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From:	General Secretariat of the Council
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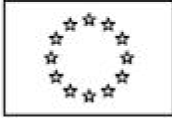
Subject:	Commonly agreed position on Flexibility in the Stability and Growth Pact

Delegations will find attached the text agreed by the Economic and Financial Committee on a commonly agreed position on Flexibility within the Stability and Growth Pact.



ECONOMIC AND FINANCIAL COMMITTEE

Brussels, 27 November 2015

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A Commonly Agreed Position on Flexibility within the Stability and Growth Pact

Flexibility for cyclical conditions, structural reforms and investment

Preamble

On 13 January 2015 the Commission adopted its Communication on flexibility within the Stability and Growth Pact (SGP). Between January and April 2015, the Economic and Financial Committee (EFC) and the EFC-Alternates (Alternates) discussed three Commission notes on the operationalisation of the Communication, namely on the new matrix of required adjustment under the preventive arm, the structural reform clause and the investment clause. On 7 April, the Council Legal Service provided to the EFC its Opinion on flexibility in the SGP. At the meeting of the EFC on 8 April 2015, the President noted that for the preparation of the 2015 European Semester Council Recommendations, the Commission would use its interpretation of the rules of the SGP as expressed in its Communication on flexibility. On 29 April 2015, the EFC agreed that the EFC-Alternates would work on preparing a commonly agreed position on the flexibility in the SGP for cyclical conditions, structural reforms, and government investments aiming at, ancillary to, and economically equivalent to major structural reforms. The commonly agreed position should preferably be reflected in an updated Code of Conduct (CoC).

This document presents the commonly agreed position on flexibility in the SGP, as agreed by the EFC on 27 November 2015, taking into account the Commission Communication and the Commission notes on the operationalisation of the Communication, the above-mentioned discussions by the Alternates and the members of the EFC between January and April 2015, and the opinion of the Council Legal Service on flexibility in the SGP. The concession of such flexibility is without prejudice to the requirement for Member States to reduce their government debt at a satisfactory pace, thereby contributing to the long-term sustainability of their public finances, in accordance with Article 126.2 of the Treaty on the functioning of the European Union and Article 2 of Regulation 1467/97. This document is intended to serve as a basis for the codification in the Code of Conduct of a commonly agreed position on flexibility in the SGP.

1. Introduction

A commonly agreed position on flexibility in the SGP would provide guidance on the best possible use of the flexibility that is built into the existing rules of the preventive arm of the SGP, without changing or replacing the existing rules. The preventive arm aims at guaranteeing a sound budgetary position in all Member States: its core is the attainment by each Member State of its medium-term sound budgetary position (so-called Medium-Term Objective or MTO), which is established according to the commonly agreed principles set out in Sub-section A(1) of Section I of the *Specifications on the Implementation of the Stability and Growth Pact*[1] (hereafter "the Code of Conduct").

The corrective arm of the Pact deals with situations in which the government deficit and/or the debt are above the reference values set in the Treaty: in these cases, Member States are then subject to an Excessive Deficit Procedure ("EDP"), which entails stricter conditions and monitoring. The commonly agreed principles on the implementation of the corrective arm of the SGP remain those established in the Code of Conduct endorsed by the ECOFIN in September 2012 and complemented by the effective action methodology endorsed by the ECOFIN in June 2014.

Subject to the rules of the SGP and without modifying existing legislation, the commonly agreed position clarifies how three specific policy dimensions can best be taken into account in applying the rules. These relate to: (i) cyclical conditions; (ii.) structural reforms; and (iii.) government investments aiming at, ancillary to, and economically equivalent to major structural reforms.

2. Flexibility for Cyclical Conditions

2.1 Matrix specifying the annual fiscal adjustment towards the Medium-Term Objective

Member States should achieve a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in periods of economic recovery, with the objective to avoid pro-cyclical policies and to gradually reach their medium-term budgetary objective, thus creating the necessary room to accommodate economic downturns and reduce government debt at a satisfactory pace, thereby contributing to the long-term sustainability of public finances.

