Box 4

Obligations of euro area countries concerning their fiscal policies under the Treaty and the Stability and Growth Pact

According to the Treaty, Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Community. Moreover, they shall regard their economic policies as a matter of common concern and shall co-ordinate them within the Council. The Council shall formulate broad guidelines for the economic policies of the Member States and shall monitor economic developments in a multilateral surveillance framework. For this purpose, Member States shall forward, inter alia, information about important measures taken by them in the field of their economic policy. Should the economic policies of a Member State be inconsistent with the broad guidelines or should they risk jeopardising the proper functioning of Economic and Monetary Union, the Council may make a recommendation to the Member State concerned and can decide to make this recommendation public.

Concerning fiscal policy in particular, Member States shall avoid excessive deficits. Compliance with budgetary discipline shall be examined on the basis of reference values for the general government deficit and gross debt in relation to GDP, whereby a number of qualifications can be applied. In particular, an only exceptional and temporary excess of the deficit over the reference value can be exempt from being considered excessive, provided that it remains close to the reference value. In assessing the budgetary position, further information can also be taken into account, e.g. the level of public investment in relation to the government deficit. The decision as to whether or not a Member State is in an excessive deficit position lies with the Council upon a recommendation from the European Commission. The avoidance of excessive deficits being a criterion for entry into Economic and Monetary Union, current euro area Member States are not in the position of having excessive deficits.

A clarification of the Treaty's fiscal norms was decided by the Council in 1997 by implementing the Stability and Growth Pact. This Pact mainly aims at (a) ensuring lasting compliance of fiscal policies with the requirement of budgetary prudence, and (b) monitoring fiscal developments with a view to receiving early warnings in the event of budgetary slippage. In this context, the Council underlines the importance of safeguarding sound government finances as a means of strengthening the conditions for price stability and strong sustainable growth conducive to employment creation.

As the main provision to ensure sound fiscal policies on a permanent basis, the Stability and Growth Pact incorporates the Member States' commitment to respect the medium-term budgetary objective of positions close to balance or in surplus. This objective would allow all Member States to deal with normal cyclical fluctuations, while keeping the government deficit at or below the reference value of 3% of GDP. Deficits of above 3% of GDP will be regarded as excessive, unless they occur only temporarily and under exceptional circumstances and provided that deficits remain close to the reference value. Such exceptional and temporary circumstances are defined as either an unusual event beyond the control of the Member State concerned which has a major impact on the financial position of the general government or as a severe recession. An excess over the reference value resulting from a severe economic downturn shall, as a rule, only be considered as exceptional if there is an annual fall in real GDP of at least 2%. A smaller decline in real GDP can only be considered as exceptional when this is suggested by supporting evidence, in particular the abruptness of the downturn or the accumulated loss of output relative to past trends. However, Member States have committed themselves not to invoke this possibility unless they are in severe recession. In evaluating whether or not an economic downturn is severe, as a rule Member States will take a reference point of an annual fall in real GDP of at least 0.75%. The temporary nature of a deficit exceeding the 3% level will be apparent from budgetary forecasts as provided by the European Commission indicating that the deficit will fall below the reference value following the end of the unusual event or the severe economic downturn.

Should a Member State's government deficit be considered excessive, the Council will formulate recommendations for the correction of this budgetary imbalance. Effective measures to this effect have to be taken by the Member State concerned within four months. Should, according to the Council's judgement, such effective action not be taken, the Council can impose sanctions. These initially take the form of a non-interest-bearing deposit quantified in relation to the Member State's GDP, which may be converted into a fine should the excessive deficit persist for more than two years.

In order to monitor budgetary developments and to receive signals of any potential budgetary slippage, as well as to facilitate the co-ordination of economic policies, an early warning mechanism has also been established in the context of the Stability and Growth Pact. For this purpose, participating Member States shall submit to the Council and Commission annual stability programmes specifying their medium-term budgetary objectives. The content and format of stability programmes follow an agreed pattern. The Council shall deliver an opinion on the stability programmes and request adjustments, should it consider a strengthening of the programme's objectives and contents to be necessary. Moreover, the implementation of the programmes shall be monitored by the Council and a recommendation shall be made to the Member State concerned if the Council identifies any significant divergence of the budgetary position from the medium-term budgetary objectives laid down in the programme.