EU Fiscal Governance : The new rules

Pat McArdle

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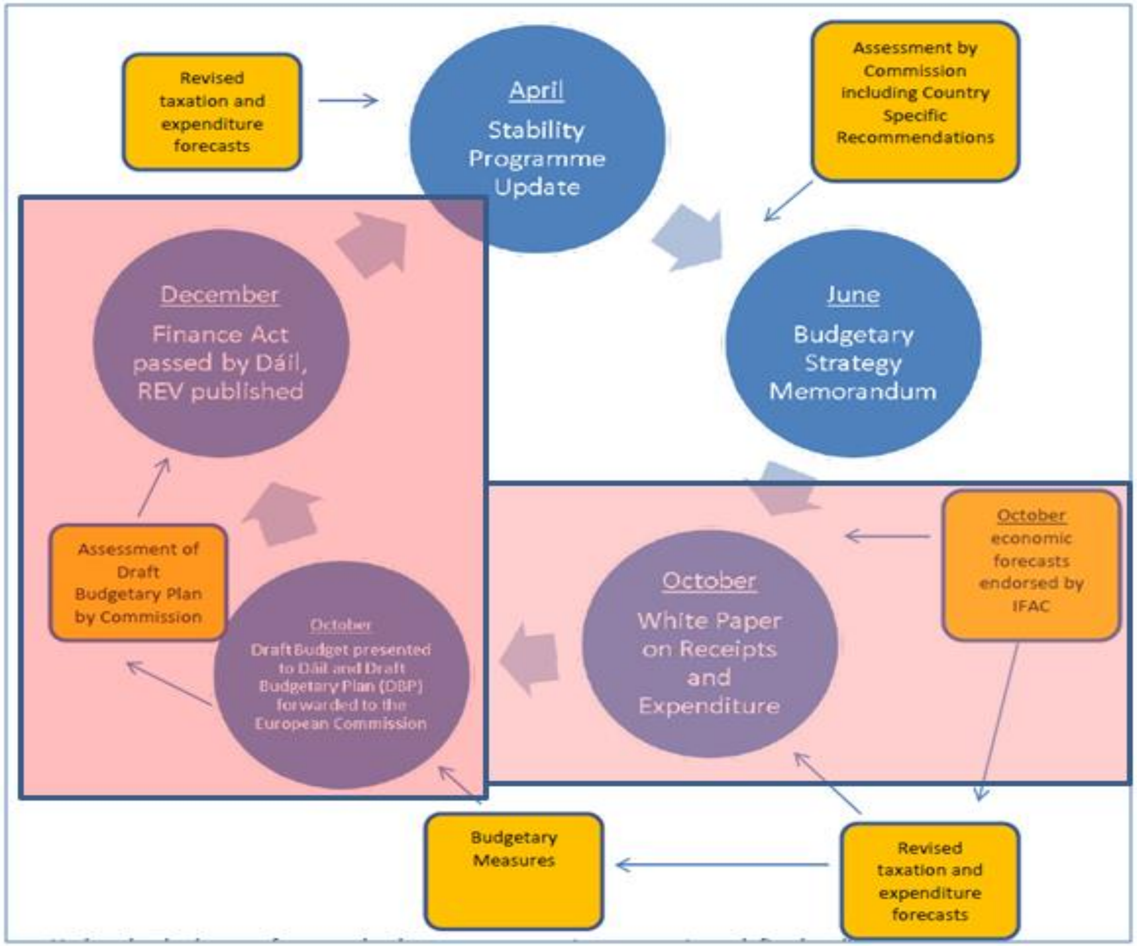
Irish Fiscal Cycle/ EU Semester

NEW



SGP Innovations 2011/2012

Country specific Medium-Term Objective in structural terms:
- Provide a safety margin with respect to the 3% deficit limit
- Ensure rapid progress towards sustainability
- Allow room for budgetary manoeuvre

Expenditure benchmark: expenditure net of discretionary measures should grow ≤ medium-term potential GDP

