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Questionmarks around the Excessive Deficit Procedure

From the EDF to the MIP

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Acknowledgements

- To my former college, former Deputy President of the Hungarian Financial Supervisory Authority, L. Naray for his inspiring remarks

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SGP (Stability and Growth Pact) as ex ante conditionality

- Formerly it was only a possibility to withhold payments from EU Funds in case of EDP
- After 2014 it is a macro conditionality

Proposal for a

- **REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Council Regulation (EC) No 1083/2006**

EU and SGP

- A political entity with monetary policy but
- Without fiscal policy

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A surrogate fiscal policy

- SGP -- Stability and Growth Pact

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SGP

- The Stability and Growth Pact (SGP) is the cornerstone of budgetary discipline. EDP is part of the pact.
- 1993 Regulation laying down the procedure to be followed in connection with excessive deficits.
- The Regulation was amended in 2005 and in 2011.

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European Economic Governance

- First budgetary deficit **was** in the centre
- After 2011 **budgetary deficit, government debt and macroeconomic imbalances** will be complexly analyzed

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Steps of procedure

- **Preventive arms** – alert mechanism
- **Corrective arms** – effective enforcement

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Excessive Deficit Procedure

- Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [Official Journal L 209 of 2 August 1997]

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3 % of GDP

- As set out in the Protocol on the excessive deficit (EDP) procedure annexed to the EC Treaty (by the Maastricht Treaty in 1992), the reference value for government deficit is 3% of gross domestic product (GDP).
- A deficit exceeding this value is considered exceptional when:

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A deficit exceeding this value is considered exceptional

- it results from an unusual event outside the control of the Member State concerned which has a major impact on the financial position of the government;
- it results from a severe economic downturn (if the excess over 3% of GDP is the result of negative annual GDP growth or a cumulative fall in production over a prolonged period of very low annual growth).

The Commission prepares a report and must take all relevant factors into account

- developments in the medium-term economic position (potential growth);
- prevailing cyclical conditions;
- the implementation of policies in the context of the Lisbon Agenda, particularly for promoting research and innovation;
- developments in the medium-term budgetary position, particularly fiscal consolidation efforts in "good times";
- reform of retirement pension schemes.
- The Community institutions are also required to give due consideration to any other factors which, in the opinion of the Member State concerned, are relevant for assessing the excess over the reference value.

The excessive deficit procedure

- **Commission Report**. Within two weeks of the Commission adopting the report it draws up if a Member State does not fulfill the criteria laid down in Article 104(2) of the EC Treaty, the Economic and Financial Committee formulates an opinion.

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The excessive deficit procedure 2.

- **Council's decision**. On the basis of the Commission's opinion, and within four months of the reporting dates established in Regulation (EC) No 3605/93, the Council decides, by a qualified majority, whether an excessive deficit exists. The Council also considers any observations made by the Member State concerned.

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The excessive deficit procedure 3.

- Where no effective action has been taken within six months of the identification of an excessive deficit, the Council decides whether to make its recommendations public.
- When considering whether effective action has been taken in response to its recommendations, the Council bases its decision on the public declarations of the Member State concerned.

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The excessive deficit procedure 4.

- Formal notice and sanctions. Within two months of its decision establishing that no effective action has been taken, the Council may give notice to the Member State concerned to take measures to reduce the deficit.

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The excessive deficit procedure 5, Sanctions

- Sanctions first take the form of a non-interest-bearing deposit with the Community. The amount of this deposit comprises:
- a fixed component equal to 0.2% of GDP;
- a variable component equal to one tenth of the difference between the deficit as a percentage of GDP in the year in which the deficit was deemed to be excessive and the reference value of 3% of GDP.
- Deposits may not exceed the upper limit of 0.5% of GDP per year.

