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Stability and Growth Pact

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Heads of state and government agreed at the March 2005 Summit to revise the EU's Stability and Growth Pact reform. Under the revised rules, member states must still keep their public deficits under a 3% GDP/deficit ratio and their debts under a 60% GDP/debt ratio.

However, the pact's rules have been made more 'flexible' across a range of areas. For example, member states will avoid an excessive deficit procedure (EDP) if they experience any negative growth at all (previously -2%), can draw on more "relevant factors" to avoid an EDP and will have longer deadlines if they do move into an EDP.

Milestones

- On 13 June 2006, the Commission published a Communication, evaluating the state of public finances in the EMU one year after the revision of the Stability and Growth Pact.

Policy Summary

The Stability and Growth Pact (SGP) was concluded by the European Council at the Dublin Summit in December 1996. It is a political agreement laying out the rules for the budgetary discipline of the member states. It is designed to contribute to the overall climate of stability and financial prudence underpinning the success of Economic and Monetary Union (EMU).

It builds on the **convergence criteria**, which member states have to fulfil in order to join the single currency. During initial negotiations leading up to the establishment of the pact, Germany was the main driving force pushing for more rigid rules.

The pact binds all parties to engage in the prompt implementation of the excessive deficit procedure (EDP), should any of them fail to meet the agreements of the pact. The procedure is enforced when a member state is running a deficit on public expenditure over revenue, of over 3% of its gross domestic product (GDP) in any year. Additionally, governments may also not allow total government debt to exceed 60% of GDP. Member states are required to report the level of their debt to the Commission promptly, which in turn relays this information to the EcoFin Council and the Monetary Committee.

If a country is found to be in serious breach of the protocol, the Commission can recommend that the Council take action against it. The EDP protects member states from action if their deficits "result from an unusual event outside the control of the member state concerned and has a major impact on the financial position of the general government" [an 'asymetric shock'] or "result from a severe economic downturn (if there is an annual fall of real GDP of at least 2%)".

Issues

Despite the clear consensus that emerged in the early 1990s over the need to formulate statistical rules to co-ordinate the multinational undertaking of EMU, the pact has been highly disputed since its inception, with critics and academics arguing especially fervently on the "arbitrary" selection of the three per cent threshold.

The Stability and Growth Pact is emerging from a major crisis after the Commission took the Council to the European Court of Justice on procedural grounds after the latter failed to take further action against France and Germany for persistent breaches of the pact's rules.

EU finance ministers reached a hard won deal on reforms to the Stability and Growth Pact at an extraordinary meeting in advance of the EU summit of heads of state and government on 22 and 23 March 2005.

In essence, big countries such as France and Germany have won concessions making the pact more 'flexible' in various parts, adding up to a considerable relaxation of the rules. In return, countries such as Austria and Netherlands have won references to "enhanced surveillance, peer support and peer pressure".

The two thresholds - 60% for the debt and 3% for the deficit - remain unchanged.

However, the following has changed:

Trigger for an excessive deficit procedure

No excessive deficit procedure will be launched against a member state experiencing negative growth or a prolonged period of low growth. Previously the exception was for countries in a recession defined as 2% negative growth, something which has been virtually unheard of among EU member states.

"Relevant factors" letting a country off an EDP

Member states recording a "temporary" deficit or one close to the 3% reference value will be able to refer to a series of "relevant factors" to avoid an excessive deficit procedure. Factors will include potential growth, the economic cycle, structural reforms (pensions, social security), policies supporting R&D plus medium-term budgetary efforts (consolidating during good economic times, debt levels, public investment).

Rather than referring to an exhaustive list of "relevant factors" as had been mooted at one stage, the deal sets out chapter headings. These will take the form of general principles whose application will be thrashed out between member states and EU institutions.

Leeway will be given where countries spend on efforts to "foster international solidarity and to achieving European policy goals, notably the reunification of Europe if it has a detrimental effect on the growth and fiscal burden of a member state".

The first part of this phrase will go some way to pleasing France, which failed to ensure that development aid and some military expenditure would be explicitly taken into account in its budgetary assessment. Germany will also be pleased as it wanted special treatment for what it regards as its high contribution to the EU budget and will no doubt try to justify this as part of efforts "to achieve European policy goals". Germany also appears to have got its way as regards the last part of the above text in that it is expected to cite the cost of German reunification.

The Council and Commission have recognised the importance of pension reforms in an ageing society by agreeing to give "due consideration" to the implementation of these reforms in their budgetary assessments relating to the excessive deficit procedure. They note that carrying out such reforms leads to a short-term worsening of public deficits but a long-term improvement in the sustainability (public debt) of public finances.

Extension of deadlines in connection with excessive deficit procedures

Countries will have two years (previously one) to correct an excessive deficit. This may be extended in cases of "unexpected and adverse economic events with major unfavourable budgetary effects occurring during the procedure". To benefit from these, countries must show proof that they have adopted the correction measures that were recommended to them.

Member states have committed to using unexpected fiscal receipts during periods of strong growth to reduce their deficits and debt.

