EU responses to the recent crises

Lecture 7
LIUC 2011

EU response

1) EU Economic Governance - reform
- Stronger SGP
- Minimum requirement national fiscal framework
- Macroeconomic surveillance

2) Repair and safeguard measures
- Financial sector repair

3) Stability mechanisms
- Financial Assistance
- Temporary financial backstop mechanisms
- European Stability Mechanism (ESM)

1.1 Stronger SGP

- **Stronger preventive action**:
  MS are required to make significant progress towards medium-term budgetary objectives (MTO). Expenditure benchmarks will now be used alongside the structural budget balance to assess adjustments towards the MTO. An interest-bearing deposit of 0.2% of GDP will be imposed on non-compliant euro-area countries.

1.1 Stronger SGP

- **Stronger corrective action** The EDP can now result from government debt developments as well as from government deficit.
- Member States with debt in excess of 60% of GDP should reduce their debt in line with a benchmark.
- Progressive financial sanctions kick in at an earlier stage of the EDP. A non-interest-bearing deposit of 0.2% of GDP may be requested from a euro-area country which is placed in EDP
- Failure of a euro-area country to comply with recommendations for corrective action will result in a fine.

The Stability and Growth Pact (SGP)

- The SGP is a **rule-based** framework for the coordination of national fiscal policies in the economic and monetary union (EMU).
- It was established in 1997 as an instrument to **reinforce** the Treaty. Revised in 2005
- The Pact consists of a **preventive** and a **dissuasive** arm.

The Pact preventive arm

- MS must submit annual **Stability or Convergence programmes**, showing how they intend to achieve or safeguard sound fiscal positions in the medium term, taking into account the impending budgetary impact of aging population.
- The Commission assesses these programmes and the Council gives its **Opinion** on them.

The medium-term budgetary objective (MTO)

- While the Treaty defines reference values for deficit and debt, the SGP defines specific budget target for the medium-term.
- The MTO represents the budgetary position that **safeguards against the risk of breaching the 3%** of GDP and ensures the long-term sustainability of public finances
- In the original SGP, all Member States were expected to pursue the attainment of a budgetary position **close-to-balance or in surplus (CTBOIS)** in the medium-term.
- The reform of the SGP in 2005 clarified that MTO should be interpreted in **structural terms (cyclically adj and net of one-off measures)** and **differentiated** to take into account country specificities : public debt, potential growth, and implicit government liabilities associated with rising expenditure due to ageing populations

Stability and convergence programmes (SCP)

The SCP must contain the following information:

- The MTO;
- the adjustment path towards the MTO and the expected path of the debt ratio;
- the underlying economic assumptions;
- policy measures to achieve the programme objectives;
- an analysis of how changes in the main assumptions would affect the budgetary and debt position;
- the medium-term monetary policy objectives and their relationship to price and exchange rate stability (*for non-euro-area countries only*)

Stability and convergence programmes (cont.)

- The Council examines the programmes at the beginning of each year and delivers an **opinion** based on assessments by the Commission and the Economic and Financial Committee (EFC).
- On the basis of this analysis, the Council opinion may suggest **policy action** to be taken by the country in question.

The Pact dissuasive arm – The Excessive Deficit Procedure (EDP)

- The **EDP** is established in the Treaty and specified in the SGP legislation.
- The EDP is triggered by the **deficit breaching the 3% of GDP** threshold of the Treaty.
- If it is decided that the deficit is excessive in the meaning of the Treaty, the Council issues **recommendations** to the Member States concerned to correct the excessive deficit and gives a time frame for doing so.
- Non compliance with the recommendations triggers further steps in the procedures, including for euro area Member States the possibility of **sanctions**.

1.2) Minimum requirement national fiscal framework

- Member States should ensure that their fiscal frameworks are in line with minimum quality standards and cover all administrative levels. National fiscal planning should adopt a multi-annual perspective, so as to attain the MTO. Numerical fiscal rules should also promote compliance with the Treaty reference values for deficit and debt.

1.3 Macroeconomic surveillance

- MS have made economic choices which have lead to competitiveness divergences and macroeconomic imbalances within the EU. A new surveillance mechanism will aim to prevent and correct such divergences. It will rely on an alert system that uses a scoreboard of indicators and in-depth country studies, strict rules in the form of a new Excessive Imbalance Procedure (EIP) and better enforcement in the form of financial sanctions for Member States which do not follow up on recommendations.

2 Financial sector repair

- The EU established a new financial supervision architecture in January 2011. It includes:
  - a European Systemic Risk Board (ESRB) for macro-prudential oversight of the financial system,
  - and three European supervisory authorities: the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority.
  - Rules have also been tightened on capital requirements for banks, investment firms and insurance companies, and new rules on remuneration and bonuses will reduce incentives for short-term risk-taking.

3.1 Financial Assistance - Greece

- On 2 May 2010, the Eurogroup agreed to provide bilateral loans pooled by the European Commission for a total amount of EUR 80 billion to be disbursed over the period May 2010 through June 2013.
- Under the Greek Loan Facility, the European Commission is not acting as a borrower but has been entrusted by the euro-area MS with the coordination and administration of the pooled bilateral loans, including their disbursement to Greece.

3.2 European Financial Stability Facility (EFSF)

- EFSF provides financial assistance to euro area MS.
- EFSF is authorised to:
  - Provide loans to countries in financial difficulties
  - Intervene in the debt primary and secondary markets.
  - Finance recapitalisations of financial institutions through loans to governments

EFSF

- To fulfill its mission, EFSF issues bonds or other debt instruments on the capital markets.
- EFSF is backed by guarantee commitments from the euro area MS and has a lending capacity of €440 bn
- EFSF is AAA
- Operations: 2 in favour of Portugal, 1 of Ireland

3.2 European Financial Stabilisation Mechanism (EFSM)

- EFSM provides financial assistance to EU MS in financial difficulties.
- Under EFSM, the Commission is allowed to borrow up to a total of € 60 billion in financial markets on behalf of the Union under an implicit EU budget guarantee.
- The Commission then on-lends the proceeds to the beneficiary Member State. This particular lending arrangement implies that there is no debt-servicing cost for the Union. All interest and loan principal is repaid by the beneficiary Member State via the Commission.

ESFM

- The EFSM has currently been activated for Ireland and Portugal, for a total amount up to € 48.5 billion (up to € 22.5 billion for Ireland and up to € 26 billion for Portugal).

3.3. European Stability Mechanism (ESM)

- On 11 July, finance ministers of the 17 euro-area countries signed the Treaty establishing the European Stability Mechanism (ESM)
- It will replace EFSF and EFSM
- maximum lending volume: €500bn. Its capital stock of €700bn will ensure that lending can effectively be made up to this amount and consists of €80bn in paid-in shares and €620bn in callable shares.
- Mission: Financial assistance to MS under strict conditions