

Inflationary Effects of Fiscal Policy: The Role of European Fiscal Rules

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- 1. The rational behind European fiscal rules**
- 2. Comparing Covid crisis and financial crisis**
- 3. Fiscal governance**
- 4. Conclusions**

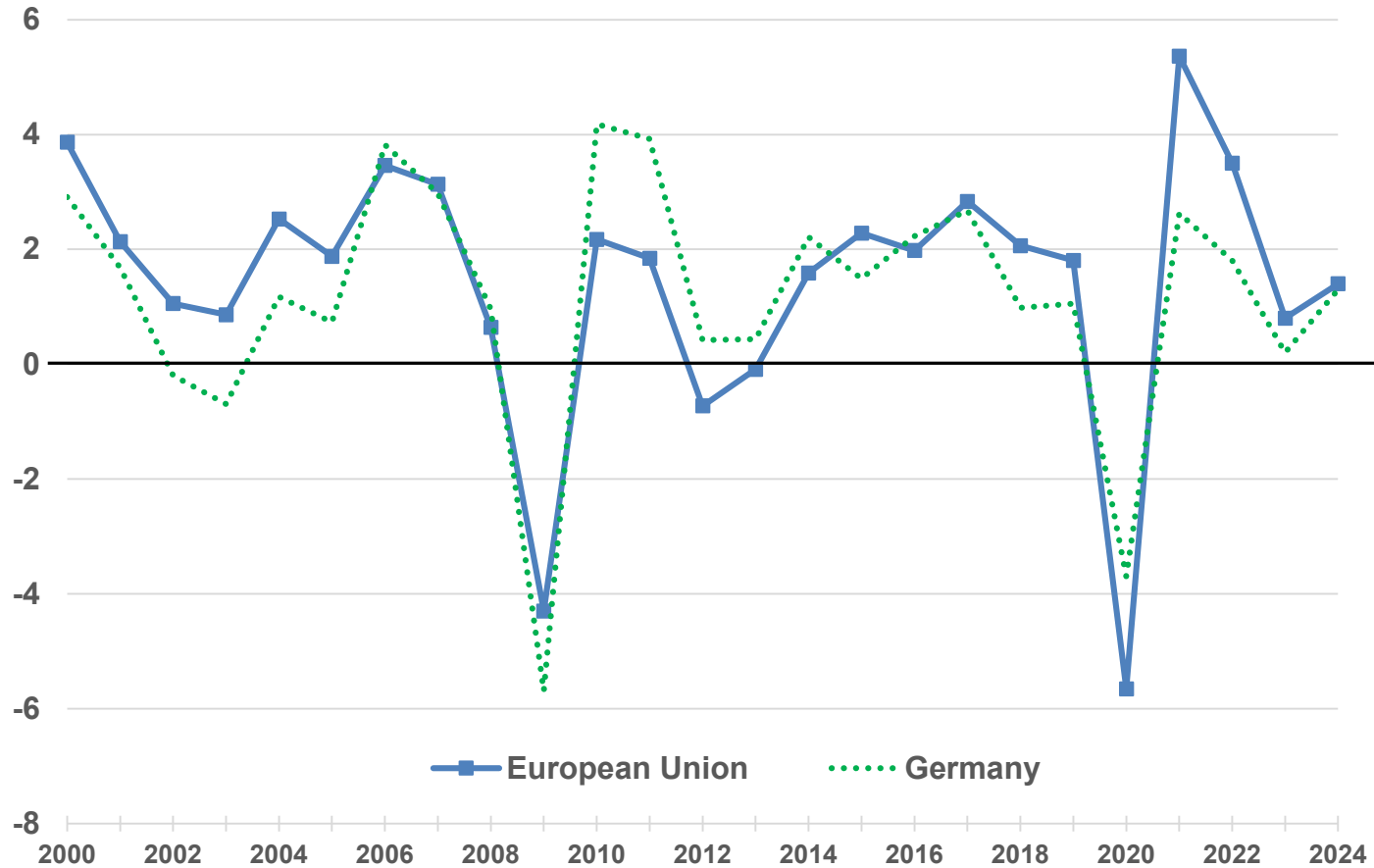
1. The rationale behind European fiscal rules

