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The "New" Stability and Growth Pact: More Flexible, Less Stupid?

The doubts and criticisms with regard to the fiscal discipline imposed by the Stability and Growth Pact (SGP) have been many and varied, and the SGP was revised as a result. The following paper evaluates the changes contained in the "new" SGP by considering the properties for ideal fiscal rules put forward by Kopits and Symansky. The analysis points towards a clear increase in flexibility together with the probable emergence of new enforcement problems. In this context, the need for new improvements within the European framework for the definition and implementation of national fiscal policies is discussed.

The creation of an Economic and Monetary Union involves the loss of important instruments of national public intervention, given that monetary and exchange policies are transferred from the sphere of national decision-making to the level of community decision-making.

The same situation does not necessarily occur regarding the definition and implementation of fiscal policy, which can be maintained under the jurisdiction of the national authorities. In this case, it becomes the only instrument at their disposal for interventions aimed at the stabilisation of the economy. Alternatively,

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a marked degree of centralisation could be observed at this level, reducing national governments' margin of control even further and transferring competences in that field to a "central" government.

The solution adopted within the framework of the European Monetary Union (EMU) was to maintain fiscal policy autonomy while limiting the space for creating public deficits and extending public debt through the adoption of (compulsory) fiscal rules, possibly complemented by the coordination of national fiscal policies.

This option was clear in the Maastricht Treaty, was reinforced by the Stability and Growth Pact,[1] and has been the subject of strong criticism, both from politicians and academics, which has partly been taken into account in the recent SGP reform.[2]

The analysis of this discussion and the assessment of the "new" SGP are the fundamental points of this paper. We start with a brief presentation of the main characteristics of the European solution for fiscal discipline and outline the main contours of the discussion. We then refer to the properties put forward by Kopits and Symansky, in 1998, for defining "ideal" fiscal rules.[3] Next, we assess the original SGP in the light of these properties and compare this analysis with others in this area. We also refer to some proposals for reformulating the SGP that have been put forward by several authors. After that, we observe the main changes that have occurred as a result of the SGP reform and evaluate them, using again the classification proposed by Kopits and Symansky. To conclude, we present some elements of final reflection, discussing possible improvements in the framework for fiscal policies in the eurozone.

The European Solution: from Maastricht to the "New" SGP

As mentioned above, the Maastricht Treaty established in 1992 the framework for national fiscal policies within the EMU. Among other rules, the Treaty:

- contained a recommendation/prohibition for the member states to avoid creating and maintaining excessive fiscal deficits (art. 104-C, no. 1);
- established the criteria for classifying deficits as excessive (public deficit to GDP ratio greater than 3% and/or public debt to GDP ratio greater than 60%, apart from exceptional cases);
- forbade the monetarisation of the public debt (art. 104);
- defined cooperation and coordination procedures for non-monetary policies (art. 103), which, as they were too complex and not compulsory, ended up a long way from the proposal contained in the Delors Report in 1989.

The option sanctioned by the Maastricht Treaty was later reinforced through the signing of the SGP, following strong German pressure. This defined a balanced budget (or a slight surplus) as a fundamental objective for the public accounts of each member state in the medium run. In this way, states were ensured some margin for manoeuvre in the event of a negative shock, without affecting the fiscal discipline defined by the rules determined in the Treaty.

In addition to this, and reinforcing the restrictive aspect of the rules and the non-commitment with regard to the question of coordination, the SGP also established that:

- countries would be obliged to present stability programmes, which would indicate the budgetary objectives in the medium run, as well as the foreseen method of adjusting possible imbalances and the anticipated evolution of the public debt to GDP ratio, with these programmes being examined by the Council and by the Commission;
- if a State, considered in excessive deficit, did not put into practice the Council's recommendations, it could be the object of sanctions in the form of fines with a fixed element (0.2% of the GDP) and a variable element (1/10 of the difference between the effective public deficit to GDP ratio and the reference value) and with a maximum level of 0.5% of the GDP per annum; an exception was made for the case in which the real GDP had decreased annually by at least 2%, as this would justify non-compliance with the 3% rule.[4]

This solution has been the object of intensive discussion and criticism in political and academic circles. This does not generally involve questioning the need for fiscal discipline, taken as an essential element for creating a favourable environment for stability and economic growth and as a means of avoiding negative external effects resulting from deficient budgetary

[1] European Council: Resolution on the Stability and Growth Pact. Official Journal of the European Communities, C 236/1, 1997.

