Ministero dell'Economia e delle Finanze
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Strengthening the economic policy coordination in the EU: problems and perspectives

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Outline of the presentation

- The Stability and Growth Pact (SPG): A never ending story
  - Legal foundations, economic rationale, and structure
  - The SPG crisis (2003) and reform (2005): Stylized facts
  - The original versus the revised version of the Pact: A comparison
- The effects of the crisis on the European economic governance
  - Towards a reinforced fiscal and macroeconomic framework
  - The proposal of the Commission
  - The Task force on economic governance
- What's next: some tentative conclusions

The SGP legal foundations: the EU existing fiscal framework (1)

- The set of numerical fiscal rules and procedures currently governing the budgetary discipline in EMU is given by the Maastricht Treaty, the EDP and the SGP.
- The public finance criteria for convergence are included in the Maastricht Treaty (art. 104C, par. 2).
- The EDP (Protocol annexed to the Treaty) sets out the procedural rules if a MS runs an excessive deficit. It consists of a series of pressures and actions aimed at reducing deficit within the 3%.
- Exceptions are provided in case of the simultaneously presence of 3 three specific factors (exceptionality, temporariness and proximity to the benchmark). However, the Treaty does not specify the content of these three conditions.

The SGP legal foundations: the EU existing fiscal framework (2)

- The detailed description of the timing and operational procedures was incorporated into the SGP (EU Council meeting in Amsterdam in June 1997) and come into force in 1999 (third stage of EMU).
- The SGP is ruled by two separate regulations and resolutions.
- The regulation 1466/97 is to strengthen the surveillance of budgetary positions and the surveillance and coordination of economic policies (the preventive arm of the Pact).
- The regulation 1467/97 is to speed up and clarify implementation of the excessive deficit procedure (the dissuasive arm of the Pact).
- The SGP confirms the 3% threshold on deficit to GDP ratio and introduces the notion of medium-term objective (MTO).

The SGP economic rationale

- In line with the political economy view, the theoretical foundations of the SGP can be summarised as follows:
- (a) imposing constraints on national fiscal policy in order to protect the independence of the ECB from political pressure;
- (b) "tying hands" to national policy–makers in order to neutralize the incentive to expand the public expenditure and preserve long fiscal sustainability (free riding behavior);
- (c) preventing the issue of moral hazard; although the existence the "no bail-out clause", the potential costs of a default on a public debt by a MS (especially a large one) could force the ECB to intervene in the monetary market.

The SGP Structure: Preventive arm

- Council Regulation No 1466/97 requires the submission of a SCP to Commission and Ecofin and by each MS.
- The SCP must indicated, the MTO, the expected path of government debt to GDP ratio, the macroeconomic framework along the forecast horizon covered by the program, a description of budgetary and other economic policy measures to be taken to achieve the objectives and the analysis of public finance sustainability (Article 3 reg. 1466/97).
- Based on the Commission assessment, the Ecofin shall consider the SCP with the ability to issue recommendations to MS whose public finance dynamics could produce an excessive deficit (Article 6).
- The ECOFIN yearly monitors the content and implementation of SCPs to prevent cases of excessive deficit.

The SGP Structure: Dissuasive arm

- Council Regulation No 1467/97 provides the definition of the existence of an excessive deficit, including the concepts of "exceptional and temporary excess" over the reference value and "severe economic downturn".
- The excessive deficit can be considered exceptional if it results (a) from an unusual event outside the control of the MS or (b) from a severe economic downturn. In any case, the deficit should remains close to the reference value.
- The deadlines for the correction of the excessive deficit, unless there are "special circumstances" (not specified!).
- Rules for the monitoring and assessment of the results of corrective actions taken.
- Deadlines for the subsequent steps in the procedure, including the application of sanctions.

