

FISCAL EXPECTATIONS ON THE STABILITY AND GROWTH PACT: EVIDENCE FROM SURVEY DATE

Marcos Poplawski-Ribeiro and Jan-Christoph Rülke

NON-TECHNICAL SUMMARY

Economic literature on fiscal rules argues that the signal and credibility gain that they convey to financial markets are two main economic arguments for their implementation. In Europe, however, skepticism about the effects of the Stability and Growth Pact (SGP) on the credibility of Europe's fiscal institutions has been an issue since its inception. Over time, with several EU countries breaching the rules of the Pact, such concerns have spiraled, generating an intense debate about its effectiveness and reliability.

This paper assesses empirically how the introduction and reform of the SGP have changed the expectations of financial market experts on fiscal policies of the four largest European Economies: France, Germany, Italy, and UK. For that we rely on the disaggregated monthly survey provided by Consensus Economics Forecasts on professional economists' deficit forecasts between May 1993 and December 2007 as a proxy for their fiscal expectations. To the best of our knowledge this is the first time that fiscal rules are analyzed by means of markets' expectations.

We test the impact of the SGP in two different dimensions. First, we look at whether the introduction and reform of the Pact have increased accuracy and decreased bias of experts' deficits forecasts. Second, we investigate how the SGP has affected the convergence and bias of their deficit forecasts compared to those of the European Commission and of each country's national fiscal authority (NFA). More convergence of experts' fiscal forecasts to the ones of those institutions could imply an increase in their credibility due to the SGP implementation.

As main results, our paper evinces that only in France accuracy of deficit forecasts by market specialists has significantly increased after the SGP. In turn, credibility of the European Commission's deficit forecasts among market specialists seems to have increased in most of the countries (France, Italy, and the UK), particularly after the Pact's reform in 2005 and up to

2007. Nevertheless, with exception of the UK, our findings suggest a lack of credibility of NFAs fiscal forecasts among market specialists during the SGP.

These results indicate a need for improvements in the enforcement and transparency of Europe's fiscal framework in order to make its fiscal institutions more credible. This is particularly relevant nowadays.

The financial crisis and the fiscal stimulus plans implemented have created serious fiscal challenges for the European countries. Restoring stability and sustainability of public finances is a top priority for several EU member states. Certainly, fiscal consolidation could also be better formulated and implemented if policymakers had further insights about what the SGP has achieved in terms of credibility and transparency.

J.E.L. Classification: E62, H11, H30, H50.

Keywords : expectations, credibility, Stability and Growth Pact, survey data.