[2] European Council: Presidency Conclusions, European Council Brussels. Concl 1, 7619/1/05, 2005. Available at http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/ec/84335.pdf.

[3] G. Kopits, S. Symansky: Fiscal policy rules, Occasional Paper 162, Washington 1998, International Monetary Fund.

[4] If the real growth of GDP was between -0.75% and -2%, the Council would decide on whether the 3% rule was to be imposed.

behaviour.[5] Instead, the discussion has been centred around the way in which this discipline should be implemented and controlled.

In the first half of the 1990s, and even at the time of the SGP discussion, the doubts and the criticisms were already extremely varied in relation to the adopted solution.[6]

On the one hand, doubts and criticisms were raised in relation to the approved framework, in particular:

- the possibility that there could be too tight a focus on the need for restrictive rules and too much incipience in the matter of coordinating fiscal policies;
- the fact that such a choice seems to sanction the main objective of low inflation, without considering an alternative that could balance the weight of the macroeconomic objectives in the context of the EMU;
- the fact that the choice made presupposed the existence of negative effects resulting from fiscal policy,[7] seemingly ignoring the potentially positive effects of expansionist fiscal policies, in particular when coordinated.

On the other hand, doubts and criticisms arose as to the way in which the need for fiscal discipline was conveyed and the way of supervising and acting on this matter or, rather, the established concrete fiscal rules. At this level, the aspects questioned included:

- the reference values themselves, taking into account that there is no theoretical demonstration as to the superiority of a public deficit with a proportion of no greater than 3% of GDP;
- the fact that different initial situations and the different weight of each economy in the context of the Union were not considered;
- the possible inadequacy of rules in the case of economic crisis or lower economic growth;
- the insufficient attention paid to the criterion concerning the public debt ratio;
- the method of calculating the public deficit relevant to the assessment of criterion fulfilment, not excluding fundamentally cyclical factors and public investment expenses with reproductive infrastructural characteristics;
- the credibility of the sanctions themselves.

Between 1996 and 2000, this type of criticism diminished in a context marked by the optimism related to the creation of the EMU and by the economic upturn. Nevertheless, at the beginning of the present century, critical discussion came to the fore once again as a result of the economic difficulties felt by some of the major states and of the growing belief that the solution adopted in terms of fiscal discipline could, in fact, be hindering a more effective fight against the negative effects of the economic crisis, or even worsening the difficulties.

In this period, opinions were voiced in favour of greater flexibility in the rules and a greater balance between nominal and real objectives, culminating in the classification of "stupid" being attributed to the SGP by the President of the European Commission at that time, Romano Prodi.

The request for greater flexibility was based mainly on the idea that a restrictive fiscal policy in a context of crisis would be counter-productive: in this context, the simple work of the automatic stabilisers probably generates higher budget deficit; if the government responds to this through budget cuts, it makes the economic crisis worse, and in doing so it may aggravate budgetary problems even further. On the other hand, only situations of severe crisis (real GDP growth below -2%) would automatically exempt the country from compliance with the 3% rule: such an exception would be insufficient, seeing as there was no consideration of situations of accumulated production loss resulting from periods of stagnation or low economic growth. In the third place, the time-period for correcting situations of excessive deficit could be too short, highlighting the undesirable pro-cyclical tendency of the restrictive policies to be taken.

