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INSTITUTIONAL MODEL EVOLUTION OF FISCAL RULES IN THE EMU

Abstract

The regime evolution of fiscal policy in the EMU indicates an internal conflict between ensuring of the convergence and flexibility to adapt to asymmetric shocks. The convergence criteria, which precede the introduction of the Monetary Union is a formal basis for limiting the discretionary fiscal decisions, but they are not sufficient to create the institutional regulators of fiscal policy that is consistent with a single central bank operation. The transition from the Maastricht criteria to the Pact of Stability and Growth showed an attempt to combine the fiscal flexibility and responsibility under the relevant rules. However, this scheme proved to be vulnerable to the possibilities of opportunistic behavior and asymmetric penalty sanctions. Empirical analysis proved the lack of fiscal convergence in the integration area that manifested itself in the automatic stabilization of asymmetric fiscal policy during the phases of the business cycle in the context of the countries. The debt crisis in the EMU gave an impetus to the introduction of the system of harder fiscal rules, which, however, is not a return to the ideology of the Maastricht criteria.

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Key words:

Fiscal rules, institutional constraints, convergence criteria, EMU, debt vulnerability, fiscal reforms.

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Introduction

Formation of currency unions gave rise to the specific framework conditions for introducing institutional constraints on discretionary fiscal policy. The emergence and functioning of the European Monetary Union has demonstrated how the experiments with a common monetary policy and decentralized fiscal regimes may cause certain conflicts in the light of the global economy evolution. The EMU economy is the second among the world economies in its physical and geo-economic potential. The global financial stability and prospects for economic growth in small open economies of Central and Eastern Europe greatly depend upon the efficiency of macroeconomic mechanism of the EMU economy. The outlines of future economic order can be bound with the evolution of the currency union and increase in their value to global macro-financial stability.

Fiscal rules in the monetary unions have their specific etymology, which requires a separate study of institutional constraints of the EMU fiscal policy as an example of the greatest and the most successful project of creating and supporting the area of common monetary policy. The debt crisis in the EU-EMU, the intensification of the divergence and deterioration in macro-financial stability reflected how much the global financial crisis may be threatening the effective functioning of the integrated association. The presence of fiscal rules did not guarantee the deterioration avoidance in the fiscal solvency within the euro zone. At that, the debt crisis mostly affected those countries which for a long time had been redistributing the greatest benefits in their favor due to their membership in monetary integration.

However, the debt problems have arisen in many developed countries, not only within the EMU, although the specific mechanism of macroeconomic policy in the latter makes it the most vulnerable to financial turbulence. Lack of possibility to change the exchange rate and a tough mandate to maintain the price policy of the European Central Bank make the problem of macroeconomic adaptation in the EMU quite complicated, both theoretically and politically. And due to that, the

debt sustainability is under the gunpoint of gambling global speculation. The case that the EMU faced the problem of sovereign solvency of individual members in the presence of fiscal rules requires going beyond criticism the basic theoretical apparatus of monetary integration and concentration on the analysis of specific fiscal rules in a Monetary Union as a whole, and their model and its evolution on the EMU example, in particular, that makes this study important.

Problems of Sovereign Solvency, Monetary Integration and Institutional Mechanisms to Ensure Fiscal Discipline

Thus, the basic gnoseological trends in fiscal policy analysis are: the developing of a model of global debt pressure in the developed countries and shift of fiscal policies into the regime of operation under extra-high levels of debt burden (Eichengreen et al., 2011, p 198; Cecchetti et al., 2011, p. 1–33; IMF, 2012; Reinhart et al., 2012, p. 69–85; Reinhart et al., 2010, p. 573–578); identifying the lack of market discipline in terms of the absence of exogenous restrictions on risky debt strategy, which is manifested especially during the expansion of global liquidity (Caceres et al., 2010, p. 1–30; Alper et al., 2011, p.1–24.); finding options of institutional constraints of fiscal expansion, especially in light of the fact that fiscal rules do not always ensure adequate macro-fiscal management, and thus, avoiding problems in the area of institutional distortions of debt strategy requires more complex institutional solutions (EC Survey, 2011, p. 1–13; Wyplosz, 2005, p. 70–84; Hagen von J., 2005, p. 1–14; Public Finance in EMU, 2010, p. 73–80); necessity substantiation for implementing large-scale programs of fiscal consolidation, including these through upgrading institutional mechanisms for monitoring fiscal expansion in order to ensure significant reducing the debt burden of the developed countries in the medium period (Sutherland et al., 2012, p. 1–76; OECD Economics Department Working Papers, 2010, p. 1–43; IMF, 2010, 93–124; Rother et al., 2010, p. 1–37).

At the same time, monetary integration significantly adjusts the analytical perspective for fiscal policy studies, and requires a specialized approach. The development of the theory of optimum currency areas has shown that fiscal policy in integration associations should be subject to general logic of the effectiveness of a common monetary policy. However, the accommodative role of fiscal policy in relation to monetary can flow from rather different theoretical and, what is a most important, functional position. According to P. Kenen**,** when the participating countries of integrated association suffer the defeat of asymmetric shocks, and the exchange rate is not applied for bringing the economy to the new equilibrium conditions, the compensation of the lost demand can be provided by special

fiscal transfers. The model of fiscal transfers will function rather effectively in the case of a certain centralization of fiscal decisions. The institutional format of central transfers is certainly determined by the depth of integration. Later N. Mintz and H. Haberler demonstrated that the effectiveness of monetary policy in the Monetary Union will be determined to a great extent by the willingness of the participating countries to form a political union. The political union is viewed from the standpoint of tending to agree on common principles of economic policy, and readiness to subordinate the loss of asymmetric shocks to membership benefits But most important thing is, that the political union is the institutional basis for coordination and centralization of fiscal policies. The operation of the system of centralized transfers as provided by P. Kenen must be based on the principles of the political union. The emphasis on a high level of integration in this case reflects significance of the legitimacy and enforcement factor, which are the components of an effective fiscal system of any country. Due to the evolution of the theory of optimum currency areas the focus has shifted towards the dominance of general principles of macroeconomic policy as a basis for consistency of response to shocks. The common policy principles enable to prevent the nominal divergence of Monetary Union without formulating certain specific constraints (detailed analysis of these issues is presented in (Mongelli, 2002, p. 5–51)).

The EMU debt crisis has increased interest in the analysis of fiscal policy in the context of how homogeneous should be the principles of its implementation. The presence of real convergence process within the EMU assumes that fiscal politicians may be different, and that, perhaps the presence of significant fiscal decentralization is the best choice. That is, if for reasons of nominal convergence the fiscal centralization in the Monetary Union is the best way to ensure its macroeconomic stability, in case of a breakdown in the value of per capita income among the member countries national budgets will better manage macroeconomic difficulties of maintaining a common currency in a decentralized mode (discussion on that issue is presented in (Bini Smaghi, 2011, Feb. 14)).

However, significant developments in the EMU fiscal convergence, as well as its institutional support point to some difficulties with the choice of the optimal model of macro-fiscal management, to which all participants agree and which will conform to the principles of the ECB monetary policy. The need for reformation of the EMU fiscal rules is constantly on the agenda of integration association policy, which was very clearly visible in the light of large-scale EMU reforms in 2011–2012 Accordingly, the purpose of the article is to show the conflict between the principles of convergence and the principles of optimal fiscal rules design, resulting in the EMU found itself in a state of increased debt vulnerabilities, and to prove that the evolution of the institutional model of such rules is a reflection of the way to overcome this conflict under the current macro-financial shocks.

Theoretical Basis of Macroeconomic Discipline in Monetary Unions: Fiscal Convergence Criteria and Fiscal Rules

However, the practical implementation of monetary integration ideas implies that achieving a certain level of similarity both, of macroeconomic and structural basis for the effective implementation of a common monetary policy requires specific criteria of membership conformity in the Monetary Union, and the monitoring of the actual situation in compliance with those criteria. The adoption of heterogeneity of the economies as pragmatic fact is a key justification of so-called convergence criteria, which have a fiscal component. Of course, fiscal convergence criteria are not fiscal rules in the meaning of G. Kopits and S. Symansky's approach (Kopits and Symansky, 1998, 56 p.) Leastwise, the model formulation of the rules and presence of the cautions as for enforcement of their execution and explicit penal sanctions for their violations may require additional specifications, that is, to go beyond the institutional foundations of convergence policy. It can be observed that actually all currency unions apply the criteria of fiscal convergence.

