Numerical Fiscal Rules in the EU Member States

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Stefan Ciobanu
Head of Fiscal Governance Unit
European Commission – DG Economic and Financial Affairs
Outline

- Definition of numerical fiscal rules
- European legal provisions
- Recent evolution
- Types of rules
- Coverage of rules
- Monitoring role of IFIs
- Conclusion
Definition and rationale

- **Permanent /long-lasting constraint on fiscal policy using numerical limits on budgetary aggregates**

- **Objectives of rules: improve fiscal discipline by**
  - Counteracting deficit bias
  - Promoting anti-cyclical fiscal policy

- **Types of rules**
  - Debt, balanced budget (nominal or structural), expenditure, revenue allocation, etc...
European legal provisions

- **Budgetary Frameworks Directive**

- **Fiscal Compact** (automatically concerns only euro area MS, but BG, DK and RO subscribed on voluntary basis)

- **Two-Pack** (concerns only euro area MS)
Budgetary Frameworks Directive

- Member States should have in place numerical fiscal rules that encompass the general government as a whole and effectively promote:
  - compliance with their EU fiscal obligations (budget balance and debt)
  - adoption of multi-annual fiscal planning horizon
- Definition and scope of the rules should be defined.
- Monitoring of compliance should be based on independent analysis.
- Escape clauses and consequences of non-compliance should be spelled out.
- Annual budgets should reflect the rules in force.
Fiscal Compact

- Budgetary position should be balanced or in surplus (min. structural balance of -0.5% of GDP or -1% if public debt significantly below 60% of GDP).
- Based on national provisions of binding force and permanent character (preferably constitutional).
- Correction mechanism should be triggered automatically.
- Escape clauses should be clearly defined.
- Independent monitoring institution should be in place.
Two-Pack

- Compliance with all numerical fiscal rules should be monitored by independent bodies.

- These bodies should provide public assessments with respect to national fiscal rules.
Evolution in the numerical fiscal rules

- Clear upward trend in the number of national numerical fiscal rules in response to legislation at European level
- Some Member States decided to introduce rules closely mimicking the EU fiscal rules (e.g. Ireland, Italy, the Netherlands).
- Other Member States developed tailor-made country-specific rules which nevertheless are "compatible" with the EU rules.
Numerical fiscal rules (EU-28)

- Revenue rule
- Debt rule
- Expenditure rule
- Balanced-budget rule
Expenditure rules

Focus on Expenditure Rules

- Expenditure = aggregate most directly under the control of government
- Evidence to support expenditure-based consolidation

Particularly efficient within a medium-term perspective

Central part of best-practice frameworks (e.g. Denmark, Sweden and the Netherlands)
Balanced budget rules

- In response to Fiscal Compact all of euro area Member States plus Bulgaria, Denmark and Romania have now in place a structural balanced budget rule.

- Same objective but no one-size-fits-all design; they are tailor-made and differ in their formulation of the target, correction mechanism, type of monitoring, etc.
Debt rules

- Formulation of debt rules differs between Member States (depends mainly on the initial level of debt):
  - Set of thresholds of debt as percentage of GDP triggering certain sanctions (e.g. Poland, Romania and Slovakia)
  - Formulation similar to that in the EU legislation: gradual sustained reduction of debt surpassing 60% of GDP (e.g. Austria, Malta)
Coverage

- The Directive calls for a set of national numerical fiscal rules encompassing the general government as a whole.

- The coverage of general government sectors under various types of rules differs between Member States.
Numerical fiscal rules 2014: Type and sectors of government

- Balanced-budget rule
- Expenditure rule
- Debt rule
- Revenue rule

Central Government (15.8%)
Regional Government (8.3%)
Local Government (24.2%)
Social Security (10%)
General Government (41.7%)
Role of IFI in regard to fiscal rules

- The BF Directive, Two-Pack and Fiscal Compact assign the task of monitoring the compliance with fiscal rules to IFIs.

- Such monitoring consists of elements like:
  - Assessment of the necessity of triggering a correction mechanism in case of deviation from the rule
  - Assessment if the correction is proceeding according to plans
  - Assessment of appropriateness of applying escape clauses.

- IFIs have potential to enhance respect of fiscal rules by governments because of reputational costs involved.
Conclusions

- *Proliferation of numerical fiscal rules in the EU prompted by the crisis and the related strengthening of EU fiscal governance.*

- *The Directive sets general guidelines for numerical fiscal rules but leaves ample scope for adjustment to country-specific needs.*

- *As a result, the combination of rules and their coverage differ from country to country. However, there is a clear predominance of balanced budget rules.*
Thank you