



## THE EU FRAMEWORK FOR FISCAL POLICIES

In order to ensure the stability of the Economic and Monetary Union, a robust framework is needed to prevent unsustainable public finances as far as possible. A reform (part of the ‘Six Pack’) amending the Stability and Growth Pact (SGP) entered into force at the end of 2011. Another reform in this policy area, the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), including the Fiscal Compact, entered into force in early 2013. Furthermore, a regulation on assessing national draft budgetary plans (part of the ‘Two Pack’) entered into force in May 2013. On 26 April 2023, the Commission presented its legislative proposals for the EU economic governance reform.

### 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) and Protocol No 13 (on the convergence criteria) to the Treaties.

### OBJECTIVES

The objective of the fiscal policy architecture of the European Union is 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 legal framework were a direct response to the sovereign debt crisis, which highlighted the need for stricter rules in the light of the spillover effects from unsustainable public finances between euro area countries. 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) TFEU. In April 2023, the Commission launched a new reform of the legal framework, building on the evolving economic governance of the EU over the past decade.

### ACHIEVEMENTS

#### A. Stability and Growth Pact

Primary EU law provides the main legal foundation for the SGP in Articles 121 (multilateral surveillance) and 126 (excessive deficit procedure) of the TFEU and Protocol No 12 on the excessive deficit procedure. Secondary EU law sets out in more detail how the rules and procedures provided for by the TFEU 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 the Member States' fiscal policies (preventive arm) and for the correction of excessive deficits (corrective arm). In its current form, the SGP 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 (EFC) (Committee of the Economic and Financial Affairs Council (ECOFIN)), contains specifications on the implementation of the SGP and provides guidelines on the format and content of the 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 makes it of great practical 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 a matrix specifying 'economic good times' and 'economic bad times' of the preventive arm and specifying which fiscal adjustment efforts are needed for the relevant cyclical situation and debt ratio). These specifications are based on a 'commonly agreed position on flexibility within the SGP' of the EFC (November 2015), which was endorsed by the ECOFIN Council in February 2016. The starting point for the discussions was the Commission communication entitled 'Making the best use of the flexibility within the existing rules of the Stability and Growth Pact' of 13 January 2015. Furthermore, the current version of the Code of Conduct contains two EFC opinions from November 2016, 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 TFEU, the amended Regulation (EC) No 1466/97 and the new Regulation (EU) No 1173/2011.

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 SCPs.

### Stability and Convergence Programmes (SCPs)

**Submission:** As part of the multilateral surveillance under Article 121 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 thereto 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 by the Commission.

**Assessment:** The Council examines the programmes on the basis of an assessment by the Commission and the EFC. 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 the 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) 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 those euro area Member States that do not take suitable adjustment action, 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. Provision is also made for fines for the manipulation of debt or deficit data.

**European Semester:** The submission and assessment of the SCPs form part of the European Semester, which is a broader process of economic policy coordination within the European Union that 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 they are swiftly rectified. The EDP is governed by Article 126 TFEU, Protocol No 12 to the Treaties, the amended Regulation (EC) No 1467/97 and the new Regulation (EU) No 1173/2011.

In accordance with 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;



- Debt criterion: debt is higher than 60% of GDP and the annual debt reduction target of one twentieth 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) 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) TFEU). Subsequently, on the basis of a Commission recommendation, it adopts a recommendation addressed to the Member State concerned (Article 126(7) 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) TFEU). After persistent failure to comply with the recommendations, the Council may give notice to the Member State concerned to take appropriate measures within a specified time limit (Article 126(9) TFEU).

Sanctions: The EDP also provides for sanctions in cases of non-compliance (Article 126(11) 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.

### 3. General escape clause of the SGP

Given the 'severe economic downturn in the euro area or the Union as a whole' created by the COVID-19 crisis, the Council (on the basis of a proposal by the Commission) activated the general escape clause under the SGP for the first time in March 2020, in order to provide leeway for the Member States to adopt emergency measures with major budgetary consequences. Once activated, the clause allows a Member State under the preventive arm to temporarily depart from the adjustment path towards the MTO, provided that this does not endanger fiscal sustainability in the medium term. If a Member State is under the corrective arm, the clause implies that the Council may decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. In short, the general escape clause does not suspend the procedures of the SGP, but it allows the Commission and the Council to depart from the budgetary requirements



that would normally apply. In March 2021, the Commission adopted a communication entitled ‘One year since the outbreak of COVID-19: fiscal policy response’, which includes, inter alia, the following statement: the decision on whether to deactivate the general escape clause or continue it for 2022 should be taken as an overall assessment of the state of the economy based on quantitative criteria. The level of output in the EU or euro area compared to pre-crisis levels would be the key quantitative criterion. Current preliminary indications would suggest to continue applying the general escape clause in 2022 and to deactivate it as of 2024.