The 2003 SPG crisis and its reform on 2005: Stylized facts

- In November 2003 Ecofin froze the implementation of sanctioning mechanism to France and Germany. The SGP crisis was officially opened.
- On September 2004, the Commission put forward a specific proposal for improving the European fiscal framework.
- After a period of negotiations between the Commission and MS, on March 2005, the Spring European Council agreed on the need of the SGP revision.
- On April 2005, following the Council guidelines, the Commission provided the requested amendments to the two Council Regulations underlying the SGP.
- In June 2005, Ecofin and European Council finally endorsed the revised version of the Pact, which immediately come into force.

The rationale of the revised SGP version

- Main objectives pursued were:
- enhancing the economic rationale of the budgetary rules to improve their credibility and ownership;
- improving "ownership" by national policy-makers;
- using more effectively periods when economies are growing above trend for budgetary consolidation in order to avoid pro-cyclical policies;
- taking better into account the Council recommendations regarding periods when economies are growing below trend;
- giving sufficient attention in the surveillance of budgetary positions to debt and sustainability.

The original versus the revised version of the SGP: A comparison

Changes in the preventive arm	Original	Revised
1. Medium-term objective (MTO)	All Member States (MS) have a medium-term budgetary objective of 'close to balance or in surplus'.	• Country-specific differentiation of MTOs according to stock of public debt and potential growth. • MTOs for euro-area and ERM II MS are set between– 1 % of GDP and balance or in surplus (in cyclically adjusted terms and net of one-offs). • Implicit liabilities to be taken into account at a later stage, when modalities for doing so are agreed by the Council.
2. Adjustment path towards the MTO	No specific provisions	• MS to take active steps to achieve the MTO. • Annual minimum adjustment for MS of the euro area or of ERM II of 0.5 % of GDP. • The effort should be higher in 'good times'. • 'Good times' are identified as periods where output exceeds its potential level, 'taking into account tax elasticities.
3. Early policy advice	Early warnings are adopted/addressed by the Council, upon recommendation of the Commission.	In addition, the Commission can issue direct 'early policy advice' to encourage MS to stick to their adjustment path. To be replaced by 'early warnings' in accordance with the Constitution once applicable.
4. Structural reforms	No specific provision.	Reforms will be taken into account when defining the adjustment path to the MTO and may allow a deviation from it under the following conditions: • only major reforms (direct/indirect impact on sustainability); • safety margin to the 3 % reference value is guaranteed; • the deficit returns to the MTO within the programme period; • detailed information is provided in the stability/ convergence programmes. Special attention to systemic pension reforms.
Fonte: European Commission, Public Finance in EMU 2005		

The original versus the revised version of the SGP: A comparison

Changes in the corrective arm	Original	Revised
Preparing a report under Article 104(3)	No obligation for the Commission to prepare a report if a deficit exceeds 3%.	• The Commission will always prepare a report in cases where there is a deficit above 3 %. • The report will examine whether the exceptions in Article 104(2) apply. • It will take into account whether the deficit exceeds government investment expenditure and all 'other relevant factors'.
Severe economic downturn	'Severe economic downturn' if there is an annual fall in real GDP of at least 2 % for the preparation of the report under Article 104(3) by the Commission, and in decisions under Article 104(6) by the Council, if observations by the Member State concerned show that the downturn is exceptional in light of evidence of the abruptness of the downturn and theaccumulated loss of output with respect to past trends. The MS commit not to invoke the severe economic downturn when growth is above – 0.75 %.	An economic downturn may be considered 'severe' in cases of a negative growth rate or accumulated loss of output during a protracted period of very low growth relative to potential growth.
'Other relevant factors' (ORFs)	No specific definition of 'ORFs' and their role in the excessive deficit procedure.	• The Commission report under Article 104(3) will take into account: – developments in the medium-term economic position (potential growth, cyclical conditions, implementation of policies); – developments in the medium-term budgetary position (public investment, quality of public finances, as well as fiscal consolidation in 'good times', debt sustainability); – any other factors, which, in the opinion of the MS, are relevant in order to assess the excess over the reference value. • ORFs will be considered in the steps from Article 104(4) to (6) only if the excess over the reference value is temporary and the deficit remains close to the reference value. Any deficit above 3 % that is neither close to the reference value nor temporary will be considered excessive. • If the Council has decided that an excessive deficit exists, the ORFs will also be considered in the subsequent procedural steps of Article 104 (except in Article 104(12), i.e. abrogation, and when deciding to repeat steps in the EDP).