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[1] http://ec.europa.eu/economy_finance/economIC_governance/sgp/pdf/coc/code_of_conduct_en.pdf

Member States that have not yet reached their MTO should take steps to achieve it over the cycle. Their adjustment effort should be higher in good times; it could be more limited in bad times. In order to reach their MTO, Member States of the euro area or of ERM-II should pursue an annual adjustment in cyclically adjusted terms, net of one-off and other temporary measures, of 0.5 of a percentage point of GDP as a benchmark. In parallel, the growth rate of expenditure net of discretionary revenue measures in relation to the reference medium-term rate of potential GDP growth should be expected to yield an annual improvement in the government balance in cyclically adjusted terms net of one-offs and other temporary measures of 0.5 of a percentage point of GDP.

The following matrix clarifies and specifies the fiscal adjustment requirements under the preventive arm of the Pact. This matrix is symmetrical, differentiating between larger fiscal effort to be undertaken during better times and a smaller fiscal effort to be undertaken during difficult economic conditions.

MATRIX FOR SPECIFYING THE ANNUAL FISCAL ADJUSTMENT TOWARDS THE MEDIUM-TERM OBJECTIVE (MTO) UNDER THE PREVENTIVE ARM OF THE PACT

		Required annual fiscal adjustment*	
	Condition	Debt below 60 and no sustainability risk	Debt above 60 or sustainability risk
Exceptionally bad times	Real growth < 0 or output gap < -4	No adjustment needed	
Very bad times	-4 ≤ output gap < -3	0	0.25
Bad times	-3 ≤ output gap < -1.5	0 if growth below potential, 0.25 if growth above potential	0.25 if growth below potential, 0.5 if growth above potential
Normal times	-1.5 ≤ output gap < 1.5	0.5	> 0.5
Good times	output gap ≥ 1.5	> 0.5 if growth below potential, ≥ 0.75 if growth above potential	≥ 0.75 if growth below potential, ≥ 1 if growth above potential

* all figures are in percentage points of GDP

Given the volatility of the output gap estimates and of the structural balance level, the requirements for annual fiscal adjustment will be frozen on the basis of the vintage data available at spring *t*-1.

In order to avoid unwarranted consequences in the event of worsened economic conditions or when it is not necessary anymore to progress towards the medium-term objective (MTO), the following shall apply:

– first, in case the actual data signal a worsening of the economic situation so that the country is considered to be in either exceptionally (OG <-4% or negative real growth) or very bad times (OG < -3%), the requirements based on the most recent data will prevail over the frozen requirements, allowing to consider exceptionally and very bad economic circumstances;

- second, in case the actual data are revised so that the country has already achieved its MTO in year t, the assessment of the country as being at or above its MTO will prevail over the frozen requirements.

The "sustainability risk" in the matrix specifying the annual fiscal adjustment refers to the medium-term overall debt sustainability as measured by the S1 indicator, among other information[2].

Progress towards the MTO is assessed on the basis of two pillars, with the structural balance being complemented by the expenditure benchmark. The expenditure benchmark establishes a maximum growth rate (i.e. the reference rate) for government spending net of discretionary revenue measures. The medium-term reference rate (as well as the share of government primary expenditure used in the convergence margin) will be updated on a yearly basis, as from spring 2015. In practice, this means that each spring of year t, when setting the required adjustment towards the MTO for the year to come t + 1, an updated medium-term reference rate is computed as the 10-year average potential GDP growth on the period [t-5, t+4]. The budgetary process in some MS requires identification of the reference rate for the expenditure benchmark before spring. A Member State may ask the Commission to provide for indicative purposes an update of its reference rate for the expenditure benchmark already in the winter of year t. However, the Commission assessments and recommendations under the framework of the European Semester will be based on the reference rate for the expenditure benchmark as calculated in the spring of year t. Should significant differences between the winter and spring computations of the reference rate materialise, these would be taken into account as appropriate in the ex post analysis under the preventive arm of the SGP.

