EUROPEAN MONETARY INSTITUTE

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OPINION OF THE EUROPEAN MONETARY INSTITUTE

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on a consultation from the Council of the European Union under Article 104c (14) of the Treaty establishing the European Community (the "Treaty") on a draft EU Council regulation on speeding up and clarifying the implementation of the excessive deficit procedure.

1. The present consultation was initiated on 5th November 1996 by the Council of the European Union which, for this purpose, transmitted to the EMI document COM(96) 496 containing the text of the Draft Regulation and its explanatory memorandum. The EMI is competent for this consultation, in accordance with Articles 104c (14) and 109f (8) of the Treaty.

2. The objective of the Draft Regulation is to further specify the procedural provisions provided for in Article 104c of the Treaty and in its Protocol n.5. Further implementing provisions, which have the scope to complement the ones of Protocol n.5 and of Council Regulation EC n.3605/93, are felt to be necessary to ensure a smooth and effective application of the excessive deficit procedure (EDP).

3. The Treaty recognises that budgetary discipline will be required in Stage Three of Economic and Monetary Union to ensure price stability. Starting from Stage Three, the Treaty prohibits to all Member States[1] excessive government deficits and includes provisions necessary to prevent and remedy excessive government deficits in Article 104(c). In order to safeguard the independence of the ESCB in the conduct of its monetary policy, with the primary objective to maintain price stability, Articles 104 and 104(a) rule out "monetary financing" of the public sector as well as "privileged access", and Article 104(b) states that the Community and the

[1] An exception for the United Kingdom is provided for in Protocol n.11.

Member States shall not be liable for or assume commitments of public entities of another Member State.

4. The EMI fully endorses the view that a lack of fiscal discipline would negatively affect the ability of the ESCB to achieve its primary objective to maintain price stability, both through a direct demand effect and through an indirect effect on inflation expectations. Directly, fiscal imbalances can contribute to expanding aggregate demand, thereby obliging the central bank to offset them in order to maintain price stability. As a result, the economy may face a sub-optimal policy mix of higher deficits and higher interest rates. Furthermore, high and persistent fiscal imbalances typically raise the issue of sustainability and thereby indirectly fuel inflationary expectations. In order to prevent negative repercussions, fiscal policies should be geared towards achieving budgetary positions close to balance or in surplus and a convergence of high debt ratios to the 60% reference value or below.

5. Fiscal discipline will be all the more important given that budgetary policies will have to cope with major challenges, in particular those resulting from high and persistent levels of unemployment and unfavourable demographic patterns. It is indeed the sustainability of government budgetary positions which will safeguard the Monetary Union against the risk that a situation arises in which an individual country is ultimately unable to service its debt from its own fiscal revenues. The fiscal convergence criteria are not to be seen as constraints on the conduct of national economic policies, but as an essential mechanism for preventing the recurrence of the experiences of several Member States in the past, when unsustainable fiscal developments adversely affected confidence, added risk premia to interest rates and hampered the achievement of long-term non-inflationary growth of output and employment.

6. Against this background the EMI endorses the objective of the EU Council regulation to strengthen the credibility and effectiveness of the EDP under Article 104c, in particular by establishing clear deadlines for the consecutive stages of the excessive deficit procedure, defining the “exceptional and temporary” circumstances when the 3% reference value for the deficit can be exceeded, laying down general rules governing the imposition of sanctions, and specifying further the pecuniary sanctions to be imposed. While this framework should be as transparent and precise as possible, and the procedures to be enshrined in the regulation should be strong and credible and contribute decisively to a sound conduct of fiscal policies in Stage

Three, the EMI does not wish to express an opinion on the specific provisions of the Draft Regulation and on the institutional aspects of this question.

7 The EMI has no objection to its opinion being made public by the consulting authority.