

Interparliamentary Conference on Stability, Economic Coordination and Governance in the EU

Vienna, 17 to 18 September 2018

Background Paper

Session 1: Implementation of a fiscal policy framework for the EU

The Stability and Growth Pact (SGP) is the main factor determining the fiscal policy framework of the EU and the Economic and Monetary Union (EMU). It establishes a system for coordinating and monitoring the financial management of EU Member States by setting limits on government deficit and debt and providing for the possibility of sanctions if these limits are exceeded. Since its establishment in 1997, the SGP has been continuously developed, which has significantly increased the complexity of fiscal rules. Apart from fiscal rules, the individual Member States have a dominant impact on fiscal policy within the Economic and Monetary Union, while the European Central Bank is the institution that determines monetary policy for the euro area as a whole.

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Points for discussion:

- Should the EU's and EMU's fiscal framework be strengthened in order to achieve better control of the common fiscal orientation? What are the main challenges?
 - Is a common fiscal capacity an appropriate and viable instrument for deepening the EMU? What conditions would such an instrument have to meet and how could it be financed?
 - In what way could the EU fiscal framework be simplified while ensuring sufficient effectiveness and flexibility? What aspects need to be considered when simplifying?
 - What is the role for national parliaments in the context of an enlarged EU fiscal-policy framework? How could the national parliaments' monitoring/supervisory powers be strengthened in this context?
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Events in the wake of the global crisis starting in 2007/08 placed the focus of public debate on fiscal policy. This was one major reason for expanding the fiscal policy framework in the years 2011 to 2013 by means of the "Six Pack" and "Two Pack" legislation and the Fiscal Compact (as part of the Intergovernmental¹ Treaty on Stability, Coordination and Control in the Economic and Monetary Union). The "Six Pack" inter alia provided for an operationalisation of the regulation governing the need to adjust if the debt limit is exceeded (annual reduction by one-twentieth of the gap between debt level and the 60 % threshold) and created possibilities for sanctions in the preventive arm of the SGP. In addition, the Medium Term budgetary Objective (MTO), which is defined as the target value for the cyclically adjusted structural budget balance net of one-off measures, has been supplemented by an expenditure benchmark defining maximum permissible spending increases based on the medium-term potential economic growth rate. The "Six-Pack" also provides the legal basis for the monitoring

¹ In its communication of 6 December 2018, the Commission submitted a [proposal](#) to integrate the substance of the Treaty on Stability, Coordination and Governance into the Union legal framework.

of macroeconomic imbalances planned for the European semester². In the Fiscal Compact, the participating states³ committed themselves to tightening individual regulations of the "Six-Pack" (structural budget deficit of no more than 0.5% of GDP at a national debt of over 60% of GDP) to enshrine fiscal rules in national legislation and to create independent national institutions to monitor compliance with fiscal rules. The "Two Pack" integrated individual provisions of the Fiscal Compact into EU law and extended the European Semester for the euro area Member States to include a common timetable for the presentation and adoption of national budgets.

The [Five Presidents' Report of June 2015](#) set out a roadmap for the next steps to improve economic governance in the euro area with the aim of gradually completing the EMU by 2025. While the implementation of some proposals will probably be possible in the medium term only, other proposals have been implemented immediately. Among other things, the course of the European Semester has been revised so that the discussion of the economic policy guidelines for the euro area now begins in November and can be used as a basis for the discussion of country-specific challenges in the spring. An independent advisory [European Fiscal Board](#) was established at European level, which began its work in October 2016 and whose tasks include regular assessments of the appropriate fiscal orientation of the euro area as well as opinions on the functioning of fiscal rules and future development opportunities. The European Fiscal Board published its first [annual report](#) in November 2017.

Starting with the [White Paper on the future of Europe](#) presented by the Commission on 1 March 2017 and the [Reflection Paper](#) on the Deepening of the Economic And Monetary Union published on 31 May 2017, options for the further development of the EMU are currently being discussed, with many proposals linked to a further development of the fiscal policy framework. The Commission specified some of its plans in the policy [package for Completing Europe's Economic and Monetary Union](#) of 6 December 2017 and in its [proposals on the medium-term financial framework](#) from 2021, while Germany and France contributed to the discussion with their joint [Meseberg Declaration](#) of 19 June 2018. This discussion was continued at the [European Council](#) meeting on 28 and 29 June 2018. The following is a summary of some initiatives and proposals with a particular impact on fiscal policy:

