

# Towards a New Generation of Fiscal Policy rules The European experience

INTERNATIONAL MONETARY FUND OAP/FAD CONFERENCE

Institutions for Fiscal Credibility – Fiscal Policy Rules and Fiscal  
Councils: Experience and Prospects in the Asia-Pacific Region

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## Contents

- Developments in the EU since the crisis
- Questions for this session
- Implications of the European experience  
with reference to the European Parliamentary elections  
and some fundamental questions

# The EU's fiscal rule: SGP

(Stability and Growth Pact)

The SGP's first arm: **The preventive arm**

This seeks to ensure that fiscal policy is conducted in a sustainable manner over the cycle.

Its cornerstone is the country-specific medium-term budgetary objective (MTO), defined in structural terms (i.e. in cyclically adjusted terms and net of one-off and other temporary measures).

Member States outline their medium-term budgetary plans in stability and convergence programmes (SCP), which are submitted and assessed annually in the context of multilateral fiscal surveillance under the European Semester.

[http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm),

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# The EU's fiscal rule: SGP

European Semester: since 2011

Yearly cycle of economic policy coordination during the first six months of the year.

European Commission undertakes a detailed analysis of EU Member States' programmes of economic and structural policies and the European Council and the Council of Ministers provide policy advice before Member States finalise their draft budgets.

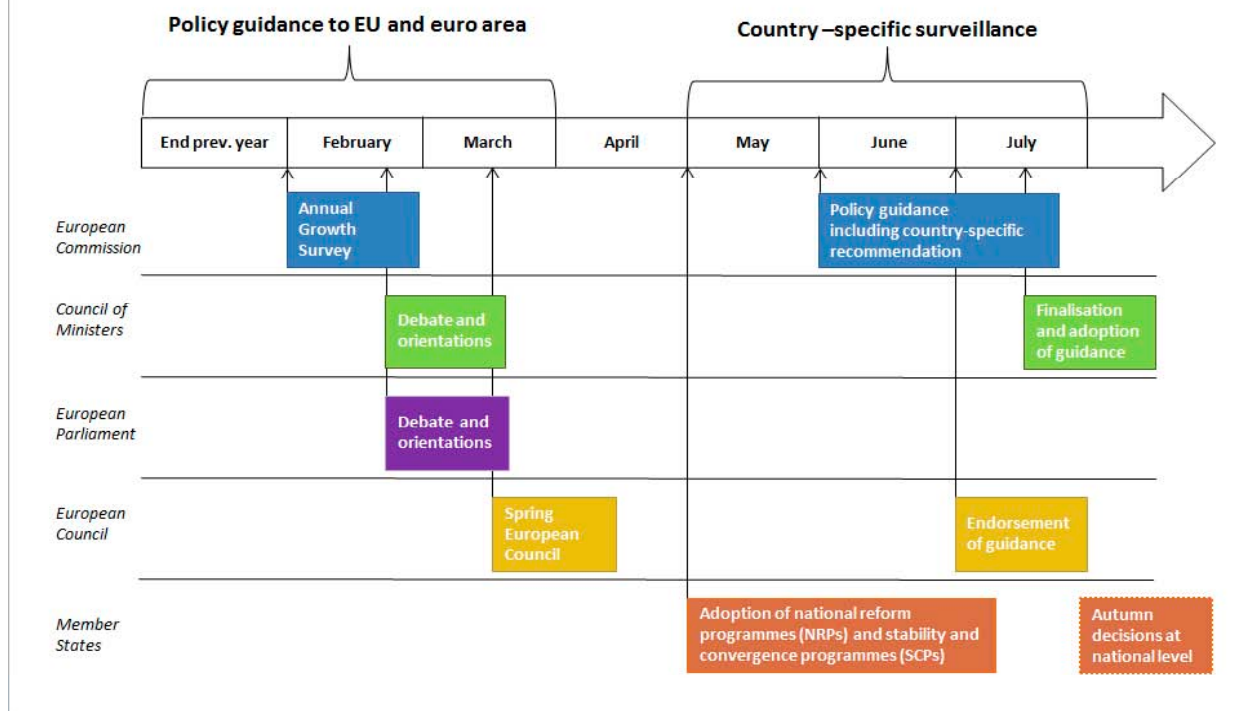
The second six months of the year is the “national semester” in which governments draw up their draft budgets and submit them to national parliamentary debate

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# The European Semester



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## The EU's fiscal rule: SGP

The SGP's second arm: **The corrective arm**

This sets out the framework for countries to take corrective action in the case of an excessive deficit and/or debt.

