The European system of fiscal rules and its implementation in the Member States

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Outline

1. The EU fiscal framework: Recent developments

2. The Fiscal Compact: State of play (including on IFIs)

3. Concluding remarks

1. THE EU FISCAL FRAMEWORK: RECENT DEVELOPMENTS

The EU fiscal framework

Rationale

- Fiscal backing to single currency
- Deficit bias

Stability and Growth Pact

- Preventive arm : medium-term objective
- Corrective arm: excessive deficit procedure

- **Rule-based approach**

⇨ National budgets, but constrained by common rules

⇨ Needed: "smart rules" (e.g. Kopits & Symansky criteria and beyond)

- **Evolution**

- "Quest" for best way to interfere
- Recent reforms: 6-pack, 2-pack, Fiscal Compact
- Increasingly detailed

Problems,
long-standing and more recent

Long-standing

→ Rules design: too lax (in good times), too stringent (in bad times)

→ Weak enforcement (the 2003 FR DE 'coup', EL before crisis)

Epitomised by recent financial crisis

→ Massive contingent risks from the private sector

→ Sovereigns of EMU exposed to liquidity stops

Fiscal governance reform
Key feature 1 : 'Smarter rules'

- Emphasis on debt and structural adjustment

→With headline balances also keeping Treaty-based role

→ Exception: adjustment programmes (action-based approach to compliance)

- Acknowledging shortcomings of structural balance:

→ Expenditure benchmark in the preventive arm

→ Practical interpretation of conditional compliance (i.e., compliance conditional on macroeconomic scenario) in the Excessive deficit procedure

Fiscal governance reform
Key feature 2 : More intense monitoring and enforcement

- Significant deviation procedure (preventive arm)

- Opinions on draft budgetary plans

- Regular reporting for EDPs

- Political commitment to follow Commission recommendations in EDP decisions (deficit criterion)

- Earlier sanctions adopted with reverse qualified majority voting (for Euro Area Member States)

Fiscal governance reform
Key feature 3 : Strengthening national appropriation

- Directive (85/2011) on *national budgetary frameworks* setting minimum requirements

- Production or endorsement of macroeconomic forecasts by independent bodies, as part of two-pack

- Fiscal Compact : Enshrinement of SBBR rule in national law at high level

→ Backed by correction mechanisms

→ And by independent monitoring institutions

The current framework: Implementation challenges

- Rules design

→ Complexity (multiple rules ⇨ curse of "complete contract")

→ Balance discipline and stabilisation (bad and good times)

→ Own house in order vs coordination ; risk-sharing ?

- Enforcement

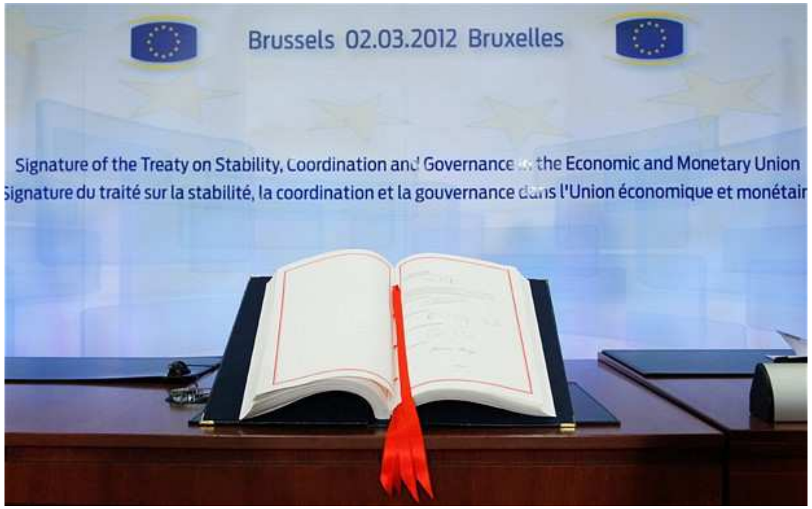
→ Accountability with unobervable variables, need for transparency and predictability

→ Respective roles of market discipline, national controls and EU surveillance

- Current hot spots

→ Debt rule and low inflation

→ Link fiscal objectives and reforms ?