2.2 Review of the flexibility clause for cyclical conditions

The Commission shall submit a review report to the Council before 30 June 2018 on the effectiveness of the matrix specifying the annual fiscal adjustment towards the Medium-Term budgetary Objective (MTO). In particular, the review will examine the success of the matrix in promoting counter-cyclical fiscal policies and the achievement by the Member States of their MTOs, thereby creating the necessary room to accommodate economic downturns. The review will also assess whether the new matrix has ensured a reduction in government debt at a satisfactory pace, thereby contributing to the long-term sustainability

[2] S1 shows the adjustment effort required, in terms of a steady improvement in the structural primary balance to be introduced till 2020 and then sustained for a decade, to bring debt ratios to 60% of GDP in 2030, taking also into account the costs arising from an ageing population.

of public finances, in line with the requirements under the debt rule as specified in Sub-section B(1) of Section I of the Code of Conduct.

3. Structural Reforms

In order to enhance the growth oriented nature of the Pact, structural reforms will be taken into account when defining the adjustment path to the medium-term objective for countries that have not yet reached this objective and in allowing a temporary deviation from this objective for countries that have already reached it.

3.1 Criteria for eligible reforms

To be fully operational, the "structural reform clause" has to rely on well-defined principles regarding the eligibility of such reforms. The Commission and the Council will base their assessment on the following criteria:

(i) The reforms must be **major**. While there are some individual reforms with a major positive impact on growth and the long-term sustainability of public finances, such as pension reforms, well-designed and comprehensive packages of reforms addressing structural weaknesses may also have a major positive impact. This is notably the case when the reforms reinforce each other's impact through an appropriate choice of policy mix and sequencing of implementation. The assessments by the Commission and the Council on whether a reform or set of reforms can be considered as major will take into account available Commission quantitative estimates on the long-term positive budgetary effects of those reforms. In any case the Commission will provide an explanation of its judgement that the reforms are to be considered as major.

(ii) The reforms must have direct **long-term positive budgetary effects**, including by raising potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances. The sustainability effects can stem either from direct budgetary savings from the reforms (such as in pensions or healthcare), or from the increased revenues drawn in the medium to long-run from a more efficient economy with a higher potential output (e.g. due to lower structural unemployment or an increased labour force), or from a combination of both kinds of effects. The long-term positive budgetary effects could be measured as the improvement in the primary budget balance in net present value equivalent terms. The budgetary effects of the reforms over time are assessed by the Commission and

the Council in a prudent way, making due allowance for the margin of uncertainties associated to such an exercise.

(iii) The reforms must be **fully implemented.** The reforms must be adopted by the national authorities through provisions of binding force, whether legislative or not, in accordance with the applicable domestic laws and procedures. In case the structural reform is not yet fully implemented, the Member State should also submit a dedicated structural reform plan – subsumed, as relevant, in the National Reform Programme (NRP) or Corrective Action Plan (CAP). A plan announcing upcoming reforms as a simple manifestation of political intentions or of wishes would not fulfil the requirements for the application of Article 5(1) of Regulation 1466/97. While it is understood that all the reforms should be adopted through provisions of binding force before being considered as eligible for the clause, it is also true that the effective implementation of adopted reforms may take time and may be subject to delays and setbacks. This raises the question of introducing strong safeguards against the risk of implementation failures.