Two - Pack - Enhanced Surveillance

Minus 0.5% of GDP as a benchmark:
- More in good times, less in bad
- **>0.5% if debt > 60% or pronounced risks**
- **<0.5% if debt <<60% and low risks**

Automatic correction mechanism in national legal order monitored independently

Possible temporary deviations:
- Major structural reforms – e.g. pensions
- **Unusual event**
- **Severe economic downturn**

Medium Term Objectives (MTOs)

- MTOs are defined in **structural** terms, i.e. cyclically-adjusted general government budget positions (net of one-off and other temporary measures)
- MTOs take **debt** levels, **ageing** and the dynamics of the **automatic stabilisers** into account
- They provide a **safety margin** with respect to the 3% deficit limit
- Ensure **rapid progress** towards sustainability (at least 0.5% of GDP per annum)
- Allow **room** for budgetary manoeuvre

Actual MTOs

- Pre-TSCG the EA MTO limit was minus 1%
- Under TSCG **EA limit is now minus 0.5%** unless debt <<60% with low risks to stability
- Ireland's MTO was minus 0.5% GDP = Structural Budget Deficit of -0.5%
- Ireland's **MTO is now 0%,** i.e. the objective is a balanced budget in structural terms
- 2014 Structural deficit = 5%; **2018 = 0%**

Size of the adjustment to MTO

- If **@MTO** - let automatic stabilisers play, i.e., zero annual adjustment, e.g. IRL post 2018.
- If **not @MTO** – adjustment of 0.5% of potential GDP, p.a. (special regime for post Programme countries)
- Expenditure %, net of discretionary revenue measures, should be set to ensure this.
- If not @MTO & **Debt > 60%** or there are pronounced risks - annual adjustment >0.5% GDP.
- EU may seek greater adjustment in good times and vice versa.

Calculating the Expenditure Benchmark

If @ MTO, the benchmark = **potential GDP growth**, (calculated as a 10-year average and revised every 3 years) **plus GDP deflator** of year t-1

If not @ MTO, a **convergence margin** is subtracted to help generate a speedy return to MTO

For example, Irish Potential GDP growth for 2014 – 2016 is 0.6%. Since we are not at MTO, a margin of 1.4% is deducted, giving a ceiling of minus 0.7%

The GDP deflator for 2013 is 1.0%, so the **Expenditure ceiling is plus 0.3% in 2014**

Definition of expenditure benchmark

- Expenditure aggregate to be assessed **excludes**:
- Spending on debt interest,
- Non-discretionary changes in unemployment benefit expenditure,
- Expenditure on EU programmes fully matched by EU funds revenue
- Moreover, investment expenditure is averaged over 4 years to even out variability