- Inflationary bias of decentralized fiscal policy in a monetary union
- Fiscal rules should overcome institutional “birth defect” of the Euro
- Design and enforcement has changed, MTO since 2007
- Monitoring takes account of macroeconomic conditions
- Major shocks: 2008/09 financial crisis and 2010/11 Covid crisis

2. Comparing Covid crisis and financial crisis

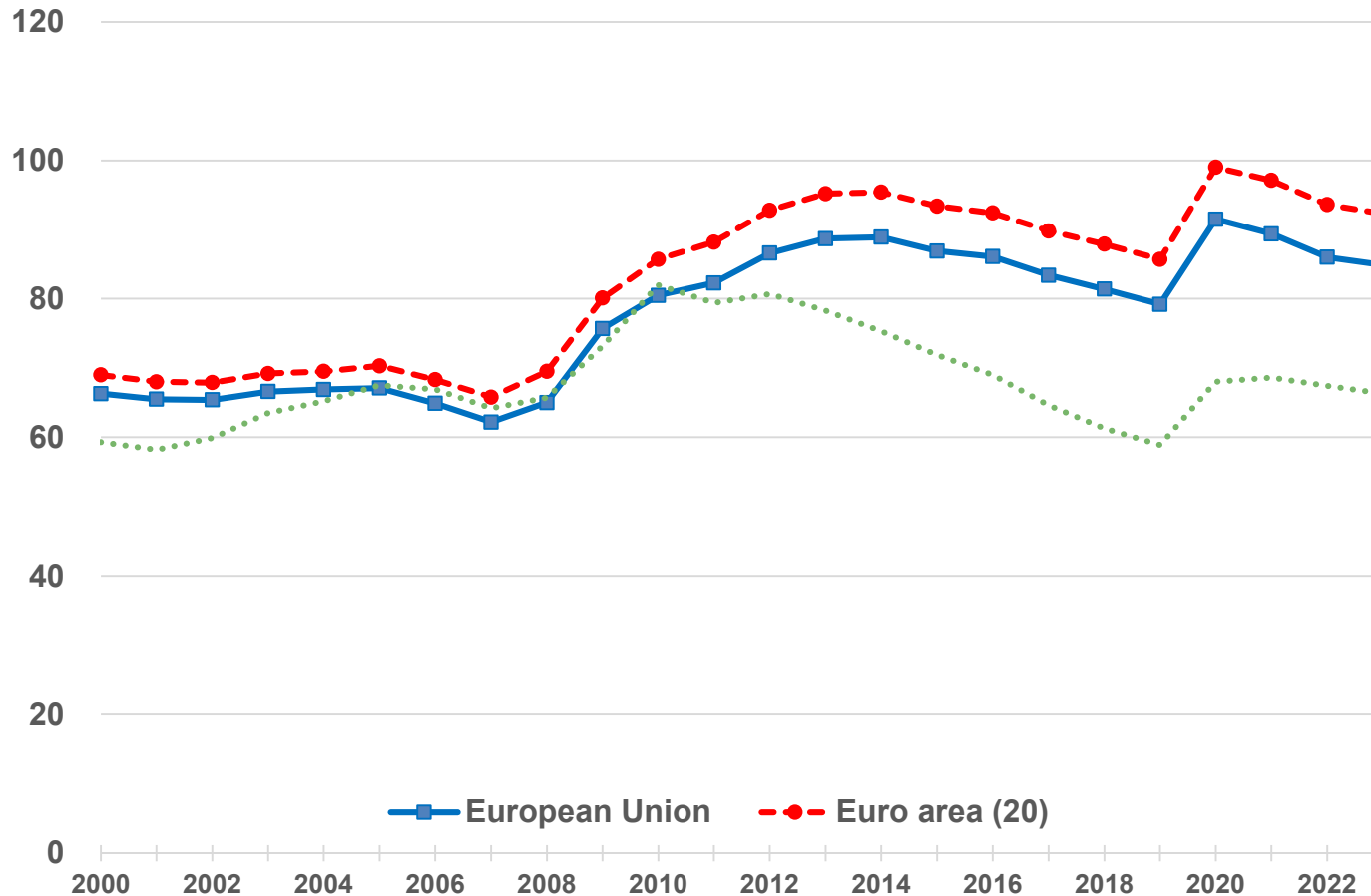
- Annual output shock: comparable magnitude
- Quicker return to normal after Covid crisis
- Differences in pre-shock public debt/GDP ratio
- Public sector deficits: comparable magnitude
- Rational for intervention differs: fiscal assistance vs. fiscal stimulus

economic growth (GDP, in %)



