

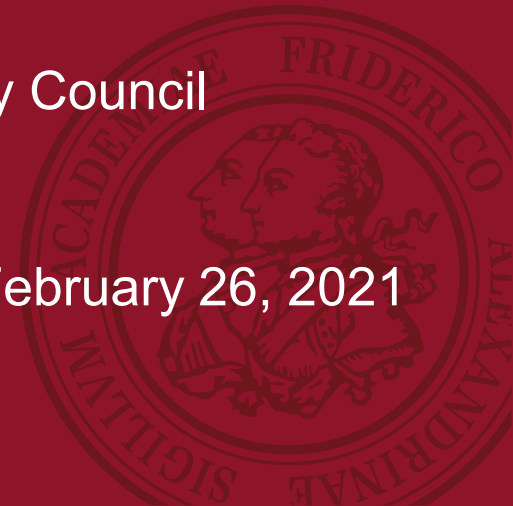
Public Debt Outlook in the EMU post-Covid

Discussion

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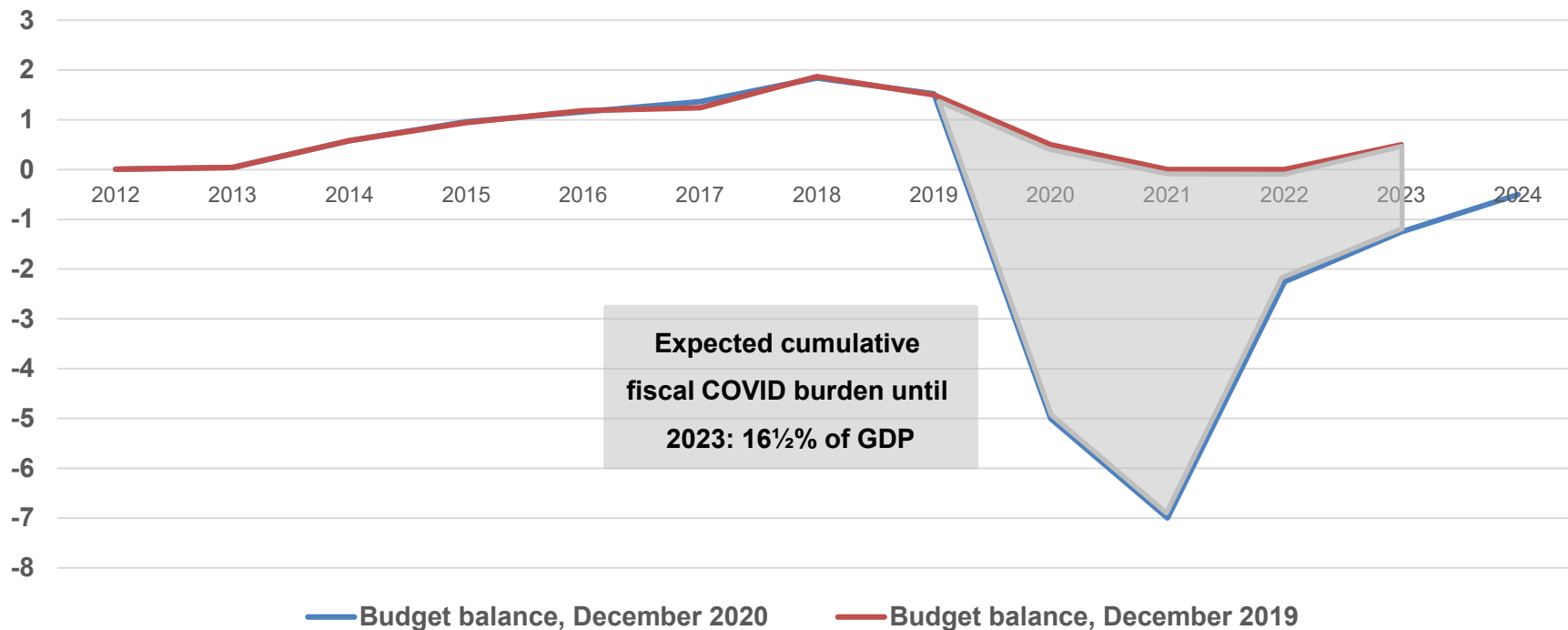
Agenda

- I. COVID as a fiscal challenge
- II. Public debt outlook
- III. How demanding are EU fiscal rules?
- IV. Relaxing the debt/GDP threshold?

