The new fiscal rules: What will change in practice?

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The crisis as en eye opener

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A comprehensive EU response to the crisis

More effective prevention of gross policy errors

Focus on debt developments in addition to the deficit

Sound fiscal policy

Better enforcement of rules

Crisis resolution instruments (temporary: EFSM/EFSF; permanent: ESM)

Sovereign liquidity provision (OMT)

More effective supervision and regulation of the financial system:
(i) Coordination: ESRB and EBA/ESMA/EIOPA; CRD III/IV
ii) Centralisation: SSM (potentially EDIRA, EDGAR))

Prevention and correction of macro imbalances

Balanced growth

Structural reform strategy (Europe 2020)

Actions for Stability, Growth and Jobs

Enhanced economic governance in the EU in steps

The 1st step: the Six-Pack

A major reform for economic governance in the EU

The 2nd step: the Two-Pack

A more stringent budgetary framework for the euro area

The 3rd step: the International Treaty

Mirroring EU rules at the national level

Next steps?

Banking, economic, budgetary and political union

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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

Enforcement

New sanction toolbox (financial fines)

Macroeconomic surveillance

New rules for the prevention and correction of macroeconomic imbalances

Enforcement

New enforcement measures (financial fines)

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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:

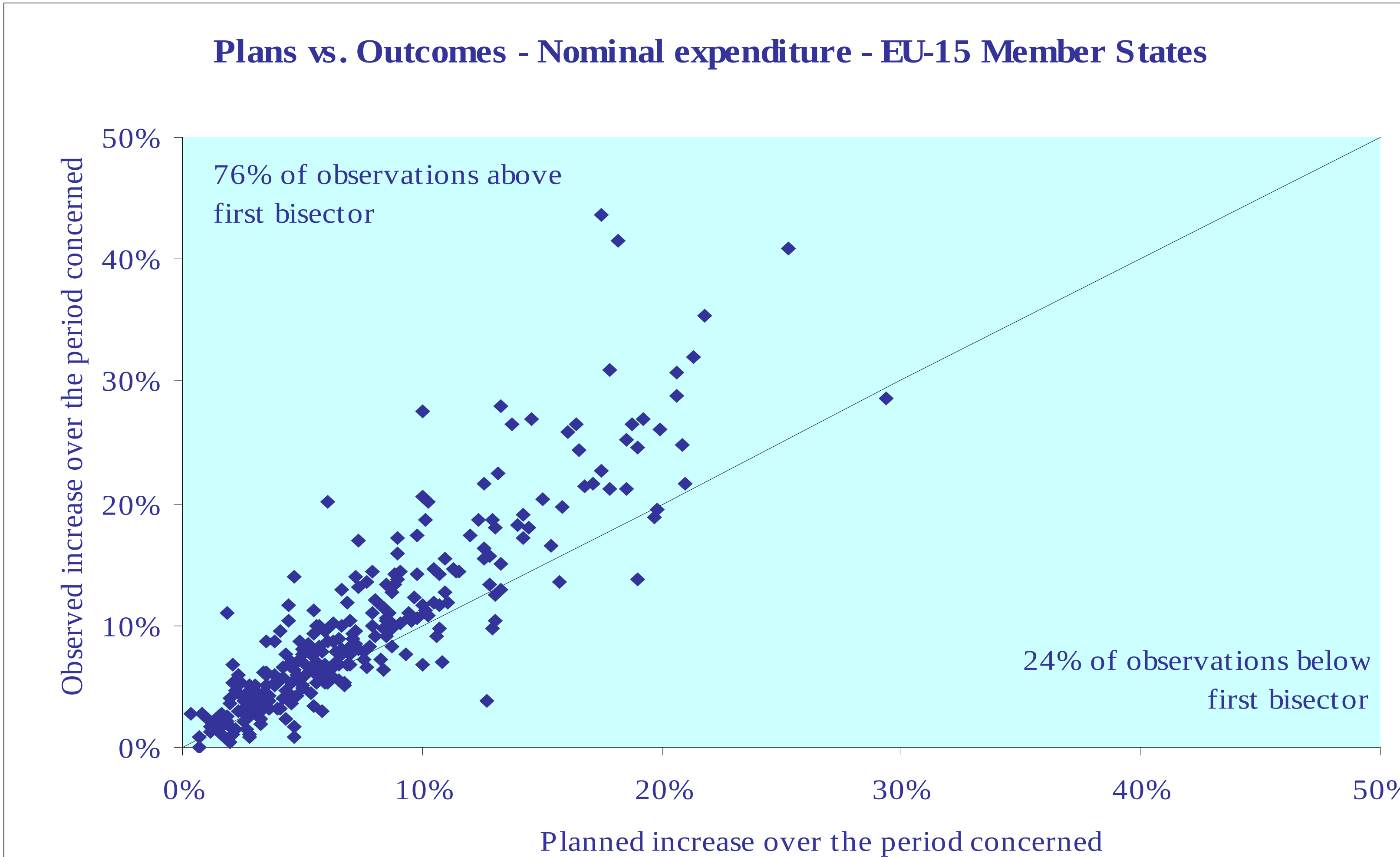
$$MTO^{ILD} = \underbrace{Balance_{debt-stabilizing\,(60\% of GDP)}}_{(i)} + \underbrace{\alpha * AgeingCosts_{\text{infinite horizon}}}_{(ii)} + \underbrace{Effort_{debt-reduction}}_{(iii)}$$