The original versus the revised version of the SGP: A comparison

Systemic pension reforms	No specific provision.	• These are treated like an ORF, but under strict conditions also with a role in abrogation. • Consideration to the net cost of the reform will be given regressively for the initial five years after an MS has introduced the reform (or five years after 2004).
Increasing the focus on debt and sustainability	No specific provision.	• The debt criterion, and in particular the concept of a debt ratio 'sufficiently diminishing and approaching the reference value at a satisfactory pace', will be applied in qualitative terms. • The Council will formulate recommendations on the debt dynamics in its opinions on the stability and convergence programmes.
Extending deadlines for taking effective action and measures		• Deadlines are extended: for a decision under Article 104(6) — from three to four months after notification; • for taking effective action following Article 104(7) — from four to six months; • for moving to Article 104(9) — from one to two months; • for taking action following a notice under Article 104(9)— from two to four months.
Minimum fiscal effort	No specific provision.	Countries in excessive deficit are required to achieve a minimum fiscal effort of at least 0.5 % of GDP as a benchmark.
Initial deadline for correcting the excessive deficit	The excessive deficit has to be corrected in the year following its identification, unless there are 'special circumstances'.	The rule remains; possible extension by one year based on ORFs and on the condition that minimum fiscal efforts have been taken.
Repetition of steps in the EDP	Not foreseen.	Deadlines for correcting the excessive deficit can be extended if: effective action has been taken by the MS concerned incompliance with the initial recommendation or notice, and unexpected adverse economic events with major unfavourable budgetary effects

The effects of the global crisis on the EU fiscal framework: Stylized facts (1)

- The recent crisis and the risk for macroeconomic and public finance stability of the Euro area have underlined the interdependence and the high vulnerability of EU economies.
- Fiscal discipline, competitiveness gaps and private sector imbalances are a matter for the EU as a whole.
- This interdependence calls for urgent actions for reinforcing economic policy coordination across the EU.
- The Lisbon Treaty and he SGP establish sound rules and procedures for implementing such economic policy coordination even if they have not been sufficiently respected.
- Over the recent years, peer pressure lacked teeth, good times were not used to reduce public debt sufficiently.

The effects of the global crisis on the EU fiscal framework: Stylized facts (2)

- EU economies are strongly interlinked through the single market.
- Cross-border trade and financial spill-over, particularly in the banking sector, are increasing and large.
- Moreover, the build-up of macroeconomic imbalances was not addressed appropriately, even though several Commission warnings.
- In a number of MS, this translated into high current account deficits, large external indebtedness and high public debt levels, largely above the 60% reference value.
- Finally, in April 2010, the financial stability of the Euro area has been put at risk, especially due to Greek sovereign debt crisis.

The proposal of the Commission: aims and structure (1)

- The main aim is twofold:
  - to establish stronger economic governance in the EU, so as to reinforce compliance with the rules and principles set out in the Treaty and the SGP, especially for the euro area;
  - to establish formal procedures to deal with macroeconomic imbalances that can jeopardize the functioning of EMU.
- The Commission approach is based on three pillars:
- reinforcing the SGP;
- addressing macroeconomic imbalances and divergences in competitiveness;
- working towards a permanent and robust framework for crisis management.

The proposal of the Commission: aims and structure (2)

- The first two pillars should be integrated into the "*European Semester*" for achieving a more integrated surveillance of economic policies (Europe 2020 strategy + SGP assessment).
- MS would benefit from early (*ex ante*) coordination at EU level when they prepare their national budgets and national reform programs (NPRs).
- European Semester applies to all EU Member States, whereas for the Euro area the new surveillance process includes the assessment of macroeconomic and competitiveness developments.
- The Greek sovereign debt crisis has also showed that a robust framework for crisis management for euro-area Member States is needed.

