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Economic governance review – Q&A

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1. General approach

How would the proposed reform avoid bilateralism and ensure equal treatment?

- A key objective of the reform of the economic governance framework is to enhance national ownership of the rules. To this end, the basis for future economic surveillance would be medium-term fiscal structural plans proposed by Member States themselves.
- The new framework would include several elements to ensure equal treatment:
    - First, the Commission would provide upfront a reference multiannual adjustment path in terms of net primary expenditure for each Member State and the corresponding level of the structural primary balance at the end of the four-year adjustment period. The methodology for determining these reference paths would be fully transparent. The reference path and the underlying methodology would be made public and presented by the Commissioned at the relevant Committees (i.e., EFC/EFC-A).
    - Second, once a Member State submits its medium-term fiscal-structural plan[1], the Commission would assess it, having particular regard to the plausibility of the macroeconomic and fiscal assumptions, to the extent that they depart from those underlying the reference path. In particular, the debt projections at unchanged policy to be included in the plan should be consistent with the comparable Commission projections. Reform and investment commitments that underpin a possible extension of the adjustment path would be assessed against common criteria. The assessment would be public and could be discussed in the relevant Committees.
    - Third, it would be for the Council to endorse the plan on the basis of an assessment by the Commission. The Council could also recommend that the Member State resubmit a modified plan.
    - Fourth, once endorsed by the Council, the plans (including the fiscal trajectory) would be the basis for surveillance by the Commission and the Council. Deviations from the agreed expenditure path would trigger enforcement actions. The move towards a single operational indicator at EU level based on observable variables increases transparency and would contribute to equal treatment.

Would the 60% of GDP debt threshold be kept?

- The Treaty reference value of 60% debt-to-GDP ratio remains unchanged.
- The Commission's orientations aim to ensure a realistic, gradual and sustained debt reduction path towards the 60% of GDP threshold, and at the same time ensure that the framework is credible and conducive to sustainable growth.
- In the current context of very high public debt in several Member States, it is important to distinguish between Member States with substantial and moderate public debt challenges.

[1] 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.

- For Member States with a substantial public debt challenge, the Commission will put forward a reference adjustment path that puts the debt ratio on a plausibly and continuously declining path after at most four years.
- For Member States with a moderate public debt challenge, the Commission will put forward a reference adjustment path that puts their debt on a plausibly and continuously declining path after at most seven years.
- In both cases, the requirement that debt should be placed on a continuously declining path at unchanged policies, i.e., without recourse to further adjustment measures, ensures a decline of public debt, in line with the Treaty. The requirement for Member States with a substantial public debt challenge implies that they move to the moderate challenge category by the end of the plan horizon. The requirement for Member States with substantial or moderate debt challenge does not impose that they move to the low debt challenges category.

- The distinction between Member States with substantial and moderate public debt challenges is based on the Commission's debt sustainability analysis. Both categories of countries would be expected to gradually reduce their debt so that it could converge towards the 60% reference value. The required speed of this reduction would however depend on the extent of the debt challenge: countries with more substantial challenges would need to address these challenges with greater urgency.

How will pro-cyclicality be avoided during the implementation of the plan?

- The reformed framework would use an expenditure rule as the sole operational indicator of medium-term fiscal planning.
- This would allow revenues to fluctuate freely throughout the economic cycle and thus ensure a high degree of macroeconomic stabilisation. It should help to ensure that buffers are built in good times, since higher-than-planned expenditure growth would be counted as a deviation for the purpose of compliance even if compensated by windfall revenues (as opposed to new revenue measures).
- Second, the reformed system would incorporate robust escape clauses to address exceptional situations when the endorsed fiscal adjustment path cannot realistically be adhered to.
    - In the event of major shocks to the euro area or EU as a whole, a general escape clause may be activated to deal with a severe economic downturn.
    - In addition, an exceptional circumstances clause would allow a Member State to deviate from its net expenditure path in the case of exceptional circumstances outside the control of the government with a major impact on public finances.

How will the reform encourage investment?

- 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 the quality of public finances and protecting public investment will be central elements of medium-term fiscal-structural plans.
- In those plans, all Member States, irrespective of the extent of their public debt challenges, will submit their commitments to reforms and public investment, as well as a net expenditure path. This will allow for a comprehensive economic policy and ensure that public investment is not reduced to achieve necessary fiscal adjustment.
- Compared to the current framework, Member States (especially those with low and moderate debt challenges) will have more leeway to set their fiscal adjustment trajectory, and therefore better integrate investment priorities. To integrate investment priorities, Member States with higher public debt challenges will comparatively have to create more room to do so by re-prioritising expenditure.
- Member States could request an extension of their adjustment path, provided they would commit to a set of reforms and investments. That set of commitments will need to respect common and transparent EU criteria, such as responding to common EU priorities and targets and relevant country-specific recommendations. Through these provisions the framework would contribute to an improvement in the quality of public expenditure.
- Finally, by supporting macroeconomic stabilisation and sustainable growth, the new fiscal framework would contribute to improving the conditions for private investment as well.

2. The debt sustainability analysis and reference net expenditure path

How are Member States classified between substantial, moderate and low public debt challenges?

- The distinction between the three types of Member States in terms of their debt challenges is not a new concept. This distinction is based on the Commission's well-established debt sustainability analysis (DSA), a framework to assess Member States' debt sustainability risks. The DSA is presented in full transparency in the 2021 Fiscal Sustainability Report (https://economy-finance.ec.europa.eu/publications/fiscal-sustainability-report-2021_en), more specifically in Chapter 2 of Volume 1 and the related boxes and annexes.
- The three challenge categories (substantial / moderate / low) correspond to the existing three sustainability risk categories (high / medium / low risk) of the standard DSA, which is run over the next 10 years. This classification therefore reflects the current and projected situation of Member States under unchanged policies (that is, not reflecting the implementation of the medium-term plans). Unlike the current level of public debt, this captures the initial budgetary position (more specifically, the primary balance), the cost of ageing in the medium term, and assumptions on growth and interest rates.
- To establish this classification, the Commission uses its DSA toolkit. This includes 10-year deterministic debt projections under several scenarios, namely a no-fiscal-policy-change baseline and stress tests capturing realistic shocks to macro-financial assumptions. To further account for uncertainty, the DSA also includes stochastic simulations.