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Macroeconomic conditionalities of EU funds – for 2014-2020 it will be obligatory

- Makes possible suspension of payments from the funds if member countries are not respecting EDP prescriptions

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Case of Hungary

- EDP started against Hungary in 2004

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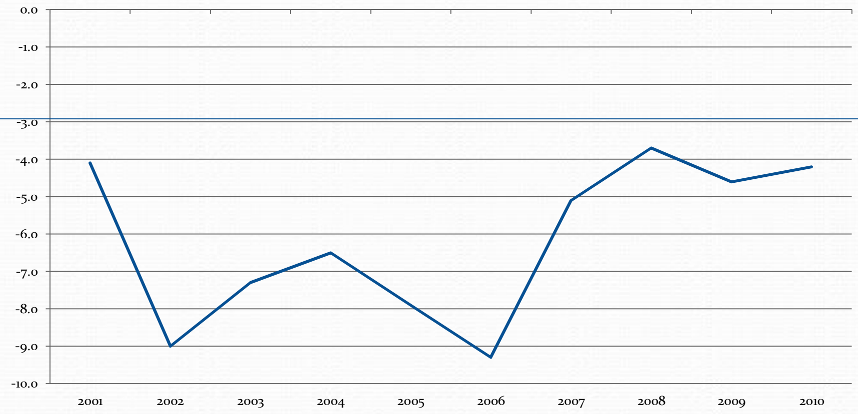
Net lending (+)/Net borrowing (-) under the EDP (Excessive Deficit Procedure) **Hungary**



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Press coverage

- "The European Union moved closer on Tuesday to taking the **unprecedented step** of **suspending development funding to a member state** to punish its lack of budgetary discipline. Finance ministers from all but one of Hungary's 26 EU peers voted to withhold **EUR 495 million** next year unless the government provides evidence of sustainable fiscal consolidation. It has been advised to bring its budget deficit to below 2.5 per cent this year and ordered to keep it sustainably below 3 per cent of GDP."

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Commission Communication: Decision has based largely on prevision

- **Commission Communication:** *Assessment of budgetary implementation in the context of the ongoing Excessive Deficit Procedures after the Commission Services' 2011 Autumn Forecast*
- *Hungary*
- 17.13 The 2011 Autumn Forecast projected economic growth at 1.4% of GDP in 2011 and 0.5% in 2012, with risks to the downside. In contrast, when preparing the 2012 budget, the Hungarian authorities projected GDP to expand by 1.5% of GDP in 2012 and 2.9% in 2013. On 15 December 2011, the government revised its 2012 growth forecast down to 0.5% **but macro-sensitive budgetary items were not updated accordingly.**

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Commission Communication: 2011 was result of one off revenues

- **In 2011** (the deadline for correcting the excessive deficit) a **budgetary surplus was expected, resulting primarily from one-off revenues**, including the **elimination of the obligatory private pension scheme** (worth 9.75% of GDP). This also resulted in permanent annual revenues of 1.3% of GDP as pension contributions to the public pillar are paid to the government in perpetuity.

Excursion: Debate on Private Pensions

- Where should Private Pensions take into account?
- If PPs are in the budget, it is increasing revenues, if not, revenues are outside
- Problem is that part of the pension system is in, some is out

Commission Communication cont. 2012 figures of Hungary will be OK

- 17.14 The Hungarian authorities submitted the 2012 draft budget to Parliament on 30 September 2011. It targets a government deficit of 2.5% of GDP in line with the latest Convergence Programme update, which assumes the continuation of temporary sectoral levies of 0.9% of GDP. Overall, the authorities estimate the deficit-decreasing effect of the measures incorporated in the draft budget to be around 4% of GDP, including an extraordinary additional budgetary reserve of 0.7% of GDP to compensate for the impact of lower growth and a weaker exchange rate on the budget.
- **The Commission forecasts Hungary's 2012 government deficit to be 2.75%.**

Commission Communication cont. ...but 2013 might be 3.25 % based on forecasts

- 17.15 Since at the time of the 2011 Autumn Forecast most of the structural reform measures were not yet sufficiently specified, the Commission forecasted Hungary's 2013 government deficit to be **3.7% of GDP**. The Commission estimates that the 2013 forecast government deficit could be updated to 3.25% of GDP, after updating this outlook with:
- budget measures;
- the recently submitted excessive deficit procedure progress report; and
- the agreement reached with the banking sector on foreign exchange mortgages.