(i) a safety margin against breaching 3% of GDP;
(ii) sustainable public finances or rapid progress towards sustainability (ageing cost)
(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).

The problem with expenditure



Source: Commission services

The Six-Pack: Ensuring prudent fiscal policy

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

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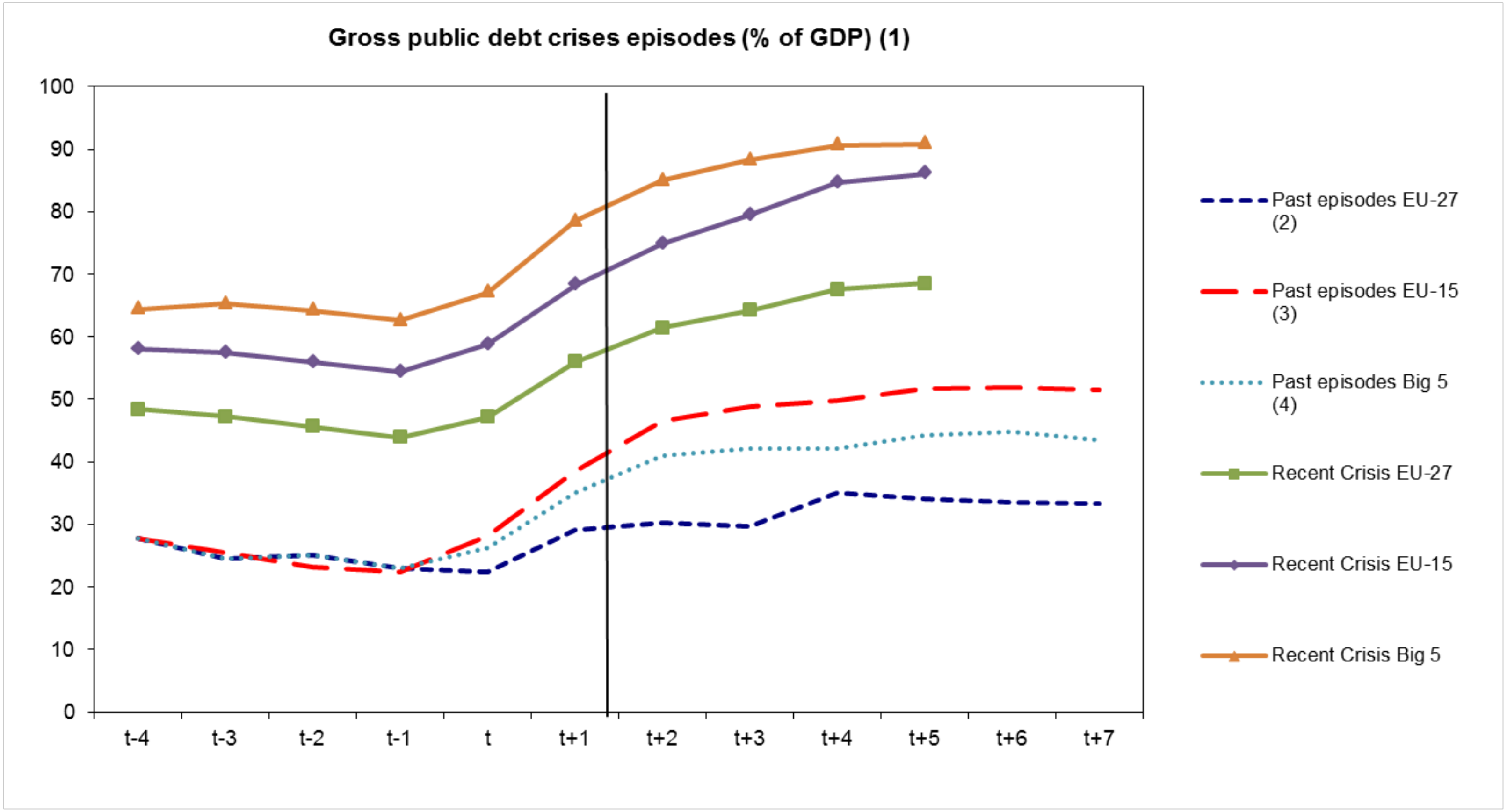
The problem with debt