The Eastern Caribbean Currency Union stipulates that member states must reduce public debt below 60% of GDP by 2020.

The European Union provides for maintaining the fiscal deficit at the level of 3% of GDP and public debt at 60% of GDP (Maastricht Treaty).

The Western African Economic and Monetary Union, like the EMU, imply the presence of the convergence criteria. Fiscal convergence requirements include maintaining a balanced budget and public debt no higher than 70% of GDP.

The Central African Economic and Monetary Union also include limitations for discretionary fiscal policy in the structure of the convergence criteria. According to them, the countries should maintain the budget balance of revenues and expenditures, unadjusted for international assistance grants and capital expenditure financed by external revenues. Public debt should not exceed than 70% of GDP.

It should be noted that between fiscal convergence criteria and, actually, fiscal rules is the functional difference. The main purpose of the convergence criteria is to determine the quantitative parameters of policy on Monetary Union membership, regardless of whether this is the stage of its formation, or the stage of current being. The implementation of the policy based on the convergence criteria is designed to ensure the maximum possible convergence of economies to make the Monetary Union function effectively. The inclusion of such fiscal vari-

ables criteria into the structure clearly shows that no matter which model of fiscal policy is chosen by the Monetary Union members (hard focus on sovereign solvency by maintaining a balanced budget, automatic stabilization combined with the ability to use variations of the structural budget balance in order to adapt the economy to shock, discretion authority for stabilizing flexibility, etc.) a framework of fiscal discipline is needed.

As seen from the above considered principles of the theory of optimum currency areas, the cautions on the necessity for homogeneity of fiscal policy are ambiguous. That is, it is just at the theoretical level that potential optimality of heterogeneous fiscal position is allowed, especially when it refers to asymmetric shocks. Fiscal convergence criteria can not directly be derived from the theory of optimum currency areas. They are a manifestation of a more general macroeconomic approach, according to which fiscal expansion when monetary policy is oriented at price stability is risky for the reasons of macroeconomic stability. Also, fiscal imbalances may be considered from the standpoint of fiscal dominance that is subordination of monetary targets to the tasks of sovereign solvency supporting. Fiscal dominance, in principle, is incompatible with the monetary policy of price stability, and the implementation of monetary policy on different principles generally raises questions about the need for establishing the Monetary Union if its members do not receive benefits in the form of a stable and reliable currency, emitted by the central bank that enjoys the confidence. That is, the restriction on fiscal policy in the convergence process should be seen from the viewpoint that the decentralization of fiscal component of economic policy can generate a series of situations that are not suitable for the operation of the Monetary Union that consists of different countries.

Further, it should be highlighted, namely:

- driving out effect Under conditions when interest rates are set by the Federal Central Bank, then the differences in scales of lending activities of individual members of the Monetary Union may lead to the emergence of negative externalities. Raising of interest rates, generating displacement effect, is one of them; asymmetry in stimulating the aggregate demand. No restrictions on fiscal flexibility to adapt to asymmetric shocks can quickly lead to significant differences in the cyclical activity. The countries with more significant opportunities to increase counter-cyclical deficits will be in a better position than the countries having a limited access to markets. While some countries pursue policies more sensitive to shocks, and others do not, in fact, cyclical divergence problem only increase. The violation of this criterion of optimal currency area as common principles of the policy and uniformity of responds to shocks ensure permanent nature of business cycles desynchronization;

- fiscal protectionism. If the possibilities to stimulate economies in the Monetary Union membership differ, it means that a country with larger opportunities to extend fiscal gaps will indirectly subsidize its producers, thereby improving their competitive position in the common market. This policy will enhance trade conflicts and disrupt the economic basis of the integration of the association;
- debt vulnerability of individual member states. In case when fiscal policy is carried out without restrictions, and it remains the only one stabilization tool, the probability of deficit bias increases. Confidence in debt policy can disappear very quickly, since the country is unable to devalue the national debt. Anti-crisis measures also raise the question of the source of assistance, and in addition to this, they increase divergence;
- debt vulnerability of the Monetary Union. Due to the tight integration of financial markets, the debt problems of certain countries can quickly turn into a debt crisis in the whole Monetary Union. The distribution channels for transfer of negative externalities and debt expansion of individual countries are commercial relations and cross-border ownership of assets. Speculation against one country can quickly turn into a large-scale sale of debt liabilities of all members of the Monetary Union, thereby provoking a crisis, the overcoming of which may raise the question of optimality to be in it for a long time.

The importance of the fiscal discipline for the effective functioning of the currency union is reflected in the structure of the legislation base of establishing rules of fiscal policy. The formation of currency unions lays the foundation for the introduction of fiscal rules on the basis of international agreements. Tab. 1 demonstrates that the majority of such rules are sanctioned by relevant international agreements.

However, the international agreements on the use of fiscal policy rules reflect the complex institutional dynamics, which aims at equalizing the functional differences between policy convergence and national policies of macroeconomic stability. The convergence criteria based on trajectory formation of Monetary Union and institutional requirements for membership therein shall become fiscal rules particularly during the Union's creation. They are explicit obligations, the compliance with which is necessary for full-fledged membership. However, if these criteria are not endowed with all the features of fiscal rules, they can generate dynamic opportunist inconsistency. The country follows the convergence requirements on the stage of entry, but after having joined the Union, changes strategy and starts conducting arbitrary policy, ignoring the membership criteria. This leads to the problem of symmetric distribution of costs and benefits, as far as the country gets benefits of membership, but does not want to bear the burden of that membership. If this policy is accompanied by significant negative ex-

ternalities, the political and institutional basis for effective functioning of monetary unification will be undermined. Hence, the construction of fiscal convergence criteria based on the model of fiscal rules or in the process of Monetary Union formation, either in subsequent periods is a positively and normatively conditioned by the necessity. Additionally, it is worth considering here a number of issues.

Table 1

Legal basis of fiscal rules. Number of introduced rules
(Fiscal Rules, IMF, 2009; Strauch R. et al., 2004(

	Type of rule			
	Expenditures	Receipts	Budget balance	Public debt
Policy liabilities	9	6	4	3
Coalition agreements	2	1	1	2
Statutory	14	3	13	7
International agreements	–	–	41	47
Defined by Constitution	–	–	4	3
Total	25	10	63	62

Note. Figures do not include the reform of the European Pact on Stability and Growth of 2012, and amendments to the Maastricht Treaty of 2012.

The convergence criteria specified as fiscal rules, and, in fact, the fiscal rules of the Monetary Union do not exclude the occurrence of certain institutional friction. We can consider two options.

First. Any country is not inclined to limit itself in the implementation of fiscal policy. Accordingly, the membership in the Monetary Union would require changing of institutional framework conditions for fiscal policy implementation; therefore it faces the complex set of formal and informal elements of macro-regulation mechanism.

If on the political and institutional level, there is the problem of neglecting the deficit bias, and fiscal institutions are built on the principles of trust, openness, discipline and sound solvency, the introduction of fiscal rules in a Monetary Union membership raise no objections.

Where a country has a number of problems in the area of deficit bias, fiscal institutions are not built in accordance with the principles of fiscal discipline, the transition to a more rigid model of control over fiscal policy can cause resistance of certain groups. Because the membership in the Monetary Union provides benefits, the membership in it will motivate some modifications in the institutional macro-political model .However, these benefits will be balanced not so much with the loss (in the sense of transition to theoretically worse than the optimal policy) of the country because of more rigid fiscal policy as the cost of individual political and institutional groups whose welfare may happen to be under limiting influence because of the transition to fiscal rules, which is required by membership in the area of monetary unification. The more obvious benefits are, the more pressure is formed in the direction of going beyond the group interests in the analysis of costs and benefits. Still more will costs and benefits of membership be compared of the country's membership as a whole, and therefore more rigid and disciplined policy has not to be regarded as socially undesirable. Even though there is some resistance to tighter macroeconomic framework conditions for membership in the Monetary Union, the possibility of package approach to the comparison of costs and benefits will rather guarantee the emerging of a favorable political configuration for consent to budget transfer to fiscal rules regime. Thus, the supranational format of fiscal rules expressed by relevant international obligations of the country may be a more effective option for introduction of fiscal rules, compared with searching for internally national consensus on their implementation. The practice of the European Monetary Union clearly indicates that without appropriate requirements for the constraints on fiscal discretion of the membership procedures, a number of countries – chronic debtors are unlikely to achieve intra-political agreement on the introduction of fiscal rules (which can be seen on the example of the central banks status [20, 185–188]. Similarly, the presence of more heavy fiscal rules at the national level, which are not in contradiction with the rules of the Monetary Union's fiscal policy, will be welcomed. Any options for fiscal discipline, expressed by idiosyncratic national approach will strengthen macroeconomic stability of the Monetary Union, and will create the informal environment, called *peer pressure*.

