

# The Stability and Growth Pact

**"Economic and Monetary Policy"**  
**Brussels, 9 January 2019**

**DG ECFIN, Fiscal Policy and Surveillance**

These slides accompany the explanation of the acquis to Albania and North Macedonia and can only be used for that purpose. Their content is subject to further development of the acquis and interpretation by the Court of Justice of the European Union'

# Outline

1. Origins and legal base of the Stability and Growth Pact
2. Successive reforms and evolution
3. Working of the preventive arm of the Pact
4. Working of the corrective arm of the Pact

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# Fiscal policy in the EU context

- EMU as unique model of economic integration
  - **Common monetary policy & decentralized fiscal policies**
- Common monetary policy
  - **Price stability**
  - **Macroeconomic stabilisation: dealing with *common* shocks**
- Fiscal policy at national level
  - **Sustainability: avoiding deficit bias**
  - **Macroeconomic stabilisation: dealing with *idiosyncratic* shocks**
- Common fiscal rules
  - **Overcoming (dis)incentives created by monetary union ('additional' fiscal bias)**
  - **Avoiding negative spillovers & overburdening monetary policy**

# The Stability and Growth Pact

- Framework within which Member States make their budgetary decisions
  - **Member States are responsible for fiscal policy**
  - **But must be compatible with the rules**
- Legal base: Treaty on the functioning of the EU
  - **Art. 121: multilateral surveillance**
  - **Art. 126: excessive deficit procedure**
  - **Art. 136: specific economic policy guidelines for the euro area**
  - **Protocol No 12 on the excessive deficit procedure**
    - Deficit criterion:** General government deficit < 3% of GDP
    - Debt criterion:** General government debt < 60% of GDP or sufficiently diminishing towards 60%

# The Stability and Growth Pact

- Secondary legislation:
  - **Regulation (EC) 1466/97** ('preventive arm'):
    - Aims to ensure sound budgetary positions
    - As long as deficit and debt criteria fulfilled, Member State remains in the Preventive arm
  - **Regulation (EC) 1467/97** ('corrective arm'):
    - aims to correct gross policy errors
    - If deficit or debt criterion not fulfilled, Member State enters the Corrective arm (= excessive deficit procedure)
- **Code of conduct**: further specifies implementation

# The Stability and Growth Pact

- Other related legislation:
  - **Data reporting to Eurostat:** [Regulation \(EC\) 479/2009](#) on the application of the Protocol on the EDP
  - **Sanctions for euro area Member States:** [Regulation \(EU\) No 1173/2011](#) on the effective enforcement of budgetary surveillance in the euro area
  - **Additional monitoring and reporting for euro area Member States:** [Regulation \(EU\) No 473/2013](#) on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area
  - **Enhanced surveillance for euro area Member States with financial difficulties:** [Regulation \(EU\) No 472/2013](#) on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability

# Fiscal policy in EMU: Who does what?

## Member States

- Decide on tax and spending levels – which drive borrowing and debt
- But must be compatible with the Stability and Growth Pact
- Fiscal Compact: National rules

## The European Commission

- Implements the Stability and Growth Pact: are Member States compliant with its provisions?
- Prepares the analysis to guide the Council

## The Council of Ministers

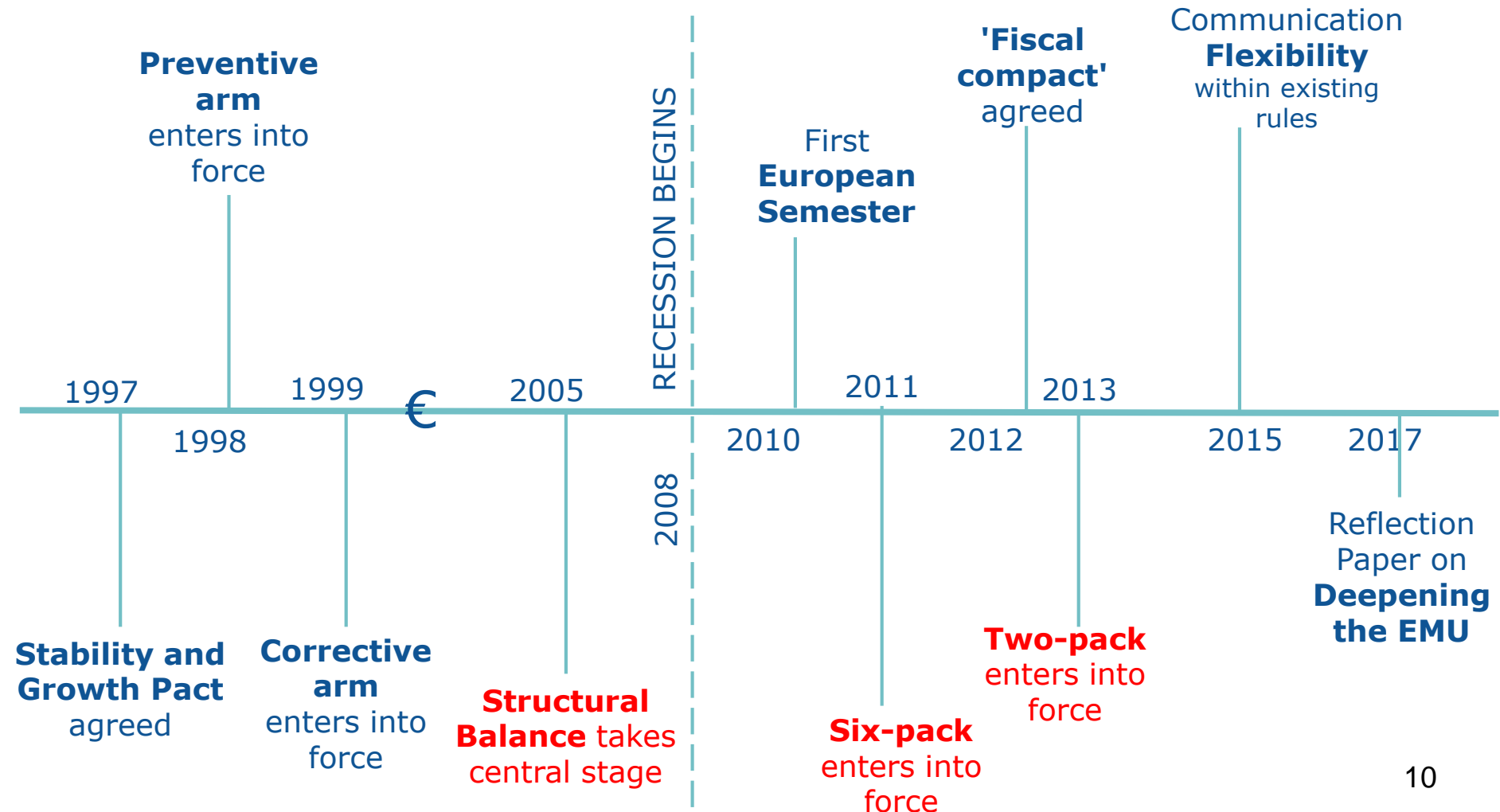
- Take the decisions on the application of the SGP



