BRIEFING

European Parliament

The 'general escape clause' within the Stability and Growth Pact

Fiscal flexibility for severe economic shocks

SUMMARY

An important element of the response to the COVID-19 pandemic will come from European Union (EU) Member States in the form of fiscal intervention. At the same time, Member States are constrained by the fiscal rules in place at both EU and national level.

The Stability and Growth Pact contains two clauses allowing Member States to undertake appropriate budgetary measures, within the Pact, in the face of exceptional circumstances. The first is known as the 'unusual events clause', while the second is termed the 'general escape clause'. In essence, the clauses allow deviation from parts of the Stability and Growth Pact's preventive or corrective arms, either because an unusual event outside the control of one or more Member States has a major impact on the financial position of the general government, or because the euro area or the Union as a whole faces a severe economic downturn.

As the current crisis is outside governments' control, with a major impact on public finances, the European Commission noted that it could apply the unusual events clause. However, it also noted that the magnitude of the fiscal effort necessary to protect European citizens and businesses from the effects of the pandemic, and to support the economy in the aftermath, requires the use of more far-reaching flexibility under the Pact. For this reason, the Commission has proposed to activate the general escape clause.

With the Council having endorsed the Commission communication, a deviation from the medium-term budgetary objective or from the appropriate adjustment path towards it may be allowed for Member States, during both the assessment and the implementation of Stability or Convergence Programmes. In the corrective arm of the Pact, the clause will allow an extension of the deadline for the Member States to correct their excessive deficits under the excessive deficit procedure, provided those Member States take effective action as recommended by the Council.

In this Briefing

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Introduction

To respond to the COVID-19 pandemic, European Union (EU) Member States will require flexibility in the measures they can take to deal with the crisis. The European Commission therefore proposed, in a 20 March communication, to activate the general escape clause of the Stability and Growth Pact (SGP), to allow temporary departures from the budgetary constraints that normally apply under the European fiscal framework.

Finance Ministers of the EU Member States held a video-conference meeting on 23 March, following which they issued a statement indicating their agreement with the Commission's assessment of the situation, that the conditions for activating the general escape clause have been fulfilled. They noted that 'the use of the clause will ensure the needed flexibility to take all necessary measures for supporting our health and civil protection systems and to protect our economies'. Moreover, they underlined that they 'remain fully committed to the respect of the Stability and Growth Pact'.

General escape clause and selection rationale

The Stability and Growth Pact contains two clauses (known as the 'unusual events clause' and the 'general escape clause'), allowing Member States to take appropriate budgetary measures, within the Pact, to face exceptional circumstances. The clauses, can be found in:

- Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 ('preventive arm') and
- Articles 3(5) and 5(2) of Regulation (EC) 1467/97 ('corrective arm').

These clauses allow deviation from parts of the preventive or the corrective arm, either because an unusual event outside the control of one or more Member States has a major impact on the financial position of the general government, or because the euro area or the Union as a whole faces a severe economic downturn.

As the current crisis falls under the latter category, the European Commission noted that it could apply the **unusual events** clause. However, the magnitude of the necessary fiscal effort to protect European citizens and businesses from the pandemic, and to support the economy following it, requires the use of more far-reaching flexibility under the Pact,[1] and so the Commission will instead activate the **general escape** clause.

In adopting its 20 March communication, the Commission informed the Council formally that it considers the conditions for activating the general escape clause have been fulfilled. With the Council having agreed with the Commission's assessment, the procedure under the SGP will be modified as follows.

