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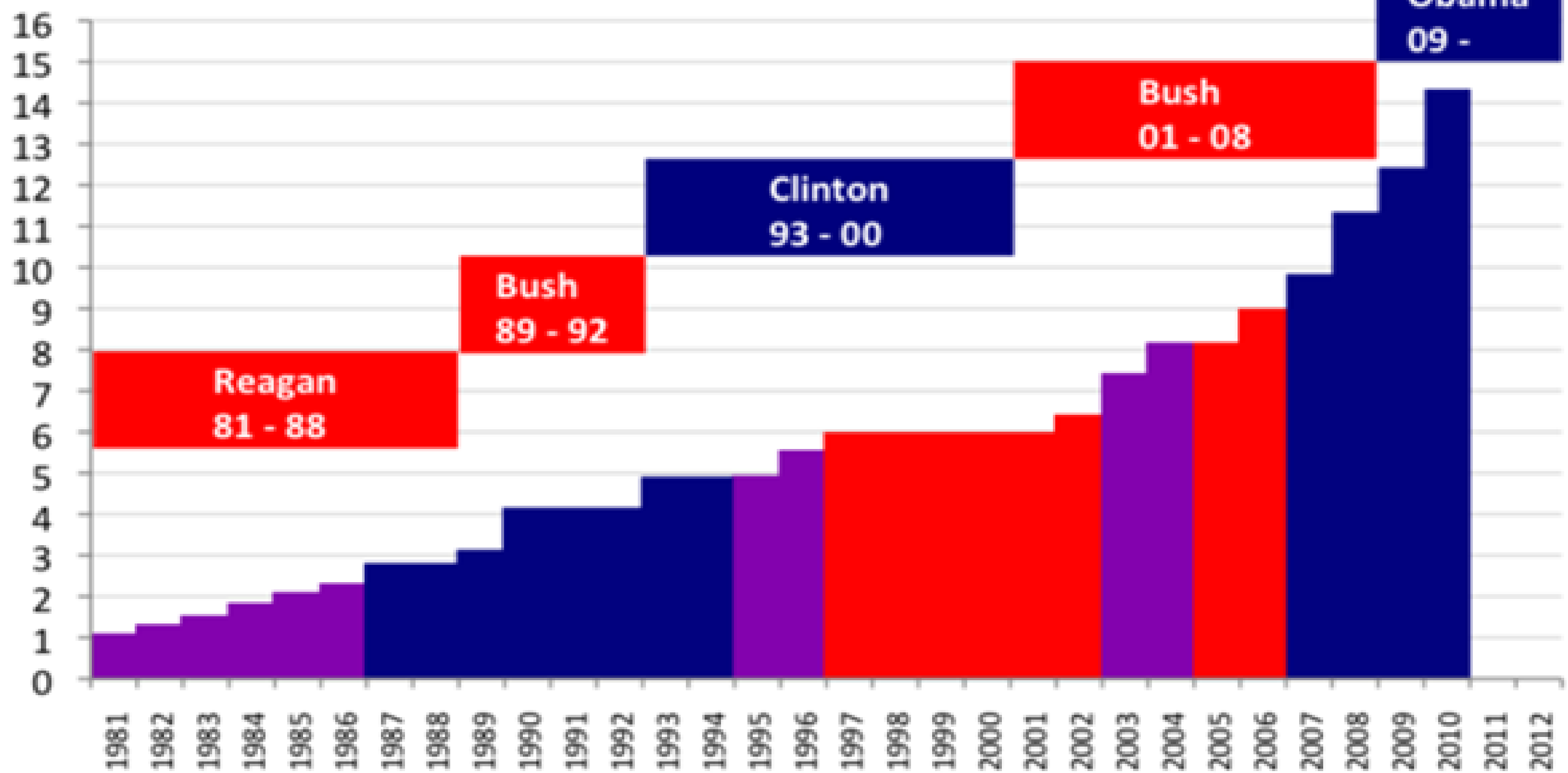
The EU “fiscal compact” to get out of the present crisis.

Ankara, TEPAV
9 April, 2012

Public Finance in EU after 2007

- In several countries fiscal stimulus policies have been implemented.
- Public funds for bail-out have a distorting effect on market mechanisms.
- A market, to work well, needs the carrot of the profit and the stick of the bankruptcy.
- In the EU and in the USA no positive impact on growth and employment has been experienced.
- The only tangible result is the growth of public debts.
- More public debt leads to lower growth.


