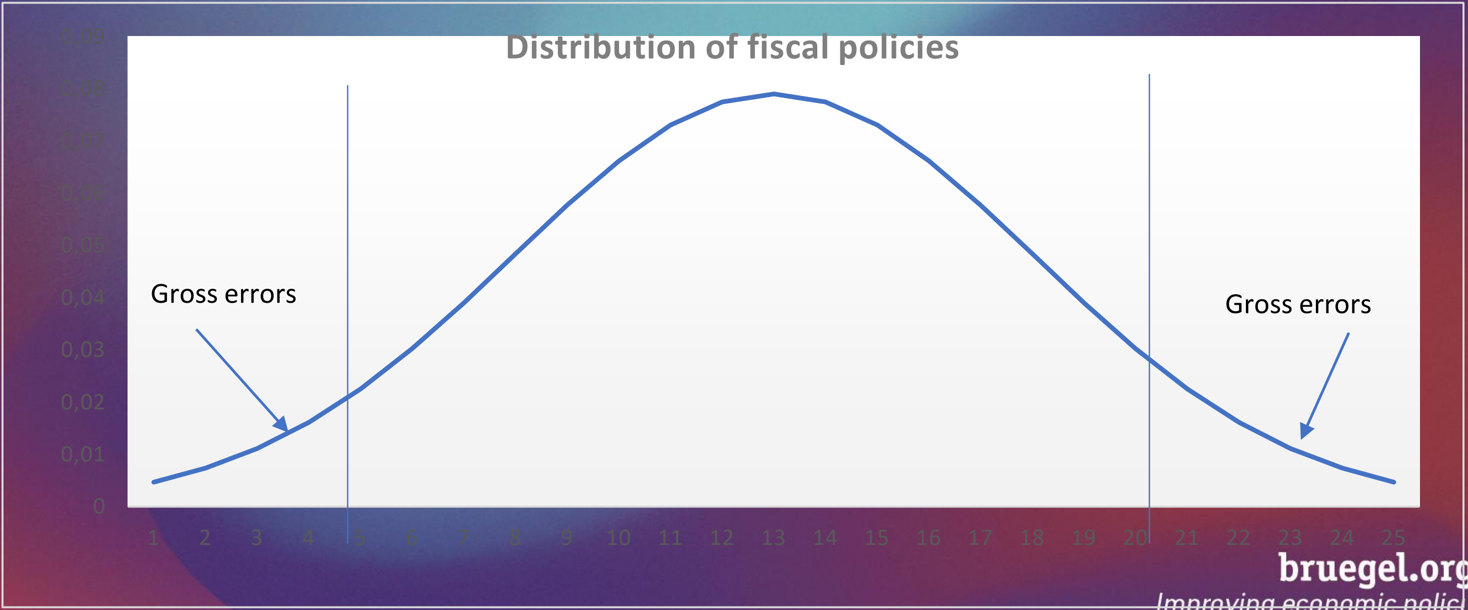
The borders of my presentation

- Central banks as fiscal backstops, not fiscal backstops for money losing central banks

- I will not deal with the optimal fiscal policy
  - Anticyclical function of fiscal policy,
  - Provision of EU public goods.
  - Help from fiscal policy for controlling inflation

- New SGP as proposed by the EU Commission

Distribution of fiscal policies GSP thinning the tails?



The contents of my presentation

I. ECB acting as fiscal backstops.
II. Mitigation: Will the new GSP lessen the risk that the ECB must backstop fiscal policy?
III. Adaptation: Will the new GSP help the ECB provide a backstop in case of crises?
IV. Conclusions

I. Central banks acting as fiscal backstops

- Is it undesirable yet inevitable? History so far and statute prescriptions (Italy, Spain, Portugal, Greece, Ireland, Cyprus)
- Is central bank backstopping tantamount to fiscal dominance?
- Multiple equilibria justification, but no excuse for backstopping
- Diamond and Dybvig pricing of central bank backstops
- Insurance analogy? Macroeconomic conditionality. Can apply deductibles?
- Progression in support of sovereigns: calibrating PEPP, TPI, OMT?

II. MITIGATION: Will the new GSP lessen the risk that the ECB must backstop fiscal policy?

- Will the new GSP reduce the risk of unsustainable government debt? Avoid Gross Policy Errors, which clearly includes unsustainable debt. Avoid putting the ECB in dilemma situations: financial instability (sudden stops) vs. price stability.
- Reduce the risk of fiscal dominance. EU Commission: “The operation of credible fiscal rules and surveillance of risks to macro-financial stability will also help the ECB attain its goals, particularly as it faces the challenge of delivering on its mandate to maintain price stability while avoiding financial fragmentation in the euro area. “

Favourable elements

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- Differentiation between High, medium and low sustainability risk.
- Intertemporal approach, not instantaneous. Projections of public debt.
- Adjustment path in terms of net primary expenditure. Plausibly and continuously declining path.
- More role for discretion, no illusion for a complete contract.
- National ownership.
- Good connection to growth through reform and investment.
- Connection to Macroeconomic Imbalances Procedure

Yet, doubts

- Difficulty is implementation.
- Especially agreeing on “universal” DSA methodology
- Lack of trust. German counter proposal on a mechanical rule, possibly superseding the DSA based method.

Other issues

- Consistency between mandated 0.5% fiscal adjustment, if 3 and 60% limits are not respected, and multiyear fiscal plans
- Role of the EU Commission.
- Possible role of national fiscal policy councils and of EFB

III. ADAPTATION: Will the new GSP help the ECB provide backstop in case of crises?

- Will the new GSP help designing conditionality in case of back stopping? TPI-OMT.
- Will the new GSP increase incentives to comply with the plans? Clear exclusion from central bank backstopping (TPI criterion).
- Will the new GSP reinforce the role of Commission and of the Council in designing conditionality needed for ECB backstopping?
- Connection with MIP

IV. Conclusions

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- A new GSP designed around the lines proposed by the EU Commission has the potential to mitigate the risk that the ECB will again be forced to act as fiscal backstop.

- The new GSP can also help manage the ECB backstop when this would, unfortunately, be needed again.

- Implementation is the weak point of the GSP and the underlying problem is the lack of trust among member countries.

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