- The approach is based on transparent assumptions and well-established methodologies that are regularly published in the Debt Sustainability Monitor and Fiscal Sustainability Report and are regularly presented in the EFC-A.
- Several criteria are taken into account to assess risks, reflecting their multiple dimensions, in line with the approach used in other EU and international institutions:
  - For the deterministic projections, the criteria are the projected debt level and trajectory, as well as an indicator that captures the realism of the underlying fiscal position (and available room for manoeuvre for corrective action if needed). For the stochastic projections, the criteria are the probability that debt will not stabilise over the next five years and the size of uncertainty.
- Besides the projected debt level and trajectory, the risk classification includes indicators that captures the plausibility of the underlying fiscal position (and room for fiscal manoeuvre).
- In intuitive terms, a country is considered at high risk (substantial public debt challenges) if its debt is high, likely to increase over the next few years and/or there is little room for corrective action; at medium risk (moderate public debt challenges) if its debt is high but continuously and realistically declining, or if it is at least broadly stabilising below 90% of GDP; and at low risk (low public debt challenges) if debt is below 60% of GDP or declining towards that level over the medium term.
- The risk classification entirely relies on the DSA and therefore does not reflect the signal from the Commission's S1 indicator. This indicator measures the structural adjustment that would be needed over 5 years to bring the debt ratio to 60% of GDP in 15 years' time, a target which would not be in line with the country-specific, gradual approach.

Is the debt sustainability analysis not too complex to ensure ownership and predictability?

- The DSA toolkit is a well-established framework, which reflects multiple dimensions of debt sustainability challenges over the medium term. It does not determine whether debt is sustainable or not: it allows, instead, for a thorough assessment of the debt trajectories identifying the degree of risks to debt sustainability in case of no further policy action. This implies taking into account the uncertainty surrounding the baseline assumptions by applying alternative scenarios and stochastic projections. The DSA also accounts for the budgetary impact of population ageing.
- The Commission's DSA is in line with state-of-the-art approaches used in other institutions, as transparently and thoroughly documented in the regular Commission's publications.
- A more simplistic approach, for instance only based on the debt level, could be criticised as disregarding the importance of the debt trajectory and the feasibility of adjustment.
- The use of the DSA is not complicating the fiscal surveillance framework. The DSA will be used at the design phase of the plan by the Commission to assess the degree of public debt challenges, determine the reference adjustment path and assess the plan put forward by the Member State. Member States will also use this approach when designing their plans (i.e., for setting the net expenditure path).

- Once the net expenditure path is endorsed by the Council, this becomes the (only) basis for fiscal surveillance. Enforcement actions are triggered if the budget execution of a Member State deviates from its net-expenditure path. Transparency and predictability will therefore be ensured over the plan's implementation horizon.
- The DSA, its methodology and underlying data will be made available to Member States.

Will the Commission publish the data sources and key assumptions of the DSA?

- The data sources and key assumptions of the Commission's DSA are already fully documented in the regular Fiscal Sustainability Report and Debt Sustainability Monitor (published every year). The Commission will continue this good practice.

Will the methodology behind the debt sustainability analysis be made public and enable replication?

- The DSA methodology is already public, as it is described in full transparency in the Fiscal Sustainability Report and the Debt Sustainability Monitor. This allows replication of the projections.
- Moreover, the debt sustainability analysis, 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.

How does the Commission take into account the cost of ageing in its DSA?

- The long-term projections for the cost of ageing are updated every three years in the Ageing Report, which is prepared jointly with Member States within the EPC Ageing Working Group. The latest report was published in May 2021. In case of major pension reforms, ad hoc peer-reviews can be organised, and these projections can be updated within the standard three-year cycle of the Ageing Report.
- In the period when the no-fiscal-policy-change assumption applies (after the T+2 Commission forecast in the standard DSA, and after the end of the adjustment period in the DSA used to determine reference adjustment paths), primary expenditure is only affected by changes in the cost of ageing.
- In Member States where the cost of ageing is expected to weigh increasingly on public expenditure, the fiscal adjustment will therefore need to cover for this increase and ensure that debt is on a 10-year declining path.

Does the DSA take into account contingent liabilities and government guarantees?

- These are not explicitly taken into account in the DSA risk classification, but they are discussed as additional risk factors as part of the Commission's overall debt sustainability risk assessment. As part of its broader analysis, the Commission performs an assessment of

additional aggravating and mitigating risk factors, only partially reflected in the DSA risk classification, and that are critical to provide an overall assessment of fiscal sustainability risks. To this end, the structure of debt is analysed along different dimensions, together with a review of government liabilities beyond (EDP) debt, in particular contingent liabilities as well as government assets and net debt.

What are the main differences between the Commission's regular DSA and the DSA used to determine the reference adjustment path for the new fiscal governance framework?

- The regular DSA is part of the Commission's tools for assessing fiscal sustainability risks under normal surveillance. It is also this regular DSA that will be used to determine (i) whether a country faces substantial, moderate or low public debt challenges (corresponding to high, medium or low DSA risk category), (ii) therefore whether and, if so, by when it needs to put its debt on a declining path and (iii) if so, what will be the reference adjustment path ensuring that debt is put on a plausibly declining path. The regular DSA runs over a 10-year period starting after the last outturn year and does not include any new fiscal measures beyond the T+2 horizon of the regular Commission short-term forecast. It includes deterministic scenarios (a no-fiscal-policy-change baseline and stress tests) and stochastic projections over five years.
- The reference adjustment path is based on the DSA that projects the 10-year debt developments as from the year that follows the end of the four-year plan (that is in T+4 with T being the first year of the plan). The aim is to ensure that, after the reference adjustment has been fully implemented, the requirements in terms of debt trajectory are fulfilled. In the case of a country with substantial debt challenges, for instance, the DSA scenarios and stochastic projections are applied to the post-plan situation to ensure that from that point on, debt is continuously declining under all deterministic scenarios over 10 years in the absence of further policy action, and that the probability that debt will decrease over the first five years is sufficiently high.

Will the Commission continue to assess Member States' sustainability risks on an annual basis (through the Debt Sustainability Monitor and the Fiscal Sustainability Report) or will it reduce the frequency and assess risks only during the formulation of the medium-term fiscal-structural plans?

- The Commission will continue its assessment of debt sustainability risks on an annual basis, as part of the EU economic and fiscal surveillance framework. To recall, this analysis is not only important for fiscal policies, but also for the formulation of Country-Specific Recommendations, in particular in the areas of pension, health care and long-term care.

Since the DSA will become more important, does the Commission consider establishing a commonly agreed methodology for the main assumptions of the deterministic and stochastic debt projection scenarios?

