Guest article

A New EU Economic Governance and Fiscal Framework: What Role for the National Independent Fiscal Institutions (IFIs)?

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Abstract[2]*: The European Commission's communication on orientations for a reform of the European Union's economic governance framework asks the European Fiscal Board (EFB) and national Independent Fiscal Institutions (IFIs) to play a more significant role in it. This vision has plenty of merit, but one needs to be careful in how to implement it. Structural reforms and public investment analysis demand an expertise hardly existing at the level of most national IFIs, and any involvement in policy design would make its assessment tricky when IFIs are part of the process: an inescapable conflict of interest would ensue. It could also be perceived as a technocratic encroachment on a democratic decision-making process. In order to play a more significant role in the EU economic governance framework, national IFIs need more resources according to the EU-wide acceptable standards of operation, and, first of all, they need to bolster their macroeconomic and debt sustainability analysis capabilities.*

Keywords*: debt sustainability, EU economic governance, fiscal rules, fiscal capacity, IFIs, investment, risk sharing, reforms, transparency.*

JEL codes: *E61, E62, F15, F33, F34, F36, H6, O52.*

Introduction

For more than a decade, an intense debate has been ongoing among experts and policy-makers on the need to overhaul the economic governance and the fiscal framework of the EU, with the euro area in focus primarily. More than anything else, the financial crisis has made obvious that the EU economic governance is suboptimal, that it is lacking key elements – although, this was, presumably, known from the very beginning of the euro area. As Otmar Issing, the first chief economist of the European Central Bank (ECB) often said, a monetary union cannot function properly by sitting on a single leg, its monetary policy. Fiscal rules and frameworks function at both the supranational and national levels, as the EU is a political and institutional construction

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among member states that maintain strong and broad sovereign prerogatives.

The European Commission (EC) encouraged the public debate on the reform of the EU economic governance framework, including its fiscal rules, and issued various documents to this end. The debate was relaunched in 2021, against the background of extraordinary, extreme events. The resurgence and persistence of high inflation and a consequent sharp tightening of monetary policies while public debts were already a major concern, make the reform of the EU's economic governance, of its fiscal framework, more salient and urgent. A recent EC document on this reform is *the Communication* of 9 November 2022, which was updated in early 2023[3].

This paper addresses the topic of the EU's economic governance framework (including its fiscal rules) and the role of national Independent Fiscal Institutions (IFI). It posits that the adequacy of the EU's fiscal framework has to be judged in relation to the overall structure of economic governance in the Union.

1. The context

Since the start of the single currency area, it was clear that ***formal institutionalised*** fiscal rules are necessary against the backdrop of no fiscal integration. I say "formal" rules since economic common sense, as an informal constraint, should induce rational decision-makers to fiscal and budgetary policy conduct that shuns recurrent large deficits and unsustainable public debts. In the euro area, market discipline (visible through sovereign bond yields) was blurred by the introduction of the single currency and a single monetary policy. The formal institutionalised fiscal rules, encompassed by the Stability and Growth Pact (SGP), operate in conjunction with the one-size-fits-all monetary policy of the ECB, with its pluses and minuses.

For the non-euro area members of the EU, financial markets, despite their erratic dynamics, continue to exert a disciplining effect on macroeconomic policies. However, liquidity squeezes and solvency crises can occur when strong boom and bust cycles are at play[4].

The sovereign debt crisis, which occurred in 2009, indicated the inadequacies of the fiscal rules which were pro-cyclical and paid insufficient attention to the big differences in the macroeconomic conditions of member states. Likewise, the rules underestimated the spillover effects, which made things worse for the euro area as a whole in the absence of stabilising instruments – such as a joint "fiscal capacity", and tools to deal with the doom loop between sovereign debt and bank balance sheets. In this regard, an EU *safe asset* would be a useful instrument.

The ECB turned out to be, as a *lender and buyer of last resort*, the *de facto* rescuer

[3] *Communication on orientations for a reform of the EU economic governance framework*, Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Brussels (9 November 2022), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022DC0583&qid=1669888504282.

