

European Commission

Directorate-General for Economic and Financial Affairs

Glossary

Automatic stabilisers Features of the tax and spending regime which react automatically to the economic cycle and reduce its fluctuations. As a result, the budget balance in percent of GDP tends to improve in years of high growth, and deteriorate during economic slowdowns.

Bottom up fiscal effort A quantification of the fiscal impact of measures introduced, obtained by summing up the impact of the individual measures. See *Top down fiscal effort*.

Broad Economic Policy Guidelines (BEPGs) Annual guidelines for the economic and budgetary policies of the Member States. They are prepared by the Commission and adopted by the Council of Ministers responsible for Economic and Financial Affairs (ECOFIN).

Budget balance The balance between total public expenditure and revenue in a specific year, with a positive balance indicating a surplus and a negative balance indicating a deficit. For the monitoring of Member State budgetary positions, the EU uses *general government* aggregates. See also *structural budget balance*, *primary budget balance*, and *primary structural balance*.

Budgetary sensitivity The variation in the budget balance in percentage of GDP brought about by a change in the output gap. In the EU, it is estimated to be 0.5 on average.

Close-to-balance requirement A requirement contained in the “old” *Stability and Growth Pact*, according to which Member States should, over the medium term, achieve an overall *budget balance* close to balance or in surplus; was replaced by country-specific *medium-term budgetary objectives* in the reformed *Stability and Growth Pact*.

Code of Conduct Policy document setting down the specifications on the implementation of the *Stability and Growth Pact* and the format and content of the *Stability and Convergence programmes*.

Convergence margin In the context of the expenditure benchmark, for Member States that have not attained their MTO, a convergence margin is computed so as to ensure the appropriate adjustment towards the MTO (i.e. an adjustment in line with the required change in the structural balance). Hence, the convergence margin results from the difference between the reference growth rate for net expenditure and the medium-term potential GDP growth.

Convergence programmes Medium-term budgetary strategies and monetary policies presented by Member States that have not yet adopted the euro. They are updated annually, according to the provisions of the *Stability and Growth Pact*. See also *stability programmes*.

Crowding-out effects Offsetting effects on output due to changes in interest rates and exchange rates triggered by a loosening or tightening of fiscal policy.

Cyclical component of budget balance That part of the change in the *budget balance* that follows automatically from the cyclical conditions of the economy, due to the reaction of public revenue and expenditure to changes in the *output gap*. See *automatic stabilisers*, *tax smoothing* and *structural budget balance*.

Cyclically-adjusted budget balance See *structural budget balance*.

Defined-benefit pension scheme A traditional pension scheme that defines a benefit, i.e. a pension, for an employee upon that employee’s retirement is a defined benefit plan.

Defined-contribution pension scheme A scheme providing for an individual account for each participant, and for benefits based solely on the amount contributed to the account, plus or minus income, gains, expenses and losses allocated to the account.

Demand and supply shocks Disturbances that affect the economy on the demand side (*e.g.* changes in private consumption or exports) or on the supply side (*e.g.* changes in commodity prices or technological innovations). They can affect the economy either on a temporary or permanent basis.

Direct fiscal costs (gross, net) of a financial crisis The direct gross costs are the fiscal outlays in support of the financial sector that increase the level of public debt. They encompass, for example, recapitalisation, purchase of troubled bank assets, pay-out to depositors, liquidity support, payment when guarantees are called and subsidies. The direct net costs are the direct gross cost net of recovery payments, such as through the sale of acquired assets or returns on assets. Thus, the net direct fiscal costs reflect the permanent increase in public debt.

Discretionary fiscal policy Change in the *budget balance* and in its components under the control of government. It is usually measured as the residual of the change in the balance after the exclusion of the budgetary impact of *automatic stabilisers*.

Economic and Financial Committee (EFC) Formerly the Monetary Committee, the EFC is a Committee of the Council of the European Union set up by Article 134 TFEU. Its main task is to prepare and discuss (ECOFIN) Council decisions with regard to economic and financial matters.

Economic Policy Committee (EPC) Group of senior government officials whose main task is to prepare discussions of the (ECOFIN) Council on structural policies. It plays an important role in the preparation of the *Broad Economic Policy Guidelines*, and it is active on policies related to labour markets, methods to calculate cyclically adjusted budget balances and ageing populations.

