IN-DEPTH ANALYSIS

European Parliament

Economic Dialogue with the European Commission on EU Fiscal Surveillance

ECON on 4 March 2021

Vice-President Dombrovskis and Commissioner Gentiloni have been invited to an Economic Dialogue on the fiscal part of the European Semester autumn package adopted by the Commission in November 2020. The fiscal elements of the package include the Commission Opinions on euro area 2021 Draft Budgetary Plans, the fiscal policy recommendation for the euro area and some elements of the 2021 Alert Mechanism Report. In March 2020, the general escape clause of the Stability and Growth Pact was activated and the Commission and the Council are expected to reassess its duration soon. The Commission has announced that it will publish on 3 March guidance for the related discussions ("*One year since the outbreak of COVID-19: fiscal policy response*").

This briefing addresses the following subjects: (1) Economic situation; (2) Surveillance of national fiscal policies; (3) Surveillance of macroeconomic imbalances (fiscal aspects); (4) Activation of the Recovery and Resilience Facility; and (5) Review of the EU economic governance framework.

1. Economic background

Recent economic developments and estimations

On 11 February 2021, the European Commission published its Winter 2021 European Economic Forecast. While it is the most recent macro-economic forecast from the Commission, it is an interim forecast covering only GDP growth and inflation figures. It does not contain public finance forecasts; those were carried out in the Autumn 2020 European Economic Forecast and will be updated in Spring 2021. Therefore, this briefing still contains public finance data from Autumn 2020, which are the latest available.

According to the Winter 2021 Forecast, GDP is projected to grow by 3.7% in 2021 and 3.9% in 2022 in the EU, and by 3.8% in both years in the euro area. The EU is expected to reach the pre-crisis level of output in mid-2022, which is earlier than anticipated in the Autumn 2020 Forecast, largely because of the stronger momentum in the second half of 2021 and in 2022. While some Member States are expected to see economic output return to their pre-pandemic levels by the end of 2021 or early 2022, others are expected to take longer. Inflation in the euro area and the EU is expected to be slightly higher in 2021 compared to last Autumn Forecast figures, but to remain subdued despite a temporary boost from base effects.

The unemployment rate in the EU, as included in the Autumn 2020 Forecast, is projected to rise from 6.7% in 2019 to 7.7% in 2020 and 8.6% in 2021, before declining to 8.0% in 2022.

The Commission highlights that the current projections are subject to significant uncertainty and both elevated positive and negative risks, predominately linked to the evolution of the pandemic and the success of vaccination campaigns. It should also be noted that some policy decisions may also improve the situation

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i.e. as Commissioner P. Gentiloni has highlighted when presenting the Winter Forecast, *"the impact of Next Generation EU should provide a strong boost to the hardest-hit economies over the coming years, which is not yet integrated into today's projections"*. See Box 2 below for some assessments of the possible impact of the Recovery and Resilience Facility.

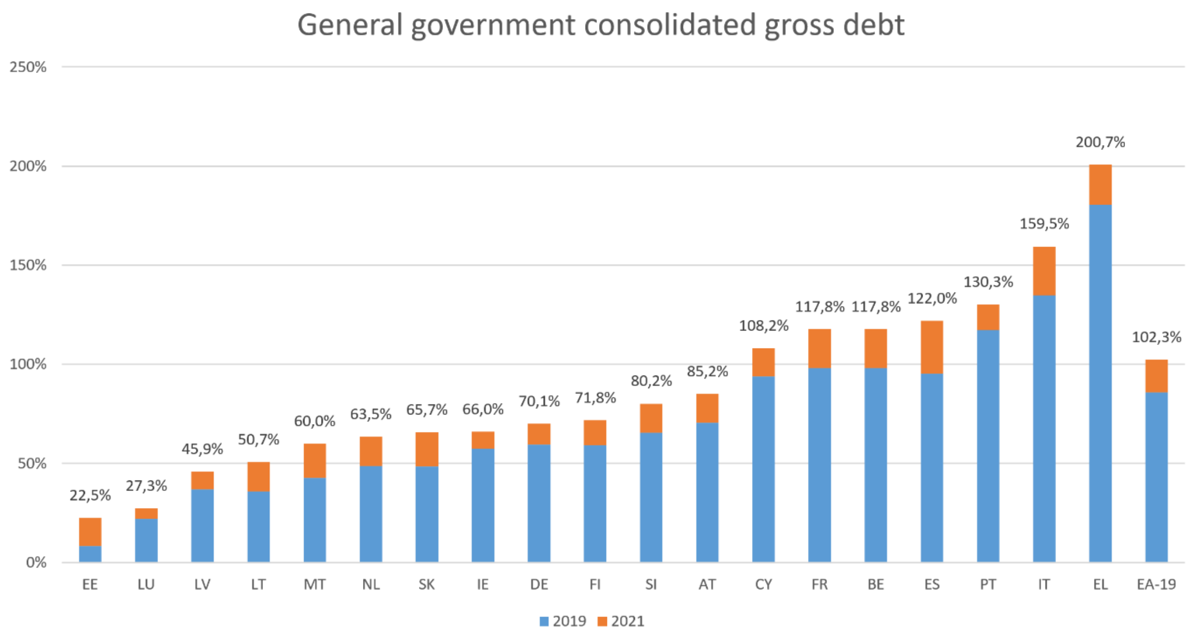
For further reading, see: EU economic developments and projections - latest update.

