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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Communication on orientations for a reform of the EU economic governance framework

1. Introduction

In October 2021, the Commission relaunched the public debate on the review of the EU's economic governance framework, inviting other EU institutions and all key stakeholders to engage. Through various fora, including dedicated meetings, workshops and an online survey, citizens and a wide range of participants, including national governments, parliaments, social partners, academia and other EU institutions, have debated how today's and tomorrow's economic challenges require reforms of the EU economic governance framework. ([1]) Discussions in the Council (ECOFIN), the Eurogroup, the Economic and Financial Committee and the Economic Policy Committee have provided Member States with an opportunity to reflect and express their views on the key objectives of the governance framework, its functioning, and new challenges to be addressed.

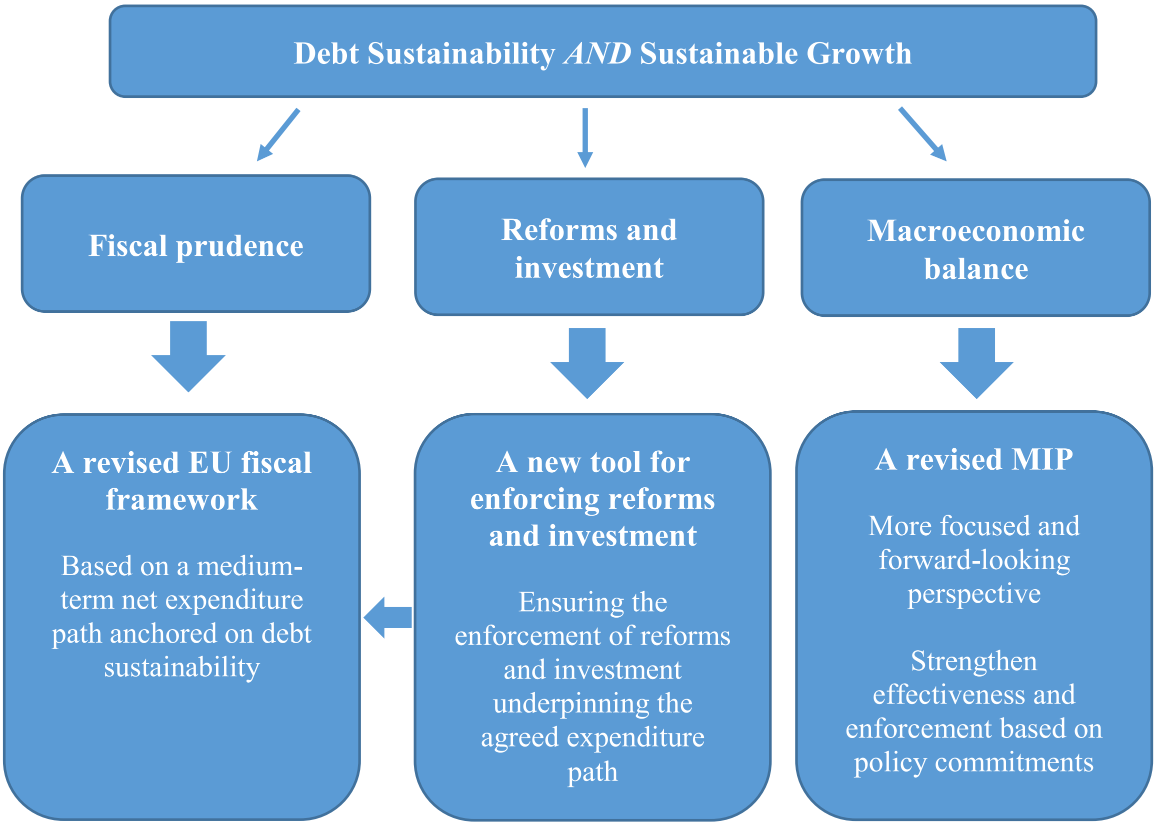
It is now time to move from debate to decisions. This Communication outlines the Commission's orientations for a reform of the economic governance framework, addressing the key economic and policy issues that will shape the EU's economic policy coordination and surveillance for the next decade. Taking into account the key concerns over the current framework, these orientations aim to strengthen debt sustainability and promote sustainable and inclusive growth in all Member States (see Figure 1), thus "rediscovering the Maastricht spirit whereby stability and growth can only go hand in hand", as indicated by President Von der Leyen in her State of the Union address. ([2]) Prudent fiscal strategies and investment and reforms that enhance sustainable growth are both indispensable and mutually reinforcing in ensuring fiscal sustainability and in enabling the green and digital transition towards a resilient economy. The reformed framework should tackle the prevailing challenges and contribute to making Europe more resilient, by sustaining strategic investment for years to come and by reducing high public debt ratios in a realistic, gradual and sustained manner. Improving national ownership, simplifying the framework and moving towards a greater medium-term focus, combined with stronger and more coherent enforcement, are key elements in the Commission's orientations.

The objective of the reform is to facilitate effective economic surveillance, anchored in a common framework that ensures equal treatment and multilateral policy coordination. The framework should be robust to changing economic conditions and uncertainty, requiring a solid and predictable rule book and escape clauses for exceptional circumstances. It should also pursue an integrated approach whereby surveillance tools complement each other, in the context of the European Semester. Effectively preventing and correcting macroeconomic imbalances will require better detection of emerging risks and maintenance of reform momentum, while placing more emphasis on EU and euro area developments, and on policy implementation. These orientations will feed into the further debate, in particular within the Council and with the European Parliament, with a view to reaching a broad consensus on the future design of the economic governance framework.

([1]) In March 2022, the Commission published a summary report on the replies to the online survey. European Commission (2022), '[Online public consultation on the review of the EU economic governance framework: summary of responses]', SWD(2022) 104 final of 28 March 2022.
([2]) [State of the Union address] by the President of the European Commission, 14 September 2022.

The Communication is set out as follows. Section 2 recalls the need for an effective governance framework, integrating the fiscal, reform and investment dimensions in order to address the challenges prevailing now and over the foreseeable future. Against this background, the key elements of the Commission's reform orientations are presented in Section 3. Section 4 develops these key elements by providing more detail on practical aspects of the proposed reforms to fiscal and macroeconomic surveillance. Section 5 outlines the next steps and concludes.

Figure 1: A new governance architecture



2. The need for an effective economic governance framework

2.1 Towards a framework that guides Member States in addressing identified challenges and common policy priorities

The EU's economic governance framework has guided Member States in achieving their economic and fiscal policy objectives. Since the Treaty of Maastricht of 1992, the framework has helped achieve macroeconomic convergence, safeguard sound public finances and address macroeconomic imbalances. Together with a common monetary policy and a common currency in the euro area, the framework has created conditions for economic stability, sustainable economic growth and higher employment for EU citizens.

The EU economic governance framework has evolved over time. Reforms have generally been made in reaction to weaknesses in the framework that have been exposed mostly in moments of economic crisis. In particular, the legislative packages known as the *six-pack* and *two-pack* responded to the lessons of the global financial crisis and the euro area sovereign debt crisis by revamping fiscal surveillance, strengthening national budgetary frameworks, reinforcing budgetary coordination in the euro area and broadening the scope of economic surveillance to include macroeconomic imbalances. ([3])

While the framework filled surveillance gaps and became more adaptable to economic conditions, it has also become more complex and not all instruments and procedures have stood the test of time. The February 2020 Communication on the economic governance review and the ensuing public debate (see Annex 1) noted the mixed success of the fiscal surveillance framework and the growing heterogeneity of fiscal positions across Member States. The framework had not differentiated sufficiently between Member States despite different fiscal positions, sustainability risks and other vulnerabilities. National fiscal policies had often remained pro-cyclical and Member States had not used good economic times to build fiscal buffers. The ability to steer the euro area fiscal stance was hampered by the lack of prudent policies in good times and remained limited in the absence of a central fiscal capacity with stabilisation features. The composition of public finances had not become more growth-friendly and national governments had not prioritised spending that enhances growth and economic and social resilience. The EU fiscal rules had become complex, with multiple indicators and reliance on unobservable variables, undermining transparency and hampering ownership and predictability. Despite improvements in national fiscal frameworks, their effectiveness varied markedly across Member States. With respect to the surveillance of macroeconomic imbalances, the framework had been successful in raising awareness of broader risks to macroeconomic stability but did not generate sufficient policy responses. The Excessive Imbalance Procedure (EIP) had never been activated. Since the creation of the Macroeconomic Imbalances Procedure (MIP), the Union had been more successful in reducing current account deficits than in reducing persistent and large current account surpluses. Surveillance had remained untested in preventing the accumulation of new vulnerabilities and risks and in fostering the adequate preventive policy action. Links between various surveillance strands had not always been fully exploited.