Preventive arm

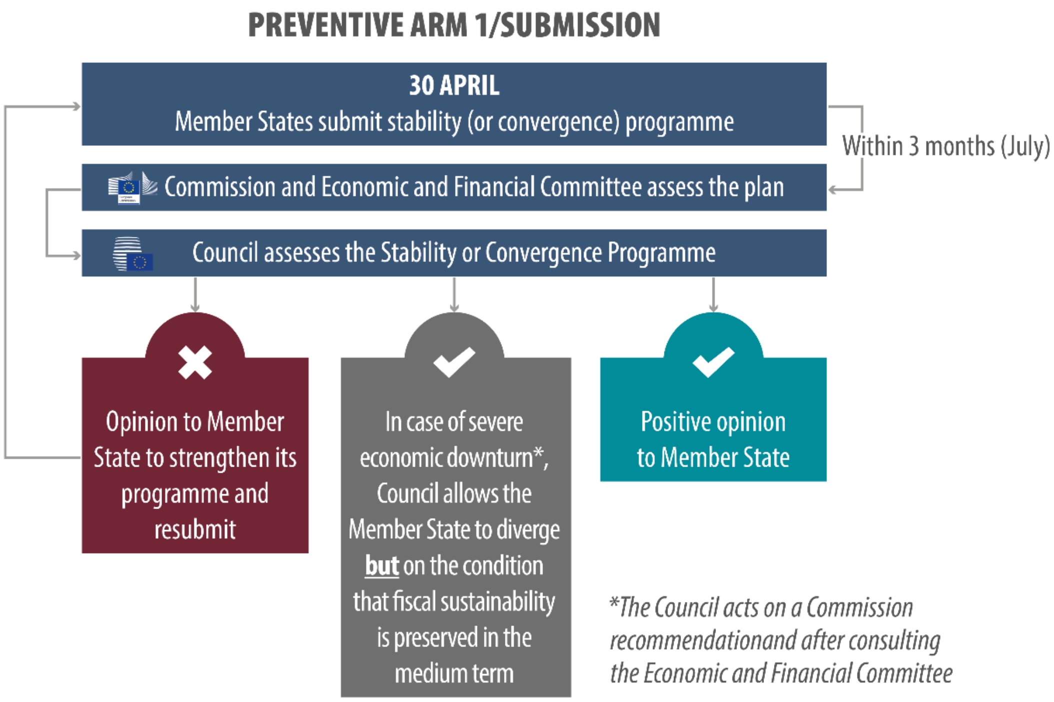
Assessment of the stability and convergence programmes

According to Article 4 of Regulation (EC) 1466/97, Member States must submit stability programmes annually, preferably by mid-April and not later than 30 April.[2] According to Article 5(1), based on assessments carried out by the Commission and the Economic and Financial Committee, the Council **examines** the medium-term budgetary objectives presented by the Member States in their stability programmes and **assesses** whether:

- the economic assumptions on which the programme is based are plausible,
- the adjustment path towards the medium-term budgetary objective is appropriate, and
- the measures being taken or proposed to respect the adjustment path are sufficient to achieve the medium-term budgetary objective over the cycle.

According to the same article, however, 'In the case of an unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government, or in periods of severe economic downturn for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term'.