- The Commission's DSA is already based on a number of commonly agreed / jointly prepared assumptions: ageing costs projections (and macroeconomic projections beyond T+10) are in line with the latest Ageing Report projections, prepared jointly with the Economic Policy Committee and Ageing Working Group; T+10 GDP projections are based on the EU commonly agreed methodology (prepared by the Economic Policy Committee / Output Gap Working Group); assumptions on interest rates and inflation have been discussed with the Member States (including at meeting of the Alternates of the Economic and Financial Committee) and received their broad support.
- The assumptions and the methodology used are fully documented in the Commission's regular Debt Sustainability Monitor and Fiscal Sustainability Report and discussed once a year with the Committees when these reports are published.
- Moreover, it was recently agreed with Member States (at the publication of the latest Fiscal Sustainability Report) that new revisions to the Commission's DSA framework would be discussed with the Member States before publication.
- The Commission would be open to discuss further steps towards achieving common agreement on other aspects of the DSA framework.

How will the debt sustainability analysis (at unchanged policy) be translated into a reference adjustment path?

- To determine reference adjustment paths, the Commission will apply its DSA methodology over the 10 years that follow the end of the plan, i.e., as from T+4 for a four-year plan. On this basis, it selects the minimum fiscal adjustment that complies with the requirements in terms of debt sustainability.
- For a Member State with substantial debt challenges, the adjustment would have to ensure that, at the latest after four years of adjustment (i.e., by the end of the plan's horizon), the 10-year debt trajectory at unchanged policies is on a plausibly and continuously declining path.
- For a Member State with moderate debt challenges, the adjustment has to ensure that, at the latest after seven years (i.e., at most three years after the plan's horizon), the 10-year debt trajectory at unchanged policies is on a plausibly and continuously declining path.
- The requirement for Member States with a substantial public debt challenge implies that they move to the moderate challenge category by the end of the plan horizon. Moreover, the adjustment does not require that Member States with substantial or moderate debt challenge move to the low debt challenge category.
- "Plausibly" means that debt should be declining under all deterministic scenarios and that the risk of debt not decreasing in the five years following the plan's horizon is sufficiently low. The deterministic scenarios include:
    - A reference scenario that applies a no-fiscal-policy change assumption as from T+4 (i.e., beyond the four-year plan, no new measures are included, and primary

expenditure is only affected by changes in the cost of ageing); for countries with moderate debt challenges, the adjustment may nevertheless continue over the next three years so that the no-fiscal-policy change assumption would apply as from T+7;
    - Three stress tests, namely the 'lower SPB' scenario (which assumes a weaker fiscal position), the 'adverse r-g' scenario (which assumes a less favourable snowball effect) and the 'financial stress' scenario (which applies a temporary shock on market interest rates).
- In addition, the reference expenditure paths should ensure that the deficit is maintained below 3% of GDP at unchanged policies over the medium term.

Will the fiscal adjustment path strengthen the link between adjustment and debt sustainability challenges?

- This is truly the spirit of the proposed reform: the fiscal adjustment paths are precisely meant to strengthen debt sustainability.
- Moreover, the reference adjustment paths are calculated on a country-specific basis in order to reflect the country's challenges in terms of debt level and dynamic, including the impact of population ageing.

Will the Commission also assess the dynamic nature of the DSA approach, i.e., does the Commission intend to publish a second reference adjustment path when the Member State presents an updated medium-term fiscal-structural plans?

- The Commission will put forward at the beginning of the process a reference adjustment path. This reference path will guide Member States when devising their medium-term fiscal plans. Once endorsed, the planned adjustment path will become binding. After the four-year implementation period of the plans, the Commission will reassess the situation and put forward a new (second) reference adjustment path if the Member State still faces substantial and moderate debt challenges, requiring further adjustment.
- In case of objective circumstances that make it impossible for the Member State to implement the plan as agreed, it can propose an amendment of the plan. As a rule, this in itself should not lead to the publication of a new reference path as the initial reference path remains relevant.

How will the growth impact of structural reforms and investments be reflected in the DSA risk classification and the net expenditure path?

- The DSA risk classification will continue to be based on the existing methodology, e.g., excluding the impact of reforms and investment other than those already included in the short-term Commission forecast and its no-fiscal-policy-change extension.
- The same will apply to the projections providing the baseline for the construction of the net expenditure path. In particular, in the Commission's DSA, growth projections are based on the commonly agreed T+10 GDP projections. The latter already take into account legislated reforms and investments, including the investments made under NGEU. The impact is included

in the standard commonly agreed methodology directly through their short-term impact, reflected in the Commission forecasts within the forecast horizon T+2; and indirectly via the commonly agreed methodology's persistence of investment rules (beyond T+2).

- When devising fiscal-structural plans, Member States should prepare budgetary and macroeconomic projections reflecting the impact of reforms and investments. These projections should be well documented and based on solid quantitative analysis.
- When a set of reforms and investments underpins a request for an extension of the adjustment path, 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. Such analysis will inform the Commission assessment with respect to the common EU criteria, among which there is that the set of reforms and investment are growth enhancing and support fiscal sustainability.

Should the reference adjustment path be seen as providing a minimum adjustment requirement for Member States?

- The reference adjustment path proposed by the Commission would limit net expenditure in such a way that debt is put on a plausibly and continuously declining path at unchanged policies and that deficit is maintained below 3% of GDP.
- However, the Commission reference path remains indicative both as a basis for an in-depth technical dialogue with Member States and as a benchmark for all Member States and the Council to ensure a transparent multilateral approach. The only binding path will be that proposed by the Member State, assessed by the Commission and eventually adopted by the Council.
- Member States could propose a trajectory different from that of reference. However, Member States would need to explain how this different trajectory complies with the requirements – in particular when it is less demanding – with solid economic arguments. Specifically, the trajectory put forward by the Member States will have to fulfil the requirements that the debt ratio is put on a plausible and continuously declining path or stays at prudent levels and that the budget deficit is maintained below the 3% of GDP reference value over the medium term. In as much as the reference paths fulfil those requirements, the more the path suggested by the Member State departs from the reference path proposed by the Commission, the more the Member State will need to justify its choice.
- The Commission, for computational reasons, would provide Member States with a linear path, while a Member States could opt for a different time profile of the adjustment, so long as back-loading of the adjustment is avoided and debt is put on a declining path by the time required.
- Finally, Member States could request an extension of the adjustment path beyond the default 4-year period, provided that they commit to a set of additional reforms and investment that respond to the common criteria set out in the Commission's communication, such as helping to bring debt on a sustainable path.

Are Member States still bound by the 3% deficit criterion?

- Yes. If the planned or observed deficit would exceed the 3% of GDP reference value, it would trigger the preparation of a Commission report based on article 126(3) of the Treaty and an Opinion by the Economic and Financial Committee based on article 126(4) of the Treaty.

The net expenditure paths in all Member States' plans should ensure that the deficit remains below 3% of GDP at unchanged policies over the medium term. This requirement is forward looking as it aims at ensuring that the deficit criterion is respected also beyond the period covered by the plan in absence of further policy action.