Commission Communication cont. ...and question of sustainability

- 17.16 Thus, the Commission concludes that the correction of the excessive deficit in 2011 (which is based on very large one-off revenues and is followed by a deficit of just below 3% of GDP that still depends on substantial one-off revenues) is not of a sustainable nature. The 2011 Autumn Forecast estimated gross public debt to increase to nearly 77% of GDP (following a temporary drop) in 2011. Based on revised exchange rate and deficit projections, the Commission now estimates that the debt ratio could currently be around 80%, and anticipate it to stabilise at around 78.5% in both 2012 and 2013.

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Some data, source EUROSTAT

- But other countries are not much better off

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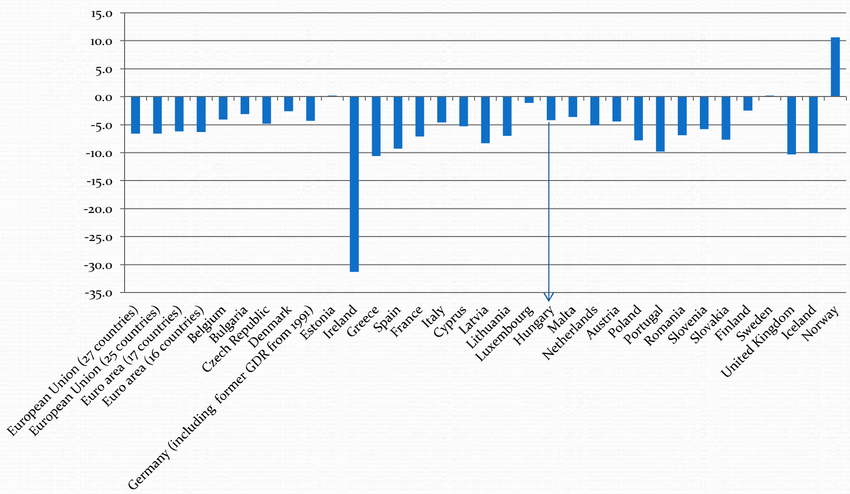
Government deficit as % of GDP, 2010



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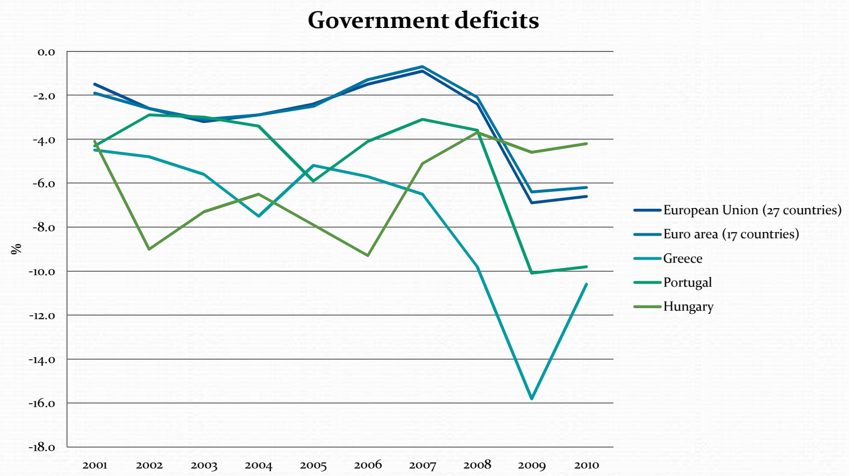