## **B. Fiscal Compact**

At the European Council meeting in March 2012, the TSCG, the fiscal component of which is the Fiscal Compact, was signed by all Member States except the UK and Czechia (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 that 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 policy framework includes, in addition to 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 in the euro area experiencing or threatened with serious difficulties with respect to their financial stability.

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’ budgetary plans. In cases of serious non-compliance with the SGP rules, the Commission can request that the plans be revised. Furthermore, the regulation 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 out 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).

#### **D. Reviews of the key legislation**

In accordance with the ‘Six Pack’ and ‘Two Pack’ Regulations, the Commission published a communication entitled ‘Economic governance review’ in February 2020. 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.

On 19 October 2021, the Commission presented a communication relaunching the public debate on the review of the EU economic governance framework, taking stock of the changed circumstances following the COVID-19 crisis. The Commission published the outcome of the public consultation in March 2022.

On 9 November 2022, the Commission finally outlined in a communication its orientations for the reform of the EU economic governance framework, addressing the key economic and policy issues that will shape the EU’s economic policy coordination and surveillance for the next decade. The Commission has proposed moving to a risk-based EU surveillance framework that differentiates between countries by taking into account their public debt challenges, i.e. risks to debt sustainability. National medium-term fiscal-structural plans are the cornerstone of the Commission’s proposed framework. They would integrate fiscal, reform and investment objectives, including those to address macroeconomic imbalances where necessary, into a single holistic medium-term plan, thus creating a coherent and streamlined process. A single operational indicator – net primary expenditure, i.e. the expenditure which is in a government’s control – would serve as a basis for setting the fiscal adjustment path and carrying out annual fiscal surveillance. Member States would be required to present national medium-term fiscal-structural plans adapted to their national circumstances. These plans would cover a period of four years, during which their public finances would have to comply with a gradual, but continuous, reduction path of excessive government debt or, for low-debt countries, maintain a prudent fiscal policy. A Member State could apply for a more flexible path by extending the duration of its national medium-term fiscal-structural plan to a maximum of seven years. In exchange, it would have to commit to more reforms and investments. As regards the governance structure, these plans would have to be agreed with the Commission and approved by the Council, similar to the national recovery and resilience plans under NextGenerationEU.

As a starting point, the Commission would present a reference fiscal adjustment path to each Member State based on a commonly agreed framework, covering a period of four years, based on its debt sustainability analysis methodology.

A distinction would be made according to a country’s level of public debt:

- For countries with moderate or high levels of public debt, the Commission would propose a multi-annual adjustment path in terms of net public expenditure covering four years;
- Member States with a substantial public debt challenge would have to complete their budgetary adjustment over the life of their plan;



- Member States with a ‘moderate public debt challenge’ would have to complete their adjustment at the latest three years after the life of their plan.

In the event of an unforeseen downturn in the macroeconomic situation, the Commission has suggested introducing a general escape clause specific to each Member State. This would be in addition to the general escape clause of the SGP, activated at the outbreak of the pandemic in spring 2020 and active until the end of 2023. The activation of such a clause would allow a Member State facing exceptional circumstances beyond its control to deviate from the agreed path.

In an attempt to improve the enforcement of the framework’s provisions, the Commission has also proposed to make the opening of a debt-based EDP more automatic and to revise the sanctions regime applicable.

On 26 April 2023, the Commission presented its legislative proposals for the EU economic governance reform, which are largely based on the principles outlined in the Commission communication of 9 November 2022. The reformed norms aim to increase political ownership, simplify fiscal rules, facilitate investments for EU priorities and promote effective enforcement. The new governance architecture envisaged by the Commission seeks to reconcile the sustainability of public finances with sustainable and inclusive growth, particularly in the light of the green and digital transitions.

## **ROLE OF THE EUROPEAN PARLIAMENT**

The European Parliament is co-legislator as regards the setting of detailed rules for multilateral surveillance (Article 121(6) TFEU), and is consulted on secondary legislation implementing the EDP (Article 126(14) TFEU). The amended SGP contains a new instrument, the Economic Dialogue, which gives Parliament a prominent role in the current fiscal policy 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 the correction of excessive deficit of the Member States in the euro area, will now have to be renewed every three years, with Parliament or the Council having the power to revoke them.

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