[4] Several new EU member states had to be supported through official financial assistance programs after the global crisis struck and financial markets froze. These countries had run very large current account deficits caused primarily by massive capital inflows which went into non-tradable sectors. Consequently, painful adjustment processes had to be introduced.

of the single currency area via unconventional operations[5], by a massive injection of base money as a counterpart to the acquisition of sovereign bonds. Quantitative Easing (QE), however much maligned by some for its unintended consequences (among which an alleged perpetuation of resource misallocation[6]), prevented the euro area from a possible collapse by bringing down the skyrocketing bond yields of highly indebted member states.

The EU sovereign debt crisis, as a reflection of the financial crisis, showed that its root causes were both ***public and private over-borrowing***, and the ECB and other central banks received a strong reminder that price stability is not synonymous with financial stability. Here one finds a main explanation for the introduction of macro-prudential rules and regulations, that should help keep macro-imbalances under control by influencing the flow of credit. The European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) are the new European regulatory institutions created in the aftermath of the financial crisis with a view to deal with systemic risks. The European Stability Mechanism (ESM), too, was instrumental in helping contain the sovereign debt crisis. These new institutions are a response to the monumental failure of the *light touch regulation* paradigm, that invited the financial debacle which erupted 15 years ago.

While macro-prudential regulations were enacted promptly and have undergone refinements over time, fiscal rules at the EU level stayed basically the same over the years, although the need to respond to peculiar circumstances forced their tweaking, nuancing and reinterpretation.

A European Fiscal Board and national Independent Fiscal Institutions (IFIs) were set up in order to monitor policy compliance with the EU and the national fiscal frameworks.

2. A new EU fiscal framework is needed

The pandemic, the energy crisis, and the invasion of Ukraine have delayed the overhaul of fiscal rules and of the EU's economic governance framework. Nevertheless, several action guidelines are clear:

- make the rules more transparent and reduce their complexity;
- do not abandon the numerical references of 3% of GDP for the budget deficit and 60% of GDP for public debt;
- adapt the rules to take into consideration national circumstances, encouraging compliance and making the adjustment of imbalances feasible;
- create tools to deal with asymmetric shocks, such as a “fiscal capacity”, and a safe asset as an instrument of risk-sharing, that should operate in conjunction with risk-reduction measures;

[5] QE was also a response to *the zero lower bound*, the inability to use conventional monetary policy to prop up economic activity in periods of sharp downturns.

[6] This line of reasoning can be found in Bank for International Settlements (BIS) documents. See, for instance, Jaime Caruana, “Stepping out of the shadow of the crisis: three transitions for the world economy”, Speech at the BIS General Meeting, 29 June 2014, available at https://www.bis.org/speeches/sp140629.pdf.

- debt sustainability, a major issue already is compounded by the tightening of monetary policies which has been required by a resurgent inflation; a "debt trap" is looming here;
- strengthen the role of the European Fiscal Board and of the national IFIs.

Some of these action guidelines are also mentioned in the EC Communication regarding the reform of the EU economic governance framework. This document refers to the need of more "national ownership of polices", for reasons that are easy to figure out. The European Fiscal Board has been quite vocal in advocating the revision of fiscal rules and stressed the need of a joint *fiscal capacity* and of *a safe asset*. The IMF[7], too, stressed the need of a *fiscal capacity*, as did many other experts.

National IFIs have supported a revision of fiscal rules as well, but there has been less agreement in favour of a joint fiscal capacity and of risk-sharing instruments. It can give food for thought that views in this respect have overlapped with the official positions of the respective member states, with the well-known divide between "frugal" states and other states. Opinions within the IFIs network have varied also on whether to judge the adequacy of fiscal framework and rules, in conjunction with the adequacy of the EU's economic governance framework, some views being that the overhaul of the EU's economic governance is a "political decision" *par excellence*.

I believe that one can hardly judge the adequacy of fiscal rules unless the design/structure of the economic governance of the EU and of the euro area, in particular, is addressed. This structure demands stabilisation and risk-sharing instruments, such as a *central fiscal capacity* and a *safe asset*, together with consistent implementation of risk-reduction measures. Nevertheless, reaching the right balance between risk-sharing and risk-reduction measures is not easy to define. Moreover, policy compromises on such sensitive issues are very difficult to achieve, owing to the high heterogeneity of economic circumstances and divergent interests among the EU member states.