2. THE FISCAL COMPACT - STATE OF PLAY (INCLUDING ON IFIs)

Fiscal Compact: State of play

- Twenty-one Member States bound at this stage

→ Eighteen euro area MS

→ Bulgaria, Denmark, Romania

Lithuania also to be bound if and when joining euro area in 2015

Note: some parties to the TSCG have not opted in to the Fiscal Compact (e.g. Poland, Sweden)

Sixteen Member States where all provisions are *reported* to be adopted

AT BE CY DE DK EE ES FI FR IE IT LV NL RO SK PT

Six Member States where some provisions are reported to be still *under finalisation/adoption*

BG EL LT LU MT SI

Fiscal Compact: Enforcement

- Entry into force: 1 January 2013

- Deadline for provisions to take effect in national law : 1 January 2014

- Article 8 TSCG: Commission "invited to present in due time to the Contracting Parties a report on the provisions adopted by each of them in compliance with article 3(2)."

- Conclusion of non-compliance → Case brought to European Court of Justice (ECJ)

- Judgement of ECJ binding on Contracting Parties. Possibility of sanctions in the event of continued non-compliance.

Fiscal Compact versus preventive arm of SGP

• Same basic rules

as preventive arm of SGP

→ Structural balanced-budget rule

→ 'Rapid convergence' towards MTO, in line with Commission timeframe

• Complements and differences

- Limit of -1% lowered to -0.5% (unless debt << 60%, no risk)
- Enshrined in high-level national legislation
- National correction mechanism (vs significant deviation procedure)
- National monitoring institution (vs EU surveillance)

Enshrining the balanced-budget rule in high-level national legislation

Article 3(2) TSCG

"… shall take effect in the 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."

⇨ Effectively limit budgetary freedom

⇨ By exerting a constraint for national authorities when adopting the budget.

Heterogeneous choices

Some examples

- Germany: Basic Law plus complementary ordinary law
- Spain: constitutional anchor plus organic law
- Italy: constitutional anchor plus "reinforced" law
- Ireland: ordinary law backed by a constitutional amendment
- Portugal: Ordinary law with a reinforced legal value
- Belgium: cooperation agreement
- France: Organic law
- The Netherlands: Ordinary law

Correction mechanism

TSCG article 3(1)e:

- "In the event of significant observed deviations from the medium-term objective or the adjustment path towards it, a correction mechanism shall be triggered automatically."
- "The mechanism shall include the obligation of the Contracting Party concerned to implement measures to correct the deviations over a defined period of time".
- Rationale:

→ Address forecast *and* policy deviations

→ Avoid moving target syndrome

Commission common principles(*)

(1) Legal status

(2) Consistency with EU framework

(3) Activation: well-defined circumstances of significant deviation

(4) Nature of correction: pre-determined rules, proportionality, MTO-adherence, "fixity", binding corrective plan

(5) Operational instruments

(6) Escape clauses in line with SGP

(7) Independent monitoring institutions

(*) Commission Communication COM(2012)342, 20 June 2012. The principles were endorsed by ministers of finance on 21 June 2012.

Possible approaches to the correction mechanism

Ex ante balanced-budget rule combined with ex post debt brake
Examples: Germany, Austria
Challenge: sound implementation

Ex post corrective plan following significant deviation
Examples: France, Portugal, Italy
Challenge: enshrine and demonstrate respect of corrective principles ("2-years rule" but which leeway?)

EU-driven correction mechanism
Examples: The Netherlands, Ireland
Challenge: Ensure tight link with EU recommendations

Independent fiscal institutions (IFIs)

TSCG article 3(2):

• "… common principles … concerning … the role and independence of the institutions responsible at national level for monitoring compliance with the rules ..."

[Reg 473/2013, Directive 2011/85:

→ Independent bodies monitoring compliance with fiscal rules

→ Independent macroeconomic forecasts]

• Rationale:

→ Combine rules and institutions, esp. for smart but complex rules

→ Foster discipline, transparency and national ownership

Commission common principles(*)

(1) Mandate: providing assessments, including on correction mechanism (activation and implementation) and escape clauses

(2) Independence criteria: i) qualified leadership and staff; ii) capacity to communicate freely; (iii) secure funding ; (iv) access to information

(3) "Comply or explain" principle: demonstrate that advice is not just ignored but government makes clear and in a structured manner its position vis-à-vis the assessments.