Extract from*:* Marco Buti, Lucio R Pench, *Fiscal austerity and policy credibility,* 20 April 2012, www.voxeu.org

The Six-Pack: Correcting fiscal imbalances

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 ratios

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 declining over <u>3 preceding years</u> at an average rate of 1/20th per year

$$bb_t = \left[bb_t^{1y} + bb_t^{2y} + bb_t^{3y}\right]/3 = 60\% + \frac{0.95}{3}\left(b_{t-1} - 60\%\right) + \frac{0.95^2}{3}\left(b_{t-2} - 60\%\right) + \frac{0.95^3}{3}\left(b_{t-3} - 60\%\right)$$

OR
= this required reduction occurring in <u>forward-looking 2-year horizon</u>, based on unchanged policy forecast.
OR
= required reduction occurring on 3-years backward-looking basis, when the <u>change in debt is adjusted for the cycle</u>

- Non-respect of numerical benchmark for debt reduction will <u>*not automatically*</u> lead to EDP → overall assessment taking into account relevant factors.

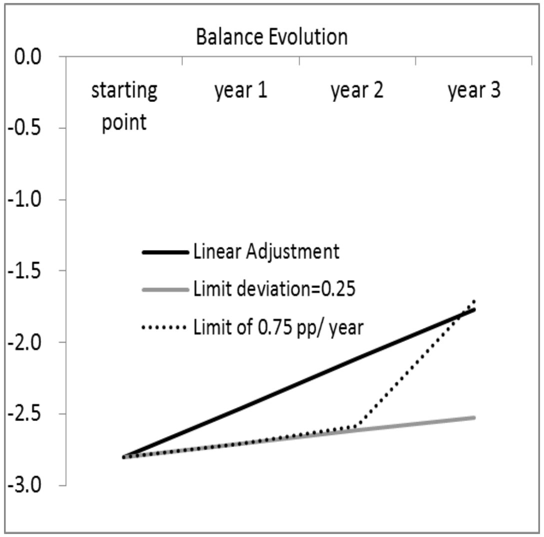
The debt reduction benchmark and the transition period

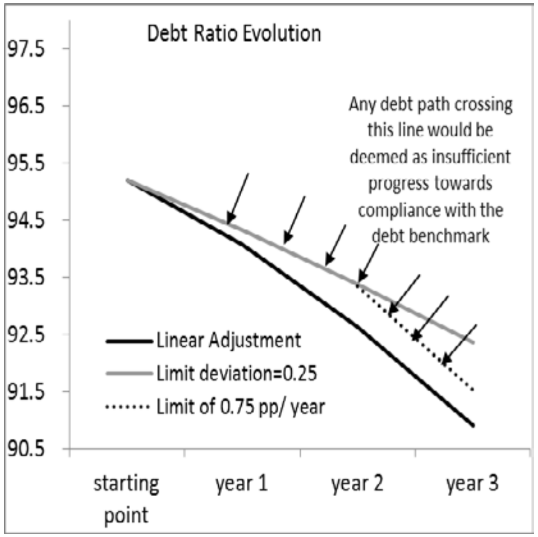
Why a transition period?

