

Fiscal Governance in the Eurozone

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- 1. Fiscal Union and the relationship between liability and control**
- 2. The existing fiscal coordination and supervision does not work**
- 3. Accountability Bonds**

1. Fiscal Union and the relationship between liability and control

Fiscal Policy Governance in Europe

	Control over Fiscal Policy		
		European	National
Liability for government debt	European	Centralised Fiscal Union	Status Quo?
	National	Treaty of Maastricht?	Decentralised Fiscal Union

2. The existing fiscal coordination and supervision
does not work

European Stability and Growth Pact:

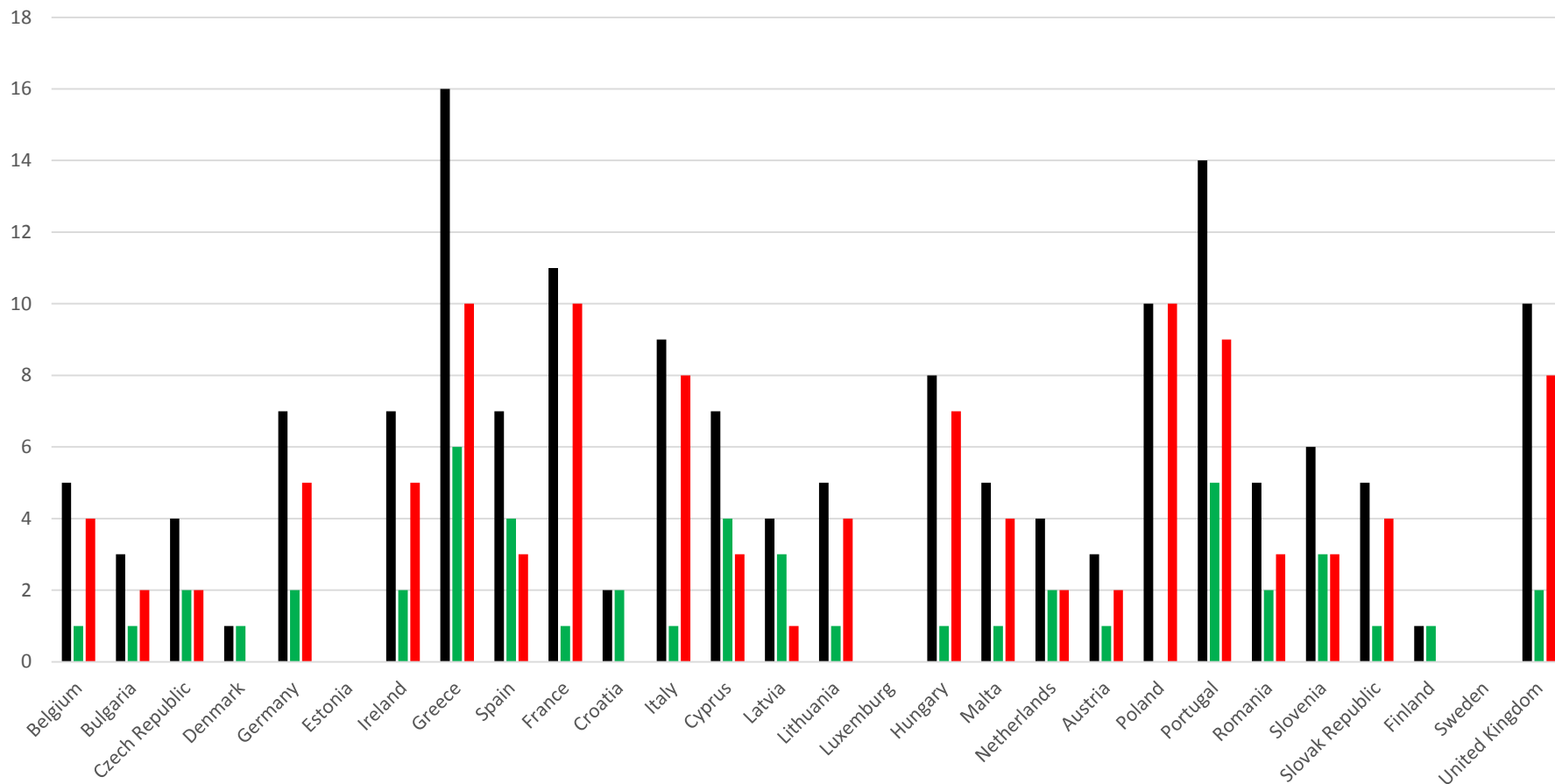
„...adherence to the medium-term objective of budgetary positions **close to balance or in surplus** will allow **Member States to deal with normal cyclical fluctuations** while keeping the government deficit **within the 3 % of GDP reference value**;“*

