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WORKING DOCUMENT

From:	General Secretariat of the Council
To:	Financial Counsellors - ECOFIN preparation
Subject:	EGR - Explanatory Note by the Presidency

Delegations will find attached the Presidency's explanatory note in view of discussions with the Ministers.

Economic Governance Review

ECOFIN 7-8 December 2023, Brussels

Based on recent discussions on the economic governance review and taking into account the European Council mandate to finalise legislative work by the end of this year, the Spanish Presidency proposes to adopt a general approach on the legislative package at the next ECOFIN on 8 December.

On 7 December, the ECOFIN will hold an open-ended dinner with the objective to reach a political agreement on pending issues. To facilitate a focused and structured discussion, the Presidency proposes selected issues of discussion in the table below. An annex with corresponding articles, including a brief state of play of discussions, is provided for the reference of Ministers.

Selected articles

	Article	Element covered
Preventive Arm Regulation	5, 7.1, 11(b)	Technical Trajectory – transparency
	6bis	Debt sustainability safeguard – implementation provisions on the average debt-reduction
	6ter, 7.2	Deficit resilience safeguard – definition and implementation provisions
	Transitory Provision	Extension of the adjustment period for the first cohort of medium-term fiscal-structural plans Potential GDP growth – smoothing
Corrective Arm Regulation	2.1(a)	Control account – implementation provisions and budgetary balance as a criterion for the non-triggering of 126(3) TFEU reports
	3.4	Annual adjustment of 0,5% as a benchmark in case of deficit-based EDP
	2.3(e), 2.4	Relevant factors – investment in defence and debt as key aggravating factor
	12.3	Cap on cumulative sanctions

ANNEX – SELECTED ARTICLES FOR DISCUSSION

1. LATEST CHANGES TO THE PREVENTIVE ARM REGULATION

A. Technical trajectory - transparency

Taking into account the call for enhanced transparency, the technical trajectory or technical information will be transmitted also to the Economic and Financial Committee and then published together with the medium-term fiscal-structural plan.

Article 5 Technical Trajectory

Where the general government debt is above the 60% of GDP Treaty reference value or the government deficit exceeds the 3% of GDP Treaty reference value, the Commission shall transmit to the Member State concerned and to the Economic and Financial Committee a technical trajectory for net expenditure covering an adjustment period of 4 years and its possible extension by a maximum of 3 years pursuant to Article 13.

Article 7.1 Prior guidance by the Commission

At the latest by 15 January of the year in which the Member States have to submit their medium-term fiscal-structural plans pursuant to Article 9 or, within 3 weeks from the request of the Member State to submit a revised plan pursuant to Article 14, the Commission shall transmit to the Member State concerned and to the Economic and Financial Committee:

- (a) the underlying medium-term public debt projection framework and results;
- (b) its macroeconomic forecast and assumptions;
- (c) the technical trajectory, if required under Article 5, or the technical information, if required under paragraph 2 of this Article, and the corresponding structural primary balance, including template spreadsheets and other relevant information required to ensure its full replicability.

Article 11 Content and requirements of the national medium-term fiscal-structural plan

The national medium-term fiscal-structural plan shall:

[...]

- (b) include the technical trajectory or technical information transmitted by the Commission pursuant to article 5. Where the national-medium-term fiscal-structural plan includes a net expenditure path that differs from 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;

B. Debt sustainability safeguard, for Member States which are not under a deficit-based Excessive Deficit Procedure

The net expenditure path will ensure an average benchmark debt reduction differentiated depending on debt levels. The period for the averaging of debt reduction will start as of the first year where the preventive arm requirements apply, thereby ensuring the necessary decline in the debt ratio in the course of the adjustment period.

*Article 6bis
Debt sustainability safeguard*

The technical trajectory shall ensure that the projected general government debt-to-GDP ratio decreases by a minimum annual average amount of:

- (a) 1 percentage point of GDP as long as the general government debt-to-GDP ratio exceeds 90%.
- (b) 0,5 percentage point of GDP as long as the general government debt-to-GDP ratio remains between 60% and 90%.

