Fiscal Rules

Large structural deficits and growing debt ratios caused by the economic and financial crisis endangered fiscal sustainability in the whole euro area. Apart from the pre-crisis Stability and Growth Pact, as well as the Maastricht Treaty, post-crisis rules like the European Stability Mechanism were created to ensure financial stability for member states. At the national level, domestic fiscal frameworks were introduced as a part of the institutional policy setting that shape fiscal policy making. According to Kopits and Symanski (1998), a fiscal rule is "a permanent constraint on fiscal policy, expressed in terms of a summary indicator of fiscal performance". These rules comprise the arrangements, procedures and institutions governing the planning and implementation of budgetary policies. The main components of domestic fiscal frameworks are numerical fiscal rules, independent fiscal institutions, and budgetary procedures governing the preparation, approval, and implementation of budget plans and medium-term budgetary frameworks for multi-annual budgetary planning.

In 2005 the European Commission launched two surveys on national fiscal rules and independent public institutions in EU member states from 1990–2005. Another survey on the existing domestic medium-term budgetary frameworks was published in 2006. The fiscal rule strength index (FRSI) and the fiscal rule index (FRI) were both calculated based on these surveys. According to the European Commission, a fiscal rule is considered strong if it is likely to be respected and may significantly influence the conduct of fiscal policy.

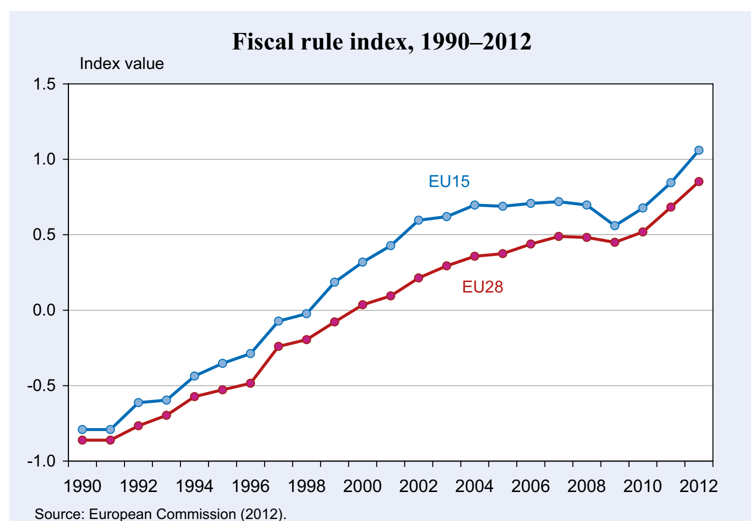
The measurement of the FRSI is based on five criteria: (i) the statutory/legal base of the rule, (ii) room for setting or revising objectives, (iii) the mechanisms of monitoring compliance and enforcement of the rule, (iv) the enforcement mechanisms of the rule, (v) the media visibility of the rule. Scores are attributed for each criterion from 1 to 3 for the criteria (ii), (iii) and (v) and scores from 1 to 4 for the criteria (i) and (iv). For example, the answer options for (i) the statutory/legal base of the rule range from four points "constitutional base" to one point "political commitment by a given authority".

The fiscal rule strength indices are aggregated to one index per country and year, creating the fiscal rule index. Effectively, the index is calculated using equal weights for all its components. This index is standardized with an average of zero and a standard deviation of one, meaning that negative values occur. The surveys are based on self-reporting by the countries and may not therefore reflect actual experience with recently implemented fiscal rules. As a result, care needs to be taken when comparing the indices from different countries with each other.

Looking at the development over the past two decades, there is a clear upward trend for the 28 member states of the European Union, as well as for the 15 states before the Eastern enlargement, as demonstrated in Figure 1. It is worth noting that the short decline during the crisis in 2009 seems to be greater for the EU15 than for the EU28, as can be seen in Figure 1. Overall, however, the fiscal rule index for the EU15 countries is constantly above the index of the EU28.

A positive relationship can be seen between the fiscal rule index and budgetary outcomes. EU member states with the highest index values show better budgetary outcomes on average. Table 1, which contains an extract of the FRI, shows some more interesting details. Since documentation of the FRI started in 1990 Germany initially had a constant index of 0.5, which subsequently started to rise, reaching 1.4 in 2012. Italy did not seem to

Figure 1



Source: European Commission (2012).

Table 1

Fiscal Rule Index, 1990-2012

	1990	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012
Austria	-1.0	-1.0	0.2	0.2	0.2	0.2	0.2	0.5	0.5	0.6	0.8
Bulgaria	-1.0	-1.0	-1.0	0.9	1.5	1.5	1.5	1.5	1.5	1.9	2.2
Denmark	-0.5	0.6	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
Finland	-1.0	0.4	0.9	0.9	0.9	1.0	0.6	0.3	0.3	0.6	0.4
France	-0.6	-0.6	0.1	0.1	0.5	0.5	0.7	1.0	0.8	1.6	1.6
Germany	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1.1	0.8	1.4	1.4
Greece	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	1.0
Hungary	-1.0	-1.0	-0.8	-0.8	-0.8	0.5	0.5	0.2	0.2	0.2	1.1
Italy	-1.0	-1.0	-0.5	0.1	0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2
Spain	-0.3	-0.3	-0.3	1.7	1.6	1.6	1.6	1.6	1.6	2.6	3.3
Sweden	-1.0	-1.0	2.2	2.2	2.2	2.3	2.3	2.3	2.5	2.5	2.5
United Kingdom	-1.0	-1.0	2.0	2.0	2.0	2.0	2.0	-1.0	1.7	1.6	1.6

Source: European Commission (2012).

invest much in fiscal rules either before the crisis or after it. Spain's investment, by contrast, has soared in recent years, from 1.6 in 2010 to 3.3 in 2012, which could be interpreted as a reaction to the crisis and a bid to improve its fiscal sustainability. The same can be observed for Greece (from –1.0 in 2011 to 1.0 in 2012). All in all, the economic crisis has obviously had a positive impact on the presence of fiscal rules throughout Europe.

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