*(VERORDNUNG (EG) Nr. 1466/97 DES RATES vom 7. Juli 1997 über den Ausbau der haushaltspolitischen Überwachung und der Überwachung und Koordinierung der Wirtschaftspolitiken, Erwägungsgrund (4).

Experience with Fiscal Policy Supervision in Europe

- 1999-2014: 159 violations of the 3% deficit limit
- 50 violations happened in recession years (negative growth rate)
- 109 violations happened in years without recessions
- Number of sanctions: 0

Violations of Maastricht Treaty 1999-2014 (3% Budget Deficit Ceiling)



Source: Own calculations, European Commission

■ Overall
 ■ allowed because of recession
 ■ not allowed

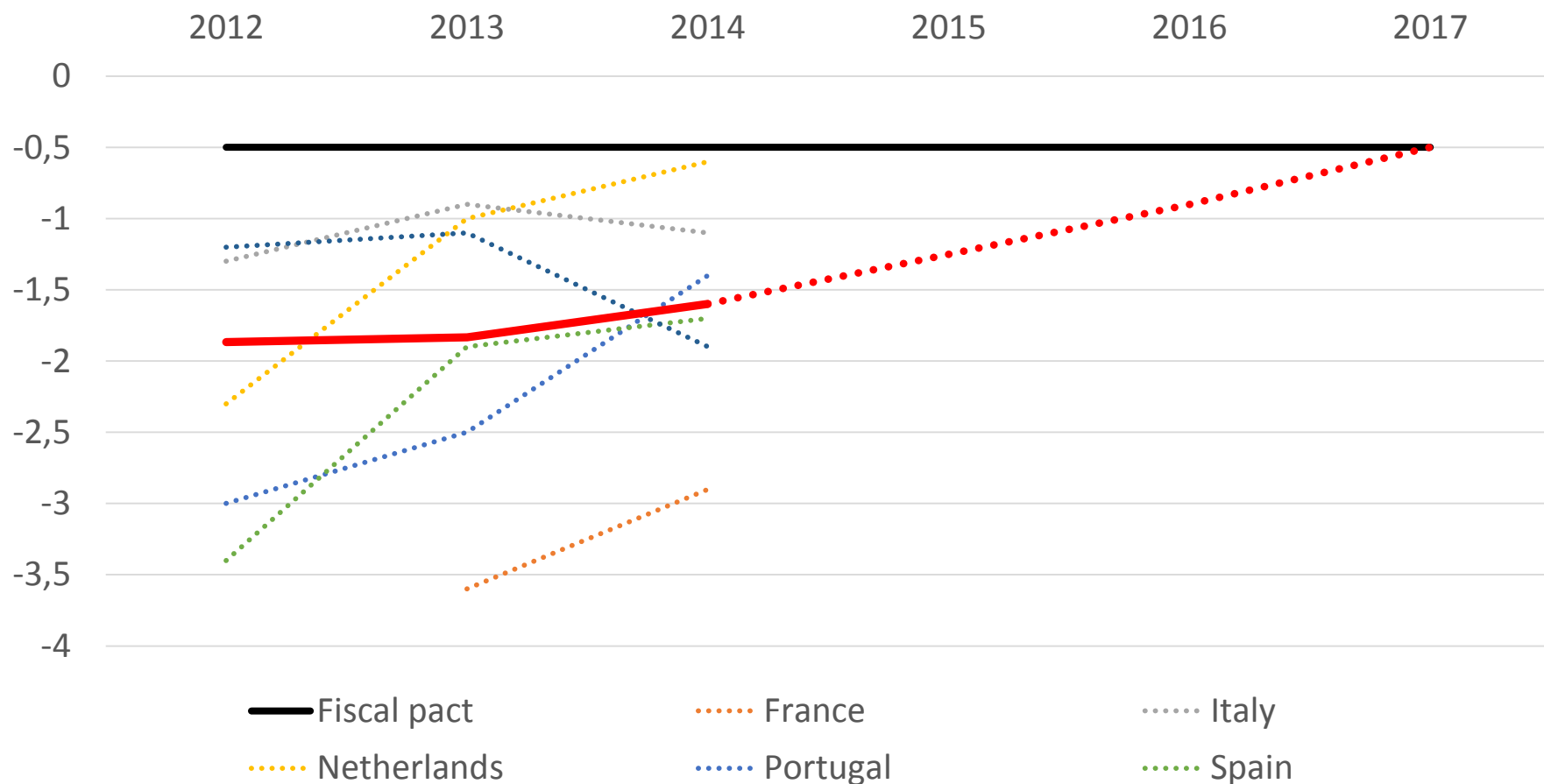
Has this improved since the debt crisis?