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# Timeline of relevant changes



# The 2005 reform

- Concept of **structural budget balance** = budget balance but excluding the impact of the economic cycle (and one-offs)
- Possibility to **modulate requirements** dependent on economic conditions
- Possible deviation from requirements if **major structural reforms** are implemented
- Give **more time** to bring deficit below 3% of GDP in case of adverse economic events

# The 2011 reform (“Six-pack”)

- Prevention of gross policy errors
  - **New expenditure benchmark**
- Focus on debt on top of deficit
  - **New benchmark for sufficiently diminishing debt ratio**
- Strengthening the national level
  - **Minimum requirements for national budgetary frameworks**
- Enforcement
  - **New sanction toolbox**

# The 2013 reform (“Two-pack”)

*Focus: euro area Member States*

The aggregate fiscal stance:

- **National fiscal policies must be sustainable while allowing automatic fiscal stabilisers to operate freely**
- **But may not result in an appropriate aggregate euro area fiscal stance (no rules for MS overachieving their targets)**

Two-pack reform:

- **Coordinated surveillance of national budgets**
- **Discussion on euro area fiscal stance in the Eurogroup**
- **Strengthening budgetary surveillance in face of financial instability**

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## EURO AREA

## NON-EURO AREA

### Countries under the corrective arm (EDP)

2018

ES



### Countries under the preventive arm

AT*		EE		LT		MT	
BE*		FI		LU		NL	
DE*		IT*		LV		SK	
IE*		SI*		CY*		PT*	
EL*		FR*					

BG		HU*		SE	
CZ		PL		HR*	
DK		RO		UK*	

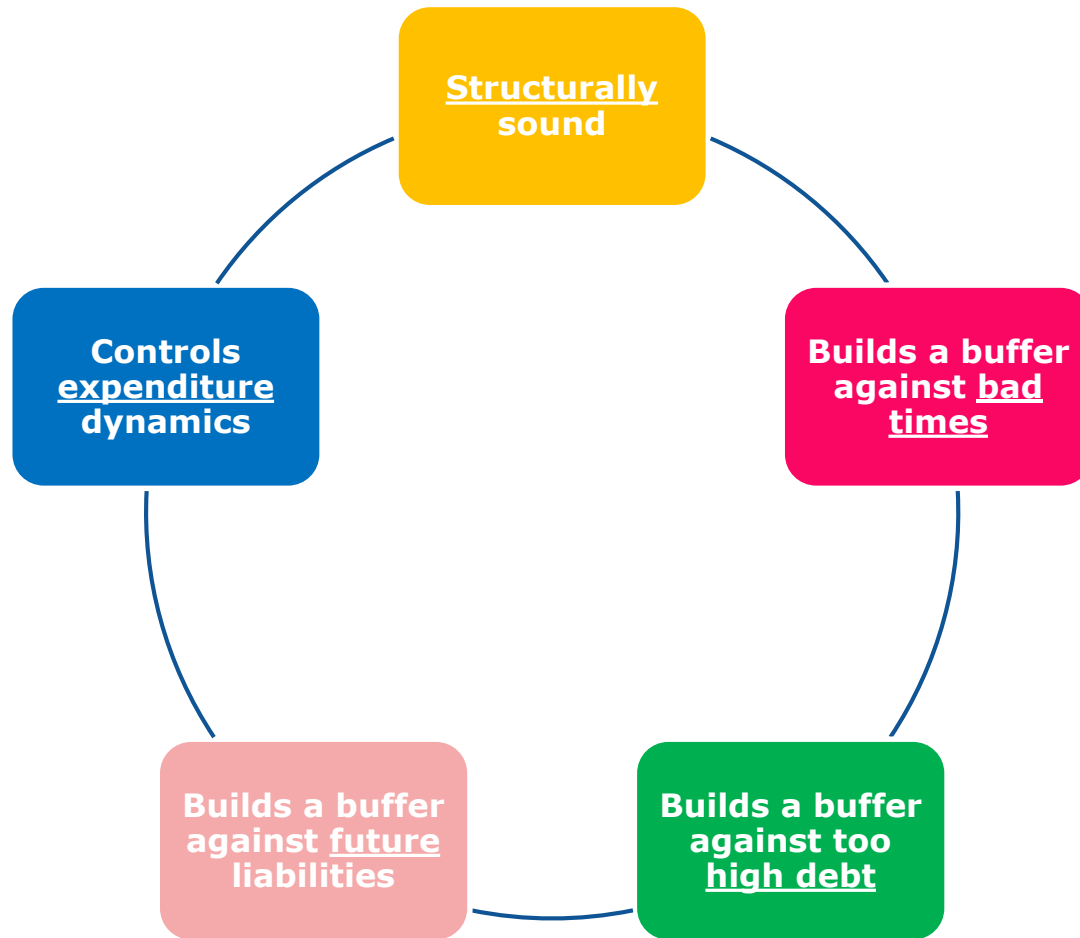
\* Member States subject to the debt rule.

# Preventive arm of the SGP: overview

Aim	Member States run prudent fiscal policies over the medium run
Legal basis	Art. 121 TFEU, Regulation 1466/97
Objective	"Close to balance or in surplus"
Operationalization	Medium-term budgetary objectives (MTO)
Requirement	At the MTO or on the path towards it
Assessment	Structural budget balance + Expenditure benchmark
Process	European Semester; SCPs
Enforcement	Significant deviation procedure



# Aim of the preventive arm: a prudent fiscal policy



# **Working of the preventive arm: The medium-term budgetary objectives**

- Country-specific target for the structural balance
- At a level that ensures:
  - (i) Safety margin with respect to the 3% threshold, also in bad times
  - (ii) Ensure sustainability or rapid progress towards it
- Euro area andERMII countries: minimum -1.0% of GDP
- Allows room for budgetary stabilisation over the cycle since it is expressed in structural terms (= excluding the impact of the economic cycle)

