

## European Parliament

Economic and Monetary Affairs Committee - Economic Governance Support Unit (EGOV)

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# Experiences with the current EU economic governance framework

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## ***Topics for second panel:***

1. Flexibility as part of rule based system in SGP and fiscal sustainability.
2. National fiscal institutions.
3. Monitoring and assessing draft budgetary plans.

Concentrate on 1.

## ***The dogs that did not bark:***

National fiscal institutions.

Pretty much absent from decision shaping (let alone decision making) specially where they are needed most (GR, IT).

**A dog the could not bark and that has disappeared:**

Monitoring and assessing draft budgetary plans.

Italy and French case decided 'politically'.  
Flexibility not founded on technical considerations  
(motivation of special circumstances, evaluation  
of reforms?).

Chief Economic Analyst in Commission (of ECFIN  
Commissioner) has been sidelined.

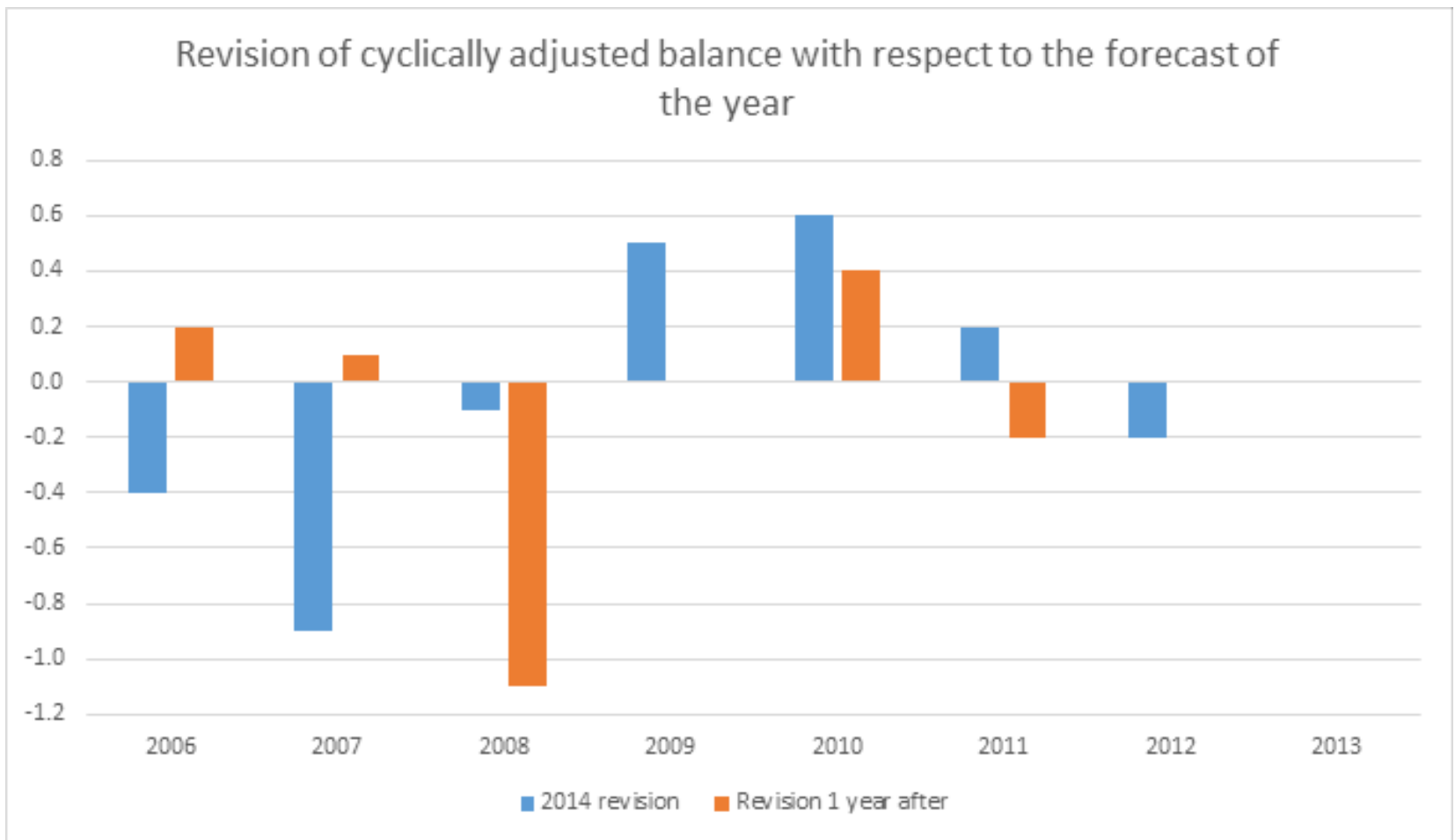
## ***General remarks on background for 'revised' SGP/Fiscal compact:***

