

Ireland and the Fiscal Compact

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- Costs of excessive public debt
- Costs of fiscal pro-cyclicality
- role of a formal fiscal framework (plus political will)
- first line of defence: domestic
- second line of defence: EU level (fiscal spillovers)

- helpful in facilitating ECB role in bond market stabilisation
- necessary for fiscal federalism
- necessary for joint bond issuance

- Fiscal Responsibility Bill (now Q2 2012)
- Oireachtas Committee Report (November 2010)
- DF report (March 2011)
- IFAC report (January 2012)
- Question: Implications of Fiscal Compact and EU Economic Governance reforms?

- November 16: “Six Pack”
 - Three fiscal regulations and one fiscal directive
 - Two regulations on “excessive imbalances procedure” (EIP)
- November 23: Two further proposed regulations by European Commission to strengthen fiscal governance (also green paper on stability bonds)
- December 9: “Fiscal Compact” proposed
- January: leaks of draft

- Very high level statement of principles
- Fiscal elements of “six pack” - more detailed guidance
- Article 3: structural budget balance
 - meets country-specific medium-term budget objective (MTBO)
 - floor of 0.5 percent
 - floor of 1 percent for ‘low risk’ countries
 - convergence towards MTBO if initially away from MTBO (0.5 percent annual improvement a reference point)
 - Automatic correction mechanism if deviation from MTBO or adjustment path
- Article 4: debt reduction commitment if debt above 60 percent
 - “one twentieth” rule

- Country-specific; reset every 3 years
- MTBO - fiscal sustainability (including demographics), other economic targets (growth, ..)
- 'Optimal' MTBO?
 - target level of public debt
 - more restrictive MTBO for high-debt countries
 - key focus for political debate
- MTBO framework consistent with any target for public spending share in GDP

- Cyclical adjustment - automatic stabilisers
- One-off and temporary measures
- Six pack - broad view (including public investment exceptions)
- “Activist counter-cyclical” measures possible: *The Council and the Commission shall take into account whether a higher adjustment effort is made in economic good times, whereas the effort might be more limited in economic bad times. In particular, revenue windfalls and shortfalls shall be taken into account.*
 - reinforces importance of actively building up surpluses in good times
 - coherence with “excessive imbalances procedure” - fiscal action to address credit cycle, current account cycle, competitiveness cycle

- Absent from DF report: “Bygones are bygones”
- Clawback policy to avoid debt drift
 - “control” account
 - German and Swiss examples

- One Twentieth Rule implies debt target in year t

$$b_t^* = 0.60 + \left(\frac{1}{3}\right)0.95(b_{t-1} - 0.60) + \left(\frac{1}{3}\right)0.95^2(b_{t-2} - 0.60) + \left(\frac{1}{3}\right)0.95^3(b_{t-3} - 0.60)$$

- Debt reduction target more robust than a (cyclically-adjusted) primary surplus target (DF report)
 - debt reduction associated with a given primary surplus depends on growth rate and interest rate

- A reference point in “six pack”, along with European Commission forecast
- Required in November 23 proposed regulation
 - European Commission?
 - Irish CPB?
 - Irish OBR?
 - ESRI?
 - Central Bank?
 - IFAC Mark II?
- More formal analysis of medium-term path for Ireland a priority

- Matching of Fiscal Responsibility Bill with EU economic governance regulations and fiscal compact
- Fiscal frameworks: long-term effectiveness?