



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 27.11.2002
COM (2002) 668 final

**COMMUNICATION FROM THE COMMISSION TO COUNCIL AND THE
EUROPEAN PARLIAMENT**

Strengthening the co-ordination of budgetary policies

1. Background

This Communication follows the conclusions of the 2002 Barcelona European Council on the need to reinforce existing fiscal policy co-ordination mechanisms, and for the Commission to “... *present proposals to reinforce economic policy co-ordination in time for the Spring European Council.*” It forms part of a more general strategy to strengthen economic policy co-ordination, including the recent efforts to streamline procedures for the adoption and implementation of the Broad Economic Policy Guidelines and the Employment Guidelines.¹ It also draws upon the relevant proposals forwarded by the Commission to the Convention on the Future of Europe.²

In particular, the Communication outlines proposals to improve the implementation of the Stability and Growth Pact (SGP), and develops the ideas presented by the Commission on 24 September 2002.³ In addition to securing the core budgetary objectives of sound and sustainable public finances, the proposals aim at raising the contribution of public finances to growth and employment in line with the Lisbon strategy.

2. The SGP: an appropriate framework for the conduct of budgetary policies with valid short and long-term objectives

Sound public finances are at the core of EMU. The emphasis on fiscal prudence derives from the awareness that economic prosperity and the viability of the monetary union cannot be sustained without tackling past fiscal policy failures, i.e. a trend towards increasing government expenditure and taxation levels combined with high structural budget deficits and government debt accumulation, and the tendency towards pro-cyclical budgetary policies which amplified rather than cushioned the effects of cyclical swings. Sound public finances contribute to growth and employment notably by contributing to a stable macroeconomic climate.⁴ By supporting monetary policy in the pursuit of price stability, interest rates (both nominal and real) have been low which is conducive to private investment and saving. Moreover, sound public finances reduce public debt and consequently the interest burden, thus creating room for a reduction in taxes and/or an increase in investment in productive public spending. Investment in physical (infrastructures), human (education, training) and knowledge (R&D and innovation) capital, if well designed, can improve long run output and growth potential, above all through their beneficial impact effect on productivity and employment. However, if higher productive public spending is financed through a rise in taxes or increased deficits and consequently higher public debt, private investment may be crowded-out thus offsetting any potential beneficial effect on growth and employment.

¹ Communication from the Commission on streamlining the annual economic and employment policy co-ordination cycles, COM(2002) 487 final of 3.9.2002.

² Communication from the Commission: A project for the European Union, COM(2002) 247 final, 22.05.2002. Contribution of Mr. Barnier and Mr. Vitorino to the Convention on the Future of Europe ‘Towards better economic policy co-ordination’, CONV 391/02 of 7.11 2002.

³ ‘Budgetary challenges in the euro zone’, Communication of Commissioner Solbes in agreement with President Prodi, SEC(2002) 1009/6, Brussels 25 September 2002.

⁴ Report from the Commission and the (ECOFIN) Council to the European Council (Stockholm 23/24 March 2001) ‘The contribution of public finances to growth and employment: improving quality and sustainability’, 12 March 2001, Council Document 6997/01. This was largely based on a Commission Communication of the same name COM(2000)846.

A unique rule-based framework for the co-ordination of budgetary policies in EMU has been established to reflect the fact that the responsibility for the single monetary policy is entrusted to an independent European Central Bank whilst responsibility for budgetary policies remains decentralised in the hands of national authorities. This framework aims at combining budgetary discipline with flexibility, and is founded on the Treaty requirement for Member States to avoid excessive deficit positions defined as general government deficits below 3% of GDP and the general government debt level remaining below 60% of GDP (or diminishing at a satisfactory pace towards the reference value).