I would also add that **the functioning of economies and the effectiveness of macroeconomic policies depend on the structure of the global financial system**. When the global financial cycles are derailed by a wide-ranging and deep deregulation of finance[8], against the backdrop of the dominant position of a major central bank, as is the case of the Fed, however prudent fiscal and monetary policies are, they can easily be overwhelmed, and pursuing a "corridor of stability"[9] is likely to be ineffective. **In addition, fiscal and monetary policies need to be complemented by macro-prudential rules and policies, since excessive private debt can be no less dangerous**

[7] Arnold, N. *et al.*, "Reforming the EU Fiscal Framework – strengthening the fiscal rules and institutions", Washington DC, IMF, 5 September 2022, available at: https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2022/08/31/Reforming-the-EU-Fiscal-Framework-Strengthening-the-Fiscal-Rules-and-Institutions-The-EUs-518388. This study suggests, *inter alia*, turning the EFB into a European Fiscal Council, as an independent European institution, with more prerogatives.

[8] As it happened with the waves of deregulation of finance that started with the Big Bang in the City of London in 1986 and continued in the US.

[9] The goal of such a corridor is mentioned by Claudio Borio and Piti Disyatat, "Monetary and fiscal policies: in search of a corridor of stability", presentation made at the DG ECFIN workshop "Fiscal policy in times of high debt and economic turbulence", 31 January 2023, Brussels.

than large public debt[10]**.** This is a major lesson derived from the sovereign debt crisis in the euro area, and other episodes of balance of payments crises around the world.

It is worth highlighting that the EC Communication mentions that the ability to steer the fiscal stance of the euro area remained limited in the absence of a "central capacity with stabilisation features" (p. 3). This remark is quite telling, namely that, while there seems to be a prevailing train of thought in favour of a *central fiscal capacity*[11], a political stalemate among member states impedes its creation. The same happens, presumably, with the European Deposit Insurance Scheme (EDIS).

3. What role for the national IFIs?

The EC Communication stresses that national IFIs have to "play an important role in each member state in assessing the assumptions underlying the plans providing an assessment on the adequacy of the plans with respect to debt sustainability and country-specific medium-terms goals, and monitoring compliance with the plan"[12]. The Communication seems to call for an extension of the IFIs' mandates. Whereas up to now IFIs have provided, basically, assessments/endorsements of macroeconomic and budget forecasts[13], EC's new vision would extend the mandate to **an assessment of structural reforms and public investment** (*the medium-term fiscal-structural plan*)[14].

This proposal has a rationale, but it raises significant questions. Thus, how would reforms in various sectors, in education and medical systems, for instance, be evaluated? A few national IFIs may have expertise in such undertakings, but most of them do not. In addition, investment projects are hard to discern in terms of concrete results. The outcome of structural reforms and investments may take years to show, whereas national IFIs would be asked to provide assessments on a regular basis. Arguably, the EC has to come up with clarifications in this regard. As adjustment paths of large public debts and deficits have to be feasible, and this is a major tenet of the orientations of the EC Communication, new tasks of the national IFIs should be approached similarly.

The concerns of the EC are fully justified in view of the enormous challenges that the Union is facing: the energy crisis, climate change, digitalisation, the impact of artificial intelligence, an overall productivity problem, security concerns, etc. On the other hand, national IFIs have a validated niche of work that concerns fiscal/budget policy and tax regimes that impact budgets. They can also judge, and some of them do it increasingly, the overall macro policy mix, though, inadvertently or not, they can insinuate themselves in the realm of monetary policy evaluation. By the way, the ECB

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[10] Ricardo Reis, among others, highlights the role of macro-prudential policy in the structure of a policy mix (see also "What can keep euro area inflation high?", 76th Economic Policy Panel Meeting, Berlin, 20-21 October 2022, available at: https://cepr.org/events/economic-policy-panel-what-can-keep-euro-area-inflation-high).

[11] See also Marco Buti and Marcelo Messori, "A central fiscal capacity to tackle stagflation", VoxEu, 3 October 2022, available at: https://cepr.org/voxeu/columns/central-fiscal-capacity-tackle-stagflation. It is telling that Marco Buti is the head of cabinet of EU Commissioner Paolo Gentiloni and a former Director General of DGECFIN.

