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## INFORMATION

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From:	General Secretariat of the Council
To:	Working Party of Financial Counsellors
Subject:	EGR - Presentation by the Commission services on the Economic Governance Review

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Delegations will find attached the presentation given by the Commission Services concerning the Economic Governance Review, discussed at the Financial Counsellors Working Party on 2 May 2023.



# European Commission proposal for a reform of the EU economic governance framework

FICO 2 May 2023

[REDACTED]  
DG ECFIN, European Commission

# Key objectives and principles of the reform

- The key objective of the reform is to strengthen debt sustainability and promote sustainable and inclusive growth through reforms and investment.
- Key principles:
  - Medium-term approach bringing together fiscal policy, investments and reform
  - Gradual and credible debt reduction thanks to prudent fiscal policy and underpinned by growth enhancing investment and reforms for EU priorities
  - More national ownership, based on common EU rules, and better enforcement
  - Simpler rules taking account of different fiscal challenges

# Context

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<b>5 February 2020</b>	Commission Communication on the economic governance review
<b>19 October 2021</b>	Commission Communication relaunching the public debate
<b>28 March 2022</b>	Commission SWD on the responses to the online public consultation
<b>9 November 2022</b>	Commission Communication on orientations for a reform
<b>14 March 2023</b>	ECOFIN conclusions on the economic governance review
<b>23 March 2023</b>	EUCO endorsement of the ECOFIN conclusions
<b>26 April 2023</b>	College adoption of legislative proposals

# Context

- Legislative proposals follow a long and intense period of consultations and discussions, which started before Covid and accelerated since October 2021.
- Legislative proposals are consistent with the Commission communication on orientations for reform (9 November 2022).
- They contain several modifications and clarification addressing concerns of Member states (i.e. safeguard provisions).

# Content of the legislative package

1. Proposal for *a new* Regulation on the effective coordination of economic and multilateral budgetary surveillance (repealing EC No1466/97)

2. Proposal for *amending* the Regulation on speeding up and clarifying the implementation of the excessive deficit procedure (EC No 1467/97)

3. Proposal for *amending* the Council Directive on requirements for budgetary frameworks of the Member States (2011/185/EU)

# 1. Proposal for a *new* Regulation on the effective coordination of economic and multilateral surveillance

- Lays down detailed rules concerning the content, submission, assessment and monitoring of national **medium-term fiscal-structural plans**.
- **Medium-term fiscal-structural plans** will cover at least 4 years and will contain a net expenditure path that ensures a convergence of debt to prudent levels:
  - Debt at the end of the adjustment period is on a plausibly declining path and stays on that path without further fiscal adjustment or is already at a prudent level;
  - Deficit will be and remain under 3% without further policy adjustment.
- **Fiscal adjustment period can be extended** if underpinned by specific reform and investments.
- **Common and transparent assessment frameworks** for fiscal effort and for reform and investments.
- **Council endorsement** of fiscal path, and reform and investment commitments underpinning extension.
- **Endorsed net expenditure path as the sole monitoring indicator**, ensuring automatic stabilisation (because the cyclical fiscal items are not included in the indicator and can fluctuate freely)
- **General and country-specific escape clauses** that involve the Council and are time bound.

# Criteria to set the technical trajectories

Commission will provide technical trajectories for Member States in breach of reference values of 3% and 60% based on a common and transparent methodology. It will be published and be an important input to the dialogue with Member States.

**Technical trajectories** should ensure that at the end of the adjustment period:

- The public debt ratio is and remains on a plausibly downward path, or stays at prudent levels;
- The government deficit is brought and maintained below the 3% of GDP reference value.

**Additional safeguards:**

- An annual minimum benchmark adjustment of 0.5% of GDP when deficit exceeds the 3% of GDP reference value;
- The public debt ratio at the end of the plan is below its initial level;
- No backloading of fiscal effort in case of extension;
- (Net) expenditure growth remains below medium-term output growth, on average, as a rule over the horizon of the plan.