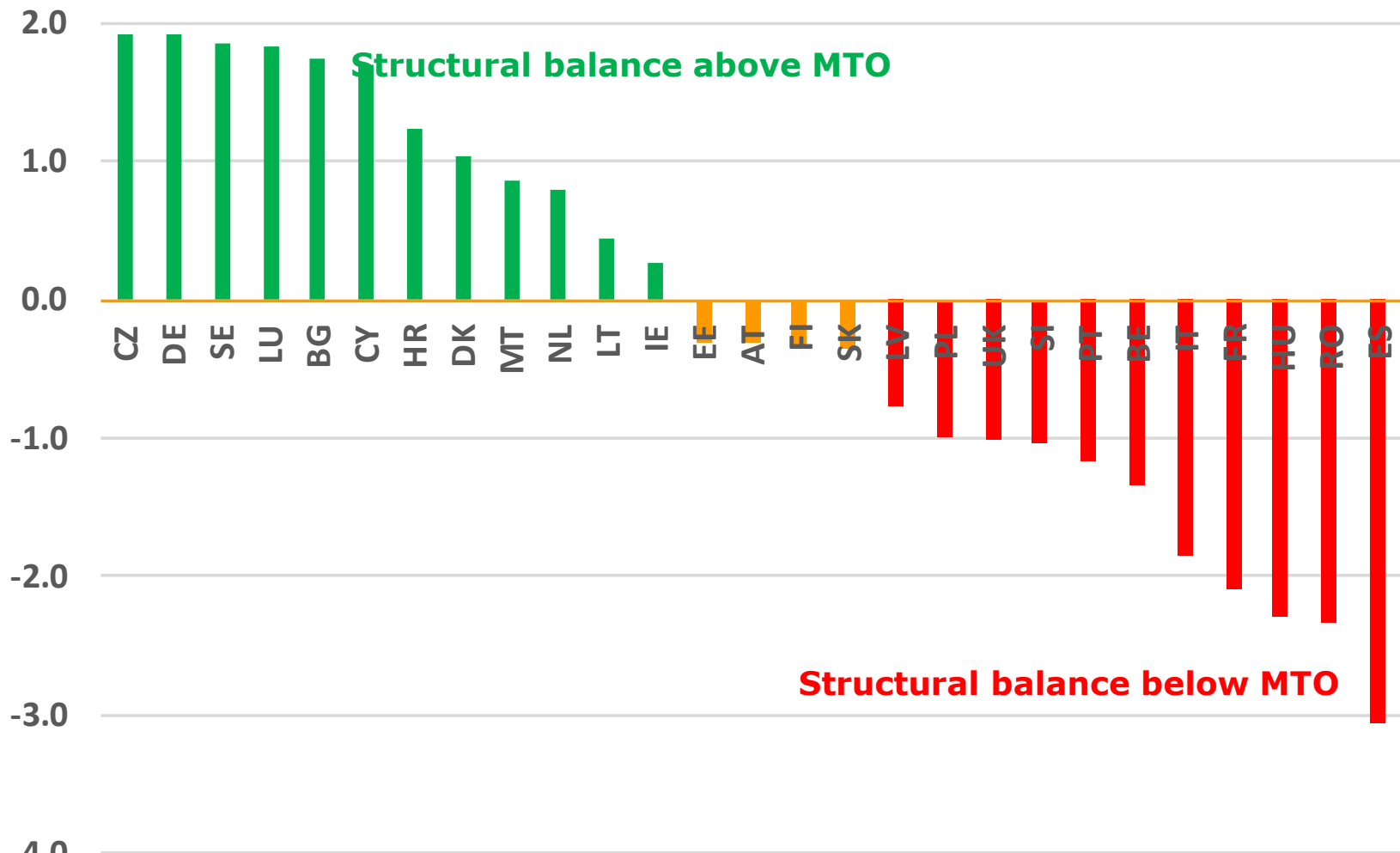
# Working: What does the Preventive Arm require Member States to do?

- If Member State at Medium Term Objective in the previous year
  - **Remain at MTO**
- If Member State NOT at MTO in the previous year:
  - **Adjust towards the MTO**
  - Required improvement of the **structural balance**:  
0.5% of GDP as a reference, less in bad times, more in good times + if high debt and/or sustainability concerns
  - Required improvement translated into an **expenditure benchmark**

# Working: Adjustment towards the MTO based on the matrix of requirements

	Condition	Required annual fiscal adjustment	
		Debt $\leq$ 60% and no sustainability risk	Debt $>$ 60% or sustainability risk
Exceptionally bad times	Real growth $< 0$ or output gap $< -4$	No adjustment needed	
Very bad times	$-4 \leq$ output gap $< -3$	0	0.25
Bad times	$-3 \leq$ output gap $< -1.5$	0 if growth below potential, 0.25 if growth above potential	0.25 if growth below potential, 0.5 if growth above potential
Normal times	$-1.5 \leq$ output gap $< 1.5$	0.5	$> 0.5$
Good times	output gap $\geq 1.5$	$> 0.5$ if growth below potential, $\geq 0.75$ if growth above potential	$\geq 0.75$ if growth below potential, $\geq 1$ if growth above potential

# Illustration: Member States' distance to their MTO (2018)



# Assessing compliance with the preventive arm requirements

- Assessment based on: **Change in structural Balance** and the **Expenditure benchmark**
  - MS that overachieved MTO: only structural balance
  - Compare observed/forecast developments with the required ones
  - Both over one year and two-year average
- Significant deviation of the MTO or the adjustment path could lead to the opening of a Significant Deviation Procedure
- Thresholds for significant deviation

Indicator \ Year	Year	
	Year $t$	$(\text{Year } t + \text{Year } t-1)/2$
Deviation SB	0.5%	0.25%
Deviation EB	0.5%	0.25%

# Working:

## The expenditure benchmark

### Analysis of government expenditure net of discretionary revenue measures

- For countries at their MTO:  
**Net expenditure must grow at most in line with potential GDP**
- For countries not at their MTO:  
**Net expenditure must grow at rate below medium-term growth rate of potential GDP**  
**Difference between two growth rates calculated to ensure structural balance improves as required (0.5% as a rule)**
- Unless excess is matched by discretionary revenue measures: **No cap on expenditure!**

## Working:

# The expenditure benchmark

## Why have an expenditure benchmark?

- Only expenditure trends can be **controlled** by government over the medium term
- Circumvent **uncertainty** surrounding the structural budget balance
- Provide **operational** guidance to MS concerning appropriate adjustment path towards the MTO
- Strengthen automatic stabilisation
  - **Expenditure on a sustainable path**
  - **Revenues are allowed to fluctuate with the economic cycle**