Will reference adjustment paths be provided for Member States with low public debt challenges?

- The purpose of the reference adjustment path is to help Member States with substantial or moderate public debt challenges in designing fiscal adjustment paths that bring debt onto a plausibly and continuously declining trajectory at the latest by the end of the four- to seven-year fiscal adjustment period. The requirement for Member States with a substantial public debt challenge implies that they move to the moderate challenge category by the end of the plan horizon. Moreover, the adjustment does not require that Member States with substantial or moderate debt challenge move to the low debt challenge category.
- Member States with a low public debt challenge (corresponding to the low-risk category in the debt sustainability analysis) have public debt that is either projected to remain below 60% of GDP or to decrease towards that threshold in the medium term based on a no-fiscal-policy change assumption. As these Member States are expected to comply with the Treaty debt threshold, they do not need to adjust from that perspective and there is no ground for providing them with a reference adjustment path.
- These Member States would nevertheless be required to submit a medium-term fiscal-structural plan, including a net expenditure path, to the Commission for its assessment. As set out in the Commission Communication, the plans should ensure that the deficit is credibly maintained below the 3% of GDP reference value at unchanged policies over a 10-year period at most three years after the horizon of the plan. Member States would also be bound by the 3% of GDP deficit threshold over the lifetime of the plan, with a planned or observed breach of that threshold triggering the preparation of a Commission report based on article 126(3) of the Treaty and an Opinion by the Economic and Financial Committee based on article 126(4) of the Treaty. Moreover, the plan should not lead to moderate or substantial public debt challenges for the Member States.

Is it possible for a Member State's debt ratio to increase during the fiscal adjustment period?

- A number of Member States currently have very high deficits. While those deficits must be reduced, it may be unrealistic and could even result being self-defeating to expect those Member States to reduce their deficits to such an extent that the public debt ratio falls

continuously from the first year of the fiscal adjustment period, as required by the current debt reduction benchmark.

- The key element of the reform orientations is that public debt is put on a plausibly and continuously declining path in the medium term, i.e., at the latest by the end of the four- to seven-year fiscal adjustment period set out in the medium-term fiscal-structural plan. The debt should be declining at unchanged policy, i.e., without further adjustment measures, in particular against the background of (typically rising) age-related expenditure.
- Moreover, stress tests and stochastic analysis will be used to ensure that the debt would also decline under adverse scenarios and, with a sufficiently large probability, under a large range of combined shocks.
- For Member States that do not have substantial debt challenges, this also provides additional leeway for strategic public investment. In the current framework, countries with low and moderate debt challenges are required to adjust their deficit towards their MTO (or stay at their MTO if already attained).

3. Design and assessment of fiscal-structural plans

When do Member States submit their medium-term fiscal-structural plans?

- Once the reform would enter into force, all Member States would submit their medium-term fiscal-structural plans in Spring T-1. These plans would replace the stability and convergence programmes (and national reform programmes) and cover the years T-1 (base year), T, T+1, T+2 and T+3 (see Annex 1 of the Communication).

How long would a medium-term fiscal-structural plan remain in place? Would the possible extension of the adjustment period mean that the plan could last up to seven years?

- The default length of the plan would be four years. It could be lengthened to match the national legislature, if a Member States so wishes.
- The adjustment period could exceed the length of the plan and would cover four to ten years, depending on the public debt challenge of the Member State concerned and the presence of investment and reform commitments that underpin a more gradual (longer) adjustment path.
- The path should be set in a way to ensure that a significant part of consolidation needs is met within the horizon of the plan and not left to future governments.

How would the framework be simplified?

- Once Member States' fiscal plans have been endorsed by the Council, primary expenditure developments (net of discretionary revenue measures and cyclical unemployment expenditure) would be the sole operational indicator that the Commission would use for fiscal surveillance and against which compliance would be assessed (beside respect of the 3% threshold for the headline deficit). The use of this indicator would allow for the operation of so-called automatic

stabilisers, since cyclical fiscal items are removed from the indicator and would move freely. This would ensure a higher degree of macroeconomic stabilisation.

- The medium-term budgetary objectives would no longer play a role in EU surveillance, nor would the 'matrix of requirement' to converge to this objective. The net expenditure path would also replace the debt reduction benchmark (the '1/20th rule'), which would no longer play a role in the framework.
- This would not prevent Member States from setting their national budgetary objectives in terms of a different indicator, such as a structural balance.

Can Member States set their fiscal adjustment paths in structural balance terms while respecting the reference adjustment path?

- Once Member States' fiscal plans have been endorsed by the Council, net primary expenditure developments would be the sole operational indicator that the Commission would use for fiscal surveillance and against which compliance would be assessed (besides respect of the 3% of GDP threshold for the headline deficit).
- At the same time, the use of net expenditure growth as the single operational indicator for EU surveillance would not prevent Member States from setting their national budgetary objectives in terms of a different indicator, such as a structural balance.

How will the Commission take account of diverging macroeconomic assumptions and other inputs to the DSA between the Commission and the Member State?

- As a first step, the Commission will put forward a reference adjustment path based on the standard assumptions used in the DSA. Member States will then prepare their medium-term fiscal plans, taking into account this reference path.
- When devising their medium-term plans, Member States may use assumptions that differ from the Commission's standard DSA assumptions over the four-year period of the plans. However, in that case, Member States would have to explain and justify the differences in a transparent manner. This is in particular relevant for Member States that request a longer adjustment period. These 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.
- Once a Member State submits its medium-term fiscal-structural plan, the Commission would assess it, having particular regard to the plausibility of the macroeconomic and fiscal assumptions, to the extent that they depart from those underlying the reference path. In particular, the debt projections at unchanged policy to be included in the plan should be consistent and comparable with the Commission projections.

How will the respect of the 3% of GDP threshold be ensured?

- When assessing the plan, the Commission will evaluate whether it is credibly ensured that the deficit is maintained below 3% of GDP over a 10-year period. This period starts after the end of the plan for Member States with substantial and moderate public debt challenges and three years after the end of the plan for Member States with low public debt challenges.
- Therefore, a Member State starting with a deficit level exceeding 3% of GDP will have to bring its deficit below 3% through a gradual reduction of the deficit, and credibly maintain it below 3% throughout the 10-year period following the adjustment period. This does not mean that Member States starting from a deficit below 3% of GDP can exceed the threshold during the adjustment period. Such a situation will trigger the preparation of an Article 126(3) report and the examination of relevant factors. Moreover, the Commission and Council could issue recommendations with early warnings before the conditions for opening an EDP are reached, i.e., if they see strong risks of a Member State breaching the 3% of GDP threshold.
- As a result of projected demographic developments and economic and fiscal headwinds (e.g., lower growth and higher age-related expenditure) ensuring that the deficit *stays* below 3% of GDP at unchanged policies will typically require reaching a more demanding position than simply *being* below the 3% of GDP deficit threshold at the end of the adjustment period.