- **Countries leaving current EDPs are likely to be in breach of the debt criterion when they have their EDPs abrogated**

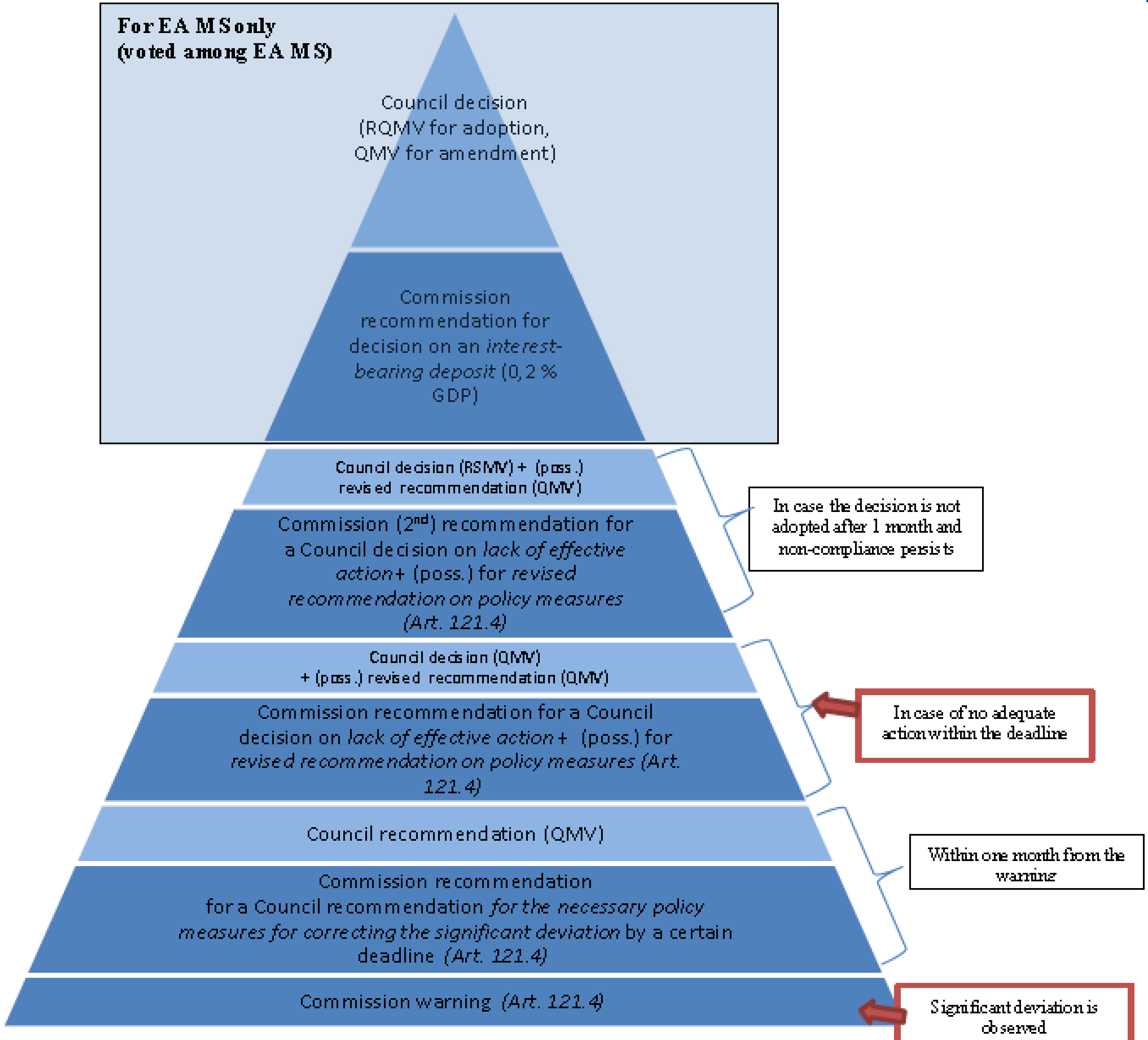
During the 3 years starting from the abrogation of their EDPs countries are required to make "sufficient progress towards compliance" so as to be compliant at the end of the 3rd year

- **Linear adjustment calculated**
- **May not deviate by linear adjustment by more than ¼ % of GDP**
- **Remaining annual correction may not exceed ¾ % of GDP**