2.2 Lessons from the recent crises

Lessons from the policy response to recent economic shocks, in particular the COVID-19 crisis, have implications for the economic governance review. In March 2020, the general escape clause of the Stability and Growth Pact (SGP) was activated. This allowed Member States to react to the COVID-19 crisis by providing sizeable fiscal support to their

([3]) A full description of the *six-pack* and *two-pack* reforms can be found in Box 1 of European Commission (2020), 'Economic governance review', COM(2020) 55 final of 5 February 2020. A full list of the underlying secondary legislation can be found in Footnote 1 (Page 1) of the Staff Working Document accompanying that communication (European Commission (2020), 'Economic governance review', SWD(2020) 210 final of 5 February 2020).

economies, temporarily departing from the SGP budgetary requirements. [4] This strong countercyclical response, together with new EU-level measures and instruments, and social safety nets and health systems at the national level, proved highly effective in mitigating the economic and social damage of the crisis. Lessons from the successful EU policy response to the crisis, including the positive interaction between reforms and investment under the Recovery and Resilience Facility (RRF), have also been useful for the review of the economic governance framework. At the same time, the crisis resulted in a significant increase in public- and private-sector debt ratios, underscoring the importance of reducing debt ratios to prudent levels in a gradual, sustained and growth-friendly manner. Fiscal prudence in times of sustained growth helps build fiscal buffers that governments can use to provide counter-cyclical fiscal support in times of crisis, when discretionary fiscal policy can be particularly effective. Investment in preparedness and resilience can also reduce the adverse economic impact of crises. Moreover, the experience before and during crisis confirmed the difficulties associated with designing policy recommendations on the basis of unobservable indicators that are subject to frequent revisions (such as the "output gap" and the "structural balance").

The green and digital transitions, the need to ensure energy security, as well as social and economic resilience, [5] and to build up defence capabilities will require sustained high levels of investment in the years to come. The COVID-19 crisis and the Russian invasion of Ukraine have also made these common priorities more visible and urgent. High levels of investment will be needed to achieve a fair twin transition (green and digital), increase social and economic resilience (including through upskilling and reskilling), increase territorial cohesion, reduce energy dependencies, and increase defence capabilities, both at the national level and in support of Europe's common priorities. Within its limited capacity, the EU budget has supported these efforts given that the twin transition, resilience, energy security and defence are common objectives for all Member States and made even more pressing by the current crisis. These objectives call for investment by corporations and households, but also for higher public investment, backed by a good composition and quality of public finances. These policies boost potential growth, strengthen resilience and help counter the negative shocks of the war. Finally, they reflect strategic EU priorities and are supported by common EU-financed programmes, such as the RRF financing provided until 2026 and cohesion policy funding.

Effective policy coordination is critical for responding to crises. The policy responses to the COVID-19 crisis, the Russian invasion of Ukraine and the ensuing energy crisis have underscored the value of strong policy coordination, including between different policy and funding tools, and between the EU and national levels. The activation of the general escape

[4] A more in-depth discussion of the response to the COVID-19 crisis and the implications of that crisis on the economic governance review can be found in European Commission (2021), 'The EU economy after COVID-19: implications for economic governance', COM(2021) 662 final of 19 October 2021.

[5] Guidance for Member States on how best to conduct distributional impact assessments of new policies, which are important in order to avoid an exacerbation of existing inequalities, can be found in European Commission (2022), 'Better assessing the distributional impact of Member States' policies', COM(2022) 494 final of 23 September 2022.

clause facilitated national fiscal responses. The interplay between fiscal policy and monetary policy was and continues to be critical for the effective macroeconomic response to the crisis. Monetary policy, created space for undertaking the necessary national fiscal policies which, in turn, helped to cushion the effects on economic growth and social cohesion. Some framework conditions, such as financial market prudential regulations and the EU State Aid framework, were temporarily adjusted. Flexibilities, including those within the EU budget, were fully applied. New EU-level tools also helped, in particular the temporary Support to mitigate Unemployment Risks in an Emergency (SURE), the Coronavirus Response Investment Initiatives (CRII) under Cohesion Policy and NextGenerationEU, including the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU) and the RRF. The effective implementation of reforms and investment in the Recovery and Resilience Plans (RRPs) provides a unique opportunity for Member States to reach a higher growth path, address economic and social vulnerabilities, improve public and private debt sustainability, strengthen resilience and accelerate the green and digital transitions, while delivering on Union objectives. More recently, in response to the energy market disruption triggered by the Russian invasion of Ukraine and Russia's weaponisation of energy, the Commission put forward a number of measures addressing high energy prices and ensuring security of supply. The Commission has also launched a series of initiatives, including the REPowerEU plan, to end dependence on Russian fossil fuels, by diversifying energy supplies, saving energy and accelerating the green transition. ([6])

The reformed framework must also help Member States to address the long-term challenges facing the EU. Long term structural trends pose a significant challenge for the sustainability of public finances and sustainable growth in EU Member States. These trends include demographic challenges and the climate crisis, with the latter becoming increasingly apparent in the form of increasing severity and frequency of extreme weather events. Coping with these challenges will require Member States to take further action, including public investment to facilitate a green and digital transition and policies focused on ensuring sound public finances, including through reform of pension systems.

3. Towards a simpler and more effective framework with greater ownership

This section presents the main contours of the Commission's orientations for reform of the economic governance framework (see Figure 2)**.** Specific issues related to the set-up and implementation of the proposed reformed framework are discussed in more detail in Section 4, which also discusses the framework for dealing with euro area Member States experiencing, or threatened with, financial stability difficulties.

3.1 A revised governance architecture with a greater focus on the medium term

The Commission's orientations seek to define a simpler and integrated architecture for macro-fiscal surveillance to ensure debt sustainability and promote sustainable and

([6]) European Commission (2022), 'REPowerEU: Joint European Action for more affordable, secure and sustainable energy,' COM (2022) 108 final of 8 March 2022.

inclusive growth. In order for the framework to be consistent across its components and deliver effective economic surveillance, there is a need to clarify the objectives of each surveillance strand, to better integrate macroeconomic and fiscal policies, and to add instruments to monitor progress and meet new objectives. Therefore, in addition to revising the EU fiscal framework and the MIP, notably by integrating fiscal, reform and investment objectives into a single holistic medium-term plan, the Commission's orientations call for the establishment of a new EU enforcement tool for reforms and investment. This tool would ensure the enforcement of Member States' reform and investment commitments underpinning a more gradual fiscal adjustment (see Section 4.1).

The Treaty reference values of 3% of GDP budget deficit and 60% debt-to-GDP ratio remain unchanged. These values are established in a Treaty Protocol and the focus of the review is on making sure that those values are adhered to in a more effective manner, especially by focusing on an appropriate and credible debt reduction path towards 60% of GDP, while at the same time ensuring that the economic governance framework is conducive to sustainable and inclusive growth.