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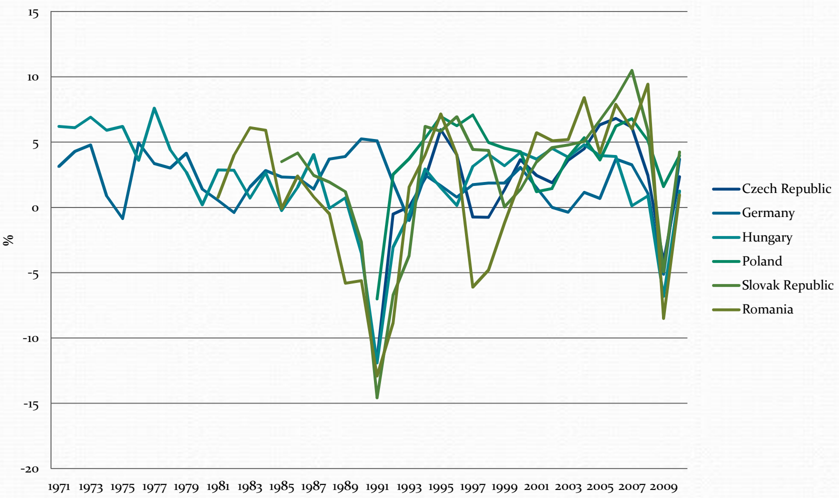
Annual GDP growth, %



Debate on previsions

Economic forecasts and fiscal policy in the recently acceded Member States

by

Filip Keereman

Directorate-General for Economic and Financial Affairs

http://europa.eu.int/comm/economy_finance

Number 234 November 2005

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The main findings of the article are the following

- Prediction mistakes for the recently acceded Member States are large and widen with the length of the projection horizon.
- This is true for GDP and government balance as well.
- The **mean absolute forecast error** (pooled average) made by the Commission services for the general **government balance** in the recently acceded Member States **is 1.3 % of GDP** in the current year (1.4 % of GDP in the year ahead forecast), with wide variations across countries. The national authorities make similar mistakes.

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Main findings continued

- On the whole the quality of the GDP forecasts made by the Commission services for the old Member States is much better than for the countries that joined the European Union on 1 May 2004
- **The volatility of the economy appears to make forecasting more difficult**
- The information set on which the forecasts are made is incomplete.

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Economic governance in the future - "Six-Pack" - guide

- More sophisticated
- More severe
- Six pack -- *five regulations and one directive proposed by the European Commission and approved by all 27 Member States and the European Parliament in October, 2011*
- *Applicable for EURO zone members*

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The Six Pack

Regulations

- Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area
- Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area
- Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies
- Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances
- Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure

Directive

- Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States

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Deficit

- From 13 December 2011 onwards, financial sanctions will apply to euro area Member States that do not take adequate action.
- **3 % of GDP**

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Public debt

- The new rules of the amended Stability and Growth Pact make the debt criterion of the Treaty absolutely operational, since it has been largely neglected over the past years.
- **60 % of GDP.**

The expenditure benchmark under the preventive arm of the Pact

- The preventive arm of the Stability and Growth Pact guides Member States towards a country-specific, medium-term budgetary objective (MTO) which sets out to ensure public finance sustainability.

Reducing macro-economic imbalances

- **MIP** – Macroeconomic Imbalance Procedure

MIP legislative basis

- The Macroeconomic Imbalance Procedure rests on two types of legislation:
- The first types of regulations set out the details of the new surveillance procedure and covers all the Member States.
- The second types of regulations establish the enforcement mechanism including the potential use of sanctions and is only applicable for the euro area Member States.
- The overall design follows the implicit logic of the stability and growth pact with a "preventive" arm and a stronger "corrective" arm for more serious cases.

MIP -- alert mechanism

- The MIP's alert mechanism consists of an indicator-based scoreboard complemented by an economic reading thereof presented in an annual Alert Mechanism Report (AMR). The composition of the scoreboard indicators may evolve over time. The Commission may organise missions, with the ECB if appropriate, to conduct the in-depth reviews which shall be made public.