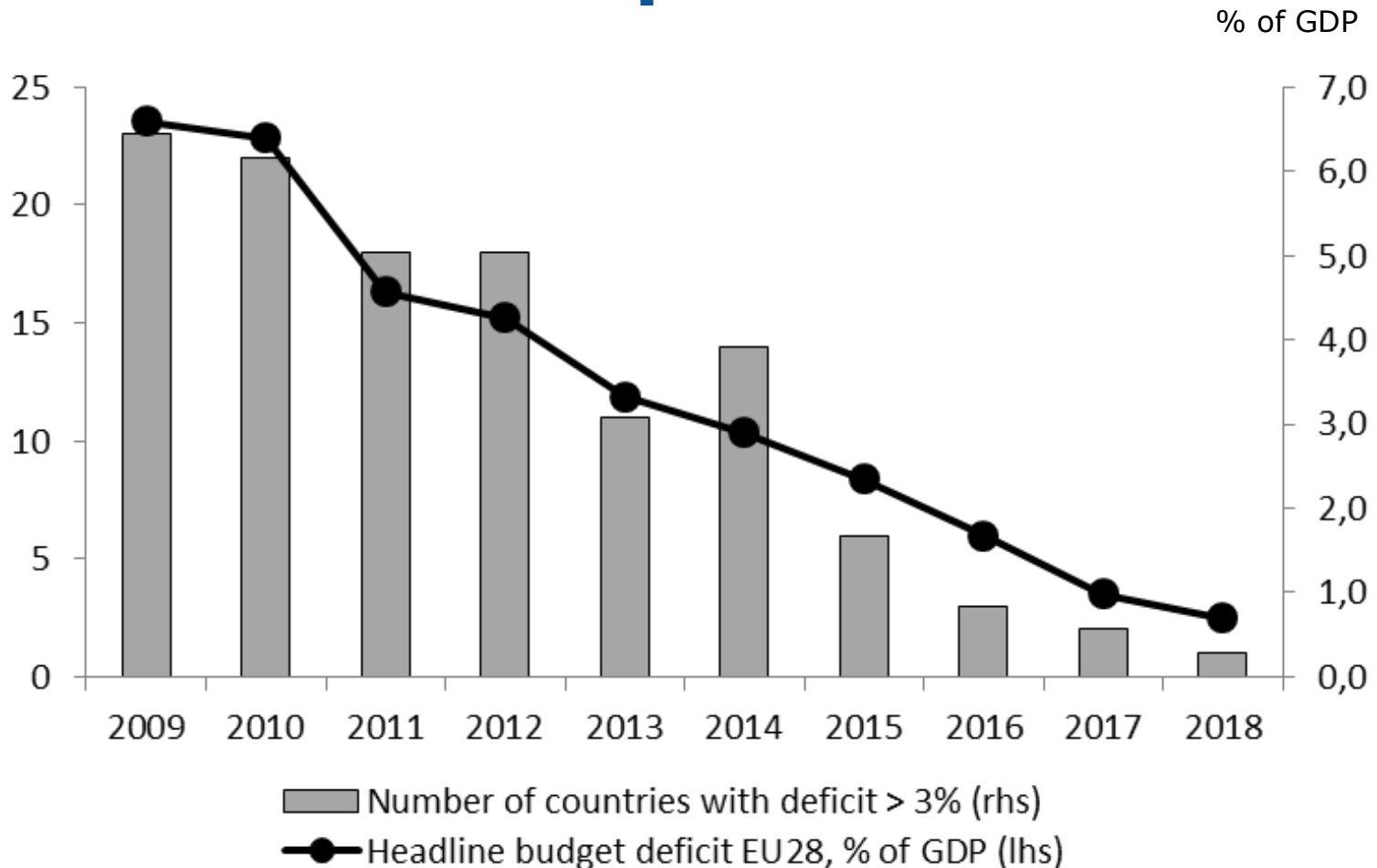
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# Corrective arm of the SGP

Aim	Correct gross policy errors (“excessive deficits”)
Legal basis	Art. 126 TFEU and Protocol 12 Regulation 1467/97
Objective	<ul style="list-style-type: none"><li>• Deficit: 3% of GDP</li><li>• Debt: 60% of GDP or sufficiently diminishing and approaching 60% at a satisfactory pace</li></ul>
Assessment	Headline balance, fiscal effort ( $\Delta$ structural balance and expenditure benchmark)
Process	Excessive Deficit Procedure: Opening – Regular monitoring – Abrogation
Enforcement	Sanctions

# Number of countries in excessive deficit procedure



# How is the debt criterion implemented?

- General government debt  $< 60\%$  of GDP **OR** sufficiently diminishing towards 60%
- "Sufficiently diminishing towards 60%" = debt reduction benchmark (introduced by Six-pack)
- Debt reduction benchmark = gap to 60% should be reduced by 5% per year on average over a period of 3 years
  - **Example: If debt is 100% of GDP, debt ratio has to decrease by 2pp per year on average over 3 year**

