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## Fiscal Council consultation on fiscal rule changes

On 25 January 2022, the Fiscal Council held an internal consultation on aspects of fiscal rule changes. The consultation was attended by Matej Avbelj, Anže Burger, Jože P. Damijan, Igor Masten, Mojmir Mrak and Dušan Mramor. The participants presented differing views about the need to change existing fiscal rules and about the potential path to making these changes. The majority agreed that changes or at least minor adjustments to existing fiscal rules for economic or political reasons were likely needed.

This is consistent with the prevailing opinion taking shape on the basis of consultations initiated at various levels by the European Commission's relaunched review of the system of economic governance in the EU. The European Commission announced the publication of outlines for fiscal rule changes before the spring cycle of preparations of medium-term budget documents that will outline the path of public finance after the general escape clause ends at the end of 2022. Most participants agreed that, due to the complicated political decision-making process, a comprehensive reform of the economic governance system by the beginning of next year would not be possible and that only transitional provisions would likely enter into force. The participants highlighted the risk of any renewal of the general escape clause for fiscal sustainability on the one hand and the risk of re-implementing the current rules for post-epidemic recovery on the other.

Most participants believe that potential changes to fiscal rules would be sensible due to the extreme complexity of the system of rules currently in force and the changed macroeconomic environment that could dictate different numeric values from those laid down in the Protocol to the Treaty Establishing the European Community and due to the changed system of economic governance. The different macroeconomic environment refers both to the changed interest rate- GDP growth differential and to the significant differences in public debt levels in EU countries. Institutional framework changes have to do mainly with the introduction of the Recovery and Resilience Facility, which, according to most participants, shows traces of a common, EU-level fiscal capacity, and also relate to the active role of the ECB in crisis management. Regarding the latter, some participants called attention to the fiscal dominance of monetary policy. Given the extremely low interest rates, this was established by major purchases of government securities in secondary markets by the central bank, which greatly hinders the normalisation of monetary policy. In these circumstances, the normalisation of monetary policy and fiscal sustainability have even become conflicting objectives.

Any reform of fiscal rules should ensure the adequate balance between strictness and flexibility and reduce their complexity; furthermore, fiscal rules should be executable, i.e. legislation must provide for compliance. At the same time, fiscal rules should ensure the counter-cyclical nature of fiscal policy and the long-term sustainability of public finance, while taking care not to significantly compromise economic development, particularly when large public funds are supposedly needed to achieve the EU's development paradigms, e.g. the green transition and digital transformation. The incompatibility of the principles of executability, simplicity and flexibility has also given rise to calls for the transformation of numeric fiscal rules towards more broadly defined fiscal policy standards. Among other things, this would alter the supervisory aspect of fiscal rules as it would produce a shift from a commitment to implementation to a commitment to monitoring fiscal rules. In this regard, the majority of participants highlighted the risk for fiscal sustainability in the event of a transition to fiscal standards as, in most countries, existing rules are respected only to a limited extent.

A reform of fiscal rules is supposed to give a more prominent role to public debt as a target variable which, at the same time, reflects the long-term sustainability of public finance. Due to major differences between EU countries in terms of the initial value of this debt, various proposals have been put forward concerning the target value of this debt and the necessary speed of adjusting this value. In countries with an extremely high debt, strict adherence to the required dynamics of debt reduction according to the currently applicable parameters would require unrealistic fiscal policy adjustments. This has given rise to ideas about a differentiated debt reduction, according to which the part of the debt incurred during the last crisis should be reduced fast while the part of debt resulting from the co-financing of investments should be reduced more slowly. This approach has aroused major doubts as to whether it is possible to properly define the part of the debt to be reduced faster or slower. The discussion also brought up the risk of maintaining the current low interest rates in the long run.

The discussion frequently underlined the need for the changed fiscal rules not to hinder the development role of public investments. There were several mentions of the possibility of according special treatment to "green investments". The necessity of the significant extent of such investments would, among other things, limit the possibility of fiscal consolidation in the future. As a result, there have been ideas of excluding such investments from the fiscal rule system. The expected significant extent of such investments requires a suitable examination of the appropriateness of their contribution to the green transition and their impact on long-term economic growth and public finance together with the appropriate qualification of supervisory institutions for such examinations. Otherwise, this could lead to abuses ("fiscal greenwashing"), which have been known to occur in the financing of such investments. If "green investments" were excluded, this solution could also pose a risk to the principle of integrity of the normative regulation of fiscal rules.

Any changes to fiscal rules at the level of the EU will also have to be reflected in changes to the national Fiscal Rule Act. According to some participants, any changes should take into account that Slovenia, due to its small size and openness, is more readily exposed to financial markets in the case of softer fiscal rules. However, the debate also pointed out that any changes to national rules should not hinder long-term economic development.

Despite their differing views on potential changes to fiscal rules, the participants agreed that the management of public finance faces great challenges in the future. Overcoming these challenges in an appropriate manner will require seeking a fine balance between fiscal sustainability, supporting economic development and strengthening well-being and ensuring enough room for responding to shocks, particularly when it comes to countries with weaker macroeconomic management. This will also require replacing short-term actions with policies aimed at solving long-term challenges, including by expanding the space for new priorities, mainly by increasing the quality of public finance. In this regard, some participants expressed the need for strengthening the role of independent fiscal institutions at the European and national levels.