It is made operational by the Excessive Deficit Procedure (EDP), a step-by-step procedure for correcting excessive deficits that occur when one or both of the following TFEU (Treaty on the Functioning of the EU) rules are breached:

- (1) the deficit must not exceed 3% of GDP
- (2) public debt must not exceed 60% of GDP  
(or at least diminish sufficiently towards the 60%)

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# The EU's fiscal rule: SGP

Non-compliance with either the preventive or corrective arms of SGP can lead to the imposition of sanctions for euro area countries.

In the case of the corrective arm, this can involve annual fines for euro area Member States and, for all countries, possible suspension of Cohesion Fund financing until the excessive deficit is corrected.

The legal basis of SGP = TFEU (Treaty on the Functioning of the EU)  
Secondary legislation governing SGP was initially approved in 1997, with significant reforms in 2005 and 2011

**The Six-pack** = the 2011 reforms

entered into force in Dec 2011, 5 Regulations and 1 Directive

Applies to 27 Member States with some specific rules for the euro-area, covers fiscal surveillance and macroeconomic surveillance under the new Macroeconomic Imbalance Procedure

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# The EU's fiscal rule: SGP

In the fiscal field, **the Six-pack** strengthens the SGP by

1. adding an expenditure benchmark (MTO) to review countries' fiscal positions
2. operationalising the Treaty's debt criterion
3. introducing an early and gradual system of financial sanctions (an interest-bearing deposit of 0.2% of GDP) for euro area Member States
4. requiring new minimum standards for national budgetary frameworks
5. surveillance of both budgetary and economic policies together under the European Semester, to ensure the consistency of the policy advice given
6. Further details on the implementation of the SGP by Member States are given in a code of conduct, which was last revised in September 2012

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# The EU's fiscal rule: SGP

**The Two-Pack** entered into force May 30th 2013

Builds on the Six Pack reforms by introducing additional surveillance and monitoring procedures for euro area Member States.

The first Regulation applies to all euro area Member States, with special rules applying to those in the Excessive Deficit Procedure (EDP)

The second Regulation sets out clear and simplified rules for enhanced surveillance for Member States facing severe difficulties with regard to their financial stability, those receiving financial assistance, and those exiting a financial assistance programme

Based on Article 136 of the EU Treaty, enabling euro area Member States to strengthen the coordination and surveillance of budgetary policies in order to ensure the necessary budgetary discipline in the Economic and Monetary Union.

[http://ec.europa.eu/economy\\_finance/articles/governance/2012-03-14\\_six\\_pack\\_en.htm](http://ec.europa.eu/economy_finance/articles/governance/2012-03-14_six_pack_en.htm)

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# The EU's fiscal rule: SGP

**The Two-Pack** introduces a European assessment of draft budgetary plans on a coordinated timeframe in Autumn for euro area Member States and improves national budgetary frameworks by requiring them to set up independent bodies in charge of monitoring national fiscal rules and to base budgetary forecasts on independent macroeconomic forecasts

For euro area Member States in EDP, a system of graduated monitoring is established in order to secure a timely and durable correction of excessive deficits and to allow an early detection of risks that a Member State does not correct its excessive deficit by the deadline set by the Council.

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# The EU's fiscal rule: SGP

**The Two Pack's** requirements placed on financially fragile countries are streamlined for countries currently receiving financial assistance while enhancing monitoring ... and thus, in some cases, address vulnerabilities even before a need for financial assistance arises

To support the effective implementation of the Two Pack legislation, Member States and the Commission have agreed on harmonised frameworks for the draft budgetary plans and for the debt issuance reports

In addition, the form and content of the new regular reporting by Member States in EDP have been set out in a delegated Regulation

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# The EU's fiscal rule: SGP

## **The Fiscal Compact**

Contained in the Treaty on Stability, Coordination and Governance (TSCG) signed in March 2012 by 25 EU MS (excluding UK and Czech Republic)

Came into force on January 1 2013 for 16 EU Member after 12 eurozone states ratified

Binding for euro-area Member States while other contracting parties will be bound only once they adopt the euro or earlier if they signal it

[http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm),

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# The EU's fiscal rule: SGP

**The Fiscal Compact** requires Member States to enshrine in national law a balanced budget rule with a lower limit of a structural deficit of 0.5% GDP, centered on the concept of the country-specific medium-term objective (MTO) as defined in the SGP.

