



Bundesministerium
der Finanzen

Fiscal Rules in Europe: anchor or straitjacket?

comments by

Dr. Christian Kastrop

Franco-German workshop on the Euro area, 21 March 2012

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Bundesministerium der Finanzen
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Berlin
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Outline

- The European debt crisis: causes and policy lessons
- Reform options and recent developments
- „European Stability Union“: Where do we stand?
- Conclusions and outlook

The European debt crisis – causes

- Sizable fiscal imbalances in most euro area countries due to
 - ⇒ crisis-related fiscal loosening and financial sector stabilisation ...
 - ⇒ ... but in many cases also failure to achieve sound fiscal positions in good times
 - Confidence crisis
 - ⇒ unsustainable fiscal positions coupled with structural economic weaknesses in a number of countries undermine market confidence
 - ⇒ negative feedback loop between public and bank balance sheets, contagion risks
- ⇒ euro area financial stability at risk

The European debt crisis - policy lessons

- European institutional framework
 - ⇒ weak economic governance prior to the crisis ...
 - ⇒ ... reflected in lax implementation of SGP rules ...
 - ⇒ ... and deficiencies in economic and structural policy coordination
- ⇒ Urgent need for reform: For a smooth functioning of EMU, governance framework needs to ensure stable fiscal and macroeconomic developments at the Member State level.

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Reform options

- Centralised powers at the EU/EA level (e.g., „European Finance Minister“) ...
 - ⇒ would reduce coordination problems ...
 - ⇒ ... but require a stronger democratic legitimation
 - ⇒ political feasibility questionable
- Enhanced European federalism
 - ⇒ subsidiarity principle suits heterogeneity at Member State level ...
 - ⇒ ... but requires convincing solution for policy coordination problems

Recent reform developments

- Recent reform developments go in the direction of an enhanced European federalism.
 - ⇒ Stronger economic policy coordination: European Semester and Euro Plus Pact
 - ⇒ Macroeconomic Imbalances Procedure: prevention and correction of macroeconomic imbalances within the EU
 - ⇒ SGP reform („Six-Pack“, „Two-Pack“): strenghtened preventive and corrective arm, enhanced sanction and enforcement mechanism, improved budgetary surveillance of EA countries
 - ⇒ Treaty on Stability, Coordination and Governance in the EMU: structural balanced budget rules at the Member State level (national transposition of rule supervised by ECJ)

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„European Stability Union“: Where do we stand? (I)

- National reform agenda :
 - ⇒ Some progress with fiscal and structural adjustment at the Member State level ...
 - ⇒ ... but risks related to cyclical developments and political frictions in some cases

- ⇒ timely correction of EDPs and implementation of announced structural reforms crucial to rebuild confidence

„European Stability Union“: Where do we stand? (II)

- European reform agenda:
 - ⇒ Recent institutional reform steps welcome ...
 - ⇒ ... but challenges: credible/effective implementation (e.g. fiscal pact) and enforcement (revised SGP)
- ⇒ Strengthened European economic governance framework needs to convincingly overcome past shortcomings, notably lax implementation related, e.g., to political discretion (ECOFIN Council)

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Conclusions and outlook (I)

- Credible and effective rules framework necessary to compensate for weakened financial market mechanism
 - ⇒ bailout expectations: EFSF/ESM
 - ⇒ financial market distortions related to non-standard monetary policy intervention (LTROs, SMP) cannot be ruled out
- Recent stabilisation on euro area debt markets might be driven by expansionary monetary policy stance
 - ⇒ euro area countries need to restore sound fiscal positions and improve their competitiveness ...
 - ⇒ ... also with a view to being prepared for future economic shocks

Conclusions and outlook (II)

Long-term European policy perspective:

- ⇒ Despite of recent progress: Euro area governance framework needs to be further developed to achieve the necessary coordination of fiscal and economic policies.
- ⇒ What if countries persistently fail to deliver their policy commitments (as observed in the past)? Do we need a European insolvency law to reinforce the no-bailout clause of the Treaty?

- ⇒ Franco-German axis has played and will play a crucial role in shaping the necessary European reform process.
 - ⇒ Both countries should now also take a leading role in the national implementation of the insitutional reforms agreed at the European level.

Thank you for your attention!

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