Latest data on public finances

According to the Commission's Autumn 2020 Forecast, the rise in government deficits in 2020 is expected to be very high across the EU, given that government spending increases and tax revenues fall, both as a result of the exceptional policy actions designed to support the economy and the effect of automatic stabilisers. The forecast projected the aggregate government deficit of the euro area to increase from 0.6% of GDP in 2019 to about 8.8% in 2020, before declining to 6.4% in 2021, reflecting the expected phasing out of emergency support measures in the course of 2021, as the economic and health situation improves.

As the Commission puts it, *"Mirroring the spike in deficits, the forecast projects the aggregate euro area debt-to-GDP ratio will increase from 85.9% of GDP in 2019 to 101.7% in 2020, 102.3% in 2021 and 102.6% in 2022."* See Figure 1 below for a cross-country comparison and Box 1 overleaf for the latest Commission debt assessments of all EU Member States.

Figure 1: Public debt (as % GDP) in Euro Area Member States in 2019 and 2021



Source: Commission Autumn 2020 Economic Forecast

A recent Commission Report on Public Finances in EMU (published on 26 February 2021) addresses *inter alia* the analytical topic of the currently negative interest-growth differentials in the EU. The report shows that negative differentials have been common in the EU, but that a high degree of variation exists across Member States. A finding of the report is that public debt tends to decline during periods when the interest growth differential is negative, but that nevertheless caution is needed with regard to the longer-term implications of the low interest rate environment; in this context it refers to smaller fiscal efforts which partly offset debt reduction during negative interest rate growth episodes, in particular in highly indebted Member States.

In this respect, one may notice the effects of recent monetary and fiscal decisions on the spreads of sovereign debt. In the words of Isabel Schnabel, Member of the Executive Board of the ECB: "*Together, the Pandemic Emergency Purchase Programme and the Recovery and Resilience Facility created the conditions for national fiscal policies to mitigate the dramatic social and economic costs of this crisis. The experience of the past year suggests that, in the presence of both facilities, all national government bonds are, in essence, considered safe assets by private investors. Indeed, never since the global financial crisis of 2008 has the spread between the GDP-weighted 10-year sovereign yield and the euro area risk-free rate been lower than today, despite the sharp rise in nominal debt and deficits*".

Box 1: Recent public debt assessments of EU Member States

In February 2021, the Commission published its regular Debt Sustainability Monitor. It includes the following conclusions:

2020 appears as an exceptional year in terms of debt dynamics. While the conditions to sustain high debt levels certainly improved over the past years, given the global fall of interest rates and the lengthening of debt maturities, a number of EU Member States recorded persistently high debt levels. In 2020, the necessary fiscal expansion to respond to the crisis has led to a large increase of government debt ratios in the Member States. Despite the severity of the crisis, large-scale monetary policy support and EU initiatives have contributed to stabilising sovereign financing conditions, and enabled financing large government borrowing needs (with euro area governments having issued more than €1 trillion of debt on a net basis last year). Yet, the pandemic heightened challenges to debt sustainability, and assessing fiscal sustainability risks appears particularly critical at the current juncture.

Reflecting the large and abrupt deterioration of public finances in 2020, resulting from the severe recession and the needed fiscal response, eleven countries appear at short-term risk of fiscal stress in the report (including Belgium, Spain, France, Croatia, Italy, Cyprus, Latvia, Portugal, Romania, Slovakia and Finland) – according to the early-warning indicator used by the European Commission.

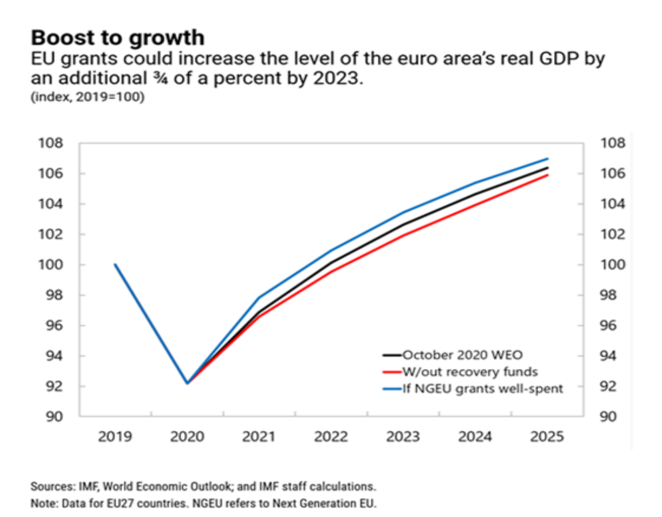
Over the medium term, eight countries are found to face high risk (Belgium, Spain, France, Italy, Portugal, Romania, Slovenia and Slovakia). These results are driven by the high debt ratio (in Belgium, Spain, France, Italy and Portugal), which is projected to only gradually fall – sometimes late - over the projection period.

For more data, see separate EGOV briefing "Public finances in Euro Area Member States: Selected indicators".