Figure 2: A suggested revised fiscal framework

National ownership embedded in EU framework	Simplification and focus on fiscal risks	Enforcement
0. Commission puts forward reference adjustment paths 1. Member States propose medium-term fiscal-structural plans 2. Annual budgets will commit to follow the fiscal trajectory and ensure that debt will start converging to prudent levels within the adjustment period 3. Member States can request a longer adjustment period underpinned by reforms and investments 4. Council endorsement of the plan 5. Stronger role of national IFIs	1. Net expenditure path anchored on debt sustainability and agreed by Council will be the single fiscal indicator 2. Surveillance and enforcement will be risk-based 3. Debt reduction benchmark, benchmark for reduction in structural balance, significant deviation procedure and matrix of requirements no longer exist	1. Deficit-based EDP (3% of GDP threshold) maintained 2. Debt-based EDP will be operationalised and strengthened, as a tool to ensure compliance with the agreed net expenditure path 3. Financial sanctions toolbox will be enriched with smarter sanctions 4. Macroeconomic conditionality will be maintained

3.2 National medium-term fiscal-structural plans as the centrepiece of the new governance architecture

National medium-term fiscal-structural plans that bring together the fiscal, reform and investment commitments of each Member State, within a common EU framework, would be the cornerstone of the proposed revised framework. ([7]) This would ensure consistency and streamline processes and deliverables, while recognising that reforms and investments can have a positive impact on fiscal sustainability. The revised EU fiscal

([7]) The fiscal-structural plans would merge the current Stability and Convergence Programmes with the National Reform Programmes.

framework would set the requirements to ensure that the debt ratio is put on a downward path or stays at prudent levels and the budget deficit is maintained below the 3% of GDP reference value over the medium term. Member States would present medium-term plans that set out country-specific fiscal trajectories as well as priority public investment and reform commitments that together ensure sustained and gradual debt reduction and sustainable and inclusive growth. All Member States would be required to address the priorities identified in country-specific recommendations (CSRs) issued in the context of the European Semester. The medium-term plans should also put forward initiatives that are in line with strategic EU priorities derived directly from agreed EU guidance and targets that require policy action by Member States. Therefore, plans should also be consistent with the National Energy and Climate Plans (which are to be aligned with the targets of the EU Climate Law) as well as with the National Digital Decade Roadmaps. During the lifetime of the RRF, cross references to the RRPs would be needed to ensure policy consistency.

This medium-term approach would allow for differentiation between Member States, within a revised common EU framework that has sustainable growth and risks to debt sustainability as a common basis. Such a common EU framework would be instrumental in transparently ensuring equal treatment between Member States. Taking the objective of debt sustainability as the starting point for EU fiscal surveillance reflects the core Treaty objective of fiscal rules in Economic and Monetary Union, which is to prevent so-called "gross errors" in the conduct of fiscal policy, as those can have negative spillovers to other Member States and to the currency union as a whole. The existing EU framework requires all Member States to make similar adjustment efforts, in particular in the preventive arm, regardless of their debt position and fiscal risks. However, debt-to-GDP ratios and debt developments differ widely across Member States. Some of them have a very high debt exceeding 90% of GDP (and exceeding 150% of GDP in two cases). Others have a debt lower than 60% of GDP. Lastly, many are in an intermediate situation, with debt between 60% and 90% of GDP.

A risk-based surveillance framework would allow to adapt the existing debt reduction benchmark to the country-specific debt ratio, while the requirement to maintain budget deficits credibly below 3% of GDP would be preserved. The current debt reduction benchmark (the so-called 1/20th rule) implies, in the current circumstances of high debt ratios post-COVID, a too demanding frontloaded fiscal effort that risks jeopardising growth and is pro-cyclical. ([8]) It should be recognised that high-debt Member States cannot abide by the existing 1/20th debt reduction benchmark, since reducing their debt ratios at this speed would have a very negative impact on growth and thereby on debt sustainability itself. Therefore, it is proposed to move to a more risk-based surveillance framework that puts debt sustainability at its core and differentiates more between countries by taking into account their public debt challenges, while adhering to a transparent and common EU framework consistent with the 3% of GDP and 60% of GDP reference values of the Treaty.

([8]) For this benchmark, see Article 2(1a) of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209 of 2.8.1997, p.6).

National medium-term plans should ensure a sustainable debt reduction path through a gradual consolidation and reforms and investments. Member States should present medium-term fiscal-structural plans that ensure debt is kept or brought onto a sustainable path by the end of the adjustment period as well as priority public investment and reform commitments. The framework reflects that there is no trade-off between reforms and investment and fiscal adjustment. Improving the quality of public finances and protecting public investment should be central elements of medium-term fiscal-structural plans, in light of the essential role of public investment and reforms in enhancing potential growth and addressing major systemic challenges such as the green and digital transition.

Moreover, Member States would be able to commit to a set of reforms and investment that help bring debt on a sustainable path and therefore could underpin a longer adjustment period and a more gradual adjustment path. The adjustment path, the reforms and investments will be discussed with the Commission and, once positively assessed, will be adopted by the Council. The plans would need to be translated in national budgets for the whole adjustment period, with the possibility for Member States to revise the plan only after a minimum period of four years. This minimum adjustment period could be lengthened to match the national legislature, if Member States so wish. The plan could be revised earlier in case of objective circumstances making the implementation of the plan infeasible, but would have to undergo the same validation process. Frequent revisions would undermine the credibility of the plans as an anchor for prudent policies.

A single operational indicator anchored on debt sustainability would serve as a basis for setting the fiscal adjustment path and carrying out annual fiscal surveillance, thus significantly simplifying the fiscal framework and increasing transparency. The use of nationally-financed net primary expenditure, i.e. expenditure net of discretionary revenue measures and excluding interest expenditure as well as cyclical unemployment expenditure, as the single operational indicator for surveillance would allow for the operation of automatic stabilisers, including revenue and expenditure fluctuations outside the direct control of the government. This would ensure a higher degree of macroeconomic stabilisation. While Member States could use alternative indicators for national budgetary purposes (e.g., a structural balance), the annual fiscal surveillance at the EU level would be conducted solely using this single operational indicator and thus the expenditure path. This single operational indicator should be defined so as to ensure debt sustainability. The agreed multiannual net primary expenditure path should ensure that debt is put or kept on a downward path at the latest by the end of the adjustment period or stays at prudent levels, while ensuring that the budget deficit is maintained below 3% of GDP over the medium term. ([9])

3.3 Agreement on the national medium-term fiscal-structural plans

The national medium-term fiscal-structural plan would be at the centre of the reformed Stability and Growth Pact and would be proposed by the Member State on the basis of a common EU framework. The revised common EU framework would set the requirements

([9]) The Commission will use its debt sustainability analysis framework given that it is a well-established analytical toolkit for assessing debt sustainability risks (see Box 1).

that ensures that public debt is put onto a downward path, or remains at prudent levels, and that the deficit is maintained below 3% of GDP. The common EU framework would also establish the criteria for assessing the reforms and investment that underpin a possible extension of the adjustment path. Member States' medium-term plans would have to comply with the common revised EU framework.

On the basis of a positive assessment by the Commission, the Council would adopt the medium-term fiscal-structural plan, including its fiscal trajectory. The Commission would assess the plan against the revised common EU framework and could only provide a positive assessment of fiscal-structural plans if debt is put on a downward path or stays at prudent levels, and the budget deficit is maintained below the 3% of GDP reference value over the medium term. Multilateral discussions in the relevant committees of the Council would ensure transparency and accountability, with the Council endorsing the adequacy of the plan. This model would strengthen national ownership. Based on a better integration of the requirements of the revised common EU framework in domestic policy debates, it would strengthen multilateral fiscal surveillance.

3.4 Implementation of the national medium-term plan and annual monitoring

To ensure transparency and facilitate the effective monitoring of the implementation of the medium-term fiscal-structural plans, Member States would submit annual progress reports. In addition to fiscal reporting, the implementation of reforms and investments covered by the medium-term plans would be detailed in these reports. ([10]) They would be the basis for annual surveillance by the Commission and Council, including possible enforcement decisions.

While more scope would be given to Member States for the design of their fiscal trajectories, a more stringent EU enforcement would underpin multilateral surveillance. Enforcement would be enhanced compared to the current framework. The excessive deficit procedure (EDP) would remain unchanged for breaches of the 3% of GDP deficit reference value (the so-called 'deficit-based EDP'). It is a well-established element of EU fiscal surveillance that has been effective in influencing fiscal behaviour and is well understood by policy makers and the general public, thanks to its simplicity. The EDP for breaches of the debt criterion (the so-called 'debt-based EDP') would be strengthened for both activation and abrogation. It would focus on departures from the agreed fiscal path, which the Member State has committed itself to and endorsed by the Council. For Member States with a substantial public debt challenge, departures from the agreed path would by default lead to the opening of an EDP. For Member States with a moderate public debt challenge, departures could lead to the opening of an EDP, if assessed as giving rise to "gross errors". The range of sanctions would be broadened, for instance by adding reputational sanctions (see Section 4.2).

