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NOTE

From: General Secretariat of the Council
To: Working Party of Financial Counsellors

Subject: EGR - Written replies by the Commission services to EP ECON on the economic governance review package

Delegations will find attached the written replies by the Commission services to the EP ECON Committee on the amending Regulation 1466/97 (the preventive arm) and on the amending Regulation 1467/97 (the corrective arm).

As stated in the disclaimers, please note that (i) the note and the replies have not been adopted or endorsed by the Commission; (ii) any views expressed are preliminary views of the Commission services and may not in any circumstances be regarded as stating an official position of the Commission, and (iii) the information transmitted is intended only for the entity to which it is addressed and may contain confidential and/or privileged material.

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EP ECON: Questions on the proposals of the economic governance review package

Proposal for replacing Regulation (EC) No 1466/97 ("Preventive arm")

- 1. European Semester Dialogue – Article 26(1):** The Commission proposal contains the following two sentences: *The European Parliament shall be duly involved in the European Semester in order to increase the transparency and ownership of, and the accountability for the decisions taken, in particular by means of an economic dialogue. The Economic and Financial Committee, the Economic Policy Committee, the Employment Committee and the Social Protection Committee shall be consulted within the framework of the European Semester where appropriate.*
Could you clarify by whom should the Council preparatory bodies (in the second sentence) be consulted? The Commission? The Parliament?

This is the same wording as the one used in the current Regulation (EC) No 1466/97 under Article 2-a (4). The Council and the Commission would continue consulting the Council committees in the context of the European Semester as per current practice.

- 2. In-depth surveillance missions - Article 35:** could you elaborate on the purpose of those missions, what exactly would be done and who would participate? Are similar missions taking place in the context of existing legislation?

Enhanced surveillance missions are already provided for in Article 11(2) and (3) of the current Regulation (EC) No 1466/97. The wording "in-depth surveillance missions" in Article 35 has replaced "enhanced surveillance missions" in Article 11 to avoid confusion with the enhanced surveillance procedure under Regulation (EU) No 472/2013. These would be fact-finding missions to understand the reasons that led to a Council recommendation because of the significant risk of deviation from the net expenditure path or a risk that the government deficit may exceed the 3 % of GDP reference value in the Member State in question (see Article 23 of the proposal). The mission would be undertaken by Commission representatives and, in the case of euro area Member States or those Member States participating in ERM2, representatives of the ECB, if appropriate, as currently provided in Article 11.

- 3. Definition of net expenditure - Annex II, point (a):** could you clarify what does the "expenditure on programmes of the Union fully matched by Union funds revenue" stand for and how is it identified/measured?

This part of the net expenditure definition which is in Article 2 of the proposal refers to the expenditure incurred by Member States for instance in the context of EU structural funds or in the context of the "RRF grants", that is fully matched by revenue from EU funds. In other words, the part of general government expenditure that is covered by EU funds does not count for computing the net expenditure: EU-funded national expenditure is neutral for the national budget. It is the same concept

as the one currently used in the calculation of the expenditure benchmark under the current Regulation (EC) No 1466/97.

- 4. Definition of net expenditure path:** Would it be expressed in levels or percentages? Would it be set in nominal targets?

In the view of the Commission services, nominal targets based on reasonable assumptions for the GDP deflator would be more transparent and easier to monitor as budgets are set in nominal terms and, if respected, would make fiscal policy more counter-cyclical, thus contributing to a better monetary-fiscal policy mix. Downward inflation surprises (typically in downturns) would give some further freedom for government spending in real terms, while upward inflation surprises (typically in good times) would not automatically translate into higher government spending. Large inflation surprises could be taken into account in the assessment phase (i.e., in the “Article 126(3) report”), while not necessarily considering a full adjustment of expenditure to inflation as justified. The fiscal path could be expressed in growth rates, or alternatively in levels of net expenditure.

Proposal for amending Regulation (EC) No 1467/97 (“Corrective Arm”)

- 5. Recital 18 on repealing the provisions related to the contributions to second pillar pension systems:** In the written replies provided to FiCos on 25 July (p. 9), it is mentioned that the impact of the upfront costs of such reforms would already be taken into account when setting the net expenditure path of plans. Where exactly is this mentioned/implied in the definition of the net expenditure path of the plans?

The Commission proposal aims to introduce a more medium-term approach to fiscal surveillance. To the extent that the upfront costs of the pension reforms in question are only temporary, they could be accommodated in the Member State’s medium-term fiscal-structural plan. Concretely, they could be taken into account when setting the multi-annual net expenditure path, while still ensuring that the requirements for debt and deficit are met by the end of the adjustment period.

In particular, according to article 12 of the proposed Regulation on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, the national medium-term fiscal-structural plan shall “*ensure the fiscal adjustment necessary to put or keep public debt on a plausibly downward path by the end of the adjustment period at the latest, or remain at prudent levels, and to bring and maintain the government deficit below the 3% of GDP reference value over the medium term*”. The medium-term approach allows Member States to incorporate temporary factors in the fiscal path, such as the upfront costs of the above-mentioned reforms. The assessment made by the Commission under article 15 of the proposal also takes a medium-term perspective.

Should there be a difference on this regard between the net expenditure path in the Member State’s plan and the technical trajectory issued by the Commission in accordance with Article 5 of the proposal, that would be discussed as part of the technical dialogue between the Commission and the

Member State, to be held in accordance with Article 10 of the proposed Regulation, and should be explained in the plan in accordance with article 11(2) of the proposal.¹

Moreover, to the extent that such reforms would support the sustainability of public finances, they could also be part of a set of reform and investment commitments underpinning an extension of the adjustment period in accordance with Article 13 of the proposal. This would allow a more gradual adjustment, which would provide fiscal space to cope with the upfront costs of such reforms.

¹ “Where the national-medium-term fiscal-structural plan includes a higher net expenditure trajectory than in the technical trajectory issued by the Commission pursuant to Article 5, the Member State shall provide in its plan sound and verifiable economic arguments explaining the difference.”