[12] *Communication on orientations for a reform of the EU economic governance framework*, p. 10.

[13] Many EU national IFIs do not undertake macroeconomic forecasts themselves.

[14] This view is supported by Olivier Blanchard, Andre Sapir and Jerome Zettelmeyer as well in "The European Commission's fiscal rules proposal: A bold plan, with flaws that can be fixed", www.piie.com, 30 November 2022, available at: https://www.piie.com/blogs/realtime-economics/european-commissions-fiscal-rules-proposal-bold-plan-flaws-can-be-fixed.

and other EU central banks refer often to fiscal policy, which shows that the overall policy mix can hardly be shunned in policy analysis in such a complicated and complex environment.

Nonetheless, getting involved in an analysis of structural reforms and public investment could become "mission impossible", unless proper conditions exist. One can examine the impact of public investment, as an aggregate, on potential economic growth, but to get into an analysis of the composition of public investment is arguably very tricky. Spending reviews are done by a few national IFIs (but not by most of them), aside from what is required on the part of national governments[15]. Spending review assessments, which are different from spending reviews per se, may become a component of the work of EU IFIs in the years to come[16]. Nonetheless, having national IFIs involved in a detailed analysis of spending and investment is an open issue.

National IFIs are apparently asked to be involved in the design of policies, since the *Communication* says, "Independent fiscal institutions could provide an *ex-ante* assessment of adequacy of the plans and their underlying forecasts, which would help national government in the design phase" (p. 16). Examining underlying forecasts sounds sensible, but an involvement, albeit subtle, of national IFIs in the policy-making process can be problematic. There are at least two relevant aspects involved in this matter.

The first aspect pertains to the substance, in view of the broader scope of assessments that would be asked of the national IFIs by the suggested new mandate. And here, it should be noted that the IFIs may not necessarily have the best views, although they may be presumed as an embodiment of "technocracy" and "independent thinking". For "independence" does not automatically imply the best judgement. For instance, public agencies/entities failed as regulatory bodies with their *light-touch regulation* of financial systems. The same happened with fiscal rules, when these were implemented during the sovereign debt crisis and austerity measures were enforced pro-cyclically and with neglect of spillover effects. The procrastination of regulatory agencies in dealing with shadow banking, as well as with crypto activity, is also unfortunate. Similarly, the EU energy market, with its underpinning rules, has flaws that have been conspicuously highlighted by the energy crisis, and examples can continue.

Macroeconomic models can hardly cope with radical uncertainty and non-linearities. In addition, economists themselves may have different theoretical propensities, which influence their policy recommendations. Therefore, caution should accompany policy prescriptions. That rigor is needed so that major policy blunders be avoided is very much true, and national IFIs can help shape policy construction to this end and enhance good practices, but one should not take for granted that independence secures the best policies by itself.

For the sake of fairness in considering the *EC Communication*, however, it is plausible to assume that the suggested broadening of national IFIs' mandates is an attempt to better capitalise on their knowledge of national circumstances.

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[15] In almost two thirds of the OECD member states, governments undertake spending reviews on a regular basis.

[16] For instance, Romania's national recovery and resilience plan envisages for the Romanian Fiscal Council to undertake spending review assessments.

A second aspect about national IFIs' direct or indirect involvement in policy design refers to their participation in this process, resulting in an inescapable conflict of interest. If national IFIs get involved in the policy design process, then a third party would presumably have to come into the picture, as a genuinely neutral assessment entity.

It is easy to comprehend that the Commission would like independent assessments of the national recovery and resilience plans implementation, coupled with more "national ownership" of these plans. However, one needs to be careful in asking national IFIs to change their mandates in ways that may unnecessarily expose them publicly, since reputational risks could ensue.

It is the *secret of Polichinelle* that policies in several EU member states have been perceived as being imposed by external institutions, especially after the eruption of the financial crisis. This perception likely added to the decried "democratic deficit" rhetoric in the Union. It is necessary to reflect on the possibility of IFIs simultaneously helping the strengthening of "national ownership of policies" by getting involved in policy design while also staying independent, as independent/neutral guardians or arbiters of fiscal rectitude and economic policy rationality. Such a situation can become counter-productive. Some may even see it as a surreptitious "technocratic encroachment" on what are and should be democratic policy-making processes. *De facto* and semantically, IFIs would have to change, and become a sort of "independent economic policy councils."