A new tool would be created to ensure the implementation of reform and investment commitments. Under the proposed reform, Member States could request a more gradual

([10]) Relevant interactions with the RRPs will be taken into account during the lifetime of the RRF.

adjustment path by putting forward a specific set of priority reforms and investments that foster long-term sustainable growth and, therefore, help improve debt dynamics (see Section 4.1). In case of non-implementation of those commitments, a new enforcement tool would lead to a revision of the adjustment path towards a stricter path. ([11]) Due to the particular risk of negative spillovers within a monetary union, it would be possible to apply financial sanctions for euro area countries in case of non-implementation.

National frameworks and processes would help achieve the objectives of the medium-term structural-fiscal plan. Independent fiscal institutions would play an important role in each Member State in assessing the assumptions underlying the plans, providing an assessment on the adequacy of the plans with respect to debt sustainability and country-specific medium-term goals, and monitoring compliance with the plan. This would entail improving the set-up and performance of independent fiscal institutions. The outcome would be a greater debate at national level and thus a higher degree of political buy-in and ownership of the medium-term plan. The Commission will reconsider the mandate and role of the European Fiscal Board in this context.

3.5 A more effective framework to detect and correct macroeconomic imbalances

The cornerstone of the Commission's orientations for the MIP would be an enhanced dialogue with Member States to achieve better implementation through ownership and commitment. Greater ownership by Member States would be achieved by reaching a common understanding between Members States and the Commission of the challenges identified under the MIP and the policies needed to address them. This would entail a dialogue, leading to a commitment from Member States to include the reforms and investments needed to prevent or correct macroeconomic imbalances in their medium-term fiscal-structural plan.

Moreover, the preventive role of the MIP should be strengthened in a macroeconomic environment characterised by new risks. Both the first screening for imbalances in the Alert Mechanism Report (AMR) and the assessment of whether imbalances exist in the in-depth reviews (IDRs) would be made more forward-looking with a view to detecting and addressing emerging imbalances early on. This could entail preparing more IDRs when flow-related variables show adverse trends, indicating high risks of a build-up of imbalances. It could also lead to IDRs concluding more frequently that no imbalances exist.

The reform would reduce the inertia that has characterised the MIP, by basing the assessment of imbalances more on the evolution of risks and policy implementation. This implies putting more weight on trend developments that are expected to be sustained and on the policies that have been implemented to address macroeconomic imbalances, when assessing whether imbalances have been corrected. This approach would lead to the de-escalation of Member States from the MIP when policies to address imbalances are in place and stock imbalances are continuously being corrected.

([11]) The precise modalities and legal basis of this instrument will need to be elaborated.

Finally, the reform would strive for an MIP that has a clear focus on macroeconomic issues that affect Member States and, at the same time, would give more visibility to the EU and euro area dimensions of imbalances. This could highlight vulnerabilities that possibly affect the EU and the euro area as a whole, and the respective contribution of the various Members States to those vulnerabilities. This would help internalise spillovers and feed into euro area recommendations.

To fully exploit the synergies between the MIP and the fiscal framework, the review foresees several links. Firstly, for Member States identified with imbalances, the medium-term fiscal-structural plans would also have to include reforms and investments to correct those imbalances. Secondly, in case of non-implementation of the MIP-relevant reforms and investment underpinning a longer adjustment period, for countries with excessive imbalances, launching the EIP would be considered. Finally, if an EIP is launched, the Member State would be asked to present a revised fiscal-structural plan, which would thus act as the corrective action plan currently provided for in EU law. ([12])

4. How would the revised economic governance framework work in practice?

Building on the main reform contours set out in the previous section, this section addresses some specific issues related to the functioning of the revised common EU fiscal framework. These issues relate to: setting up and agreeing on the national medium-term fiscal-structural plans; assessing compliance of fiscal outcomes with the endorsed expenditure path; and identifying and monitoring the correction of macroeconomic imbalances. This section also covers the framework governing financial assistance, i.e., the framework for euro area Member States experiencing, or threatened with, serious difficulties with respect to their financial stability.

4.1 How to set up and agree on the plan?

Submission, assessment, endorsement and revision of the national medium-term fiscal-structural plan

As part of the common framework, the Commission would put forward for Member States with a substantial or moderate public debt challenge, a reference multiannual adjustment path in terms of net primary expenditure covering at least 4 years. The reference adjustment path would be anchored on debt sustainability meaning that for Member States with substantial and moderate fiscal challenges, it should ensure that, even in the absence of further fiscal measures, debt would remain on a plausibly downward path after the fiscal adjustment period and that the deficit would be maintained below the 3% of GDP threshold (see Box 1 for more details). For each Member State, the multiannual expenditure path that would put debt on a downward trajectory could thus be translated into the corresponding level of the structural primary balance to be achieved at the end of the 4-year

([12]) For the corrective action plan, see Article 8 of Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306 of 23.11.2011, p.25).

period. The debt sustainability analysis ([13]), the reference multiannual adjustment path, and the corresponding level of the structural primary balance at the end of the 4-year adjustment period would be made public by the Commission. These elements would provide a common reference for the assessment of the plans to be proposed by Member States.

In putting forward the reference adjustment path covering at least 4 years, the Commission would apply the following common framework:

- For Member States with a substantial public debt challenge, the reference net expenditure path should ensure that by the horizon of the plan (4 years), i) the 10-year debt trajectory at unchanged policies is on a plausibly and continuously declining path and ii) the deficit is maintained below the 3% of GDP reference value at unchanged policies over the same 10-year period.
- For Member States with a moderate public debt challenge, the reference net expenditure path should ensure that, i) at most 3 years after the horizon of the plan, the 10-year debt trajectory is on a plausibly and continuously declining path at unchanged policies; and ii) by the horizon of the plan, the deficit is maintained below the 3% of GDP reference value over the same 10-year period.

To assess plausibility, the Commission would use stress tests and stochastic analysis, simulating common shocks related to short and long-term interest rates, nominal GDP growth, the primary budget balance and nominal exchange rates. This analysis would be made public together with the reference net expenditure path. The Commission would also make available the methodology and underlying data.

When assessing the plan, the Commission will also evaluate whether it is credibly ensured that the deficit is maintained below 3% of GDP over a 10-year period.

For Member States with a low public debt challenge, the deficit should be maintained below that reference value at unchanged policies over a 10-year period at most 3 years after the horizon of the plan.

As a following step, each Member State would submit a medium-term fiscal-structural plan for assessment by the Commission and endorsement by the Council. The plans would outline the medium-term fiscal path, and reform and investment commitments. The fiscal adjustment path would be set in terms of net primary expenditure, i.e. expenditure net of discretionary revenue measures and excluding interest expenditure as well as cyclical unemployment expenditure. The medium-term fiscal path would be translated into corresponding annual spending ceilings. For Member States identified with imbalances under the MIP, the plans would also include reforms and investments to correct those imbalances. The submission of the plan would be preceded by an in-depth technical dialogue with the Commission. The Commission would assess the medium-term plan in an integrated manner, taking account of the interactions between the fiscal trajectory, and reforms and investments. The assessment would take place on the basis of a common EU assessment framework and

([13]) The debt sustainability analysis would play a role as a risk-assessment tool only in the design and not in the implementation of the plans.

transparent methodologies, retaining the possibility of seeking additional information or requesting a revised plan.

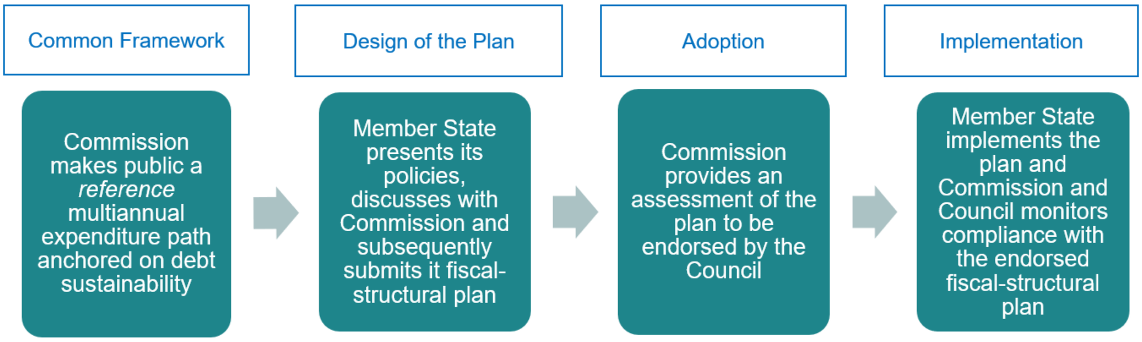
The Member State could request and be granted an extension of the adjustment period by a maximum of 3 years, provided it underpins its plan with a set of reforms and investments that supports sustainable growth and debt sustainability. Member States could propose a more gradual adjustment path, provided that this more gradual path is underpinned by a set of priority reform and investment commitments. These commitments would be assessed using a common EU assessment framework (see following sub-section). They would need to support debt sustainability and respond to common EU priorities and targets, as well as ensuring that the national fiscal-structural plan addresses all or a significant subset of relevant CSRs. Relevant reforms and investment in the RRPs would duly be taken into account during the lifetime of the RRF.