3.2 Activation of the structural reform clause

Member States that want to benefit from the structural reform clause should apply for it in their Stability or Convergence Programmes (SCPs). The flexibility is granted in the context of the assessment of the SCPs, specifically in the relevant Country Specific Recommendation. This Country Specific Recommendation could make the granting of flexibility conditional on the subsequent fulfilment of certain eligibility criteria (e.g. the respect of the safety margin). Euro area Member States may request to benefit from the Structural Reform Clause at the time of the Draft Budgetary Plans to be submitted by 15 October. Non-euro area Member States may also apply for the structural reform clause by 15 October through an *ad hoc* application[3]. The structural reform clause may be granted provided it is endorsed by the Council in the autumn of the same year as an updated Country Specific Recommendation. The Commission and the Council will consider that the criterion related to the implementation of reforms is in part fulfilled *ex ante* when:

- The Member State presents a medium-term structural reform plan which is comprehensive and detailed and includes well-specified measures and credible

[3] In order to ensure equal treatment of all Member States, the Commission and the Council shall have regard to the different budgetary year of the United Kingdom, with a view to taking decisions with regards to the United Kingdom at a point in its budgetary year similar to that at which decisions have been or will be taken in the case of other Member States.

timelines for their adoption and delivery. The implementation of the reforms will be monitored closely in the context of the European Semester.

- In the specific case of a Member State in the Excessive Imbalances Procedure (EIP), it has submitted a Corrective Action Plan (CAP) providing the necessary information. The implementation of the reforms will then be monitored through the EIP.

In both cases, Member States will be expected to provide in-depth and transparent documentation, providing quantitative analysis of the short-term costs – if any – and of both their medium-term budgetary and potential growth impact. The documentation must also include details on the timetable of implementation of the reforms. Concurrently, Member States will provide an independent evaluation of the information provided to support their application for a temporary deviation under the reform clause, including on the estimated short and medium-term impact on the budgetary position and on the timetable for the implementation of the reforms. Alternatively, Member States should provide comprehensive independent information to support the estimated impact and planned timetable. The Commission will when possible also provide to the Council its estimate of the quantitative impact of the reforms on the long-term positive budgetary effects and on potential growth.

3.3 Operationalisation of the structural reform clause

In the specific case of pension reforms consisting in introducing a multi-pillar system that includes a mandatory, fully-funded pillar, the methodology to allow them to be taken into account in the preventive arm of the Pact is outlined in Article 5 of Regulation (EC) No 1466/97.

For other structural reforms, the Commission and the Council will base themselves on the information contained in the dedicated structural reform plan (or Corrective Action Plan). In this case, the Council will grant eligible Member States additional time to reach the MTO, hence allowing temporary deviations from the structural adjustment path towards it, or to deviate temporarily from the MTO for Member States that have reached it, provided that:

(i) the reforms meet the above criteria;

(ii) the temporary deviation does not exceed 0.5 % of GDP;

(iii.) the cumulative temporary deviation granted under the structural reform clause and the investment clause (see Section 4) does not exceed 0.75 % of GDP;

(iv.) In case the structural reform is planned but not yet fully implemented, the Commission and the Council - when setting via the CSR the required structural effort for the year t+1 - will base themselves on the requirements as per the matrix of the preventive arm, i.e. without any deviation from the adjustment path from the MTO or from the MTO itself. However, the CSR will also state that if the planned reform is fully implemented, the *ex post* assessment of compliance with the requirements of the preventive arm will incorporate the allowed deviation, i.e. by subtracting it from the requirement set by matrix of adjustment;

(v.) the MTO is reached within the four year horizon of the Stability or Convergence Programme of the year in which the clause is activated. In order to ensure that, in the benchmark case of an annual adjustment of 0.5% of GDP, the Member State can regain their MTO within the required four year timeframe, the maximum initial distance which the structural balance of a Member State applying for the structural reform clause can be from the MTO is 1.5% of GDP in year t;

(vi.) the application of the structural reform clause is restricted to one single time per period of adjustment towards the MTO. In other words, once a Member State has benefitted from the structural reform clause, it will not be allowed to benefit from the clause again until it has attained its MTO. This restriction maintains the integrity of the MTO as the central target of the Preventive Arm of the Pact, as to allow multiple or concurrent applications of the clauses could effectively negate the requirement for Member States to achieve their MTO in the medium-term. This conclusion is supported by the record of Member States since the inception of the SGP evidencing in several cases a 100% failure rate in terms of achieving the MTO;

(vii.) an appropriate safety margin is continuously preserved so that the deviation from the MTO or the agreed fiscal adjustment path does not lead to an excess over the 3 % of GDP reference value for the deficit.