The suspension of the SGP for two large European countries, France and Germany, which occurred in November 2003,[8] determined the demise of its original form and the appearance of a "new" SGP after March 2005.

[5] P. De Grauwe: The Economics of Monetary Integration, 6th edition, Oxford 2005, Oxford University Press.

[6] W. Buiter, G. Corsetti, N. Roubini: Excessive Deficits: Sense and Nonsense in the Treaty of Maastricht, in: Economic Policy: a European Forum, April 1993, pp. 58-100; O. Rubio, D. Figueras: Federalismo y Unión Monetaria en Europa (Federalism and Monetary Union in Europe), Instituto de Estudios Fiscales, P.T. No. 10/98, 1998.

[7] R. Solow: Is Fiscal Policy Possible?, in: R. Solow (ed.): Structural Reform and Macroeconomic Policy, 2004, Palgrave Macmillan.

[8] Note that this political decision went against the Commission's proposals [European Council: '2546th Council Meeting Economic and Financial Affairs (Press Release)', 14492/1/03 REV 1 (en), Brussels 2003, available at: http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/78051.pdf]. Later on, the European Court of Justice would annul the Council's decisions on those countries [Official Journal of the European Union: Order of the Court (2004/C 228/33), 11 September 2004, pp. 16-17].

Properties of "Ideal" Fiscal Rules

An analysis of the need (or not) for changes to the original SGP and of the possible improvements introduced with its recent reform can be made by considering the classification put forward by Kopits and Symansky, concerning the definition of "ideal fiscal rules". Reasonable consensus for this classification has been reached among authors with different positions regarding the kind of rules and their supporting indicators.[9]

According to this classification, for a set of fiscal rules to be seen as "ideal", they would have to be:

- "clearly defined" in terms of the indicators to be used, the institutional cover and the specific escape clauses, in such a way as to avoid ambiguities and deficiencies in practical application;
- "transparent" in terms of the set of governmental operations, including accounting, forecasting and institutional arrangements, so as to obtain "popular support";
- "simple", so that they could be fully understood by the public;
- "enforceable" in the sense that there are legal or constitutional rules through which to enforce them, as well as credible sanctions for cases of non-compliance and the definition of the competent authority to apply them;
- "flexible" in order to deal with exogenous shocks, i.e. situations beyond the authorities' control;
- "adequate" in relation to the specific objectives;
- "consistent" with each other, as well as with other macroeconomic policies and other policy rules;
- "efficient", so that they could be seen as catalysts of fiscal reform that would be, to a certain extent, necessary to ensure the sustainability of the budget position.

These eight requisites cover a mixture of economic and political concepts. In particular, the first four are of a more political nature, while the other four are more economic in nature. On the other hand, not only is it difficult for any set of fiscal rules to meet the eight requirements, but some trade-offs are inevitable between them: at the economic level, for example, between transparency and flexibility or between simplicity and possibility of application; at the political level, for instance, between transparency and simplicity.

In any case, they are based on a set of target properties for defining fiscal rules and making them credible, and in each concrete case, a choice will have to be made according to preference for some of these requirements: "choosing among the alternative trade-offs remains a political choice".[10]

It must also be taken into account that this classification was put forward in order to assess the quality of fiscal rules within a national framework. As stated by Buti et al.,[11] the multinational nature of the rules in the European case affects their design and implementation. On the one hand, there are questions related to subsidiarity and to national sovereignty, implying that the rules must be as neutral as possible in view of the social preferences of each member state. On the other hand, the nature and relevance of the mentioned trade-offs may differ: for example, with the successive enlargements of the Union, the heterogeneity and dispersion of preferences have increased and it has become even more difficult to find optimal uniform fiscal rules.