The second option. The country has already had fiscal rules, the structure of which does not coincide with the model of membership rules in the Monetary Union. Since the structure of the rules specifies the format of fiscal policy targets, the differences in the approaches to the role of the budget in macroeconomic corrections may indeed provide a basis for political interpretation of theoretical counter-positions. If the conceptual differences are strong enough, then the probability of rule changes will entirely depend on the structure of the costs and benefits of membership. The example of the EU-EMU shaping clearly showed the presence of a certain conflict between the Great Britain and, actually, the EMU. The fiscal model of Great Britain involves restrictions on public debt by 40% of GDP combined with the golden rule. In terms of the model of fiscal policy it means the admissibility of almost unlimited flexibility in response to shocks (be-

cause there does not exist restrictions on budget deficit), but the improvements concerning return to the debt limit will require significant primary surpluses. The EMU model expressed with convergence rules, and subsequently by the Stability and Growth Pact, provides for limited flexibility, but the debt limit is also much higher. The first approach implies that the British rule includes a large amplitude, and low frequency, while the European – moderate amplitude and moderate frequency. As some researchers show, both rules may have their advantages and disadvantages. (The British emphasize that their model of fiscal rules is better, although it is not obvious. (Murray and Wilkes, 2009, p. 1–12) That is, the choice in favor of each of them is based on the political interpretation of theoretical conclusions. Due to this, a slippery balance of costs and benefits of membership in the Monetary Union allows the manipulation of political interpretation of the comparative characteristics of competing models of the rules. In case of necessity to have the arguments as for fiscal policy, there will always be an opportunity to appeal that just those rules are better, and they are better because they are more suited to a certain functional purpose.

The current asymmetry in fiscal policy is another example of why the fiscal convergence criteria should be based on the principles of the rules. If in the current period there is observed quite a significant gap in the levels of public debt, or in the nature of the responds of the primary budget balance to shocks, then without a forced consolidation around convergent requirements the fiscal policy will find itself in the position of a strong dependence on the previous trajectory of the system of public finance. Asymmetric dynamic inconsistency and negative externalities will be originated by the fact, that different starting positions of debt load will determine the future effectiveness of stabilizing fiscal policy. That's why between the size of public debt and the interest payments there is a direct connection, a stabilizing force of fiscal impulse and, respectively, the counter-cyclical budget performance will be determined by the possibilities of the country concerning a debt maneuver. In other words, without a sufficient homogeneity in the levels of public debts, the asymmetric shocks will clear the way for deficit bias. The countries with stronger burden of government debt may tend to it because the significant burden of interest payments will limit the size of the primary deficit, and therefore a stimulating effect will be achieved by expanding deficits and increasing debts. The countries with low initial level of public debt can not follow its return to the previous level after a period of the stabilization costs growth. They will not be in the institutional fairway of peer pressure. Therefore, the transition from the formation stage to the stage of further operation requires an increased attention to the fact that the convergence policy evolved into institutional provision of fiscal discipline. The rules of policy is the easiest way to build a suitable environment to force the proper maintenance of the fiscal determinants for effective functioning of the Monetary Union

The prevention of the delayed deterioration of fiscal positions in case of permanent shocks, either in case of impossibility to reduce the public debt below

a prescribed maximum after remaining on a stable point for a long time, as it was in previous cases, shows the vulnerability of the area of common monetary policy towards setting aside in time the fiscal problems of individual participants. The changing nature of shocks, as well as the accumulation of vulnerability to global or idiosyncratic shocks through the channels which are not provided by a standard theory of optimal currency areas and, respectively, does not consider the economic model of policy convergence, may cause unpreparedness to those challenges that are unknown at the present time so far. The presence of certain fiscal buffers and requirements for keeping away from a prolonged stay on the edge of the optimal level of debt burden will admit that, if necessary, the expansionary fiscal policy will benefit confidence. Its stabilization efficiency will be significantly higher compared with the case when the lack of confidence in the fiscal expansion will require a rapid transition to implementing the policy of fiscal consolidation. Similarly, any optimal value associated with the measurement of the debt burden, falls under the «Lucas critique». Fiscal rules of the Monetary Union should not be simply a continuation policy of convergence, but also the mechanism for the member countries' adaptation to functioning in the environment of global fluctuations. Willingness to switch to new, much harder rules for fiscal policy to maintain the effectiveness of the Monetary Union should be included in the theoretical model and political ideology of economic integration. Finding mechanisms to improve the efficiency of the Stability and Growth Pact within the EU-EMU Summits in 2010–2012 demonstrated that this commitment is often politically motivated. The countries having even harder rules at the national level, take the position of peer pressure position of the countries that lack fiscal discipline. The countries which have to agree on harder rules, consider it as a manifestation of shifting balance of costs and benefits, either as a challenge to national sovereignty. Under any circumstances it brings us back to the problem of the mentioned before packaged approach to the analysis of costs and benefits of membership in the common currency area.

Evolution of the institutional model of fiscal discipline in the EMU in light of the debt crisis in the euro zone

The EMU example shows that the transformation of the fiscal convergence criteria into fiscal rules is not only slow, but also allows some deviation from the original idea of introducing strict limits on deficits and debts So, as we know, the fiscal aspect of the convergence criteria was provided by the Maastricht Treaty. Since 1992 the membership in the euro-zone (and also in the European exchange rate mechanism II) suggests that the overall budget deficit should not exceed 3% of GDP, and public debt – 60% of GDP. This specification reflected in

full the idea that the discretionary fiscal policy should be significantly limited. Achieving of debt sustainability and strengthening of the community principles of the fiscal policy mechanism will create a sound basis for the functioning of the Monetary Union. (Economic and Monetary Union, 1996, p. 24) In light of the gaps between the levels of state debts and budget deficits values it can be stated that the Maastricht fiscal criteria seemed unrealistic, if we take into account the introduction of euro in 1999. Also, the definition of acceptable limits of the budget deficit and public debt looked as being carried out on the basis of median values in the developed countries for a long period of time, and not in accordance with the current fiscal situation in the EU. Limit of 3% of GDP budget deficit and 60% of public debt to GDP ratio at the time of the establishment of the EMU and the euro introduction reflected almost arithmetic mean value, but not the median one for the whole integrative zone. Table 2 figures clearly demonstrate that

Table 2

Fiscal convergence in the EMU before the introduction of euro, 1991–1998

	Budget deficit,% of GDP			Public debt, % of GDP		
	1991	1995	1998	1991	1995	1998
Austria	2.6	2.6	2.3	58.7	69.0	64.7
Belgium	6.5	4.1	1.7	129.4	133.7	118.1
Denmark	2.1	1.6	1.1	64.6	71.9	59.5
Germany	3.3	3.5	2.5	41.5	58.1	61.2
Greece	11.5	9.1	2.2	92.3	111.8	107.7
Spain	4.9	6.6	2.2	45.8	65.7	67.4
France	2.2	4.8	2.9	35.8	52.8	58.1
Ireland	2.3	2.0	–1.1	95.0	81.6	59.5
Italy	10.2	7.1	2.5	101.4	124.9	118.1
Luxembourg	–1.9	–1.5	–1.0	4.2	6.0	7.1
Netherlands	2.9	4.0	1.6	78.8	79.7	70.0
Portugal	6.7	5.1	2.2	71.1	71.7	60.0
Finland	1.5	5.2	–0.3	23.0	59.2	53.6
Sweden	1.1	8.1	–0.5	53.0	78.7	74.1
Un. Kingdom	2.6	5.8	0.6	35.7	54.1	52.3
EU-15	4.3	5.0	2.4	56.1	71.3	68.0
Criterion	3	3	3	60	60	60

Source: based on data of ECB Convergence Report for the respective years (www.ecb.int).