The average decrease shall be computed from the year before the start of the technical trajectory or the year in which the excessive deficit procedure is projected to be abrogated under Regulation [XXX corrective arm of the SGP], whichever occurs last, until the end of the adjustment period.

C. Deficit resilience safeguard, for Member States which are not under a deficit-based Excessive Deficit Procedure

To ensure a safety margin below the 3% Treaty reference threshold, while making the framework more robust to uncertain developments of macro-fiscal variables, also ensuring budgetary manoeuvre for countercyclical policies, the Presidency proposes to introduce a deficit resilience safeguard in the new Preventive Arm Regulation. It should act as an ex-ante requirement to be met by the Commission technical trajectory and the technical information. The specific calibration of the deficit resilience safeguard has been brought into the Regulation, in Article 6ter.

*Article 6ter
Deficit resilience safeguard*

1. The Commission technical trajectory, referred in Article 6, shall ensure that fiscal adjustment continues, where needed, until the Member State reaches a deficit level that provides a common resilience margin of 1,5% of GDP relative to the 3% of GDP deficit Treaty reference value in normal economic circumstances. The margin shall allow room for budgetary manoeuvre, considering in particular the need for public investment and reforms.
2. The annual improvement in the structural primary balance to achieve the required margin shall be of [0,3-0,4]% of GDP, which shall be reduced to [0,2-0,25]% of GDP in case of an extension of the adjustment period in accordance with Article 13.

Recital 14ter

Risk-based requirements for the technical trajectory are expected to be sufficient to bring deficits levels well below the 3% Treaty reference value. However, in order to make the framework more robust to uncertain developments of macro-fiscal variables, the technical trajectory should also provide for a common resilience margin relative to the 3% of GDP deficit Treaty reference value or convergence towards it. This common resilience safeguard should apply to all Member States irrespective of their government debt levels, to ensure the build-up of fiscal buffers for adverse circumstances and shocks, thereby facilitating the conduct of counter-cyclical policies in the Union fiscal framework.

Article 7.2

Technical information

For Member States having a general government deficit below the 3% of GDP Treaty reference value and general government debt below the 60% of GDP Treaty reference value, the Commission shall provide technical information regarding the structural primary balance necessary to ensure that the headline deficit is maintained below the 3% of GDP Treaty reference value without any additional policy measures over the medium and long-term, and indicating whether this implies fiscal adjustment needs. Technical information shall also ensure compliance with the deficit resilience safeguard referred in Article 6ter during the plan.

D. Transitory provision – RRF commitments and potential GDP growth

With a view to ensure continuity in the implementation of ongoing investments and reforms, aligned with our common priorities, two transitory provisions are introduced: i) commitments of Recovery and Resilience Plans will be taken into account for the extension of the adjustment period, with special consideration for highly ambitious Plans, as stated in recital 23 bis, ii) Recovery and Resilience Facility loans and the national co-financing of EU projects in 2025 and 2026 will be protected, as an exception to the no-backloading clause. Furthermore, given the highly uncertain context and ongoing structural changes, the new Working Group on Debt Sustainability Analysis will review common methodologies as a priority, but given time constraints, for the first cohort of plans, Member States will be allowed to use more stable series of potential growth provided it is duly justified.

Transitory Provision
Extension of the adjustment period linked to RRF commitments

For the first cohort of medium-term fiscal-structural plans:

[...]

- (b) During the lifetime of the Recovery and Resilience Facility, in accordance with Regulation (EU) 2021/241, commitments included in the approved Recovery and Resilience Plan of the Member State concerned shall be taken into account for an extension of the adjustment period in accordance with article 13.
- (c) Projects related to Recovery and Resilience Facility loans as well as national co-financing of EU funds in 2025 and 2026 will be taken into account whenever a Member State requests an exception to the no-backloading safeguard referred to in Article 6 point c, provided that this does not endanger fiscal sustainability in the medium term.
- (d) Acknowledging the exceptional impact of recent economic shocks and current uncertainty on estimates of potential growth, Member States may use more stable series than the ones resulting from the commonly agreed methodology, provided it is duly justified by economic arguments and the cumulated growth over the projection horizon remains broadly in line.