An Evaluation of the Original SGP

Using the properties defined by Kopits and Symansky, some authors have assessed the performance of the SGP in a very positive way. Table 1 shows the assessment made by Buti el al. in 2003, based upon which only slight changes to the SGP rules would be justified. These changes should reinforce its capacity for application and for incentive to fiscal reforms, the fields in which the European fiscal rules obtained the worst classification, according to the same authors. Also according to them, an attempt to change the rules radically would involve a severe political and economic problem.[12]

This optimistic view was not shared by various authors, such as Creel in 2003, nor is it shared by us, as shown in Table 1.

In the first place, the SGP proved incapable of being "enforceable" or even of promoting some change in the behaviour of the transgressors by raising the costs of public debt subsequent to a loss of credibility. Particularly enlightening at this level are examples

[9] M. Buti, S. Eijffinger, D. Franco: Revisiting EMU's Stability Pact: A Pragmatic Way Forward, in: Oxford Review of Economic Policy, Vol. 19, No. 1, 2003, pp. 100-111; J. Creel: Ranking Fiscal Policy Rules: the Golden Rule of Public Finance versus the Stability and Growth Pact. Documents de Travail de l'OFCE 2003-04, Observatoire Français des Conjonctures Économiques, July 2003.

[10] J. Creel, op. cit., p. 6.

[11] M. Buti, S. Eijffinger, D. Franco, op. cit.

[12] "The obvious risk is that of ending up in a vacuum in which the old rules are called into question while the agreement on a new set of rules fails to materialise. Venturing the EMU without fiscal rules would be a leap in the dark. At the same time, given the current level of political integration, the conditions for a federal system of public finances do not seem to exist." Ibid., p. 28.

Table 1
Comparison of the SGP Rules with the Properties of the "Ideal Rules"

"Ideal" fiscal rules	Buti et al. in 2003	Creel in 2003	Our Analysis
(1) "Clearly defined"	++	+	++
(2) Transparent	++	+	+
(3) Simple	+++	+++	+++
(4) Flexible	++	+	+
(5) Adequate for the final objective	++	+	–
(6) Enforceable	+	–	–
(7) Consistent	++	–	–
(8) Efficient	+	–	–

Key: +++ "very good"; ++ "good"; + "adequate"; – "weak"

such as the suspension of the SGP, the fact that some countries successively transgressed the rules without being sanctioned or the null impact on long-term interest rates when Ecofin adopted an excessive deficit procedure for France in 2002/2003.

Then, the capacity to encourage countries to carry out structural reforms also proved to be very low, which did not allow counter-cyclical policies to be adopted at a time of recession or of weak economic growth, except at the expense of transgressing the rules.

On the other hand, flexibility also proved to be only apparent. It is certain that although the mechanism incorporates exception clauses and it would be possible to let the automatic stabilisers act without going into transgression if member states began with an initial situation of balance. But the truth is that these clauses seem to be too severe and the starting-point for some countries was already very close to the limit situation.

Finally, adequacy to the final objective of fiscal discipline and consistency with other macroeconomic policies fell short of what is desirable:

- some of the countries did not fulfil their stability programmes;
- the pact did not encourage coordination, and did not even refer to it;
- the coherence between a counter-cyclical fiscal policy and a more expansionist monetary policy within a framework of low probability of inflationist consequences also does not seem to have been ensured.

In this context, the removal of the weaker points would require a deeper reform of the fiscal rules. In fact, the discussion in most recent years has produced various proposals for procedure reform and, in some cases, for the supporting indicators themselves. Amongst them, the following are worth mentioning.