Figure 1: Annual procedure under the preventive arm



Implementation of the stability and convergence programmes

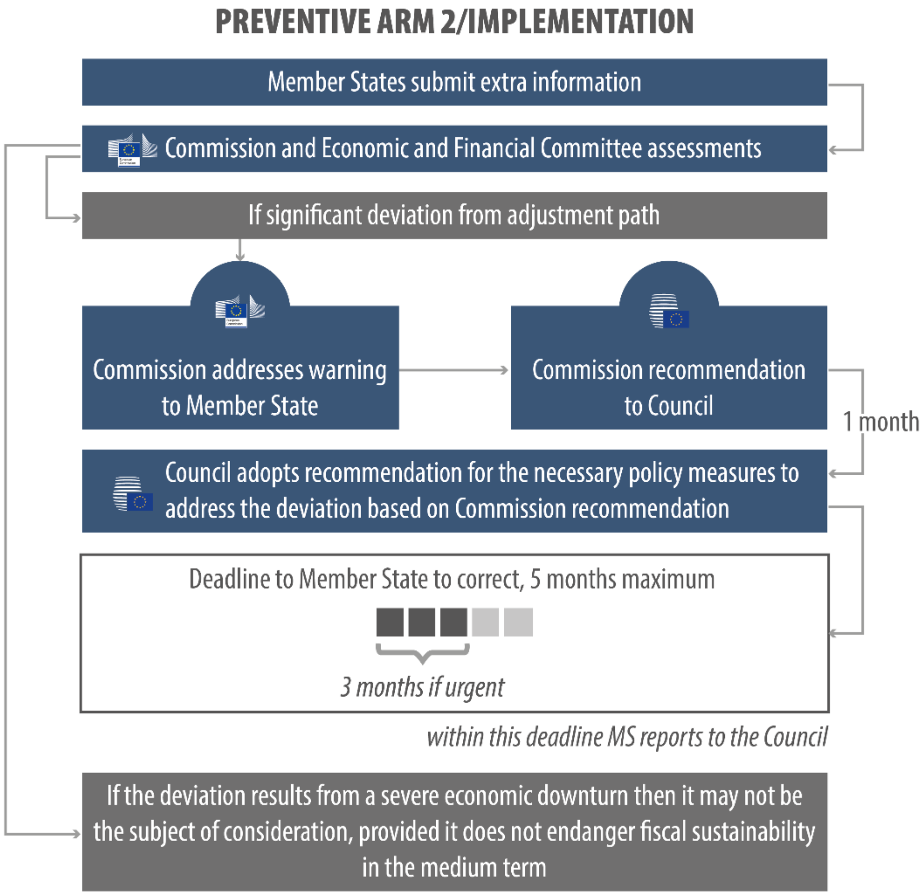
Article 6 of the same Regulation provides that the Council and the Commission monitor the **implementation** of the stability programmes, on the basis of information provided by participating Member States and of assessments by the Commission and the Economic and Financial Committee, 'in particular with a view to identifying actual or expected significant divergences of the budgetary position from the medium-term budgetary objective, or from the appropriate adjustment path towards it'.

Should the Commission observe a significant deviation from the adjustment path towards the medium-term budgetary objective, it addresses a warning to the Member State concerned, in accordance with Article 121(4) TFEU, to prevent the occurrence of an excessive deficit.

Within one month of the adoption of the warning, the Council examines the situation and adopts a recommendation for the necessary policy measures, on the basis of a Commission recommendation. The Council recommendation sets a deadline of between three (in case the situation is deemed particularly serious) and five months for the deviation to be addressed.

Nonetheless, Article 6(3) provides that a deviation from the medium-term budgetary objective or from the appropriate adjustment path towards it, may be omitted from consideration, when it results from an unusual event outside the control of the Member State concerned or in cases of severe economic downturn for the euro area or the Union as a whole. Articles 9(1) and 10(3) of the Regulation contain similar provisions for convergence programmes.

Figure 2: Procedure for monitoring implementation of stability and convergence programmes



Corrective arm

Article 126 TFEU concerns the excessive deficit procedure. According to paragraph 2, the Commission examines compliance with budgetary discipline on the basis of the deficit and debt criteria. If a Member State does not fulfil the requirements under one or both of these criteria, paragraph 3 of the Article states that the Commission must prepare a report, on which the Economic and Financial Committee formulates an opinion with two weeks (Article 126(4) TFEU and Article 3(1) of Regulation (EC) 1466/97).

Taking the Economic and Financial Committee's opinion into account, if the Commission considers that an excessive deficit exists or may occur in a Member State, it addresses an opinion and a proposal to the Council and informs the European Parliament (Article 3(2) of Regulation (EC) 1466/97).