European Fiscal Pact:

Article 3 (1)

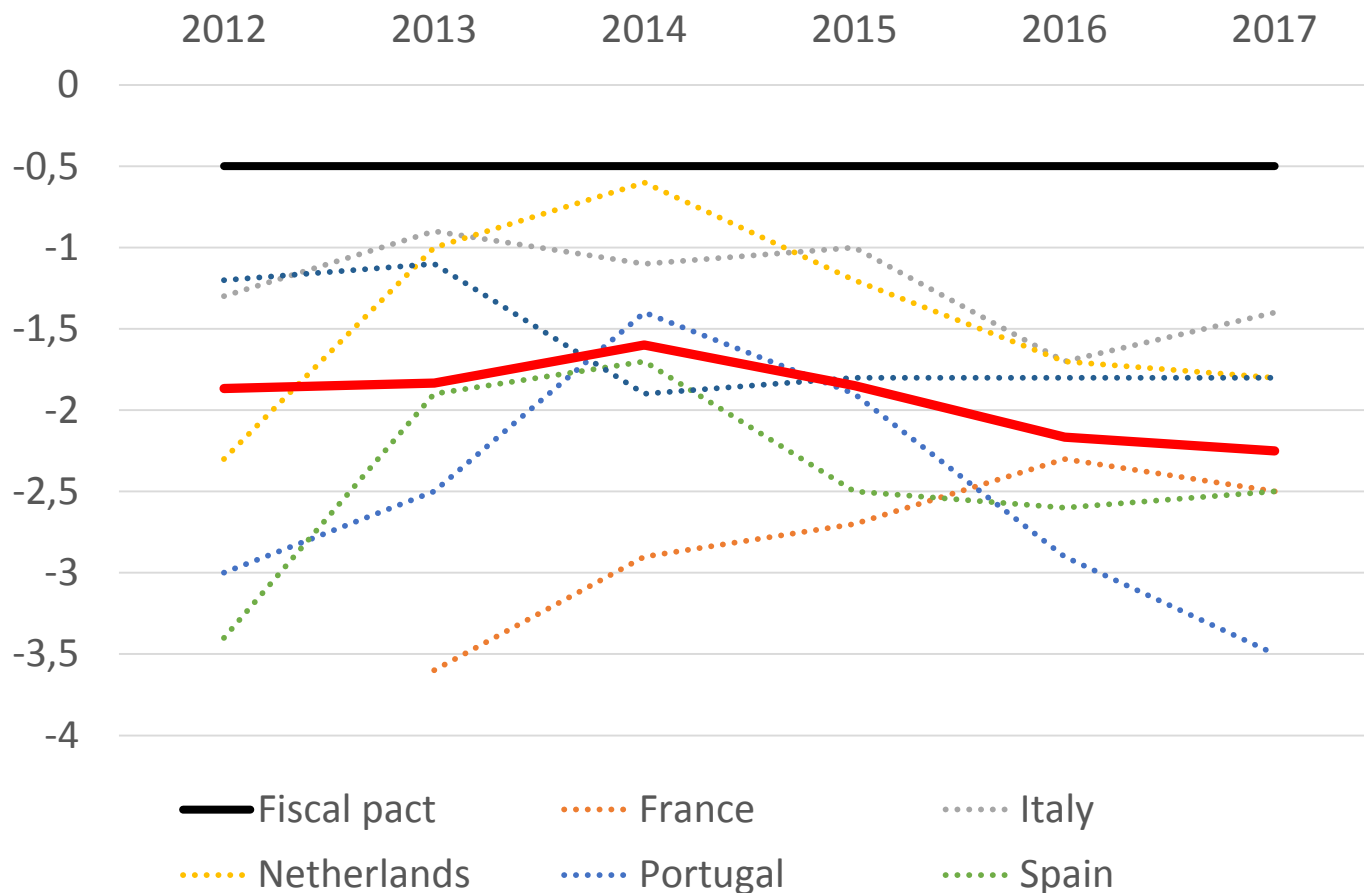
- (a) the **budgetary position** of the general government of a Contracting Party shall be **balanced or in surplus**;
- (b) the rule under point (a) shall be deemed to be respected if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, **with a lower limit of a structural deficit of 0,5 % of the gross domestic product** at market prices. The Contracting Parties shall ensure **rapid convergence** towards their respective medium-term objective.