- Casella proposed that the aggregate budget balance of the eurozone should be taken into account, together with a market system of deficit assignment.[13] In this way, the maximum limit established for the proportion of public deficit to the GDP would be valid only for the eurozone as a whole, with each member state individually being able to exceed this limit, by exchanging (on the market) rights to create deficits. In these circumstances, a country that was hit by a negative shock could use fiscal policy in a counter-cyclical way, buying rights from countries with a surplus.
- Several authors, including Mills and Quinet, Brunila, von Hagen, Fitoussi and Creel, and Creel,[14] have proposed the introduction of a rule relating to the composition and quality of public expenditure or the change to the "golden rule" of public finance. The focus on the side of public expenditure, rather than the budget balance, would offer the advantage of greater possibility of control, since this depends less on the economic cycle than the fiscal revenue. The adoption of the "golden rule" would allow intertemporal dilution of the costs of public investment and could, according to Creel, generate better results in the light of the criteria of the aforementioned ideal fiscal rules.
- Voicing the opinion that the objectives conveyed in the maximum limit of 3% for public deficit to GDP and in the budget balance in the medium and long run would be arbitrary and inconsistent with an adequate budget position,[15] Buiter and Grafe proposed a change in assessing structural balance and introduced the idea of a "permanent balance rule".[16] The permanent budget balance would be the difference between the average long-term future value of fiscal revenue (constant) and public expenditure. The adoption of this indicator would enable less restriction on the performance of fiscal policy for countries

[13] A. Casella: Tradable Deficit Permits: Efficient Implementation of the Stability Pact in the European Monetary Union, in: Economic Policy, Vol. 29, 1999, pp. 323-361.

[14] P. Mills, A. Quinet: The Case for Spending Rules, in: Fiscal Rules, Banca d'Italia, 2001, pp. 319-330; A. Brunila: Fiscal Policy: Coordination, Discipline and Stabilization, Discussion Paper No 7-2002, Helsinki, Bank of Finland; J. von Hagen: More Growth for Stability – Reflections on Fiscal Policy, ZEI Policy Paper, June 2002; J. P. Fitoussi, J. Creel: How to Reform the European Central Bank, Centre for European Reform, 2002; J. Creel, op. cit.

[15] Similar, in fact, to the criticisms of the Maastricht rules that Buiter et al. (op. cit.) had already formulated in 1993.

[16] W. Buiter, C. Grafe: Patching up the Pact: Some Suggestions for Enhancing Fiscal Sustainability and Macroeconomic Stability in an Enlarged European Union, in: Economics of Transition, Vol. 12, No. 1, 2004, pp. 67-102.

with greater potential for economic growth and a higher rate of inflation.

- Considering that budget sustainability depends essentially on the stock of public debt and not on the individual values of the public deficit, Pisani-Ferry suggested the introduction of a Debt Sustainability Pact.[17] Such a pact would oblige the presentation of medium-term programmes that would reveal the medium-term objectives for the proportion of public debt to GDP and would enable the states in which this indicator was less than 50% to be exempt from the procedures of excessive deficit and the associated sanctions. Fiscal discipline would be oriented according to a longer time perspective and based on the long-term sustainability of the budget situation.
- Believing that the numerical rules in force did not attack at source the problem of possible fiscal indiscipline and that the SGP would need a more credible application, less dependent on the decisions of the parties at which it is aimed, several authors, including Wren-Lewis, von Hagen, and Wyplosz,[18] suggested reinforcing financial market discipline and adopting procedural and institutional reforms. In this area, it is particularly worth mentioning the suggestions put forward by Wyplosz to create independent "National Committees for Fiscal Policy", responsible for ensuring supervision of fiscal discipline and debt sustainability.

Finally, it should be pointed out that each of these proposals would also present some difficulties in terms of concrete definition or implementation.[19]

The "New" SGP: Evaluating Changes

As mentioned above, the inversion of the economic situation at the beginning of the 21st century and the worsening of real problems, associated with the loss of competitiveness and employment, prompted renewed debate and criticism, in both the academic and political fields.

