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The EU Approach to Fiscal Risk identification and Disclosure

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Taxonomy proposed by the European Commission (Public Finance 2005)

- **Explicit/implicit liabilities**
- **Non contingent/contingent liabilities**
 1. Macroeconomic risks: the most developed approach to fiscal risks
 2. Implicit liabilities: budgetary consequences of ageing
 3. Contingent liabilities: financial crisis ?

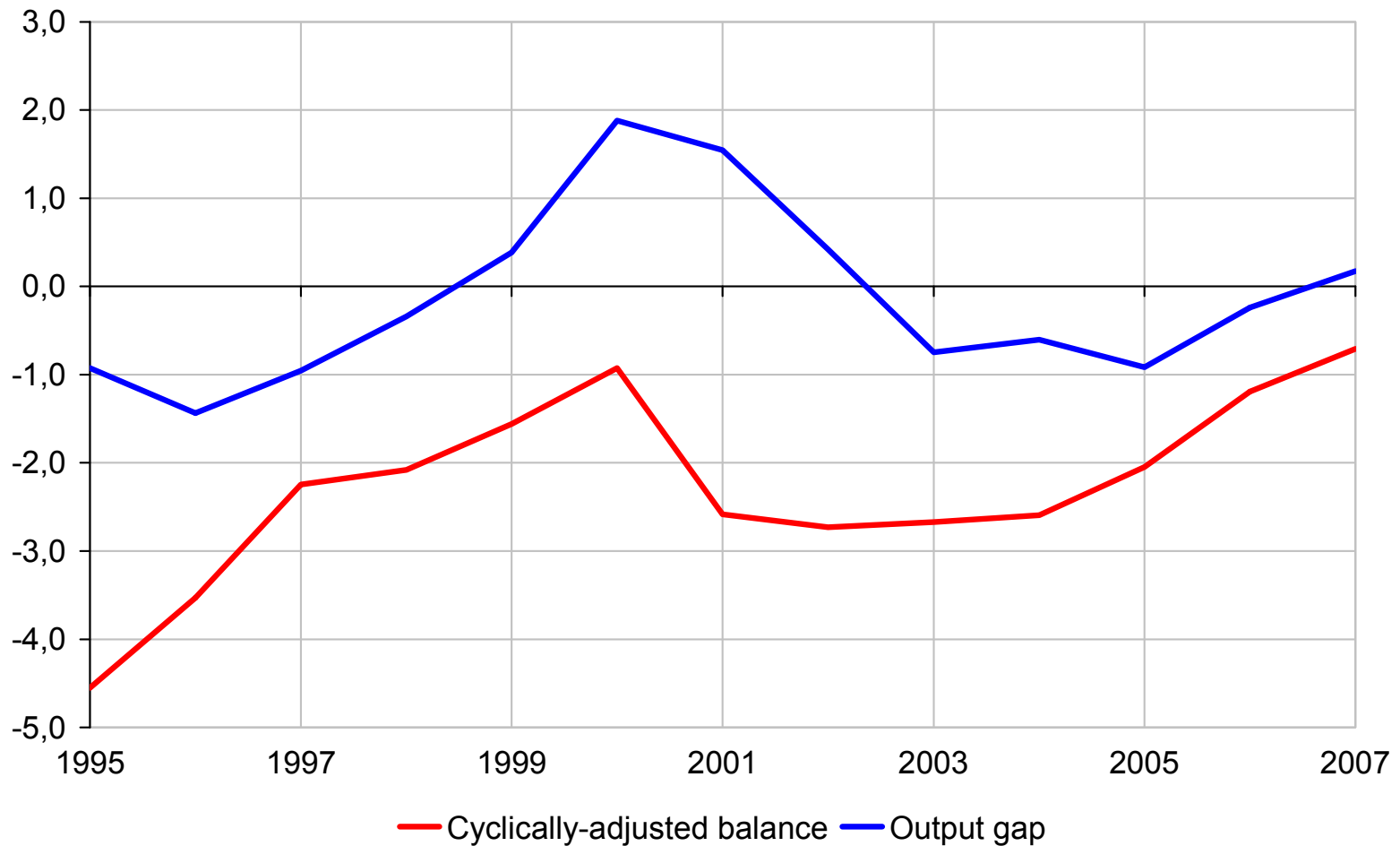
1- Macroeconomic risks

European framework = risk-management oriented

- 1- From the risk of breaching the 3% ceiling...
=> “minimum benchmarks”
- 2- ... to measurement issues...
=> commonly agreed methodology
- 3- ...to risks linked to political decisions and cycle management
=> attention paid to “good times”

1- Macroeconomic risks

Deficit bias in the Euro Zone (data Eurostat, European Commission)



1- Macroeconomic risks

Leading to the reformed SGP (2005)

- Redefined the notion of exceptional circumstances: weaker condition (resulting from “a negative growth rate or from an accumulated loss of output during a protracted period of very low growth relative to potential output”).
- Medium term objective (MTO): in structural terms and not nominal terms. minimum structural improvement of 0,5 point of GDP each year required during the adjustment towards the MTO
- Better appreciation of the the cyclical position (defining good times/bad times), especially when applying the preventive arm. The treatment of good times was improved.

