

## **Box 5**

### **Sound and efficient public finances: Section 2.3 of the “Broad guidelines of the economic policies of the Member States and the Community”**

According to the Treaty, “*Member States shall regard their economic policies as a matter of common concern and shall co-ordinate them within the Council*” (Article 99.1; ex Article 103.1). In this context, the Council shall “*formulate a draft for the broad guidelines of the economic policies of the Member States and of the Community, and shall report its findings to the European Council*” (Article 99.2; ex Article 103.2). On this basis, the European Council shall “*discuss a conclusion on the broad guidelines of the economic policies of the Member States and of the Community*” and, based on this conclusion, “*the Council shall (...) adopt a recommendation setting out these broad guidelines*”.

According to the “Presidency Conclusions”, the European Council on 3 and 4 June 1999 welcomed the broad guidelines and recommended their adoption to the ECOFIN Council. These guidelines state that in general the contribution fiscal policies can make to fostering economic growth, employment and stability in the euro area is to undertake “*sustained efforts to bring budgets securely to close to balance or to a surplus over the medium term through a full and determined implementation by Member States of their stability programmes*”. More specifically, Section 2.3 of the aforementioned guidelines reads as follows.

*“Visible progress in reducing general government budget deficits was made in 1996 and 1997. Yet, budgetary consolidation was generally only modest in 1998 even though economic activity generally expanded at a*

*strong pace and the budgetary positions of most Member States were not in line with the medium-term objective of the Stability and Growth Pact.*

*Further budgetary consolidation is therefore needed. This will create the necessary scope to face adverse cyclical developments. In addition, Member States should strive to reduce the vulnerability of budgets to rising interest rates, make government spending and taxation more conducive to growth and employment creation and to prepare for the longer-term budgetary challenges associated with an ageing population.*

*Within the framework of the Stability and Growth Pact, all Member States submitted stability programmes or convergence programmes that set out the medium-term objective for the budgetary position of close to balance or in surplus and the adjustment path towards this objective. Up to the first few months of 1999, the Council examined all programmes and delivered an opinion on all programmes. In conducting budgetary policies during 1999 and beyond, Member States are urged:*

- (i) to achieve budgetary positions of close to balance or in surplus no later than by the end of 2002 in conformity with the stability and convergence programmes;*
- (ii) given the expectation of a mild, temporary slowdown, to meet fully their 1999 budgetary targets; and*
- (iii) provided the economic outlook unfolds better than expected in their stability or convergence programmes, to front-load the budgetary adjustment efforts envisaged in their programmes as of the year 2000 and, where programmes target minimum adjustment, to aspire to more ambitious objectives and update stability/convergence programmes accordingly.*

*For budgetary adjustment and restructuring to take place efficiently, it has to take into account the particularities of each Member State's economic, social and institutional conditions. In general, and without threatening the necessary ongoing consolidation process, Member States are urged to:*

- (i) improve their budgetary positions through expenditure restraint rather than through tax increases; in this context, to enhance the credibility of budgetary consolidation and to influence private sector expectations positively, Member States would be well advised to introduce or enhance the mechanisms and institutions that help control spending so that taxes could be cut without jeopardising the achievement or maintenance of healthy budgetary positions; and*
- (ii) improve the sustainability and efficiency of their public finances through:*
  - (a) reviewing pension and health care systems in order to be able to cope with the financial burden on welfare spending of the ageing of the population and the need to influence future labour supply, in line with the options already being examined by the Member States;*
  - (b) reversing, where appropriate, the decline in government investment; in this context the Union and the Member States should be guided by the Commission's four-point action plan that was submitted to the Vienna European Council;*
  - (c) giving incentives for investment in human capital and providing for the necessary financing of other active labour market policies that are called for in the Employment Guidelines while taking into account the national budgetary position;*
  - (d) reducing the overall tax burden and especially the tax wedge on the lower paid preferably via reduced spending or through shifts to environmental, energy or consumption taxes; to increase the employment effects of reductions in the fiscal burden on labour and non-wage labour costs, the social*

*partners are urged, at their various levels of responsibility and action, to commit themselves to actions aimed at improving the conditions for job creation and investment;*

*(e) improving the efficiency of their taxation systems; and*

*(f) pursuing tax co-ordination further so as to ensure a smooth functioning of the Single Market and to avoid harmful tax competition; the Council awaits the outcome of the ongoing discussions on the VAT system, taxes on energy, the taxation of corporate income and the taxation of the interest on savings in line with the conclusions of the European Council held in Vienna in December 1998.*

*In just the same way as the Member States, the Community also is called upon to continue to maintain strict budgetary discipline. Strict budgetary discipline must be applied to all categories of the financial perspectives, while respecting the inter-institutional agreement on budget discipline and the improvement of the budget procedure.”*