Box 2: Estimated impact of the Recovery and Resilience Facility (RRF)

The staff of three institutions (the European Commission, the European Central Bank and the International Monetary Fund) provided their initial assessments on how the RRF can affect the economic development in the near, medium and longer term.

According to the IMF, "*EU recovery funds could play a critical role in accelerating the green and digital transitions and boosting potential growth. The €750 billion Next Generation EU recovery funds—€390 billion of which are grants—should be used to catalyze investments to reduce carbon emissions and improve productivity through digitalization. The grants are already expected to boost the level of EU countries' real GDP by ¾ of a percent by 2023 and, if well-spent, the impact could be double. The package could have an even bigger impact if countries are ambitious in implementing key structural reforms in their recovery plans.*"



The analysis published by the Commission highlights that the RRF will give *"a temporary (yet sustained over several years) fiscal impulse across EU Member States"*; however, the impact on *"national public debt in the medium term will depend on a number of factors"*. The Commission claims that there will be both direct and indirect effects related to the RRF. As the Commission puts it, the grant component of the RRF represents an additional source of public revenue for national governments, which in turn will directly impact the budget balance. As the Commission points out, the additional expenditure will boost aggregate demand during the implementation period of the RRF (up until 2026), and is also expected to increase potential growth over the medium term, especially if the expenditure increases the physical and human capital, and is accompanied by significant structural reforms. The Commission estimates that the RRF would reduce EU debt-to GDP ratio by around 1 percentage point by 2026. Its simulations also show that the positive impact of the RRF on the EU GDP growth will be positive till 2030 and potentially beyond.

The ECB has assessed the potential macroeconomic impact from the RRF for the euro area countries on the basis of three different scenarios. Its assessment concludes that *"if used for productive public investment ... [RRF] funds could increase real output in the euro area by around 1.5% of GDP over the medium term. The magnitude and persistence of the positive output effect beyond the end of ... disbursements depend crucially on the impact of the public investment projects on the economy's overall productive capacity."* Based on its estimation, the ECB further finds that if RRF funds were used as fiscal transfer and not as investments, they would *"lack any long-term productivity-enhancing effects and only lift demand in the short run, they [would] lead mainly to additional debt"* and therefore, the RRF would not allow to exploit the potential positive medium-term output effects. Based on its analysis, the ECB suggests that *"if high-debt countries have limited capacity to absorb ... [RRF] funds for investment, the next best use would therefore be to reduce debt (in the case of grants) or replace debt with ... [RRF] loans with lower interest payments. In that case, output in high-debt countries would still increase, driven by positive spillover effects from investment in less-indebted countries and by positive effects from reductions in sovereign risk premia"*.

2. EU fiscal surveillance - latest developments

Activation of the general escape clause

In March 2020, the COVID-19 outbreak led the Commission to assume a severe economic downturn of the euro area and the EU as a whole and to consider that the conditions for the activation of the general escape clause of the SGP are fulfilled. Also in March, EU Finance Ministers agreed with that assessment, thus providing clarity that the general escape clause has been activated. The activated clause allows Member States in the preventive arm to temporarily depart from the respective adjustment paths towards their medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. If a Member State is in the corrective arm, the clause implies that the Council may decide, on a Commission recommendation, to adopt a revised fiscal trajectory. In short, the general escape clause does not suspend the procedures of the SGP, but allows the Commission and the Council to depart from the budgetary requirements that would normally apply.

Fiscal policy measures in the context of the general escape clause

Against the background of the above mentioned procedural framework, the EU Member States have adopted budgetary, liquidity and economic policy measures (including schemes approved under temporarily flexible EU State aid rules) to increase the capacity of their health systems and provide relief to those citizens and sectors that were particularly impacted (for an overview of measures at EU level, please see specific EGOV briefing); according to current Commission estimates, the national measures amount to about EUR 3 trillion. The latest available country-specific overview compiled by Commission services dates from February 2021. The Commission Report on Public Finances in EMU 2020 (published on 26 February 2021) states in this context "*Member States provided ample liquidity to counter the economic fallout of the pandemic, with state guarantees accounting for the largest category, amounting to almost 20% of GDP.*"

In May 2020, the Commission adopted Excessive Deficit Procedure (EDP) reports under Art. 126(3) TFEU for nearly all Member States [1], in which it finds that all assessed Member States do not comply with the deficit criterion (and some nor with the debt criterion). However, the Commission also considered - due to the pandemic - that at this juncture, a decision on whether to place Member States under the EDP should not be taken. Note that all Member States except Romania are currently in the preventive SGP arm [2] and that many Member States have also triggered national escape clauses to suspend national budgetary rules.

The Council recommended in July 2020, as part of the Country Specific Recommendations (CSRs), without providing country specific fiscal targets, that Member States should take all necessary measures to address the pandemic, sustain the economy and support the ensuing recovery and that, when economic conditions allow, they should pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. In addition, the fiscal policy related 2020 CSRs contains country specific elements, notably relating to strengthening the health care system.