The EMU formation and the transition to a single European currency admitted that almost half of its members will not meet the fiscal convergence criteria. Also, the necessity to follow the policy of meeting those criteria provided that certain countries had to start aggressive programs of fiscal consolidation, or significantly reduce the assets of public sector to reduce the size of government debt, if significant changes in the structure of public finances would not be achieved in the short term. Reliance on the fact that within the process of the single currency functioning, the policy of fiscal convergence will continue, was partly justified given the fact that most countries, at least politically, showed their willingness to go through the harmonization of the level of debt burden in accordance with the agreed principles of effective macroeconomic policy in the Monetary Union. Mean values of the Maastricht criteria did not cause hard resistance even among marginal borrowers such as Belgium and Italy, indicating the presence of a certain Euro-optimism (Buiter et al., 1993, p. 60–75). Lowering of interest rates was taken for an integral feature of the ECB policy which was expected to be trustful and which would strictly follow the policy of price stability. Implicitly, this meant that the integration of financial markets combined with rigid monetary policy would create favourable conditions for easing the burden of interest that would facilitate the adhering to the down trajectory of public debt.

However, a significant level of already accumulated public debt and slow fiscal convergence created a very specific situation, the reflection of which was the introduction of fiscal rules in the EMU, the design of which from a macroeconomic point of view deviated from the logic of the Maastricht criteria. On the one hand, from the perspective of the design of fiscal rules, the fiscal convergence criteria are inflexible and increasingly focused on the control over the deficit bias and homogeneity of fiscal positions. Interest payments under sufficiently large public debt, almost completely absorbed the stabilizing effect of permissible 3% of budget deficit to GDP. The Maastricht criteria in that form completely ignored the stabilization performance criteria of fiscal policy and did not include cautions against variation of structural budgetary balance in response to economic fluctuations. Theoretical analysis of the Maastricht criteria even at an early stage of their implementation reflected stiffness required for convergence, against the flexibility that was required for the stabilization efficiency. That is, at first there was a clear tolerating of more rigid approach (Buiter et al., 1993, p. 60–75). In addition, a new model of active apologetics of mix policy in the Monetary Union was applied. Fiscal policy should take over the responsibility for adapting economy to the new equilibrium conditions when monetary policy is centralized and is carried out according to the priority of price stability, while the exchange rate channel of macroeconomic adaptation was absorbed due to monetary unification. On the other hand, the maintaining of fiscal convergence in a situation, where the steps were taken to stabilize the mitigating of the heavy Maastricht regulations would require a more robust institutional framework for monitoring fiscal policy in the context of the countries. Intelligent environment on the eve of the introduction of the euro clearly formulated two basic vectors of the Maastricht criteria transformation in

the EMU fiscal rules. The Pact on Stability and Growth (PSG), adopted in Amsterdam in 1997 with the additions made in 2005 reflects a compromise both, on the part of macroeconomic theory and on the part of policy of Euro-integration. The EMU fiscal rules should allow for some cyclic flexibility, but at the same time provide a monitoring and penalties for violation of medium-term fiscal targets agreed at the level of the European Commission. The main components of the PSG are presented in Table 3.

Table 3

Main components of the Pact on Stability and Growth before reforms in 2005 and 2012 (Schuknecht, 2004, p. 1–34; Fischer et al., 2006, p. 4–21, Barnes et al., 2012, p. 1–28)

The Maastricht criteria are the base for the EMU fiscal rules designed to ensure debt sustainability and fiscal convergence. 3% budget deficit and 60% public debt remain key limits of fiscal aggregates behaviour.
In order to provide some flexibility in fiscal policy, the country can apply medium-term targets for structural budget balance. According to the state of the EMU EU economy as a whole, as well as taking into consideration special circumstances, the value of the structural budget deficit may fluctuate. In the medium term perspective, structural budget balance should not exceed 1% of GDP.
Where the country is below medium-term targets for structural budget balance the actions should be taken on fiscal consolidation in the amount of 0.5% of GDP.
The system of penalties for non-compliance with fiscal discipline. If a country significantly deviates from the medium-term targets for structural budgetary balance and does not take measures to correct, then according to the decision of the European Commission the procedure of penalties introduction begins regarding the policy of excessive deficits. The model of penalties is two-tiered. When the procedure of sanctions is activated for excessive deficits according to the decision of the European Commission, the penalty fee includes a deposit, which bears s interest of 0.2% of GDP. This penalty is applied to the country, which significantly deviates from the medium-term fiscal targets and enables to implement recommendations of the European Commission on fiscal consolidation. When the country is in a state under the sanctions in the form of interest bearing deposit payment, but at that, it does not take measures to achieve medium-term goals, the penalty is imposed in the form of deposits, not bringing interest in the same amount.

According to the 2005 reforms the Stability and Growth Pact was amended with adjustments, designed to take into account the heterogeneity of the member countries of the Monetary Union in terms of already accumulated debt. If a country supports the national debt at or below 60% of GDP, its medium-term fiscal objective allowed maintaining 1% of GDP structural budget deficit. If a country is overloaded with the state debt, its structural balance should come to a zero balance or to minor excess.

As can be seen from the design of fiscal rules according to the Stability and Growth Pact, the Maastricht principles flexibilization combined with the formalization of the enforcement mechanism is not a straightforward choice of the fiscal policy model in the EMU. Macro-theoretical and institutional analysis of the PSG reflected the presence of potential problems in the area of fiscal discipline in the EMU, which ultimately affected the increasing of debt vulnerability of many members of the Monetary Union during and after the global financial crisis.

First, under the absence of monetary channels for adjustment to shocks, the fiscal policy is regarded as the most significant mechanism for mitigating cyclical fluctuations. More flexible budget response to a shock should be compensated by the lack of monetary respond. The combination of decentralized flexible fiscal and centralized stiff monetary policy began to be seen as a basic model of mix policy in the EMU, which has significant advantages. Moreover, if the Maastricht restrictions are imposed on the fiscal expansion, a certain proportioned flexibility would not threaten the process of economic convergence, but would rather enhance the real and nominal convergence by smoothing business cycles in terms of member countries. (Schuknecht, 2004, p. 1–34) Since the decentralized flexibility is associated with automatic stabilizers rather than the discretionary policy displacements, it would not be the threat to the stability of the Monetary Union. (Marin, 2002, p. 1–36). An earlier approach to the problem of fiscal discipline testified to be more categorical concerning the role of balanced budgets in the economic growth and macroeconomic stability in the process of the European integration. (Economic and Monetary Union, 1996, p. 24) Certain change in the visions of optimal fiscal policy is clearly rooted in the late 1990s, resulting in the automatic stabilizers and cyclic structural balance was conceived as the best alternative to a rigid course of fiscal discipline. (Lima et al., 2003 p. 58–63) Remarkably, that the emphasis was not made on the inclusion of fiscal homogeneity in the subject domain of the analysis according to the EMU currency criteria of the optimality of monetary area (Mongelli, 2002, p. 5–51; Dorrucci and Firpo, 2002, p. 5–50). As a result of that, an automatic stabilization of fiscal policy implicitly was viewed as a functional complement to the alignment of business cycles, which is more important for the nominal and real convergence.

Second, moving beyond the Maastricht stiffness was needed due to the variation of the value of the debt burden in the EU – EMU and the conditionality of current policy by the past character of the debt expansion. Thus, the empirical research clearly shows that the current fiscal policy rather strictly is limited by the

previous state of public finances, and the burden of interest payments is an important factor for limiting the budgetary manoeuvre through primary deficit (Tujula and Wolswijk, 2004, p. 3–40; Ardagna et al., 2004, p. 3–36; Caselli et al., 1998). The presence of in the PSG the macro-model of the medium-term fiscal objectives, expressed on a cyclical basis, clearly showed the convergence criteria deviation towards more flexible and complex fiscal rules.

