The Stability and Growth Pact

Governments have an income and expenditure budget in just the same way as individuals. And if their outgoings exceed the money coming in, they get into debt. At the start of the process of European Monetary Union, the public finances of certain Member States were none too good. It was feared that this might impede the success of the Union.

To prevent Member States from slackening off their budgetary discipline after having joined the euro area and thus from threatening the smooth functioning of Economic and Monetary Union, a Stability and Growth Pact was endorsed at the European Council meeting in Amsterdam in June 1997.

By signing this pact, the Member States of the European Union at the time undertook to ensure a moreorless balanced budget over the medium term. The euro area countries were required to present their respective stability programmes by 1 March 1999 and, in order to guarantee some degree of continuity, update them every year. Member States that did not want to participate in the third stage of EMU for the time being and which have therefore not yet adopted the euro, like the United Kingdom, Denmark and Sweden, have to produce a convergence programme, just like the countries that joined the EU after 1997.

The pact, which consists of a set of rules for coordinating national fiscal policies, has both a preventive and dissuasive objective. The annual stability and convergence programmes have to show that the medium-term fiscal situation is sound and will remain so, even when taking account of the effects of population ageing. As soon as the European Commission notices that a Member State is moving towards an "excessive" deficit, it can ask the Council to give an early warning signal. By giving out its own economic policy advice, the Commission can also order them to respect the commitments that they have made under the pact.

A Member State that fails to take the necessary measures to halt an excessive deficit situation incurs sanctions. To start with, the penalty will take the form of a non-interest-bearing deposit with the European Commission, but it can then be converted into a fine if the excessive deficit is not corrected within the following two years. The European Investment Bank can also play a role in the sanctions policy by granting less credit to the Member State in question. Sanctions are nevertheless not automatic. They are only imposed after the Council has taken all circumstances into consideration.

The new fiscal compact or "the Treaty on Stability, Coordination and governance" entered into force 1 January 2013 and goes one step further.

It comprises a thorough reviewing of the budgetary objectives, forges new alliances between the euro area Member States for fiscal control and can correct via automatic sanctions.

For more information:

- G. LANGENUS, **The Stability and Growth Pact: an eventful history**, NBB, Economic Review, June 2005
- Information sheets: Fiscal policy, n. 4
  The Maastricht Treaty, n. 18