Strengthening the SGP (first pillar): the preventive arm (1)

- Preventive budgetary surveillance must be reinforced, so as to allow early detection and action (to be included in the assessment of the SCPs).
- The Commission proposes an early peer review at EU level of the broad budgetary guidelines of each MS, thus informing the MS's competent authorities of the EU perspective and guidance before they adopt their national budget.
- The Commission proposes to reinforce Eurostat mandate to audit national statistics in order to increase data accuracy and transparency (avoiding the case of Greece).

Strengthening the SGP (first pillar): the preventive arm (2)

- The Commission proposes the possibility of imposing interest-bearing deposits on MS making insufficient progress to their MTOs in good economic times, because of inadequate fiscal policies. (Change in secondary legislation needed)
- The Commission also encourages Member States to integrate in their national law the Treaty obligations on budgetary discipline (Protocol Nr.12 TFUE), putting in place budgetary procedures that ensure compliance for instance through legally binding instruments.
- In this regard, FR has recently announced the adoption of a constitutionally-grounded national fiscal rule (the same is already place in DE).

Strengthening the SGP (first pillar): the dissuasive arm (1)

- Speeding up procedures, in particular for those MS in repeated breach. (Change in secondary legislation needed)
- For instance, the initial steps of the procedure could be skipped for countries in repeated breach.
- More attention will be given to the debt criterion: MS with debt ratios above 60% of GDP should become subject to the EDP if the decline of debt in a given period falls short of an appropriate benchmark, in line with art. 126 TFUE. (Some changes in secondary legislation needed)
- Broader and more timely use of the EU budget to ensure compliance with the SGP should be considered.
- Suspension of the Cohesion Fund is foreseen at a late stage in the EDP, according to art 126 (8) TFUE.

Strengthening the SGP (first pillar): the dissuasive arm (2)

- Under the new Financial Perspectives, the establishment of fair, timely and effective incentives for compliance should be established.
- For instance, once the existence of an excessive deficit is established (art.126 (6) TFUE), MS could be asked to redirect funds to improve the quality of public finances, i.e. reducing transfers and public consumption to favour public investment.
- Cohesion policy could play a greater role, by strengthening institutional capacity and efficiency of public administrations. *Ad hoc* proposals will be presented in the 5th Cohesion Report.
- A more rigorous application of the existing suspension clause for Cohesion Fund commitments should be pursued in case of current breaches of the Pact.

Competitiveness and other macro-economic imbalances (second pillar): the state of play (1)

- The accumulation of large and persistent imbalances among Euro area MS potentially undermines the cohesion of the euro area and hampers its functioning.
- During its first decade, the Euro area has seen steady divergence in the current account and competitiveness positions of its MS.
- Some (large) Euro area MS have accumulated large current account deficits and experienced large losses in competitiveness. These trends were associated with a misallocation of capital and labour, unsustainable accumulation of debt and housing bubbles.
- Other MS accumulated large current account surpluses reflecting persistent weakness in private sector demand.

Competitiveness and other macro-economic imbalances (second pillar): proposals (2)

- Introducing a broader economic surveillance framework for the euro area, going beyond the budgetary dimension to address also macroeconomic imbalances (competitiveness developments and underlying structural challenges).
- Under the Europe 2020 strategy, developing a specific policy framework for the Euro area to tackle broader macroeconomic imbalances by considering the deep economic and financial inter-linkages and their impact on the single currency,
- The European Council therefore asked the Commission to present a proposal by June 2010 to strengthen coordination within the Euro area.

Competitiveness and other macro-economic imbalances (second pillar): proposals (3)

- Upgrading the peer review of macroeconomic imbalances (Eurogroup competence) into a structured surveillance framework based on art.136 TFEU.
- Assessing the risk of emerging macro-economic imbalances, for the euro area as a whole and on a country basis, using a scoreboard of external and internal indicators (current accounts, unit labour costs, public and private sector debt or asset prices).
- Releasing *country-specific recommendations* on actions to be taken by a Euro area MS within a stipulated time, stemming from a more in-depth analysis of imbalances.
- In this regard, formal acts will be taken by Ecofin Council with only euro area Member States voting.