While the Pact does not provide the tools for monitoring the enforcement of structural reforms, the legal framework in which the Pact operates – notably the European Semester process and the new Excessive Imbalances Procedure (EIP) – allows the Commission and the Council to assess challenges and imbalances requiring structural reforms, and for monitoring action taken by the Member States. When a Member State is granted a temporary deviation under the reform clause, the Commission shall prepare an assessment of the progress or full adoption and delivery of the reforms in line with the agreed timetable of implementation.

The Council shall grant the temporary deviation after the Commission assessment confirms the full implementation of the agreed reforms. In case a Member State fails to implement or reverses the agreed reforms, the temporary deviation from the MTO, or from the adjustment path towards it, will be considered as not warranted. If such a failure results in a significant deviation from the MTO or the path towards it, the Commission will apply the procedure envisaged in Article 6(2) and Article 10(2) of Regulation (EC) No 1466/97. This means that the Commission will issue a warning to that Member State, followed by a proposal for a Council recommendation, to ensure that the Member State takes the appropriate policy measures within five months to address that deviation. For euro area Member States, continued failure to comply can ultimately lead to a requirement to lodge an interest-bearing deposit[4].

3.4 Trajectory of the temporary deviation

Member States qualifying of the structural reform clause will be granted a temporary deviation of up to 0.5% of GDP in year t+1 which permits their structural balance to worsen by this amount from the balance that would have prevailed in the absence of the structural reform clause. In order to provide equality of treatment among Member States that are both at and on a path towards the MTO, it is necessary to require the Member States to adjust on a trajectory that is parallel to their original path, but to halt that adjustment if, while being entitled to the deviation, they reach the point where they are within 0.5% of GDP of their MTO (i.e. their MTO minus the temporary deviation). In the fourth year of the adjustment period covered by the structural reform clause, the deviation is no longer applied and the Member State is then required to adjust according to the matrix. In the benchmark case, this will return the Member State to its MTO. Therefore, a Member State which is at the MTO will be allowed to depart from the MTO for three years. A Member State that starts out at 1.0% of GDP from the MTO in the year the clause is applied for, will not be required to adjust in year t+1, implement an adjustment in year t+2, apply no adjustment in year t+3 and finally adjust again in year t+4. A Member State that starts out at 1.5% of GDP from the MTO in the year the clause is applied for will not be required to adjust in year t+1 and will implement the adjustment in years t+2, t+3, and t+4.

[4] Article 4 of Regulation (EU) No 1173/2011.

4. Government investments aiming at, ancillary to, and economically equivalent to the implementation of major structural reforms

Under the preventive arm of the Pact, some investments aiming at, ancillary to, and economically equivalent to the implementation of major structural reforms may, under certain conditions, justify a temporary deviation from the MTO of the concerned Member State or from the adjustment path towards it.

4.1 Legal framework

Regulation (EC) No 1466/97, in Article 5(1) and Article 2a of the Regulation, recognises "major structural reforms" and "public investment" as two different concepts.

Article 5(1) of Regulation 1466/97 (also known as the "flexibility clause") provides that *"When defining the adjustment path to the medium-term budgetary objective for Member States that have not yet reached this objective, and in allowing a temporary deviation from this objective for Member States that have already reached it, provided that an appropriate safety margin with respect to the deficit reference value is preserved and that the budgetary position is expected to return to the medium-term budgetary objective within the programme period, the Council and the Commission shall take into account the implementation of major structural reforms which have direct long-term positive budgetary effects, including by raising potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances."*

Article 2a of Regulation (EC) 1466/97 states that "*The medium-term budgetary objectives shall ensure the sustainability of public finances or a rapid progress towards such sustainability while allowing room for budgetary manoeuvre, considering in particular the need for public investment.*" Such a room of manoeuvre is however limited by the Code of Conduct to Member States with relatively low debt.