Which investment and reforms would justify a longer adjustment path?

- The set of reforms and investments underpinning a longer fiscal adjustment path would need to fulfil a number of criteria, in particular, they should be growth enhancing and support fiscal sustainability.
- They should also 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, 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 country-specific recommendations, and should include reforms and investments to correct any identified imbalances under the MIP.
- They should be sufficiently detailed, frontloaded, time-bound and verifiable. They should also ensure that country-specific investment priorities can be addressed without leading to investment cuts elsewhere over the planning horizon.

How would reforms and investment be incentivised if a Member State is not asking for an extension of the fiscal adjustment period?

- Country-specific policies to boost employment and sustainable growth, and to prevent or correct macroeconomic imbalances, would continue to be discussed in the context of the European Semester. This means that country-specific recommendations (CSRs) would continue to be issued.
- All Member States would be required to address in their medium-term fiscal-structural plans the priorities identified in the CSRs, including those aimed at addressing imbalances identified

under the MIP. The plans would also need to 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. In this way, the plans would contain reforms and investment related to the achievement of the twin transition and other EU priorities, the enforcement of which would be subject to the normal procedures of the European Semester.

- The possibility for Member States with substantial or moderate public debt challenges to request a longer fiscal adjustment period (by up to three years) would give them more leeway to address national investment and reform needs in the context of the medium-term fiscal-structural plans. Member States that request a longer fiscal adjustment period would be subject to additional enforcement mechanisms with regards the reform and investment commitments set out in the medium-term fiscal-structural plans.

What happens if there is no agreement on the plan with the Member States?

- 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.
- Should the process not lead to the adoption of the plan put forward by the Member State, the reference multiannual net expenditure path would be used by the Commission, following endorsement by the Council, for the purpose of fiscal surveillance and enforcement.

4. Monitoring and enforcement

What is the timing of the annual cycle of monitoring and how does it fit with the European Semester?

- The European Semester will remain the key channel for the Commission and the Council to monitor Member States' economic policies.
- 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 Spring. In addition to fiscal reporting, the implementation of reforms and investments covered by the medium-term plans would be detailed in these reports.
- Together with the EDP data notifications to Eurostat, the annual progress reports would be the basis for annual surveillance by the Commission and Council, including possible enforcement decisions. There would no longer be a need for annual fiscal recommendations for Member States that comply with their agreed net expenditure paths.
- 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.
- Compliance with the endorsed reform and investment commitments that underpin a more gradual fiscal path would also 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 those reform and investment commitments. Member States would report on progress with their implementation in their annual progress reports together with a report on the policy action taken to address CSRs.

What is the role of the debt sustainability analysis (DSA) in the monitoring of fiscal plan?

- The DSA would play a role as a risk assessment tool in the design phase. It would not play a role in the implementation of the plans: once the net expenditure path has been endorsed by the Council, it would be the sole reference for assessing compliance.
- Concretely, the DSA would be an important input into the Commission's guidance for the fiscal adjustment paths to be put forward by Member States.
- In particular, it would inform the debt challenge category, which in turn has implications for the fiscal adjustment requirements.
- The reference fiscal adjustment path (and the corresponding level of the structural primary balance after four years), which the Commission would issue at the very start of the process, would also be produced using the Commission's DSA methodology.

How is enforcement improved in the new model?

- As a general principle, giving Member States more leeway in setting their medium-term fiscal adjustment paths must go hand-in-hand with a greater focus on enforcement at the EU level, in particular with respect to breaches of the Treaty-defined deficit and debt thresholds.
- The proposed reform would simplify and clarify the triggers for enforcement procedures, by focusing on Member States' deviations from the agreed medium-term paths.
- The proposal includes several elements that would contribute to better enforcement:
    - First, the deficit-based excessive deficit procedure would be retained. This 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.
    - Second, the credibility of the debt-based excessive deficit procedure would be enhanced by clarifying the conditions for opening and abrogating these procedures. For a Member States with a substantial public debt challenge, a deviation from the net expenditure path in the plan would result by default in the opening of an EDP.
    - Third, the Commission would keep notional control accounts of all Member States to keep track of the cumulative deviations of the net-expenditure path. This information would be used in enforcement decisions.
    - Fourth, the range of sanctions would be broadened, by adding reputational sanctions. The effective use of financial sanctions would be de-constrained by lowering their amounts, so that they would have effectively a reputational, not a (macro)economic, effect.
    - Fifth, the existing provisions related to Macroeconomic conditionality remain unchanged.

- A new tool to enforce reforms and investment underpinning a more gradual adjustment path would be introduced. 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.

How will the Commission deal with deviations from the net expenditure path? How large will the allowed deviations be for countries with different levels of debt risk?

- Deviations from the endorsed net expenditure path will be the main focus of fiscal surveillance on the part of the Commission and Council over the lifetime of the medium-term fiscal-structural plans. The Commission will also monitor planned or observed breaches of the 3% of GDP deficit threshold.
- The Commission proposes the use of notional control accounts for each Member State to keep track of cumulative deviations from the agreed multiannual net primary expenditure paths. Operational aspects of these notional control accounts will require further discussion.
- For Member States with a substantial or moderate debt challenge, material deviations from the net expenditure path would lead to the preparation by the Commission of an Article 126(3) report (and the subsequent Article 126(4) Opinion by the Economic and Financial Committee). The analysis in the report (and the subsequent EFC opinion) would take relevant factors into account, as required by the Treaty. For Member States with a substantial public debt challenge, a deviation from the agreed path would result by default in the opening of an EDP on the basis of the debt criterion. For Member States with a moderate debt challenge, departures could lead to the opening of an EDP, if assessed as giving rise to "gross errors" (as per Article 126 TFEU).
- Deviations from the net adjustment path by Member States with a low public debt challenge would not give rise to enforcement actions by the Commission on the basis of the debt criterion, provided that the deviation does not entail a change in the public debt challenge category. These Member States can *de facto* not be subject to a debt-based EDP, because their debt is below 60% of GDP or declining towards that level. The Commission will prepare an Article 126(3) report for these Member States in the event of a planned or observed breach of the 3% of GDP deficit reference value.

How does the notional control account work? Is there an automatic threshold for the cumulative deviation in order to open a debt-based EDP?

