Conselho das Finanças Públicas

Session 2: Restoring fiscal sustainability

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Discussion on:

- **Ms. Lucie Villa**, Vice-President, Sovereign Risk Group, Moody’s
- **Mr. Martin Larch**, Head of Secretariat of the European Fiscal Board, European Commission

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Comments on:

Ms. Lucie Villa, Vice-President, Sovereign Risk Group, Moody's

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“Credit ratings are a measure of debt sustainability”

… which is a direct connection to IFIs mandates.

For example, CFP mandate includes “the analysis of public debt dynamics and its sustainability”

Rating agencies and IFIs analysis are of great mutual interest, and it is common for us to meet with them.

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What do we learn from rating agencies?

- An external view on the country's economy and public finances perspective
- Also, an important point of view concerning the general (world, European) economic outlook
- With a dynamic (time) and cross section (other countries) perspective
- Reports from rating agencies are an important data and information source and may provide some methodological inspiration
- Contact with them may limit some "own country bias" from our side

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Two questions:

- "higher interest rates"… higher nominal rates but lower real rates? Are not lower real interest rates a bonus for the government?
- Why should governments reduce their primary surpluses?

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Comments on:

Martin Larch

Fiscal sustainability in the EU:

Insights from the compliance tracker of the EFB secretariat

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Why EU fiscal rules?

- the need to avoid disproportionate use of Community savings by one country
- a possible bias towards lack of fiscal restraint

These were (very important) concerns when a single currency was adopted. The implied softening of the external constraint (e.g. the currency appreciation cost that may result from a fiscal expansion in a single country/single Money framework) had to be dealt with fiscal rules. Discipline imposed from the market was deemed as ineffective.

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Some other (historical, or political economy) reasons for adopting fiscal rules in EU:

- the initial differences in public debt levels
- different traditions across countries concerning fiscal discipline and the central bank independence

One perspective was probably not sufficiently emphasized:

- that "fiscal rules", or at least fiscal discipline and sustainability, are important for a country on its own sake.

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Tracking compliance

Compliance is quite low, especially in high debt countries.

It does not seem to have improved in the period 2008-2021

- is this because of covid?
- or other reasons…?

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False sense of safety in boom periods

The logic seems is the following:

better compliance ➡ more fiscal space ➡ fiscal policy less procyclical

no compliance ➡ no fiscal space ➡ procyclical fiscal policy

Again, some political economy considerations:

- The “procyclical fiscal policy disease”.
- In a downturn: austerity, government cuts spending, public investment, wages, taxes are increased. It probably loses the coming election.
- In a better time: people feel they have to be compensated by past suffering. Government increases spending and wages, taxes are decreased.

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Compliance in a reformed system

- The early view: Tie the hands of fiscal policy makers

A big problem to be solved in an international setting: Rules may be seen as external imposed and therefore as not democratic and not made in the country's interest. This gives rise to non-compliance and a rise of euroceptic views. It may be self defeating.

- Updated view: Hands of policy makers cannot be tied, but they need advice and ownership

It seems much better. It may be more realistic and work better. Rules have to be internalized, so it is felt that fiscal sustainability and the rules that ensure it are in the national interest, and do not come only as an external constraint.

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Updated view and IFIs

IFIs should play a very important role in this updated view. They are national, independent from government and EU institutions and designed with the fiscal sustainability purpose. They are a piece of paramount importance in what concerns increasing national ownership. They may provide invaluable insights into ageing, health and social care, public investment and the Green transition, the impact of defense expenditure and of higher interest rates.

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Thank you