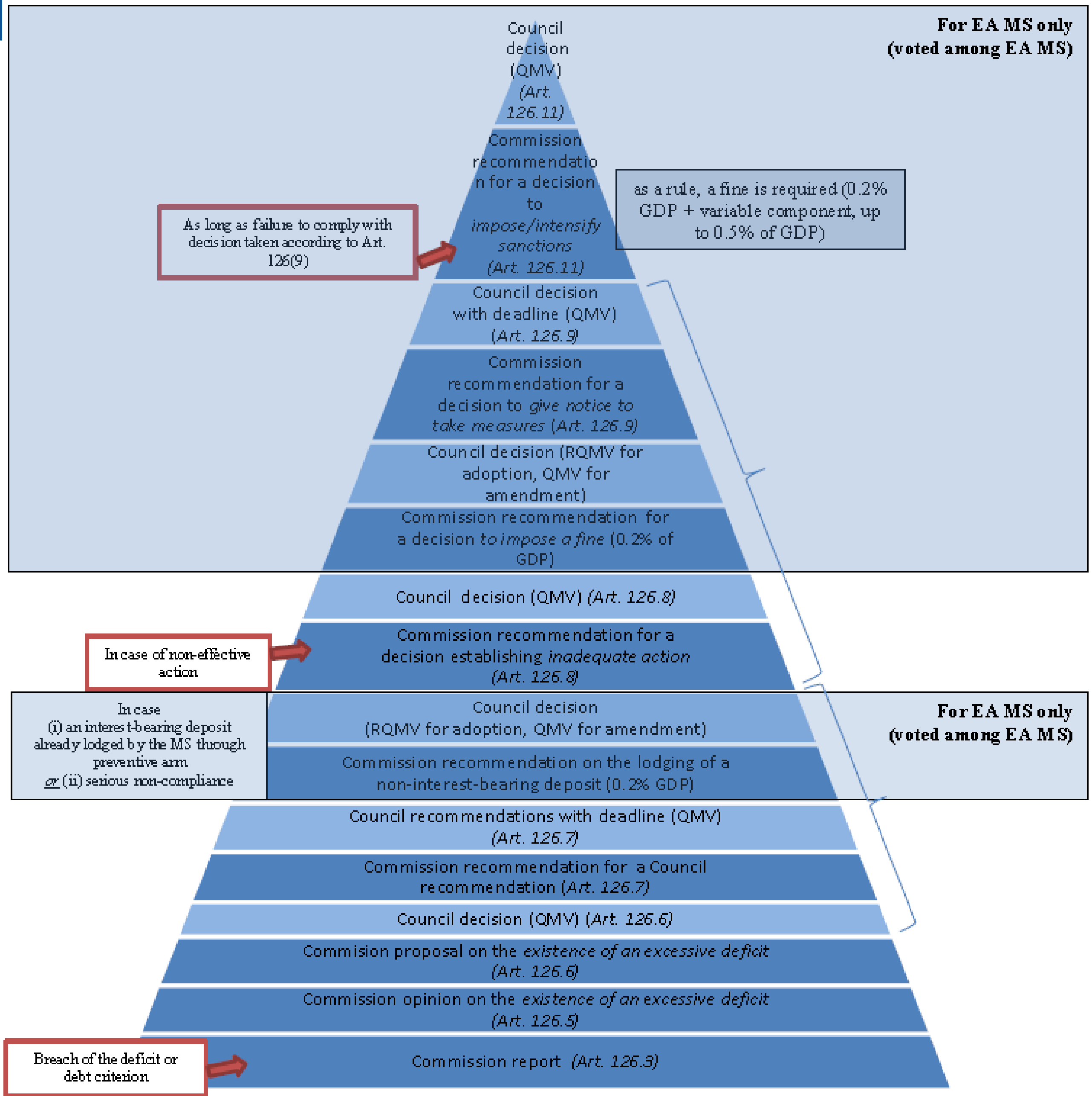




The Six-Pack - Graduated approach backed by sanctions: (i) preventive arm



The Six-Pack - Graduated approach backed by sanctions: (ii) corrective arm



The Six-Pack: Improving national ownership

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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 to strengthen national ownership and to set uniform requirements for national budgetary rules and procedures

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 – Key Innovations

Enhanced monitoring for all euro area MS

Rationale	*Innovation*	*Articulation with existing framework*
Ensuring that Union policy recommendations in the budgetary area are appropriately integrated in the national budgetary preparations	*Common Budgetary Rules* *Numerical fiscal rules on budget balance implementing MTOs in national budgetary processes* *Independent fiscal council* *Independent macroeconomic forecast*	*Reinforces the Directive on national budgetary frameworks by encapsulating the core concept of the SGP in national rules* *Reinforces the preventive arm of the SGP*
Better synchronizing key steps in preparation of national budgets	*A Common Budgetary Timeline*	*Complements the European semester*