- The notional control account would keep track of annual deviations from the expenditure ceilings, summing those deviations over time. As such, repeated small deviations will result in the control account showing a larger cumulated deviation. At the same time, a negative deviation in one year could be offset by a positive deviation in another.
- As such, the control account will inform enforcement actions, in particular a report under TFEU Article 126(3) following a deviation from the net expenditure path. The size of the

notional account balance will also be considered as part of the assessment in an Article 126(3) report. For Member States with substantial debt challenge, a deviation from the agreed path would result by default in the opening of the EDP.

- The precise modalities of the control account will need to be discussed and specified at a later stage.

Will the Commission take enforcement actions against a Member State that complies with its net expenditure path but fails to put public debt on a plausibly declining path at the end of the adjustment period?

- No, enforcement actions would solely be triggered by deviations from the net expenditure path, breaches of the 3% of GDP deficit threshold, and lack of implementation of reform and investment commitments underpinning a more gradual adjustment path.
- However, rising debt will be taken into account when setting a reference adjustment path for the next plan and when assessing this new plan.

How will the Commission monitor investment and reforms? How will they be enforced?

- Reform and investment commitments will be monitored by the Commission and the Council under the European Semester. For Member States where a more gradual fiscal adjustment path is agreed, the monitoring would be more intense. If a Member State fails to implement its reform and investment commitments linked to a more gradual adjustment path, a new tool would empower the EU to require a stricter adjustment path in the plan and (for euro area Member States) impose financial sanctions.
- A strengthened monitoring and enforcement process is also envisaged for the MIP. The EIP will remain available 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.

Can Member States reopen the fiscal-structural plans during the lifetime of those plans? What are the conditions?

- As a general principle, it would be difficult and not advisable for Member States to revise their plans during the four-year default duration of those plans. Frequent revisions would undermine the credibility of the plans as an anchor for prudent policies.
- However, in the event of objective circumstances that make compliance with the plan impossible, a new medium-term plan could be proposed. It would have to undergo the same validation process.
- A change of government will not be a reason per se to change the plan.

- A request for an amendment of the plan should in itself not lead to a change in the reference path for net expenditure put forward by the Commission, as the initial reference path remains relevant.

What if a Member State changes debt challenge category after the endorsement of its plan?

- The Commission will continue to update its standard DSA and publish its risk classification over the short, medium and long term in its regular flagship reports on debt sustainability.
- However, the endorsed adjustment paths that Member States commit to in their medium-term plans are binding over four years and will in principle not be updated during the implementation period. A change of debt challenges would therefore not lead to the reopening of plans.
- However, it would be taken into account when deciding on the opening of a debt-based EDP in case of deviations from the net expenditure path.

5. Institutional setup

What is the future of the European Fiscal Board (EFB)?

- The EFB is tasked to evaluate the implementation of the EU fiscal framework, in particular its horizontal consistency, possible cases of serious non-compliance and the appropriateness of the fiscal stance. It advises the Commission on these issues and points to policy options if it identifies risks for the proper functioning of EMU. It also cooperates with national IFIs to exchange best practice and facilitate common understanding. The Commission stands ready to reconsider and discuss the mandate and role of the EFB in view of the discussion on the orientations for a reformed framework.
- This cannot lead to alteration in the institutional balance set by the Treaty.

What will be the role of independent fiscal institutions in the reform framework? How can it be ensured that there is no overlap with Commission surveillance?

- The text of the Commission Communication implies that many independent fiscal institutions (IFIs) would have to expand their activities into new areas. These new requirements could well be codified in an update of Council Directive 2011/85/EU. IFIs' assessments could serve as one important source of input into the assessment of the Commission and the Council who would, of course, take into account all relevant information and retain the power to propose and adopt any final decision, ensuring equal treatment of all Member States.
- With expanded tasks comes a need for a commensurate increase in human and budgetary resources. In addition, to safeguard the independence of IFIs as they take on a more prominent role in fiscal surveillance, further action may be needed. This could involve steps such as improving access to non-public information or putting in place arrangements for increased stability of funds of IFIs.

- Transposing changes in the Directive into national law and building up stronger IFIs will need time and, as IFIs currently are quite a heterogeneous group, some Member States may need more time than others. A transitional period may therefore be necessary during which the new rules are already in force while the IFIs still grow into their new role.
- While the Communication envisages a more important role for IFIs in the assessment of Member States' fiscal-structural plans, it does not impose a one-size-fits-all model for how this role is to be fulfilled concretely. This leaves room for some variation in approaches among IFIs, just as currently is the case with regard to the production or endorsement of macroeconomic forecasts underlying the fiscal plans of Member States.
- Independent fiscal institutions could also assess explanations provided by governments regarding deviations from the endorsed plans.

What are the implications for the Fiscal Compact?

- While the Commission is proposing that fiscal surveillance at the EU level be based on a net expenditure path endorsed by the Council, this would not prevent Member States from setting their national budgetary objectives in terms of a structural balance. Nor does it prevent Member States from moving towards a medium-term objective set in structural terms.
- Indeed, the reference expenditure path set out by the Commission at the very start of the process could for the purpose of transparency and following the commonly agreed methodology be translated into a corresponding level of the structural primary balance to be achieved by the end of the adjustment period.
- The Fiscal Compact is part of an intergovernmental treaty outside the EU legal framework. In that Treaty the signatories committed to incorporating the Fiscal Compact into EU law. The Commission will examine this further in the context of an agreement on the EU economic governance set-up.

Do the reform orientations include new data requirements?

- The Communication actually indicates a list of technical specification, which would be important for the formulation of the Member State's medium-term plan and the Commission's assessment of it (see page 15 of the Communication). Among others, the plan would in particular set out assumptions and projections of the trajectory of relevant macro-variables over the adjustment period covered by the plan and the subsequent no-policy-change extension of the projection for the following 10 years.
- There would also be a need to enhance data availability in some areas. This particularly stems from the fact that the focus of surveillance is shifting from the annual deficit and debt figures to the multiannual evolution of expenditure.
- At the same time, the main operational indicator, i.e., net primary expenditure, nets out discretionary revenue measures, interest payments and cyclical unemployment expenditure, similarly to the current expenditure benchmark, which has been a regular part of surveillance over the last decade (and is already agreed to be the decisive in EDP surveillance). The

availability of data used for calculating the expenditure benchmark has greatly improved in recent years. Crucially, information on flows between Member States and the EU institutions, which allow to distinguish between nationally- and EU-financed expenditure, is set to become compulsory under the amended ESA 2010 from September 2024.

6. Next steps

What are the next steps before the possible tabling of a legislative proposal?

- 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 EU economy.
- In the Commission's view, a thorough reform of the EU economic governance framework will require legislative changes. On the basis of the orientations and the ensuing discussion, the Commission will consider tabling legislative proposals.
- Member States and the Commission should reach a consensus on the reform of the economic governance framework ahead of Member States' budgetary processes for 2024. This will be key to ensure confidence in and credibility of the EU economic governance framework and to manage smoothly the transition period until the final adoption of the changes by the co-legislators.