Competitiveness and other macro-economic imbalances (second pillar): proposals (4)

- In case of insufficient action, Ecofin Council could decide, on the basis of a Commission proposal, on more precise economic policy recommendations, depending on the situation of the MS concerned.
- Recommendations could generally address the functioning of labour, product and services markets, in line with the IGs.
- Recommendations could also cover macro-prudential aspects to prevent or curb excessive credit growth or excessive asset price development, in line with the future European Systemic Risk Board analysis.
- The Commission could also issue early warnings directly to a euro area member state where necessary.

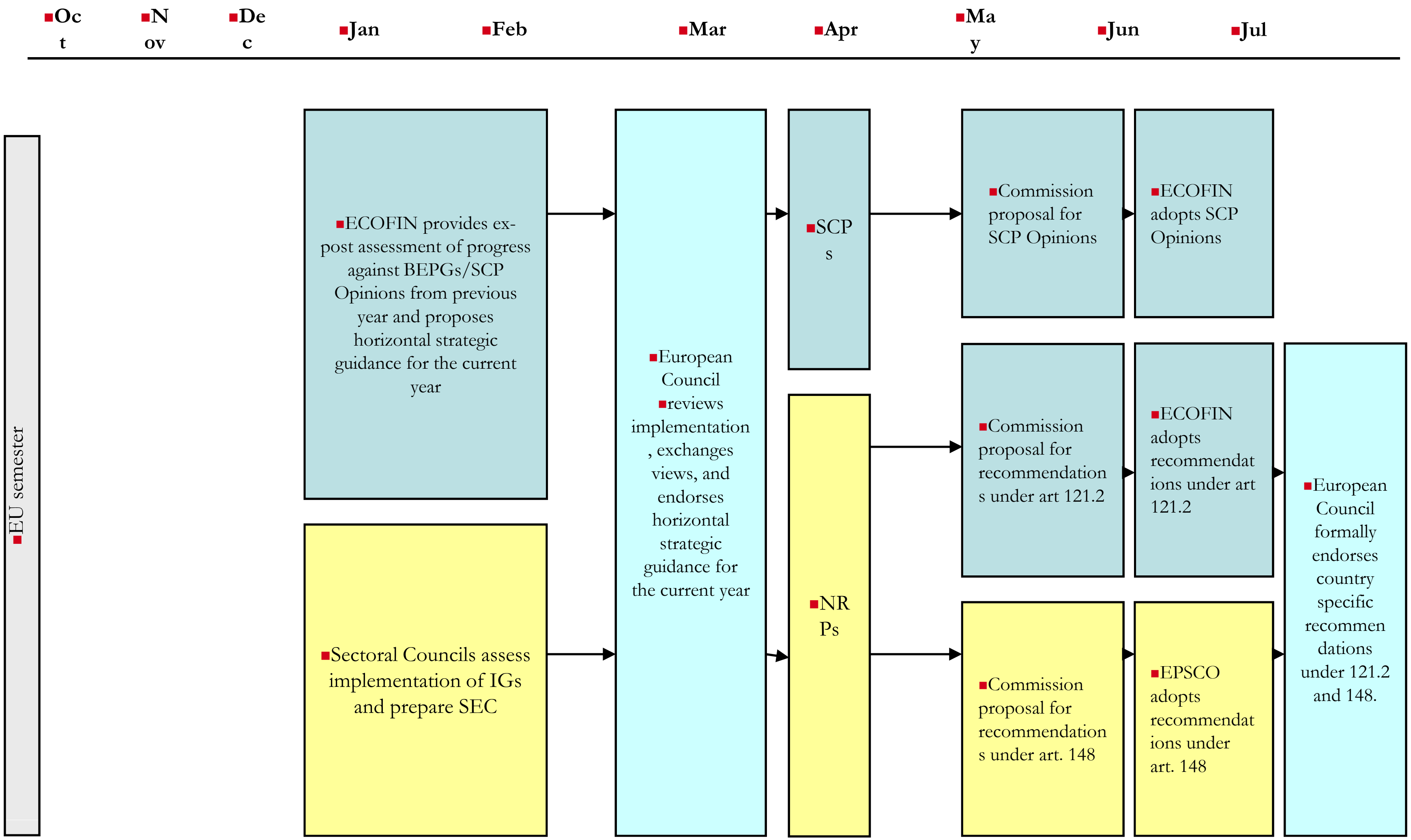
Incorporating the first and second pillar: the European Semester (1)

