

# Revisiting and revising subnational fiscal frameworks following the crisis: a discussion

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# Disclaimer

The opinions and views in this presentation are mine and do not necessarily reflect those of the National Bank of Belgium or the European Fiscal Board.

# The paper

- **A comprehensive overview:**
  - Current state of fiscal rules and challenges to their design and implementation.
  - Nicely documents recent trends and stylized facts.
  - Update evidence on effectiveness of fiscal rules.
- **Many parallels between rules at CG vs. SNG level**
- **My take:**
  - Some quite fundamental differences between FR applied to SNG vs. CG, that the paper brings out, but maybe not enough...
  - Cross-sectional heterogeneity is far greater for SNGs than for CGs → very hard to draw general guidance and produce a **mapping of feasible/desirable fiscal rules into the universe of SNGs.**
  - Emphasize a comparative analysis of compliance and actual enforcement actions at CG and SNG levels. Is compliance much stronger at SNG level? And why?

# Why fiscal rules at SNG level?

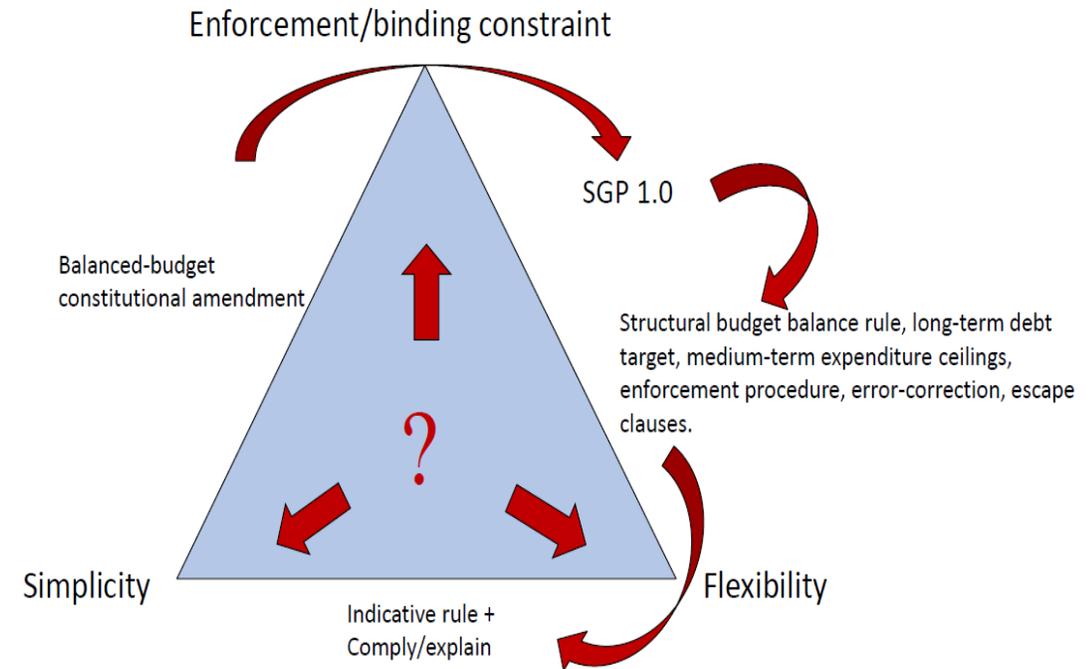
- **It's government...**
  - ...so same bias towards excessive debt and deficit.
  - In many cases, softer budget constraints and greater incentives to be irresponsible (e.g. some sort of bailout expected).
  - But: market discipline may be stronger IF credible no-bail out (BE, CH, US).
- **Beyond SNG financial responsibility, fiscal policy coordination needed :**
  - FR applying to the general government in place (EU) → need to share the effort.
  - Macro stabilization: FP plays a much bigger role now, but SNGs are not natural providers of macro stabilization (economies of scale: macro stab belongs to the center).
  - Pro-growth fiscal policy: depending on intergovernmental fiscal arrangements, SNGs must play their part in country-wide strategies (e.g. in BE, Regions are mostly in charge of public investment → key to NRRP success).

# SNGs are special in many ways → huge heterogeneity

- **Among such specificities**
  - Naturally less emphasis on macroeconomic stabilization (by institutional design and because the economic case is less clear).
  - Often less control over their own budget: mandates from the center, limits on own revenue sources,... (extreme example: FWB in Belgium). → Victims of flawed intergovernmental fiscal arrangements:
    - Vertical imbalances,
    - Unfunded mandates.
  - Greater risk of illiquidity/credit rationing.
  - Crisis management: Bailout or not ? (refers to type of fiscal federalism: cooperative vs. competitive)
- **Implications for fiscal rules? Rule selection/calibration/enforcement highly specific to each entity**
  - Specific mandates affects desirability of certain rules vs. others (e.g. golden rules).
  - Legal base, monitoring and enforcement procedure (role of central institutions—courts, MoF, IFI—and of market discipline—risk is monitored more seriously than for the sovereign).
  - Feasibility of certain rules (e.g. CAB unfeasible for most SNGs).
  - Ability to comply with a rule (echoes lack of control issue).

# FR for SNGs: let's keep it simple

- **Keep in mind what rules can do (discipline) and what they cannot do (pro-growth policies):**
  - FR should improve policies and as such serve all public finance objectives, but there is a **lexicographic** ordering here: financial responsibility comes first → this is what secures access to credit!
  - This will avoid replicating for SNGs, the mistakes made for CG and GG... remember the trilemma... but de-emphasize "flexibility."
- **Para 87 of the paper worries me** a bit when it talks about "ample room for improving" SNG fiscal rules by making them look more like CG or GG rules.



# The future

- **Think harder about tailoring** FR to SNG specificities, not just emulating what is done for the sovereign.
- **Remember that rules cannot make up for flawed fiscal federalism amendments.** Let unfunded mandates and vertical imbalances cause a fiscal crisis : *“Men only act in a state of necessity and usually only recognise necessity in a situation of **crisis**.”* (J. Monnet).
- **Challenges:**
  - The meaning of fiscal responsibility when  $r-g < 0$  (less relevant for most SNGs).
  - Find concrete ways to tame procyclicality (more likely when liquidity constraints or credit rationing is present).
  - Monitoring is key: often much less transparency at SN level.
- **A role for IFIs?** Yes but central ones (e.g. SP or BE).