Recent Developments in fiscal governance in the EU

Lessons from the crisis: from the Six-Pack to the Fiscal Compact
A comprehensive EU response to the crisis

- **Sound fiscal policy**
  - More effective prevention of gross policy errors
  - Focus on debt developments in addition to the deficit

- **Balanced growth**
  - Prevention and correction of macro imbalances
  - Structural reform strategy (Europe 2020)
  - Macro-prudential supervision
  - Regulation and supervision of financial systems

- **Crisis resolution instruments** (firewalls)
  - Better enforcement of rules
  - Balanced growth
  - Sound fiscal policy
  - Crisis resolution instruments (firewalls)
Enhanced economic and fiscal governance in the EU in three steps

The 1st step: the Six-Pack
A major reform for economic and fiscal governance in the EU

The 2nd step: the Two-Pack
A more stringent framework for the euro area

The latest step: the International Treaty
Mirroring EU rules at the national level
## The Six-Pack

### A key reform of economic governance

#### Fiscal rules

- Prevention of gross policy errors: introducing the concept of expenditure benchmark
- Focus on debt on top of deficit: explicit benchmark for a sufficiently diminishing debt ratio
- Strengthening the national level: Minimum requirements for budgetary frameworks of the Member States

#### Macroeconomic surveillance

- New rules for the prevention and correction of macroeconomic imbalances

#### Enforcement

- New sanction toolbox
- New enforcement measures
Where did we stand?

Central concept of the Stability and Growth Pact is the medium-term budgetary objective (MTO) = a numerical value for the structural deficit which ensures:

(i) a safety margin against breaching 3% of GDP;
(ii) sustainable public finances or rapid progress towards sustainability
(iii) room for stabilisation over the cycle

Adjustment path towards MTO = 0.5% of GDP; more in good, less in bad times.

Enforcement through peer pressure (Council recommendations).
Lessons learned:
- Central concept is based on the structural balance, which is not observable → difficulties with estimates, time-lag, etc…
- No quantification of deviation, enforcement through peer pressure → lacks teeth

Innovation: a 2-pillar structure: an expenditure rule complementing the structural balance

= operational guidance for adjustment path towards MTO

Def: expenditure growth should not exceed a reference rate of potential GDP growth

✓ If significant deviations from the rule (= 0.5% of GDP in one or 0.25% of GDP on average in two consecutive years) → recommendation to correct + interest-bearing deposit for euro area MS
✓ Safeguard clauses: can deviate from the rule if unusual event or severe economic downturn for the euro area or the EU as a whole
Where did we stand? Excessive deficit procedure only opened on the basis of the deficit criterion (3% of GDP)

Lessons learned: did not ensure decreasing debt-to-GDP ratio

Innovation: Operationalization of the "debt criterion"

= Numerical benchmark for sufficiently diminishing debt-to-GDP ratio

= distance with respect to the 60% of GDP Treaty reference value declines over 3 preceding years at an average rate of 1/20th per year

Or

= this required reduction will occur in forward-looking 2-year horizon, based on unchanged policy forecast.

• Effect of the cycle to be taken into account
• Non-respect of numerical benchmark for debt will not automatically result in the country being placed in EDP → overall assessment of relevant factors.
## The Six-Pack: New sanctions toolbox

<table>
<thead>
<tr>
<th>Step of the procedure</th>
<th>Sanction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustment towards the MTO/expenditure rule not respected</td>
<td>Interest-bearing deposit 0.2% of GDP</td>
</tr>
<tr>
<td>Opening of the EDP</td>
<td>Non-interest-bearing deposit 0.2% of GDP</td>
</tr>
<tr>
<td>Failure to take effective action to correct the excessive deficit</td>
<td>Fine 0.2% of GDP</td>
</tr>
<tr>
<td>Repeated failure to take effective action to correct the excessive deficit</td>
<td>Fine 0.2% of GDP + variable component</td>
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The Six-Pack: improving national ownership

**Where did we stand?**

- Considerable variation in the quality of national fiscal framework
- Well-designed fiscal frameworks can substantially contribute to sound fiscal policies
- EU budgetary framework insufficiently entrenched in national frameworks