In order to reinforce the preventive aspects of this framework and to help Member States avoid excessive deficit positions, the Treaty requirements were complemented by the Stability and Growth Pact (consisting of two Council Regulations and solemn political commitments enshrined in a Resolution of the 1997 Amsterdam European Council).⁵ The SGP establishes a requirement for Member States to achieve and maintain budgetary positions of ‘close to balance or in surplus’.⁶ This is meant to ensure that fiscal policy contributes to an environment in which monetary policy can effectively maintain price stability whilst being growth supportive. Moreover, by maintaining a budget position of ‘close to balance or in surplus’, Member States have the necessary room for manoeuvre for cyclical stabilisation through the working of the automatic stabilisers without the 3% of GDP reference value for deficits being breached. In addition, it would lead to a lower interest burden, thus creating further scope for governments to pursue growth enhancing reforms.

Overall, the SGP provides an appropriate framework for prudent budgetary management that is in the economic self-interest of all countries, individually and collectively, irrespective of EMU or their participation in the euro area. The budgetary objective of ‘close to balance or in surplus’ provides ample room to allow the automatic stabilisers to operate fully in response to economic downturns. It is also an appropriate medium and long-term goal given the need for sustainable public finances in light of ageing populations. Recent projections show that in the absence of policy reforms, public spending could increase by between 4% and 8% of GDP in most countries due to the effects of ageing populations in coming decades.⁷ This suggests that some Member States should consider running budget surpluses over the coming decade as there is a limited window of opportunity prior to the budgetary effects of ageing populations taking hold.⁸

3. Mixed budgetary performance since 1999

Impressive budgetary consolidation was achieved in the years running up to the launch of the euro, with substantial declines in underlying budget deficits in most Member States and

⁵ OJ L 209 of 2.8.1997 and OJ C 236 of 2.8.1997.

⁶ These budgetary rules are backed up with detailed and regular surveillance procedures. Member States are required, on an annual basis, to submit stability or convergence programmes in which they set down a medium-term target that meets the ‘close to balance or in surplus’ requirement’ and an adjustment path towards it. The budgetary targets set down in programme, as well as compliance with previous commitments, are subject to intensive peer review by the Commission and Member States in the Council.

⁷ The timing and size of the projected increase in public spending varies considerably across member States. In general, the increase in public spending is projected to commence around 2015 and peak around 2040.

⁸ Economic Policy Committee (2001): “The Budgetary challenges posed by ageing populations”, EPC/ECFIN dd655/01/EN. An overview of how the Commission assessed the sustainability of public finances in Member States and the main policy conclusions is provided in the report *Public finances in EMU – 2002*, European Economy Reports and Studies N°3, 2002.

government debt being placed on a downward trajectory. This turnaround can in part be attributed to the Maastricht convergence criteria, and demonstrates the potential effectiveness of EU fiscal rules provided policy actors fully assume their responsibilities.

However, the process of budgetary consolidation has ground to a halt since 1999, and in some cases has reversed. For the euro area as a whole, the favourable growth conditions in 1999 and 2000 were not used to reduce underlying deficits towards the 'close to balance or in surplus' objective of the SGP. The underlying deficit in 2001 for the euro area increased to 1.9% of GDP in a context where growth turned out to be slower than expected: the deterioration in the underlying budgetary situation can be attributed to unfunded tax cuts, a lack of control of expenditures and discretionary increases in public expenditures in some Member States. The underlying budget position is not projected to improve in 2002.

This aggregate picture hides diverging performances across Member States and a number of positive achievements. Seven euro area countries and ten EU Member States reached budget positions of 'close to balance or in surplus' by 2001. Government debt to GDP ratios have generally been on a downward trajectory with large reductions being recorded in several Member States. This created room for the automatic stabilisers to operate during the current economic slowdown, which contrasts with previous downturns when governments had to tighten fiscal policies so as to prevent debt levels from entering unsustainable trajectories. In addition, several Member States have been able to pursue ambitious tax reform strategies and some improvements have been recorded in re-directing public expenditures towards more productive items that are conducive to growth and employment.