Country-specific medium-term objectives

Medium-term objectives will be tailored to individual member states based on their current debt ratio and potential growth. This will vary from -1% of GDP for low debt/high potential growth countries to balance or surplus for high debt/low growth countries.

Reliability of statistics provided by member states

The Council wants to beef up Eurostat's resources, powers, independence and accountability. As a reaction to the Greek underreporting of statistics, it says that imposing sanctions on a member state "should be considered" when there is infringement of the obligations to duly report government data. The Commission unveiled a proposal to improve the reliable reporting of statistics on 22 December 2004.

Involvement of national parliaments in the process

Member states' governments have been called on to present stability/convergence programmes and Council opinions on these to their national parliaments.

Positions

The **European Central Bank** has expressed "serious concern" about the above changes to the pact. It is anxious that changes in the 'corrective arm' of the pact (excessive deficit procedure) do not undermine confidence in the EU's fiscal framework and the sustainability of public finances in eurozone countries. It calls on member states, the Commission and Council to implement the new version of the pact rigorously to ensure prudent fiscal policies.

The **German Bundesbank** says that the new rules have considerably weakened the pact, with fewer incentives for keeping sound public finances and enforceable rules due to the numerous exceptions and special rules. Differentiating its application from one country to another will make it less transparent, more complicated and harder to implement, says the bank. It is particulary concerned that the upper 3% deficit limit has been relaxed under the excessive deficit procedure.

The employers confederation **UNICE** expressed concern that the deal reached by EU finance ministers on 20 March would open the way to a pact "à la carte" that is neither transparent, nor rule-based nor equitable. It was particularly concerned about what it referred to as the unlimited widening of factors which member states could use to justify running a deficit above 3% of GDP.

Trade union confederation **ETUC** welcomed the deal, seeing it as an opportunity to introduce economic common sense into the rules governing Europe's fiscal framework. It calls on the Commission and Council to provide a European framework by relaunching the European Growth Initiative and says that member states wishing to make use of the new pact rules should be invited to draw up national plans that invest in the Lisbon priorities.

Eurochambres, the European Association of Chambers of Commerce and Industry, warned that the deal would have negative effects on Europe's debt levels, tax and interest rates and would potentially cost jobs.

In a teleconference call on 15 February 2005, Michael Deppler, the Director of the **International Monetary Fund's European Department** advocates an increased role for debt in thinking about what right fiscal policies ought to be. He argues for this both from a medium-term point of view, but also as a cross-check on some of the gamesmanship that goes on with the deficit figures.

Calling for more onwnership at national level, he argues for independent, nonpartisan national 'fiscal councils' which would assess and vet national budgets and stability paths from the longer-term perspectives for national parliaments. The fiscal councils would permanently monitor, report and assess the fiscal policies of governments, and do so vis-à-vis parliaments but also vis-à-vis the wider public. In his view they should be doing this year in and year out, elections or no elections. He notes that the Central Planning Bureau carries out a somewhat similar function in the Netherlands.

Commenting on the 2007 deadline for Italy, **Daniel Gros from the think tank the Centre for European Policy Studies (CEPS)** told EurActiv that the reformed Stability and Growth Pact had not improved the situation in the slightest and that it was always the same old story: "It shows that the excessive deficit procedure can neither be implemented or enforced in practice because countries are given such a long time to make adjustments. In reality, what will happen is that Italy has two years to move under the 3% deficit/GDP ratio, it will probably do so by the 2007 deadline and then, in 2008, it will go back into an excessive deficit procedure."

Asked by EurActiv if adequate steps had been taken to prevent similar situations to Greece in, for example, the new member states, Gros said that “in reality countries tend to use creative accounting to improve their statistics by half a percentage point here or there” and that “it would be difficult to nail them down to anything more accurate than that”. He does not see the problem of ‘creative accounting’ as a major future problem for the Stability and Growth Pact.

In a commentary on the reform of the Stability and Growth Pact, **Guillaume Durand and Julien Bouzon, policy analysts from the think tank the European Policy Centre**, say that the wording of many provisions, especially regarding the exceptions to the 3% ceiling, is vague enough to fuel intractable political bickering between the Commission and member states. They express disappointment that the Ecofin reform did not live up to the hopes of many Europeans for a Pact geared much more toward the long-term sustainability of public finance, rather than overly focused on the 3% reference value.

"Rather than the reformed pact, which is relatively weak and no stronger than the previous version, a major disciplining factor could be the markets and how much of a risk premium they factor into government debt. Currently not all financial markets have fully factored in riskier government debts (such as Italy's) into the premium. This would act as a serious incentive for countries to get their financial houses in order as, if they do not, they will be punished by having to pay higher and higher interest on their debts," argues policy analyst Guillaume Durand from the Brussels-based think tank the European Policy Centre.

