



THE EU FRAMEWORK FOR FISCAL POLICIES

To ensure the stability of the Economic and Monetary Union, the framework for avoiding unsustainable public finances needs to be strong. A reform (part of the 'Six-Pack') amending the Stability and Growth Pact entered into force at the end of 2011. Another one, the intergovernmental Treaty on Stability, Coordination and Governance, including the Fiscal Compact, entered into force in early 2013. A regulation on assessing national draft budgetary plans (part of the 'Two-Pack') entered into force in May 2013.

LEGAL BASIS

- Articles 3, 119-144, 136, 219 and 282-284 of the Treaty on the Functioning of the European Union (TFEU);
- Protocol (No 12) on the excessive deficit procedure; Protocol (No 13) on the convergence criteria annexed to the TFEU.

OBJECTIVES

The fiscal policies architecture of the European Union aims to build a robust and effective framework for the coordination and surveillance of the fiscal policies of the Member States. The 2011-2013 reforms of the structure are a direct response to the sovereign debt crisis, which showed the need for stricter rules, considering the spillover effects from unsustainable public finances within the euro area. The revised framework therefore draws on the experiences of the initial design failures of the European Monetary Union and attempts to reinforce the guiding principle of sound public finances, which is enshrined in Article 119(3) of the TFEU.

ACHIEVEMENTS

A. Stability and Growth Pact

Primary Union law provides the main legal foundation for the Stability and Growth Pact (SGP) in Articles 121 (multilateral surveillance) and 126 of the TFEU (excessive deficit procedure) and Protocol No 12 on the excessive deficit procedure. Secondary Union law sets out in more detail how the rules and procedures provided for by the Treaty have to be implemented. The first Economic Governance Package ('Six-Pack') entered into force on 13 December 2011, reforming and amending the rules of the SGP. The amended SGP provides the main instruments for the surveillance of Member States'



fiscal policies (preventive arm) and for the correction of excessive deficits (corrective arm). In its current form, the SPG consists of the following measures:

- Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, as amended by Council Regulation (EC) No 1055/2005 of 27 June 2005 and Regulation (EU) No 1175/2011 of 16 November 2011. This regulation constitutes the preventive arm;
- Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, as amended by Council Regulation (EC) No 1056/2005 of 27 June 2005 and Council Regulation (EU) No 1177/2011 of 8 November 2011. This regulation constitutes the corrective arm;
- Regulation (EU) No 1173/2011 of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area;

In addition, the 'Code of Conduct', which is an opinion of the Economic and Financial Committee (Committee of the Economic and Financial Affairs Council - EFC), contains specifications on the implementation of the SGP and provides guidelines on the format and content of Stability and Convergence Programmes (SCPs). Though the 'Code of Conduct' is formally below the level of a regulation, the fact that it specifies how to implement the SGP in practice makes it of high importance. Its most recent update, agreed by the EFC on 15 May 2017, includes specifications on flexibility within the existing rules of the SGP (via so-called investment and structural reform clauses and via a matrix specifying economic good and bad times within the preventive arm of the Pact); these specifications are based on a 'Commonly agreed position on flexibility within the SGP' as agreed by the EFC in November 2015 and endorsed by the ECOFIN Council in February 2016; the starting point for the discussions was the Commission communication on flexibility of January 2015. Furthermore, the current version of the 'Code of Conduct' contains two opinions - of November 2016 - of the EFC, which put a stronger focus on the expenditure benchmark, while the structural balance indicator remains an essential part of the fiscal surveillance framework.

1. Preventive arm of the SGP

The aim of the preventive arm is to ensure sound public finances by multilateral surveillance based on Article 121 of the TFEU. The amended Regulation (EC) No 1466/97 and the new Regulation (EU) No 1173/2011 form the secondary legislation foundation.

A key concept in surveillance and guidance is the country-specific medium-term budgetary objective (MTO). The MTO of each country has to be in a range of between -1% of GDP and balance or surplus, corrected for cyclical effects and one-off temporary measures. This objective has to be revised every three years, or when major structural reforms are implemented which impact on the fiscal position. Core instruments in the preventive arm of the SGP are the Stability and Convergence Programmes.

Stability and Convergence Programmes (SCPs)

Submission: As part of the multilateral surveillance under Article 121 of the TFEU, in April of each year, each Member State has to submit a stability programme (in the case



of euro area Member States) or a convergence programme (for non-euro area Member States) to the Commission and the Council. The stability programmes must contain, inter alia, the MTO, the adjustment path to it and a scenario analysis examining the effects of changes in the main underlying economic assumptions on the fiscal position. The basis for the calculations must be the most likely macro-fiscal (or more prudent) scenarios. These programmes are published.

Assessment: The Council, on the basis of an assessment by the Commission and the EFC, examines the programmes. In particular, progress made towards achieving the MTO is scrutinised. A new element in the amended SGP is the explicit consideration of the development of expenditure in the assessment.

Opinion: On the basis of a Commission recommendation and after consulting the EFC, the Council adopts an opinion on the programmes. In its opinion, the Council can ask the Member States to adjust their programmes. The opinion forms an integral part of the country-specific recommendations adopted by the Council at the end of each European Semester.

Monitoring: The Commission and the Council monitor the implementation of the SCPs.

Early warning: In case of major deviations from the adjustment path to the MTO, the Commission addresses a warning to the Member State concerned in accordance with Article 121(4) of the TFEU (Articles 6 and 10 of amended Regulation (EC) No 1466/97). This warning is given in the form of a Council recommendation requesting the necessary policy adjustments by the Member State concerned.

Sanctions: For euro area Member States, the amended SGP also provides for the possibility of imposing sanctions in the form of an interest-bearing deposit amounting to 0.2% of the previous year's GDP, when the Member State concerned does not take appropriate adjustment action. Provision is also made for fines for the manipulation of debt or deficit data.