# The excessive deficit procedure

## Trigger



**Deficit > 3%**  
of GDP  
and/or  
**Debt > 60%**  
of GDP and not  
diminishing at  
a satisfactory  
pace

## Step 1



**Commission  
report** on the  
reasons behind  
the breach

## Step 2



**Council  
decision** on  
opening EDP  
based on  
**Commission  
opinion**

Provides  
**recommendat  
ions,  
deadlines,  
targets**

## Step 3



MS has **3-6  
months to  
comply** with  
recommenda  
tions

## Step 4

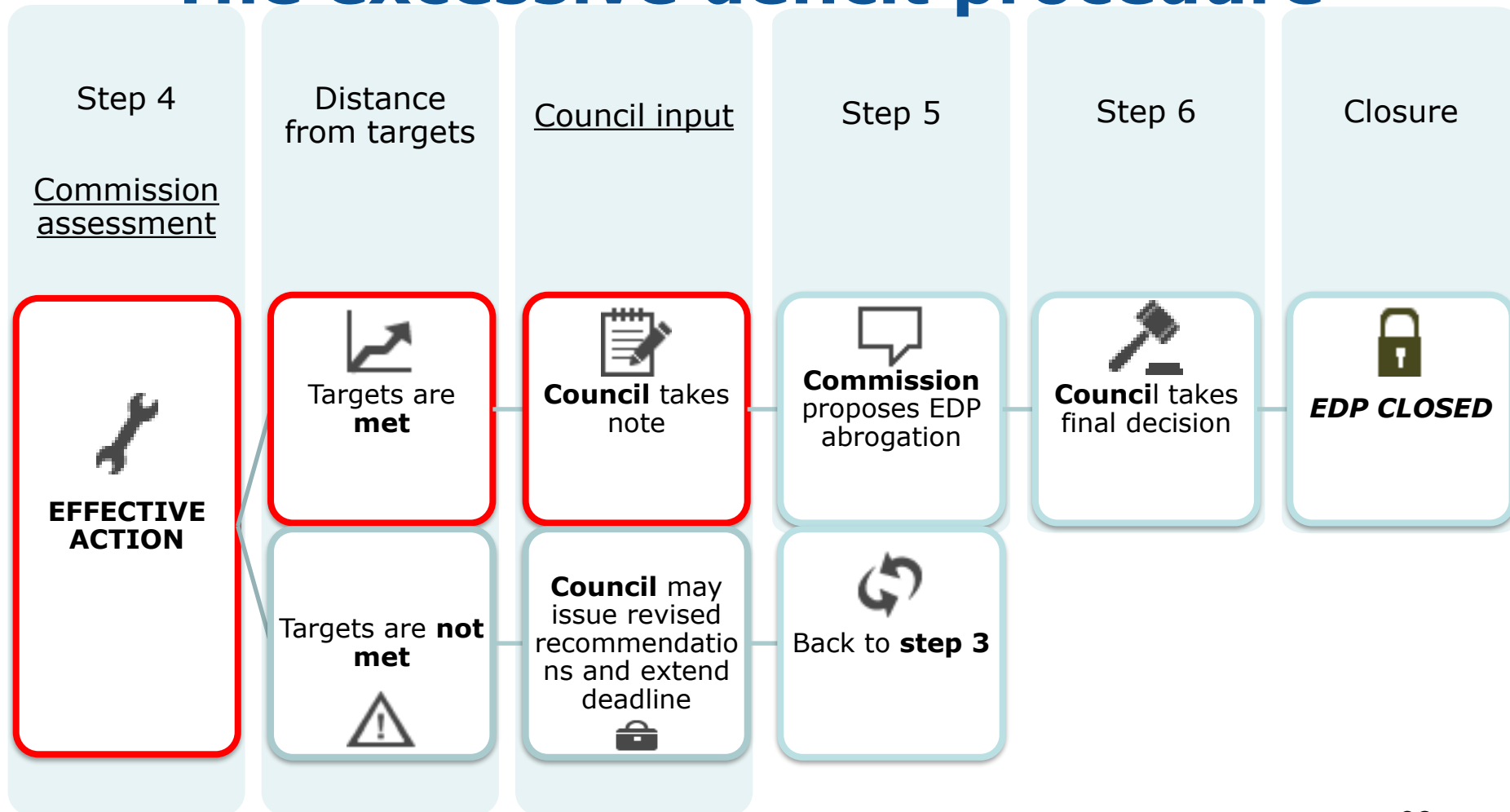


Commission  
assesses  
**'effective  
action'** and  
informs the  
Council

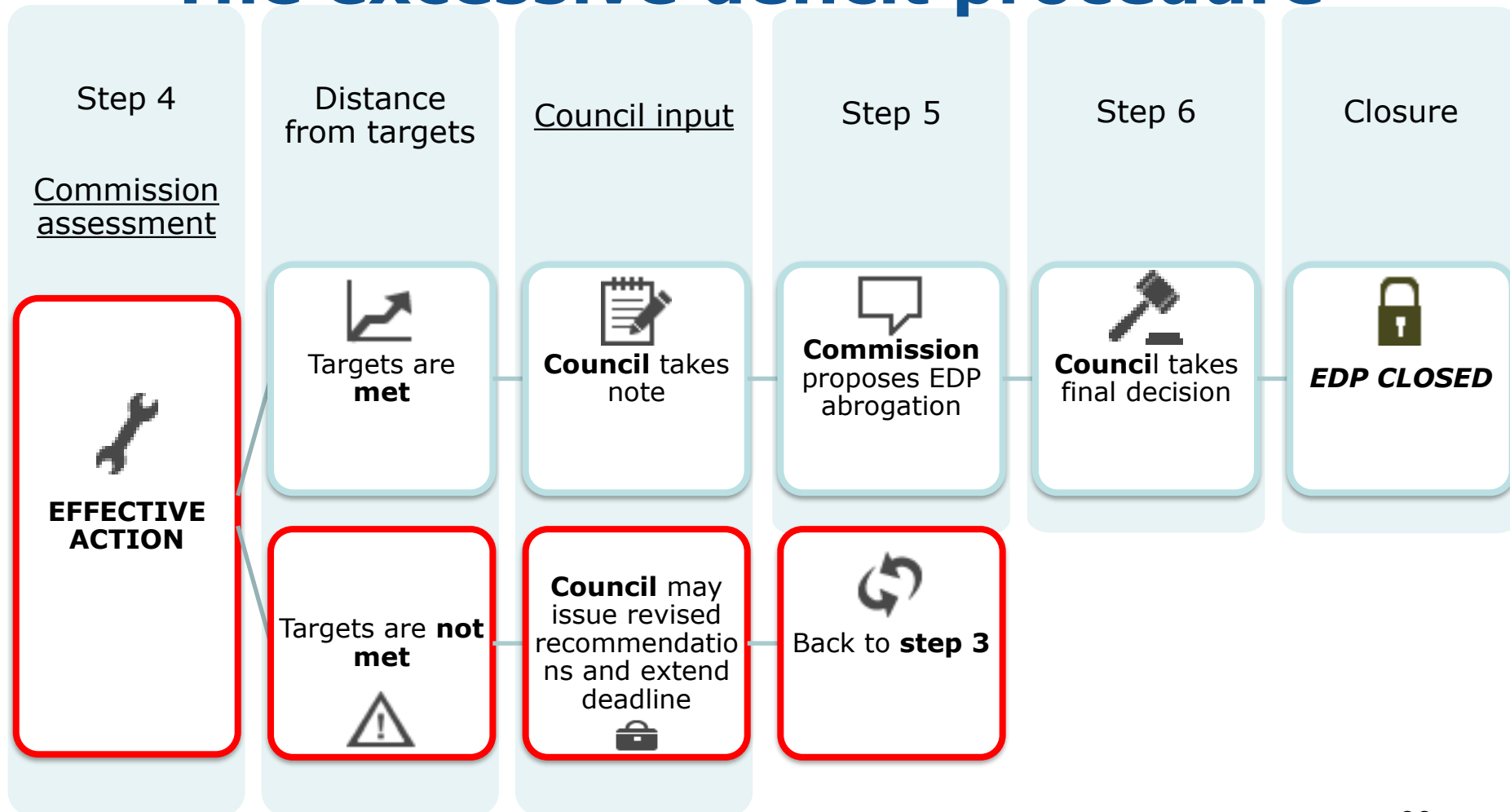
# The excessive deficit procedure

- Council recommendation with
  - **A deadline**
  - **An adjustment path (annual deficit targets)**
  - **Annual structural fiscal efforts (at least 0.5% of GDP)**
  - **Annual limit to the growth rate of net primary expenditure (EB)**
- assessment of effective action by the Commission
- Abrogation when deficit durably below 3% of GDP and compliance with forward-looking component of debt benchmark