While the 2020 CSRs focus on tackling the socioeconomic impacts of the COVID-19 pandemic and facilitating the economic recovery, the 2019 CSRs also covered reforms that are essential to address medium- to long-term structural challenges. In accordance with the recitals of the 2020 CSRs, the 2019 CSRs country-specific recommendations remain pertinent and will continue to be monitored throughout the 2021 European Semester. By April, in the context of the implementation of the RRF (see section 4 below),

[1] The exceptions were Romania, which was already in the corrective arm of the Pact, and Bulgaria, since it was not expected to breach the numerical Treaty reference thresholds on public deficit and debt.

[2] Romania is since April 2020 in Excessive Deficit Procedure, for reasons relating to pre-pandemic times.

Member States are requested to put forward their respective Recovery and Resilience Plan (RRP), that should *inter alia* contribute to achieving their CSRs.

In November 2020, the Council (ECOFIN) took note of the Commission intention to propose in 2021 only CSRs on the budgetary situation of the Member States, as envisaged under the SGP, as it considered it important to reflect on future fiscal policy orientations (non fiscal CSRs will not be issued). At the same time, the Council underlined that the high uncertainty about the development of the COVID19 pandemic and its economic and social impact needs to be taken into account in fiscal policies.

The euro area Member States submitted in October their Draft Budgetary Plans (DBPs) for 2021, containing *inter alia* forecasts on GDP growth, public deficit, public debt and budgetary structural balances. A comparison (see separate EGOV note) of these national forecasts with the Commission Autumn 2020 forecasts reveals some significant differences (especially for 2021), which is not surprising given the particular high uncertainty linked to the impact of the pandemic. The comparison also shows that the following countries have in general more optimistic figures for 2020 and 2021 than the Commission: Belgium, Greece, Spain, France, Italy, Cyprus, Austria, Portugal and Slovakia.

All the Commission opinions (November 2020) on the 2021 DBPs for the euro area Member States conclude that the DBPs are "*overall in line with the fiscal policy recommendation adopted by the Council on* 20 July 2020" and that most of the measures in the DBP support economic activity against the background of considerable uncertainty. Most of the measures in the DBPs are assessed to support economic activity.

Box 3: Autumn 2020 Budgetary Surveillance

In accordance with EU Regulation 473/2013, euro area Member States which are not subject to a macro-economic adjustment programme shall submit annually a Draft Budgetary Plan (DBP) for the forthcoming year to the Commission and the Eurogroup by 15 October.

The objective of submitting DBPs to the COM and the Eurogroup is to enable an **enhanced monitoring of national budgetary policies** in the euro area and ensure that the national budgets are consistent with the economic policy recommendation issued in the context of the SGP and the European Semester for economic policy coordination.

The surveillance of the DBPs **is complementary and linked** to other EU economic governance procedures. Regarding countries in the preventive arm of the SGP, the COM assesses usually in its DBP Opinions the extent to which Member States have implemented the Country-Specific Recommendations, in particular the compliance with their Medium-Term Objective (MTO) or with the adjustment path towards it. In autumn 2020, due to the exceptional circumstances of the pandemic, the COM Opinions on the DBPs are however diverging from the normal practice: their focus is now on the the assessment of the budgetary measures for 2021 instead of the medium-term; they assess whether the planned supportive measures are in line with the Council recommendations of 20 July 2020 and the guidance provided in the letters sent to Member States by the Commission on 19 September 2020; they is also assessed whether the measures are temporary or not. *The latter is important in the context of preserving fiscal sustainability in the medium term, in line with the general escape clause.*

However, the Commission points out some potential issues with regard to a few Member States: "*For Belgium, France, Greece, Italy, Portugal and Spain, given the level of their government debt and high sustainability challenges in the medium-term before the outbreak of the COVID-19 pandemic, it is important to ensure that, when taking supporting budgetary measures, fiscal sustainability in the medium term is preserved.*" Furthermore, for Austria, Belgium, Cyprus, Estonia, Finland, Germany, Greece, Ireland, Latvia, Luxembourg, Malta, Netherlands, Portugal, Slovenia and Spain, the measures are assessed to be (mostly) temporary. However, the Commission also concludes that "*some measures set out in the DBPs of France, Italy, Lithuania and Slovakia do not appear to be temporary or matched by offsetting measures.*" It concerns also the updated DBP of Lithuania of December 2020.

When and how to deactivate of the general escape clause

In July 2020, the European Fiscal Board stated in a report that a review date and the conditions for an exit from the escape clause have not been indicated and should be discussed and agreed as soon as possible. It also noted that ''*In principle, the clause should be deactivated as soon as the severe economic downturn in the EU and the euro area comes to an end. However, there is no commonly accepted or agreed definition of a severe economic downturn. The Commission and the Council may hold different views. Also within the Council views may diverge considerably, especially if the economic impact of the Covid-19 crisis differs across countries: some may soon embark on an upturn, others may experience negative growth for longer.*''

The Commission Communication on the Opinions on the 2021 DBPs includes the following statement on the general escape clause: *"In light of this need and the still high uncertainty about the economic consequences of the pandemic, the general escape clause will remain active in 2021. In spring 2021, taking into account updated macroeconomic projections, the Commission will reassess the situation and take stock of the application of the general escape clause."*

On 26 February, Commissioner Gentiloni stated: *"When it comes to the Stability and Growth Pact and the general escape clause, we have made clear our stance for this year. The question now is: what about 2022? Next week, we will provide guidance for the period ahead and the criteria that we will look at to decide on the general escape clause. This will form the basis for discussions in the Eurogroup and ECOFIN, and decisions. Once again, we should be clear that when it comes to fiscal support at the current juncture, the risks of doing too little outweigh the risks of doing too much".*

The Commission is expected to adopt in the coming days (by 3 March) a Communication with guidance for Member States on the appropriate fiscal stance ("*One year since the outbreak of COVID-19: fiscal policy response*").