US Public Debt Ceiling Since 1981 - $ Trillions
Obama
09 -
Bush
01 - 08
Clinton
93 - 00
Bush
89 - 92
Reagan
81 - 88
16
15
14
13
12
11
10
9
8
7
6
5
4
3
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1
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1981
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1983
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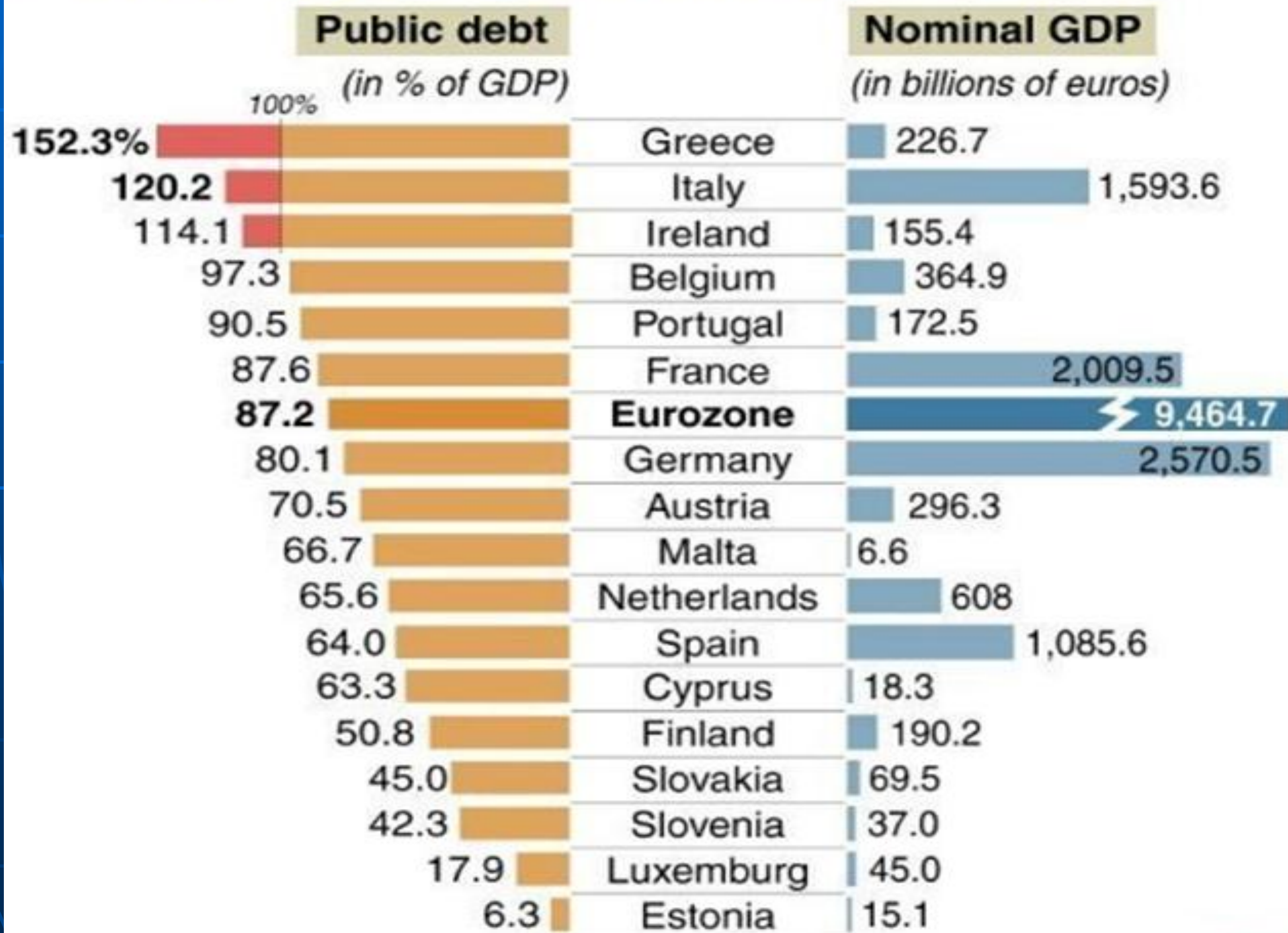
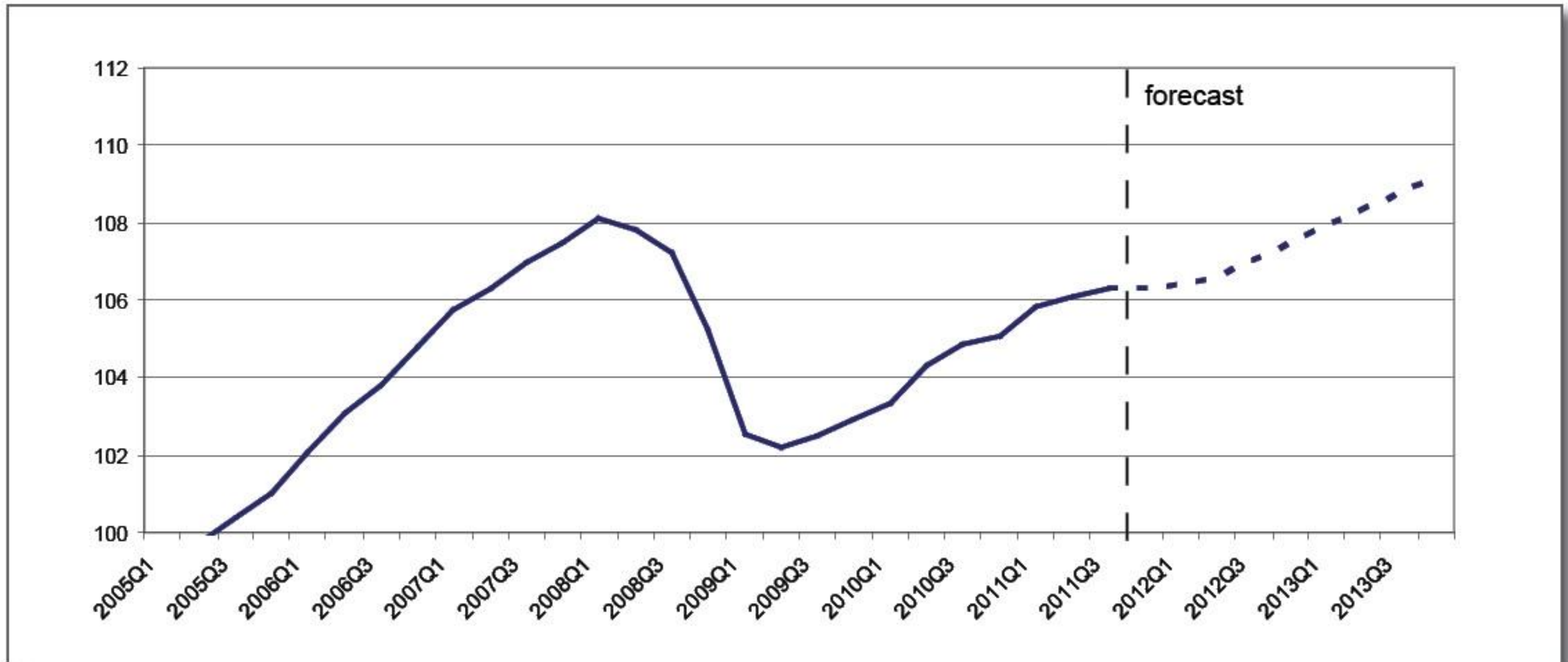


