Benoît Cœuré: The importance of independent fiscal councils

Opening remarks by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the workshop on "Fiscal councils, central banks and sound public finances", Frankfurt am Main, 27 January 2016.

*   *   *

Summary

Setting the stage for a workshop at the ECB on fiscal councils, central banks and sound public finances, Benoît Cœuré underlines in his opening remarks that sound public finances in all euro area member countries is a precondition for completing Economic and Monetary Union. Even if these days "there is no appetite for moving towards a 'United States of Europe'", he says, "there is a common understanding" that euro area member countries need to further integrate their fiscal and economic policies. Benoît Cœuré focuses on the requirements that need to be met for national fiscal councils and the European Fiscal Board (EFB) to be fully effective. "Independence" is the key word at both national and European levels. The EFB is also charged with the important task of coordinating fiscal policy in the euro area to avoid pro-cyclical fiscal policies. "At this juncture using fiscal space would speed up the euro area's return to growth and support the ECB's objective of medium-term price stability", says Benoît Cœuré. "But, in many countries, such fiscal space simply does not exist, because rules have not been enforced in the past. Setting up independent institutions such as the fiscal councils at the national level and the EFB at the European level could prove to be a decisive step in this direction."

* * *

Dear guests from the Network of EU Independent Fiscal Institutions,

Dear colleagues from the European System of Central Banks,

Ladies and gentlemen,[1]

It is a great pleasure for me to open this high-level workshop.

The European sovereign debt crisis has reminded us painfully that sound public finances in *all* euro area Member States are an indispensable prerequisite for the smooth functioning of the European monetary union.

This has, of course, been well understood for a long time. For example, the Delors Report of 1989 stressed that "uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the Community."[2]

To address these concerns the Maastricht Treaty introduced a number of safeguards: the no-bail-out clause, the excessive deficit procedure and the monetary-financing prohibition. Yet, for well-known political reasons, the Maastricht Treaty stopped short of assigning responsibility for fiscal and economic policies to the central level. Member States retained responsibility for these policy fields. At the same time, the Treaty called on governments to treat such policies as a matter of common concern. It also entrusted the task of ensuring appropriate coordination of national policies to the European Commission.

---

1 I would like to thank Maximilian Freier for his assistance in preparing this remark. All views expressed herein remain mine.

2 Delors, Jacques (1989), *Report on Economic and Monetary Union in the European Community*, Committee for the Study of Economic and Monetary Union, April.

In the monetary field, a new, fully independent body was created, namely the European Central Bank. The responsibility for the conduct of euro area monetary policy was delegated to the ECB's Governing Council. At the same time the independence of national central banks was strengthened considerably in many countries. The institutional set-up for monetary policy was thus starkly different from that for fiscal and economic policies.

The crisis exposed the flaws in the set-up governing fiscal and economic policies. Over the past six years there have been numerous initiatives to rethink the fiscal and economic governance framework. The political reality is that there is no appetite for moving towards a "United States of Europe", as foreseen by Victor Hugo and Winston Churchill, and envisaged by Jean Monnet at the beginning of the 1950s, when the precursor of the European Commission was created (the High Authority of the European Coal and Steel Community).[3] However, there is a common understanding that euro area Member States need to further integrate their fiscal and economic policies if the euro area and its member countries are to prosper in the future. This point is made forcefully in the Five Presidents' Report which was published in June last year.[4]

The Five Presidents' Report proposed a multi-stage process towards genuine Economic and Monetary Union (EMU). The first step is to revive economic convergence among Member States. This requires Member States to put their public finances on a sound footing. It also requires Member States to undertake the necessary structural reforms to strengthen their growth potential and resilience to shocks. Making determined progress in these fields is an economic and political precondition for moving on to the second stage, for which a joint shock-absorption mechanism could be envisaged.[5]

In this respect, I am convinced that national independent fiscal institutions and the European Fiscal Board can make decisive contributions to the success of stage one when it comes to ensuring responsible fiscal policies.

Of course, there are important differences between monetary and fiscal policies in terms of the potential for delegation to technocrats. Monetary policy is a technical task aimed at minimising market distortions and undesirable economic fluctuations. In order to overcome commitment problems, central banks were made independent and provided with a price stability mandate.

By contrast, fiscal policy has strong allocation and redistribution dimensions, which need to reflect national political preferences. Accordingly, fiscal policy has remained the innate prerogative of democratically elected governments. This is supported by the findings of the political-economy literature, which points to the need for limits on the delegation of these policies to independent experts.[6] Proposals have been made to set up independent fiscal agencies with a clearly defined and limited role, such as deciding on the overall fiscal balance, and then leaving it to the political system to decide on taxes and expenditures[7], but they have not gained much traction.