- European **fiscal rules** have evolved considerably over time, which has also significantly increased the level of complexity of their application. In the context of discussions on the further development of EMU, many call for a simplification of fiscal rules, for example by focusing on a debt and on an expenditure rule. Prepared on a request from the ECON Committee of the European Parliament, [three external papers](#) advance proposals to simplify the SGP. A concept for redesigning fiscal rules and the fiscal policy framework of EMU in general was published by 14 German and French economists as [CEPR Policy Insight](#) and discussed in numerous comments. In its [Annual Report 2017](#), the European Fiscal Board has also emphasised the complexity and lack of transparency of the SGP in its current form and announced it would submit concrete [proposals](#) for SGP revision in its Annual Report 2018. In a [Communication on Further Steps towards Completing Europe's Economic and Monetary Union](#) the Commission has announced a revision of fiscal rules with a view to achieving substantial simplification by 2025. Following an [Opinion of the Economic and Financial Committee](#) (EFC) published on 29 November 2016, the Commission's assessment of compliance with fiscal rules now focuses

² As of 2011, the European Semester has been providing the framework for economic-policy coordination within the EU.

³ The Fiscal Compact is binding for the 19 Member States of the Eurozone plus Bulgaria, Denmark and Romania.

more on the expenditure rule, which has the particular advantage that government spending can generally be better planned and managed than government revenue.

- The Commission's [proposal](#) on the medium-term financial framework envisages to significantly strengthen the **Reform Support Programme for the period 2021 to 2027** with a total budget of €25 billion. The largest component would be the reform delivery tool (€22 billion), which would provide financial support to Member States for key reforms within the framework of the European Semester.⁴ In addition, the reform assistance programme would include a convergence facility to assist Member States wishing to adopt the euro and would continue the existing programme of technical assistance to Member States in implementing structural reforms.
- Strengthening fiscal policy coordination within the EMU could be achieved through the creation of a common fiscal instrument ("**common fiscal capacity**"). The Commission's [proposal](#) in this regard provides for the establishment of a European Investment Stabilisation Function (EISF) for the next medium-term financial framework period. This should help cushion the impact of large asymmetric shocks and thus support the effect of the automatic stabilisers by maintaining the level of investment. In the event of a major asymmetric shock in a Member State, eligible investments in that Member State may be supported through back-to-back loans and interest subsidies. The Commission would grant the loans up to a ceiling of €30 billion. For the EU budget, they would thus constitute contingent liabilities which would only become material if a Member State were to default on the repayment of a loan granted. The interest rate subsidies are to come from a stabilisation fund which could be financed from annual contributions by euro area Member States from the seignorage income (income from the issue of banknotes) of central banks. Although the focus of the instrument will be on the euro area Member States, other EU Member States could also participate in ESIF, provided they contribute to its financing.
- The **European Stability Mechanism (ESM)** was established in 2012 by an intergovernmental treaty between the euro area Member States to take over the tasks of the European Financial Stabilisation Facility (EFSF) as a permanent bailout facility of the euro area.⁵ On 6 December 2017, the Commission presented a proposal for a [Regulation establishing a European Monetary Fund](#) (EMF) based on the ESM. The establishment of the EMF is intended to further develop the ESM as a central instrument for dealing with possible crises in the euro area and to enshrine it in the legal framework of the EU. The proposal would also give the ESM/EMF the role of a common backstop for the Single Resolution Fund within the banking union. At the [Euro Summit](#) on 29 June 2018, the EU leaders agreed that the Eurogroup would work out the terms of reference of the common backstop by December 2018 and agree on the modalities for the further development of the ESM.
- On 6 December 2017, as a further initiative to develop EMU, the Commission presented a [proposal](#) for the creation of a European Minister of Economy and Finance to represent the common economic policy interest of the EU and the euro area and to oversee the use of the common budgetary instruments. According to the proposal, the Minister could also take on the function of a Vice-President of the Commission and the Chairperson of the Eurogroup.

⁴ On 23 March 2018, the President of the European Commission Jean-Claude Juncker and Portuguese Prime Minister António Costa agreed to launch the first pilot project for the new reform delivery tool to address skills gaps in Portugal.

⁵ On 20 August 2018, the third ESM assistance programme for Greece was completed. This means that no assistance programmes are currently under way, but the ESM is retrospectively monitoring the former programme countries.