Public investments cannot be assimilated "*tout court*" as structural reforms, unless it is duly shown that they are instrumental to the achievement and implementation of the said reforms. It is not legally feasible to establish ex ante that all co-financing expenditure by Member States in investment projects amounts to structural reforms and that such expenditure qualifies for the application of Article 5(1) of Regulation 1466/97.

Government investments that can be eligible for a temporary deviation must be national expenditures on projects that are to a large extent financed by co-funding by the EU under the European Structural and Investment Funds[5], Trans-European Networks and the Connecting Europe Facility, as well as national co-financing of projects also co-financed by the European Fund for Strategic Investments. The temporary deviation for such investments will be subject to a plausibility assessment by the Commission and the Council, where consideration is given to whether the priority or project in question aims at, is ancillary to, and economically equivalent to the implementation of structural reforms. An investment can be considered economically equivalent to a major structural reform only if it can be shown that the investment has a major net positive impact on potential growth and on the sustainability of public finances.

The Commission's plausibility assessment will be based on the detailed information on the contribution of the investment projects to the implementation of structural reforms and their economic equivalence to a structural reform, including on the positive, direct and verifiable long-term budgetary effect of the expenditure covered by the temporary deviation. This information is necessary to ensure compatibility with Article 5(1) and Article 9(1) of Regulation 1466/97, i.e. the SGP provisions which allow temporary deviations from the MTO or the adjustment path towards it to accommodate structural reforms with positive, direct and verifiable effect on fiscal sustainability, including via potential growth. Therefore the Member State should present information by main category of projects co-financed by the EU (including the EFSI), the size of the expenditure involved, the key features and objectives of the investment project and specifying how it will contribute to boost potential growth and the long-term sustainability of public finances.

4.2 European Fund for Strategic Investments (EFSI)

On 25 June 2015, the Council adopted a regulation on a European Fund for Strategic Investments (EFSI) aimed at stimulating the economy. The Fund will offer a new risk-bearing capacity which will allow the EIB to invest in equity, subordinated debt and higher risk tranches of senior debt, and to provide credit enhancements to eligible projects. An initial contribution to this risk-bearing capacity will be made from the EU budget, in the form of a

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[5] See Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

new guarantee fund, and from the EIB's own resources. The use of this EU guarantee and of EIB funds has no impact on the deficit or debt levels of Member States.

The capacity of the EFSI can be further increased through additional financial contributions from Member States. In addition to contributing to the EFSI, Member States will have the possibility to co-finance individual projects also co-financed by it.

4.2.1 Financial contributions from Member States to the EFSI

In their assessment of the necessary fiscal adjustment under the preventive and corrective arms, the Council and the Commission will consider that:

- Initial deficit increasing contributions into the EFSI can be considered as one-off expenditures. Under the preventive arm of the Pact, one-off expenditures will not affect the MTO or the required fiscal adjustment towards it, as these are set in structural terms.
- Under the corrective arm of the Pact (the EDP), compliance with the fiscal adjustment effort recommended by the Council would not be affected, since this is also measured in structural terms. A contribution to the EFSI should therefore not lead to a Member State being found non-compliant with its EDP recommendation.
- In case of a non-respect of the deficit reference value, when preparing the report envisaged under Articles 126(3) and 126(4) TFEU, the Commission and the Council will consider the contribution to the EFSI to be a "relevant factor" in line with Article 2(3) of Regulation (EC) No 1467/97. This means that an EDP will not be launched if this non-respect is due to the contribution, and if the excess over the reference value is small and is expected to be temporary.
- In case of a non-respect of the debt reference value, when preparing the report envisaged under Articles 126(3) and 126(4) TFEU, the Commission and the Council will consider the contribution to the EFSI to be a "relevant factor" in line with Article 2(3) of Regulation (EC) No 1467/97. This means that an EDP will not be launched if the non-respect is due to the contribution.