Third, the PSG macro-design showed that the shift from the convergence priority towards the priority of flexibility is a definite continuation of the line on the status quo in further convergence of the economies of the Monetary Union. As the empirical study shows, the role of common factors in the behaviour of the budget balance in the EU began to grow significantly in 1985, while the value of net borrowings greatly varies in the process of adjusting to specific shocks. These results demonstrated that the increased homogeneity in fiscal policy is derived from the synchronization of business cycles, rather than the convergence in the field of public finance. (de Bandt and Mongelli, 2000, p. 5–28) Specific national framework conditions of fiscal divergence are not less important determinants of differences in the trajectories of the budget deficit and public debt than asymmetric macroeconomic shocks imposed on the long-term fiscal policy conditionality by past practices (Tujula and Wolswijk, 2004, p. 3–40). Differences in the institutional framework terms of fiscal policy, including budgetary procedures, form the prerequisites for fiscal divergence (Strauch et al., 2004, p. 3–45). The adoption of the Pact has confirmed the formed trend that fiscal convergence in the EMU mostly referred to the principle of automatic stabilization and budget cyclical balance. Uniformity of response to recession through expanding the budget deficit is more distinct than the symmetry in the respond of surplus to economic growth (Kozyuk, 2006, p. 57–67). Without extra cautions on budget surplus during the boom and with wide possibilities of interpretation of going beyond limitations of medium-term fiscal objectives the EMU fiscal rules should be recognized as unbalanced if the convergence in deficits and public debt is the individual value and the functional component of effective common monetary policy. In fact, it means that the Pact has laid formal bases for such a macro-model of fiscal policy, which allows for asymmetric automatic stabilization in the context of business cycle, and the presence of controversial issues, multifaceted interpretations and points of the bureaucratic debates have opened the way for the asymmetric application of enforcement to fiscal consolidation by countries. Consequently, the Stability and Growth Pact was criticized almost immediately after its introduction (Buti, 2006, p. 16–17; Rui and Afonso, 2007, p. 224; Verde, 2006, p. 484; Fischer et al., 2006, p. 4–21).

Fourth, from the standpoint of determining the criteria of the «ideal» fiscal rules according to G. Kopits and S. Symansky (Kopits and Symansky, 1998, p. 56) (K-S criteria) the PSG has much space for improvement. The analysis of the Stability and Growth Pact accordance with the K-S criteria shows that there are significant problems. In the first approach the Pact does not meet the follow-

ing criteria (Marneffe et al., p. 13–15). Traditional dilemma of fiscal rules design, which involves a choice between the alternatives like «trust versus flexibility» and «flexibility vs. simplicity» is fully reflected in the transition from the Maastricht criteria to the EMU fiscal rules. The PSG flexibility originated the problem of confidence in debt sustainability of some countries. Also the flexibility as the Pact target orientation caused a complex scheme of macroeconomic and institutional formats of fiscal policy implementation, which reflected a clear departure from the simplicity, certainty and clarity of the original Maastricht approach and therefore, transparency and confidence in the EMU fiscal rules.

Fifth, the institutional design of the Pact, especially regarding standards concerning enforcement of the rules following showed the presence of serious theoretical and political-institutional failure. The activation of the procedures for monitoring excessive budget deficit, the interpretation of the special conditions that allow going beyond the medium-term fiscal objectives, the voting rules in the process of sanctions application allow opportunistic behaviour and, in principle, do not ensure fiscal discipline. The institutional analysis of fiscal rules clearly indicates that without such a component as a compulsion to follow them, and explicit sanctions, those rules are hardly to be considered as such by definition (Wyplosz, 2005, p. 70–84; Hagen von J., 2005, p. 1–14; Schuknecht, 2004, p. 1–34; Drazen, 2002, p. 1–28). But the validity of the rules in accordance with international agreements raises several problems, known as the need for «*self-enforcing contracts*» and «*soft laws*» (Schuknecht, 2004, p. 1–34).

A) If the rule is established at the international level, and is absent at the national level, and moreover, the country is not inclined to follow it, the presence of additional conditions including the so-called «self-enforcement contract» would prevent the opportunistic behaviour better than the international contractual obligations. The latter do not guarantee a clear line on the use of enforcement, because there is no impartial body that would provide the basis for legitimate enforcement. The body that introduces the sanctions in the EMU according to the Maastricht Treaty and the Pact on Stability and Growth can not be considered completely independent and impartial. Voting procedures do not ensure objective results either. However, the acuteness of the problem may seem imaginary, if we take into account that most studies state the absence of gains from opportunistic behaviour in the long run. Deficit bias, leading to a deterioration of debt sustainability, can worsen the macro-situation in the country. This cooperative behaviour of the participating countries is a better alternative, even if the opportunistic behaviour is conditioned by the political business cycle. In fact, the system of fiscal rules in 2012, demonstrated the vulnerability in the aspect that the countries would tend to self-deter of the opportunistic behaviour. Another dimension of the problem is the collective deficit bias in response to asymmetric use of enforcement to implementing the sanctions introduced by the authority, whose impartiality is in doubt. If the macro-financial environment favours that, the collective defi-

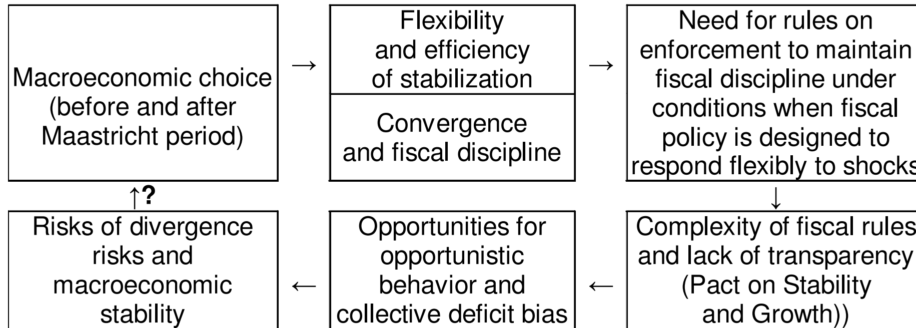
cit bias in some cases can develop into a demonstrative moral risk on the part of governments, whose fiscal policy is clearly contrary to debt sustainability.

B) In contrast to «self-enforcement contracts» the concept of «soft laws» allows solving problems within the international agreements. If the implementation of the contracts, or in other words, fiscal rules at the national level is problematic from the political and institutional view, it does not mean that the system of deterring the opportunistic behaviour will be ineffective if it is regulated by the allied regulations. Because of the specificity of the lack of enforcement legitimacy in international treaties, the latter are taking the form of «soft laws». The effects of «soft laws» is due to the reduction of transaction costs associated with monitoring of opportunistic behaviour in the groups the benefit from the existence of which is relied on voluntary cooperative strategy for individual members. The presence of international obligations offers great opportunities for informal correction of the behaviour of those who takes an opportunist position. Having formal means of enforcement, even if their activation is often done in violation of the principles of formal impartiality, it only strengthens «soft laws». Hence, the latter are still the best option of the problem solution than the absence of any institutional specified mode of coordination of the participants and preventing opportunism.

The analysis of the PSG from the institutional positions provides no definite answer. On the one hand, the evolution of the institutional model of fiscal rules has shown that the adoption of the Pact is a movement towards complexity by weakening the system of enforcement. The PSG in the version adopted in 1997 and in 2005 was rather a «soft law» (Schuknecht, 2004, p. 33–34). Only fiscal policy reforms of the EU–EMU in 2012 demonstrated the return to the idea of necessity to introduce «self-enforcement contracts» (Barnes et al., 2012, p. 1–28). That is, if the mere presence of the PSG is a value, then its institutional characteristics as the «soft law» should not cause negative evaluations, because the system of formal and informal enforcement was activated many times (e. g. with respect to Greece and Portugal). On the other hand, bureaucratic disputes as for the interpretation of certain provisions of the «exceptional conditions» between Brussels and individual countries, the failure to ensure impartiality and objectivity in the application of «excessive deficit procedure» (more likely the sanctions are applied to small countries and with limited peer pressure on large countries) demonstrated that the institutional model of the EMU fiscal rules may tend to frustration (Heipertz and Verdun, 2004, p. 768; de Haan J. et al., 2003, p. 13–15). Schematically, the dynamics and the institutional dilemma of the fiscal rules model can be represented in Fig. 1. In light of the debt crisis in the EMU and 2012 reforms we can see a dynamics fixation of institutional search for fiscal policy model, which reflects that the departure from the Maastricht principles in favour of fiscal flexibility does not guarantee the debt sustainability.

