Fiscal Monitoring in the Euro-Area

Since the introduction of the Euro, monetary policy has been centralised while fiscal and wage policies have not. For fiscal policy, however, the Stability and Growth Pact of 1997 (Maastricht Treaty) sets up a monitoring and intervention mechanism that aims at reducing budget deficits and public debt levels in order to support (or at least not to counteract) the monetary policy measures of the European Central Bank. This mechanism rests essentially on three pillars, which are described in the table:

– A medium-term early warning mechanism (Stability Programmes),
– a short-term system for monitoring the implementation of the Stability Programmes
– and an Excessive Deficit Procedure.

Fiscal Monitoring in the Euro Area: Three Pillars

Early Warning Mechanism	**Implementation of the Stability Programmes**	**Excessive Deficit Procedure (abbreviated version)**
1. **Annual submission** (before 1 March) of **"Stability Programmes"** (Euro countries) and of **"Convergence Programmes"** (non-Euro EU member) to ECOFIN Council, to EFC and to EC. **Content** (for both types of programmes): • medium-term development of budgetary position; target according to "Pact": close to balance or in surplus • main underlying assumptions • relevant budgetary and other economic policy measures • sensitivity analysis of changes in the main economic assumptions • coverage of preceding, current and at least 3 following years. 2. EC and EFC elaborate (separately) assessments of the programmes. 3. ECOFIN Council examines - on the basis of these assessments and within at most 2 months after submission of the programme • whether the medium-term budget objectives provide for a safety margin to avoid an **excessive deficit** • whether the assumptions are realistic • whether the measures are sufficient. 4. If ECOFIN Council considers that the objectives and contents of a programme should be strengthened, the Council "shall ... invite the member state concerned to adjust its programme." (1466/97; Art. 5,2)	1. **Semi-annually** (1 March and 1 September) submission of **budgetary data** by member states to EC. 2. EC and EFC examine (separately) budgetary data, whether they comply with budgetary discipline, i.e. whether there is (a risk of) an **excessive deficit.** **Two cases of "budgetary discipline"** • Budget deficit < 3 % and: debt < 60 % or sufficiently diminishing or approaching the reference value (60%) at a satisfactory pace • Budgetdeficit > 3 %, but: the deficit is not regarded as excessive, because it is exceptional and temporary and close to the reference value and: debt ratio is sufficiently diminishing or approaching the reference value at a satisfactory pace 3. If the EC sees (risk of) an excessive deficit, the **Excessive Deficit Procedure** (EDP) is started.	1. If there is (a risk of) an excessive deficit, ECOFIN Council is informed by EC and EFC. 2. ECOFIN Council (11 euro-area countries + 4 non-euro-area countries; together 87 votes)[a] decides by qualified majority (i.e. 2/3 of 87) whether the deficit is excessive or not. 3. If the deficit is held to be excessive, recommendations (not published) are made to the member state concerned. 4. ECOFIN Council assesses the effectiveness of the measures announced by the member state. 5. If the measures are regarded as ineffective or not implemented, ECOFIN Council may make its recommendations public and give notice to take own measures. 6. If the excessive deficit persists - due to non-implementation or despite implementation - ECOFIN Council applies **sanctions** on the member state concerned. 7. Sanctions will consist in a non-interest bearing deposit of 0.2 % of GDP (fixed component) + a variable component of 1/10 of the difference between factual deficit/GDP and the reference value (3%). 0.5 % of GDP is the upper limit for the deposit. The deposit might be converted into a fine if the excessive deficit has not been corrected within 2 years. a) Number and distribution of votes will change on 1 January 2005 according to article 3 of the enlargement protocol adopted in 2001 at Nice.

Notes: EC: European Commission; EFC: Economic and Financial Committee; ECOFIN Council: Council of Ministers of Economic and Financial Affairs.

Source: CESifo on the basis of the "Stability and Growth Pact", June 1997.

The institutions charged with implementing the monitoring and intervention system are the European Commission (EC), the Economic and Financial Committee and the ECOFIN Council. The European Central Bank plays an important role in critically analysing the most recent versions of the Stability Programmes as well as the most recent budgetary performance of the euro-area countries.

From the outset of the Maastricht Treaty, economists have criticised the narrow, inflexible and unclear definition of "budgetary discipline". According to the Treaty, budgetary discipline (see table) may not exist with a budget deficit of less than the famous 3 percent of GDP, but it may exist with a budget deficit that is higher than 3 percent. The latter case depends on whether the deficit is regarded as not "excessive", namely exceptional, temporary and close to 3 percent. Thus, business cycle fluctuations are taken into consideration by the Treaty, but in a poorly defined manner. Instead, one should consider the *cyclically adjusted (or structural) budget deficit.*

The – more or less informal – consensus that has now been formed in Europe relates the 3 percent budget deficit rule to the cyclically adjusted budget. That means: if the total deficit (e.g. due to a business cycle downswing) exceeds the 3 percent limit but the structural deficit does not, the deficit is not regarded as excessive.

However, some countries, like France and Germany, experience even structural budget deficits which have been in 2002 at around 3 percent (total deficit of around 3.7 percent). A consensus in Europe has been reached that in such cases an excessive deficit procedure can only be avoided if the structural deficit is reduced by at least 0.5 percentage points per year.

The current period of weak growth in several European countries shows that the past efforts and achievements – during better times – in reducing the budget deficits have not been courageous enough to provide sufficient leeway for counteracting a business cycle downswing.

For further information see DICE Database, especially the following tables:
Fiscal Monitoring in the Euro Area: Procedure with an Excessive Deficit;
Stability Programmes and Stability Performance of the Euro Member States;
Cyclically Adjusted Net Lending or Net Borrowing in Europe.

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