



**COUNCIL OF
THE EUROPEAN UNION**



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Council reaches agreement on measures to strengthen economic governance

The Council today¹ agreed a general approach on a package of measures aimed at strengthening economic governance in the EU – and more specifically in the euro area – as part of the EU's response to the challenges highlighted by recent turmoil on sovereign debt markets.

The agreement will enable the presidency to start negotiations with the European Parliament, with the aim of reaching an overall agreement in June, thus respecting the timetable set by the European Council.

Recognising that existing EU instruments did not generate a satisfactory decline of public debt and catered insufficiently for macroeconomic imbalances, the proposals are aimed at enhancing budgetary discipline in the member states and broadening the surveillance of their economic policies. They translate the recommendations of a task force on economic governance, chaired by the President of the European Council, Herman Van Rompuy², which concluded that the EU's monetary union will not be able to function properly in the long term without increased economic coordination.

Four of the proposals deal with reform of the EU's Stability and Growth Pact. They are aimed at enhancing the surveillance of fiscal policies, introducing provisions on national fiscal frameworks, and applying enforcement measures for non-compliant member states more consistently and at an earlier stage. The other two proposals target macroeconomic imbalances within the EU.

¹ At a meeting of the Economic and Financial Affairs Council.

² Final report of the task force, 21 October 2010:

http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/117236.pdf

P R E S S

The package consists of:

- a draft regulation amending regulation 1466/97 on the surveillance of member states budgetary and economic policies;
- a draft regulation amending regulation 1467/97 on the EU's excessive deficit procedure;
- a draft regulation on the enforcement of budgetary surveillance in the euro area;
- a draft regulation on the prevention and correction of macroeconomic imbalances;
- a draft regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area;
- a draft directive on requirements for the member states' budgetary frameworks.

Reform of the Stability and Growth Pact

- Preventive arm of the pact

To promote attainment by the member states of their medium term objectives (MTOs), the reform would introduce an expenditure benchmark, which implies that annual expenditure growth should not exceed a reference medium-term rate of GDP growth. This is meant to ensure that revenue windfalls are not spent but instead allocated to debt reduction. If a member state has not reached its MTO, a significant deviation in expenditure development from its reference expenditure growth path could eventually lead to sanctions.

- Corrective arm of the pact (excessive deficit procedure)

Greater emphasis would also be placed on the debt criterion of the Stability and Growth Pact, with member states whose debt exceeds 60% of GDP (the EU's reference value for debt) required to take steps to reduce their debt at a pre-defined pace, even if their deficit is below 3% of GDP (the EU's deficit reference value).

To determine whether the debt ratio is sufficiently diminishing toward the 60% of GDP threshold, a numerical benchmark would be introduced. A debt-to-GDP ratio above 60% would thus be considered sufficiently diminishing if its distance with respect to the 60% reference value had decreased over the previous three years at an annual rate of one-twentieth. However, a decision to subject a country to the excessive deficit procedure would not only be based on the numerical benchmark, but would also take into account other relevant factors, such as implicit liabilities related to private sector debt and ageing cost. The net cost of implementation of a pension reform would also be considered.

To strengthen the corrective arm of the Stability and Growth Pact, a new set of financial sanctions would be introduced for euro-area member states; these would apply earlier on in the excessive deficit procedure, and using a graduated approach. A non-interest-bearing deposit amounting to 0.2% of GDP may be imposed already when decision has been taken to subject a country to the excessive deficit procedure. If the Council's recommendation for correcting the deficit is not followed, a fine will be imposed. Further non-compliance would result in the sanction being stepped up, in line with the existing provisions in the Stability and Growth Pact.

To trigger the sanction more automatically than at present, a so-called reverse majority rule would be introduced, whereby the Commission's proposal for imposing a deposit or a fine would be considered adopted unless turned down by the Council via qualified majority.

Alongside the reform of the Stability and Growth Pact, the draft directive sets out to ensure that the objectives of EU budgetary coordination are reflected in the member states' budgetary frameworks. Accounting, statistical and forecasting practices will be brought into line with EU standards. Member states will adopt multi-annual fiscal planning to ensure that the medium-term objectives set at EU level are achieved. They will also introduce rules to promote compliance with the deficit and debt thresholds.

Surveillance of economic policies

Beyond budgetary surveillance, the legislative package is aimed at broadening the surveillance of the member states' economic policies.

It would establish a mechanism for the prevention and correction of excessive macroeconomic imbalances, made up of two regulations which outline an "excessive imbalance procedure" and introduce the possibility of fines being imposed on member states found to be in an "excessive imbalance position" and repeatedly failing to comply with recommendations.

The starting point of the new framework will be an alert mechanism for the early detection of imbalances, which will be assessed using a "scoreboard" of economic indicators. This will be supplemented by country-specific qualitative expert analysis.

If the imbalance is considered to be excessive, the member state concerned could be subject to an excessive imbalance procedure, and would be called on to adopt a corrective action plan within a specific timeframe. The procedure would give the Council more flexibility in setting deadlines than for the excessive deficit procedure in order to account for the less direct influence of government policies in addressing imbalances.

If the Council decided that the member state concerned has taken appropriate action, the procedure would be held in abeyance and could be closed if the Council concluded that the imbalance was no longer considered to be excessive.

On the other hand, repeated non-compliance with the recommendations could in the case of euro area member states eventually lead to sanctions. Specifically, a decision to impose a yearly fine equal to 0.1 % of the member state's GDP would be adopted through the "reverse majority" rule described above.

Fines collected in the context of both the excessive imbalance and excessive deficit procedures would be transferred to the crisis fund created for the euro area to provide financial assistance to member states in difficulty (i.e. the European Financial Stability Facility and the future European Stability Mechanism).