Recital 23 bis

Where Recovery and Resilience Plans include ambitious reforms and investments, in particular with regards to economic growth and fiscal sustainability over the medium term, they should be considered to significantly contribute to compliance with the requirements for the extension of the adjustment period pursuant to Article 13.

2. LATEST CHANGES TO THE CORRECTIVE ARM REGULATION

A. Control account

With a view to act in timely manner upon deviations from the net expenditure path, an annual and a cumulated threshold for the control account have been introduced. The breaching of these thresholds will trigger a 126(3) TFEU report by the Commission for Member States with a debt-to-GDP ratio above 60% and with a headline deficit.

Article 2.1.a
Control account threshold

[...] The Commission shall prepare a report in accordance with Article 126(3) TFEU when the ratio of the government debt to GDP exceeds the reference value, the headline balance is in deficit and when the deviations recorded in the control account of the Member State either exceed:

- a) [0,25 - 0,5 percentage points of GDP] annually, or
- b) [0,5 - 0,75 percentage points of GDP], cumulatively

B. Structural Primary Balance

In order to preserve the overall consistency of the corrective and preventive arms, the Presidency proposes to define the 0,5% benchmark adjustment of the corrective arm in structural primary terms (Article 3.4 and recital 16). Over the medium-term, the definition in structural or structural primary terms has a neutral impact on adjustment requirements. In the short-term, however, defining the requirements in structural terms can lead to unrealistic and frontloaded adjustments, as transitory increases in the interest burden would need to be immediately offset. Defining the requirements in structural primary terms would instead provide for smoother fiscal adjustment paths, while ensuring that total effort over the adjustment period remains the same.

Article 3.4

Structural Primary Balance & Corrective Path

[...] Where the excessive deficit procedure was opened on the basis of the deficit criterion, for the years when the general government deficit is expected to exceed the reference value, the corrective net expenditure path shall be consistent with a minimum annual structural [primary] adjustment of at least 0,5% of GDP as a benchmark. [...]

C. Relevant factors for opening EDP

In line with the landing zone of the November ECOFIN: i) special consideration is given to the level of public debt challenges as a key aggravating factor while avoiding automaticity in the opening of Excessive Deficit Procedures; ii) acknowledging geopolitical tensions and security challenges, investment in defence is protected through its recognition as a relevant factor when assessing the existence of an excessive deficit.

Article 2(3)

Relevant factors

3. The Commission, when preparing a report under Article 126(3) TFEU, shall take into account all relevant factors as indicated in such Article, in so far as they significantly affect the assessment of compliance with the deficit and debt criteria by the Member State concerned.

The report shall reflect, as appropriate:

- (a) the degree of public debt challenges based on the methodology referred to in Article 8 of Regulation [on the preventive arm], the evolution of the government debt position and its financing, and the related risk factors, in particular the maturity structure, the currency denomination of the debt and contingent liabilities, including any implicit liabilities related to ageing and private debt;
[...]
- (e) the increase of government investment in defence, where applicable, considering also the time of recording of military equipment expenditure.

Article 2(4)
Overall assessment of relevant factors

4. The Council and the Commission shall make a balanced overall assessment of all the relevant factors, specifically, the extent to which they affect the assessment of compliance with the deficit and/or the debt criteria as aggravating or mitigating factors. Where the Member State faces substantial public debt challenges as referred to in paragraph 3(a), it shall be considered a key aggravating factor. Favourable cyclical economic, budgetary and financial developments shall not be considered as mitigating factors, while unfavourable developments may be considered as mitigating factors. [...]

D. Sanctions

The maximum cap on fines has been eliminated, to preserve incentives to take effective action in response to EDP Recommendations.

Article 12(3)
Sanctions

3. ~~The cumulated amount of the fines referred to in paragraphs 1 and 2 shall not exceed 0,5 % of GDP.~~