1- Macroeconomic risks

Differences between planned and actual data (% of actual GDP)

	2004	2005	2006	2007
Stability Program 2003				
public balance	0	-0,1	-0,2	-1,2
public receipts	0,8	1,8	2,1	1,7
public expenditure	-0,9	-2,0	-2,3	-2,9
Stability Program 2004				
public balance	0	-0,1	-0,2	-1,1
public receipts	0,2	0,5	0,7	0,4
public expenditure	-0,3	-0,7	-0,9	-1,5
Stability Program 2005				
public balance	0	0	0,5	0
public receipts	0,2	0,1	0,9	0,9
public expenditure	-0,2	-0,2	-0,5	-1,0

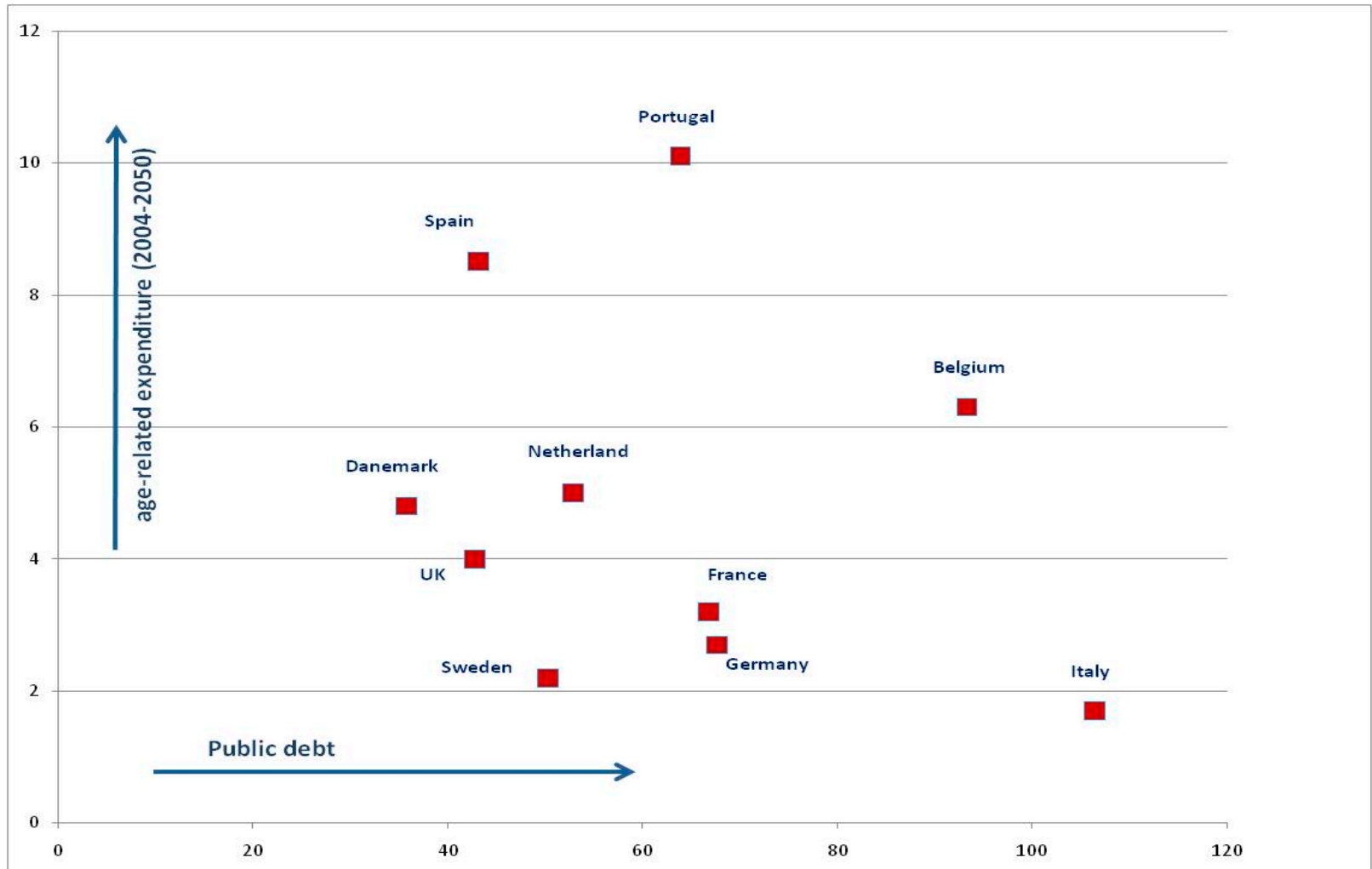
1- Macroeconomic risks

Current issues

- Bad times ?
- How to implement “cautiousness” and realism in the multi-annual programs? How to stick to medium term targets and the pre-defined structural path?
- How to promote national appropriation of the European rules?

2- Long term risks and implicit liabilities

Sustainability in the context of ageing (source Eurostat, European Commission)