ESA2010 / ESA95 European accounting standards for the reporting of economic data by the Member States to the EU. As of September 2014, ESA2010 has replaced the earlier ESA95 standard with regard to the comparison and analysis of national public finance data.

European Financial Stability Facility is a company owned by euro area Member States created following the decisions taken in May 2010 by the Council. The EFSF is able to issue bonds guaranteed by euro area Member States to lend to euro area Member States in difficulty, subject to conditions negotiated with the European Commission in liaison with the European Central Bank and International Monetary Fund and to be approved by the Eurogroup.

European semester is the yearly cycle of economic policy coordination, which takes place over the first six months of the year. The European Commission undertakes a detailed analysis of Member States' programmes of economic and structural policies and the European Council and the Council of Ministers provide policy advice before Member States finalise their draft budgets.

Excessive Deficit Procedure (EDP) A procedure according to which the Commission and the Council monitor the development of national *budget balances* and *public debt* in order to assess and/or correct the risk of an excessive deficit in each Member State. Its application has been further clarified in the *Stability and Growth Pact*. See also *stability programmes* and *Stability and Growth Pact*.

Expenditure rules A subset of *fiscal rules* that target (a subset of) public expenditure.

Fiscal consolidation An improvement in the *budget balance* through measures of *discretionary fiscal policy*, either specified by the amount of the improvement or the period over which the improvement continues.

Fiscal governance Comprises all arrangements, procedures, rules and institutions that underlie the conduct of budgetary policies of general government. The terms fiscal governance and fiscal frameworks are used interchangeably in the document.

(Numerical) Fiscal rule A permanent constraint on fiscal policy, expressed in terms of a summary indicator of fiscal performance, such as the government budget deficit, borrowing, debt, or a major component thereof. See also *expenditure rules*.

General government As used by the EU in its process of budgetary surveillance under the *Stability and Growth Pact* and the *excessive deficit procedure*, the general government sector covers national government, regional and local government, as well as social security funds. Public enterprises are excluded, as are transfers to and from the EU Budget.

Government contingent liabilities Obligations for the government that are subject to the realization of specific uncertain and discrete future events. For instance, the guarantees granted by governments to the debt of private corporations bonds issued by enterprise are contingent liabilities, since the government obligation to pay depends on the inability of the original debtor to honour its own obligations.

Government implicit liabilities Government obligations that are very likely to arise in the future in spite of the absence of backing contracts or law. The government may have a potential future obligation as a result of legitimate expectations generated by past practice or as a result of the pressure by interest groups. Most implicit liabilities are contingent, i.e., depend upon the occurrence of uncertain future events.

Indirect taxation Taxes that are levied during the production stage, and not on the income and property arising from economic production processes. Prominent examples of indirect taxation are the value-added tax (VAT), excise duties, import levies, energy and other environmental taxes.

Interest burden *General government* interest payments on public debt as a share of GDP.

Maastricht reference values for public debt and deficits Respectively, a 60 % *general government* debt-to-GDP ratio and a 3 % *general government* deficit-to-GDP ratio. Those thresholds are defined in a protocol to the Maastricht Treaty on European Union. See also *Excessive Deficit Procedure*.

Medium-term budgetary framework An institutional fiscal device that lets policy-makers extend the horizon for fiscal policy making beyond the annual budgetary calendar (typically three-five years). Targets can be adjusted under medium-term budgetary frameworks (MTBF) either on an annual basis (flexible frameworks) or only at the end of the MTBF horizon (fixed frameworks).

Medium-term budgetary objective (MTO) According to the reformed *Stability and Growth Pact*, *stability programmes* and *convergence programmes* present a *medium-term objective* for the budgetary position. It is country-specific to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risks to the sustainability of public finances, and is defined in structural terms (see *structural balance*).

Minimum benchmarks The lowest value of the structural budget balance that provides a safety margin against the risk of breaching the *Maastricht reference value for the deficit* during normal cyclical fluctuations. The minimum benchmarks are estimated by the European Commission. They do not cater

for other risks such as unexpected budgetary developments and interest rate shocks. They are a lower bound for the *medium-term budgetary objectives (MTO)*.