Some Member States, however, have failed to complete the transition to the 'close to balance or in surplus' requirement of the SGP.. Deficit levels in Portugal reached 4.1% of GDP in 2001 and the Council on 5 November 2002, adopted a Decision on the existence of an excessive deficit position. A deficit of 3.8% of GDP is forecast for Germany in 2002, and the Commission has adopted a report under Article 104(3) of the Treaty on the risk of an excessive deficit position. The Commission has also adopted a Recommendation for the Council to send an early-warning to France on account of significant divergence from budget targets in 2002 and because its deficit for 2003 is projected to be 2.9% of GDP, perilously close to the 3% of GDP reference value.⁹

There are also worrying developments as regards government debt where slight increases have been recorded in several Member States. Italy and Greece give most cause for concern as their debt levels remain well above 100% of GDP, very little progress has been made in the past four years to reduce debt levels towards the 60% of GDP reference value. These Member States could have been expected to record significant decreases in the debt ratio, but this did not materialise mainly on account of large and persistent debt increasing financial operations.¹⁰ Moreover, these developments have taken place despite the reduction in interest rates following their membership in the euro area.

4. Difficulties in the implementation of the SGP

⁹ The Commission Recommendation for an early warning is based on Article 6.2 of Council regulation 1466/97 of 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies.

¹⁰ On the basis of budget targets set down by Member States in their stability programmes, and taking account of nominal GDP growth, the debt ratio should have fallen by several percentage points of GDP per annum. This decline did not materialise, in part because the budget targets were missed and/or because of large and persistent debt increasing financial operations.

Based on the experience of four years in EMU, it is evident that the existing rule based framework for the co-ordination of budgetary policies remains appropriate and is essential for the smooth functioning of EMU. The SGP goal of budget positions of ‘close to balance or in surplus’ remains an economically valid objective. Furthermore, a rules-based approach to the co-ordination of budgetary policies that relies on peer pressure can generate results provided it is accompanied by firm political commitments. However, recent events have highlighted a number of difficulties with the implementation of the SGP, which can be summarised as follows:

- ***political ownership of the SGP by Member States has diminished.*** While most countries continue to subscribe to the goals and objectives of the SGP, in some countries there has been a growing divergence between budgetary commitments and concrete actions to achieve stated targets. There has been an unwillingness to acknowledge the implication of EMU on the conduct of fiscal policy at national level. More generally, Member States have not played their role in exerting peer pressure on countries that miss budgetary targets by a wide margin via the enforcement mechanisms of the SGP;
- ***it has been difficult to establish clear and verifiable budget objectives which take account of underlying economic conditions.*** The targets for budget balances of Member States are set down in stability and convergence programmes in nominal terms. However, in assessing compliance with budgetary commitments, and in particular the adjustment path to ‘close to balance or in surplus’, it is necessary to consider the effect of the economic cycle on the budget position. This has proved difficult in the absence of an agreed method to calculate cyclically-adjusted budget balances, and also because the nominal deficit targets in the programmes of Member States were sometimes based on optimistic growth assumptions and with adjustment efforts back-loaded towards the end of the time horizon of programmes. Measuring compliance has therefore not been straightforward and this in turn weakened the enforcement mechanisms of the SGP. This has resulted in the policy debates at EU level focusing excessively on procedural issues and relatively minor changes in nominal budget balances, to the detriment of dialogue on the substantive economic and budgetary policy challenges facing Member States;
- ***the framework for the collection and assessment of budgetary statistics has experienced a number of difficulties.*** Of greatest concern are the reporting anomalies detected in some Member States, which in the case of Portugal led to a very large upward revision of deficit levels. In addition, *ex post* revisions to budgetary data are getting larger. There is also a need to examine the discrepancy between deficits recorded on accrual basis and debt issuance in cash terms in some Member States. Finally, the decision making processes of Eurostat on the classification of certain budgetary operations could be speeded up;
- ***some Member States did not run sound budgetary policies in good times.*** A failure to pursue budgetary consolidation in 1999 and 2000 when growth conditions were favourable led to a deterioration in underlying budget positions and inadequate room for the automatic stabilisers to operate in the subsequent economic slowdown. This failure to allow the automatic stabilisers operate symmetrically over the economic cycle illustrates inadequate surveillance and enforcement mechanisms to deal with unwarranted pro-cyclical loosening of the fiscal stance;
- ***the enforcement procedures of the SGP have been found wanting at critical junctures.*** In particular, the early-warning mechanism has not proven effective in dealing with significant slippage from budget targets set down by Member States in their stability and