# The excessive deficit procedure

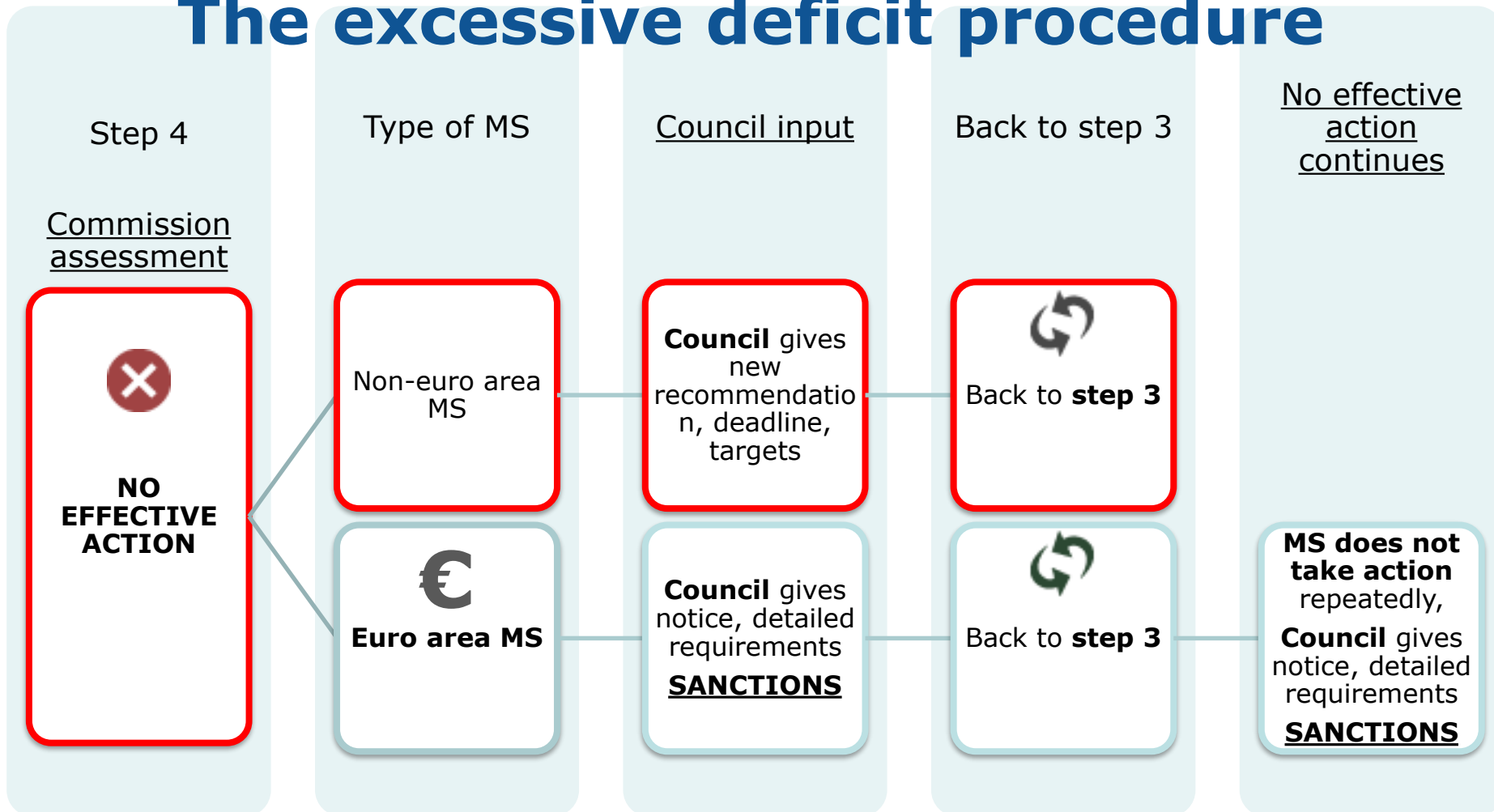


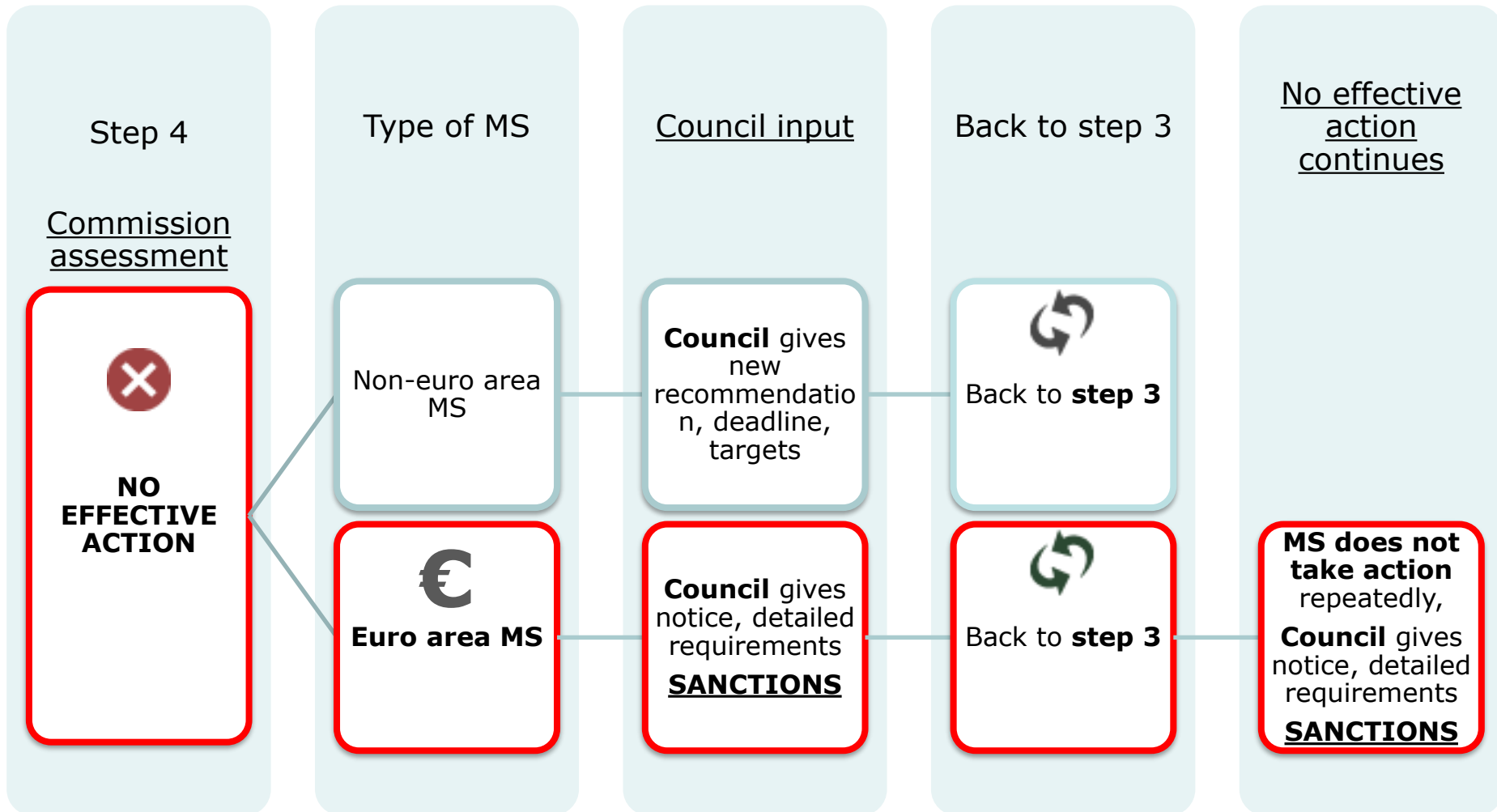
# The excessive deficit procedure





# The excessive deficit procedure





# Sanctions toolbox: euro area

When?	What?
Opening of the EDP	Non-interest-bearing deposit 0.2% of GDP
Failure to take effective action to correct the excessive deficit	Fine 0.2% of GDP
Repeated failure to take effective action to correct the excessive deficit	Fine 0.2% of GDP + variable component

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For all MS except UK: suspension of commitments or payments under the structural funds

# More reading

## SGP legislation

[https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/legal-basis-stability-and-growth-pact\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/legal-basis-stability-and-growth-pact_en)

## Vade mecum on the Stability and Growth Pact (technical handbook on the SGP)

[https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition\\_en](https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition_en)

# More reading

## Preventive arm

[https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/preventive-arm\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/preventive-arm_en)

## Excessive deficit procedure

[https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/corrective-arm-excessive-deficit-procedure\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/corrective-arm-excessive-deficit-procedure_en)

## Stability or convergence programmes

[https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/stability-and-convergence-programmes\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/stability-and-convergence-programmes_en)

## Draft Budgetary Plans

[https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries_en)