Its provisions also increase the role of independent bodies given the task of monitoring compliance with the national fiscal rules, including the operation of the national correction mechanism in case of deviation from the MTO or the adjustment path towards it (also included in the Two Pack)

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# The EU's fiscal rule: SGP

## **The Euro Plus Pact: Stronger Economic Policy Coordination for Competitiveness and Convergence**

To give further impetus to the governance reforms, 23 Member States, including six outside the euro-area (Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania), signed the Euro Plus Pact in March 2011.

The Pact commits signatories to even stronger economic coordination for competitiveness and convergence, also in areas of national competence, with concrete goals agreed on and reviewed on a yearly basis by Heads of State or Government.

The Euro Plus Pact is integrated into the European semester and the Commission monitors implementation of the commitments.

[http://ec.europa.eu/economy\\_finance/articles/governance/2012-03-14\\_six\\_pack\\_en.htm](http://ec.europa.eu/economy_finance/articles/governance/2012-03-14_six_pack_en.htm)

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## Questions for the session

What is the international experience with fiscal policy rules (effectiveness, side effects,...)? Has good international practice evolved since the crisis?

Answer:

In Europe, huge steps have been taken in terms of supra-nationally set fiscal rules since the crisis

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## Questions for the session

What is the room for tailoring national fiscal frameworks to country-specific circumstances?

What is the risk of “rules overhang” (too many rules, possibly inconsistent)?

What are the terms of the trade-off between simple and transparent rules – likely to be more credible – and flexible ones – more vulnerable to manipulations?

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# Questions for the session

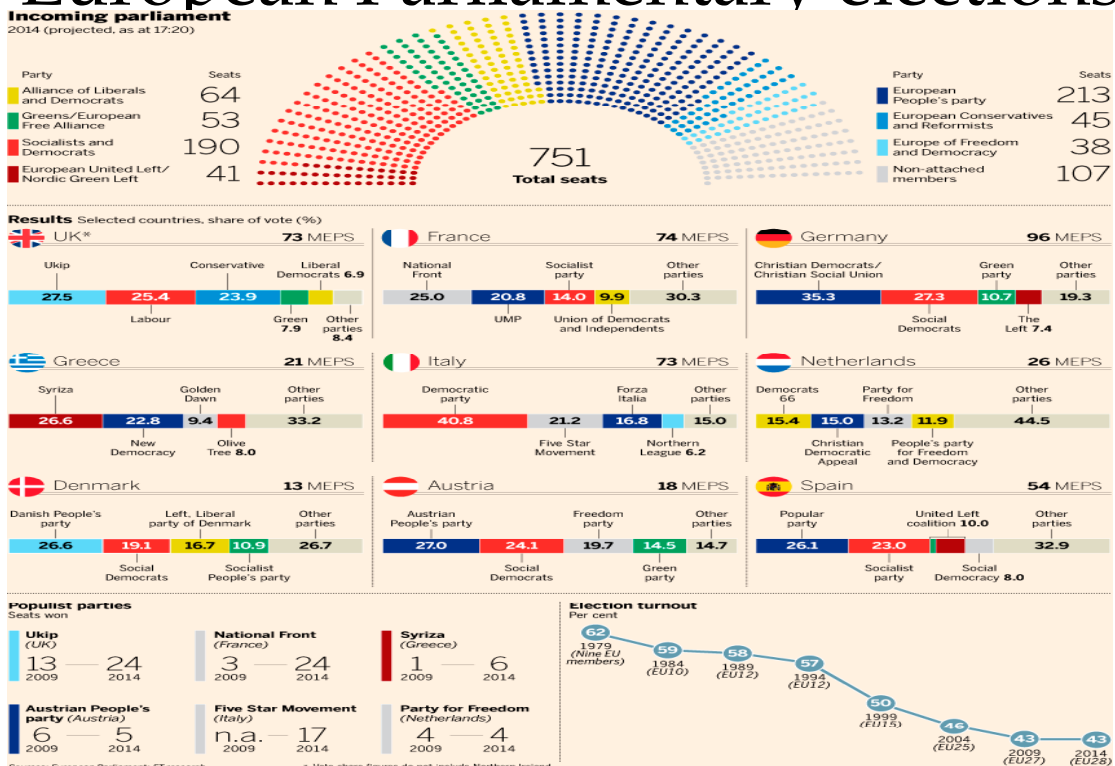
Answer:

For Europe, the revisions of fiscal rules happened in the context of crisis and conditionality

They give rise to important questions about democratic legitimacy, and the relationship between democracy and fiscal (and other) sustainability

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## European Parliamentary elections



# European Parliamentary elections

- Ironically, people voted “against the EU” and “against the European Commission” when in fact it was the power of the European Council (i.e. their respective governments) that increased after the crisis
- Having said that, it is true that the new measures give the Commission powers to intervene in the budgetary process of Member States
- The European Parliament has done nothing to stop this so far, and the different Eurosceptic parties may not be able to join forces to make major changes
- What is worrying is the voters’ views reflected in the EP election results

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# European Parliamentary elections

- The fiscal rules have already become EU law although some anti-crisis measures have been adopted outside the EU framework (i.e. as intergovernmental agreements) , because the markets would not wait and because “multi-speed Europe” was on the rise
- But if electorates vote for an anti-bailout head of state, he/she may try to reverse/delay the measures necessary for fiscal sustainability
- In Greece, anti-bail-out parties on the left and right together won over 40% of the vote

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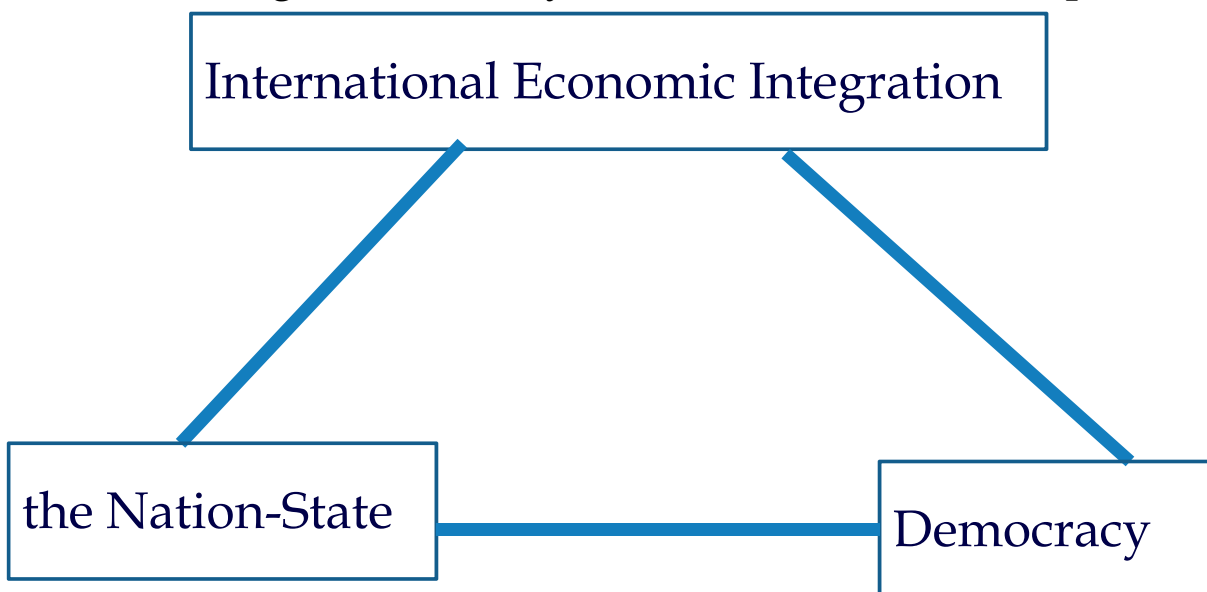
# Some fundamental questions about fiscal policy

