How Could the SGP be Simplified?

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Outline

- **Background**

- **Evaluation of the Pact**

- **Options for reform**

- **Concluding remarks**

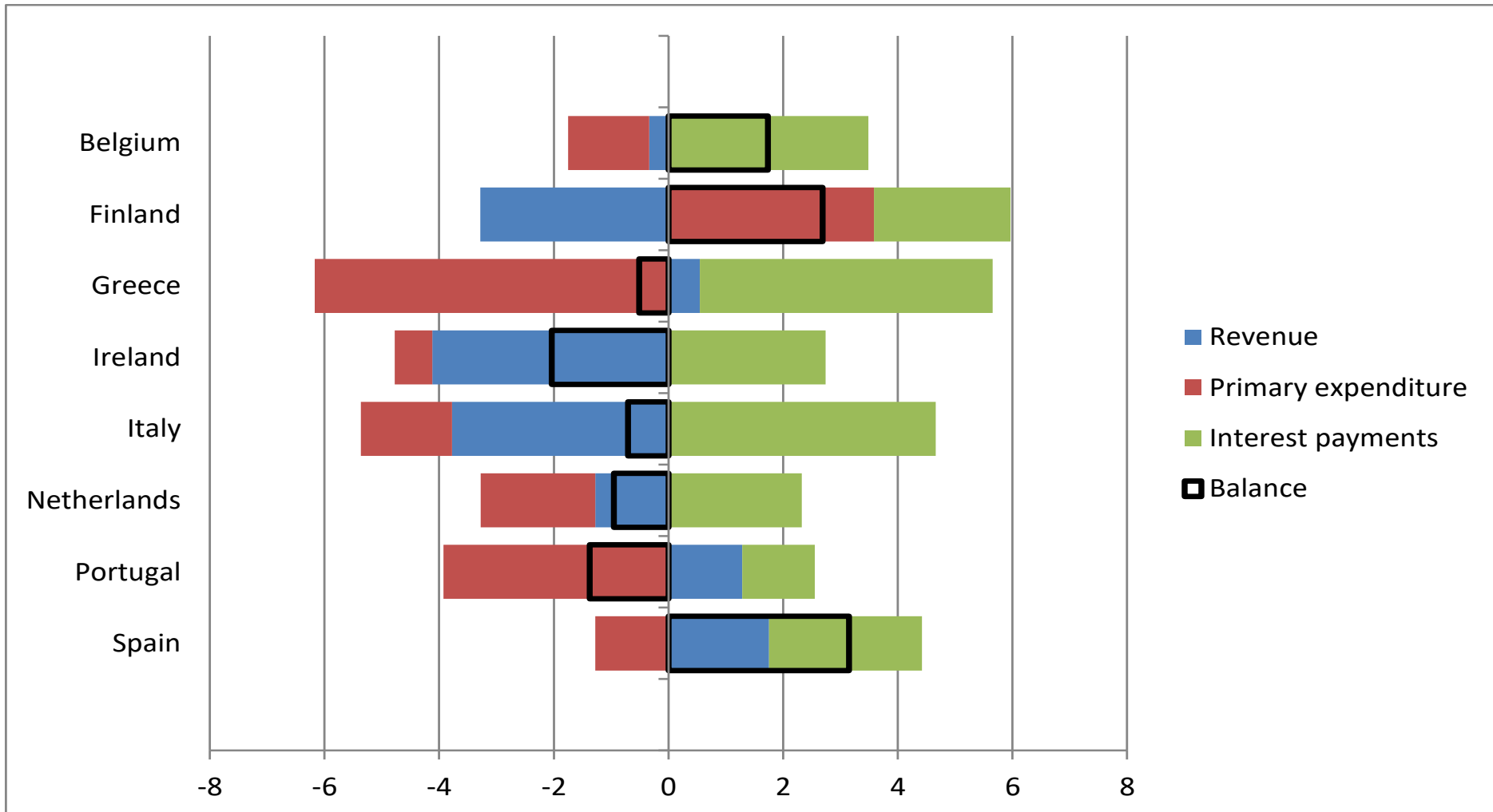# Background

Original version and implementation

- **Well-designed: simple, transparent, flexible**

- **Insufficient political ownership**

- **Erosion of fiscal space, procyclical expansionary stance**