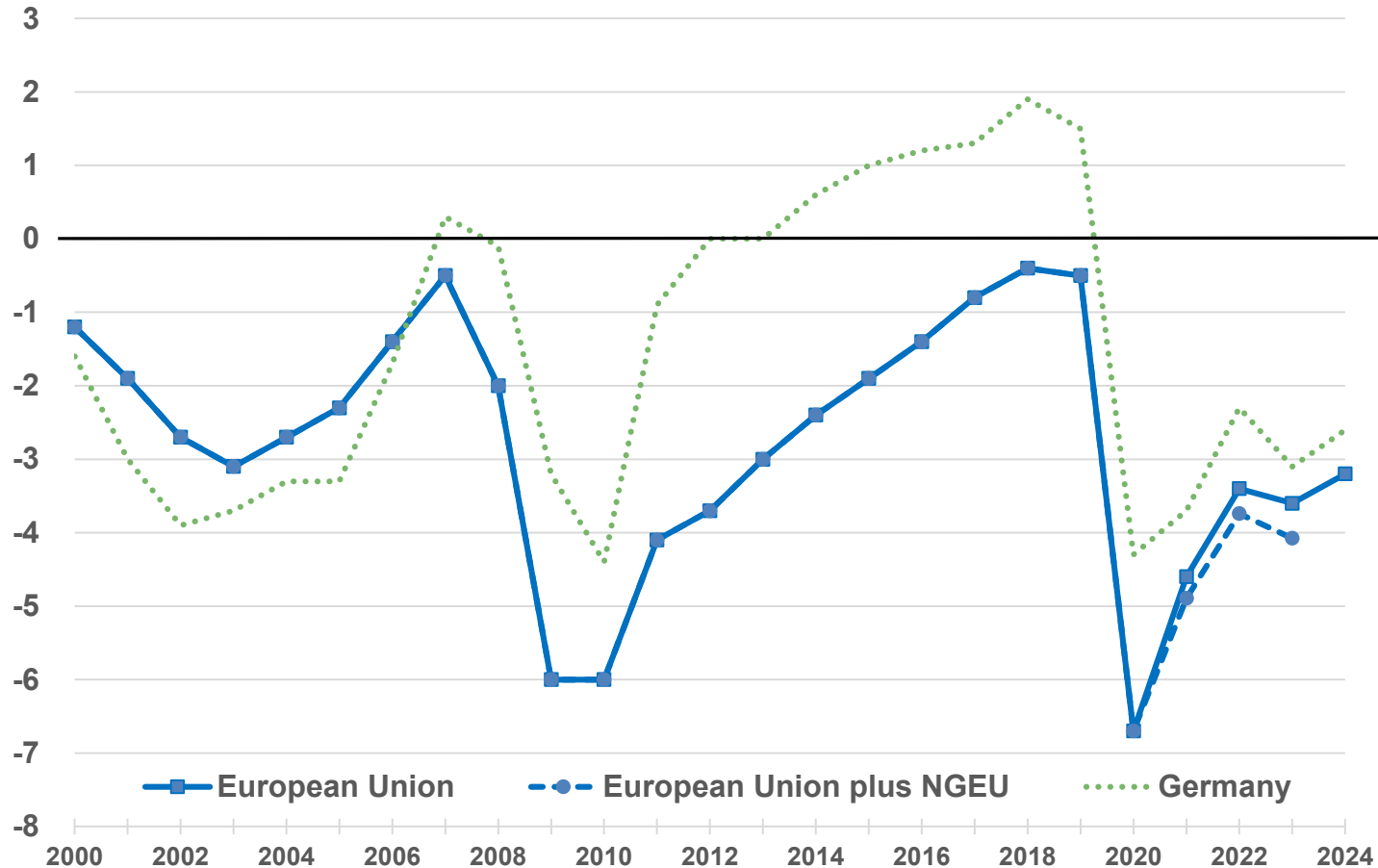
Sources: European
Commission's Ameco
Database, 2022-2024 EC's
Winter Forecast

debt/GDP ratio (in %)



Sources: European
Commission's Ameco
Database

net lending (in % of GDP)



Sources: European Commission's Ameco Database, 2022-2024 Autumn Forecast

Next Generation EU: Grant share (0.47) of disbursements based on the semi-annual reports on the execution of the Next Generation EU funding operations. For 2023 total disbursements are predicted at 160 billion, twice the amount planned for the first half of the year.