Box 4: Some conclusions from papers prepared by external experts upon the request of EP

The paper by **Gern, Kooths and Stolzenburg** proposes that "*the general escape clause should be lifted as soon as epidemiological conditions allow for a sustained normalisation of economic activity. This could be the case in 2022, if vaccines are made available to a sufficiently large share of the population in 2021. Under the current framework, we propose a transitory arrangement following the deactivation of the general escape clause in which all Member States remain under the preventive arm of the SGP. Reflecting increased uncertainty about the long-run effects of the crisis on the economy, the corrective arm would remain idle for another two years and the Commission would consider pre-crisis estimates of potential output as a benchmark to determine fiscal adjustment needs*".

The paper by **Luisa Lambertini** suggests that the deactivation should take place only once the economies have recovered from the effects of the pandemic and it is clear that they are approaching their pre-Covid-19 levels; concretely, the paper by Lambertini recommends that pre-Covid-19 economic conditions, as captured by the Commission autumn 2019 forecast of the 2020 output gap or the 2019 level of real GDP, be taken as a reference for lifting the general escape clause: "*Each Member State should revert to the prescription of the SGP when this State's output gap has returned to its pre-Covid-19 level*".

The paper by **Erik Jones** concludes *inter alia* that ''*Finding a balance between a durable recovery and fiscal sustainability explains why it is necessary to have transitional arrangements in place when deactivating the general escape clause. The SGP makes provision for this through the unusual circumstances clause. More important, the European Recovery Program provides an opportunity to enhance the credibility of the European Union's pattern for fiscal policy surveillance and macroeconomic policy coordination while at the same time replacing national fiscal stimulus that might be removed through consolidation efforts.*''

The paper by **Philipe Martin and Xavier Ragot** proposes that the deactivation of the general escape clause should take place only when a reform of the SGP has been agreed upon and the EU has returned to its pre-crisis level in terms of GDP per capita or employment. The authors propose country specific fiscal recommendations during the transitory period, before the activation of new rules, with the objective of avoiding pro-cyclical policies, allowing transitory fiscal stimulus and avoiding an unmotivated permanent increase of their structural deficit.

A separate EGOV briefing provides more detailed summaries of all the four papers.

3. Surveillance of macro-economic imbalances - some fiscal aspects

The Commission published in November 2020 its latest Alert Mechanism Report, which presents the analysis of the macroeconomic situation and imbalances in the EU and in each Member State, as well as in the euro area.

The pandemic crisis has interrupted most of the positive developments observed until 2019 (especially on public debt and current account deficits) and is aggravating a number of existing macroeconomic imbalances, including both government and private debt-to-GDP ratios. It should be noted that part of the increase in debt-to-GDP ratios in 2020 is the mechanical effect of much reduced nominal GDP.

Several Member States are and will be affected by multiple and interconnected vulnerabilities.

Government debt-to-GDP ratios are rising; the loss in output and in revenues associated with the recessions in 2020, as well as the huge support measures put in place by governments to cushion the impact of the crisis, are at the origin of increased borrowing and growth in debt stocks in all EU Member States. The debt rises reflect also debt-increasing measures that include forms of financial support (loans and equities) not recorded in government budget balances: these effects are forecast to be the highest in Cyprus, Denmark, Germany and Slovenia.

New risks emerge, most notably related to debt repayment by the private sector (households and business) that might become difficult due to the reduced economic activity. Difficulties in debt repayments might affect banks' balance sheets and profitability. In addition, difficulties related to debt repayments - especially by businesses - could imply that implicit guarantees provided by the governments are called, thereby further deteriorating public finances. In 2021, debt ratios are expected to stabilise or mildly decline in around half of the Member States, and expected to further rise in the remaining EU countries. The increases of government debt ratios are generally expected to be sharper where pre-crisis debt levels were already relatively high: this reflects the fact that recessions have generally been more severe in these countries, mainly because infections were widespread and followed by strong containment measures, and because the economies rely more on sectors like tourism (Greece, Italy, Portugal and Spain).

The maturity structures of government debt might imply additional risks for some countries: they differ significantly across the Member States, implying also different refinancing needs in the near future. The gross financing needs in the coming years are forecast to be at or above 20% of GDP for Belgium, France, Hungary, Italy and Spain. Some non-euro area countries, including Hungary and Romania, face additional risks because relatively large shares of their public debt are denominated in foreign currency.

According to the Commission, the implications of growing (public and private) debt-to-GDP ratios require monitoring also in a number of Member States not currently identified with imbalances. In Belgium, both private and government debt are expected to grow above the MIP thresholds. In Denmark, Finland, and Luxembourg, private debt is forecast to further grow above threshold. Government debt is expected to further grow to above 60% of GDP in Austria and Slovenia.