2- Long term risks and implicit liabilities

Sustainability and ageing: indicators used by the European Commission

- **S2 indicator: inter-temporal budget constraint**

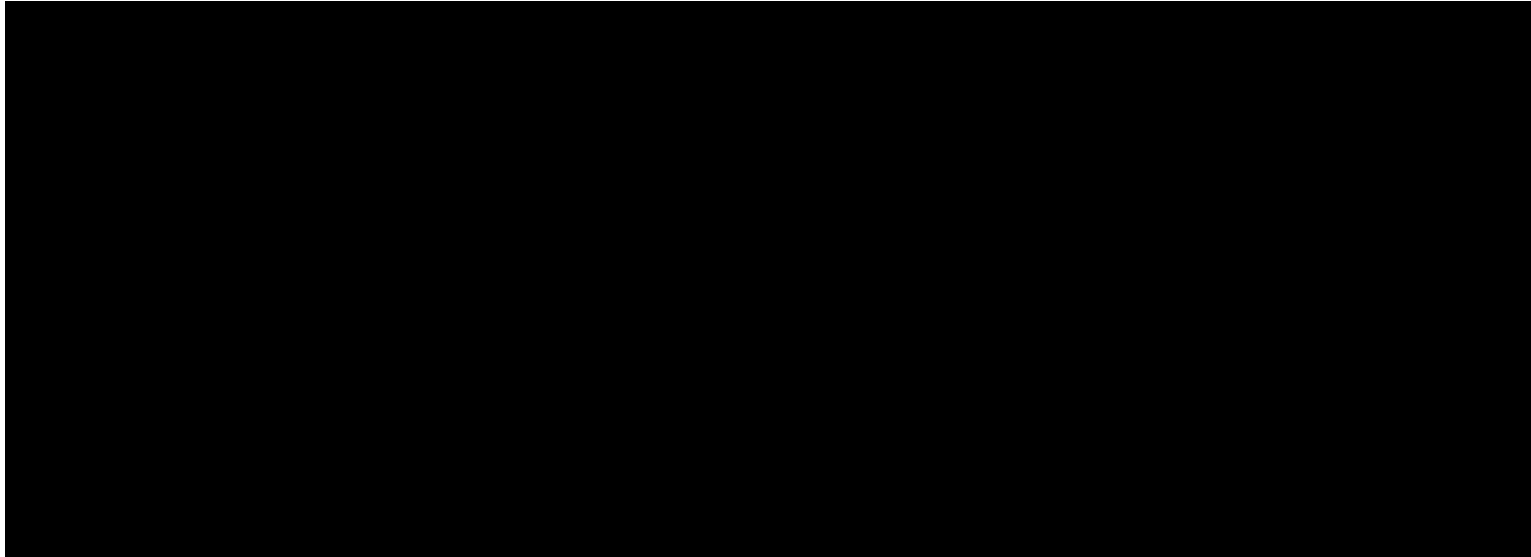
$$s_2 = \underbrace{\rho D_0 - sp_0}_{\text{current debt - stabilizing gap}} - \underbrace{\rho \sum_{t=1}^{\infty} \frac{a_t}{(1+\rho)^t}}_{\text{future developments in the structural primary balance}}$$

- **S1 indicator: permanent change in the structural balance required to reach a debt ratio of 60% of GDP in 2050**

$$s_1 = \underbrace{\rho D_0 - sp_0}_{\text{current debt - stabilizing gap}} + \underbrace{\frac{\rho (D_0 - D_T)}{(1+\rho)^T - 1}}_{\text{additional effort to reach 60% in 2050}} - \underbrace{\frac{\rho \sum_{t=1}^T \frac{a_t}{(1+\rho)^t}}{\sum_{t=1}^T \frac{1}{(1+\rho)^t}}}_{\text{future developments in the structural primary balance}}$$

