Box 7

The excessive deficit procedure

The excessive deficit procedure as part of the European fiscal policy framework

The European fiscal policy framework establishes rules ensuring fiscal discipline and preserving the stabilising role of public finances. It consists of the fiscal provisions laid down in the Maastricht Treaty, including notably the excessive deficit procedure (EDP). The latter defines, inter alia, the reference values for the general government deficit ratio (3% of GDP) and public debt ratio (60% of GDP). The framework also includes the Stability and Growth Pact, which promotes economic policy co-ordination and defines the conditions under which to apply the EDP. Peer pressure and sanctions are the main mechanisms employed under the EDP in order to dissuade governments from incurring unsustainable deficits.[1]

1 *The Stability and Growth Pact strengthens the surveillance process "to prevent, at an early stage, the occurrence of excessive general government deficits and to promote [...] the co-ordination of economic policy" (Council Regulation No. 1466/97) "[…] and to deter excessive general government deficits and, if they occur, to further their prompt correction" (Council Regulation No. 1467/97).*

The two stages of the excessive deficit procedure

In accordance with the Pact, two basic stages can be distinguished in the implementation of the EDP. First, there is the assessment stage, which triggers the EDP procedure. In this stage, the European Commission prepares a report whenever a given country breaches the reference values or is at risk of an excessive deficit, and then decides on whether it should address an opinion to the Council on the existence or risk of an excessive deficit. The ECOFIN Council decides whether the country's deficit is indeed excessive or not. In the event of an affirmative decision, the Council also recommends measures to put an end to this situation and sets a time frame for its correction, which is the year following its identification at the latest.

Second, there is a follow-up stage, which includes the possibility of imposing sanctions. If the Council decides that the given country has fully implemented the recommended measures, the procedure is suspended until the Council decides that the excessive deficit has been corrected in time. However, should the country not adopt the necessary measures to correct its excessive deficit in a timely manner, or should the measures prove insufficient, further procedural steps follow. Ultimately, if there is continued non-compliance, the Council may impose a pecuniary sanction on that country. The sanction takes the form of a non-interest-bearing deposit of up to 0.5% of GDP that could turn into a fine if excessive deficits persist.

Flexiblity of the procedure and challenges

The implementation of the formal procedure is spelled out in great detail in the Stability and Growth Pact, but it nevertheless provides some flexibility. At the assessment stage, deficits above 3% of GDP may not be considered excessive if they result from an unusual event outside the control of the government, or a severe economic downturn. In its report, the European Commission should also take into account, amongst other things, the public investment share and the medium-term position of public finances when assessing whether a deficit above 3% is excessive. At the follow-up stage, special circumstances may extend the time period a given country has to correct an excessive deficit. Moreover, pecuniary sanctions are to be applied as a rule rather than unconditionally.[2] The flexibility of the procedure is important because it prevents an overly rigid and mechanical approach from being taken in applying the EDP. Allowing for exceptions is appropriate because it is impossible to cover all economic and political contingencies with a simple rule relying solely on numerical values. However, the scope for flexibility also presents a challenge as it needs to be used with caution. Too lenient an implementation of the EDP would bear the risk that countries in excessive deficits do not undertake the necessary corrective action and others are not sufficiently dissuaded from incurring such imbalances.

2 *See Council Regulation No. 1467/97, Article 2 (1) and (2), Article 3 (4) and Articles 11 and 14, as well as Article 104 (3) of the Maastricht Treaty.*