The Commission notes "*the extent to which those developments entail additional risks for macroeconomic stability is surrounded by large uncertainty, as the outlook for debt crucially depends on medium and longer-term growth prospects, which are currently difficult to assess*".

Additional information on the implementation of MIP is available in this EGOV note.

4. The activation of the Recovery and Resilience Facility

The amended Semester cycle

Due to the pandemic, the European Semester for economic policy coordination in 2021 will look rather different (in both form and substance) to what it was in previous cycles.

The national RRPs, to be submitted by Member States during spring 2021, will become the main reference document for the Member States' forward-looking economic policy initiatives. Other Semester documents and steps will also have a different configuration to cater for the activation of the Recovery and Resilience Facility (RRF). Some of the main changes relate to:

- Member States being encouraged to present their National Reform Programmes and RRPs in one single document;
- Other than on fiscal matters, the Commission will not propose CSRs to Member States that present RRPs;
- in 2021, Country Reports will be replaced by the analytical documents assessing Member States' RRPs;
- Fiscal surveillance will be limited, due to the activated general escape clause under the SGP, and the Stability or Convergence Programmes will detail how to maintain fiscal sustainability going forward;
- Member States are required to take into account the Euro Area Recommendation when preparing their RRPs (see box below);
- The 2018 and 2019 CSRs, along with other relevant policy orientations set out in the context of the European Semester, will guide Member States RRPs, and Member States will report on progress in the framework of the Semester.

Box 5: 2021 recommendation on the economic policy of the euro area

The 2021 euro area recommendation (EAR) are expected to be finally adopted after the March 2021 European Council. The COVID crisis and its responses are at the centre of concerns in the draft EAR. In particular, EAR 1 focusing on fiscal policies, recommend maintaining supportive (and coordinated) policies throughout 2021, as the health emergency persists. Emergency measures are to be phased out "*once economic conditions allow, while combatting the social and labour market impact of the crisis*."

Following on from Eurogroup discussions, on 22 February, in a speech during the European Parliamentary Week, the Eurogroup President noted the Eurogroup intends to agree, by July, "*a common understanding on the appropriate fiscal stance*" to feed into the draft budgetary plans for 2022, which member states will be submitting in autumn. The Eurogroup is to be involved in discussing and coordinating implementation of the EAR and their relationship with the RRPs. For further information on the 2021 EAR, see specific EGOV briefing.

The main features of the RRF

Following a Commission proposal of 27 May 2020, the RRF regulation (EU 2021/241) was agreed between the co-legislators and entered into force on 12 February 2021. The RRF will provide Member States with grants (up to EUR 312.5 bn, 2018 prices) and loans (up to EUR 360 bn, 2018 prices) for financing packages of investments and reforms, aimed at addressing structural weaknesses and making their economies more resilient. Investments and reforms should focus on six identified pillars including the digital and green transitions; economic, social and territorial cohesion; health, economic and social resilience and policies for the next generation.

Member States may apply for grants and loans through their RRPs, which are adopted by the Council, on a proposal from the Commission. Payments under the Regulation can only be made until 31 December 2026. The plans should address the objectives set out in the RRF Regulation (see above) and challenges identified in the European Semester, particularly the country-specific recommendations addressed to Member States in 2019 and 2020. The Commission provided guidance to the Member States addressing notably the format of the RRPs, the "do no significant harm principle" and state aid matters.

Grants are to be allocated in accordance with criteria set out in the Regulation, partly taking into account the real impacts of the COVID crisis in Member States' economies. The funds will be available once Member States are assessed to be compliant with the milestones and targets set out in their RRPs; 13% of the allocated amount for grants may be disbursed once the RRP is adopted (pre-financing). Disbursements can be suspended if a Member State is found to be in breach of specific obligations under the EU economic governance framework (article 10 of the Regulation).

The Regulation also foresees provisions on transparency, requiring the Member States and the Commission to provide information (namely to the EP, allowing to discharge its scrutiny responsibilities) on reviews and controls on use of EU funds. It establishes the basis for a Recovery and Resilience Dialogue to take place at the Parliament's request, and recovery and resilience scoreboard to be set for compiling information allowing the assessment of implementation of the RRPs.

Box 6: RRF and European Parliament scrutiny

The European Parliament (EP) has a specific role to play in scrutinising the RRF and the use of EU funds throughout the European Union Investment Instrument (EURI). Notably, the EP can launch the Recovery and Resilience Dialogues with the Commission and will notably be receiving information from the Commission on the RRPs, on the Commission assessments and on Member States meeting the agreed milestones and targets. Through the Interinstitutional Agreement negotiated with the Council and the Commission, EP will also be able to scrutinise the use of EURI. The Commission plans to start issuing bonds to finance the RRF as soon as the framework is in place. Once the RRPs are adopted, Member States can request the Commission to release the pre-financing (up to 13% of their allotted quotas for grants and, if applicable, 13% of their loan requests). The Commission estimates issuance for financing the RRF to start in mid-2021 (once the Own Resources Decision is ratified by all Member States). See specific EGOV briefing for further details on the EP scrutiny of the RRF.