What fiscal rules will apply in 2024 when the general escape clause will be deactivated?

- Pending a revised legislative framework, the operation of the economic governance framework will continue to be based on the existing legal framework.
- The Commission will provide guidance for fiscal policy for the period ahead in the first quarter of 2023.The guidance will reflect the economic situation, the specific situation of each Member State and the orientations laid down in the Commission's Communication provided a sufficient degree of convergence across Member States is achieved by that time.
- In spring 2023, guidance for 2024 will be issued through Country-Specific Recommendations.

DG ECFIN, European Commission
February 2023

Economic governance review – Q&A part II

The 9 November Communication provides extensive orientations for the reform of the governance framework and in particular of the fiscal rules. Member States, through the EFC, have submitted a large number of questions for clarification. Many of these can be answered by referring to the Communication. Six key questions that are central to the functioning of the framework are discussed below with a view to ensuring a consistent approach. They address: (i) structural reforms and investment; (ii) the reference path; (iii) the spending ceilings; (iv) the functioning of the deficit based EDP; (v) revisions of the medium-term structural-fiscal plans; and (vi) the enhanced role of IFIs.

DISCLAIMER

This Q&A has not been adopted or endorsed by the European Commission. Any views expressed are the preliminary views of the Commission services and may not in any circumstances be regarded as stating an official position of the Commission. The information transmitted is intended only for Member States or the entity to which it is addressed and may contain confidential and/or privileged material.

1. Structural reforms and investments (plans, assessments, implementation and enforcement)

a. How does the new tool for enforcing reforms and investment work? When should it be triggered? What should be the process? What happens if investments are cut to meet expenditure ceilings? How can reform reversal be prevented?

Text of the Communication:

- *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 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. <u>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.</u> Due to the particular risk of negative spillovers within a monetary union, it would be possible to apply <u>financial sanctions for euro area countries in case of non-implementation</u>. [p8]*
- *[…] in case of non-implementation of the reforms and investment underpinning a more gradual adjustment path, <u>a new enforcement tool would lead to a revision of the adjustment path in a more restrictive sense</u>. [p17]*
- *Compliance with the endorsed reform and investment commitments that underpin a more gradual fiscal path would be <u>monitored annually in the context of the European Semester</u>. To ensure proper monitoring, the national medium-term plan should include <u>sufficient detail as well as a timeline for the implementation of reform and investment commitments</u>. Member States would report on progress with the implementation of these commitments in their <u>annual progress reports</u> together with a report on the policy action taken to address CSRs. [p17]*
- *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 <u>revised multiannual net primary expenditure path</u> (in a more restrictive sense while ensuring a high quality of public finances) and (for euro area Member States) to also impose <u>financial sanctions.</u> [p18]*

- 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.
- Member States may request a more gradual 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.
- These investment and reform commitments would be assessed against clear criteria as reflected in the Commission Communication together with the proposed adjustment path.
- The scope and timeline of the investment and reforms underpinning a more gradual adjustment path should be set in the initial Council recommendation endorsing the plan, including by a number of verifiable and time-bound deliverables.

- Member States would report on the achievement of reform and investment commitments in their annual progress reports. Failure to deliver on the reform and investment commitments would trigger enforcement.
- If the verifiable and time-bound reform and investment commitments (underpinning the more gradual adjustment path) are not met, the Council, on a recommendation from the Commission, would recommend that the extension of the multi-annual expenditure path is shortened, with a corresponding lowering of the expenditure ceilings (steepening of the adjustment).
- The satisfactory fulfilment of reform and investment commitments shall presuppose that measures related to previous commitments have not been reversed by the Member State concerned. Member States therefore have to confirm in the annual implementation report (for assessment by the Commission) that measures related to previously satisfactorily addressed reform and investment commitments have not been reversed.
- Following shortening of the multiannual net primary expenditure path, the assessment of compliance with the fiscal path could lead to the opening of a debt-based EDP (see section 3.c below).
- The plan should ensure that the level and quality of public investment increases over the plan's horizon. In case a Member State materially reduces investment levels or investment quality contrary to its commitments, the same procedure as for failure to implement reforms will apply.
- Assessments of implementation of reforms and investment commitments underpinning a more gradual adjustment path would be integrated in the European Semester and would be comprehensive.

b. How should other CSRs that are not considered for the extension of the adjustment be addressed in the medium-term plan, and how should they be assessed (in the plan and in the annual implementation reports)?

Text of the communication:

- *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.[p6]*

- All Member States should explain in their medium-term fiscal-structural plan, how the plan and the reforms and investments it contains responds to the country specific recommendations (CSRs) issued under the European Semester and how it is consistent with the National Energy and Climate Plans (NECPs) and the National Digital Decade Roadmaps (NDDRs).
- In case the Member State would not request an extension of the adjustment path, these explanations could be provided with a level of detail similar to that under the current guidance for Stability and Convergence Programmes and National Reform Programmes.
- In the context of its assessment of the plan, the Commission would provide its observations on the CSR coverage and NECP/NDDR consistency. In the absence of a request for an extension of the adjustment path, the assessment of CSR coverage and NECP/NDDR consistency would not be a

reason for the Commission having a negative opinion on the medium-term fiscal structural plan and its fiscal trajectory.

2. Reference path

a. *Is the reference path the minimum requirement to meet the DSA conditions? To what extent can the Member State deviate from the Commission's reference path?*

Text of the communication:

- *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. [p10]*

- The purpose of the 'reference path' should be that of providing guidance to Member States with a 'substantial' or 'moderate' debt challenge for drawing up their plans.
- The presentation and publication of the reference paths by the Commission and the discussion in the relevant Council Committees would ensure multilateralism and transparency upstream before submission of the plans by the Member States and their endorsement by the Council. For transparency and a smooth process, the Commission will put forward upfront both a baseline and extended (with 3 additional years) version of the reference path.
- At the same time, the expenditure path in the plans submitted by Member States and endorsed by the Council maybe different from the baseline reference path or the extended reference path, under the condition that the Member State concerned justifies it based on substantiated economic reasons, in particular if they imply lower annual adjustment.
- The Commission will make a transparent overall economic assessment of the plausibility and assumptions of the debt path put forward by the Member State concerned.

3. Spending ceilings

a. *The working of the 'expenditure rule'. Will it be set in real or nominal terms, and in levels or growth rates?*

Text of the communication:

- *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. (…) The plans would need to be translated in national budgets for the whole adjustment period. [p11]*

- The medium-term fiscal adjustment path could be defined in nominal or real terms, in levels or in growth rates.

