



# **Budgetary Surveillance in the EU: A Rule-Based Framework**

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# The importance of having fiscal targets

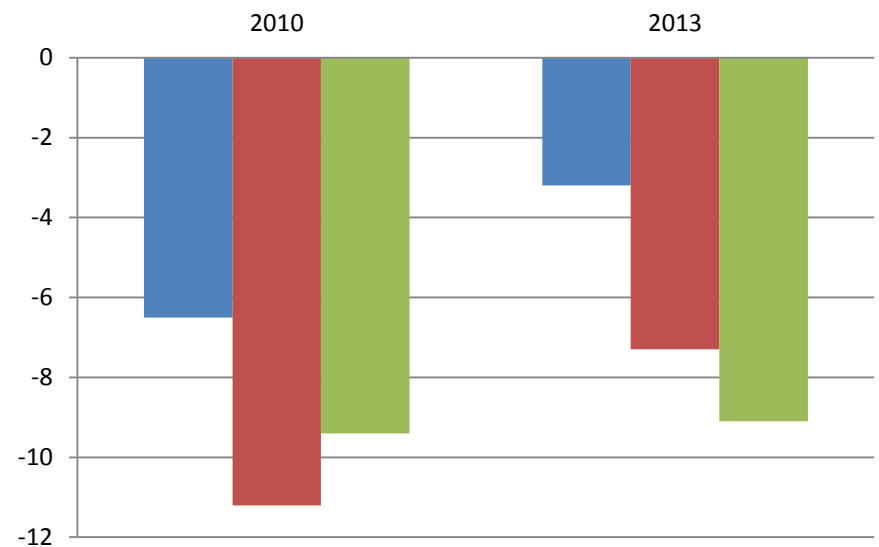
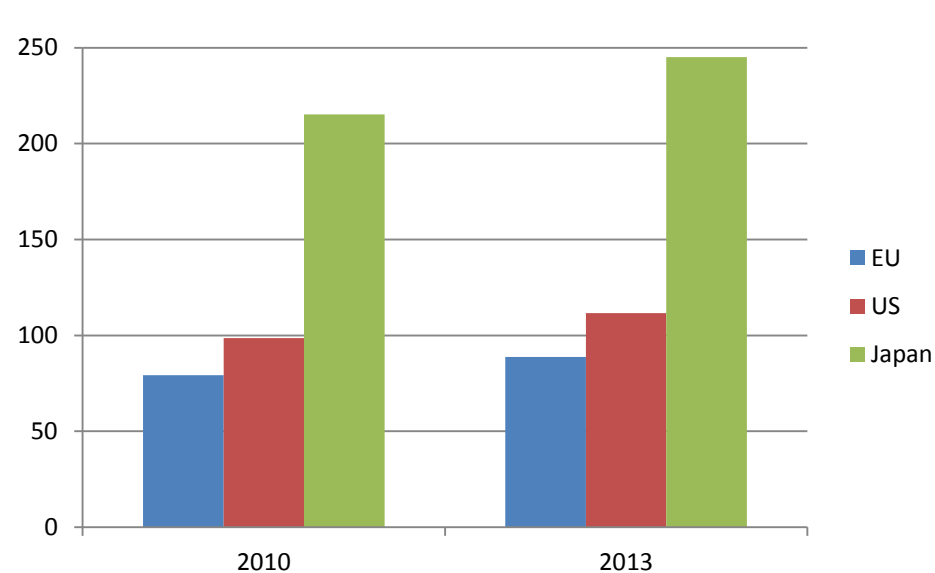
**Toronto Summit Declaration (2010):** *"Sound fiscal finances are essential to sustain recovery, provide flexibility to respond to new shocks, ensure the capacity to meet the challenges of aging populations, and avoid leaving future generations with a legacy of deficits and debt."*

**What was true in 2010 is still true today.** The crisis has brought about large increases of public debt ratios in many countries. The best way forward for the G20 is to agree on an appropriate update of the Toronto fiscal commitments which aimed at tackling both high deficit and debt levels.