There are national IFIs in the EU that operate as large think tanks (e.g., in Belgium, in the Netherlands), which undertake a wide range of analyses, including the economic platforms of political parties. However, to consider such entities as role models that can and should be replicated all over the Union, no matter what, can be misleading. Apart from their current mandates and available resources, the varied cultural, historical, political, and institutional settings within the EU member states condition what is feasible and, probably, desirable to do in upgrading the mandates of the national IFIs. There could be an argument in substantiating a very broad policy analysis activity and possible involvement in policy design: when there is a high turnover of succeeding ministers and governments, which can be seen as endemic political and governance instability with the potential to harm policy making, therefore such involvement could operate as an "economic policy stabilizer". Nevertheless, such an argument is not so convincing, since economic policy design and implementation cannot be put on *automatic pilot*, which may itself be flawed. It is undeniable, however, that IFIs must be strengthened and the Commission and the EFB are right to emphasise that minimum common standards have to exist to this end.

At the same time, there should not be a normative approach to the national IFIs' assessment of fiscal adjustment paths which derive from official economic and fiscal forecasts. It is expected, however, that IFIs can influence policy-making through their opinions and assessments.

Table 1. EC proposal of bolstering IFIs' mandate vs. current status

Current status of IFIs	EC proposal	Pitfalls of EC proposal
Ex ante: large variety of mandates and capabilities, but a common denominator focuses on economic forecasts and budget construction analysis	*Ex ante*: evaluate assumptions underlying country medium-term plans, including **reforms and investment programs**; assess assumptions underlying forecasts and debt development	1) very limited existing expertise for assessing structural reforms and investment plans 2) getting involved in policy making may create a conflict of interest and incur reputational risks
Ex post: assessment of budget performance and compliance with national and EU rules	*Ex post*: monitor compliance with medium-term plans and of budgetary outturns with the expenditure path	**Summing up: IFIs need to evolve toward the EU wide minimum standards of operation and focus on what they can do best. New tasks should be realistic**

Source: compiled by the author.

On debt sustainability analysis

Regarding debt sustainability analysis, it is useful to have common conceptual constructs when factoring in aging and climate change costs in national IFIs assessments. As the IMF departmental paper suggests, a common methodology for debt sustainability analysis should be used by the national IFIs[17].

It is also necessary to consider the costs of the war in Ukraine and the probable significant rise in defence expenses in many EU member states in the years to come: *the peace dividend* has probably come to an end. Against the backdrop of the energy crisis and the war in Ukraine, some economies are becoming a sort of *sui generis* "war economies" and resource allocation is heavily impacted. De-globalisation and *decoupling* in the world economy would also influence potential economic growth and debt sustainability.

The energy crisis, with the ensuing high rise in the relative price of energy (and of other critical materials), impacts incomes and resource allocation heavily, with massive distributional effects. All these evolutions affect public budgets and debt sustainability analysis should take them into account.

National tax regimes should be considered as well in view of very low fiscal revenues in some member states. Likewise, the international fiscal regime needs to be reformed further to reduce tax evasion and avoidance, however ambitious this objective is due to extremely powerful vested interests. Tax-havens jurisdictions in the EU need to be eliminated, even if it is done gradually.

[17] Arnold, N. *et al.*, "Reforming the EU Fiscal Framework – strengthening the fiscal rules and institutions", Washington DC, IMF, 5 September 2022, available at: https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2022/08/31/Reforming-the-EU-Fiscal-Framework-Strengthening-the-Fiscal-Rules-and-Institutions-The-EUs-518388.

Debt sustainability assessment has to consider *hidden liabilities* that come into the open ever more due to monetary policy tightening (and *quantitative tightening* – QT).

Fiscal rules and macro-prudential rules

An evaluation by the EFB of the overall fiscal policy stance of the euro area does make sense, but it cannot be done separately from examining the macro-prudential policy stance in the euro area, as private sector deficits can harm the euro area as much as public sector deficits. Such an evaluation must consider the functioning of the global financial system as well, in which a dominant role is played by the monetary policy of the Fed[18]. It is justified for the EFB to consider overall systemic risks, which go beyond the remit of judging fiscal policies.