15 April
- Medium-Term fiscal plans made public with Stability Programmes.

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 – Key Innovations

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Enhanced monitoring for euro area MS

Rationale	*Innovations*	*Articulation with existing framework*
Ensuring an appropriate integration of EU policy recommendations in the national budgetary preparations	*Additional monitoring requirements* *Draft budgetary plans for the forthcoming year submitted before 15 October* *to the COM* *=> might request a revision of the draft* *=> possible Opinion* *to the Eurogroup => discussion based on assessment by the COM*	*Complement the European Semester* *Provide an independent opinion on the draft budget to all stakeholders in the budgetary process*
	Closer monitoring for Member States in EDP	*Complement to the corrective arm of the SGP*
Securing a timely and durable correction of excessive deficits	*Initial stage: comprehensive report + audit of quality of statistics* *Regular report:* - If under 126(7) every 6 months - If under 126(9) every quarter *Any additional information on a request from the COM*	*Compliance with COM Opinion on draft budgetary plan taken into account* *in report under 126(3)* *in recommendation on a non-interest-bearing deposit* *in decision under 126(6).* *Reports of the closer monitoring taken into account* *anytime, to assess whether correction by the deadline is at risk* *can lead to a COM recommendation* *compliance with such recommendation assessed when deciding on effective action (stepping up or abrogation of the EDP)*

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

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The new fiscal governance framework in the euro area

Autumn

Presentation of draft budgetary plan for following year

→ Possible Opinion by the COM

→ Discussion at the eurogroup

End of Year

Budget Law

The European Semester

December

Annual Growth Survey: Overall guidance for the EU

Produced by the Commission - Discussed by the Council - Endorsed by the Spring European Council

March

Annual Growth Survey: Overall guidance for the EU

European Council Policy orientations

April

Medium-term budgetary plans
Stability or Convergence Programmes

Based on Reg 1466/97 - Produced by EU Member States

Medium-term structural reform plans
National Reform Programmes

Based on a political agreement - Produced by EU Member States

June

Country-specific recommendations

Produced by the Commission - Adopted by the Council with endorsement of the European Council

Implemented by EU Member States

The latest step: the International Treaty

25 Member States (all but CZ, UK) –
Entry into force requires ratification by 12 euro area MS
(so far, formal ratification achieved by AT, CY, EL, PT, SI as well as LV, DK)

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)
- ... but deviation allowed in case of "exceptional circumstances" (as in the SGP)

Reinforcement of the correction of fiscal imbalances

- Change in the voting rule (similar to RQMV)
- Economic partnership programme

Enforcement

- Rules in national law through provisions of "binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes. "
- 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

Common principles for the automatic correction mechanism

→ Commission Communication (20.06.12) specifying 7 common principles for correction mechanism – endorsed by ECOFIN

- **Legal status**
- **Consistency with EU framework**
- **Activation** (significant deviation)
- **Nature of the correction** (size and timeline shall be framed by pre-determined rules)
- **Operational instruments** (expenditure rules, coordination of sub-sector of general government)
- **Escape clause** (= exceptional circumstances as defined in the SGP)
- **Role and independence of monitoring institutions**

Role and independence of monitoring institutions

→ **public assessments over**

- Activation of the mechanism
- Correction in line with plans and rules

→ **'Comply or explain' principle**

→ **High degree of functional autonomy:**

- statutory regime grounded in law
- freedom from interference, public communication
- nomination procedure based on experience and competence
- adequate resources and appropriate access to information

Next steps?

June 2012 report by 4 Presidents: towards a genuine Economic and Monetary Union

→ **4 building blocks:**

- **An integrated financial framework:** single European banking supervision and a common deposit insurance and resolution framework
- **An integrated budgetary framework:** build-up of fiscal capacity, common decision-making on budgets, common instruments of stabilisation/adjustment, issuance of common debt… towards a fully-fledged fiscal union
- **An integrated economic policy framework:** stronger economic coordination, broader scope
- **Democratic legitimacy and accountability:** articulation EP, national parliaments, etc..

→ **Timeline** December

Thank you