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Alert Mechanism Report

- The alert mechanism consists of **an indicator-based scoreboard** complemented by an economic reading thereof presented in an annual Alert Mechanism Report (AMR). The economic reading of the scoreboard indicators implies that there is no automaticity involved (i.e. a "flash" for an indicator does not lead to an automatic conclusion that there is an imbalance).

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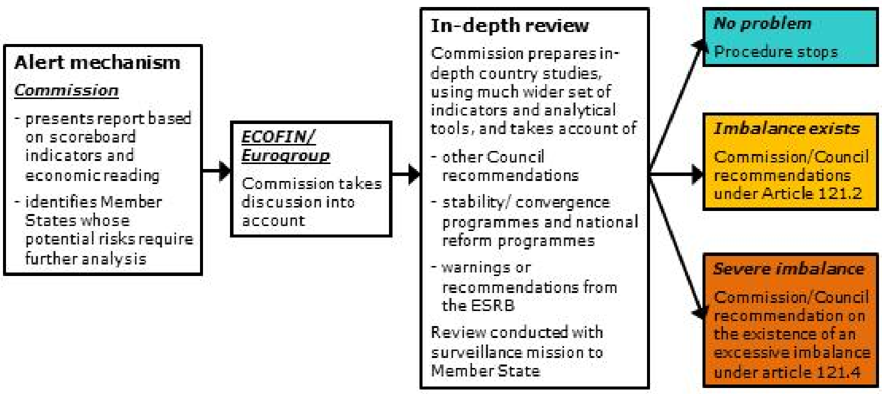
Alert Mechanism



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Scoreboard Indicators

1. 3 year backward moving average of the current account balance as percent of GDP, with a threshold of +6% of GDP and -4% of GDP;
2. net international investment position as percent of GDP, with a threshold of -35% of GDP;
3. 5 years percentage change of export market shares measured in values, with a threshold of -6%;
4. 3 years percentage change in nominal unit labour cost, with thresholds of +9% for euro-area countries and +12% for non-euro-area countries;
5. 3 years percentage change of the real effective exchange rates based on HICP/CPI deflators, relative to 35 other industrial countries, with thresholds of -/+5% for euro-area countries and -/+11% for non-euro-area countries;

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Scoreboard Indicators

1. private sector debt in % of GDP with a threshold of 160%;
2. private sector credit flow in % of GDP with a threshold of 15%;
3. year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%;
4. general government sector debt in % of GDP with a threshold of 60%;
5. 3-year backward moving average of unemployment rate, with a threshold of 10%

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Documents

- Regulation (EU) No 1176/2011 of 16 November 2011 on the prevention and correction of macroeconomic imbalances
- COM(2012) 68 final: Alert Mechanism Report 2012 [128 KB] : the economic reading of the scoreboard and recommendations for in-depth reviews
- Statistical Annex of the Alert Mechanism Report [4 MB] : data on scoreboard and additional indicators
- Scoreboard data platform: Interactive database for the indicators of the scoreboard and additional 'reading' indicators
- European Parliament resolution of 15 December 2011 on the Scoreboard for the surveillance of macroeconomic imbalances: envisaged initial design
- Council conclusions on an early warning scoreboard for the surveillance of macroeconomic imbalances , 8 November 2011
- Views of the European Systemic Risk Board (ESRB) on the Envisaged Scoreboard Indicators Relevant for Financial Market Stability [55 KB] , 9 December 2011
- Occasional Paper 92/2012: Scoreboard For The Surveillance of Macroeconomic Imbalances : technical explanations on the scoreboard

