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EU Economic governance "Six-Pack" enters into force

On 13th December 2011, the reinforced Stability and Growth Pact (SGP) enters into force with a new set of rules for economic and fiscal surveillance. These new measures, the so-called "Six-Pack", are made of five regulations and one directive proposed by the European Commission and approved by all 27 Member States and the European Parliament last October. This change represents the most comprehensive reinforcement of economic governance in the EU and the euro area since the launch of the Economic Monetary Union almost 20 years ago. In line with 8-9 December European Summit agreements, the legislative package already brings a concrete and decisive step towards ensuring fiscal discipline, helping to stabilise the EU economy and preventing a new crisis in the EU.

The economic and financial crisis exacerbated the pressure on the public finances of EU Member States. Today, 23 out of the 27 Member States are in the so-called “excessive deficit procedure” (EDP), a mechanism established in the EU Treaties obliging countries to keep their budget deficits below 3% of GDP and government debt below (or sufficiently declining towards) 60% of GDP. Member States currently in excessive deficit procedure must comply with the recommendations and deadlines decided by the EU Council to correct their excessive deficit.

The European Parliament and the Council adopted a package of six new legislative acts, upon a proposal by the European Commission and which will come into force on 13 December 2011. It represents a major step towards economic stability, restoring confidence and preventing future crises in the euro area and the EU..

Deficit

From 13 December 2011 onwards, financial sanctions will apply to euro area Member States that do not take adequate action. Member States currently in excessive deficit procedure should comply with the specific recommendations the Council addressed to them to correct their excessive deficit. In case a euro area Member States does not respect its obligations, a financial sanction can be imposed by the Council on the basis of a Commission recommendation, unless a qualified majority of Member States vote against it. This is the so-called “reverse qualified majority” voting procedure[1], which makes the enforcement of the rules stricter and more automatic, therefore more dissuasive and credible. Such a financial sanction can be activated at any moment after 13 December, if and when the conditions are met.

1 In case the Member State concerned faces a notice under Article 126(9), the financial sanction will be adopted by qualified majority voting as foreseen by the Treaty.

Public debt

The new rules of the amended Stability and Growth Pact make the debt criterion of the Treaty absolutely operational, since it has been largely neglected over the past years. Another major element of the new rules is that a new numerical debt benchmark has been defined: if the 60% reference for the debt-to-GDP ratio is not respected, the Member State concerned will be put in excessive deficit procedure (even if its deficit is below 3%!), after taking into account all relevant factors and the impact of the economic cycle, if the gap between its debt level and the 60% reference is not reduced by 1/20th annually (on average over 3 years).

Given that that most Member States are already in excessive deficit procedure, and therefore have to comply with agreed fiscal consolidation paths, a transitional period is foreseen in the amended legislation to ensure no abrupt change in these agreed paths. Accordingly, each Member State in excessive deficit procedure is granted a three-year period following the correction of the excessive deficit for meeting the debt rule. This does not mean that the debt rule does not apply at all during this period as the amended Regulation foresees that Member States should make sufficient progress towards compliance during this transitional period. A negative assessment of the progress made towards compliance with the debt benchmark during the transition period could lead to the opening of an excessive deficit procedure. Sufficient progress towards compliance with the debt rule should start on 13 December 2011, depending on country-specific deadlines for correction of their excessive deficit.

The expenditure benchmark under the preventive arm of the Pact

The preventive arm of the Stability and Growth Pact guides Member States towards a country-specific, medium-term budgetary objective (MTO) which sets out to ensure public finance sustainability. The new rules define a new 'expenditure benchmark' to help assess progress towards these MTOs. This expenditure benchmark places a cap on the annual growth of public expenditure according to a medium-term rate of growth. For Member States that have not yet reached their MTO, the rate of growth of expenditure should be below this reference rate in order to ensure adequate progress.

This new instrument will improve the budgetary planning and outcomes of Member States by ensuring that expenditure plans are adequately resourced by equivalent permanent revenues. However, it does not constrain, in any way, the level of public expenditure, as long as it is financed effectively.

The provisions of the preventive arm of the Pact provide the main guidance for budgetary planning and budgetary execution by Member States when they are not subject to an excessive deficit procedure. Today, this is only the case for Estonia, Finland, Luxembourg and Sweden. All the other EU member States are in the corrective arm.

Effective enforcement of the rules is as important as the rules themselves. This equally applies to the preventive arm. The amended Stability and Growth Pact allows stronger action when the budgetary execution of a Member State deviates significantly. In order to enforce this rule, deviations have been quantified and can lead to a financial sanction (an interest-bearing deposit of 0.2% of GDP as a rule) in case of continuous non-correction. Such a sanction is proposed by the Commission and adopted by “reverse qualified majority” voting in the Council.

Furthermore, if its budgetary plans do not comply with the provisions of the preventive arm, a Member State can be requested to present new plans that do comply. Member States not in EDP will have to demonstrate compliance with the provisions of the preventive arm in their next stability or convergence programmes as of next Spring 2012, in the context of the European Semester. Member States under EDP should show compliance after the correction of their excessive deficit.