**Lessons learned:** Need for strengthening national ownership and having uniform requirements as regards the rules and procedures forming the budgetary frameworks of the MS

**Innovation: minimum characteristics for national budgetary frameworks**

- Accounting and statistical reporting
- Rules for preparation of the forecasts for budgetary planning
- Country-specific numerical fiscal rules
- Budgetary procedures
- Medium-term budgetary frameworks
- Independent monitoring and analysis
- Regulation of fiscal relationships between public authorities across sub-sectors of general government
- Implementation by end-2013 but euro area political commitment to transpose by end-2012
The Two-Pack

A more stringent framework for the euro area

**Enhanced monitoring**

- Common provisions for
  - monitoring and assessing draft budgetary plans and
  - ensuring the correction of excessive deficits of Member States in the euro area

**Enhanced surveillance for financially fragile MS**

- Strengthening of economic and budgetary surveillance of Member States
- experiencing or
- threatened with serious difficulties with respect to their financial stability in the euro area
The Two-Pack: A more stringent framework for the euro area

Rationale/lessons learned

Enshrining core principles of European framework in national framework to increase ownership

Better synchronizing key steps in preparation of national budgets

Innovation

Common Budgetary Rules

- Numerical fiscal rules on budget balance implementing MTOs in national budgetary processes
- Monitoring institution (fiscal council)
- Independent macroeconomic forecast

A Common Budgetary Timeline

- 15 April: Medium-Term fiscal plans made public.
- 15 October: Draft Budget Laws for the general government made public with the independent macroeconomic forecast on which they are based.
- 31 December: Budget Laws for the general government adopted and made public.
### The Two-Pack

#### Rationale/lessons learned

Ensuring appropriate integration of EU policy guidance in the national budgetary preparations:

- Equip the national Parliaments with an independent assessment
- Allow an assessment of the overall situation

Securing a timely and durable correction of excessive deficits

#### Innovations

**Draft budgetary plans submitted before 15 October**

- Comission
  - might request a revision of the draft in case of serious breach of European rules
  - Opinion if necessary

- Ministers of finance => discussion based on an overall assessment

**Closer monitoring for Member States in EDP**

- Comprehensive and regular reporting including audit of quality of statistics
- Any additional information on a request from the COM
- In case of risk of non-compliance with the deadline for correction → additional recommendations
The Two-Pack

The new fiscal governance framework in the euro area: scenario for a Member State compliant with all rules

**Autumn**
Presentation of draft budgetary plan for following year
- Possible Opinion by the COM
- Discussion at the eurogroup

**European Semester – Spring**
- Assessment of compliance with preventive arm of SGP (structural balance + expenditure benchmark)
  - *Ex ante* for in-year and following years
  - *Ex post* for previous year
- Macroeconomic surveillance
- Policy guidance and recommendation

**End of Year**
Budget Law
25 Member States (all but CZ, UK)

Entry into force requires ratification by 12 euro area MS (Greece, Portugal, Slovenia and Poland have already ratified – Irish referendum on 31 May)

3 main chapters:

Economic Policy Coordination
- Coordination of major economic policy reform plans in euro area MS
- Coordination of debt issuance plans

Reinforced Governance
- Euro Summit meetings shall take place at least twice a year
- Appointment of a President of the Euro Summit (by Heads of State or Government of euro area)

and... the Fiscal Compact
The Fiscal compact: Mirroring EU rules at national level

General government budget shall be balanced or in surplus
- Implementation of the EU medium-term objectives (MTOs) at national level
- Automatic correction mechanism triggered when significant deviations from the objective (as in the SGP) surveyed by independent institutions
- ... but deviation allowed in case of "exceptional circumstances" (as in SGP)

Reinforcement of the correction of fiscal imbalance
- Change in the voting rule
- Economic partnership programme to ensure a durable effective correction of excessive deficits through implementation of structural reforms

Enforcement
- rules in national law through provisions of "binding force and permanent character, preferably constitutional"
- If MS fails to transpose properly, the matter will be brought to EU Court of Justice (possibility of financial sanction of up to 0.1% of GDP)
- Compliance with the national rule monitored at the national level by independent institutions
Thank you