5. Review of the EU economic governance framework

In accordance with the so-called "Six-pack" and "Two-pack" Regulations[3], the Commission published in February 2020 a Communication on "Economic governance review". The purpose of this Communication was to start a public debate on the extent to which the different surveillance elements introduced or amended by the 2011 and 2013 reforms have been effective in achieving their key objectives, namely:

(i) ensuring sustainable government finances and growth, as well as avoiding macroeconomic imbalances,

(ii) providing an integrated surveillance framework that enables closer coordination of economic policies in particular in the euro area, and

(iii) promoting the convergence of economic performances among Member States.

In the context of the review exercise, the Commission launched a public debate, to give stakeholders the opportunity to provide their views on the functioning of surveillance so far and on possible ways to enhance the effectiveness of the framework in delivering on its key objectives. Originally, citizens and institutions were invited to submit their responses to the questions set in the Communication by 30 June 2020. However, the public debate has been impacted by the need to focus on the immediate challenges of the coronavirus crisis. Therefore, the period of public consultation has been extended and the Commission is expected to return to the review exercise when the immediate challenges have been addressed.

[3] Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and on the suitability of Council Directive 2011/85/EU", i.e. the set of legal acts comprising the provisions on the EU economic governance framework, published in 2011 and 2013, also known as "Six-pack" and "Two-pack".

When the consultation process is relaunched, it has to be factored in that the context for the debate has changed substantially since the February 2020 Communication by the Commission.

On 26 February 2021, at an event of the European Fiscal Board, Commission Vice President Dombrovskis stated the following, with regard to the review of EU fiscal rules (bolding added by the authors):

***Over time, our fiscal framework has grown to serve an increasingly wide range of objectives**. In itself, that could be an issue to reflect upon. Perhaps 'less is more'. It began as an instrument that was meant to avoid inconsistencies between decentralised fiscal policies and a single monetary policy. Now, it is an all-embracing tool to address sustainability and stabilisation needs, and to incentivise reforms and investments. We are now considering to what extent it should pay more attention to investment and growth, or to challenges such as the green and the digital transitions.*

*As I mentioned, the framework has become **too complex**. With this in mind, we should now reflect on the best ways to achieve all these different objectives. One avenue for simplifying the framework would be to move away from indicators that are not directly observable, such as output gaps and structural balances.*

*Another important element is to make sure that the framework delivers sustainable fiscal positions in all Member States. **We need a credible debt anchor that is adhered to**. These ideas reflect what the European Fiscal Board already said in its September 2019 report.*

*But it is clear that these **discussions will take some time** (...)*

At the same conference, Commissioner Gentiloni emphasised the following aspects (bolding added):

***First, we need to reflect on how our fiscal rules can support sustainable growth even as they keep spending under control.** Both dimensions are essential. We should not forget that public finances should serve our public policy priorities. And the European priorities boil down to the three dimensions of sustainability: climate, environment and social. (...) In this context, a special treatment for growth-enhancing expenditure is in my view needed. Or to put it another way, our fiscal rules should be adapted to improve the composition of public finances and make sure that any new debt is good debt.*

***Second, we must reflect on the role that a 'debt rule' should play in our fiscal framework.** While a strict debt rule could lead to a drastic, pro-cyclical and self-defeating and improbable adjustment, a credible mechanism to steer debt onto a gradual and steady downward trajectory remains warranted. **The requirements here must be realistic**: this is key to ensuring enforceability and reducing the risk of divergence in our Union and our Single Market. (...)*

***Third, we need to ensure that fiscal policy acts in a counter-cyclical manner** and contributes to macroeconomic stabilisation. (...) And as long as monetary policy is constrained, I believe that fiscal policy will continue to play a greater role in macroeconomic stabilisation.*

*So better coordination is needed to achieve **the right policy mix in the euro area**, in particular in terms of determining the euro area fiscal stance. This is also why the Economic Governance Review should be looked at jointly and in parallel with the ECB Strategy Review so that the two reviews result in a coherent outcome.*

*We should have a reflection on whether there is a need to turn to the **general escape clause more often in economic downturns**, in order to account for the effective lower bound on monetary policy. A single, more readily usable escape clause could be balanced by eliminating the multitude of exceptions that currently apply to the normal provisions of the Stability and Growth Pact. (...)*

*Of course, the first best way of strengthening the role of fiscal policy against shocks remains the **introduction of a permanent fiscal capacity in the euro area**. (...)*

The ECON Committee has launched an own-initiative report: *The review of the macro-economic legislative framework for a better impact on Europe's real economy and improved transparency of decision-making and* *democratic accountability* (Rapporteur Margarida Marques). Meetings with experts on different relevant topics have taken place and the draft report is being prepared.

Following a request of the ECON Committee, expertise by academic experts has been published on:

- "The role of fiscal rules in relation with the green economy" and
- "Benefits and drawbacks of an "expenditure rule", as well as of a "golden rule", in the EU fiscal framework".

For each of both topics, three papers by academic experts have been published; a separate EGOV briefing provides summaries of them.