As a following step, the plan would be adopted by the Council on the basis of a Commission assessment. After the Commission has assessed the medium-term plan, on the basis of a common assessment framework, the Council would either adopt the plan or recommend that the Member State resubmit a modified plan. In case there would be no agreement between the Member State and the Commission, the reference multiannual net expenditure path would be used by the Commission and the Council for the purpose of fiscal surveillance and enforcement.

As a last step, the Member State would implement the plan, with annual monitoring by the Commission and the Council under the European Semester. The national plan as endorsed by the Council should commit the annual national budgets for a period not inferior to four years. The agreed fiscal trajectory could be revised before this period only in the case of objective circumstances making the implementation of the plan infeasible. Any revision proposed by the Member State would need to be assessed by the Commission and adopted by the Council, as is the case for the plan itself.

For Member States found to be in a situation of macroeconomic imbalances when the medium-term plan is already in place, the plan would not, as a rule, be re-opened to incorporate the policy approach to address those imbalances. A policy dialogue with the Member State would be initiated to identify the measures needed to address the imbalances. These would be communicated by the Member State in a letter and would eventually be incorporated in the medium-term plan when updated, on the basis of the assessment and approval process described above (Box 2).

Figure 3: Overview of the process



Common assessment framework for the medium-term plan

In the design phase, the Commission would assess whether the multiannual fiscal adjustment path put forward by Member States is consistent with ensuring that debt is put or kept on a downward path by the end of the adjustment period at the latest or remains at prudent levels and that the deficit is maintained below 3% of GDP over the medium term. The reference adjustment path would serve as a common basis for the discussion and for the assessment of the plans by the Commission. The reference adjustment path should also ensure that the deficit is maintained below the 3% of GDP reference value over the medium term. For Member States that are already in EDP when the plan is submitted, the Commission would assess whether the plan is consistent with relevant Council recommendations and decisions.

If a Member State has requested an extension of the adjustment period by a maximum of 3 years, such a request would be assessed positively in case the longer adjustment path is underpinned by appropriate and timebound reform and investment commitments. Member States would be expected to provide in-depth and transparent documentation, providing quantitative analysis of the short-term costs – if any – and of the medium-term budgetary and potential growth impact of the reform and investment commitments. When assessing such a request, the Commission would use the following criteria to assess the set of reform and investment commitments put forward by Member States. They should:

- be growth enhancing and support fiscal sustainability.
- address common EU priorities, including the National Energy and Climate Plans (aligned with the targets of the EU Climate Law), the National Digital Decade Roadmaps, ([14]) and the implementation of the European Pillar of Social Rights, and ensure that the fiscal-structural plan addresses all or a significant subset of relevant CSRs, including, where applicable, recommendations issued under the MIP.

([14]) Submitted, in accordance with Article 7 of the Decision of the European Parliament and the Council establishing the Digital Decade Policy Programme 2030, nine months after the date of its entry into force (expected in January 2023).

- be sufficiently detailed, frontloaded, timebound and verifiable.
- ensure that country-specific investment priorities can be addressed without leading to investment cuts elsewhere over the planning horizon.

On the basis of a positive Commission assessment, the Council would adopt the extended adjustment path and the reform and investment commitments underpinning this path.

In practice, the following technical specifications would be important for the formulation of the Member State's medium-term plan and the Commission's assessment of it:

- The plan would set out assumptions and projections of the trajectory of relevant macro-fiscal variables. This would cover the macroeconomic and fiscal path for the adjustment period covered by the plan and the subsequent no-policy-change extension of the projections for the following 10 years. The debt projections at unchanged policy to be included in the plan should be consistent with the comparable Commission projections (see Box 1 for more details).
- The plan of a Member State that requests a longer adjustment period would need to include in-depth and transparent documentation, providing evidence of how the set of reform and investment commitments support sustainable growth and fiscal sustainability as well as quantitative analysis of both the medium-term budgetary and potential growth impact of the set of reforms and investment underpinning the longer adjustment period.
- The plan would include the projected expenditure financed by RRF grants, cohesion policy funds and other EU transfers. Other data and reporting requirements, both for the medium-term plan itself and the annual progress report, would need to be further developed, starting from the current requirements for the Stability and Convergence Programmes and National Reform Programmes, but with a longer horizon.
- The agreed multiannual net primary expenditure path would be translated into annual expenditure ceilings over the adjustment period to be respected in relation to nationally-financed expenditure, while the plan would include projected expenditure financed by RRF, cohesion policy funds and other EU transfers. The path would be set in a way to ensure that a significant part of consolidation needs are met within the adjustment period and not left to future governments. Annual and in-year fiscal surveillance would monitor expenditure developments in order to avoid that small annual slippages cumulatively lead to large deviations from the path.

4.2 How to assess compliance of fiscal-structural outcomes?

Principles for assessing compliance

The implementation of the medium-term fiscal-structural plans would be monitored against the respect of the agreed multiannual net primary expenditure path endorsed by the Council. While monitoring and enforcement would continue to be based on the annual and in-year surveillance cycle, with a particular role for annual reports, the focus of surveillance would be to ensure adherence to the medium-term plan. Nationally-financed expenditure would have to stay within the agreed multiannual net primary expenditure path. Given that the use of net primary expenditure as single operational indicator for surveillance would allow for the operation of automatic stabilisers, no deviation from the path due to cyclical conditions would be justified (as this would give rise to the risk of being applied asymmetrically in bad times and thus undermine adjustment and debt sustainability). Likewise, while the Member States would remain free to undertake additional reforms or investments, new policy initiatives would not imply a reopening of the agreed multiannual net primary expenditure path.

Robust escape clauses are needed to address exceptional situations where the endorsed adjustment path could not realistically be adhered to. Strict adherence to the agreed multiannual net primary expenditure path would allow fiscal policy to be countercyclical, building fiscal buffers in good times and allowing for the necessary policy response in bad times. ([15]) However, for major shocks to the euro area or EU as a whole, a general escape clause would be maintained to deal with a severe economic downturn allowing for a temporary deviation from the fiscal path. In addition, an exceptional circumstances clause would allow for temporary deviations from the medium-term fiscal path in the case of exceptional circumstances outside the control of the government with a major impact on the public finances of an individual Member State. This would require that the overall size of the shock exceeds a 'normal' range (e.g., costs of natural disasters should be anticipated within bandwidths). The triggering and extension of general and country-specific clauses would require the consent of the Council.

To increase ownership and transparency at the national level, independent fiscal institutions could play a role in the monitoring of compliance with the national medium-term fiscal-structural plans in support of the national governments. Independent fiscal institutions could provide an *ex-ante* assessment of adequacy of the plans and their underlying forecasts, which would help national government in the design phase. This would increase the ownership of the plans at the national level and strengthen transparency before endorsement of the plan at the EU level. Moreover, independent fiscal institutions could strengthen enforcement at the national level by being responsible for providing an assessment of *ex-post* compliance of budgetary outturns with the agreed multiannual net primary expenditure path and, when applicable, an assessment of the validity of explanations regarding deviations from the path. The Commission and the Council, in charge of EU surveillance, could take into account the assessment of independent fiscal institutions but would necessarily retain the power to propose and adopt the final decision.