Public debt in the eurozone
Public debt
(in % of GDP)
100%
Nominal GDP
(in billions of euros)
152.3%
Greece
226.7
120.2
Italy
1,593.6
114.1
Ireland
155.4
97.3
Belgium
364.9
90.5
Portugal
172.5
87.6
France
2,009.5
87.2
Eurozone
9,464.7
80.1
Germany
2,570.5
70.5
Austria
296.3
66.7
Malta
6.6
65.6
Netherlands
608
64.0
Spain
1,085.6
63.3
Cyprus
18.3
50.8
Finland
190.2
45.0
Slovakia
69.5
42.3
Slovenia
37.0
17.9
Luxemburg
45.0
6.3
Estonia
15.1
Source: IMF (2011 forecasts)
AFP

EU GDP level in recent years

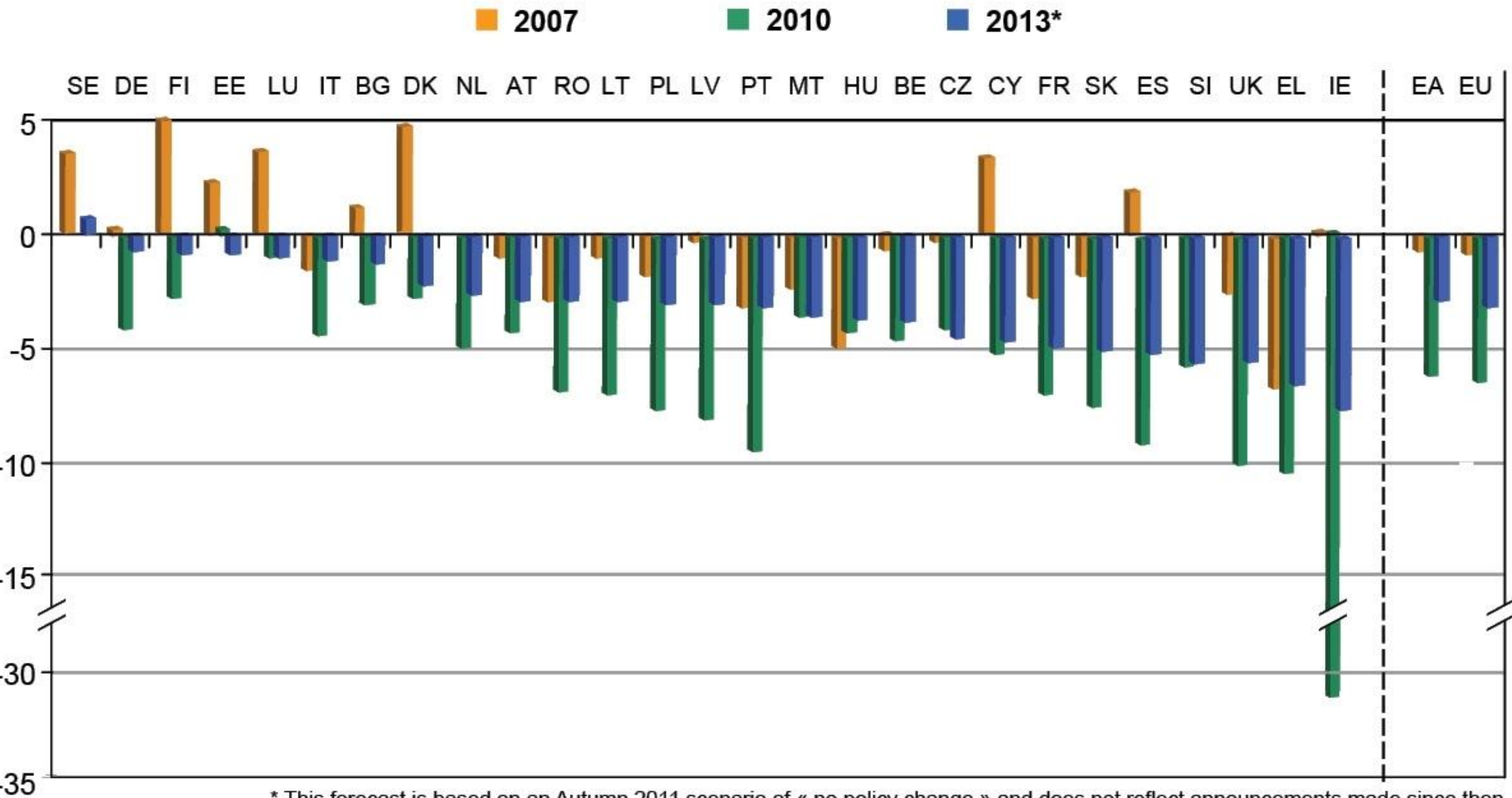
(first quarter 2005 = 100)



EU GDP grew strongly early in 2011, but has slowed substantially since then. Growth in 2012 is expected to be slow.