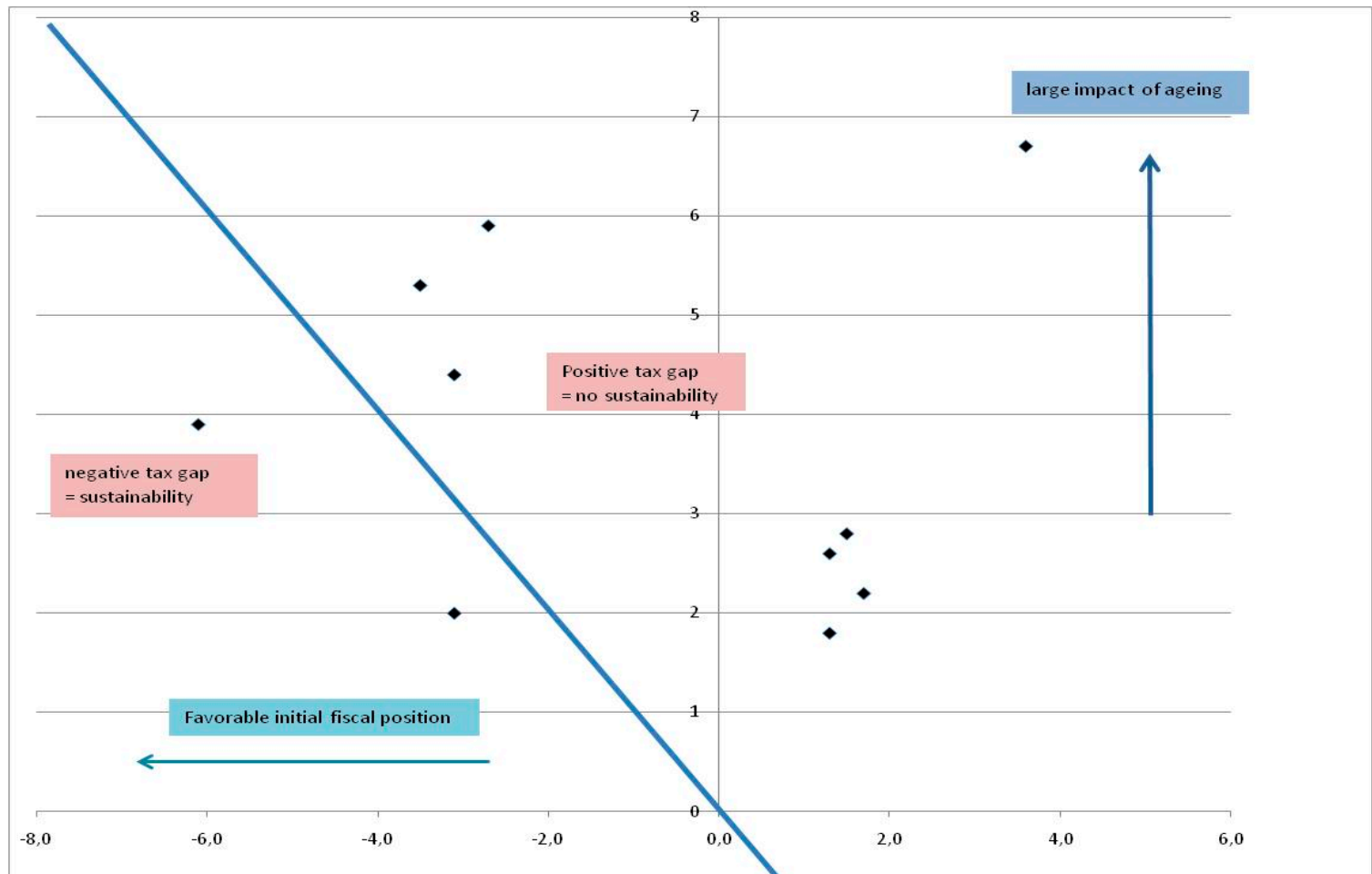
2- Long term risks and implicit liabilities

**Sustainability and ageing: indicators used by the European Commission
Breakdown for S1 and S2**



2- Long term risks and implicit liabilities

Sustainability and ageing: indicators used by the European Commission S2 indicator- initial conditions/long term conditions



3- Contingent liabilities/Banking sector

- Guarantees and “hidden subsidies” investigated in the recent years: registration problems, ways of “unveiling” them...
- What does the recent crisis change on the budgetary surveillance ?
 - No more a risk, but a shock
 - Shock is symmetric, with possible spillovers
 - Do the operation of bail out reduce the sustainability of the Member States’ public finance?