Structural Budget Deficit and Fiscal Pact 2012-2017



Data: European Commission Winter Forecast 2016

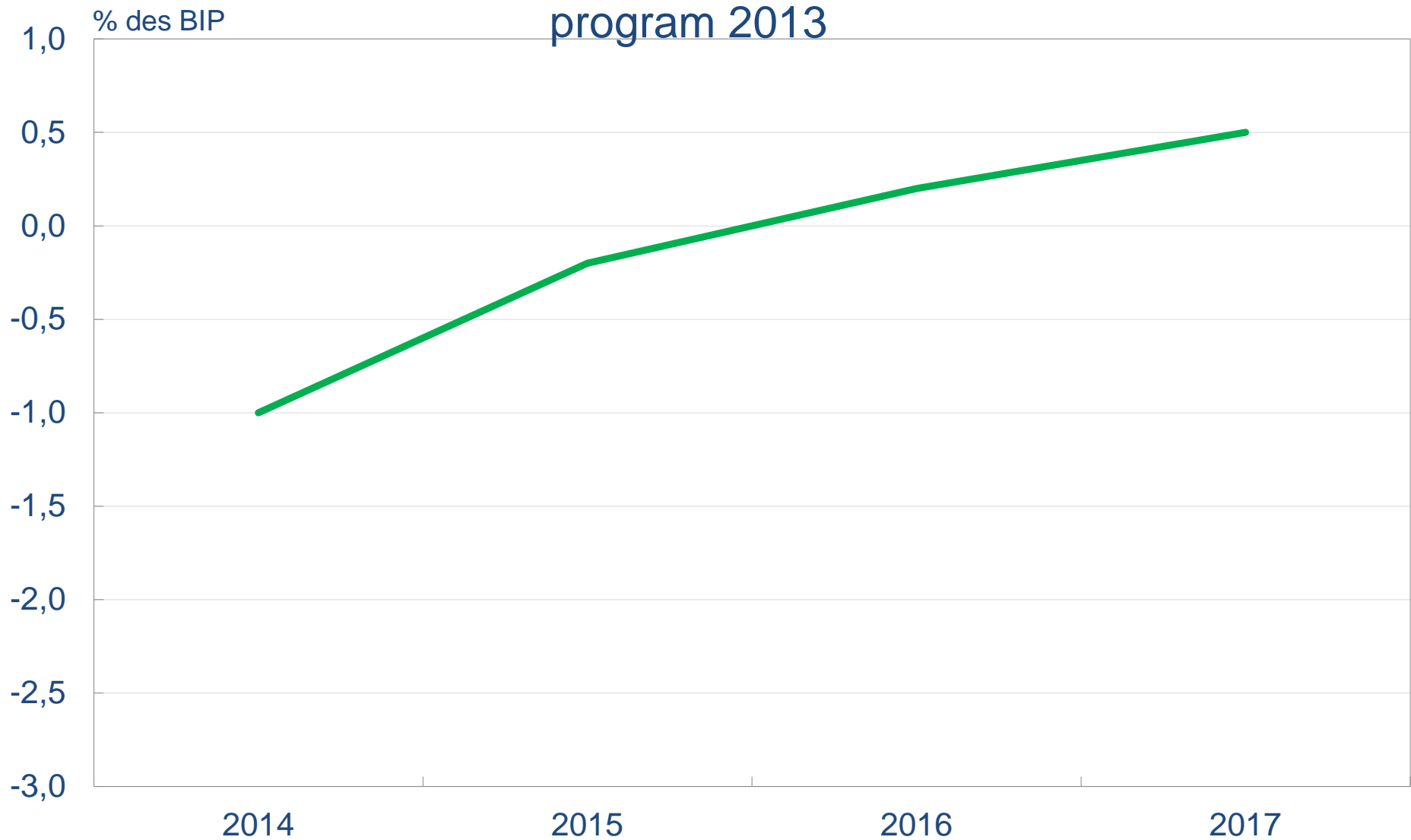
Structural Budget Deficit and Fiscal Pact 2012-2017



