Public finances in EMU 2006

2007/2004(INI) - 13/06/2006 - Non-legislative basic document

PURPOSE: to review implementation of the revised Stability and Growth Pact.

BACKGROUND: in 2005, the EU Heads of Government endorsed a revised Stability and Growth Pact (SGP) by approving:

- Council Regulation 1055/2005/EC *amending Regulation 1466/97/EC on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies* (for a summary see SYN/2005/0064) and

- Council Regulation 1056/2005/EC *on amending Regulation 1467/97/EC* (see CNS/2005/0061)

The 2005 SGP reform confirmed the fundamental rules and principles of the Treaty and re-established the consensus for sound fiscal policies. The 3% and 60% ceilings for government deficit and debt remain the same. The changes that have been made, however, are as follows:

- the early identification, and prompt correction of, excessive deficits;

- increased flexibility;

- the implementation of structural policies that enhance growth potential and the long-term sustainability of government finances in line with the Lisbon strategy for growth and jobs;

- the strengthening of budgetary consolidation efforts in times of economic growth;

- setting a clearer link to country-specific situations;

- making decisions in relation to the “excessive deficit procedure” based on an **overall** economic analysis; and

- increasing focus on structural fiscal consolidation rather than on short-term national results.

This new framework entered into force in summer 2005. One year on and the Commission has prepared this Communication in order to review the implementation of the revised SGP.

CONTENT: in its report, the Commission finds that experience, thus far, is positive. Overall, the budgetary adjustments have resumed and there has been a smooth and consistent implementation of the SGP procedures. Some concerns are emerging regarding the implementation of the preventative arm of the Pact and it remains unclear whether fiscal consolidation needs to be stepped up in line with upbeat growth prospects. Success will be measured on Member States’ ability to achieve fiscal adjustment in the years ahead.

Since March 2005 the Commission has had to prepare only three reports on Member States whose deficit exceeds 3% of GDP. Further, co-operation between the Commission and the Council has improved. Experience shows that by introducing more room for economic judgement in the fiscal surveillance process, the reform has stimulated a constructive and transparent economic policy dialogue at an EU level on the individual country cases. As a result peer support has been strengthened.

However, in spite of clear improvements, the Commission notes that questions remain vis-à-vis the credibility of the medium-term budgetary adjustments planned by the Member States. Experience with the original SGP highlighted, that to be credible, medium-term budgetary plans needed to be based on realistic and cautious macroeconomic forecasts and underpinned by permanent measures and structural reforms. On this point, the Commission's assessment is mixed.

An encouraging feature of the last round of Stability and Convergence Programmes is that medium-term budgetary projections are, in almost all cases, based on realistic macroeconomic assumptions. This constitutes a major improvement on previous years when budgetary forecasts were typically based on overly optimistic macroeconomic forecasts.

A further positive departure is that recourse to one-off and other temporary measures within a medium-term planning has vanished. Such measures represent less than 0.1% of the EU GDP in 2006 and are negligible in 2007 and 2008. In a number of cases, however, the measures underlying the envisaged consolidation are not sufficiently specified. The combination, in some programmes, of a back-loaded fiscal adjustment with a lack of specification of measures underlying the projected consolidation is a source of concern.

The future challenges identified by the Commission, in the years ahead, include:

- ensuring that the spirit of the reforms are followed through during good times;
- focusing on the sustainability of government finances;
- improving statistical governance;
- offering improved synergies between fiscal policy and growth; and
- supporting fiscal rules and institutions at national level.

To conclude, the one year experience with the revised SGP indicates that the EU's fiscal framework is gaining in credibility. It has permitted an enhanced economic rationale of the rules; it has increased Member State involvement in the framework; and it has introduced a more co-operative relationship amongst the participants. These developments warrant some optimism regarding future implementation plans.