4.2.2 Co-financing by Member States of investment projects also co-financed by the EFSI

From the point of view of the implementation of the Pact, the Commission and the Council will take into account national co-financing of investment projects that are to a large extent

financed by co-financing by the EFSI in the application of a temporary deviation under the conditions set out in Section 4.3 below.

4.3 Criteria for eligible investments under the EFSI and other investment under the preventive arm of the Pact

Under the preventive arm of the Pact, some other investments aiming at, ancillary to, and economically equivalent to the implementation of major structural reforms may, under certain conditions, justify a temporary deviation from the MTO of the concerned Member State or from the adjustment path towards it. An investment can be considered economically equivalent to a major structural reform only if it can be shown that the investment has a major net positive impact on potential growth and on the sustainability of public finances.

For such investments, a Member State will benefit from a temporary deviation of up to 0.5% of GDP from the structural adjustment path towards the MTO, or from the MTO for Member States that have reached it, if the following conditions are met:

(i.) its GDP growth is negative or GDP remains well below its potential (resulting in a negative output gap greater than 1.5 % of GDP);

(ii.) the deviation from the MTO or the agreed fiscal adjustment path towards it does not lead to an excess over the reference value of 3 % of GDP deficit and an appropriate safety margin is preserved;

(iii.) subject to a total maximum temporary deviation of 0.5% of GDP for an application for flexibility for investment by a Member State, the deviation is equal to the national expenditure on eligible projects that are to a large extent financed by co-funding by the EU under the European Structural and Investment Funds [6], Trans-European Networks and Connecting Europe Facility, and to national co-financing of eligible investment projects also co-financed by the EFSI, which have direct long-term positive and verifiable budgetary effects;

[6] Including eligible projects co-financed through the Youth Employment Initiative.

(iv.) the cumulative temporary deviation granted under the structural reform clause and the investment clause does not exceed 0.75 % of GDP;

(v.) co-financed expenditure should not substitute for nationally financed investments, so that total public investments are not decreased. In order to evaluate the respect of this condition, the Commission will assess the change in gross fixed capital formation for the year of the application of the clause on the basis of the Commission forecasts to check that there is no fall in overall investment;

(vi.) the Member State must compensate for any temporary deviations and the MTO must be reached within the four-year horizon of its current Stability or Convergence Programme.

(vii.) As with the Structural Reform Clause, in order to preserve the integrity of the MTO, the full temporary deviation (corresponding to the total amount of the national part of eligible co-financed expenditure but not exceeding 0.5% of GDP) will be granted for one single time per period of adjustment towards the MTO. For the following years, only positive incremental changes would be added to the initial temporary deviation. In other words, once a Member State has benefitted from a total temporary deviation of 0.5% of GDP under the "investment clause", it will not be allowed to benefit from the clause again until it has attained its MTO.

The trajectory of the temporary deviation stemming from the application of the "investment clause" should be established in line with the "structural reform clause".

The country-specific temporary deviation will depend on several factors. Ex-ante, the potential deviation will depend on the commitments of the EU structural funds towards each Member State as well as on the level of planned co-financing. Ex-post, the allowed deviation will depend on the effective payments of EU structural funds and on the correspondent effective co-financing. In case the actual co-financing falls short of projected co-financing, a correction will be added to the required change in the structural balance, which could potentially lead to the opening of a significant deviation procedure.

