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Maastricht criteria: 20th century rules in the 21st century

The Maastricht convergence criteria were designed to ensure that countries adopting the single currency are able to achieve steady growth even by abandoning independent monetary policy. The criteria reflected the economic policy consensus, evolving since the late 1980s, that smoothing economic cycles should be left primarily to monetary policy while fiscal policy should remain passive. The latter should take specific action only if automatic stabilisers (such as unemployment benefits, changes in tax revenue etc.) are unable to smooth economic fluctuations.

The designers of the criteria aimed to make sure that none of the Member States jeopardised the achievement of price stability (e.g. by adopting undisciplined fiscal policy). To this aim, the criteria, measured the achievement of price stability and markets' judgement of sustainability (long-term yields and exchange rate stability). As for fiscal policy, quantitative rules were set to limit the deficit (no more than 3 per cent of GDP) and the government debt to GDP ratio (60 per cent of GDP, or at least approaching the reference value at a satisfactory pace). The fiscal rules have been further 'refined' in the Stability and Growth Pact.

The seemingly independent criteria were, in reality, absolutely not independent of one another. Assuming nominal growth of 5 per cent, derived from an economic growth rate of around 3 percent which was assumed to be desirable and achievable and, a close to 2 percent inflation rate, defined as price stability, the 3 percent deficit-to-GDP ratio would have stabilised the government debt to GDP ratio at a 60 percent level. An important underlying concept behind the criteria was that, in the longer term, economic growth depended only on supply-side factors, and monetary policy could at best help the economy to return to trend in response to cyclical fluctuations, but it could not have an effect on the growth rate.

Three decades later, it became clear that these assumptions were overly optimistic. The required 5 percent growth has been falling steadily as decade averages since the 1990s. In the persistently low inflation and growth environment, euro-area nominal growth (!) has been only 1.8 per cent in the 2010s. For this reason, using the logic of fiscal rules, a 1.1 per cent government deficit would have been needed to achieve the 60 percent debt ratio over the long term. Taking the opposite approach, the debt to GDP ratio would stabilise at above 160 percent assuming the growth rates of the past decade and the 3 percent deficit threshold (and at around 130 percent with the 2.4 percent average deficit achieved). Indeed, it may be no coincidence that it is precisely the fiscal rules that Member States have breached most often.

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The latest crisis has moreover drawn attention to new lessons. The financial sector, left unaddressed by the criteria, is capable of significantly and persistently influencing the growth path. The building up of excessive debts prior to the crisis, mainly in the private sector, led to the emergence of asset price bubbles. As these burst, the problems arising from the demand lost were exacerbated by the fiscal adjustment efforts intended to meet the deficit objectives. The rigid fiscal rules did not allow for a replacement of missing household and corporate demand. Even today, when there are numerous forecasts for an impending global economic downturn, this problem still exists. Without an internal growth engine, one of the world's largest economic regions is drifting exposed to the changes of global winds.

In contrast to the economic policy pragmatism characterising the US and China, the consequences of the set of criteria paralysing the euro area's economic policy have started to become visible in more and more areas. Weak private sector investment activity, the further erosion of competitiveness, the widening gap between Europe and its competitors all can be traced back to this problem.

In summary, data for the past three decades suggest that the requirements of the Maastricht criteria have been far from being met. The criteria are static. They do not actually provide an opportunity to manage a crisis associated with a sharp decline in demand, and are impossible to comply with or only at the price of unjustified economic losses, when facing changes in macroeconomic conditions and the emergence of 21th century new megatrends. A reform of the economic policy framework is in the best interest of the euro area and the European Union as a whole.