---

3 See Monnet, Jean (1952), "The United States of Europe", in *The United States of Europe has begun: The European Coal and Steel Community – Speeches and Addresses 1952–1954*, pp. 58–60.

4 See Juncker, Jean-Claude, Tusk, Donald, Dijsselbloem, Jeroen, Draghi, Mario and Schulz, Martin (2015), *The Five Presidents' Report: Completing Europe's Economic and Monetary Union*, June.

5 On convergence in the euro area, see Cœuré, Benoît (2016), *Rebalancing in the euro area: are we nearly there yet?,* speech at the Danish Economic Society, Kolding, 15 January.

6 Alesina, Alberto and Tabellini, Guido (2007), "Bureaucrats or Politicians? Part I: A Single Policy Task", *American Economic Review*, Vol. 97(1), pp. 169–179; and Maskin, Eric and Tirole, Jean (2004), "The Politician and the Judge: Accountability in Government", *American Economic Review*, Vol. 94(4), pp. 1034–1054. Both papers point to the conclusion that, albeit technical, fiscal policies are intrinsically redistributive and should therefore be made by elected representatives.

7 Wyplosz, Charles (2005), "Fiscal Policy: Institutions versus Rules", *National Institute Economic Review*, Vol. 191(1), January, pp. 64–78.

In any case, there is general agreement that independent fiscal councils can play an important role in overcoming the commitment problems which often prevent governments from pursuing sound fiscal policies in a time-consistent manner.[8] Importantly, this argument holds true both when the commitment problems arise from policy rules and when they result from discretionary decisions. Therefore, fiscal councils are likely to play a key role in any evolution in the institutional set-up of the euro area, including moving from rules-based to institutions-based fiscal decision-making.

In the remainder of my remarks, I would like to focus on the general requirements that need to be met for national fiscal councils and the European Fiscal Board to be fully effective.

The key role of national independent fiscal institutions

The European Union fiscal governance framework was strengthened with the “six-pack” and the “two-pack” legislation. The two-pack introduced a requirement for euro area countries to set up an independent body, such as a fiscal council, that is responsible for monitoring compliance with numerical fiscal rules. Moreover, it also required that macroeconomic projections should be produced or endorsed by an independent body.

In doing so, fiscal councils can ensure transparency on rules and their implementation. Moreover, fiscal councils can foster national ownership of the governance framework and increase the reputational cost to governments when they violate the fiscal rules.[9] Unfortunately, regulation that is jointly agreed at the European level is often portrayed as having been imposed by “Brussels”. Members of national fiscal councils – particularly if they build up a good reputation – can counter this argument by explaining the economic virtues of a stability-oriented fiscal policy framework.

To effectively deliver on their tasks, fiscal councils need to build and maintain strong institutional credibility. This requires insulation from political interference, and it is here that the experience of independent central banks can provide important lessons.

First, similar to central banks, fiscal councils require institutional independence. That is, they should have a legal identity which is separate from other bodies of government. At the same time, it should be ensured that fiscal councils have broad and timely access to information, particularly detailed budgetary data.

Second, fiscal councils should be functionally independent. They should be free to choose how to assess and communicate on fiscal policies. Importantly, fiscal councils need to be able to communicate publically in order to effectively mobilise public opinion and, if necessary, to counteract political incentives for unsound fiscal policies.

Third, decision-makers in national fiscal councils require personal independence. They should be appointed on the basis of their professional qualifications for a fixed term. They should be relieved of their duties only in exceptional circumstances, for example if they no longer fulfil the conditions required for the performance of their duties or if they have been found guilty of serious misconduct.

Fourth, fiscal councils require financial independence. That is, they require sufficient resources to deliver on their mandate. To this end, the financing of independent fiscal institutions should be outside of the government’s immediate discretion. They could, for example, be funded directly by parliament rather than from the government budget.

---

8 Calmfors, Lars (2015), “The Roles of Fiscal Rules, Fiscal Councils, and Fiscal Union in EU Integration”, in Harald Badinger and Volker Nitsch (eds.), *The Routledge Handbook of the Economics of European Integration*, Routledge.

9 See Calmfors (2015), op. cit.

Evidence suggests that, where these principles of independence are met, fiscal councils can improve budgetary discipline.[10]

Complementing national independent fiscal institutions with the European Fiscal Board

Ensuring sound public finances in Europe will also require changes to the EU's fiscal governance framework. European legislators should make it a priority to reduce the excessive complexity of the rules. A lack of transparency can make fiscal rules appear arbitrary and undermine their legitimacy. A review of the fiscal rules should add clarity and facilitate the assessment of compliance with them, while preserving their stability-oriented nature. The International Monetary Fund has made such proposals in the past.[11] The European Commission has announced that it will come up with proposals to simplify the framework soon.[12]

It can be argued that complexity results from a lack of trust in the institutions in charge of enforcing the rules, preventing full delegation and making it necessary to write an all-encompassing contract that covers all possible states of the world. The institutional set-up therefore needs to be strengthened.