This discussion culminated in the SGP reform, with the aim of greater flexibility of application, without affecting the maintenance of fiscal discipline. In the context of this reform, the following were established:

- the extension of the period for implementing and making effective the measures for correcting excessive deficits, possibly up to 4 (or even more) years, instead of 1 and 2 years as it was before;
- the relevance of the structural correction in periods of effective product growth above its potential level, taking as a reference the decrease in structural deficit by around 0.5% per annum, enabling more margin for manoeuvre in periods in which economic difficulties arise;
- the attribution of greater relevance to the criterion relating to the proportion of public debt to GDP (practically ignored until now), as a means of assessing the sustainability of the budget position in the medium and long run;
- the extension of circumstances that may allow the country to have a public deficit over 3% of GDP, including situations of negative real GDP growth (instead of below -2%) and cases of accumulated production losses during an extended period of considerably weak growth in relation to potential growth;
- the possibility of including different "pertinent" factors when taking decisions on the situation of excessive public deficit, enabling the consideration of various forms of public expenditure as justifying factors for a public deficit ratio superior to the maximum limit (namely expenses in areas such as defence, social security reform, policies supporting innovation, research and development, European reunification – particularly in the case of Germany – etc.)

It is now important to assess the terms of this "reform" in the light of the theory and, in particular, of the properties of the "ideal" fiscal rules, in order to conclude whether the SGP has become "more flexible and less 'stupid' ".

As can easily be identified, some of the criticisms and reform proposals may have been taken into account at the time of the "review", in particular in terms of the need for greater flexibility of the rules. In fact, both the extension of the period for correcting excessive deficits and the extension of the escape clauses, or even the possibility of considering different attenuating factors or a situation of apparent excessive deficit, seem to provide the states with a wider margin for manoeuvre in the event of a situation of exogenous shock, due to changes in circumstances that are beyond governmental control.

[17] J. Pisani-Ferry: Reforming the SGP: Does it matter? What should be done? in: R. Liddle and M. J. Rodrigues (eds.): Economic Reform in Europe - Priorities for the next five years, Policy Network, 2004.

[18] S. Wren-Lewis: Changing the Rules, in: New Economy, Vol. 10, 2003, pp. 73-78; J. von Hagen, op. cit.; C. Wyplosz: Fiscal Policy: Institutions versus Rules, in: National Institute Economic Review, Vol. 191, 2005, pp. 70-84.

[19] A good description of them can be found in M. Buti, S. Eijffinger, D. Franco: The Stability Pact Pains: A Forward-Looking Assessment of the Reform Debate, CEPR Discussion Paper No. 5216, 2005.

Table 2
Comparison of the Original SGP with the "New" SGP (2005) – Our View

"Ideal" fiscal rules	SGP (1997)	SGP (2005)
(1) "Clearly defined"	++	+
(2) Transparent	+	–
(3) Simple	+++	+++
(4) Flexible	+	+++
(5) Adequate for the final objective	–	+/– (?)
(6) Enforceable	–	–
(7) Consistent	–	–
(8) Efficient	–	+ (?)

Key: +++ "very good"; ++ "good"; + "adequate"; – "weak"

In this area, the assessment of the "new" SGP, according to our interpretation of the criteria defined by Kopits and Symansky, is more favourable in the aspects relating to flexibility, going from a classification of "adequate" to "very good" (Table 2). The analysis made by Buti et al. in 2005 points in the same direction, though within a somewhat different framework to the original analysis.

In our opinion, it seems equally possible to give this "new" SGP a more favourable rating in two other areas, albeit with some reservations. In the first place, in terms of the criterion of "adequacy" relative to the fundamental objective, in which the qualitative classification would go from "weak" to "adequate": if the renewed attention to fulfilment of the criterion relative to public debt is credible, some creative accounting and the putting of some expenses off-budget could be discouraged, as well as possibly raising the long-term sustainability of the budgetary positions. In any case, the doubts as to the credibility of this change, taking into account its track record and the reduction in the degree of "enforcement", due to the inclusion of several attenuating factors, could make the classification maintain its former negative value.

Secondly, in terms of the criterion of "efficiency": in this case, the reference to the importance of structural balance and the need for structural corrections in periods of effective economic growth above the potential level could lead governments to redouble their attention to the necessary taxation and public spending reforms, which would change the classification in this area from "weak" to "adequate" (or even "good"). In any case, the fact that the "new" rules could lead to too much flexibility might not result in an alteration to the rating in this area.