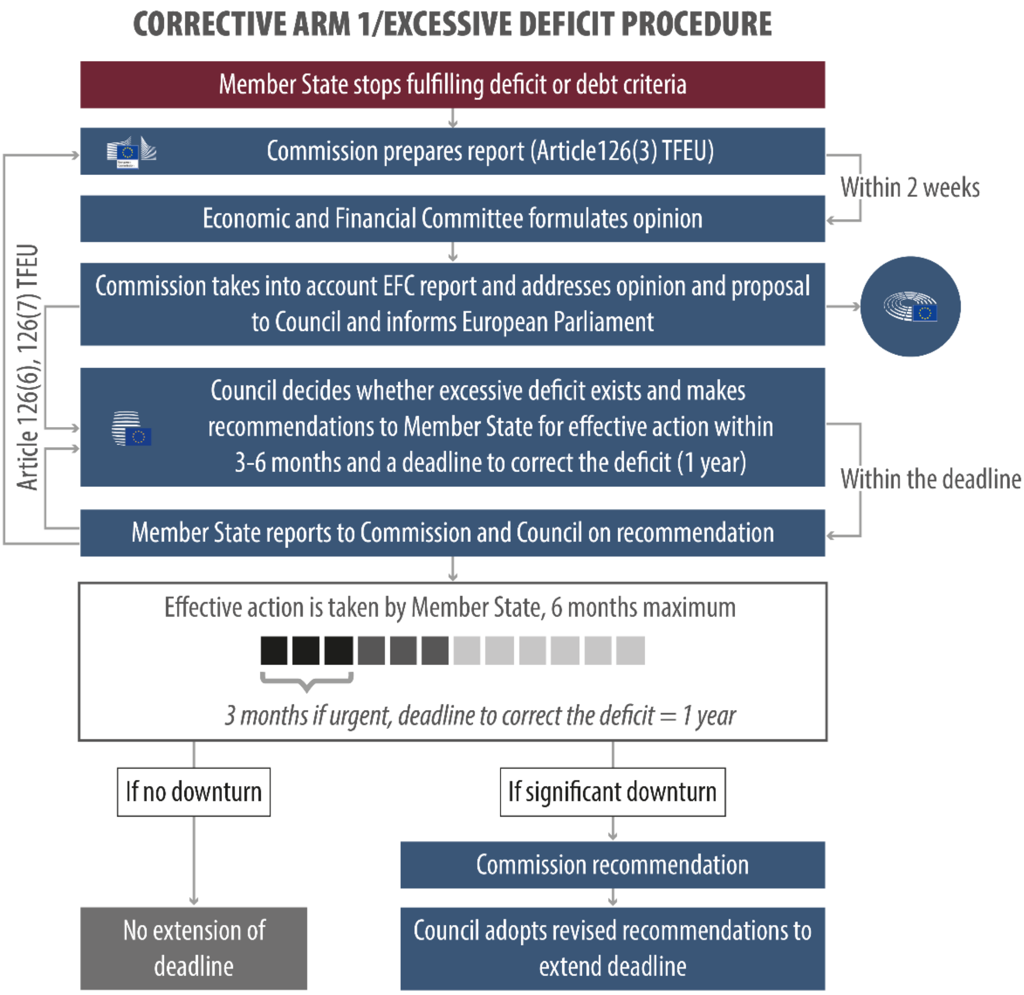
The Council decides whether an excessive deficit exists and makes recommendations to the Member State concerned (Article 126(7) TFEU and Article 3(3) of Regulation (EC) 1466/97). The Council recommendation establishes deadlines (Article 3(4) of Regulation (EC) 1466/97) for:

- effective action to be taken by the Member State (three months if a serious situation, otherwise up to six months),
- correction of the excessive deficit (usually one year from its identification).

The Member State reports to the Council on the measures taken. If the Member State takes effective action, Article 3(5) of Regulation (EC) 1467/97 provides that, a severe economic downturn in the euro area or in the Union as a whole may lead the Council to decide, on a recommendation from the

Commission, to adopt a **revised** recommendation and extend the deadline for the correction of the excessive deficit by one year.