4.4 Activation of a temporary deviation for eligible investments

The "investment clause" (IC) is activated ex-ante upon request from Member States in their Stability or Convergence Programmes (SCPs). The flexibility is granted in the context of the assessment of the SCPs, specifically in the relevant Country Specific Recommendation. This Country Specific Recommendation could make the granting of flexibility conditional on the subsequent fulfilment of certain eligibility criteria (e.g. the respect of the safety margin). Euro area Member States may request to benefit from the "investment clause" also at the time of the Draft Budgetary Plans to be submitted by 15 October. Non-euro area Member States may also apply for the "investment clause" by 15 October through an *ad hoc* application[7]. The "investment clause" may be granted provided it is endorsed by the Council in the autumn of that same year as an updated Country Specific Recommendation. The application should be submitted in the year ahead of the application of the clause. That is, in the SCP or at the time of the DBP (or the ad hoc application by a non-euro area MS) submitted in year t for an application of the clause in year t+1.

Ex-ante, the Commission will assess the eligibility of such investments where on the basis of the detailed information provided by the Member States (see Section 4.1 above), consideration is given to whether the priority or project in question aims at, is ancillary to, and economically equivalent to the implementation of structural reforms. The Commission will conclude that an investment can be considered as being economically equivalent to a major structural reform if it can be shown that the investment has a major net positive impact on potential growth and on the sustainability of public finances. The Commission will also assess ex-ante whether the projects satisfy the requirement that they are to large extent financed by EU co-funding.

Ex-ante, the Commission will also assess eligibility to the IC with respect to the spring forecast of year t and will factor it in the ex-ante guidance it provides at the occasion of the European Semester. Ex-post assessment will be based on outturn data available in year t+2, as it is usually the case. The temporary deviation will be reviewed in order to reflect the effective co-financing of the Member States. The (downward) revision of this temporary deviation shall not imply that a Member State implements an effort superior to the one necessary to reach its MTO.

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[7] In order to ensure equal treatment of all Member States, the Commission and the Council shall have regard to the different budgetary year of the United Kingdom, with a view to taking decisions with regards to the United Kingdom at a point in its budgetary year similar to that at which decisions have been or will be taken in the case of other Member States.

When requesting the application of the IC, Member States should include in their SCPs the following information (for the years t to t+4):

- The forecast path of co-financing expenditure, including for EFSI projects (as a % of GDP).
- The corrected path of its structural balance resulting from the application of the IC, while planning to reach the MTO within the timeframe of the SCP. Member States shall also take due consideration of the annual fiscal adjustment requirements towards the MTO as defined in Section 2.1 given their projections for GDP and the output gap in their SCPs.
- As specified in Section 4.1, detailed information on the contribution of the investment projects to the implementation of structural reforms and their economic equivalence to a structural reform, including the positive, direct and verifiable long-term budgetary effect of the expenditure covered by the temporary deviation. This information is necessary to ensure compatibility with Article 5(1) and Article 9(1) of Regulation 1466/97, i.e. the SGP provisions which allow temporary deviations from the MTO or the adjustment path towards it to accommodate structural reforms with positive, direct and verifiable effect on fiscal sustainability, including via potential growth.
- Member States will provide an independent evaluation of the information provided to support their application for a temporary deviation under the investment clause, including on the estimated long-term impact on the budgetary position. Alternatively, Member States should provide comprehensive independent information to support the estimated impact.
- The Member State should demonstrate that the eligible co-financed investment does not substitute for nationally funded investments, so that the total share of public capital expenditure is not decreased.
- Member States who have benefitted from the IC will also report in the SCPs on the actual level of co-financing, including for EFSI projects, following the year of application.

5. Review of the structural reform clause and the investment clause

By the end of June 2018, the Commission will carry out a review on the application of the structural reform and investment clauses, taking full account of the economic situation at

that time and the achievement of its objectives. The review will examine the achievement by the Member States of their MTOs, thereby creating the necessary room to accommodate economic downturns. The review will examine to what extent the projects eligible for the investment clause were co-funded by the EU and whether the investment clause led to new investments. The review will also examine the implications of the continuation of the investment clause. The review may, as appropriate, be accompanied by proposals to the Economic and Financial Committee for a possible modification of the commonly agreed position on flexibility in the SGP.