Links

European Union

- Kommission: Stabilitäts- und Wachstumspaktreform: Kommission begrüßt Einigung auf Neuerungen (27. Juni 2005)
- Europäischer Rat: Schlussfolgerungen (23. März 2005)
- Luxemburgischer Ratsvorsitz: Accord sur la réforme du pacte de stabilité et de croissance
- Luxemburgischer Ratsvorsitz: Extraordinary EcoFin meeting on improving the implementation of the Stability & Growth Pact (20. März 2005)
- Rat: Economic and Financial Affairs Council minutes (18. Januar 2005)
- Eur-Lex: Verordnung des Rates über den Ausbau der haushaltspolitischen Überwachung und der Überwachung und Koordinierung der Wirtschaftspolitiken (7. Juli 1997)
- Kommission: Kommission sieht Deutschland und Frankreich auf richtigem Weg zur Korrektur des übermäßigen Haushaltsdefizits im Jahr 2005 (14. Dezember 2004)
- Kommission: Excessive deficit procedure
- Europäischer Gerichtshof, Pressemitteilung: Kommission/Rat, "Der Gerichtshof klärt die Zuständigkeiten der Kommission und des Rates in Bezug auf das Verfahren bei einem übermäßigen Defizit (13. Juli 2004)
- EUR-Lex: Council Regulation on speeding up and clarifying the implementation of the excessive deficit procedure
- Rat: Statemement by EU economy and finance ministers on Commission v Council ECJ ruling (13. Juli 2004)
- Kommission: Stellungnahme der Kommission zum Defizit-Urteil des EuGH (13. Juli 2004)
- Parlament: Reform of Stability Pact is on track, says Almunia
- Kommission: Die Kommission legt eine Strategie zur Verbesserung der Qualität der Haushaltsstatistik fest (22. Dezember 2004)
- Kommission, Mitteilung: Stärkung der Economic Governance und Klärung der Umsetzung des Stabilitäts- und Wachstumspakts (3. September 2004)
- Kommission: Commissioner Almunía speech on strengthening economic governance and improving the Stability and Growth Pact (3. September 2004)
- Eur-Lex, EG-Vertrag: Rechtsgrundlage: Öffentliche Defizite und Defizitverfahren (Artikel

104)

- Scadplus: Entschließung des Europäischen Rates von Amsterdam über den Wachstums- und Stabilitätspakt

Governments

- UK - HM Treasury: The Stability and Growth Pact: a discussion paper (März 2004)
- Deutsche Bundesregierung: Schröder und Chirac: Stabilitätspakt wachstumsorientiert auslegen (7. März 2005)

NGOs and Think-Tanks

- Centre for European Policy Studies (CEPS): Who monitors public finances?
- Centre for European Policy Studies: EMU at Risk, 7th Annual Report of the CEPS Macroeconomic Policy Group
- Centre for European Policy Studies (CEPS): The Stability Pact is dead! Long live the Treaty?
- Centre for European Reform: A pact for stability and growth
- Centre for European Policy Studies (CEPS): The Dog that Lost Its Bark: The Commission and the Stability Pact
- European Policy Centre: Commentary - The reform of the Stability and Growth Pact: Upholding a more flexible rule (16. Juni 2005)
- European Policy Centre (EPC): Reforming the SGP: Does it matter? What should be done? (17. November 2004)
- European Policy Centre: A "Good Quality Finance Rule"
- Leuven Universität: The Stability and Growth Pact in need of reform (September 2003)
- EPC: Lisbon and the Stability and Growth Pact: Working for Recovery - briefing with Commissioner Almunía (28. Januar 2005)
- Centrum für angewandte Politikforschung (CAP): Zwischen Neuinterpretation, Anpassung, Revision und Reform - Positionen zum Stabilitäts- und Wachstumspakt (Januar 2005)

Political Groups

- Liberale Fraktion ALDE: Freezing the procedure against France and Germany is not a pardon (14. Dezember 2004)
- Sozialdemokratische Fraktion SPE: Reform of the Stability and Growth Pact - comments by Poul Nyrup Rasmussen (no direct link but searchable) (3 Sep. 2004)
- Fraktion der Christdemokraten EVP-ED: Hans-Gert Poettering zum Treffen der europäischen Finanzminister: Bedauerlicher Rückschritt für europäische Währungsstabilität (21. März 2005 2005)

Business & Industry

- Arbeitgeberverband UNICE, Pressemitteilung: Stability and Growth Pact: restore workability and confidence (3. März 2005)
- Arbeitgeberverband UNICE: Pressemitteilung - UNICE President Strube meets Prime Minister Jean-Claude Juncker (19. Januar 2005)
- Europäischer Gewerkschaftsbund (EGB): ETUC invites EU policy-makers to balance national flexibility in the new stability pact with European co-ordination (24. März 2005)

- Eurochambres: Chambers insist on strong, strict Stability and Growth Pact (21. März 2005)

International Organisations

- Internationaler Währungsfonds (IWF): Stability & Growth Pact reform policy discussion (should not be reported as representing the IMF's views)
- Internationaler Währungsfonds (IWF): Transcript - teleconference call by the IMF's European Department Director Michael Deppler

EU Actors positions

- Europäische Zentralbank: Erklärung des EZB-Rats zum Bericht des ECOFIN-Rats über eine verbesserte Umsetzung des Stabilitäts- und Wachstumspakts (21. März 2005)
- Deutsche Bundesbank: Stabilitäts- und Wachstumspakt entscheidend geschwächt (21. März 2005)