1. Should emphasis be on short-term stabilisation or long-term stability?
2. Should the encouragement of reform be one objective of fiscal policy?
3. How to attain (fiscal) sustainability in a democracy with an ageing society/mature economy

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## Another Impossible Trinity?

in addition to “monetary policy autonomy, exchange rate stability and free movement of capital”:



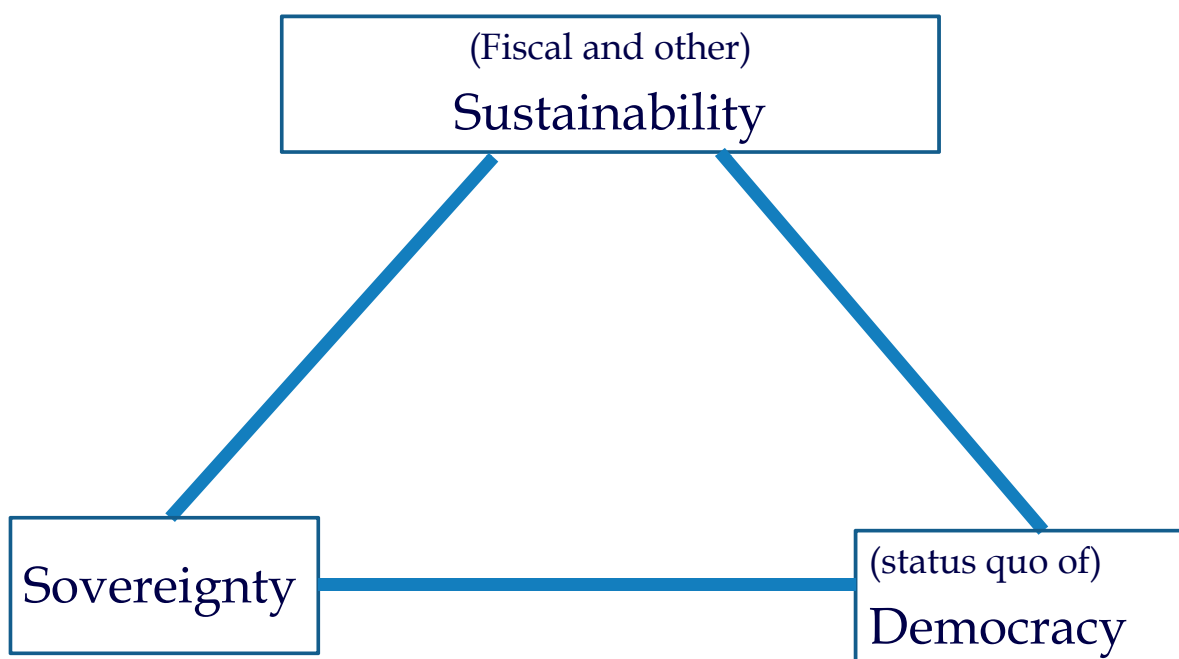
Rodrik, Dani (2007)

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# Another Impossible Trinity?

in addition to that:



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## Another Impossible Trinity?

- EU Member States that cannot reform on their own are yielding on "Sovereignty" in order to obtain "Sustainability" without changing their version of "Democracy"
- EU Member States that introduced fiscal discipline on their own (changed the way their "Democracy" was functioning via an increased sense of ownership of its citizens) are achieving "Sustainability" while keeping "Sovereignty"
- Japan risks losing "Sustainability" by keeping "Sovereignty" and (unchanged) "Democracy"

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## Appendix: The EU's definitions

- Fiscal rules: A permanent constraint on fiscal policy, expressed in terms of a summary indicator of fiscal performance, such as the government budget deficit, borrowing, debt, or a major component thereof
- Budgetary rules: Rules and procedures through which policy-makers decide on the size and the allocation of public expenditure as well as on its financing through taxation and borrowing
- Expenditure rules: A subset of fiscal rules that target (a subset of) public expenditure

Source: [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/2013/pdf/ee-2013-4.pdf](http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee-2013-4.pdf)

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