Enforcement of compliance with the medium-term fiscal path and the opening of EDPs

Stronger *ex-post* enforcement would be the necessary counterpart of a risk-based surveillance framework that provides more leeway to Member States to set their

([15]) The complementarity between adherence to rule-based fiscal policy and the need for coordination to address exceptional situations has been acknowledged in the eligibility criteria for the activation of the ECB's Transmission Protection Instrument (TPI), as Member States' compliance with the EU fiscal framework is one of the criteria to be considered by the Governing Council of the ECB when deciding whether to activate the TPI.

adjustment paths. Assessment of compliance and enforcement would be carried out on a continuous basis, in particular based on the annual progress reports and EDP data notifications. For euro area Member States, the Commission would also assess compliance of the draft budgetary plans with the agreed multiannual net primary expenditure path in the autumn. There would no longer be a need for annual fiscal recommendations for Member States that comply with their medium-term plans. At the same time, the Commission/Council could issue recommendations with early warnings before the conditions for opening an EDP are reached, namely, if they see strong risks of breaching the 3% of GDP threshold or in case of deviations from the agreed multiannual net primary expenditure path that do not lead to the opening of an EDP.

The deficit-based EDP would be maintained, while the debt-based EDP would be reinforced and become a key tool for enforcing continued compliance with the agreed multiannual net primary expenditure path. The existing rules for the opening and closing of a deficit-based EDP would remain unchanged. The process for launching a debt-based EDP under the reformed rules would be activated when a Member State with debt above 60% of GDP deviates from the agreed multiannual net primary expenditure path set out in the medium-term fiscal plan endorsed by the Council. In such a case, the Commission would prepare a so-called 'Article 126(3) report' that assesses relevant factors, as foreseen in the Treaty. For a Member State with a substantial public debt challenge, a deviation from the agreed path would result by default in the opening of an EDP. The path under the EDP would in principle be the one originally endorsed by the Council. In case this original path is no longer feasible, due to objective circumstances, the Commission could propose to the Council an amended path under the EDP. Also, in case of non-implementation of the reforms and investment underpinning a more gradual adjustment path, a new enforcement tool would lead to a revision of the adjustment path in a more restrictive sense. The Commission would use notional control accounts for each Member State to keep track cumulative deviations from the agreed multiannual net primary expenditure path over time. This would strengthen the medium-term memory of the system and avoid that small deviations eventually add up to large deviations.

Enforcement mechanisms would be reinforced:

- The effective use of *financial sanctions* would be de-constrained by lowering their amounts.
- *Reputational sanctions* would be enhanced. For example, Ministers of Member States in EDP could also be required to present in the European Parliament the measures to comply with the EDP recommendations.
- *Macroeconomic conditionality* exists for structural funds and for the RRF and would be applied in a similar spirit. EU financing could also be suspended when Member States have not taken effective action to correct their excessive deficit.

Clear conditions would need to be fulfilled for abrogation of EDPs. Abrogation would require the deficit to remain credibly below 3% of GDP (in line with current provisions) and, for debt-based EDPs, that the Member State demonstrates durable compliance with the agreed multiannual net primary expenditure path for 3 years, ensuring that debt is credibly put on a downward trajectory at the end of the adjustment period.

Enforcement of compliance with reform and investment commitments

Compliance with the endorsed reform and investment commitments that underpin a more gradual fiscal path would be monitored annually in the context of the European Semester. To ensure proper monitoring, the national medium-term plan should include sufficient detail as well as a timeline for the implementation of reform and investment commitments. Member States would report on progress with the implementation of these commitments in their annual progress reports together with a report on the policy action taken to address CSRs.

A new tool would be created to enforce the reform and investment commitments underpinning a more gradual adjustment path. If a Member State were to fail to implement its reform and investment commitments, the tool would empower the EU to request a revised multiannual net primary expenditure path (in a more restrictive sense while ensuring a high quality of public finances) and (for euro area Member States) to also impose financial sanctions.

4.3 How to better identify and assess the evolution of macroeconomic imbalances?

The cornerstone of the reformed MIP would be the joint determination of a policy strategy to address imbalances, through enhanced dialogue and commitment.

- Similarly to the fiscal adjustment path, the policy approach to prevent and correct macroeconomic imbalances would be based on *improved ownership,* following a dialogue with the Commission on the basis of the Commission's IDR and, where applicable, CSRs. This would result in commitments in the medium-term fiscal-structural plan, whose implementation will be taken into account in the analysis of the evolution of imbalances.

- As under fiscal surveillance, *a strengthened monitoring and enforcement process* would be envisaged for the MIP. Therefore, the EIP would remain the tool to enforce policy action in Member States with excessive macroeconomic imbalances, including imbalances that jeopardise or risk jeopardising the proper functioning of the economic and monetary union, when those Member States are not taking appropriate policy action.

- To ensure overall consistency with the commitments taken in the medium-term fiscal-structural plan, if an EIP were launched, this would lead to *the re-opening of the fiscal-structural plan on the basis of a revised plan submitted by the Member State, which would act as the corrective action plan under the EIP*. Such a single plan would allow for a more coherent and integrated macro-fiscal monitoring process.

- To reinforce the *macroeconomic focus and the EU/euro area dimension*, the MIP scoreboard would be complemented with the inclusion of values for the EU and the euro area for all indicators. Systemic challenges, notably related to climate change, environment and the energy transition, will be covered in the context of the European

Semester, and referred to in the AMR and IDR when they have a clear link to macroeconomic imbalances.

- To allow for a *more forward looking and early risk detection*, a reformed MIP needs to pay more attention to flow-related variables, throughout the main stages of MIP surveillance. The AMR would put more emphasis on whether trends are projected to continue and their expected impact in the Member States selected for an IDR. This would allow for more frequent IDRs when adverse trend developments are observed, even if not fully reflected in stock imbalances. The assessment of whether imbalances exist would remain based on the three criteria of gravity, evolution and the policy response. However, the criteria of evolution and the policy response by the Member State concerned would be given more weight in the assessment. That could help reduce the perceived inertia around the classification of imbalances.
- To increase the dynamics of the MIP, the *de-escalation of Member States in MIP would be based on clear criteria.* Such criteria could include, for instance, that imbalances have narrowed for at least two years and that flows support the expectation of sufficient further reduction; forecasts should show continued improvements and the policy commitments, including those specified in the national fiscal-structural plan, have to be implemented. Shorter IDRs could be prepared when imbalances are being corrected, while fully-fledged reports would be foreseen every three years, as a rule, unless the Commission sees a need for such an analysis in the meantime.

4.4 Focused and streamlined post-programme surveillance

The economic governance review also comprised an assessment of post-programme surveillance. The February 2020 Communication considered that the framework for surveillance of Member States experiencing, or threatened with, serious difficulties with financial stability had led to a number of improvements and generally worked well. Nonetheless, the importance of retaining adequate national ownership of programmes was highlighted, as well as that issues of transparency and accountability also persist. ([16])

The flexibility of enhanced surveillance as a crisis resolution tool should be preserved. Enhanced surveillance has proven itself to be a flexible instrument, having been successfully utilised at the end of a Macroeconomic Adjustment Programme for Greece, from 2018 until 2022. It allowed for an effective follow-up of reform commitments, enabling a subsequent transition towards post-programme surveillance. However, the value of enhanced surveillance as an early intervention measure remains equally important for preventing a situation in a euro area Member State deteriorating to the point of a need for a Macroeconomic Adjustment Programme.

([16]) Since that time, the European Court of Auditors found that while post-programme surveillance was an appropriate tool, its efficiency was hampered by unclear objectives and insufficient streamlining and focus in implementation, and it made several recommendations to the Commission to consider addressing such shortcomings in the context of the economic governance review.

Post-programme surveillance should be given clear objectives with its intensity linked to those objectives. Post-programme surveillance would focus on: (i) assessing repayment capacity through considering the economic, fiscal and financial situation; (ii) monitoring the implementation of unfinished reforms that begun under the adjustment programme; and (iii) assessing whether corrective measures are needed in the context of concerns for repayment capacity or continued market access. The intensity of post-programme surveillance would evolve with time along with the change in focus and with the assessment of risks. Whilst the initial years would be more intense as there is also the monitoring of the implementation of unfinished reforms that begun under the adjustment programme, over time this element would decrease as reforms are implemented. As such, in "normal" times, post-programme surveillance would focus on assessing repayment capacity through considering the economic, fiscal and financial situation and could be streamlined where repayment risks are assessed to be low, also through a better integration with other surveillance tools. Should the economic, fiscal or financial situation deteriorate, such an approach would allow for a renewed increase in the intensity of post-programme surveillance that would take up the work of assessing whether corrective measures are needed.