National IFIs may also have to judge national macro-prudential policy stances as the latter influence external imbalances. Additionally, heads of national IFIs should attend the meetings of national supervisory bodies that deal with overall systemic risks.

It should be noted that the European Systemic Risk Board (ESRB) and the ECB examine the application of macro-prudential regulations, and increasingly this is extended to the non-bank financial sector, which poses growing systemic risks as it is poorly regulated.

4. The EU economic governance: risk reduction and risk sharing[19]

The *EC Communication* does not tackle the risk-reduction vs. risk-sharing issue, though it says that a missing "central fiscal capacity" is limiting the stabilisation policy options. A central fiscal capacity, as well as the European Deposit Insurance Scheme (EDIS), is not yet operating in the EU. This is consequential for the new EU and national fiscal frameworks, and for the work of national IFIs and of the EFB as well.

Nonetheless, it is ominous that the Recovery and Resilience Facility/ NextGenerationEU is funded by issuing joint bonds, which may prove to be more of a permanent instrument eventually. Such a development is likely one venue of action in the EU regarding its economic governance framework.

Nota bene: after the ECB announced the QT, a tightening of monetary conditions in the euro area, a special instrument – the transmission protection instrument (TPI) was announced as a means to deal with the situation of highly indebted countries[20].

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[18] As Helene Rey says, the trilemma is a dilemma for most of the emerging economies and, as such, capital flows controls can be useful ("International channels of transmission of monetary policy and the Mundellian trilemma", *IMF Economic Review*, vol. 1, no. 64, 2016, pp. 6-35).

[19] I referred to it in "In the euro area discipline is of the essence, but risk-sharing is no less important", SUERF Policy Note, Issue No. 30, April 2018, available at: https://www.suerf.org/policynotes/2437/in-the-euro-area-discipline-is-of-the-essence-but-risk-sharing-is-no-less-important.

[20] At that time, big spikes in Italian, Spanish and Greek bond yields took place. The announcement of the new special ECB facility brought them down.

Risk-reduction vs. risk-sharing

Some member states highlight the need to reduce non-performing loans (NPL) – a *legacy problem* – as a *risk reduction* measure, prior to implementing a *risk-sharing* scheme (such as EDIS – a collective deposit insurance scheme, and a central fiscal capacity). However, over time, the flow of non-performing loans hinges essentially on economic performance, and not on a particular level of NPLs. In the absence of mechanisms and instruments fostering economic convergence in the euro area, the NPL stocks at national levels would tend to diverge again. One can imagine a diversification of banks' loan portfolio that would diminish the threats posed to their balance sheets by activities in weaker economies. However, a complete decoupling of banks from the economies of the weaker member states is not realistic and, more importantly, is not welcomed, while contagion effects can still be significant. If banking groups diversify their government bond portfolios while considerable competitiveness gaps persist among member states, and if sovereign bond ratings are no longer "risk-free", a strong preference for holding safer bonds would ensue.

European "safe assets" and financial integration

Eurobonds, as risk-pooling assets, would make the euro area more robust, but mutualisation of risks is rejected for fear of a "transfer union". Hence came the idea of a synthetic financial asset (sovereign bond-backed securities – SBBS)[21], which results from the pooling and slicing of sovereign bonds into tranches without joint liability[22]. Nevertheless, the SBBS pose a key problem: the supply of senior tranches depends on the demand for junior tranches, and this demand is likely to fall dramatically during periods of market stress, when some member states' market access may be severely impaired.

Would the Capital Markets Union (CMU) and Banking Union (BU) overcome market fragmentation and economic divergence in the absence of arrangements that would enable the accommodation of asymmetric shocks and foster economic convergence? Some argue that a complete BU (and CMU) would dispense with the need of public risk-sharing. But is it sufficient for a robust Euro area (EA) that risk-sharing applies to finance only? Additionally, would private risk-sharing be sufficient to cope with systemic risks? What about the lender of last resort function in capital markets in view of the expansion of shadow-banking? Would a collective deposit insurance scheme involve private money only? Fiscal risk-sharing may be needed in worst-case scenarios.