The most negative element of the recent SGP reform seems to be the excessive and particularly subjective number of attenuating situations for non-compliance with the maximum ratio of 3% between the public deficit and GDP. If some of these attenuating circumstances seem clearly pertinent, namely with regard to some public investment expenses or in relation to the clearance for certain kinds of structural reforms at the level of social security, the inclusion of others, apparently at the choice of each state in the eurozone,[20] seems once again to raise the problem of creativity at the level of public accounting, as well as difficulties in the practical application of fiscal discipline rules.

The apparently exaggerated set of "escape valves" could thus make the new version of the SGP even less "enforceable" than the former, which would naturally harm the rating in almost all the properties of the "ideal rules", in particular in terms of "applicability" (where the negative classification is maintained, with the possibility of becoming even more negative), of the "adequate definition" and of "transparency" as well as, under certain circumstances and such as indicated above, of the "efficiency" and of the "adequacy" to the final objective.

It is worth noting that somewhat identical concerns were raised by Buti et al. in 2005, leading to a significant convergence between our appraisal and the assessment developed by these authors, which was not the case for the original SGP. At the same time, authors clearly critical of the original SGP also express concerns about the potential for the opportunistic use of the exceptions and the fact that the true roots of the problem are not tackled.[21]

Finally, there does not seem to be any reason for changing the classification given to the remaining two areas: of "simplicity" ("very good"), since the supporting indicators are the same and are perfectly understandable to the general public; and of "consistency" ("weak"), since there continues to be no obligatory and sanctioned reference to the coordination of national fiscal policies. Consequently, there seems to be no reason for more effective coherence between the various national fiscal policies and between these and the common monetary policy.

Concluding Remarks

In this paper we assess the rules of the "new" SGP, bearing in mind the properties established by Kopits

[20] R. H. Alves: European Union and (Fiscal) Federalism, in: John McCombie, Carlos Rodriguez (eds.): The European Union, 2007, Palgrave Macmillan, forthcoming.

[21] For example, W. Buiter: The 'Sense and Nonsense of Maastricht' Revisited: What Have We Learnt About Stabilization In EMU? CEPR Discussion Paper No. 5405, 2005; B. Coeuré, J. Pisani-Ferry: A Sustainability Pact for the Eurozone, in: L. Tsoukalis (ed.): Governance and Legitimacy in EMU, European University Institute, 2005.

and Symansky in 1998 and the framework of the discussion of the last two decades on the method of implementing fiscal discipline in the eurozone.

Our analysis clearly indicates that the changes that occurred in March 2005 have made the Pact "more flexible and less 'stupid' ", enabling more time for adjustment in the face of difficult budget situations and, at least theoretically, encouraging structural reforms and the good use of favourable economic situations in order to reorganise public accounts. Equally, by increasing the number of circumstances in which the 3% rule may be overcome, including situations of stagnation or weak economic growth or favouring incentives to R&D activities,[22] the Pact has become a better "friend" of growth, without harming stability.

The main criticism now seems to centre round "enforcement", since the fact that there is a vast set of factors that allow the non-classification of a deficit as excessive would seemingly lead to situations of less compliance and even to the repetition of creative and lax behaviour in some countries, just as in the past.

In this context, certain suggestions could be put forward so as to enable some improvement in the conditions of SGP application:

These suggestions would certainly improve the classification given to the fiscal discipline rules of the SGP. However, they would not end the discussion on the ideal fiscal discipline framework within the euro area. One of the most important issues that are still open is the question of how to provide an adequate policy mix in the context of the EMU, as the mere adoption of fiscal rules, even if well classified in terms of the former properties, will hardly do it.