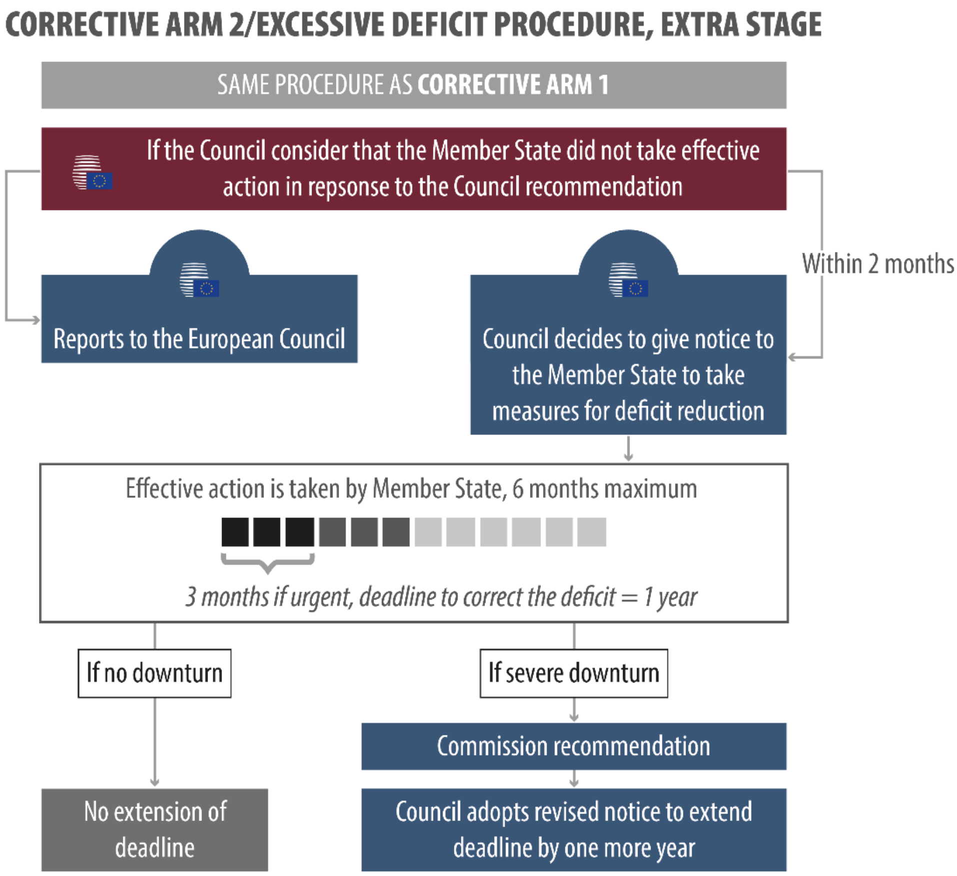
Figure 3: Procedure under the corrective arm when a Member State no longer fulfils either or both the deficit and debt criteria



However, the Council may decide that no effective action has been taken by the Member State in response to its recommendations within the period required. Within two months of this decision, it may further decide to give notice to the Member State concerned, to take measures for the deficit reduction in accordance with Article 126(9) TFEU, within a specified time limit.

Within that period of time, according to Article 5(2) of Regulation (EC) 1467/97, in the case of a severe economic downturn in the euro area or in the Union as a whole, the Council may decide, following a recommendation from the Commission, to adopt a revised notice under Article 126(9) TFEU, to extend the deadline for the correction of the excessive deficit again, by one year as a rule.

Figure 4: Procedure when a Member State has not taken effective action following a Council recommendation under the corrective arm



MAIN REFERENCES

Multilateral surveillance – Article 121 TFEU.

The Excessive Deficit Procedure (EDP) – Article 126 TFEU.

Council Regulation (EC) 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (the preventive arm of the Stability and Growth Pact).

Council Regulation (EC) 1467/97 on speeding up and clarifying the implementation of the Excessive Deficit Procedure (the corrective arm of the Stability and Growth Pact.

Communication from the European Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, 20 March 2020, COM(2020) 123 final.

ENDNOTES

1 In its 13 March 2020 communication on the coordinated economic response to the coronavirus outbreak, based on a scenario analysis, the Commission presented an economic scenario that showed that real GDP could contract by 1 % in the EU in 2020 and did not rule out more adverse scenarios, should the pandemic have a deeper impact.

2 In essence, stability programmes are three-year budget plans which detail the specific policies each country intends to implement to boost jobs and growth and prevent/correct imbalances, as well as concrete plans to ensure compliance with the EU's outstanding country-specific recommendations and fiscal rules.

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