

Box 7

POLITICAL COMMITMENTS AND THE STABILITY AND GROWTH PACT

Economic stability and sustainable growth in the context of Economic and Monetary Union depend inter alia on the determination of the Member State governments to conduct sound fiscal policies. Important political commitments have recently been made in this respect.

On 20 April 2007 the Eurogroup ministers of finance and economy, in their spring orientation debate on budgetary policies, reaffirmed their adherence to the sound fiscal policy principles of the revised Stability and Growth Pact (SGP). They agreed that the euro area was experiencing economic good times and undertook to make full use of the current economic growth and the better than expected tax revenues to pursue sound fiscal policies in line with SGP provisions. Ministers confirmed their commitment to actively consolidate public finances in good times and to use unexpected extra revenues for debt and deficit reduction. Member States that had not yet reached their medium-term budgetary objective (MTO) were expected to speed up the pace of deficit and debt reduction in order to achieve at least the annual fiscal adjustment benchmark, in structural terms, of 0.5% of GDP. Euro area countries committed to achieve their MTO in 2008 or 2009 and all of them agreed to aim for 2010 at the latest. Finally, those countries that had achieved their MTO were expected to avoid fuelling macroeconomic imbalances through a loosening of fiscal policy in good times.

On 9 October 2007 the ECOFIN Council adopted conclusions on how to improve the effectiveness of the SGP. The conclusions emphasised that the SGP should be fully implemented and that Member States that had not yet reached their MTOs should speed up the pace of deficit and debt reduction and allocate higher than expected revenues to this end. Specifically, the Council conclusions contained the following pledges:

- Ensuring progress towards sustainable fiscal positions is a key priority, in line with the preventive arm of the SGP, to prepare for the impending budgetary impact of ageing

populations. Countries not yet at their MTO should speed up the pace of deficit and debt reduction. In particular, countries participating in the euro area or in ERM II should pursue an annual adjustment in cyclically adjusted terms, net of one-off and temporary measures, of 0.5% of GDP as a benchmark. The adjustment effort should be higher in good times.

- Long-term fiscal sustainability, notably the future impact of ageing, is to be better taken into account in the MTOs. The criteria and modalities for taking into account implicit government liabilities in the definition of MTOs will be discussed early in 2008. Member States would present new MTOs in the updates of stability and convergence programmes in the autumn of 2009, providing for a revision of MTOs every four years.
- National fiscal rules and institutions, including monitoring mechanisms, are important in the attainment of sound budgetary positions. Rules-based multiannual fiscal frameworks can help to adhere to medium-term budgetary plans, including by controlling expenditure. Domestic ownership of the EU fiscal policy framework is enhanced by an appropriate involvement of national parliaments.
- The regular assessment of national fiscal policies is to be enhanced by a more comprehensive analysis of the overall macroeconomic situation and by improved tools for measuring the underlying fiscal positions of Member States, notably with a view to avoiding pro-cyclical fiscal policies in good times. If necessary, stability and convergence programmes should specify further measures to fill the gap between MTOs and fiscal trends.

Strengthening the preventive arm of the SGP is important to ensure that MTOs are reached quickly and to avoid a repetition of the past mistake of reducing structural consolidation efforts in good times. The renewed ECOFIN Council commitment and the ensuing proposals are hence welcome in principle. Care should, however, be taken to ensure that refinements to the way the Pact is implemented do not make the framework overly complex and dilute its rules-based nature.