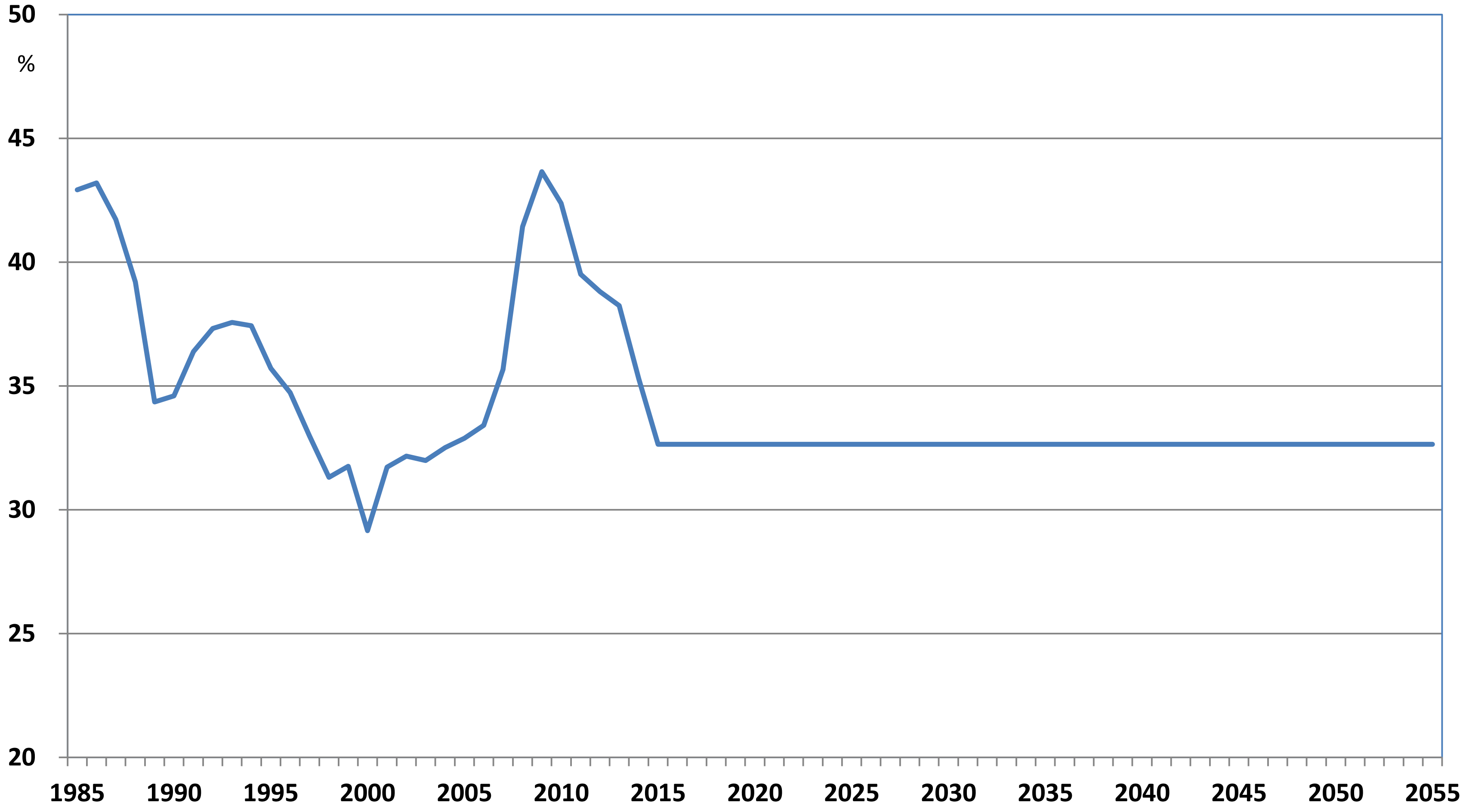
Rationale

- The rationale is to focus on spending that is:
  - (i) independent of the cycle (by netting out the cyclical elements of unemployment spending),
  - (ii) within the government's control (by netting out interest expenditures),
  - (iii) has to be paid for out of tax revenues (by netting out spending on programmes directly funded by the EU), and
  - (iv) without penalising peak investment (by averaging investment over a number of years).