# Role of the country-specific recommendations

## European Semester fully preserved

- Plans to contain information on national policy priorities responding to main economic challenges as identified in the country-specific recommendations
- **If no extension:**
  - Content and level of detail similar to current guidance for SCPs and NRPs
  - Assessment of CSR implementation, including, where applicable, MIP-relevant CSRs, to remain broadly unchanged from today and to continue to inform following CSR cycle
  - Negative assessment of CSR implementation would not be a reason to request a revised plan
- **In case a set of reforms and investments underpin an extension:**
  - Within the overall set of reform and investment commitments, those that underpin extended adjustment have to fulfil specific criteria and entail additional reporting requirements

# Assessment criteria for reforms and investment

The set of reform and investment commitments underpinning an extended adjustment path to fulfill the following criteria:

- be growth enhancing;
- support fiscal sustainability;
- address common EU priorities (i.e., Green Deal, European Pillar of Social Rights, Digital Decade, Strategic Compass for Security and Defence);
- address relevant country-specific recommendations, including, where applicable, recommendations issued under the Macroeconomic Imbalances Procedure;
- ensure that the overall level of nationally financed public investment over the lifetime of the plan is higher than the medium-term level before the period of the plan.

# Preventive arm - Main legislative text

## 10 chapters forming the main legislative text

- Chapter I: Subject-matter and definitions
- Chapter II: European Semester
- Chapter III: The technical trajectory
- Chapter IV: National medium-term fiscal-structural plans
- Chapter V: Implementation of the national medium-term fiscal-structural plans
- Chapter VI: Economic dialogue
- Chapter VII: Interaction with Regulation (EU) No 1176/2011
- Chapter VIII: Interaction with Regulation (EU) No 472/2013
- Chapter IX: Delegated powers
- Chapter X: Common provisions

# Preventive arm - Annexes

## 7 annexes containing technical details of the Regulation

- I. Criteria for setting the technical trajectory for Member States having a public debt above 60% of GDP reference value or government deficit above 3% of GDP reference value
  - II. Information to be provided in the national medium-term fiscal-structural plans
  - III. Information to be provided by Member States in the Annual Progress Reports
  - IV. Functioning of the control account
  - V. Methodology to assess plausibility by the Commission
  - VI. Common priorities of the Union
  - VII. Assessment framework for the set of reform and investment commitments underpinning an extension of the adjustment period
- All annexes except annex I can be changed by delegated acts.

## 2. Proposal for *amending* Regulation on the speeding up and clarifying the excessive deficit procedure

- **Rationale:** better enforcement of fiscal trajectories as counterpart to greater leeway for Member States to set their fiscal paths
- **Instruments:**
  - *Control account* to keep track of cumulative deviation from the endorsed net expenditure path.
  - Existing rules for the opening and closing of *deficit based EDPs to remain unchanged* (breach of the 3% deficit reference value) ...
  - ... but *reformed debt-based excessive deficit procedure* (deviation from the net expenditure path).
  - *Lower sanctions*, but increasing as long as the Member State does not act.
  - Reforms and investment that allowed a longer adjustment path: non-implementation could result in a *shortening of the adjustment period* (= more restrictive fiscal targets).
  - Macro-economic conditionality – outside the Stability and Growth Pact - remains unchanged

## 2. Proposal for *amending* Regulation on the speeding up and clarifying the excessive deficit procedure

- **Clarifications on opening and abrogation of debt based EDPs:**
  - Opening based on usual 126(3) report triggered by deviations from the endorsed fiscal path;
  - Debt-based EDP “by default” for Member States with substantial debt challenges;
  - Streamline use of relevant factors;
  - Abrogation based on compliance with EDP recommendation over 3 years.
- **Common quantitative benchmark adjustment** of 0.5% GDP annually retained from existing legislation when Member State has a deficit above 3% GDP.

## 2. Proposal for *amending* Regulation on the speeding up and clarifying the excessive deficit procedure

### Main amendments (not exhaustive)

- **Section 1: Definitions and assessments**
  - Article 1: definitions
  - Article 2: assessment of compliance with Treaty criteria
- **Section 2: Speeding up the EDP**
  - Article 3: recommendations under article 126(7) TFEU
  - Article 5: notice under article 126(9) TFEU
  - Article 8: abrogation - conditions added in Regulation
- **Section 4: Sanctions**
  - Article 12: amount of fines
- **Section 5: Transitional and final provisions**
  - Article 17b [new]: transitional provisions

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# Amendments to Directive 2011/85/EU

# Outline

- Reasons for the proposal
- Main changes:
  1. A stronger role for IFIs
  2. A clearer mid-term orientation
  3. A greener, climate-resilient and more inclusive budgeting
  4. Simplification & clarification

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# Reasons for the proposal

## Amendments to the Directive mainly aim at:

Reinforcing ownership and medium-term orientation, consistent with EGR spirit;

Enhancing IFIs and MTBFs in line with ECA 2019 recommendations;

Addressing weaknesses from transposition and implementation checks, as reported in COM 2020 suitability review;

Improving quality of public finances by inserting climate, environmental and distributional considerations in line with EU policies.