5. Conclusions

This Communication sets out the main features of a reformed EU economic governance framework. The main elements outlined in this Communication respond to the need for a reformed framework that is fit for the challenges of this decade. The necessary financing for the just transition to a digital and green, climate-neutral economy and higher debt-to-GDP ratios call for fiscal rules that allow for strategic investment, while safeguarding fiscal sustainability.

Swift agreement on revising the EU fiscal rules and other elements of the economic governance framework is a pressing priority at the current critical juncture for the European economy. Member States and the Commission should reach a consensus on reform of the economic governance framework ahead of Member States' budgetary processes for 2024. In light of the mounting challenges that the EU is facing, there is a need for strong budgetary and structural policy coordination and effective economic and fiscal surveillance. Sound public finances that can respond in a coordinated manner to the prevailing challenges and to the achievement of common EU priorities have become increasingly important in the face of recent and current crises. This would also reassure financial markets on the institutional robustness of the euro area, which rests on sustainable public finances and on preventing and addressing macroeconomic imbalances in all Member States. The operation of credible fiscal rules and surveillance of risks to macro-financial stability will also help the ECB attain its goals, particularly as it faces the challenge of delivering on its mandate to maintain price stability while avoiding financial fragmentation in the euro area.

A thorough reform of the EU economic governance framework would require legislative change. Amending the underlying legislation would allow for clarification and simplification of the framework. It would provide a high degree of legal certainty for the operation of a reformed framework, with the necessary involvement of the Council and the European Parliament. Agreeing on necessary legislative change would follow the ordinary legislative procedure, involving on most aspects the Council and the European Parliament on an equal footing.

Most of the objectives of the proposed reform to the MIP could be pursued within the existing legal provisions. In particular, pursuing a more forward-looking approach to better assess risks and the adjustment of the criteria followed to decide on the existence and classification of imbalances and their correction could be accommodated within the current legal framework.

On the basis of these orientations and the ensuing discussion, the Commission will consider tabling legislative proposals. It will again provide guidance for fiscal policy for the period ahead in the first quarter of 2023. This guidance will facilitate the coordination of fiscal policies and the preparation of Member States' stability and convergence programmes for 2024 and beyond. The guidance will reflect the economic situation, the specific situation of each Member State and the orientations laid down in this Communication provided a sufficient degree of convergence across Member States is achieved by that time. In spring 2023, guidance will materialise through CSRs.

Box 1: The debt sustainability criterion

To determine the reference adjustment path ensuring the convergence of debt to prudent levels, the Commission would use a well-established and transparent methodology, drawing from its debt sustainability analysis (DSA) framework, and agreed with Member States. For Member States with a substantial public debt challenge, the Commission would put forward a reference adjustment path ensuring that in each Member State, after fully implementing the plan, debt would remain on a plausibly downward path after the adjustment period, on the basis of a 10-year trajectory and assuming unchanged policies after the adjustment period. This reference adjustment path is associated with a level of the structural primary balance at the end of the adjustment period that ensures that debt is on a plausibly downward path. For Member States with a moderate debt challenge, the reference path would be less demanding.

The Commission's DSA framework is a well-established analytical toolkit for assessing debt sustainability risks. It includes a baseline projection for the debt trajectory over 10 years, along with additional deterministic debt projections underpinned by alternative assumptions for fiscal, macroeconomic and financial variables, as well as stochastic analysis capturing broad macroeconomic uncertainty. The *DSA baseline* rests on a no-fiscal policy change assumption where no additional fiscal measures are incorporated beyond the horizon of the plan, and primary spending is only affected by changes in ageing-related costs as projected in the latest joint Commission-Council Ageing Report. Real GDP growth is in line with the latest Commission medium-term projections using the EU commonly agreed methodology, taking into account the impact of investment under the NextGenerationEU package. Inflation and interest rates converge to market-based expectations. For the *deterministic* projections, the risk assessment relies on the projected debt level, the debt trajectory and the plausibility of the targeted fiscal position (and room for corrective action if needed). For the *stochastic* projections, the risk assessment is based on the probability that debt will not stabilise over five years and on the size of macroeconomic uncertainty. ([1]) On this basis, this analysis classifies countries into three overall risk categories: *low*, *medium* and *high*. A *high* risk category indicates substantial public debt (sustainability) challenges that need to be addressed by fiscal and macroeconomic policies.

An adjustment path consistent with the convergence of debt to prudent levels should ensure that for a Member State with a substantial or moderate public debt challenge, debt would be put on a plausibly downward path on the basis of a 10-year trajectory beyond the plan's horizon. For Member States with a substantial public debt challenge, this would be the case if the 10–year debt trajectory beyond the plan's horizon were on a plausibly and continuously declining path. For Member States with a moderate public debt challenge, this would be the case if, at most 3 years after the horizon of the plan, the 10-year debt trajectory were on a plausibly and continuously declining path. These conditions should be met at unchanged policies after implementing the medium-term plan, i.e. in the absence of new fiscal policy measures beyond the adjustment period, and, to account for realistic risks, under a standard set of adverse scenarios such as those considered in the Commission's DSA framework. Finally, there should be a sufficiently low probability that debt increases in the five years following the plan's horizon.

Assumptions and projections of the trajectory of relevant macro-fiscal variables would be set out in the plan for a period of 10 years after the period covered by the plan. This would cover the macroeconomic and fiscal path for the period covered by the plan and the subsequent no-policy-change extension of the projections for the following 10 years (see Table 1).

Table 1: Time horizon of the projections and of the assessment criterion

Time horizon	**T**	**T+[X]**	**…**	**T+[X]+10**
Projections and assessment criterion	Last outturn year	Plans' projections (including binding period) *Base year to run the DSA*	Plans' projections based on a no-fiscal policy change extension	DSA end date

Note: The adjustment period of 4 years could be exceptionally extended up to 7 years in order to facilitate major investments and reforms.

(1) Further details on the methodology can be found in the 2021 Fiscal Sustainability Report.

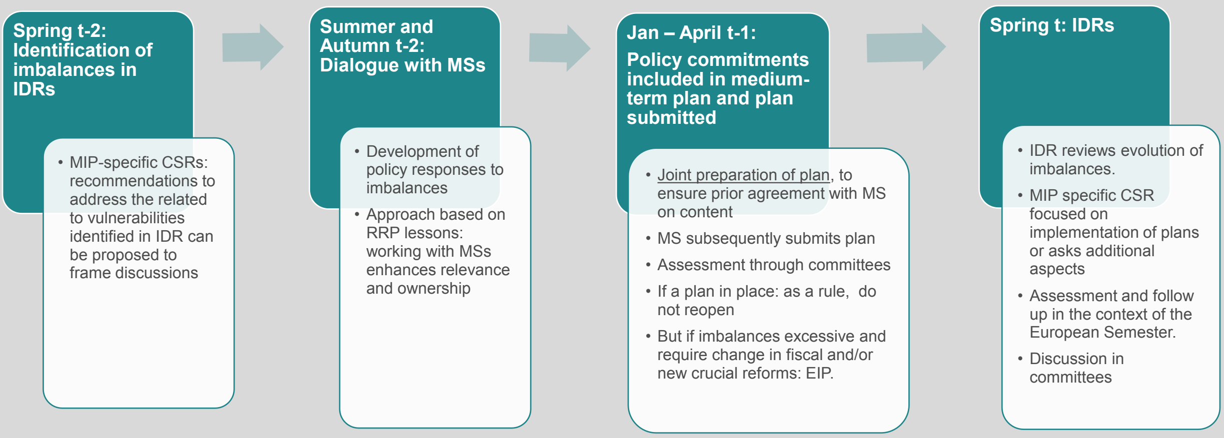
Box 2: The policy response to new imbalances under the MIP

Agreement of the national medium-term plan and the MIP

Immediately following the identification of imbalances in an IDR (and possible publication of MIP-specific CSRs to serve as guidance), the reformed MIP would envisage a dialogue with the Member State. This would take place over the summer and autumn. The aim would be to build a common understanding of the challenges and to identify the reforms and investments that would lead to the correction of imbalances (Figure 1).

On the basis of this dialogue, the Commission and the Member State would jointly agree a policy approach to correct imbalances, in line with the RRP approach. The agreed set of reforms and investments would be incorporated in the national medium-term plan when the plan is agreed. The national medium-term plan could also include cross references to measures already included in the RRP as well as relevant investments financed by Cohesion Policy programmes, to give a comprehensive overview of the policy commitments of the Member States.