Figure 1

Institutional choice of fiscal rules model in the EMU



Empirical panorama of the EMU fiscal divergence and fiscal system reformation of euro- zone

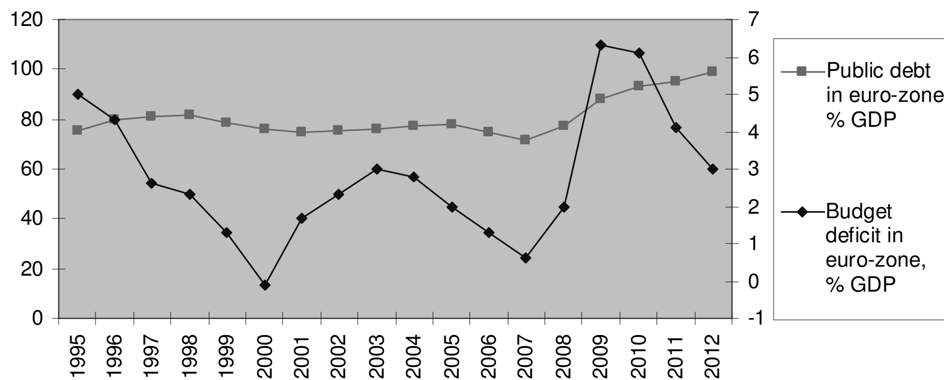
Empirical analysis of the fiscal situation in the EMU indicates that the identified gaps in the institutional theoretical model of the Stability and Growth Pact should be amended The alternative to the «convergence versus flexibility» is distorted in the light of how a specificity of pre-crisis macro- financial environment caused a tendency to divergence, which further strengthened after the crisis. Thus, the evolution of the EMU fiscal position, shown in Fig. 2, gives ground to think that despite the introduction of fiscal rules, neither the Maastricht requirements, nor the Pact on Stability and Growth became catalysts for reducing the debt burden on the average within the EMU to the level of 60% of GDP.

As shown in fig. 2, the variation in the level of public debt is much lesser than the budget deficit, which confirms the thesis about the nature of fiscal stabilization policy and its focus on maintaining demand in terms of macroeconomic shocks. Moreover, before the crisis, the same tendency was not observed to the connection between deficits and debts. By 2000, the deficit reduction was closely connected with a slight reduction in the debt burden. After that, a slow decline in the negative budget balance was accompanied by a decrease in value of debt to GDP if compared with the first period. In fact, it is a sign of the reduction of interest payments size. To achieve the same effect after the global financial crisis is no longer possible. The sharp decline in budget deficits can not directly inhibit the

growth of public debt. The absence of damped trend of the public debt value to GDP under the Maastricht limits indicates that the overall EMU tough requirements with respect to fiscal discipline were undermined by asymmetrical stabilization considerations. The prolonged stay on the trajectory of government debt, whose value exceeds the norm, also shows the unwillingness of most countries to achieve its reduction below the 60% level only because this level allows the absence of sanctions and is taken as the nominal anchor of debt sustainability.

Figure 2

Fiscal position of euro-zone, 1995–2012



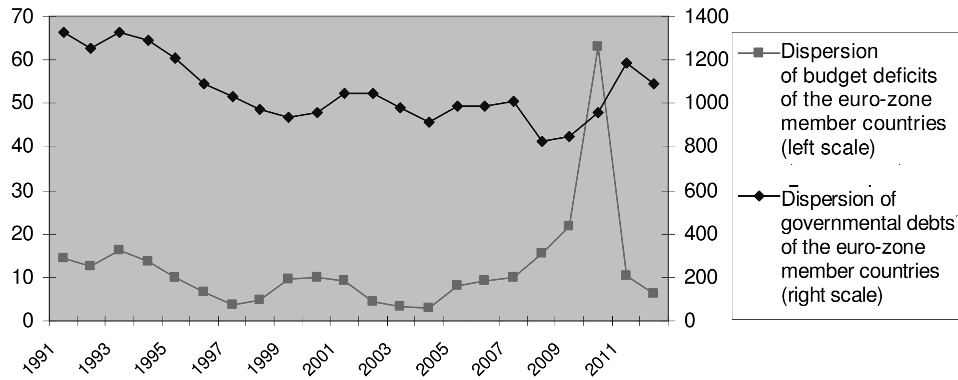
Source: based on data from OECD (www.oecd.org.) and ECB (www.ecb.int).

The analysis, the fiscal convergence shows that it is even more controversial, as is presented by the data presented in fig. 3–5.

Firstly, the Maastricht criteria, confirmed in the Pact had to define a sufficiently clear tendency to decrease dispersion parameters of fiscal imbalances in the integration area. Even allowing for some variations of deficits according to idiosyncratic shocks, the debt limit would appear a relatively steady trend of budget deficits and government debts dispersion. However, fig. 3 shows some different trend. One can see the presence of certain micro-cycles in the processes of fiscal convergence. Until 2005, the general trend was clearly observed tending to shorten the gaps in size of budget deficits and public debts in the context of countries.

Figure 3

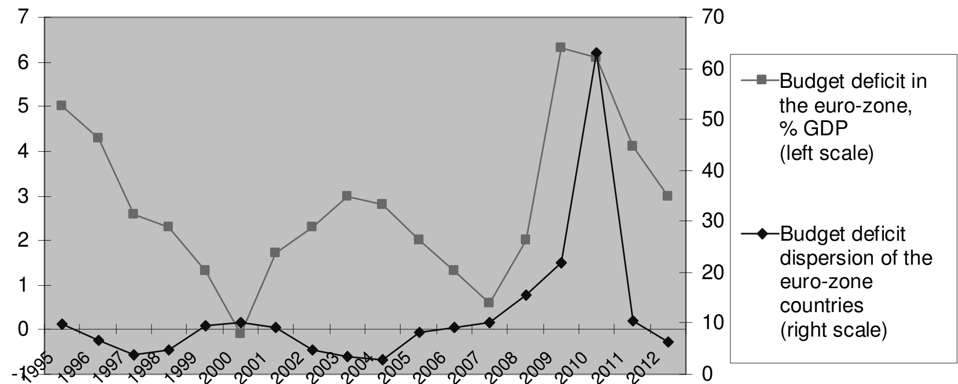
Fiscal convergence in the euro zone, 1991–2012



Source: based on data from OECD (www.oecd.org.) and ECB (www.ecb.int).

Figure 4

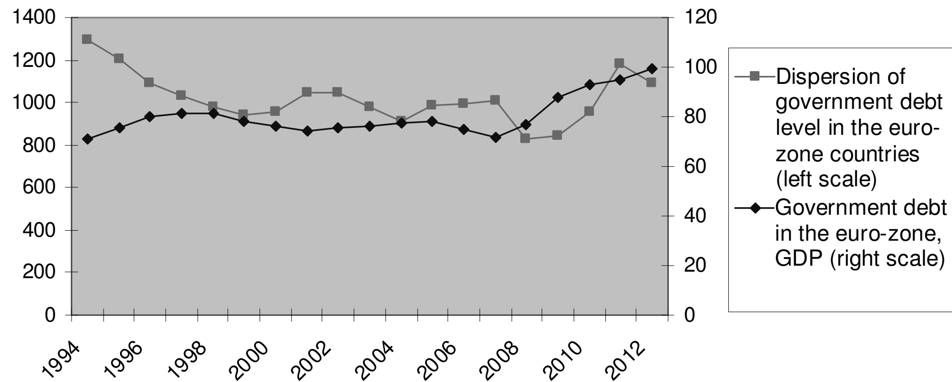
Budget deficit of the euro-zone and the dispersion of budget deficits of the euro-zone member countries, 1995–2012



Source: based on data from OECD (www.oecd.org.) and ECB (www.ecb.int).