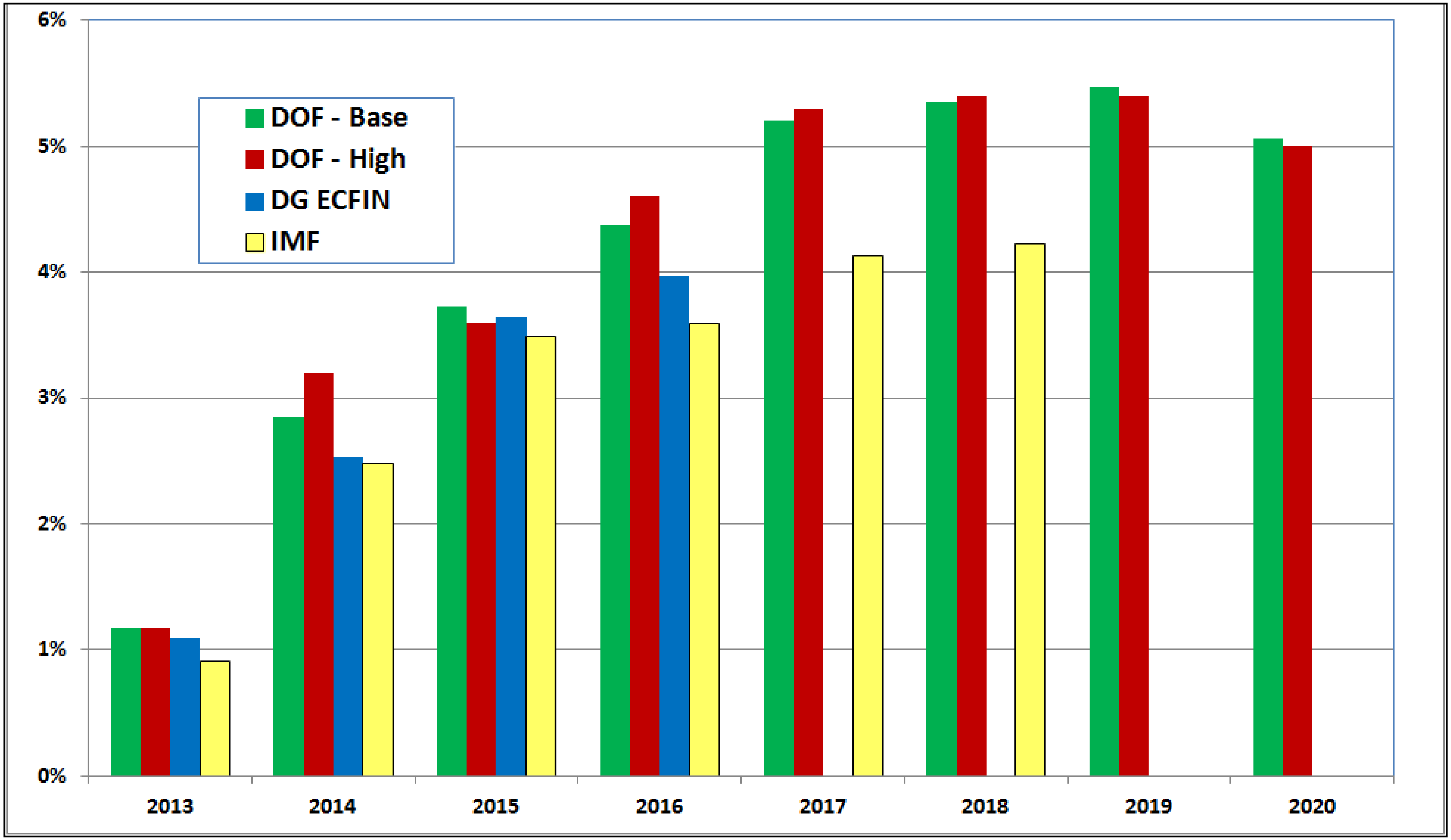
New Government

- Member States, when preparing the first Stability or Convergence Programme after a new government has taken office, are invited to show **continuity** with respect to the budgetary targets endorsed by the Council on the basis of the previous Stability Programme

Expenditure ex interest as % GDP



Nominal GDP Forecasts



Strategy for Growth projections

	2012	2013	2014	2015	2016	2017	2018	2019	2020
GGB % GDP	-8.2	-7.3	-4.8	-3.0	-2.4	- 1.0	0.5	0.4	0.0
Primary balance (% GDP)	-4.5	-2.7	0.0	1.9	2.6	3.8	5.1	4.7	4.1
Output gap (% potential GDP)	-1.1	-1.0	-0.1	0.4	0.6	1.0	1.0	0.7	0.0
Structural Budget Balance (% GDP)	-7.7	-6.5	-5.0	-3.1	-2.7	-1.4	0.0	0.0	0.0
Interest as % GDP	-3.7	-4.6	-4.8	-4.9	-5.0	-4.8	-4.6	-4.3	-4.1
Implicit interest rate	3.6%	4.0%	4.0%	4.3%	4.4%	4.4%	4.4%	4.4%	4.4%
Nominal GDP growth		1.2%	2.8%	3.7%	4.4%	5.2%	5.4%	5.5%	5.1%
Government Debt (% GDP)	117	124	120	118	115	110	104	98	93