CIVITAS

Stability and Growth Pact

Introduction

The nineteen EU members that use the Euro as their currency agree to keep the amount they spend and borrow under control in order to help create stable conditions for the new currency. This agreement is called the Stability and Growth Pact (SGP). However, several Eurozone members have not kept to the rules, so the SGP was reformed in 2005 to allow countries more flexibility and again in 2011 to tighten the rules. Given the uneven performance of the new currency, the failure of the original SGP has been widely criticised.

History

The Maastricht Treaty (1992) set rules for all countries to reach in order to achieve Economic and Monetary Union (EMU): low inflation, low interest rates and controlled public debt and spending. The SGP, agreed in 1997, said that the same rules should apply once the Euro was launched. All EU members had to take part, but some, like Britain, who had decided not to use the Euro were not bound by the penalties.

How does the SGP work?

The original SGP said that all countries in the Eurozone should aim to keep their annual budget deficit below 3% of GDP, and keep total public debt below 60% of GDP. If a country broke the rules, it had to take measures to reduce its deficit. If it broke the rules in three consecutive years, the Commission could impose a fine of up to 0.5% of GDP.

Once the Euro was launched, many countries had difficulty meeting the SGP rules. In 2003, the largest economies in the Eurozone, France and Germany, broke the rules. However, because these countries promised to reach the SGP targets as soon as possible, the Commission did not take strong action against them. This made the SGP look weak and the Council of the European Union decided to suspend it. In March 2005, the European Council agreed a reformed SGP with much more flexible rules. Even these were challenged in August 2007, when the French President, Nicholas Sarkozy, looked to revitalise the French economy outside the SGP framework.

In 2008, the global economic crisis sparked concern that a number of member states would break the SGP rules. Greece's spiralling public debt presented the biggest concern as it began to affect the stability of the Euro, leading to speculation that the Eurozone could not survive the crisis. At a summit in February 2010, EU leaders promised that the Euro was not in danger and instructed Greece to cut its public spending and raise taxes to repay its debt. However, despite tough austerity measures, it quickly became apparent that Greece would need stronger financial backing from the EU. On 2 May 2010, Eurozone states and the IMF agreed to a 'Stabilisation Mechanism' - a fund that low interest loans could be drawn from. The Eurozone countries provided €80 billion for Greece, with a further €30 billion coming from the IMF. In a move to restore confidence in the Euro, the fund was made available to all Eurozone members.

However, confidence waivered as the contagion spread and other Eurozone member states struggled to contain their debt. In late 2010, an €85 billion bailout package was agreed for Ireland. The Lisbon Treaty was amended to allow for the creation of a permanent crisis mechanism for the Eurozone, the European Stability Mechanism (ESM), which came into force in July 2012. In May 2011 a bailout of €78 billion was agreed for Portugal with the IMF, the EFSF and the ESM all contributing €26 billion each. Greece's second bailout loan was agreed in February 2012.

Eurozone ministers have attempted to strengthen the SGP by tightening sanctions for member states that break budgetary rules. In December 2011, the EU passed a so-called "six-pack" of legislation on economic governance. Four of these laws were used to reform the SGP by enforcing a stricter application of fiscal rules.

In 2015 a third Greek bailout was agreed, worth €85 billion, after Greece failed to meet the deadline for a crucial payment to the European Central Bank.

Author: Wil James, Civitas 01/2006
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Facts and figures

- In 2006, Germany's public debt was 66.8% of GDP and Greece's was over 100%. In 2014 Germany's public debt was 74.7%; Greece's was 177.1%.
- In 2014, France's public debt reached 95% of the country's GDP (its highest ever level).

Arguments

For

- The SGP shows that the eurozone countries are committed to the Euro.
- Many economists argue that the exemptions in the reformed pact make it more flexible and allow for the deficit limit to be broken to create economic growth.
- The SGP discourages governments from destabilising the Eurozone by borrowing money to win elections and instead encourage them to think about long-term stability.

Against

- Even if the old SGP was too rigid, the new version has so many exemptions that it is in fact difficult to breach its regulations.
- By failing to impose penalties on Germany and France, the Commission has shown that there are no effective rules on budget deficits or public debt in the Eurozone.
- Because countries have to meet the targets every year, the new rules do not take account of the flexibility governments sometimes need to balance their budgets across the economic cycle.
- The rules should allow for a deficit of capital spending as long as a country's current account is balanced.

"I know very well that the stability and growth pact is stupid…. The pact is imperfect. We need a more intelligent tool and more flexibility."

Romano Prodi, EU Commission President, 1999-2004

"[SGP] is a political totem, a symbol that euro-using countries will not cheat each other."

The Economist, 24 October 2002

Technical Terms

- ***Eurozone:*** the nickname commonly used to describe the sixteen member states that use the Euro.
- ***Budget deficit:*** this is the difference between the amount of money the government spends and the amount it receives in taxation and other revenue.
- ***Public debt:*** the government borrows money to make up for the shortfall in revenue to fund government projects. As a result it has debt with lenders, which it pays off over a number of years.
- ***Economic cycle:*** this is the periodic fluctuation of supply and demand in the economy.

Links

- http://www.guardian.co.uk/eu/story/0,,1094666,00.html
- http://www.euractiv.com/en/euro/stability-growth-pact/article-133199

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