Admitting that a situation of great (political) difficulty would be involved if fiscal "centralisation" were promoted, the solution could involve a significant degree of fiscal policy coordination. In accordance with the relevant literature, this solution would tend to produce welfare gains when compared with non-cooperative solutions,[23] although it would also continue to show some difficulties.[24]

It is worth noting that at the level of economic literature itself, the analyses of the coordination of monetary policies continue to predominate, with a much lower number of studies aimed at the coordination of fiscal policies (and these with monetary policies), even though the European case has encouraged development in this area.[25] In this context, this area appears to be potentially fertile ground in terms of future research.

Finally it should be said that, despite the greater flexibility resulting from the change in some rules, it is not clear that an environment suitable for combating the negative effects resulting from specific or asymmetric shocks has been created. Within this framework, the creation of a limited mechanism of absorption of this type of shock could enable a more satisfactory solution, possibly without requiring a very significant budgetary increase.

Such a solution would result in an attempt to promote some form of "insurance", typical of federations with a single currency and advised, for instance, by the relevant literature in the context of the optimal currency areas. At this level, and for the European case, some proposals have been already made, namely following the pioneering works presented in the 1990s by Italianer and Vanheukelen, and Italianer and Pisani-Ferry, constituting another potential field for future research.[26]

[22] Note, for instance, that recently Afonso and Alves suggested that temporarily excessive deficits should be allowed for the small and less developed countries within the euro area, in order to let the government subsidise R&D activities and, thus, reduce the level of development gap. O. Afonso, R. H. Alves: «To Deficit or Not to Deficit»: Should the European Fiscal Rules Differ Among Countries?, FEP Working Papers, No. 219, July 2006.

[23] There is a great deal of literature on this subject, starting with the seminal works of Niehans, Cooper and Hamada. Cf. J. Niehans: Monetary and Fiscal Policies in Open Economies Under Fixed Exchange Rates: an Optimizing Approach, in: Journal of Political Economy, Vol. 76, 1968; R. Cooper: The Economics of Interdependence, New York 1968, McGraw-Hill; K. Hamada: A Strategic Analysis of Monetary Interdependence, in: Journal of Political Economy, 1976.

[24] Among others, see the arguments developed by Frankel and Rockett, Miller and Salmon, Maillet and Tabellini. Cf. J. Frankel, K. Rockett: International Macroeconomic Policy Coordination When Policymakers Do Not Agree on the True Model, in: American Economic Review, Vol. 78, 1988, pp. 318-340; M. Miller, M. Salmon: Policy Coordination and Dynamic Games, in: W. Buiter and R. Marston (eds.): International Economic Coordination, 1985, Cambridge University Press; P. Maillet: La Politique Économique Dans l'Europe d'Après 1993, Paris 1992, Presses Universitaires de France; G. Tabellini: Domestic Politics and the International Coordination of Fiscal Policies, in: Journal of International Economics, Vol. 28, 1990.

[25] Taking the case of the European Union as a base, it is worth consulting Beetsma and Bovenberg, Uhlig, or Muscatelli et al. Cf. R. Beetsma, A. Bovenberg: Designing Fiscal and Monetary Institutions for a European Monetary Union, in: Public Choice, Vol. 102, Nos. 3-4, 2001, pp. 247-269; H. Uhlig: One Money, but Many Fiscal Policies in Europe: What Are the Consequences?, CEPR Discussion Papers, No. 3296, April 2002; V. Muscatelli, P. Tirelli, C. Trecroci: Fiscal and monetary policy interactions: Empirical evidence and optimal policy using a structural New-Keynesian model, in: Journal of Macroeconomics, Vol. 26, No. 2, 2004, pp. 257-280.

[26] A. Italianer, M. Vanheukelen: Proposals for Community Stabilisation Mechanisms: Some Historical Applications, in: European Economy, special edition on 'The Economics of Community Public Finance', 1992; A. Italianer, J. Pisani-Ferry: The regional-stabilisation properties of fiscal arrangements, in: J. Mortensen (ed.): Improving economic and social cohesion in the European Community, New York 1994, St. Martin's Press, pp. 155-194.