Data: European Commission Winter Forecast 2016

Example of how the
'European Semester' works:
Stability program France 2013

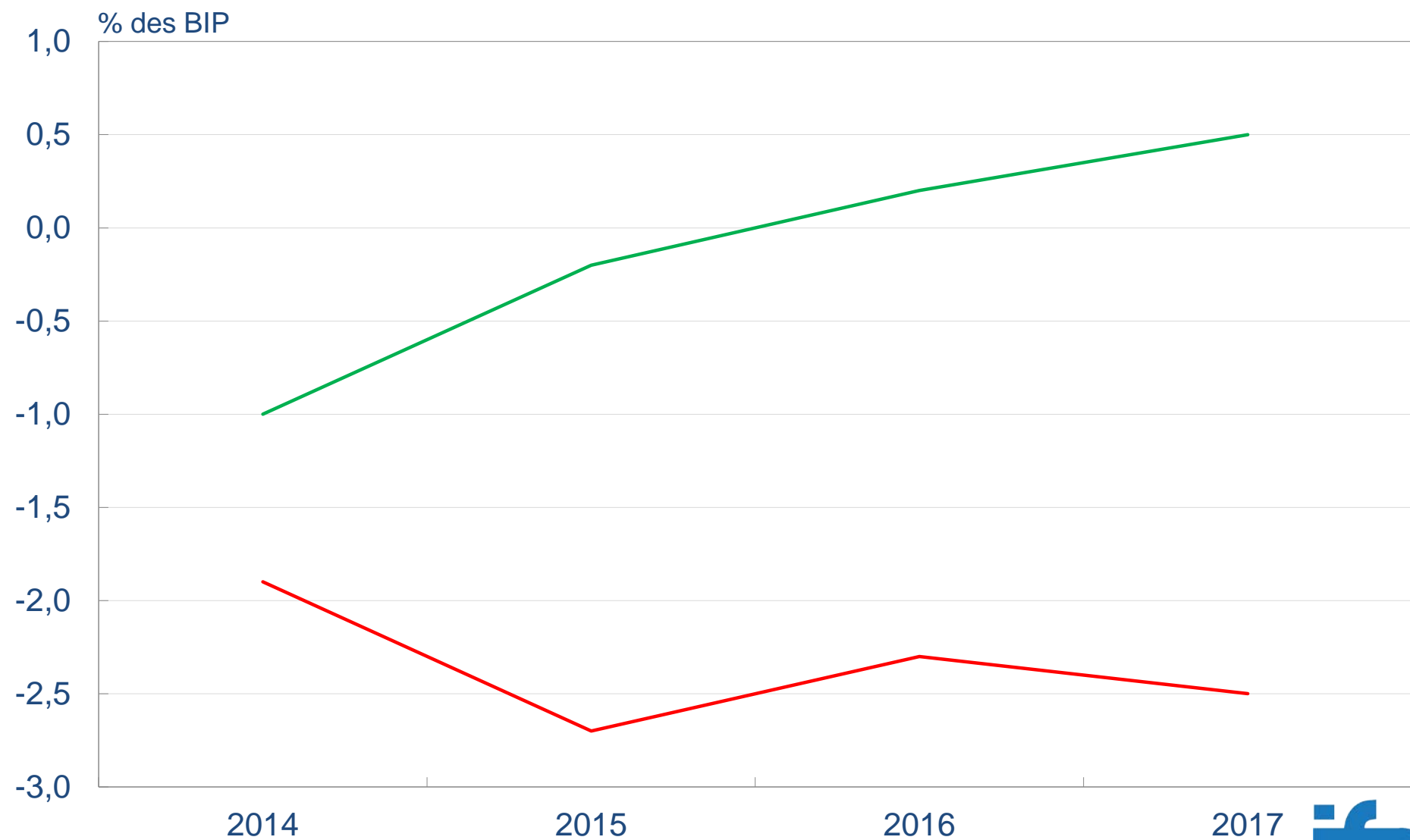
Structural deficit France as announced in stability program 2013