Figure 5

Debt burden and debt convergence in the euro-zone, 1994–2012



Source: based on data from OECD (www.oecd.org.) and ECB (www.ecb.int).

But at that, the dispersion in both indicators fell most rapidly from 1991 to 1997 that is before the transition to euro. This means that the convergence programs before the adoption of the Pact appeared to be much more efficient mechanism for ensuring fiscal homogeneity in the EMU. It is proved by the data of figure 4, ascertaining that the drop of the size of the budget deficit in the EMU for the specified period corresponds with the falling rate of dispersion. The absence of a similar connection on the public debt (figure 5) indicates the conditionality of the debt growth by the past fiscal policy, resulting in variation inertia of the burden of interest payments in the context of the countries. The adoption of the Pact in 1997 is the point of a new cycle of fiscal convergence, showing the increasing of the values variability of public debt and budget deficit, but on a smaller range than in the pre-Maastricht period. That is, the Pact, as predicted by its macro-functional design allowed flexibility, but somewhat limited opportunities to debt expansion.

Second, the dispersion of the budget deficit and government debt before crisis are in a sufficiently clear correction retraction with indicators of fiscal imbalance and debt burden. In other words, fiscal activism is rather symmetrically distributed in the context of the member countries of the euro-zone. The need to increase the budget deficit is similar in terms of the countries, resulting in its dispersion fell which was prior to the crisis. The same is applied to the government debt. At the first approximation, this means that the shocks correlation is rather high. The EMU member countries have achieved a significant level of convergence and form an optimal currency area. However, at the second approximation

it means that symmetric worsening of fiscal balance is not compensated by symmetrical tendency to the formation of surpluses. Otherwise, the index of dispersion would not be in the inverse dependence of relevant parameters. The symmetry in the context of the cycle, similarly inherent to all the countries would mean a relatively stable rate of dispersion. This situation indicates that achieving of the convergence in nominal and real plane does not significantly affect the fiscal convergence. The EMU countries still remained in a situation of apparent lack of homogeneity in the area of fiscal policy. The PSG did not eliminate differences in responds to fiscal shocks. Traditional problems in terms of the cycle of automatic stabilization have not been resolved within the European model of fiscal rules. Alongside with preserving tendency for the national debt to remain within and over a certain limit, this has led to greater divergence as a result of the crisis and the emergence of asymmetries in sovereign solvency in terms of the member countries.

Thirdly, as other studies prove, the EMU divergence occurred neither amidst, nor after the crisis, but before it (Bini Smaghi, 2011), which suggests a factor of cyclic behavior of global liquidity to be more important in explaining the reason for the discrepancy of macroeconomic trajectories in the integration area. However, the crisis provided the greatest effect on the gaps extension of fiscal positions of the EMU member countries. Since the onset of the crisis the increase of the dispersions of budget deficit and public debt begins to correlate with the sharp deterioration in the fiscal balance and debt load. And only since 2011, when the signs of the debt crisis in the developed countries have become apparent, the tendency arose to consolidate around the necessity to balance budgets in the medium term that later referred to the national debt. However, the most dangerous is the situation where the lack of incentives for economic growth in the medium term leads to the conservation of so-called moderate deficits that cement the trajectory of public debt, which does not meet the framework of the Maastricht and the Pact convergence requirements. This is evident from the fact that since 2011, the fall in the deficit and slowing the growth rates of public debts have been reducing the dispersion of these indicators. Most countries happen to be in a almost the same situation with inflated level of public debt, the need to reduce budget deficits and the lack of clear evidence that fiscal policy will be able to solve the dilemma of restoring solvency and trust of markets to debt policy, on the one hand, and support of demand and employment under a continuing recession and the action of automatic stabilizers on the other side.

The introduction of new mechanisms to ensure financial stability in the euro-zone, together with the signs that the ECB monetary policy will be more flexible as for the liquidity supporting in the markets, proved insufficient to stabilize the situation. An important component of the mechanism of speculation against sovereign debt instruments of member countries is the lack of confidence that without the inflationary depreciation of the real value of the debt, the individual countries will be able to overcome the problems in public finance, particularly

under the absence of price levers to restore competitiveness in the countries of the «South». Fiscal consolidation and more rigid institutional model of fiscal rules together with the relevant structural reforms is the best option to stabilize the situation. In such conditions of the Pact reformation, alongside with a series of new initiatives in the field of macro-financial monitoring of the integrative processes from the view of the convergence have to demonstrate further convergence of economies of participating countries on the basis of macroeconomic discipline.

In 2012, after a period of instability in the markets of sovereign debts of Greece, Spain, Italy, Ireland, Portugal and the deterioration in overall public finance in the EMU countries, and the deterioration in expectations concerning the future of euro, the reform of the Monetary Union started. It consists of five regulatory changes, the guidelines and the new Treaty. The basis for the reform is the wording of the Pact on Stability and Growth, known as the «fiscal compact» (a play on words from English, where compact means an agreement, a gasket) (Barnes et al., p. 1–28). The main purpose of the reform is the following:

- to improve the efficiency of the mechanisms of fiscal discipline in the EMU due to the fact that acting till 2012 fiscal rules could not hold the situation in public finances under control;
- to strengthen the centralized control over public finances of member countries both, on the basis of the expansion of the European Commission, and on the basis of mechanisms improvement for coordination of macroeconomic and structural policies in the integration area;
- to resume the process of convergence, in particular to strengthen its role in the system of fiscal rules that would guarantee the avoiding of asymmetries and imbalances in the debt burden in terms of participating countries;
- to guarantee sovereign solvency and restore the markets' confidence in the institutional model of fiscal policy which would enable to overcome the debt crisis and begin the complicated procedures of fiscal consolidation under the terms of stabilizing expectations and easing the burden of accumulated debt liabilities;
- to reduce tension in the area of institutional interaction between the participants of the Monetary Union and its governing bodies, as well as to streamline the procedures of sanctions implementation for non-compliance of the commitments.

At the first approximation it is observed that the SDR and «fiscal compact» are based on the same macroeconomic model that provides the interpretation of Maastricht criteria as the basic constraints of fiscal policy, and the admissibility of stabilizing flexibility within the business cycle. However, in terms of fiscal disci-

pline, enforcement of rules implementation, and a mechanism for returning to base debt limit Pact as amended in 2005 and «fiscal compact» differ (see table 4).

Table 4

Comparing models of the EU fiscal rules before and after 2012 reform
(Reinhart et al., 2012; Barnes S., et al., 2012)

Enforcement mechanism	Fiscal rule to 2012	Fiscal rule after 2012
Corrective actions of the Pact on Stability and Growth	3% of GDP – national budget deficit	Similarly
	60% of GDP gross national debt	Similarly
		Reducing of the national debt by an average of 1/20 of the value which exceeds 60% within 3 years
Preventive measures of the Pact on Stability and Growth	Medium-term fiscal objectives of the structural balance of the general government budget	Similarly
	Improving of the structural budget balance by 0.5% of GDP, if the medium-term fiscal target was not achieved	Similarly
		Benchmarking expenditure of growth according to GDP trend
«Fiscal Compact»	–	The structural budget balance as a medium-term fiscal target
	–	Improving the structural budget balance by 0.5% of GDP if the medium-term fiscal target was not achieved

As seen from the generalizes presented in table 4, the «fiscal compact» includes formal and procedural cautions respectively the reducing of the public debt if it exceeds 60% of GDP. Also, unlike the Pact, it does not allow the primary deficit if the debt exceeds 60% of GDP. Imperative requirement to reduce public debt in such circumstances is limiting the excessive flexibility of the Pact, and requires recovery of the convergence and homogeneity in the EMU. At that, the very flexibility is allowed, but the smaller the debt is, the higher flexibility can the country affords itself during fiscal policy pursuing.

In more precise variant of the Pact on Stability and Growth reforms the weakest procedural and formal nuances of the institutional model of fiscal policy are significantly specified, encouraging the highest responsibility and discipline. The Pact reforms practically touched its all key components, including: the application procedures for the countries with excessive deficits, preventive measures; enforcement mechanism to implement fiscal rules (see table 5).