(*) Commission Communication COM(2012)342, 20 June 2012. The principles were endorsed by ministers of finance on 21 June 2012.

The EU-driven strengthening of IFI core tasks

>Assess ex post fiscal rules

>Monitor the structural balanced-budget rule

>Produce or endorse macro forecasts

>Monitor all domestic fiscal rules

>Fiscal policy watch

>Normative assessments

>Policy costings

>Surveillance of subnational governments

>Sustainability estimates

Degree of involvement in budgetary process

Timeline

2011	2012	2013	?
Directive 85/2011 All EU MS	Fiscal Compact 21 Signatory Parties	Regulation 473/2013 Euro-Area MS	Other tasks in national mandates = best practices?

A tentative typology of IFIs (I)

"The forecasting-only institutions"

- Assigned forecasting tasks
- Well-established institutions
- Other non-conflicting technical tasks in mandate
- De facto autonomy within government deriving from technical expertise
- Larger staffing
- Recent inclusion in the IFI world (since 2013 Regulation)

"The assessing-only entities"

- Specialised in ex-post fiscal rules assessment
- Embedded in hosting entities
- Benefiting from their resources and authority…
- …but need for internal ring-fencing arrangements
- Smaller staffing
- Relatively new in fiscal assessments

"The Fiscal Councils"

- Mandate excluding non-fiscal policy related issues
- Generally focussed on periodic fiscal policy and rule assessment
- Smaller teams of skilled personnel
- Usually stand-alone bodies
- Often of recent establishment
- Mandate significantly influenced by EU reforms (6P, 2P)

"The Advanced Fiscal Councils"

- Broad, multi-faceted, mandate encompassing forecasting and fiscal policy/rules assessment
- Stand-alone entities with sizeable staff
- Often of recent establishment
- Often in MS having faced heavy fiscal consolidation needs

A tentative typology of IFIs

The forecasting-only institutions • Austrian WIFO • Dutch CPB	**The assessing-only institutions** • Finnish Court of Auditors • Dutch Raad Van State
The Fiscal Councils • Swedish Fiscal Policy Council • Irish Fiscal Advisory Council	**The Advanced Fiscal Councils** • Portuguese Public Finance Council

Great diversity in practice

- Set-up: 'Stand-alone' (e.g. Ireland, Portugal, Slovakia) versus attached to existing institution with ring-fencing arrangements (Germany: Stability council, France: Cour des comptes, Italy: Parliament)
- Mandate: can be broad (Denmark, Portugal, Slovakia) or specific (Germany, France) or ideally both (Italy, Spain, Ireland).
- Staffing: generally in proportion with breath of the mandate, but large differences (spanning from a few people to several tens)
- Access to information: possible good practice of memorandum of understanding with administrations (e.g. Ireland)
- Appointment and dismissal procedures: generally based on competence and experience, possible preference for longer, non-renewable terms (e.g. Spain: 6 years non-renewable)
- Comply or explain: often specifically laid down in legislation albeit sometimes left implicit (e.g. Denmark, Finland). In any case, practice will be the true test.

3. CONCLUDING REMARKS

Concluding remarks

- The system of EU fiscal rules has significantly evolved, taking good lessons from the experience, albeit in an 'incremental' manner, ending up in a highly sophisticated construction.

- Arguably the system scores reasonably well on some dimensions (such as adequacy and flexibility, with however caveats), while its performance on other dimensions remains uncertain (enforcement) or has become questionable (simplicity).

- The focus is now on soundly implementing the framework, which implies some further moderate, country-differentiated, fiscal consolidation in most Member States, though there is slight room for manoeuver in a few countries.

- On the Fiscal Compact specifically, the emerging picture is likely to be a half-filled glass, as Member States are careful to avoid blatant departure from the requirements while not always going for the most stringent options.