convergence programmes. In addition, this needs to occur in sufficient time to allow countries to take corrective measures before the 3% of GDP reference value is threatened;

- ***the SGP has struggled to develop into an effective co-ordination framework for dealing with country-specific circumstances in a consistent manner, assuring the long-term sustainability of public finances while supporting structural reforms that are designed to enhance employment and growth potential.*** Considerable scope exists within the SGP framework to take account of differences in the quality and sustainability of public finances across Member States. But the challenge for the SGP is to move from a case-by-case approach towards policy making based on economically rigorous criteria that are applied consistently over time and across countries, and which safeguards the core objective of sound and sustainable public finances;
- ***it has been difficult to communicate effectively with the press, markets and the public on the benefits of achieving and sustaining sound public finance positions, and also how the SGP works.*** This is partly due to the fact it takes time for economic agents to adjust to the new policy framework in place since the launch of the euro and also because the institutional procedures of the SGP are complex. In addition, effective communication has been hampered by conflicting statements on the appropriate conduct of budgetary policies. Overall, the difficulty in understanding the rationale of the SGP and especially the precise budget commitments set down in stability and convergence programmes has weakened external pressure on Member States to run sound budget policies.

5. Proposals to improve the interpretation of Stability and Growth Pact

To reinforce the existing mechanisms for the co-ordination of budgetary policies in EMU, the Commission presents five proposals which would introduce some more flexibility in the interpretation of the SGP, but which at the same time ensure a more rigorous adherence to the goal of sound and sustainable public finances. The proposals in this Communication can be achieved within the framework of existing Treaty provisions and SGP Regulations. Therefore, they do not alter the core budget requirements (to avoid excessive deficit positions) or objectives (to achieve and sustain budget positions of ‘close to balance or in surplus’). Neither do they create new procedures, as upgraded budgetary surveillance will take place on the basis of stability and convergence programmes.

i) Establishing budgetary objectives that take account of the economic cycle. The Commission proposes that the ‘close to balance or in surplus’ requirement of the SGP is defined in underlying terms throughout the economic cycle, i.e. net of transitory effects and especially the effects of cyclical fluctuations on budgets. The principle tool for assessing underlying budget positions will be the common methodology to measure cyclically-adjusted budget balances which has been agreed by Member States and the Commission.

ii) Transitional arrangements for countries with underlying deficits exceeding the ‘close to balance or in surplus’ requirement. In striving to achieve the ‘close to balance or in surplus’ goal of the SGP, the size of budgetary consolidation efforts required of Member States with underlying deficits should take account of economic conditions. The Commission proposes that a general principle be established requiring countries with such underlying deficits to achieve an annual improvement in the underlying budget position of at least 0.5% of GDP each year until the ‘close-to-balance or surplus’ requirement of the SGP has been reached. This rate of improvement in the underlying budget position should be higher in countries with

high deficits or debt. Also, a more ambitious annual improvement in underlying budget positions should be envisaged if growth conditions are favourable.

iii) Avoiding pro-cyclical budget policies in good times. To avoid a pro-cyclical loosening of fiscal policies in good times, the automatic stabilisers should operate symmetrically over the cycle. This implies running nominal surpluses when economic conditions are favourable. Effective enforcement procedures are also required to deal with an unwarranted loosening of fiscal policies in good times. As a general rule expansionary fiscal policy for stabilisation purposes, should be confined to Member States that have already created enough budgetary room to do so.

