Box 8

Sound fiscal policies for stability and growth in the euro area

The debate on strengthening the co-ordination of budgetary policies

In autumn 2002 the European Commission initiated a debate on the appropriate interpretation and role of the Stability and Growth Pact, which led to the Eurogroup agreement of October 2002 and the ECOFIN report on strengthening the co-ordination of budgetary policies in March 2003. In this report, Member States agreed to leave the rules unchanged, while at the same time providing some clarification for the assessment of fiscal policies, which should result in an appropriate balance between discipline and flexibility when implementing the Stability and Growth Pact. Most notably, countries with fiscal positions which are not close to balance or in surplus are requested to improve their cyclically adjusted positions by a minimum of 0.5% of GDP per year (thereby confirming the earlier agreement made in the Eurogroup). Moreover, the report stresses the importance of undertaking consolidation as part of a comprehensive strategy, of avoiding pro-cyclical policies, of creating sufficient budgetary safety margins and of attaining sustainable public finances. At the same time, it grants the ECOFIN Council some discretionary leeway in the implementation of the Stability and Growth Pact.

Sound policies

There is a broad consensus that the following elements are the basic ingredients for sound fiscal policies aimed at securing sustainable public finances and enhancing stability and growth in the euro area:

- Governments have reaffirmed their commitments to fiscal discipline. In this respect, the October 2002 Eurogroup agreement on achieving budgetary positions close to balance or in surplus in the medium term is an appropriate strategy, combining progress in fiscal consolidation with a certain degree of flexibility.

- Public finance plans should be part of a medium-term-oriented strategy including ambitious and comprehensive, expenditure-based structural reform. This will reinvigorate confidence and growth, while facilitating the attainment of fiscal objectives.

- When these requirements are fulfilled and consolidation strategies are adequate, countries can rely on the operation of automatic stabilisers to contribute to macroeconomic stability and growth. However, the operation of automatic stabilisers in a weak economic environment cannot be used as an ex ante justification for breaching the reference value of 3% of GDP for the deficit. This could give rise to moral hazard problems, weakening the necessary diligence required to prevent excessive deficits and to correct them within the time frame set by the ECOFIN Council.

- In order to succeed in their strategies, all governments need to exercise and accept appropriate peer pressure, in particular, by means of a rigorous, though prudently flexible, implementation of the excessive deficit procedure. This would also imply a willingness to impose sanctions and enforce sufficient debt reduction where needed.

- High-quality and timely data reporting followed by a careful assessment of budgetary developments, in particular as regards compliance with consolidation requirements, are essential prerequisites.