One-off and temporary measures Government transactions having a transitory budgetary effect that does not lead to a sustained change in the budgetary position. See also *structural balance*.

Output gap The difference between actual output and estimated potential output at any particular point in time. See also *cyclical component of budget balance*.

Pension fund A legal entity set up to accumulate, manage and administer pension assets. See also *private pension scheme*.

Potential GDP The level of real GDP in a given year that is consistent with a stable rate of inflation. If actual output rises above its potential level, then constraints on capacity begin to bind and inflationary pressures build; if output falls below potential, then resources are lying idle and inflationary pressures abate. See also *output gap*.

Primary budget balance The *budget balance* net of interest payments on *general government* debt.

Primary structural budget balance The *structural budget balance* net of interest payments.

Private pension schemes The insurance contract specifies a schedule of contribution in exchange of which benefits will be paid when the members reach a specific retirement age. The transactions are between the individual and the insurance provider and they are not recorded as government revenues or government expenditure and, therefore, do not have an impact on government surplus or deficit.

Pro-cyclical fiscal policy A *fiscal stance* which amplifies the economic cycle by increasing the *structural primary deficit* during an economic upturn, or by decreasing it in a downturn. A neutral fiscal policy keeps the *cyclically-adjusted budget balance* unchanged over the economic cycle but lets the *automatic stabilisers* work.

Public debt Consolidated gross debt for the *general government* sector. It includes the total nominal value of all debt owed by public institutions in the Member State, except that part of the debt which is owed to other public institutions in the same Member State.

Public investment The component of total public expenditure through which governments increase and improve the stock of capital employed in the production of the goods and services they provide.

Significant deviation A sizeable deviation from the MTO or the adjustment path towards it. If it is established ex post, it will trigger a Significant Deviation Procedure.

Significant Deviation Procedure (SDP) A procedure according to which the Commission and the Council enforce compliance with the preventive arm in order to correct a significant deviation from the MTO or the adjustment path towards it. The procedure aims at encouraging timely correction of budgetary slippage, reducing the risk for a Member State to run an excessive deficit. Its application has been further clarified in the Stability and Growth Pact.

“Snow-ball” effect The self-reinforcing effect of public debt accumulation or decumulation arising from a positive or negative differential between the interest rate paid on public debt and the growth rate of the national economy.

Sovereign bond spread The difference between risk premiums imposed by financial markets on sovereign bonds for different states. Higher risk premiums can largely stem from (i) the debt service ratio, also reflecting the countries' ability to raise their taxes for a given level of GDP, (ii) the fiscal track record, (iii) expected future deficits, and (iv) the degree of risk aversion.

Stability and Growth Pact (SGP) Approved in 1997 and reformed in 2005 and 2011, the SGP clarifies the provisions of the Maastricht Treaty regarding the surveillance of Member State budgetary policies and the monitoring of budget deficits during the third phase of EMU. The SGP consists of two Council Regulations setting out legally binding provisions to be followed by the European Institutions and the Member States and two Resolutions of the European Council in Amsterdam (June 1997). See also *Excessive Deficit Procedure*.

Stability programmes Medium-term budgetary strategies presented by those Member States that have already adopted the euro. They are updated annually, in accordance with the provisions of the *Stability and Growth Pact*. See also *Convergence programmes*.

Stock-flow adjustment The stock-flow adjustment (also known as the debt-deficit adjustment) ensures consistency between the net borrowing (flow) and the variation in the stock of gross debt. It includes the accumulation of financial assets, changes in the value of debt denominated in foreign currency, and remaining statistical adjustments.

Structural budget balance The actual *budget balance* net of the *cyclical component and one-off and other temporary measures*. The structural balance gives a measure of the underlying trend in the budget balance. See also *primary structural budget balance*.

Sustainability A combination of budget deficits and debt that ensure that the latter does not grow without bound. While conceptually intuitive, an agreed operational definition of sustainability has proven difficult to achieve.

Tax elasticity A parameter measuring the relative change in tax revenues with respect to a relative change in GDP. The tax elasticity is an input to the *budgetary sensitivity*.

Top down fiscal effort A quantification of the fiscal impact of government policy, obtained by looking at the overall change in the structural balance. This may differ from the *bottom up* measure due to the incomplete coverage of the latter, second-order economic effects or different assumptions about the non-policy change assumption.