European Semester: The submission and assessment of the SCPs forms part of the European Semester, which is a broader process of economic policy coordination within the European Union and which includes the preventive arm of the SGP.

2. Corrective arm of the SGP

Excessive deficit procedure (EDP)

The purpose of the EDP is to prevent excessive deficits and to ensure their prompt correction. The EDP is governed by Article 126 of the TFEU, Protocol No 12 annexed to the Treaty, and the amended Regulation (EC) No 1467/97 and the new Regulation (EU) No 1173/2011.

According to the amended SGP, an EDP is triggered by the deficit criterion or the debt criterion:

- Deficit criterion: A general government deficit is considered to be excessive if it is higher than the reference value of 3% of GDP at market prices; or
- Debt criterion: debt is higher than 60% of GDP and the annual debt reduction target of 1/20 of the debt in excess of the 60% threshold has not been achieved over the last three years.



The amended regulation also contains provisions clarifying when, if a deficit is higher than the stated reference value, it will be considered exceptional (resulting from an unusual event or a severe economic downturn, etc.) or temporary (when forecasts indicate that the deficit will fall below the reference value following the end of the unusual event or downturn).

Articles 126(3) to 126(6) of the TFEU lay down the procedure for assessing and deciding on an excessive deficit. The Commission prepares a report if a Member State does not comply with, or if there is a risk that it will not comply with, at least one of the two criteria. The EFC formulates an opinion on this report. If the Commission sees an excessive deficit as a given (or as a possible occurrence), it addresses an opinion to the Member State concerned and informs the Council. On the basis of a Commission proposal, the Council has the final decision on whether an excessive deficit exists (Article 126(6) of the TFEU). It subsequently, on the basis of a Commission recommendation, adopts a recommendation addressed to the Member State concerned (Article 126(7) of the TFEU) to demand that effective action be taken to reduce the deficit, setting a deadline of no longer than six months. Where the Council establishes that no such action has been taken, its recommendation may be made public (Article 126(8) of the TFEU). After persistent failure to comply with the recommendations made, the Council may notify the Member State concerned to take appropriate measures within a given time limit (Article 126(9) of the TFEU).

Sanctions: The EDP also provides for sanctions in cases of non-compliance (Article 126(11) of the TFEU). For euro area Member States, as a rule, this sanction is a fine, consisting of a fixed component (0.2% of GDP) and a variable component (up to a maximum of 0.5% of GDP for both components taken together).

Provision is made for additional sanctions for euro area Member States in Regulation (EU) No 1173/2011 on the effective enforcement of budgetary surveillance in the euro area. The sanctions are imposed at different stages of the EDP and entail non-interest-bearing deposits of 0.2% and a fine of 0.2% of previous years' GDP. Under the same regulation, provision is also made for sanctions for statistical manipulation.

B. Fiscal Compact

At the European Council meeting in March 2012, the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), the fiscal component of which is the Fiscal Compact, was signed by all Member States except the UK and the Czech Republic (Croatia also did not sign this treaty, neither before nor after its EU accession on 1 July 2013). The Fiscal Compact provides for the balanced budget 'golden rule', with a lower limit of structural deficit of 0.5% of GDP (if public debt is lower than 60% of GDP, this lower limit is set at 1% of GDP), to be enshrined in national law, preferably at constitutional level (the 'debt brake'). Member States may bring proceedings against other Member States before the Court of Justice of the European Union in cases where this rule has not been properly implemented. Additional provisions include, inter alia, automatic triggering of the correction mechanism and enforced rules for countries under the EDP. In addition, financial assistance from the European Stability Mechanism will only be provided to Member States which have signed the Fiscal Compact.



C. Further reforms strengthening economic governance in the euro area

The 2011-2013 reforms of the economic governance of the Union and of the fiscal policies framework includes, besides the revised SGP rules and the intergovernmental TSCG, two regulations whose purpose is to further strengthen economic governance in the euro area (the 'Two-Pack'):

- Regulation (EU) No 473/2013 of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area; and
- Regulation (EU) No 472/2013 of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area.

The main elements of the first regulation are to provide for common budgetary timelines for all euro area Member States, and for rules on the monitoring and assessment by the Commission of Member States' budget plans. In cases of serious non-compliance with the SGP rules, the Commission can request that the plans be revised. Furthermore, it stipulates that euro area Member States which are subject to an EDP must present an Economic Partnership Programme detailing the policy measures and structural reforms needed to ensure an effective and lasting correction of the excessive deficit. The Council, acting on a proposal from the Commission, adopts opinions on the economic partnership programmes.

The second regulation concerns Member States experiencing or threatened with serious difficulties with respect to their financial stability. It sets rules for enhanced surveillance, financial assistance and post-programme surveillance (as long as a minimum of 75% of the financial assistance received has not been repaid).

ROLE OF THE EUROPEAN PARLIAMENT

The European Parliament is co-legislator as regards the setting of detailed rules for multilateral surveillance (Article 121(6) of the TFEU), and is consulted on secondary legislation implementing the EDP (Article 126(14) of the TFEU). The amended SGP contains a new instrument, the Economic Dialogue, which gives Parliament a prominent role in the current fiscal policies framework in that it entitles Parliament's competent committee to invite the President of the Council, the Commission, the President of the European Council, the President of the Eurogroup and, if appropriate, a Member State, for an exchange of views. Parliament is also kept regularly informed about the application of the regulations. Furthermore, the Commission's powers to impose extra reporting requirements within the framework of the new regulation on monitoring and assessing draft budgetary plans and ensuring correction of the excessive deficit of the Member States in the euro area will now have to be renewed every three years, with Parliament or the Council able to revoke them.

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