iv) The goals of the Lisbon strategy: ensuring that public finances contribute to growth and employment. The ‘close to balance or in surplus’ requirement could be interpreted to cater for the inter-temporal budgetary impact of large structural reforms (such as productive investment or tax reforms) that raise employment or growth potential in line with the Lisbon strategy and/or which in the long-term improve the underlying public finances positions. To ensure that this interpretation of the SGP does not jeopardise the commitment to sound public finances, the Commission proposes:

- a small temporary deterioration in the underlying budget position could be envisaged only if the Member State concerned has already made substantial progress towards the ‘close to balance or in surplus’ requirement and if general government debt is below the 60% of GDP reference value. Also, the Member State concerned must demonstrate in its stability or convergence programme that there are clear economic and budgetary benefits attributable to the proposed reform. In assessing the programme, the Commission must ascertain that there is a clear and realistic deadline for returning to a position of “close to balance or in surplus” within the time horizon of the stability or convergence programme. Budgetary projections must be based on a sound and prudent macroeconomic scenario to be verified against those of the Commission, with due account taken of the need to avoid inappropriate pro-cyclical policies. An adequate safety margin must be provided at all times to prevent nominal deficits from breaching the 3% of GDP reference value. Finally, the Member State concerned should commit to introduce the necessary corrective measures in the event of a failure to stick to the adjustment path for returning to a budget position of ‘close to balance or in surplus’.
- a small deviation from the ‘close to balance or in surplus’ requirement of a longer-term nature could be envisaged for Member States where debt levels are well below the 60% of GDP reference value, and when public finances are on a sustainable footing. This will require a careful assessment to be made of outstanding public debt, contingent liabilities (such as implicit pension obligations) and other costs associated with ageing populations. An adequate safety margin must be provided at all times to prevent nominal deficits from breaching the 3% of GDP reference value.

v) The sustainability of public finances should become a core policy objective. Sustainability concerns should be explicitly taken into account when assessing the budget positions of Member States under the SGP. To this end, greater weight must be attached to government debt ratios in the budgetary surveillance process. The debt criterion of the excessive deficit procedure, which requires debt levels above 60% of GDP to approach the reference value at a ‘satisfactory pace’, should be made operational. Countries with debt levels well above the 60% of GDP reference value should outline a detailed strategy to reduce their debt level to below the reference value in their stability and convergence programmes. The assessment of the sustainability of public finances as part of stability and convergence programmes should

be upgraded, with firm policy conclusions as to whether the budgetary policies ambitious enough to meet the challenge posed by ageing populations. As part of a comprehensive three-pronged strategy to prepare for ageing populations (i.e. debt reduction, raising employment rates of women or older workers, and reform of pension and health care systems), Member States in their stability or convergence programmes should consider running budget surpluses in coming years, i.e. over and above the ‘close to balance or in surplus’ requirement of the SGP. Finally, Member States and the Commission should intensify efforts to produce revised projections of the budgetary impact of ageing populations by 2005.

6. A four-point programme to improve the implementation of the Stability and Growth Pact

The difficulties in the implementation of the SGP described above cannot be resolved simply by adjusting the interpretation of key provisions. To be effective, fiscal rules, need to be accompanied with:

- a firm political commitment of all parties concerned to adhere to their budgetary commitments at EU level and to exercise their role in the process of peer-review and enforcement;
- timely and high quality analysis of the economic and budgetary conditions so that policy conclusions are based on reliable data and firm analytical underpinnings;
- effective enforcement procedures that address slippage from agreed budgetary targets in a timely and robust manner;
- measures to improve communication so as to enhance the external pressure on Member States to run sound fiscal policies.