Comment of the European Council on July 9 2013:

Given the high and further increasing level of public debt and given the fact that the correction of the excessive deficit has again been postponed, to 2015, it is all the more important that the budget 2013 is implemented strictly and that significant consolidation efforts will be undertaken in the following years.

Structural Deficit France 2014 - 2017



News › World › Europe

French ministers demand Hollande abandon austerity and condemn Angela Merkel's 'right-wing dogma'

Condemnation of Angela Merkel's domination of eurozone economic policy and 'forced march' of spending cuts could be designed to increase Hollande's bargaining power in Brussels

Europe's day of anti-austerity strikes and protests turn violent - as it happened

Video showing Spanish riot police striking demonstrators in Tarragona today (see 6.55pm)

Graeme Wearden

Wednesday 14 November 2012 17.31 GMT

3. Accountability Bonds*

* Fuest, Heinmann, Schröder (2016)

- Accountability bonds are *junior government bonds*
- All existing government bonds are senior relative to acc. Bonds, no changes for senior bonds
- Accountability bonds have (various) automatic triggers for restructuring
- The ECB does not buy accountability bonds
- Accountability bonds are standardized (5 year maturity)
- Positive risk weights in banking regulation

Trigger	Type of restructuring
Debt exceeds 120% of GDP	Automatic prolongation, interest moratorium,
Country starts ESM programme	Total loss

When is a country required to issue Accountability Bonds?

- European Fiscal Pact is used as starting point: Structural deficit should not exceed 0,5% of GDP
- If a country exceeds that limit with its current deficit, the excess deficit is financed with Accountability bonds
- **Example:** Structural budget deficit of Spain 2017 (forecast): 2,5% of GDP; 2% of GDP are issued in the form of accountability bonds

- **Intuition:** If a country exceeds debt levels beyond jointly decided level, it needs to bear the full cost, no ‘subsidization’ of debt via joint liability (analogy to ‘polluter principle’ in environmental economics)
- **Option:** Countries build up a buffer of Acc. Bonds in ‘good’ times that reduce obligation to issue them in bad times.

Accountability Bonds: What are their particular advantages?

- **Gradual step** towards credible sovereign debt restructuring
- Avoid risk of destabilising large parts of existing bond markets by focusing on **debt flows not stocks**
- Restore **market discipline *at the margin*** without increasing the cost of refinancing the existing stock of debt
- Give **greater relevance to fiscal policy coordination at the EU level**

What is the difference to existing proposals for debt restructuring?

- Accountability bonds focus on **flows** (yearly deficit) rather than **stocks** of debt
- Blue Bond Red Bond Proposal (Delpla/Weizsäcker): Converting 60% of the **stock** of debt into senior debt would impact on the remaining stock of (red bond) debt
- German Council of Economic Advisers: Debt Redemption Pact: Stock based approach, 60% of GDP remaining under national control
- Mody (2013): ‘Sovereign Cocos’, transformation of the stock of debt

Thank you very much