# Worrying levels of debt and deficit

General government gross  
debt (% of GDP)

General government net  
lending/borrowing (% of GDP)



# Presentation Outline

- Fiscal Policy in the EU Context
- An overview of the SGP: The preventive and corrective arms
- Multilateral economic coordination & surveillance
- Evolution and reform of the SGP
- Conclusions

# The rule-based framework for fiscal policies in the EU

## *The Stability and Growth Pact (SGP)*

- **Introduced in 1997; reformed in 2005 & 2011**
- **Aims to ensure sound public finances**
- **Key tenets:**
  - **Avoidance of excessive deficits/debt**
  - **Medium-Term Budgetary Objectives**
  - **Economic cooperation & surveillance**
- **Two Arms: Preventive and Corrective**

# Fiscal Policy in the EU Context

*EMU as unique model of economic integration*

- **Common monetary policy & decentralized fiscal policies**

*Fiscal policy within a monetary union*

- **Single monetary policy and irrevocable fixing of exchange rates**
- **Fiscal policy at the country level: Stabilization, Spillovers**

***Common rules ensure that fiscal policy can support monetary policy***

# The original Maastricht assignment

|                | Objective  | specification   | Adjustment path                           | Enforcement mechanism            |
|----------------|--|---|---|----------------------------------|
| Preventive arm | Requirement of a close to balance or in surplus position | none  | none                                      | none                             |
| Corrective arm | Correct gross policy errors                              | Sets limits: <ul style="list-style-type: none"> <li>- Deficit of 3% of GDP</li> <li>- Debt of 60% of GDP or sufficiently diminishing</li> </ul> | Defined within the EDP process (Art. 126) | At the very end of the procedure |

# Fiscal policy in EMU: Who does what

## Member states

- Makes decisions about tax and spending levels – which drive borrowing and debt
- Subject to the constraints of the Stability and Growth Pact

## The European Commission

- Implements the Stability and Growth Pact: are member states compliant with its provisions?
- Prepares the analysis to guide the Council

## The Council of Ministers

- Take the decisions on the application of the Stability and Growth Pact



# An overview of the SGP: The Preventive Arm

- Guidelines to ensure that fiscal policy is conducted in a sound and sustainable manner over the normal economic cycle
- Defines both budgetary objectives and also the processes for surveillance
- Cornerstone of the preventative arm is the medium-term budgetary objective (MTO)

# Preventive Arm Continued

## *The MTO*

- Country-specific fiscal target for medium-term budgetary planning set to ensure sound financial management.
- Countries must attain their MTOs or be on the adjustment path towards it.
- Defined in structural terms, a cyclically adjusted measure of the budget balance that is net of one-off and temporary measures.
- Assessed both ex ante and ex post.

# An overview of the SGP: The Corrective Arm

- Framework for corrective action for countries whose gross errors of fiscal policy have resulted in either their deficits or their debt exceeding defined reference values

## **Reference values:**

**3% of deficit-to-GDP**

**60% (and not sufficiently diminishing at  
a satisfactory pace) of debt-to-GDP**

- Implements the excessive deficits procedure (EDP)

# Evolution and Reform of the SGP

Key factors prompting reforms:

- Economic integration significantly deepened – introduction of single currency
- Enlargement: larger and more heterogeneous union.
- Need for increased economic rationale underlying rules
- Lessons learned: weaknesses identified during financial and economic crisis

*BUT, the underlying rationale and principles remain in place.*

## 2005 Reforms

*Motivated by four main circumstances:*

- Deteriorating budgetary performance
- Increasing difficulties in the application of the rules
- More diverse economic conditions
- Repeated criticism on some aspects of the rules (too rigid, asymmetric)