To strengthen the implementation of the SGP, the Commission proposes that the following four-point programme be agreed in time for the 2003 Spring European Council.

i) Member States should reaffirm their political commitment to the SGP in a “Resolution to reinforce the co-ordination of budgetary policies” to be endorsed by the European Council at their meeting in Spring 2003. The Resolution would represent the solemn political commitment of the Commission, Member States and Council to implement the SGP in accordance with the proposals set down in this Communication. It could make explicit the criteria for interpreting key SGP provisions, e.g. that the ‘close to balance or in surplus’ requirement is assessed in underlying terms, that countries with underlying deficits must achieve an annual rate of underlying budgetary consolidation of at least 0.5% of GDP and that countries with a very high level of debt must respect a satisfactory pace of debt reduction. In addition, it could establish a firm political commitment that a more flexible application of the ‘close to balance or in surplus’ requirement would only be envisaged if strict conditions and safeguards are met. Finally, the Resolution could set down commitments on the part of Member States to respect certain behavioural norms in the co-ordination of budgetary policies at EU level, e.g. to take due account of the implications for the euro area when setting budgetary policies at national level, to play their role in the process of peer pressure and in particular facilitate the implementation of the enforcement procedures of the SGP .

ii) Upgrading the analysis of economic and budgetary policies. The following measures are needed to upgrade economic and budgetary surveillance at EU level:

- the quality and timeliness of government finance statistics need to be improved as they are the foundation on which budgetary surveillance is built. The Commission proposes that a ‘Code of best practices on the reporting of budgetary data’ be endorsed by the (ECOFIN) Council in time for the next excessive deficit procedure reporting of 1 March 2003 and the 2003 Spring European Council¹¹. Member States should commit themselves in the Code to adopt practices that upgrade the quality, transparency, timeliness and reliability of budgetary statistics. The Code will also clarify and streamline the procedures to be followed by the Commission to ensure a more effective, timely and transparent action in its role as statistical authority in this domain;
- it is essential that greater reliance on underlying budget positions in the EU surveillance process be accompanied with an improved analysis of Member States’ budget positions. This is because in contrast to the actual budget balance, the underlying budgetary position is not directly observable. The key challenge is to distinguish budgetary components that have more permanent effects from purely short-term transitory elements. The Commission and the Council have developed a method to cyclically adjust budget balances (CAB) based on a production-function approach to estimating output-gaps, and this will be used as the starting point for an assessment of the underlying budget position.¹² Nonetheless, a degree of caution must be exercised when interpreting changes, especially on an annual basis, given the complexity and imprecision when measuring cyclically adjusted budget balances. In assessing whether the budgetary commitments set down by Member States in their stability and convergence programme meet the requirements of the SGP, the Commission will use its own forecast to assess the realism of the macroeconomic assumptions on which the budgetary targets are based. To ensure a consistent assessment across Member States, the Commission proposes that the ‘Code of conduct on the content and presentation of stability and convergence programmes’¹³ be updated also to require Member States to provide information on important one-off budgetary operations.
- in assessing stability and convergence programmes, more attention needs to be paid to the quality of public finances. The emphasis should also be on whether the composition of proposed budgetary measures is conducive to growth and employment, and also whether they are likely to achieve a sustainable improvement in the budget balance. *Inter alia*, this involves examining the balance between tax increases and expenditures cuts to achieve improved budget balance, the overall dynamic and composition of public expenditures and whether they favour productive items, the impact of tax reforms, and finally the degree to which consolidation relies on one-off budget measures which cannot be expected to achieve a sustained improvement in public finance positions;
- the Commission intends to reinforce its surveillance of Member States’ economies, and in particular to concentrate on countries which have difficulties in meeting the requirements of the SGP. The Commission will organise more frequent and comprehensive missions to the Member State. Also in-depth country studies shall be carried out and made public.¹⁴

¹¹ Communication from the Commission on the need and the means to upgrade the quality of budgetary statistics. COM (2002) 670 of 27.11.2002

¹² Economic Policy Committee (2001), “Report on a potential output and the output gap”, ECFIN/EPC/670/01

¹³ The revised Code of Conduct, endorsed by the ECOFIN Council in July 2001, along with an assessment of how it has worked, is published in *Public finances in EMU – 2002*.