- **Uniform treatment of government paper by ECB**

- **Noncompliance with EDP by France and Germany, 2003**

- **Moral hazard by member governments, markets**

- **Eurostat unauthorized to evaluate primary data sources**

Background

Erosion of fiscal space
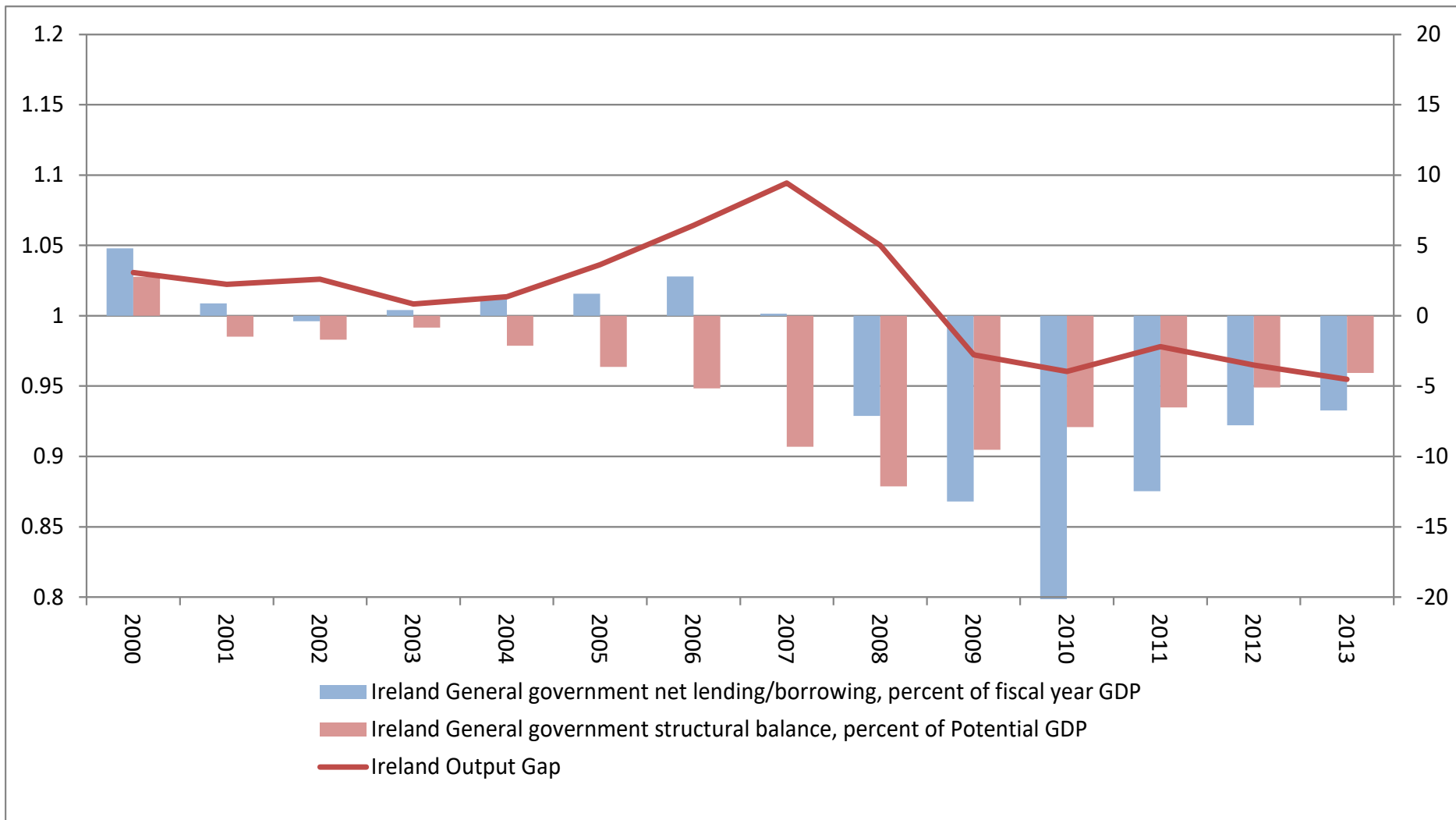## Net Contribution to Government Balance, 1998-2005
(Cyclically adjusted, % of GDP)