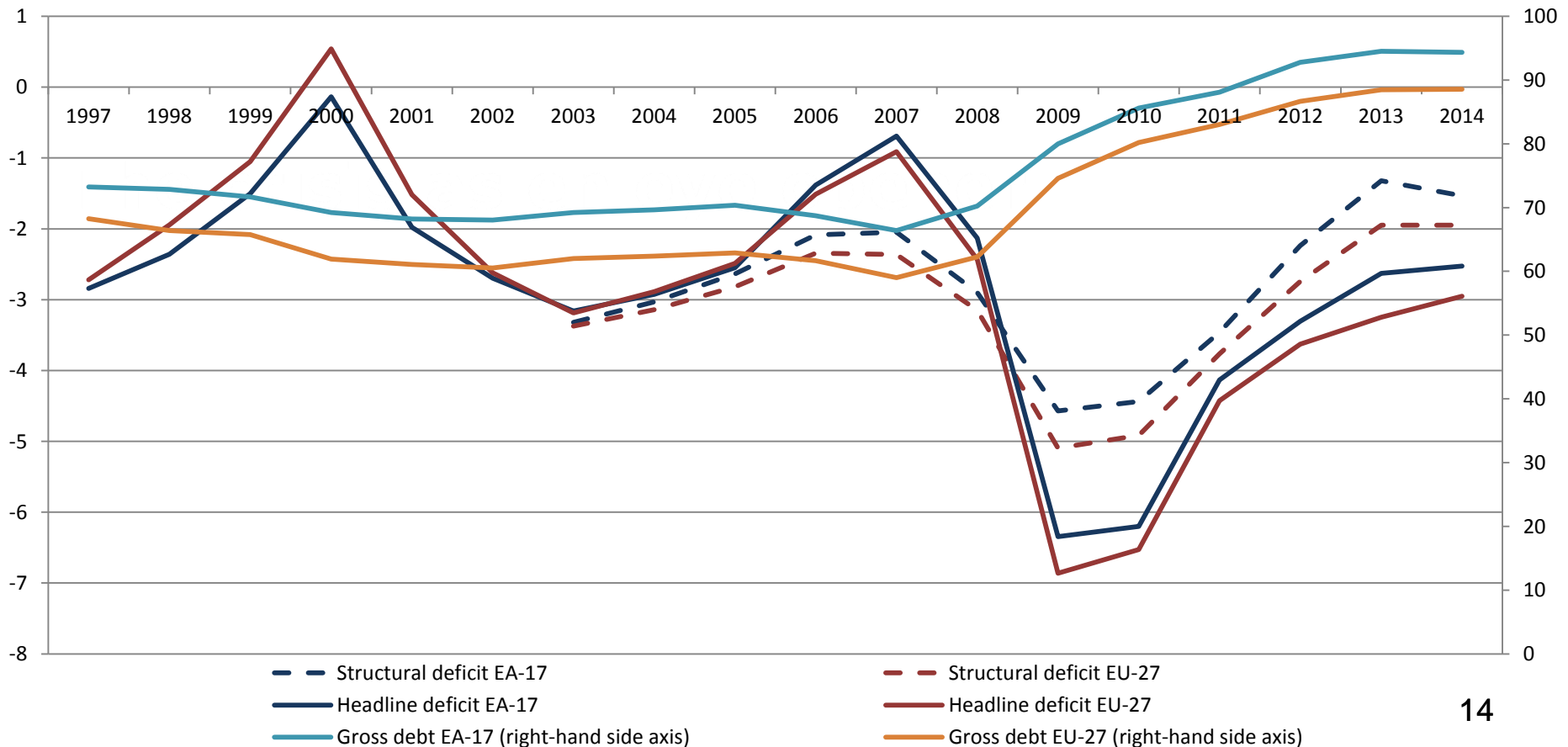
# The crisis as eye opener



## General government deficit and debt in the euro area and in the EU (% GDP)

1997-2014

Autumn 2012 Forecasts of the Commission services





## Weaknesses in fiscal governance

- Public finances not in strong enough position despite overall positive performance of fiscal governance during the crisis.