¹⁴ For example, see Directorate General for Economic and Financial Affairs (2002): ‘Germany’s growth performance in the 1990s’, *Economic Papers* N° 170.

iii) More effective enforcement procedures. The Treaty and SGP provide a range of surveillance enforcement mechanisms for dealing with slippage's from budgetary targets. To ensure that they are operational, the Commission proposes:

- to specify the criteria that the Commission will use when deciding whether to activate the early-warning mechanism in the event of significant divergence from budgetary targets, which in turn would be used by the Council in deciding whether to endorse the Commission Recommendation. Three factors should be taken into account, namely the size of the budgetary slippage (extent to which budget positions diverge from the targets set down in stability or convergence programmes), whether the divergence of actual balances from target can be explained by cyclical or discretionary factors, and thirdly the possibility of deficits rising and approaching the 3% of GDP reference value. These proposals would imply that an early-warning could be sent to a Member State even if its nominal or underlying budget balance is some way below the 3% of GDP reference value.
- that an inappropriate pro-cyclical loosening of the budget in good times (taking account of the starting budgetary position and monetary conditions facing the country concerned) should be viewed as a violation of budgetary requirements at EU level, and should lead to an appropriate and timely response through the use of instruments provided in the Treaty.
- to clarify the interpretation of the debt criterion of the excessive deficit procedure,¹⁵ i.e. what would constitute a 'satisfactory pace' of debt reduction towards the 60% of GDP reference value. For instance, an appropriate pace of debt reduction would be the reduction of the debt ratio resulting from compliance with the 'close to balance or in surplus' requirement of the SGP. On the basis of a defined 'satisfactory pace' and in accordance with the Treaty, the failure on the part of a high debt country to achieve the established pace of debt reduction should lead to the Commission to activate the excessive deficit procedure and prepare a report under Article 104(3). In assessing compliance with this requirement, the Commission will examine all the components that drive debt developments, as the pace of debt reduction depends upon some factors that can be shaped by government policies and other factors which lie outside governments' immediate control.

These improvements can be brought about within the existing Treaty and SGP framework, via supplementary provisions in the existing 'Code of Conduct on the content and presentation of stability and convergence programmes'. In a longer-term horizon, the enforcement mechanisms of the EU budgetary surveillance process can be further strengthened by adopting the relevant proposals made by the Commission to the Convention on the Future of Europe. *Inter alia*, the Commission could be given the authority to issue early warnings directly to Member States without recourse to a Council vote: this could lead to more direct and timely signalling of budgetary problems.

iv) Better communication through openness and transparency. Reliable and timely information must be given on the budgetary commitments of Member States and on how the SGP is being implemented. Responsibility for improved communication lies with all actors.

¹⁵ Article 104(2) of the Treaty on the excessive deficit procedure states that "*The Commission shall monitor the development of the budgetary situation and of the stock of debt in Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline on the basis of the following two criteria ... whether the ratio of government debt to gross domestic product exceeds a reference value [60% of GDP], unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.*"

The Commission already publishes an annual report on *Public finances in EMU* and also provides some details of its assessment of stability and convergence programmes in press releases. However, there is scope to enhance the flow of information. For its part, the Commission intends to make public its detailed assessment of stability and convergence programmes. Also, the Commission in July each year will publish a mid-year review of budgetary developments in the Quarterly Report on the Euro area. This will examine how Member States are faring in meeting their budgetary targets. It will also provide an assessment of economic conditions and prospects, as well as general orientations of budgetary policies which Member States should take into account in preparing their annual budgets during the autumn months.