- 1) FC 'imposed' as price for German money ('A man convinced against his will is of the same opinion still').
- 2) Now is the time when the intellectual economic case for reducing debt is weakest.
- 3) Unobservable variables will always be contested and revision sap willingness to apply strictly.

⇒ ***Huge gap between letter of law and spirit in application!***

***(Plus export growth more important for adjustment than fiscal balance. SGP fails to distinguish between foreign and domestically held debt.)***

# Italy: data revisions key: cyclical component looks different ex post



## ***Much emphasised problem: debt deflation:***

How to reduce debt/GDP ratio when nominal GDP is not growing.

Problem exists, but not all decisive. Two aspects:

- 1) Flows: difference between GDP growth and interest rates.
- 2) Stock: evaluate debt/GDP with GDP at sustainable competitiveness level of domestic prices.

⇒ ***Problem on both accounts manageable.***

***(Problem much worse during 1990s.)***

## Snowball effect: g-i, not so bad today

	DE	IT
Average 1994-2000	-2,6	-1,3
Average 2000-2007	-1,3	0,1
Average 2008-2014	0,3	-2,7
2014 August	2,9	0,7



## ***Stock view of debt deflation:***

Divide debt not by actual (nominal) GDP, but by GDP evaluate at the (relative) price level which would restore competitiveness to 1999 level (which should be sufficient since Germany then had a current account deficit).

***=> Debt ratios worse, but not by huge proportion as most 'deviations' in competitiveness have been corrected, see next table.***

	Debt/GDP 2013	Adjustment factor	Adjusted Debt/GDP
<b>EA-12</b>	95	1.00	95
<b>Belgium</b>	106	1.04	110
<b>Germany</b>	74	0.93	69
<b>Ireland</b>	111	1.04	115
<b>Greece</b>	175	1.03	180
<b>Spain</b>	98	1.09	107
<b>France</b>	96	0.98	94
<b>Italy</b>	132	1.05	139
<b>Portugal</b>	128	1.08	138
<b>Slovenia</b>	82	1.25	103

***An aside before concluding remarks:***

***‘Revised’ SGP/Fiscal compact needed for world in which government debt is treated as riskless and banking system unstable. Partially no longer the case:***

- 1) Banking Union much weakens the sovereign/banks loop.
- 2) AQR has strengthened balances sheets of banks.
- 3) Experience of Greek PSI remains in market.

***⇒ Much less need to be concerned about ‘excessive’ deficits and debt. ‘Next country to overspend will have a problem, not the euro area!’***

***(Plus could have changed treatment of sovereign debt on banks balance sheets imposing diversification.)***

Concluding remark:

‘Flexibility in a rules based system’ is a worthy goal, but impossible to attain as flexibility is used to undermine rules and data revisions make application of fines very problematic.

⇒ Rationale for SGP/FC much weakened.

⇒ Better to make financial system resistant to ‘excessive debt/deficits’.

	Debt/GDP	Adjustment factor	Adjusted Debt/GDP
<b>EA-12</b>	95	1.00	95
<b>Belgium</b>	106	1.04	110
<b>Germany</b>	74	0.93	69
<b>Estonia</b>	10	1.58	16
<b>Ireland</b>	111	1.04	115
<b>Greece</b>	175	1.03	180
<b>Spain</b>	98	1.09	107
<b>France</b>	96	0.98	94
<b>Italy</b>	132	1.05	139
<b>Cyprus</b>	107	1.09	118
<b>Luxemburg</b>	23	1.17	27
<b>Malta</b>	71	1.13	80
<b>Netherlands</b>	70	1.03	72
<b>Austria</b>	87	1.01	88
<b>Portugal</b>	128	1.08	138
<b>Slovenia</b>	82	1.25	103
<b>Slovakia</b>	54	1.17	63
<b>Finland</b>	60	1.01	60