Reducing macro-economic imbalances

Over the past decade, the EU has registered serious gaps in competitiveness and major macroeconomic imbalances. A new surveillance and enforcement mechanism has been set up to identify and correct such issues much earlier: the Excessive Imbalances Procedure (EIP), based on Article 121.6 of the Treaty. It will rely on the following main elements:

- **Preventive and corrective action**: The new procedure allows the Commission and the Council to adopt preventive recommendations under article 121.2 of the Treaty at an early stage before the imbalances become large. In more serious cases, there is also a corrective arm where an excessive imbalance procedure can be opened for a Member State. In this case, the Member State concerned will have to submit a corrective action plan with a clear roadmap and deadlines for implementing corrective action. Surveillance will be stepped up by the Commission on the basis of regular progress reports submitted by the Member States concerned.

- **Rigorous enforcement**: A new enforcement regime is established for euro area countries. It consists of a two-step approach whereby an interest-bearing deposit can be imposed after one failure to comply with the recommended corrective action. After a second compliance failure, this interest-bearing deposit can be converted into a fine (up to 0.1% of GDP). Sanctions can also be imposed for failing twice to submit a sufficient corrective action plan. The decision-making process in the new regulations is streamlined by prescribing the use of reverse qualified majority voting to take all the relevant decisions leading up to sanctions. This semi-automatic decision-making procedure makes it very difficult for Member States to form a blocking majority.

- An early warning system: an alert system is established based on an economic reading of a scoreboard consisting of a set of ten indicators covering the major sources of macro-economic imbalances. The composition of the scoreboard indicators may evolve over time. The aim of the scoreboard is to trigger in-depth studies which will do deep dive analyses to determine whether the potential imbalances identified in the early-warning system are benign or problematic. The Commission can organise missions, with the ECB if appropriate, to conduct the in-depth reviews which shall be made public.

Planned scoreboard

- 3 year backward moving average of the current account balance as a percent of GDP, with the a threshold of +6% of GDP and - 4% of GDP;
- net international investment position as a percent of GDP, with a threshold of -35% of GDP;
- 5 years percentage change of export market shares measured in values, with a threshold of -6%;
- 3 years percentage change in nominal unit labour cost, with thresholds of +9% for euro-area countries and +12% for non-euro-area countries.
- 3 years percentage change of the real effective exchange rates based on HICP/CPI deflators, relative to 35 other industrial countries, with thresholds of -/+5% for euro-area countries and -/+11% for non-euro-area countries;

- private sector debt in % of GDP with a threshold of 160%;
- private sector credit flow in % of GDP with a threshold of 15%;
- year-on-year changes in house prices relative to a Eurostat consumption deflator, with a threshold of 6%;
- general government sector debt in % of GDP with a threshold of 60%;
- 3-year backward moving average of unemployment rate, with the threshold of 10%.

More information:

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Enforcement measures underpinning the SGP in the euro area		
Trigger of the sanction	**Sanction**	**Adoption**
Council decision establishing failure to take action in response to a Council recommendation under Art. 121(4).	Interest-bearing deposit (as a rule 0.2% of GDP)	Reverse Qualified I Voting
Council decision based on Art.126(6) of the Treaty (i.e. existence of an excessive deficit), only if the Member States had already lodged an interest-bearing deposit (i.e. in case of non-compliance with the preventive arm provisions) or in case of particularly serious non-compliance with the rules	Non-interest-bearing deposit (as a rule 0.2% of GDP)	Reverse Qualified I Voting
Council decision based on Art.126(8) of the Treaty (i.e. non-effective action in response to the recommendation to correct the excessive deficit under Art. 126(7))	Fine (as a rule 0.2% of GDP)	Reverse Qualified I Voting
Council decision based on Art.126(11) of the Treaty (i.e. non-effective action in response to the notice to correct the excessive deficit under Art. 126(9))	Fine 0.2% of GDP + variable component)	Qualified Majo Voting

Member States	Deadline for EDP Correction (when applicable)	2011 projections Commission services Autumn 2011 forecast (% of GDP)		End of transition period for the numerical debt reduction benchmark (when applicable, only for Member States with debt-to-GDP ratio above 60%)
		General government debt	General government balances	
Member States not currently subject to an excessive deficit procedure				
FI		46.7	-1.0	
SE		37.6	0.9	
LU		18.4	-0.6	
EE		5.7	0.8	
Ongoing excessive deficit procedures				
HU	2011	73.4	3.6	2014
MT	2011	67.8	-3.0	2014
BG	2011	17.5	-2.5	
IT	2012	120.6	-4.0	2015
BE	2012	96.2	-3.6	2015
CY	2012	65.3	-6.7	2015
PL	2012	56.7	-5.6	
LV	2012	45.6	-4.2	
LT	2012	39.9	-5.0	
RO	2012	33.7	-4.9	
PT	2013	99.4	-5.8	2016
FR	2013	85.1	-5.8	2016
DE	2013	81.8	-1.3	2016
AT	2013	72.3	-3.4	2016
NL	2013	65.0	-4.3	2016
ES	2013	64.8	-6.6	2016
DK	2013	46.4	-4.0	
SK	2013	44.4	-5.8	
SI	2013	43.1	-5.7	
CZ	2013	41.7	-4.1	
EL	2014	156.9	-8.9	2017
UK	2014/15	85.2	-9.4	2017
IE	2015	106.1	-10.3	2018