Legend:
- Revenue
- Primary expenditure
- Interest payments
- Balance

Background
Procyclical expansionary stance

Ireland: Government balance and output gap, 2000-13

Ireland General government net lending/borrowing, percent of fiscal year GDP

Ireland General government structural balance, percent of Potential GDP

Ireland Output Gap

Background
Moral hazard in financial markets

Euro area: sovereign risk premium
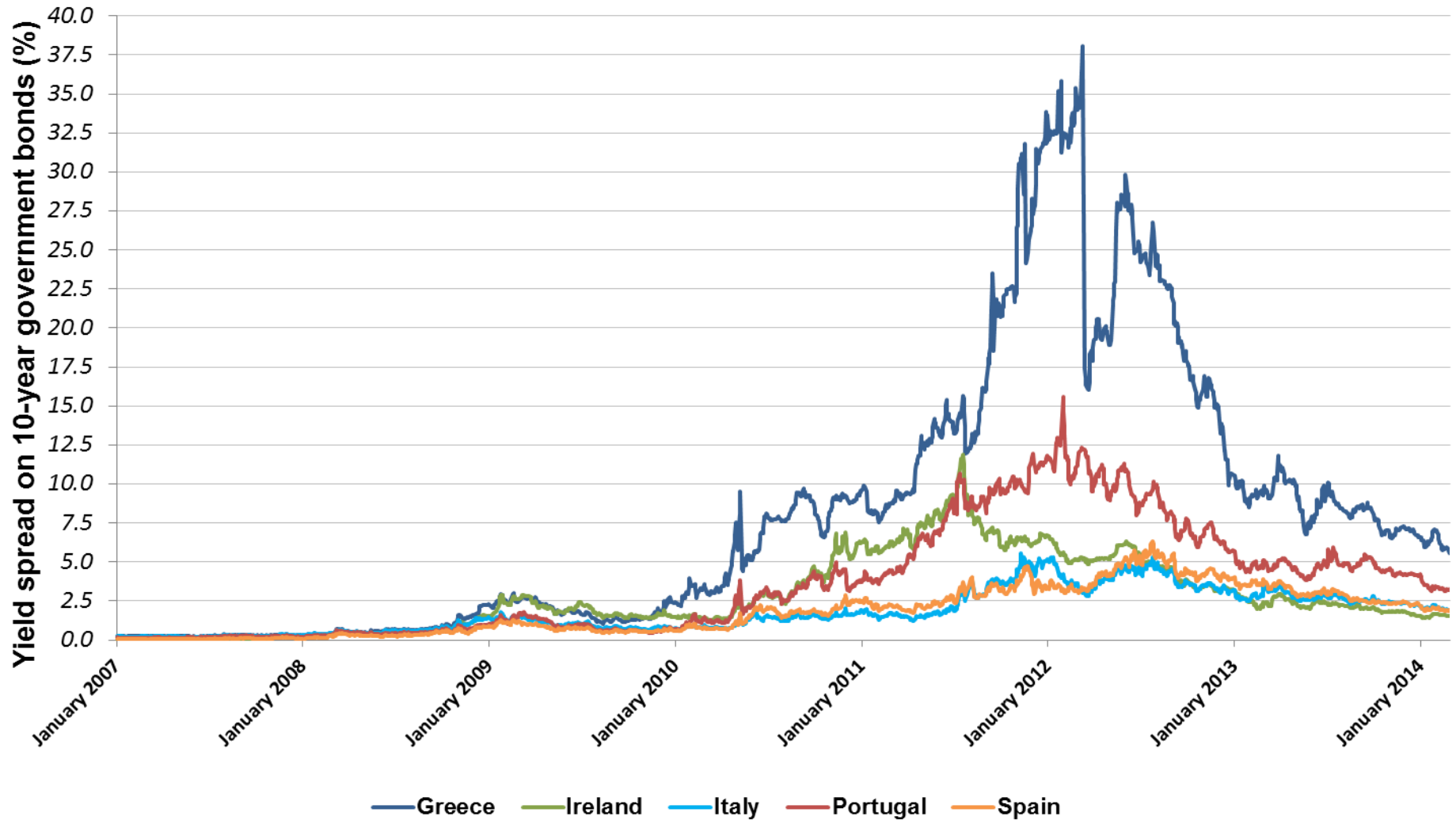
Evaluation of the Pact

Template: K-S criteria of good practice

Criterion	Original version Buti and Giudice (2002)	Present version
Definition	+++	+++
Transparency	+++	++
Simplicity	++	
Flexibility	++	+++
Adequacy	++	++
Enforceability	++	+
Consistency	++	++
Efficiency	++	++

Key: +++ very good; ++ good; + fair.

Evaluation of the Pact

Major weaknesses of the present version

- Most complex among macro-fiscal rules

- Deterioration in transparency

- Enforcement: -- openly political Commission
  -- continued erosion of credibility

Options for reform

1. *Consolidation of SB/MTO and debt reduction*
   [roots: Sweden, Brazil]

- Convergence to debt reference value

$$d_n^* < d_t \qquad \rightarrow \qquad s_t^* \geq \left(\frac{r-g}{1+g}\right) d_{t-1} + \Delta d_t^*$$

- Retain expenditure benchmark

- Commission: technical surveillance role only

- Council: political role, policy recommendations

- Junior sovereign bonds to finance unjustified excess deficits

Options for reform

2. Operational real debt rule
[roots: Hungary, US]

- Convergence to (nominal) debt reference value

  in year t:
  $$S^*_{t+3} = r^f_{t+3}D^f_{t+2} + \Delta D^*_{t+3}$$

  in year t+1:
  $$B^*_{t+3} \geq S^*_{t+3} - M^f_{t+3}$$

- Commission: technical surveillance role only

- Council: political role, policy recommendations

- Junior sovereign bonds to finance unjustified excess deficits

Options for reform

3. *Market-based autonomous approach*
[roots: Canadian, Swiss, US subnational gov'ts]

- Member states choose own national fiscal rules

- IFIs: monitoring compliance with national rules

- DG ECFIN, EFB: overall technical surveillance and guidance

- Council: effective enforcement of no-bailout principle

Concluding remarks

Challenges ahead

- **Eventual monetary tightening by ECB ?**

- **Narrowing fiscal space without structural reform ?**

- **Major test upfront: Italy ?**

- **Steps toward fiscal union ?**

References

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