Source: European Commission

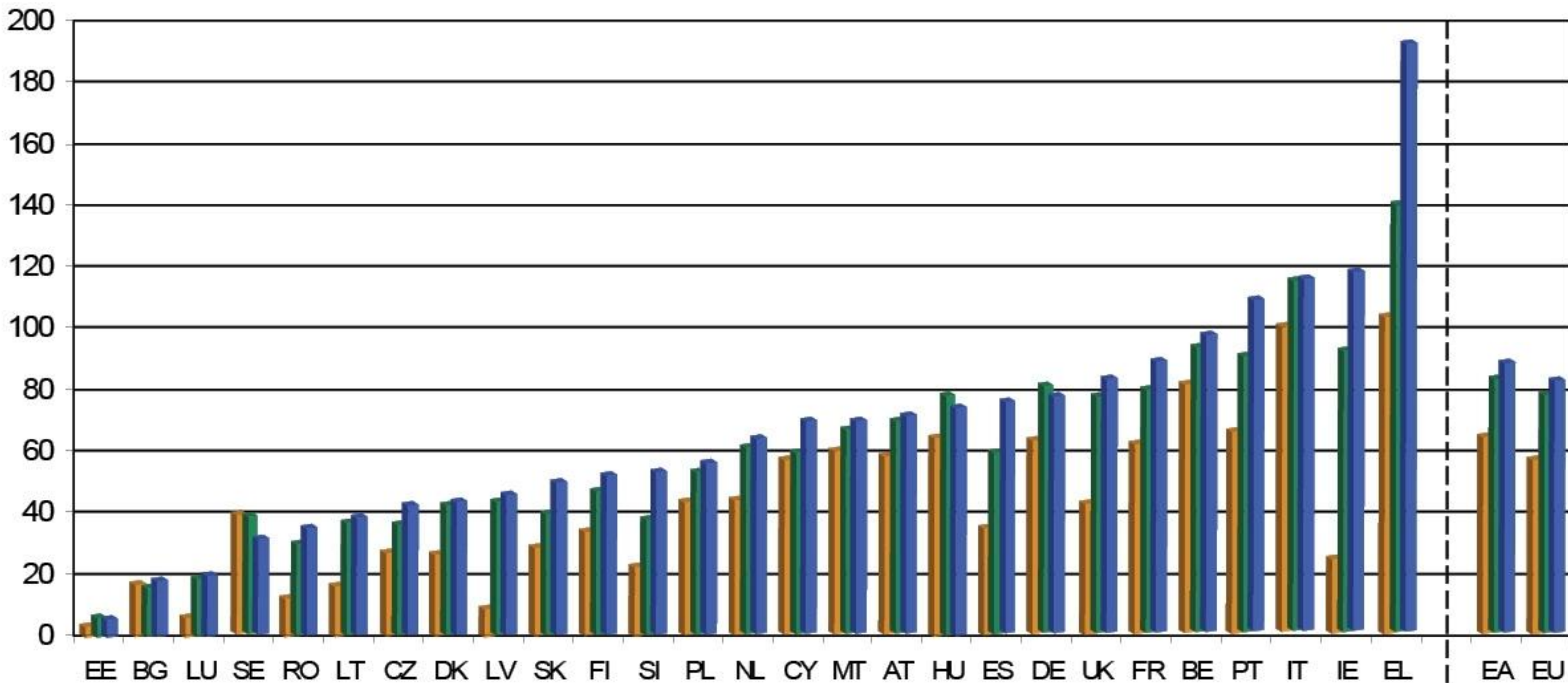
Government deficit in % of GDP



* This forecast is based on an Autumn 2011 scenario of « no policy change » and does not reflect announcements made since then