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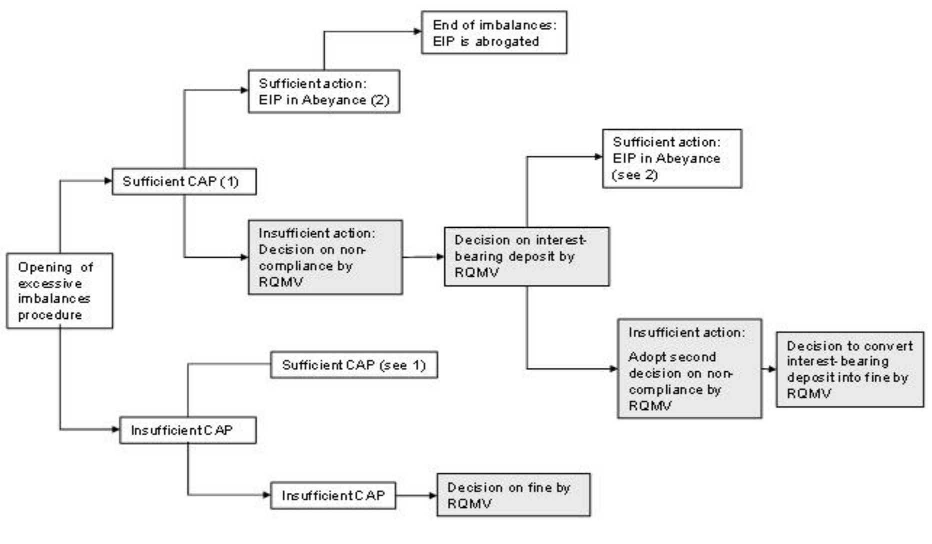

Notes: CAP – corrective action plan; EIP – excessive imbalances procedure; RQMV – reverse qualified majority voting

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CAP -- Corrective Action Plan

- In case the in-depth review points to severe imbalances in a Member State, the Council declares the existence of an excessive imbalance and adopts a recommendation asking the Member State to present corrective actions within a specified deadline. Then, and this is a key feature in this new procedure, the Member State is obliged to present a corrective action plan (CAP) setting up a roadmap to implement corrective policy actions. The CAP should be a detailed plan for corrective actions with specific policy actions and implementation timetable

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Rigorous enforcement

- A new enforcement regime is established for euro area countries. The corrective arm consists of a two-step approach:
- An **interest-bearing deposit** can be imposed after one failure to comply with the recommended corrective action
- After a second compliance failure, this interest-bearing deposit can be converted into **a fine** (up to 0.1% of GDP)
- Sanctions can also be imposed for failing twice to submit a sufficient corrective action plan.

European Economic Semester

- **The European Semester**
- The European semester is a six-month period each year when Member States' budgetary, macro-economic and structural policies are coordinated effectively so as to allow Member States to take EU considerations into account at an early stage of their national budgetary processes and in other aspects of economic policymaking.

The key stages in the European semester are as follows:

- In **January**, the Commission issues its Annual Growth Survey, which sets out EU priorities for the coming year to boost growth and job creation.
- In **March**, EU Heads of State and Government issue EU guidance for national policies on the basis of the Annual Growth Survey.
- In **April**, Member States submit their plans for sound public finances (Stability or Convergence Programmes) and reforms and measures to make progress towards smart, sustainable and inclusive growth (National Reform Programmes).
- In **June**, the Commission assesses these programmes and provides country-specific recommendations as appropriate. The Council discusses and the European Council endorses the recommendations.
- Finally, end of June or in early **July**, the Council formally adopts the country-specific recommendations.

Further problems

- Possible subjective interpretation of MIP criteria
- No exact limits
- Problems of enforcement – in case of Hungary cost of reducing budgetary deficit would be the same as the punishment
- What if an euro-zone country is not paying the fee?

Political debate

- Romanian MEP **Victor Boştinaru** (Socialists and Democrats) said that macro-conditionality was not necessary, since countries have already signed up to the EU's Fiscal Stability Pact and would face sanctions if they did not comply to the agreed financial rules. His comments were echoed by another Romanian MEP, **Ramona Mănescu**, coordinator in the regional policy committee for the Liberals group in the European Parliament, who added: "We question whether it is really the best option to punish beneficiaries for member states' mistakes."

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Thanks for your attention!

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