# 1. A stronger role for IFIs

## Safeguards for independence -Art 8(1), 8(2) and 8(3):

- IFIs established by binding provisions; members appointed transparently and based on competences;
- Adequate and stable resources; adequate and timely access to information; ability to communicate publicly.

## New tasks -Art 8(4):

- Produce or endorse (macroeconomic and) budgetary forecasts, debt sustainability assessments, impacts of policies on fiscal sustainability and sustainable and inclusive growth;
- Monitor compliance with (national fiscal rules and) EU rules; conduct regular reviews of the national fiscal framework; participate in regular hearings at the national parliament.

## Higher accountability -Art 8(5):

- Comply-or-explain principle for IFIs' assessments and opinions;

## 2. A clearer mid-term orientation

- Extending forecast requirements to multi-annual period – Art 4
- Clarifying the link between annual budgeting and multi-annual budgeting –Art 10:

Annual budget legislation shall be consistent with the national budgetary objectives over the medium term referred to in Article 2, point (e). ~~the provisions of the medium term budgetary framework.~~

# 3. A greener and more inclusive budgeting

## **Recital 19 calls for greener and more inclusive budgetary processes:**

‘Green budgeting tools can help redirect public revenue and expenditure to green priorities. (...)’

Member States should publish the information on how the relevant elements of their budgets contribute to achieving climate and environmental national and international commitments and the methodology used (...)

Member States are invited to publish information on the distributional impact of budgetary policies and take into account employment, social and distributional aspects in the development of green budgeting.’

## **New elements in MTBFs – Art 9(2)d requires:**

- assessing the medium- and long-term impacts of policies on sustainable and inclusive growth.

# 3. A more climate-resilient budgeting

## **New elements in MTBFs – Art 9(2)d requires:**

- specifying, to the extent possible, the macrofiscal risks from climate change as well as environmental and distributional impacts, and the implications on public finances of climate-related policies.

## **New reporting requirements – Art 14(3) requires MS to publish:**

- information on disaster and climate-related contingent liabilities to the extent possible;
- information on economic losses incurred due to disasters and climate-related shocks, including the fiscal costs borne by the public sector and the instruments used to mitigate or cover them.

# 4. Simplification & clarification

## **Some provisions deleted as no longer useful:**

- monthly cash-basis data requirement (Art 3(1), Article on the UK (Art 8), and provisions in the preventive arm Regulation proposal (Art 4(4) and 4(5)).

## **Improved wording for provisions interpreted in an ambiguous way:**

- Independent bodies to conduct ex-post evaluations (Art 4(6)); clarifications for Art 14(1), 14(2) and 14(3).

# EGR consistency with the Fiscal Compact

## Fiscal Compact

- ⇒ Sound and sustainable public finances and promotion of sustainable growth;
- Convergence to medium-term positions taking into account country-specific sustainability risks (Art 3)
  - Analysis of expenditure net of discretionary revenue measures for compliance assessment
  - Possible deviations only under exceptional circumstances
  - Role of monitoring compliance to IFIs

## EGR

- ⇒ Sound and sustainable public finances and promotion of sustainable and inclusive growth;
- Medium-term orientation anchored on country-specific debt challenges;
    - Net-expenditure path as main indicator;
    - Deviations possible under exceptional circumstances;
    - Role of monitoring compliance to IFIs

The substance of the Fiscal Compact is *incorporated* into the EU legal framework according to Art 16 of TSGC, removing legal uncertainty.

# A proposal for the EFB

Future revisions to the Commission decision establishing the EFB are considered.

The proposal for the preventive arm Regulation (explanatory memorandum) indicates:

- (...) the Commission will explore how to strengthen the role of the European Fiscal Board, while preserving the surveillance role conferred on the Commission by the EU Treaties.
- (...) New tasks for the European Fiscal Board could include informing the periodic evaluation of the reformed framework and providing assessments on the implementation of central elements of the reformed governance system. The Board could also provide an opinion to inform the Council decision on activating (or extending) the general escape clause.