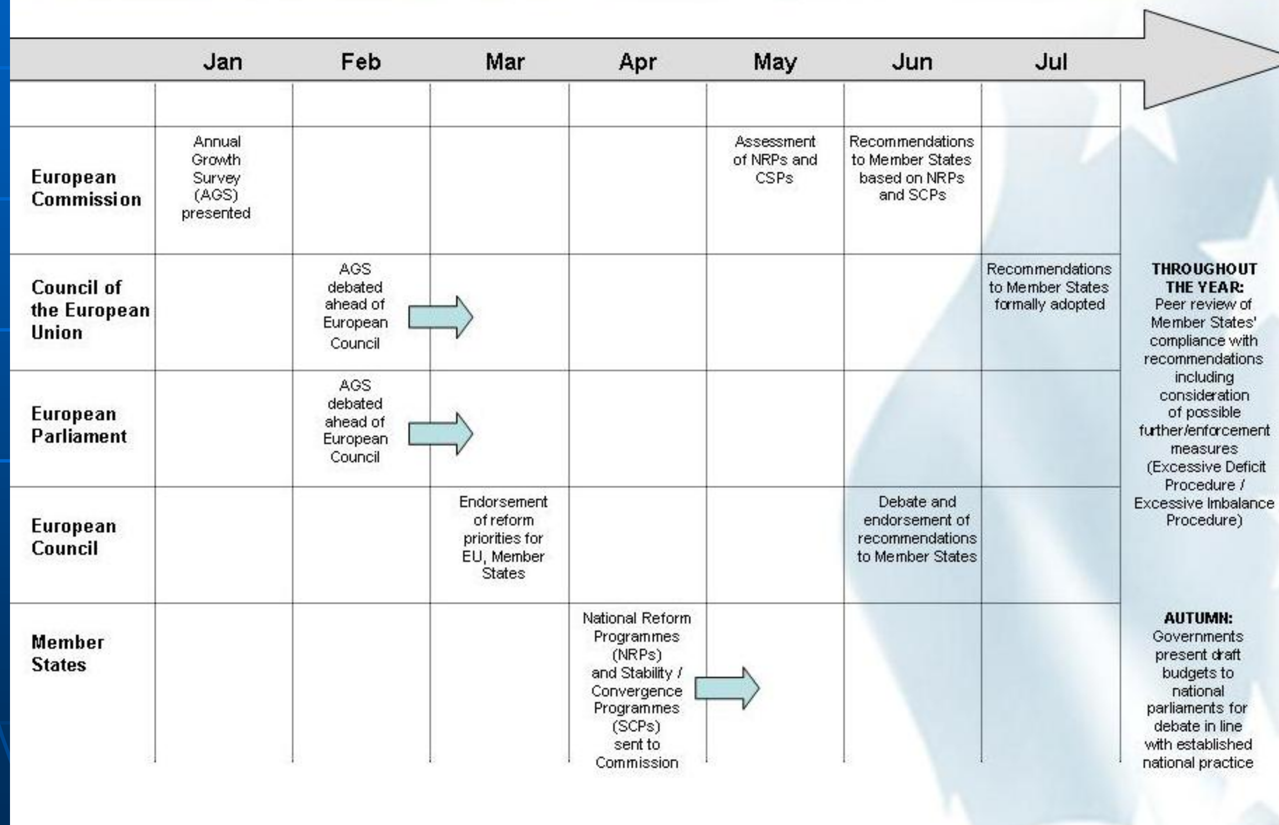
Source: European Commission

Government debt in % of GDP



* This forecast is based on the Autumn 2011 scenario of « no policy change » and does not reflect announcements made since then

Source: European Commission



The European Semester: Who does what and when?

	Jan	Feb	Mar	Apr	May	Jun	Jul	
European Commission	Annual Growth Survey (AGS) presented				Assessment of NRPs and CSPs	Recommendations to Member States based on NRPs and SCPs		
Council of the European Union		AGS debated ahead of European Council →					Recommendations to Member States formally adopted	**THROUGHOUT THE YEAR:** Peer review of Member States' compliance with recommendations including consideration of possible further/enforcement measures (Excessive Deficit Procedure / Excessive Imbalance Procedure)
European Parliament		AGS debated ahead of European Council →						
European Council			Endorsement of reform priorities for EU, Member States			Debate and endorsement of recommendations to Member States		
Member States				National Reform Programmes (NRPs) and Stability / Convergence Programmes (SCPs) sent to Commission →				**AUTUMN:** Governments present draft budgets to national parliaments for debate in line with established national practice

European economic governance (1)

European Semester

nd of year

Annual Growth Survey: Overall guidance for the EU

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

arch

European Council policy orientations based on the Annual Growth Survey

pril

Stability or Convergence Programmes

Produced by EU Member States
except those under financial assistance programmes

National Reform Programmes

Produced by EU Member States
except those under financial assistance programmes

une

Country-specific recommendations

including fiscal policy and macroeconomic imbalances

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

European economic governance (2)

Measures effective from 13 December 2011

Fiscal surveillance

Monitoring of fiscal policy

Commission assessment of Member States based on structural budget balance

Additional steps proposed by the Commission on 23 November 2011:
Examining draft national budgets (October)
Possible Commission opinion on draft national budgets (November)

Risk of fiscal imbalances

Excessive Deficit Procedure

Deficit higher than 3% of GDP or deficit lower than 3% and debt higher than 60% of GDP and annual debt reduction target of 1/20 of debt not achieved over 3 years

Preventive action

- Step 1: Recommendations to the Member State
- Step 2*: 0.2% of GDP to be deposited with interest