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This document is available on the internet at: www.europarl.europa.eu/supporting-analyses

Annex 1: EU Gross domestic product

	Eurostat* (01/2021)					EC (02/2021)			IMF (10/2020)			ECB (12/2020)			OECD (12/2020)		
	2018	2019	2020 Q2	2020 Q3	2020 Q4	2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	2022
BE	1.8	1.7	-11.8	-11.6	-	-6.2	3.9	3.1	-8.3	5.4	2.7	-6.7	3.5	3.1	-7.5	4.7	2.7
DE	1.3	0.6	-9.7	8.5	0.1	-5.0	3.2	3.1	-6.0	4.2	3.1	-5.5	3.0	4.5	-5.5	2.8	3.3
EE	4.4	5.0	-5.5	3.3		-2.9	2.6	3.8	-5.2	4.5	3.7	-2.5	2.9	4.2	-4.7	3.4	3.3
IE	8.5	5.6	-3.2	11.1	-	3.0	3.4	3.5	-3.0	4.9	4.3	0.5	3.1	3.9	-3.2	0.1	4.3
EL	1.6	1.9	-14.1	2.3	-	-10.0	3.5	5.0	-9.5	4.1	5.6	-10.0	4.2	4.8	-10.1	0.9	6.6
ES	2.4	2.0	-17.9	16.4	0.4	-11.0	5.6	5.3	-12.8	7.2	4.5	-11.1	6.8	4.2	-11.6	5.0	4.0
FR	1.8	1.5	-13.7	18.5	-1.3	-8.3	5.5	4.4	-9.8	6.0	2.9	-9.3	4.8	5.0	-9.1	6.0	3.3
IT	0.9	0.3	-13.0	16.0	-2.0	-8.8	3.4	3.5	-10.6	5.2	2.6	-9.0	3.5	3.8	-9.1	4.3	3.2
CY	5.2	3.1	-13.1	9.4	-	-5.8	3.2	3.1	-6.4	4.7	3.6	-6.2	4.1	3.4			
LV	4.0	2.1	-7.1	7.1	-	-3.5	3.5	3.1	-6.0	5.2	5.0	-4.7	2.8	5.3	-4.3	2.4	4.0
LT	3.9	4.3	-5.9	3.8	1.2	-0.9	2.2	3.1	-1.8	4.1	3.7	-2.0	1.9	4.0	-2.0	2.7	3.1
LU	3.1	2.3	-7.4	9.8	-	-3.1	3.2	4.3	-5.8	5.9	3.7	-5.2	4.7	5.0	-4.4	1.5	3.8
MT	5.2	4.9	-17.1	12.7	-	-9.0	4.5	5.4	-7.9	4.8	5.5	-7.5	5.9	4.4			
NL	2.4	1.7	-8.5	7.8	-	-4.1	1.8	3.0	-5.4	4.0	2.1	-4.3	2.9	2.9	-4.6	0.8	2.9
AT	2.6	1.4	-11.6	12.0	-4.3	-7.4	2.0	5.1	-6.7	4.6	2.1	-7.6	3.0	4.0	-8.0	1.4	2.3
PT	2.8	2.2	-13.9	13.3	-	-7.6	4.1	4.3	-10.0	6.5	4.8	-8.1	3.9	4.5	-8.4	1.7	1.9
SI	4.4	3.2	-9.8	12.4	-	-6.2	4.7	5.2	-6.7	5.2	3.4	-7.6	3.1	4.5	-7.5	3.4	3.5
SK	3.8	2.3	-	-	-	-5.9	4.0	5.4	-7.1	6.9	4.8	-5.7	5.6	4.8	-6.3	2.7	4.3
FI	1.5	1.1	-3.9	3.2	-	-3.1	2.8	2.0	-4.0	3.6	2.0	-3.8	2.2	2.5	-4.0	1.5	1.8
EA	**1.9**	**1.3**	**-11.7**	**12.4**	**-0.7**	**-6.8**	**3.8**	**3.8**	**-8.3**	**5.2**	**3.1**	**-7.3**	**3.9**	**4.2**	**-7.5**	**3.6**	**3.3**
BG	3.1	3.7	-10.1	4.3	-	-4.9	2.7	4.9	-4.0	4.1	3.7				-4.1	3.3	3.7
CZ	3.2	2.3	-8.5	6.9	-	-5.7	3.2	5.0	-6.5	5.1	4.3				-6.8	1.5	3.3
DK	2.2	2.8	-7.1	5.2	-	-3.5	2.9	3.6	-4.5	3.5	2.5				-3.9	1.8	2.5
HR	2.8	2.9	-15.0	6.9	-	-8.9	5.3	4.6	-9.0	6.0	4.4						
HU	5.4	4.6	-14.6	11.4	-	-5.3	4.0	5.0	-6.1	3.9	4.0				-5.7	2.6	3.4
PL	5.4	4.5	-9.0	7.9	-	-2.8	3.1	5.1	-3.6	4.6	4.5				-3.5	2.9	3.8
RO	4.5	4.2	-12.2	5.8	-	-5.0	3.8	4.0	-4.8	4.6	3.9				-5.3	2.0	4.4
SE	2.0	1.3	-8.0	4.9	0.5	-2.9	2.7	4.0	-4.7	3.5	2.9				-3.2	3.3	3.3

** Note: For 2018 and 2019 the GDP growth is provided year-on-year change, while 2020 Q1, Q2 and Q3 are quarter-on-quarter changes.*