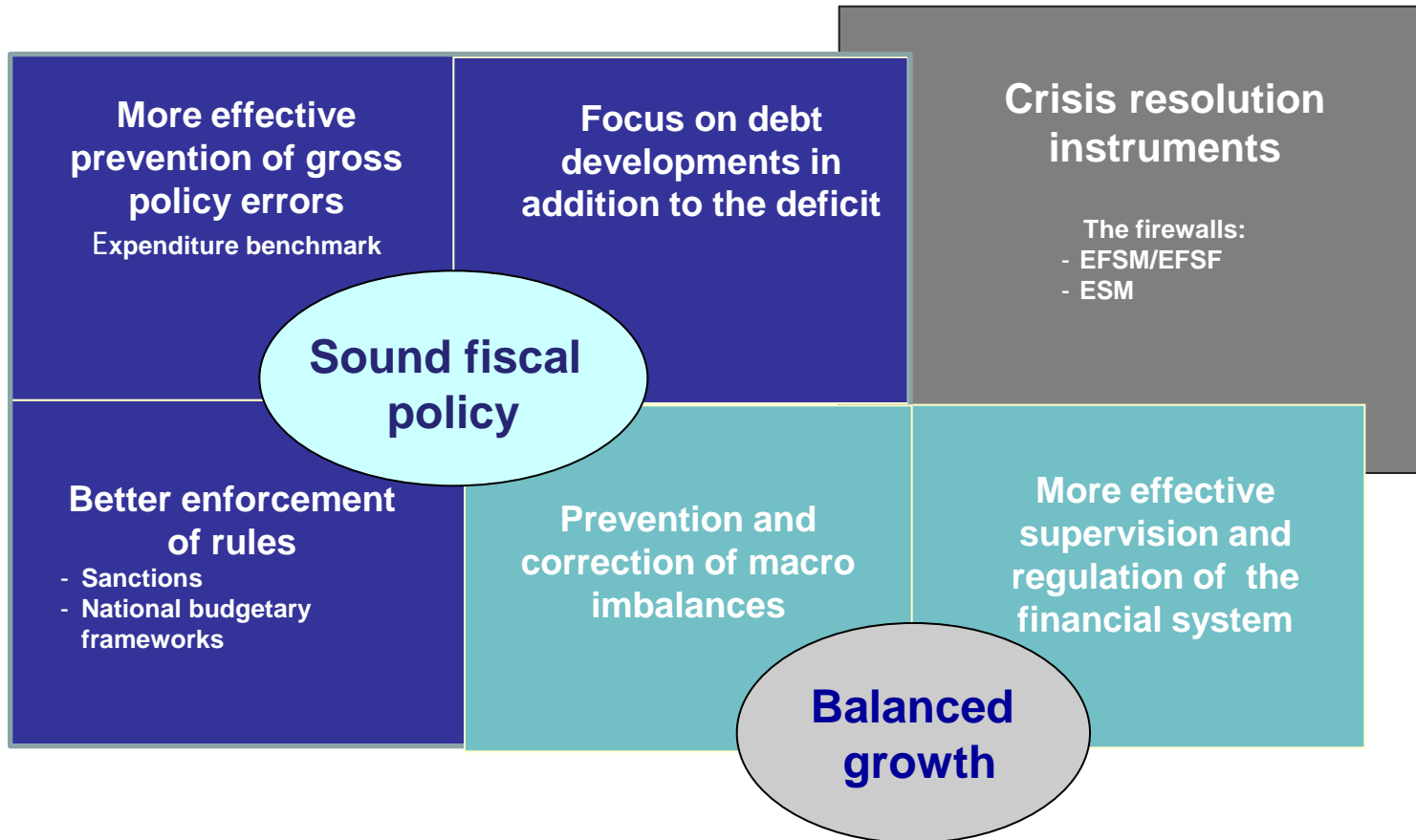
## Narrow scope of the economic governance

- Insufficient focus on macro-fiscal imbalances, surveillance and coordination of macroeconomic policy.

## No crisis resolution mechanism

- No tool for financial assistance in the euro area.

# a comprehensive EU response to the crisis





# A key reform of economic governance: reinforcing European surveillance of fiscal and macroeconomic policies

## **Fiscal rules**

*Prevention of gross policy errors*  
New expenditure benchmark

*Focus on debt on top of deficit*  
New benchmark for sufficiently  
diminishing debt ratio

*Strengthening the national level*  
Minimum requirements for national  
budgetary frameworks

## **Enforcement**

New sanction toolbox

## **Macroeconomic surveillance**

New rules for the  
prevention and correction  
of macroeconomic  
imbalances

## **Enforcement**

Financial sanctions



## Two Regulations building on the Fiscal surveillance leg of the Six Pack for euro area Member States

### ***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 Fiscal Compact: Mirroring EU rules at national level

## *Recalls main commitments of the SGP*

- Country-specific medium-term objectives (MTOs)
- Numerical debt reduction benchmark under the EDP (= Six-Pack)

## *Complements the SGP's toolbox*

- *Ex ante* coordination of debt issuance plans
- Economic partnership programmes for Member States in EDP

## *Strengthens implementation of the SGP*

- **Implementation of MTOs at constitutional (or equivalent) level**
- **Assorted with automatic correction mechanisms** (triggered in case of significant deviation... except if exceptional circumstance) **and monitoring by independent institutions**
- **More stringent lower limit for MTOs (-0.5%),** with a calendar for convergence
- Behavioural commitment to support Commission proposals/recommendations for EDPs in the euro area

## **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

# Conclusions 1

- ❖ Common Fiscal Rules Necessary to Support EMU
- ❖ Rationale and Principles of SGP Remain Valid in EU, Despite Changing Political/Economic Dynamics
- ❖ Reforms Strengthened both Preventive and Corrective Arms
- ❖ Lessons for Fiscal Surveillance from the Crisis
  - Better prevention**
  - Focus on debt**
  - Better enforcement mechanism**
  - Better articulation between the national and European levels**
  - Need for Additional Measures for Euro Area**
- ❖ Deep and Genuine EMU: Work Continues – Next steps: Banking, Budgeting and political union

## Conclusions 2

Fiscal challenges in the EU/EA very different from the African ones.

Different institutional settings and objectives

Share the need to strike the right balance between counter-cyclical purposes and sound public finances.

In this respect, the European experience can be of some interest for African countries.



Commission  
européenne

# Thank you