The progress of the euro area and of the banking union demands a reconciliation between rules and discipline on one hand, and private and public

[21] Brunnermeier, M. K., Garicano, L., Lane, P., Pagano, M., Reis, R., Santos, T., Thesmar, D., Van Nieuwerburgh, S., & Vayanos, D. (2011), "European Safe Bonds (ESBies)", The Euronomics Group, available at: https://personal.lse.ac.uk/vayanos/euronomics/esbies.pdf.

[22] A senior tranche (deemed to be equivalent in strength to the German Bunds), a mezzanine (medium-risk) tranche, and a junior (seen as highly risky) tranche, with the latter bearing the brunt of losses in case of default.

risk sharing on the other[23]**. Finding an adequate calibration between rules and risk-sharing, and between private and public risk-sharing, remains however an open question.**

Arguably, only private risk-sharing schemes (CMU) would not make the euro area more robust. Financial markets are too fickle and produce systemic risks recurrently. Unless it will get adequate risk-sharing schemes, the euro area will continue to be rigid and prone to recurrent tensions. ECB special operations are a de facto risk-sharing instrument.

The euro area needs several elements: liquidity assistance during times of market stress; schemes to cushion asymmetric shocks; non-automatically triggered sovereign debt restructuring (automaticity as a condition for ESM support programmes would cause panic in the markets); rules for adjusting imbalances should not be pro-cyclical; the macroeconomic imbalance procedure (MIP) should operate symmetrically (for both large external deficits and surpluses countries); a euro area-wide macroeconomic policy that should reflect in the fiscal policy stance over the business cycle; no de-regulation of finance and strong regulation of non-bank financial entities including crypto assets.

5. Final remarks

EC's Communication on orientations for a reform of the EU's economic governance framework is more than timely and adds value to a series of similar documents. It puts emphasis on medium-term plans that should target robust economic growth and public debt sustainability, feasible adjustment paths for public debts, fiscal risks-based assessments and surveillance. More national ownership of these plans is a valuable aim, though the "technology" to achieve it is still to be elaborated.

The EFB and national IFIs are asked to play a more significant role in the architecture of the EU economic governance framework. While this vision has merit, one needs to be careful in how to conceive and implement it. There are benefits, but also pitfalls of broadening the national IFIs' mandates.

IFIs have a niche of work that concerns fiscal/budget policy and tax regimes which impact budgets. They also judge overall macro policy. Getting them involved in an analysis of structural reforms and public investment could backfire unless proper conditions exist. The involvement of national IFIs in the policy design process can be problematic. There are at least two aspects involved here. One is of substance in view of the much broader scope of assessments that would be asked of IFIs. And here, national IFIs may not necessarily have the best view, be they presumed to be an embodiment of independent thinking. A second aspect of IFIs' involvement in policy design refers to their participation in the process, while they are expected to perform its assessment: an inescapable conflict of interest ensues.

[23] See also A. Benassi-Quere *et al.*, "Reconciling risk-sharing with market discipline: A constructive approach to euro area reform", Centre for Economic Policy Research, *Policy Insight*, No. 91, January 2018, available at: https://cepr.org/system/files/publication-files/103106-policy_insight_91_reconciling_risk_sharing_with_market_discipline_a_constructive_approach_to_euro_area_reform.pdf; J. Bini Smaghi, "Reconciling risk-sharing with market discipline", LUISS School of European Political Economy, *Policy Brief*, 30 January 2018, available at: https://sep.luiss.it/wp-content/uploads/2022/09/PB3.18-RECONCILING-RISK-SHARING-WITH-MARKET-DISCIPLINE.pdf.

To think that IFIs could, simultaneously, help strengthen "national ownership of policies" by getting involved in policy design while also being independent, supposedly neutral guardians of fiscal rectitude and economic policy rationality, can become counter-productive. It could be perceived as a technocratic encroachment on a democratic decision-making process, and there are cases of "technocratic" governments which had modest results, or had even failed.

What is clear is that national IFIs have to make their contribution in discouraging egregious populist temptations and demagoguery, to help instil public governance with common sense and vision, and consolidate good practices.

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