In October last year the European Commission published a decision setting up a European Fiscal Board (EFB).[13] In line with the recommendations of the Five Presidents' Report, the EFB should provide an independent assessment of the Commission and the Council's application of the Stability and Growth Pact. While the European Commission should continue to enforce these rules, it should provide a justification where it deviates from the views of the EFB. This will help to increase the transparency and consistency of fiscal surveillance at the European level.

Beyond fiscal surveillance, the EFB can also play an important role in fiscal policy coordination in the euro area. The sum of national budget balances should lead to an appropriate fiscal stance at the level of the euro area as a whole. While effectively steering the euro area's fiscal stance will be challenging as long as there is no central fiscal capacity, coordinating national fiscal policies is key to avoiding pro-cyclical fiscal policies and facilitating the smooth functioning of EMU.

When defining the role of the EFB, we have to acknowledge that there may be a trade-off between the breadth of its mandate and the effectiveness of its actions. This should be taken into account when thinking about the allocation of tasks between the EFB and national fiscal councils.

You will have the opportunity for an in-depth discussion on the EFB's set-up and its mandate in one of the sessions. In my view, the following questions are of particular interest: Is the EFB sufficiently independent to fulfil its tasks? Are there conflicts between the main elements of the

---

10 See ECB (2014), "Fiscal councils in EU countries", Box 8 in the *Monthly Bulletin*, June, pp. 96–100; Nerlich, Carolin and Reuter, Wolf Heinrich (2013), "The design of national fiscal frameworks and their budgetary impact", *ECB Working Paper Series*, No 1588; Debrun, Xavier, Hauner, David and Kumar, Manmohan S. (2009), "Independent Fiscal Agencies", *Journal of Economic Surveys*, Vol. 23(1), pp. 44–81; and ECB (2009), "Experience with government debt reduction in euro area countries", Box 10 in the *Monthly Bulletin*, September, pp. 84–86.

11 Andrle, Michal, Bluedorn, John, Eyraud, Luc, Kinda, Tidiane, Brooks, Petya Koeva, Schwartz, Gerd and Weber, Anke (2015), "Reforming Fiscal Governance in the European Union", *IMF Staff Discussion Note*, SDN/15/09.

12 See European Commission (2015), *On steps towards Completing Economic and Monetary Union*, COM(2015) 600 final, 21 October.

13 See Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board, OJ L 282, 28.10.2015, p. 37–40.

EFB's mandate? How can we ensure that the EFB complements and reinforces the role of national independent fiscal institutions?

Overall, we are all hoping that the European Fiscal Board will contribute to better compliance with the common fiscal rules, a more informed public debate and stronger coordination of national fiscal policies.

To achieve these objectives, the EFB should not fall short of the principles established in the context of the creation of independent fiscal councils at the national level. Looking ahead the mandate and institutional independence of the EFB should be clarified and strengthened to ensure that it can play a key role in increasing transparency and improving compliance with the fiscal rules.[14]

Conclusions and outlook

Let me conclude.

I have argued that, in the light of the European sovereign debt crisis and persistent sustainability concerns, it is more important than ever to make a credible commitment to stability-oriented fiscal policies. This is a necessary condition for fiscal policy to be in a position to support and complement the ECB's monetary policy.[15] We can see today how much a lack of compliance with the rules has hampered the euro area's ability to deliver an efficient macroeconomic policy stance. At this juncture using fiscal space would speed up the euro area's return to growth and support the ECB's objective of medium-term price stability. But, in many countries, such fiscal space simply does not exist, because rules have not been enforced in the past. Setting up independent institutions such as the fiscal councils at the national level and the EFB at the European level could prove to be a decisive step in this direction. While achieving credibly sustainable public finances is an important goal in itself, it is also the precondition for completing EMU.

In today's workshop, you will discuss in much more detail some of the critical issues that I touched upon in my opening remarks: Where do we stand with the establishment of independent fiscal institutions in European countries? What experience do we have in terms of the effectiveness of fiscal councils in European countries? How should fiscal rules be designed in order to make them transparent and enforceable? How should the responsibility for fiscal policies be divided between the national and the European levels?

I am looking forward to hearing some fruitful discussion. Thank you very much for your attention.

---

[14] See ECB (2015), "The creation of a European Fiscal Board", Box 5 in the *Economic Bulletin*, Issue 7, pp. 28–31.

[15] See Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board, OJ L 282, 28.10.2015, p. 37–40.