Figure 1: Timeline for the policy response to a finding of imbalance with new national medium-term plan



A new source of imbalance is found during the life of the national medium-term plan

If a new source of imbalances is found while the national medium-term plan is already in place, following the identification of these vulnerabilities in an IDR under the European Semester cycle, the medium-term plan in place will, as a rule, not be reopened but a policy dialogue with Member States would be initiated to reach a common understanding of imbalances and of the measures needed to address them**.** The agreed policy approach to address imbalances, including reforms and investments, will be communicated by the Member State through a letter to the Commission and the Council and discussed in the committees. The agreed policy agenda may subsequently be included: (i) in a new national medium-term plan (if not resolved in the lifetime of the original plan); OR (ii) in an amended medium-term plan (if the previous plan is no longer feasible). If the imbalances are excessive and require an immediate change of fiscal policy and new crucial reforms, the EIP would be launched, the plan re-opened and act as a corrective action plan.

Annex 1: Timing of EU surveillance

I. The medium-term fiscal-structural plan

Dec T-2	**High-level guidance** on medium-term EU reform and investment priorities based on Commission input
Jan –Mar T-1	**Technical guidance :** Commission engages in dialogue with Member States providing reference expenditure paths ensuring debt sustainability according to agreed criteria.
April T-1	Member States provide their **medium-term plan** covering **T-1, T, T+1, T+2, T+3,** factoring in public investment needs and reforms
May/June T-1	***Ex ante* assessment of medium-term plan by COM/Council:** After assessing its adequacy, Council endorses the plan or requests a resubmission

II. Annual implementation/monitoring

Autumn T-1*	**Assessment of DBP for T** (vis-à-vis fiscal medium-term plan)
Spring T+1**	**Ex-post assessment of fiscal outcome for T**

Note: The timetables for submission of new plans (after the initial start of the revised SGP) may deviate depending on the Member States' political cycles.

* In Autumn T, there will be an ex ante assessment of the Draft Budgetary Plan (DBP) for year T+1.

** In Spring T, there cannot yet be a full ex post assessment of fiscal outcomes as year T marks the start of the implementation of the plan.

Annex 2 – Outcome of the public debate ([17])

Following the relaunch of the economic governance review in October 2021, ([18]) **stakeholders contributed to the debate through an online public survey.** Stakeholders responded to eleven open questions on different aspects of EU economic governance. The survey received 225 valid contributions from respondents in 25 countries. The Commission summarised its main takeaways in a report published in March 2022. ([19]) The characteristics of the survey participants did not mirror those of the EU population and, as such, the replies cannot be interpreted as representative of the prevailing view of all EU citizens and stakeholders. However, the variety and depth of the contributions provide valuable input. Many respondents expressed the view that the governance framework should become more growth-friendly, more mindful of social issues, and that it should support the policy priorities for the green and digital transitions. Most respondents acknowledged the need for the fiscal framework to support the resilience of EU economies to shocks and that debt sustainability should remain a central objective of the EU fiscal rules, while the adjustment path towards lower government debt should be realistic and gradual. Many respondents stressed the need to incentivise investment as a necessary feature of the economic governance framework. Green investment was identified as deserving special attention due to global climate and environmental challenges, while a few respondents cautioned against giving preferential treatment to investment expenditure in fiscal surveillance. Participants also called for simplification, transparency and stronger national ownership. Many respondents viewed the RRF as a good inspiration for the governance framework, in terms of fostering national ownership and promoting reforms through positive incentives. Several respondents support stronger compliance and enforcement of the surveillance framework. Several respondents called for further synergies between the SGP and the MIP, as it could help improve the growth-friendliness of public finances and the simultaneous achievement of various policy objectives.

Several contributors to the public debate have called for a permanent central fiscal capacity. ([20]) Such a tool could address longer-term challenges through the provision of common public goods that would boost sustainable growth and help stem inflation and/or improve macroeconomic stabilisation. The Five Presidents report in 2015 identified sound

([17]) Other EU institutions have made a number of useful contributions to the public debate on the economic governance framework. For example, in response to a dedicated request from former Commission President Jean-Claude Juncker, the European Fiscal Board in September 2019 published its '*Assessment of the EU fiscal rules with a focus on the six- and two-pack legislation*'. On 8 July 2021, the European Parliament (with MEP Margarida Marques acting as *rapporteur*) adopted a Resolution '*on the review of the macroeconomic legislative framework for a better impact on Europe's real economy and improved transparency of decision-making and democratic accountability*'. Both the European Economic and Social Committee and the European Committee of the Regions have published opinions on the economic governance review, in December 2020 and February 2021 respectively.

([18]) European Commission (2021), 'The EU economy after COVID-19: implications for economic governance', COM(2021) 662 final of 19 October 2021.

([19]) European Commission (2022), 'Economic Governance Review – Summary report of the public consultation', SWD(2022) 104 final of 28 March 2022.

([20]) European Fiscal Board 2020; ECB Occasional Paper 273, September 2021; OECD Economic surveys Euro-area, September 2021; IMF Departmental Paper No 2022/014, September 2022.

guiding principles for its design, notably that such a capacity should not lead to permanent transfers between countries, it should maintain the incentives for sound fiscal policy-making at the national level, and it should be developed within the framework of the European Union. As suggested in the public debate, a central fiscal capacity for the EU or euro area could take into account the examples of recent years' successes (i.e., the European Fund for Strategic Investments, SURE, and the RRF).

The debate also included a series of thematic discussions with Member States at the Economic and Financial Committee and the Economic Policy Committee. These discussions focused on the sustainability of public debt, the need to promote investment, the pro-cyclicality of fiscal policy, enforcement and governance of the EU fiscal rules, the interaction between EU and national fiscal frameworks, the relevance and effectiveness of the MIP and the need to maintain it focused on macroeconomic challenges, and the lessons to be learned from the RRF. The potential long-term implications of the Russian invasion of Ukraine for resilience and security were also discussed. The euro area dimension of the economic governance, and the MIP in particular, was discussed at the Eurogroup Working Group.

Discussions have centred on identifying key issues to be addressed in a reformed economic governance framework. Some elements of consensus have emerged, in particular in the discussions with Member States. Some of these, in particular those regarding the fiscal framework, have already been outlined in the Commission Communication of 2 March 2022. ([21]) They are as follows:

- **Ensuring public debt sustainability and promoting sustainable growth** through investment and reforms are two sides of the same coin and key to the success of the EU fiscal framework.
- **More attention to the medium term** in the EU fiscal surveillance appears as a promising avenue.
- **Insights can be drawn from the design, governance and operation of the RRF**.
- **Simplification, stronger national ownership and better enforcement** are key objectives.

Discussions have also highlighted key issues that could be addressed in a reformed economic governance framework regarding the MIP:

- **Increasing the MIP's effectiveness should be a key priority.** This can be achieved by increasing the focus on its core objective, which is to prevent risks to macro-financial stability from turning into imbalances and to foster policy action, taking into account the functioning of the EU and the euro area as a whole. A clearer focus would facilitate communication regarding the identification of macroeconomic imbalances and the necessary policy response, and enhance the visibility of the procedure.

([21]) European Commission (2022), '[Fiscal policy guidance for 2023]', COM(2022) 85 final of 2 March 2022.

- **Recent crises and the heightened level of uncertainty highlight the need to enhance the ability of the MIP to identify emerging risks**. This could be achieved through the use of a more forward-looking approach that is able to trigger policy response early on.
- **Ensuring ownership is crucial to increase the traction of the MIP**. This calls for an enhanced dialogue with Member States, which may build on the experience of the RRF. Making the EIP more operational would also support increased traction.

In parallel, the Conference on the Future of Europe also reflected on how to build a stronger EU economy, social justice and jobs. ([22]) It proposed that the EU strengthens its competitiveness and resilience and promotes future-oriented investments focused on the green and digital transitions with a strong social and gender dimension, taking also into account the examples of the Next Generation EU and the SURE instrument. According to the Conference, the EU needs to take into account the social and economic impact of the war against Ukraine and the link between the EU economic governance with the new geopolitical context.

([22]) European Commission (2022), 'Conference on the future of Europe', COM(2022) 404 final of 17 June 2022.