- The European Semester would establish an integrated (structural and fiscal policies) surveillance cycle, allowing a synchronized, effective and efficient assessment.
- Such process would start early in the year with a horizontal review under which the European Council, based on input from the Commission, would discuss the main economic challenges for the EU and the Euro area in view of giving strategic guidance.
- The results of this discussion would be taken into account by MS when preparing their SCP and NRP.
- MS are encouraged to involve their national parliaments in full respect of national rules and procedures in the process before submission.

The European Semester (2)

- The SCP and NRP would be issued simultaneously.
- Submission of the SCP should take place in the first half of the year instead of towards the end of the year.
- The Council, based on the Commission assessment, would subsequently provide assessment and guidance, at a time when budgetary decisions are still in a preparatory phase at national level.
- The results of such *ex ante* budgetary and economic surveillance at EU level among peers would allow the competent national authorities to be informed of the EU perspective and guidance.

The European Semester: A tentative calendar (2)



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A permanent and robust framework for crisis management (third pillar)

- Recent events have shown that "better to be safe than sorry“.
- The best crisis mechanism is fiscal discipline and tackling imbalances before they occur.
- In case of crisis, corrective action is needed to avoid contagion effects. If corrective action is not enough, additional interventions are needed.
- Possible EU intervention are allowed based on the temporary European stabilisation mechanism agreed by ECOFIN on 9th May 2010.
- Proposal for a permanent crisis resolution mechanism accompanied by a detailed and demanding programme of policy conditionality will be shortly issued by the Commission.

The Task Force on economic governance (1)

- Established by the Spring European Council in March 2010.
- It includes representatives of all 27 MS– mostly Ministers of Finance - Commissioner Rehn, ECB President Trichet, Eurogroup President Juncker, the European Council President, Van Rompuy.
- First meeting on 21 May 2010. Agreement found on the 5 main objectives:
- (1) Achieving greater budgetary discipline by strengthening the SGP;
- (2) Developing instruments to reduce the divergences in competitiveness between the MS and, in particular, in the Euro area;
- (3) Building up an effective crisis mechanism in order to be able to deal with the current problems.

The Task Force on economic governance (2)

- (4) Reinforcing economic governance in order to be able to act quicker and in a more coordinated and more efficient manner.
- (5) Drawing lessons from this recent crisis, the measures we have taken for Greece (on 2 May) and in a broader framework (on 7 and 9 May) have proven that the European Union is able to act.
- Deadline for submitting specific proposals by MS is the end of May.
- The Task Force we will meet at least twice before the summer.
- Preparatory work will be done by a group of 'Sherpa's‘, which will present a "Progress Report" to the European June Council, while the final report is expected before the European Council of October.

What's next: the first Member States' reaction

- The Commission proposals do not imply Treaty changes. They are based on making full use of the surveillance instruments available under the Lisbon Treaty.
- The Lisbon Treaty provides plenty of room for progress through a better and full use of the existing economic policy instruments (art. 136), and through revised and new secondary legislation.
- However, MS have expressed serious concerns about the Commission package.
- First, albeit its right of initiative, the Commission tries to impose its views, exploiting the effects of crisis.
- Second, the EU scrutiny of state budgets could reduce national fiscal sovereignty and the early peer review could not fully respect the prerogatives of national parliaments.

- GRAZIE!