3. Fiscal governance: financial crisis

- Fiscal rules were applied country-by-country
- 20 of 27 states subjected to Excessive Deficit Procedures
- Start of consolidation requested immediately after recovery

3. Fiscal governance: Covid crisis

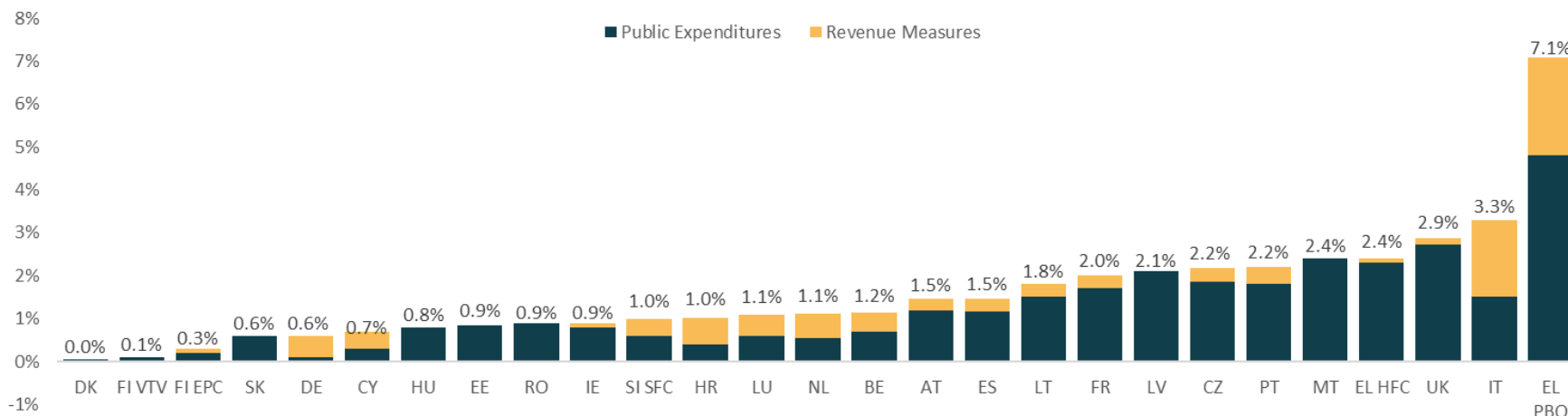
- General escape clause activated: „severe economic downturn“
- Temporary Covid measures included in structural deficit
- Pre-crisis non-compliance: tabula rasa (cf. EFB, 2020)
- Unconventional measures for relief and stimulus: SURE and NGEU

3. Fiscal governance: Covid crisis, cont.

- Given quick recovery, consolidation should have started 2022
- EU Commission suggested to keep escape clause activated until pre-crisis output was reached,
- in 2022, it used discretion to keep escape clause activated,
- linked de-activation of escape clause with own proposal for new fiscal rules, and
- suggested to base fiscal guidance for 2024 on the proposed rules.

3. Fiscal governance: energy crisis

- Escape clause still activated in 2022, when inflation jumped up
- Member states provide inflation relief: about 1% of GDP in 2022



Note: The total size of adopted fiscal measures in 2022 is shown. Fiscal stimulus is measured as a first-round effect in general government (ESA2010) terms. The figures for Ireland relate to Modified GNI rather than GDP. Source: The Network of EU Independent Fiscal Institutions, European Fiscal Monitor (2023).

4. Conclusions

- “Whatever it takes” attitude has compromised fiscal rules
- Quick return to rule-based fiscal policy would have reduced inflationary pressure
- *Swapping horses when crossing streams:*
when most needed, fiscal rules are in limbo
- Crisis mode helps to create fiscal leeway: a lesson for politicians?

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<https://www.publicfinance.rw.fau.eu/>

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