Corrective action: Excessive Deficit Procedure

- Step 1: EDP recommendations and closer monitoring
- Step 2*: Deposit of 0.2% of GDP without interest
- Step 3*: Fixed fine of 0.2% of GDP (up to max. of 0.5%)
- Step 4*: Variable fine if continuous non-compliance

Macroeconomic imbalances surveillance

Monitoring of macroeconomic imbalances

ALERT MECHANISM REPORT
based on scoreboard results of 10 indicators (e.g. unemployment, public and private indebtedness, housing market trends, competitiveness, productivity)

In-depth country studies

Existence of macroeconomic imbalances

Excessive macroeconomic imbalances

Preventive action
Recommendation to the Member State

Corrective action: Excessive Imbalance Procedure

- Step 1: Council recommendation and corrective action plan by Member State
- Step 2*: 0.1% of GDP to be deposited with interest in case of lack of corrective action
- Step 3*: 0.1% of GDP to be paid as annual fine in case of repeated lack of action or non-compliance with Council recommendations

*These sanctions only apply to euro area countries.

Commitments agreed at the European Council on 9/12/2011

"Fiscal compact"

Golden Rule on balanced budgets

Structural deficit
- < 0.5% of GDP = OK
- > 0.5% of GDP = not OK

Excessive Deficit Procedure
+

- Automatic consequences unless qualified majority is opposed
- Preparation of "economic partnership programmes" by Member States under the EDP, detailing structural reforms
- Ex-ante reporting of plans for new debt issuance
- Automatic penalties if deficit exceeds 3% of GDP

Stronger policy coordination

- Coordination of major reforms
- Euro Summits at least twice a year

Immediate response

European Stability Mechanism

Opening in July 2012

- Involvement of private sector based on IMF rules
- Emergency procedure to respond to financial threats
- Re-assessment of EFSF and ESM firepower in March 2012

Leveraging of the European Financial Stability Facility (EFSF)

1. Partial protection of new bond issued by beneficiary member states.
2. A combination of public and private funding to buy bonds of beneficiary member states.

EFSF closing mid-2013

Additional resources for the International Monetary Fund of up to €200 bn

Financial Backstops

European Financial Stabilisation Mechanism

€60bn lending capacity for euro area countries, guaranteed by EU Budget

European Financial Stability Facility

€440bn lending capacity for euro area countries, guaranteed by euro area countries

International Monetary Fund

Up to €250bn, topped with €200 bn from euro area Member States central banks* with a limit of ½ of the amount drawn from EFSF and EFSM

Bilateral Loans

The Greek Loan Facility agreed in May 2010 is made up of bilateral loans from participating euro area countries.

The EFSM-EFSF-IMF support to Ireland is also supplemented by bilateral loans from by Denmark, Sweden and the UK.

New Regulations proposed by the Commission on 23 November 2011 clarify procedures for launch of macroeconomic adjustment programmes and surveillance of programme countries

- Council can recommend that a Member State seeks financial assistance
- A Member State can ask for a precautionary financial assistance
- Macro-economic adjustment programme to be agreed between Member State, the Commission, ECB, IMF (and other lenders)
- Enhanced surveillance with quarterly reviews by Commission in liaison with ECB
- Post-programme surveillance (until repayment of 75% of the loan)

As of mid-2012

European Stability Mechanism (effective lending capacity €500bn)

* On 9 December, Heads of State or Government of the euro area decided "to consider the provision of additional resources for the IMF of up to €200 bn in form of bilateral loans".

- Policies for deficit elimination and debt reduction will have to be based on cuts in expenditures, not on tax increases.
- Better the State as night watcher then the Leviathan.
- Balanced budget (primary surplus) and public debt under control. DDD economies create long run misery.
- Constitutional rules to keep deficit and debts under control.

How to get out of the crisis and head for long run growth.

- **The teachings of the Asian Crisis.**
- **What to avoid**:
- Interference with marked mechanisms.
- Fiscal stimulus policies.
- Fiat money, quantitative easing.

- **What to do**
- Monetary and fiscal policies have to deliver macroeconomic stability.

- An environment made of expectations firmly anchored to price stability and moderate taxation rate and low degree of volatility of economic activity. In such an environment confidence of consumers, investors and entrepreneurs keeps high and stable.

- Competition, free trade, smooth working of market mechanisms., as road to growth.
- Growth generated in the private sector, not by state interventions.

- Policies granting economic freedom. More economic freedom leads to more growth and more welfare.

THE END