Development banks: fiscal surveillance perspective

Ingrid TOMING
European Commission, DG ECFIN

Outline

- *Stability and Growth Pact in a nutshell*
- *Focus on debt criterion*
- *Fiscal surveillance aspects of development banks*

Stability and Growth Pact in a nutshell

- *Corrective arm (Excessive Deficit Procedure)*
  - **Deficit criterion (3% of GDP)**
  - **Debt criterion (60% of GDP)**
- *Preventive arm*
  - **Medium-term objective and Structural Balance**
    - Structural balance: cyclically-adjusted balance net of one-off measures
    - Medium-term objective: country-specific numerical value for the Structural Balance, which has built-in buffers against debt, bad economic times and future liabilities
  - **Expenditure benchmark**
    - Expenditure rule that avoids unsustainable expenditure trends

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The two arms of the Pact

	Preventive arm	Corrective arm
When?	Deficit < 3% of GDP *and* Debt < 60% of GDP (or sufficiently diminishing)	Deficit > 3% of GDP *or* Debt > 60% of GDP and not sufficiently diminishing
Objective	Ensure prudent fiscal policies	Correct gross policy errors
Require-ment	• Structural balance remains at country-specific Medium-Term Objective (MTO) or on a path towards it • Expenditure benchmark is respected if not at MTO	• Headline balance should be brought below 3% of GDP • Debt > 60% of GDP or declining by 1/20 of a difference to 60% annually
Procedural steps?	If deviation: Significant Deviation Procedure after an '*overall assessment*'	• Opening of an excessive deficit procedure (EDP) • Intermediate annual targets to be respected ("effective action") • Abrogation, if excessive deficit corrected

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Member States' status under SGP

EURO AREA	NON-EURO AREA

Countries under the corrective arm (EDP)

2018

ES

Countries under the preventive arm

Euro area			
AT*	EE	LT	MT
BE*	FI	LU	NL
DE*	IT*	LV	SK
IE*	SI*	CY*	PT*
EL*,**	FR*		

Non-euro area		
BG	HU*	SE
CZ	PL	HR*
DK	RO	UK*

* Member States subject to the debt rule.
** Member States under an economic adjustment programme.

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Most important indicators

- *Government **deficit/surplus** ratio to GDP*
- *Government **debt** ratio to GDP*
- ***Reasons** for breaching deficit or debt ratios*

  Punctual and transitory event or sustained worsening?
- ***Cyclical conditions** of the economy*
- *Dynamics of **total expenditure***
- *Dynamics of **investment***
- *Level and dynamics of **interest expenditure***
- *Discretionary **changes in revenue policy***
- *Impact of **structural reforms***
- ***Stock-flow adjustment** for debt*

Focus on debt criterion

- ***Maastricht or EDP debt**: gross debt at nominal (face) value consisting of currency and deposits, debt securities and loans*
- ***Rule**: debt < 60% of GDP or sufficiently diminishing towards 60%*
- ***Debt reduction benchmark**: gap to 60% should be reduced by 5% (1/20) per year on average over a period of 3 years*

    Example: If debt is 100% of GDP, debt ratio has to decrease by around 2pp per year on average over 3 years

  The debt reduction benchmark is met if:

  - ✓ the gap to the 60% value has declined as required
  - ✓ OR the excess is only due to the impact of the economic cycle
  - ✓ OR the required reduction will occur in forward-looking 2-year horizon, based on Commission unchanged-policy forecast

- ***Transitional period**: for 3 years after the correction of the excessive deficit for MS that were in EDP at the entry into force of the Six-pack (Minimum Linear Structural Adjustment)*

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Built-in safeguards in the SGP

- *Opening of the deficit-based EDP*
  - ✓ Not automatic if excess over 3% is small, temporary and exceptional
  - ✓ Relevant factors (investment, exceptional event beyond government's control, …)
- *Opening of the debt-based EDP*
  - ✓ Not automatic irrespective of the size of the breach
  - ✓ Relevant factors
- *Opening of the Significant Deviation Procedure under the preventive arm*
  - ✓ Not automatic (but size of the breach and consistency across indicators matter)
  - ✓ An overall assessment
- *Communication on flexibility (preventive arm)*
  - ✓ Structural reform clause
  - ✓ Investment clause

Potential impact of development banks on government deficit and debt – <u>subject to ongoing discussions</u>

<u>Classification in S.13</u>

- *Balance ↑↓ (revenue and expenditure)*
- *Debt ↑ (possibly mitigated by consolidation)*
- *Reclassification may capture some market activities and related debt*

<u>Rearrangement</u>

- *Balance ↑↓ (depending on circumstances)*
- *Debt ↑ if imputed*
- *The nature of rearranged transactions is more likely non-market*

Fiscal surveillance perspective of development banks

<u>Classification in S.13</u>

+ *Simplicity*
+ *Captures non-market transactions and related debt as they occur*

− *Captures (partial) market transactions and related debt => impact can be large, especially on debt*

<u>Rearrangement</u>

− *Requires more frequent assessment of individual transactions*

+ *Captures non-market transactions and related debt as they occur*

Tentative conclusions

- *Methodological discussions are still ongoing*
- *As a general principle, all operations by government should be reflected in deficit and debt*
- *SGP has sufficient built-in safeguards to address changes in statistical methodology*
  - ➢ But may lead to new data needs

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Thank you!