I. COVID as a fiscal challenge

- Health policy is key
- Support of household incomes and business earnings
- Revenue shortfalls
- Temporary shock: once epidemic is contained, return to growth
- Uncertainty regarding length of period
- Optimal policy response involves tax smoothing

I. COVID as a fiscal challenge: Germany

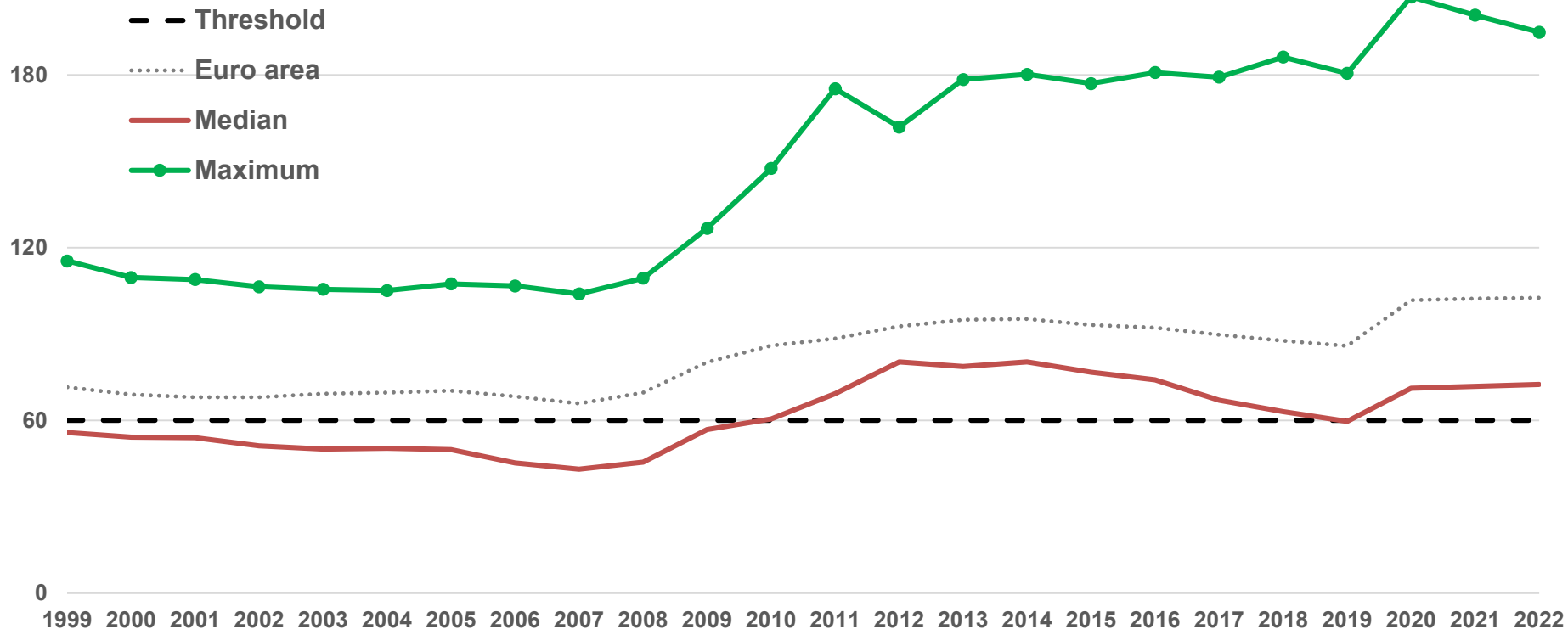


Source: Advisory Board of the Stability Council (2019, 2020)

II. Public debt outlook

- EU fiscal rules have not prevented tax smoothing.
- Debt/GDP will exceed 60% threshold in the majority of countries.

II. Public debt outlook: debt/GDP



Source: European Commission November 5, 2020/AMECO Database

II. Public debt outlook: legacy debt

- Median debt/GDP among EA-19 in 2019: 59.6%
- In 9 of 19 cases, COVID hit countries with debt exceeding 60%.
- Pre-COVID non-compliance with fiscal rules
(see also European Fiscal Board, 2020)

III. How demanding are EU fiscal rules?

- EDP unlikely triggered on basis of debt/GDP alone (e.g., Bundesbank, 2017; European Fiscal Board, 2020)
- When escape clause ends and MTO is not met, fiscal adjustment requirement is 0.5% of GDP.
- Ending of temporary COVID measures counts as adjustment.
- Fiscal support provided by EU:
Asymmetric distribution of NGEU and SURE helps adjustment in high-debt countries. Maximum of annual grants and guarantees under NGEU amounts to 3% of GNI among EMU countries (see Darvas, 2020).

IV. Relaxing the debt/GDP threshold?

- Fiscal rules *per se* are inefficient: nobody wants to optimize under restrictions.
- EU fiscal rules are a commitment device to address common-pool/free-rider problems of the monetary union (Beetsma and Uhlig, 1999; Chari and Kehoe, 2007).
- If rules are relaxed to accommodate non-compliance – by setting a higher threshold for debt/GDP or redefining debt – credibility/commitment is lost (finally).

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