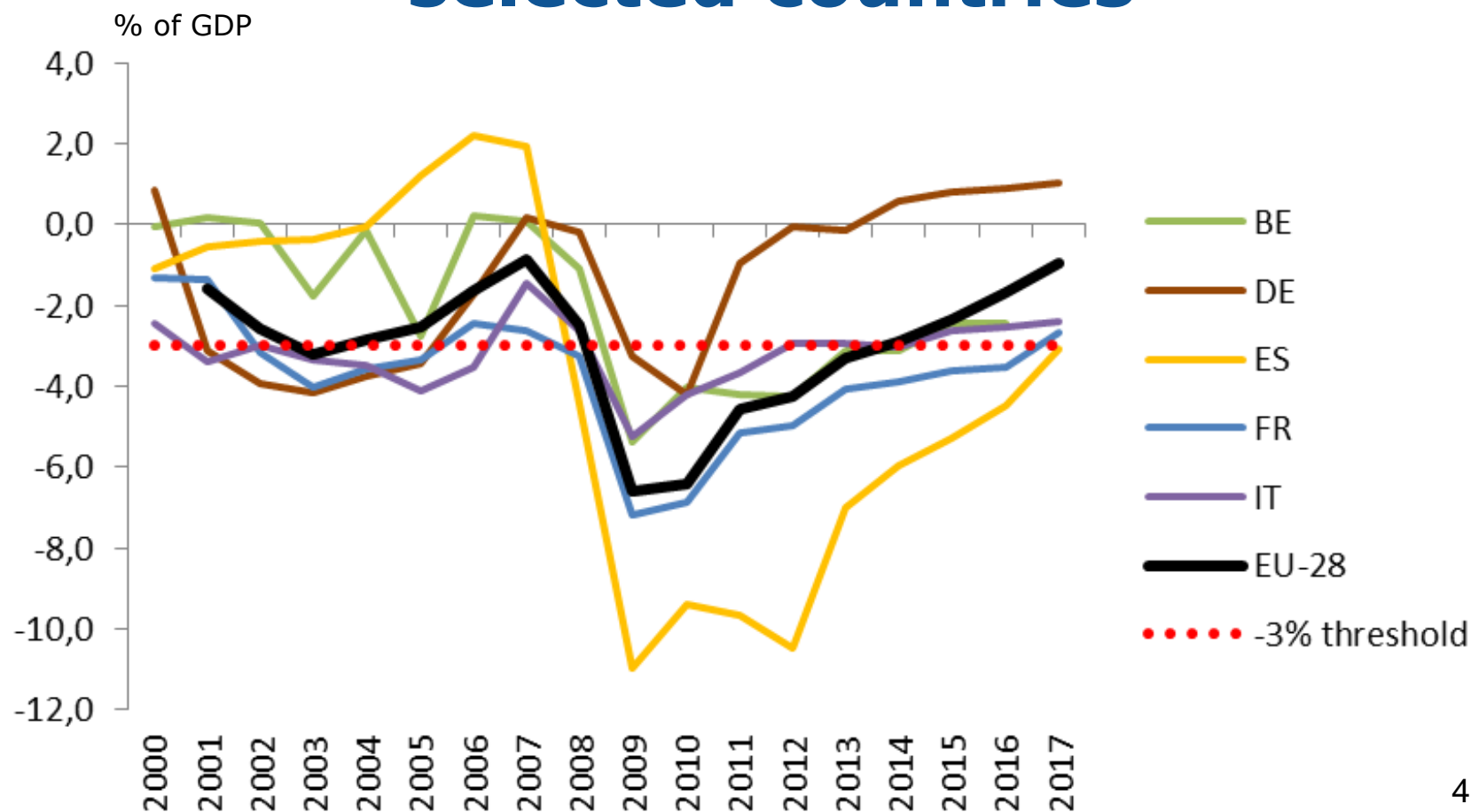
# **Thank you for your attention**

***Henk VAN NOTEN***  
***Fiscal Policy and Surveillance***  
***DG ECFIN – European Commission***

**henk.van-noten@ec.europa.eu**

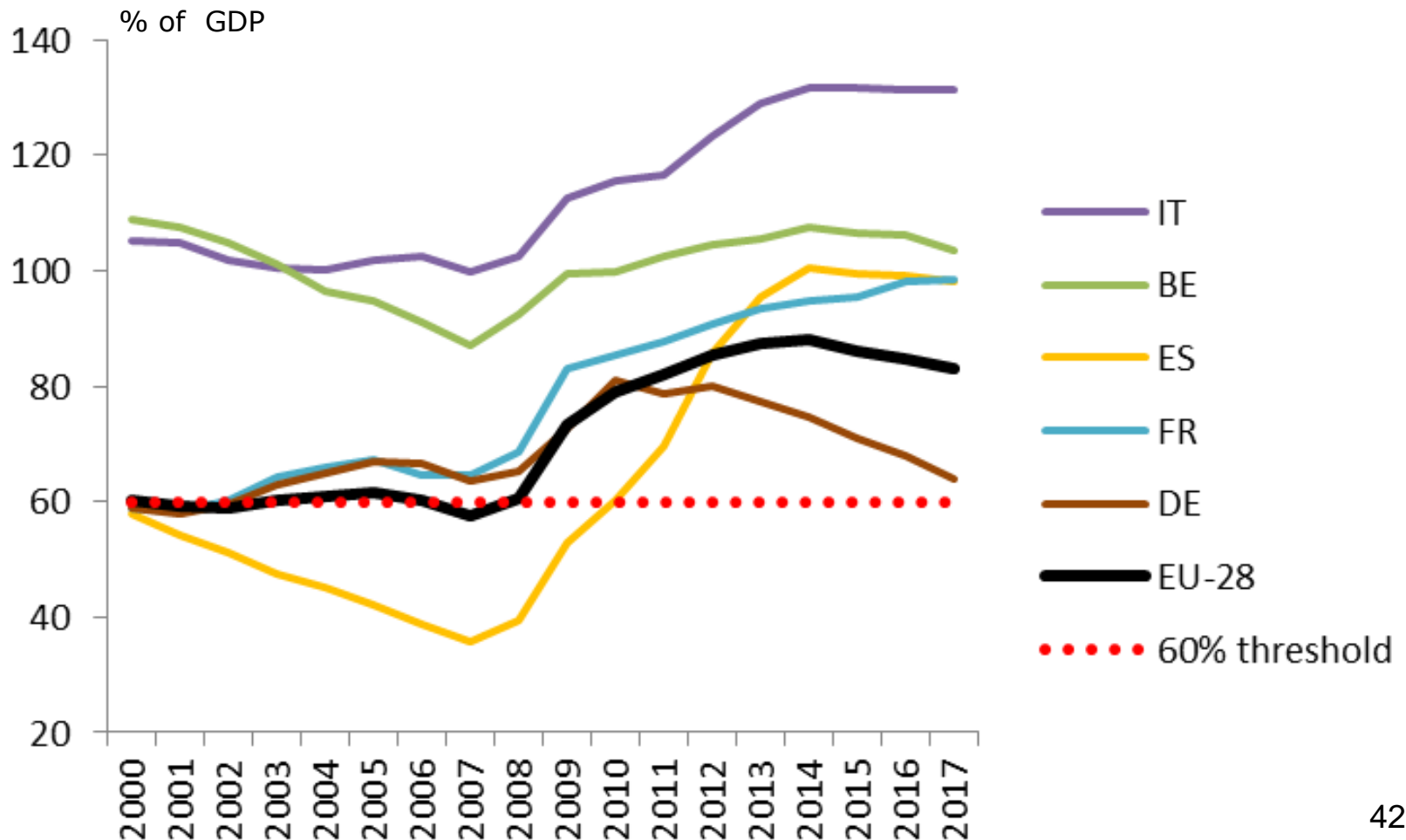
# Background

# Headline budget balance as % of GDP, selected countries





# Debt-to-GDP ratio, selected countries



# Working of the preventive arm: The structural balance

- Central concept: **structural budget balance**  
*= budget balance excluding the impact of the economic cycle and the impact of one-off factors*

IF  $\Delta SB > 0 \Rightarrow$  Fiscal position is improving

IF  $\Delta SB < 0 \Rightarrow$  Fiscal position is deteriorating

# Flexibility in the SGP

- **Commonly Agreed Position on Flexibility** – adopted in February 2016
- Provides **additional guidance**, without changing or replacing the existing rules of the Pact
- Focuses **on three specific dimensions**:
  - **Cyclical conditions**
  - **Structural reforms**
  - **Investments**, in particular in relation to the setting up of the new(ish) European Fund for Strategic Investments (EFSI)

# European Semester

- Every spring, on the basis of budgetary plans presented in Stability and Convergence Programmes and COM forecast:
  - **Ex post assessment of previous year (t-1)**
  - **In-year assessment (t)**
  - **Ex ante assessments (t+1 and beyond)**
- Assessment can trigger:
  - **Significant Deviation Procedure under Preventive Arm** (only ex post)
  - **Excessive Deficit Procedure** (if Treaty criteria not fulfilled) **or step-up**
  - **Sanctions**
- Fiscal CSRs for following year (for countries not yet at MTO):

*"Achieve the medium-term budgetary objective in 2019."*

*"Ensure that the nominal growth rate of net primary government expenditure does not exceed x% in 2019, corresponding to an annual structural adjustment of x% of GDP."*

# Draft Budgetary Plans (euro area MS)

- Every autumn, on the basis of budgetary plans presented in Draft Budgetary Plans (by 15 October) and COM forecast:
  - **In-year assessment (t)**
  - **Ex ante assessment (t+1)**
- Assessment takes the form of COM Opinions
  - **Risk assessment** ("compliant", "broadly compliant", "risk of non-compliance")
  - **Possibility of requesting revised Draft Budgetary Plan** (in case of particularly serious non-compliance with SGP)