Table 5

Basic procedural reforms of the Stability and Growth Pact in appliance to 2012 reform (Barnes et al., 2012, p. 1–28; EC Survey, 2011, p. 1–13)

Implementation of the procedures for excessive deficits
The application of quantitative benchmarks of public debt reduction to GDP when it exceeds 60% through reducing by one-twentieth of the amount exceeding 60% over the following three years.
Changing the definition of «exceptional circumstances» that allowed deviations from the adhering to the set medium-term fiscal objectives, for the definition of «severe economic recession in the euro-zone and the EU», allowing more clearly follow the grounds to increase primary deficits.
Increased emphasis on macroeconomic forecasting system in determining the parameters of the budget deficit and the medium-term fiscal objectives, taking into account implicit liabilities, release of funds from pension reform, excessive imbalances and potential growth.
Measures to correct fiscal policy, in case of identification must be taken within three months, compared with previous term for measures implementation within six months.
Implementation of preventive measures procedures
Implementation of country-specific medium-term fiscal objectives, as well as measures of fiscal consolidation amount to 0.5% of GDP, in case when these objectives are not achieved, and the budget parameters must account for the unexpected earnings and structural reforms.

Setting of the benchmarks with respect to the significant deviation from the medium-term fiscal targets by 0.5% of GDP in the first year and by 0.25% in the second year, taking into account the unexpected receipts, the funds released from pension reforms, and means to overcome natural disasters.
Setting higher benchmarks in the medium-term fiscal objectives calculation for the countries whose public debt exceeds 60% of GDP, or for the countries which are recognized as these, where public debt is an obvious risk of exposure to the stability trajectory.
Activation of time limiting procedure of disagreement by six months, when the Commission report should be submitted with its recommendations to the European Council. If the latter does not take into account such recommendations, they are the subject of the approval by the inversely majority.
Application of benchmarks on the budget expenditures. Implementation of medium-term fiscal objectives involves determining of the expenditure trajectory, whose growth is provided at a level that is below the medium-potential GDP growth until the medium-term fiscal objectives are not achieved. However, such expenditures shall not include interest payments, costs associated with the unemployment problems, and the funds centralized in the EU budget.
Improving the effectiveness of enforcement as for budget discipline in the euro zone member countries
Sanctions in the form of 0.2% of GDP deposit of yielding interest, in cases where the country can not take measures according to the recommendations of the EU Council on correcting significant deviation from the medium-term fiscal objectives of the EU Council Decision to apply the sanction is made on the basis of the rule of the inverse qualified majority. Proposals for changes in the decision may be made by a qualified majority.
Sanctions in the form of 0.2% of GDP deposits that brings no interest in the case when the previous sanction is applied, but the EU Council identifies excessive deficits and disagreement with the decision on the fiscal correction is very serious.
Debt in the amount of 0.2% of GDP in the case when the EU Council decided that the country does not take any measures to correct excessive deficits. Deposits bringing no interest are converted into debts.
Delegating to the European Commission the right to investigate serious signs of possible manipulation of statistics and the application of sanctions as a penalty in the amount of 0.2% of GDP.

According to the new EU model of fiscal rules most countries should begin the process of fiscal correction of fiscal policy, and some of them for a long time will have to maintain a primary surplus to achieve medium-term fiscal targets (Barnes et al., 2012, p. 1–18; Hagen von J., 2005, p. 1–14).

The principal component of institutional reform of fiscal policy in the EMU is the introduction of requiring the presence of rules of fiscal policy in national legislation of member countries of preferably constitutional nature. The most preferred are the fiscal rules that involve setting limits on budget deficits and public debts at a level that is below the Maastricht one. Also, fiscal reforms in the EU suggest that fiscal policy at the national level should be carried out in accordance with the principle of discipline. Meeting the fiscal discipline in member countries is expected through challenging macroeconomic and structural reforms, the most severe part of which is the reform of the institutional framework of fiscal policies that include: introduction of rules; the establishment of independent fiscal agencies; identification of procedures limiting the discretionary fiscal policy and increase compliance of the planning, developing, approval and implementation of budgets with the principles of fiscal discipline; the centralization of fiscal powers; the transition to medium-term budget planning (EC Survey, 2011, p. 1–13; Public Finance in EMU, 2010, p. 73–80; National Fiscal Frameworks, 2010, p. 98–115).

The inclusion into the package of fiscal reforms the mandatory requirements for the severe national fiscal rules reflects the complex institutional dynamics of the European Union.

First, similar practice has already occurred in central banks. The Maastricht requirements clearly stated that the national central banks of the EMU member countries should be independent, and their mandate had to provide for achieving the price stability. Further the ECB rather heavy monitors the compliance with this requirement and the evaluation of the candidate countries for joining the EMU is carried out according to strict procedures for compliance. These requirements were viewed as indispensable elements for achieving institutional homogeneity, which was supposed to promote convergence. In the monetary policy the factor of institutional determinants of convergence was seen as prevailing. Dissemination of that practice on fiscal policy to some extent reflects the attempt to replicate the success of central banks in the field of combating inflation, now to project it for fiscal and debt sustainability. Despite some fiscal theory lag in the area of institutional mechanisms for ensuring fiscal discipline behind the monetary policy (in terms of price stability through institutional decisions), the complexity of the debt problems and ambiguity of opportunities to carry out a large-scale fiscal consolidation in many countries requires the streamlining of approaches to ensure effective macro-budget management. Hence, the paradigm shift in the fiscal theory opens the way for the creation of the intellectual basis for the institutional framework reformation of fiscal policy.

Secondly, the need for fiscal rules at the national level is dictated by the controversial experience of implementation of the Pact on Stability and Growth. Frustration of Maastricht principles in favor of flexibility and efficiency of stabilization together with the desire to compensate this through the discipline in the area of public debt generated a complex system of institutional interactions between the member countries and the governing bodies of the EU, who made significant

asymmetries in the interpretation of the grounds for going beyond the established limits and fiscal sanctions Legitimacy problems arising alongside with the institutional leverages of fiscal rules implementation in the Monetary Union should be compensated by national framework conditions of fiscal policy. That is, if the system of the union rules allows gaps in ensuring fiscal discipline and adherence to it, such a system should be supplemented by a requirement to introduce national rules. The institutional model of fiscal rules is two-tiered, as a result of that the responsibility for its implementation is the subject of monitoring both, at the level of the EMU, and at the level of individual countries. This pragmatic response of the EU fiscal reforms developers shows not so much implicit recognition of the failure of international approaches to the construction of supranational fiscal rules as the search for more relieved model of discipline and responsibility ensuring.

The introduction of even more hard and fast rules, compared with the Maastricht criteria and PSG in some countries, shows that there is an intention to increase the role of self-responsibility for macroeconomic, financial and debt sustainability, even if it generates some asymmetries in case when other countries are more tended to more opportunistic behavior. Such intentions can be among «peers» and not be subject to «peer pressure», so the relative benefits of fiscal opportunism happen to be the losses of confidence on the side of the markets, and the emergence of problems as for the sovereign solvency. The debt crisis in the developed countries, and the risks with respect to the increased doubt in the future of euro continue to urge actions of fiscal correction

Conclusions

The effective functioning of the Monetary Union is impossible without ensuring of fiscal discipline. The assumption that the flexible decentralized fiscal policy compensates the lack of macroeconomic flexibility is overvalued due to the lack of institutional means for deterring the opportunistic behavior in the budget area. Refusal from the simple and strict Maastricht criteria and introduction of more flexible and formally rigorous Pact on Stability and Growth showed a departure from the original ideology of convergence towards the controlled fiscal decentralization. However, the institutional weakness of the Pact meant that fiscal homogeneity in the EMU began to be systematically violated because of asymmetric automatic stabilization of fiscal policy in the context of the phases of business cycle. Fiscal reforms in 2012 showed recovery of a stricter approach to fiscal discipline in the EMU due to the improved design of fiscal rules. However, the basic ideology of the revised Pact remains unchanged. The compensation of macroeconomic flexibility of fiscal rules in the EMU is compensated by the increasing of institutional rigidity in the form of national «fiscal self-limitations». The evolution and complexity of the institutional model of fiscal discipline in the EMU shows the conservation of potential conflict between convergence and fiscal flexibility.

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