- Setting annual spending ceilings in levels rather than a path in growth rates enhances accountability and simplicity, as actual expenditure can be assessed against the planned expenditure ceilings more accurately to identify any annual deviations. It also helps to keep track of past deviations in a transparent manner, thereby helping to ensure that the plans are time consistent and that annual slippages do not cumulate into large deviations over time. Spending ceilings in levels also reduce the scope for a pro-cyclicality bias in the conduct of fiscal policies compared to expenditure path in percent of GDP.
- The Commission provides a reference expenditure path (in growth rates). The Member State, in its plan, will need to translate the path into annual expenditure ceilings.
- The Commission services' current thinking is that *nominal* ceilings may be preferable as they are better understood, more transparent, more strongly linked to the budget, and easier to monitor. Moreover, annual budgets are set in nominal terms—so the link to the annual budgets is stronger when nominal spending ceilings are used. Using nominal ceilings will also simplify the EU fiscal framework and could strengthen ownership, thanks to a closer alignment with national budgetary arrangements—nominal expenditure rules are prevalent in Member States.
- In the case of nominal ceilings, adequate procedures should be in place for ensuring that meeting the expenditure ceilings is under government control also in case of substantial inflation surprises. If nominal ceilings are set and there would be a situation of a major inflation surprise, this could be an objective ground for requesting to amend the plan. Such requests for amendment should be based on a thorough economic justification.

b. How are discretionary revenue measures assessed and taken into account in the expenditure ceilings?

Text of the communication:

- *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.[p8]*

- The **net** expenditure indicator allows Member States to decide on their size of government by e.g., increasing (decreasing) revenues with discretionary revenue measures with an equivalent increase (decrease) in the expenditure ceiling.
- The methodology for assessing discretionary revenue measures would be the same as currently applied for the measurement of net expenditure relative to the so-called expenditure benchmark. Member States present estimates of the revenue impact of discretionary revenue measures and the Commission assesses transparently their plausibility.
- The methodology and process for the reflection of discretionary revenue measures in the expenditure ceiling and the ex-post treatment of shortfalls/windfalls compared to projected revenue impacts in surveillance should consider the following objectives:
    - Member States should have flexibility to determine their size of government and finance spending increases with offsetting revenue measures.
    - Meeting the expenditure ceiling should be, to the extent possible, under the direct control of the government. Unforeseeable shortfalls of discretionary revenue measures should not lead to an ex-post revision of the expenditure ceilings.
    - Consequences for sustainability of shortfalls of proceeds of the discretionary revenue measures outside the control of the government, compared to ex ante projections of the

revenue impact, will be (automatically) reflected in the next medium-term fiscal structural plan through the requirements on the debt projections.
  - Member States' optimistic bias in the ex-ante assessment of the revenue impact of discretionary revenue measures should be minimised by requiring a Commission assessment of the impact of the measure. The Commission will take into account that assessment when conducting its assessments of adherence to the endorsed fiscal adjustment path.

c. *Clarification of how deviation from expenditure path would be considered for the purposes of opening of debt-based EDP.*

Text of the communication:
  - *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.[p14]*
  - *Nationally-financed expenditure would have to stay within the agreed multiannual net primary expenditure path.[p15]*
  - *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.[p17]*
  - *The Commission would use notional control accounts for each Member State to keep track of 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.[p17]*

- The endorsed net expenditure path of the plan will be the single operational indicator, against which compliance will be assessed. Upward deviation from the net expenditure path will result in the preparation by the Commission of an Article 126(3) TFEU report for Member States with substantial and moderate public debt challenges (with a debt ratio in excess of 60% of GDP).
- The notional control account would track all deviations, both upward and downward, and cumulate them over time, putting annual deviations into a multi-annual perspective.
- In line with the provision of Article 126(3), the report would assess all 'relevant factors', including the size of the notional account balance. While no 'automaticity' can be envisaged for the decisions on the existence of an excessive deficit, the Commission orientations distinguish clearly between two categories of Member States.
  - For a Member State with substantial public debt challenges, the default is for the Commission to propose the opening of a (debt-based) EDP (Council decision on the existence of an excessive deficit under Article 126(6) and Council recommendation for its correction under Article 126(7)).
  - For a Member State with a moderate public debt challenge, the opening of the EDP would depend on the balance of 'the relevant factors'.
- In both cases, the degree of ambition of the adjustment path in the endorsed plan should be considered when deciding on the existence of an excessive deficit based on the debt criterion. In particular, if the Member State's expenditure path in its national plan is more ambitious than the

Commission's reference path and the deviation from the path is not significant when measured against the Commission's reference path, opening of the EDP should be avoided.

- The endorsed net expenditure path remains the single operational indicator against which compliance will be assessed also in case favourable economic conditions would ex post improve fiscal outcomes. In particular, the opening of EDP as set out above should be confirmed for Member States that deviate from the expenditure path, even if debt would turn out lower than required by the Member State's plan or the reference path.

4. The functioning of the deficit-based EDP

a. Are Member States still bound by the 3% deficit criterion?

Text of the communication:

- *The revised EU fiscal 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.[p7]*
- *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.[p7]*
- *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.[p7]*
- *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.[p9]*
- *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.[p17]*
- *Abrogation would require the deficit to remain credibly below 3% of GDP.[p17]*

- Yes. The net expenditure paths in all Member States should ensure that the deficit is maintained below 3% of GDP reference value of the Treaty.
- Therefore, Member States starting from a deficit below 3% of GDP should not plan exceeding the reference value. For Member States starting with a deficit level exceeding 3% of GDP, the deficit should be brought below 3%.
- In addition, when assessing the Member States' plan, the Commission will evaluate whether it credibly ensures that the deficit is maintained below 3% of GDP over a 10-year period, on a no policy change basis. This period starts after the fourth year of the plan for Member States with substantial and moderate public debt challenges and after seven years for Member States with low public debt challenges.
- As a result of the fiscal and economic impacts of the projected demographic developments (lower growth and higher age-related expenditure) as well as the impacts of the economic cycle, ensuring that the deficit *stays* below 3% of GDP at unchanged policies over a 10-year period will typically require reaching a position well below the 3% of GDP deficit reference value of the Treaty at the end of the adjustment period.

b. How will the respect of the 3% of GDP threshold be ensured?

- If the planned or observed deficit would exceed the 3% of GDP reference value of the Treaty, the Treaty-based provisions related to the deficit-based EDP would apply, as it is currently the case.
- In the case of a breach of the 3% GDP reference value the Commission will issue a 126(3) report.
- The Commission will take into account all 'relevant factors' in the steps leading to the decision on the existence of an excessive deficit, as foreseen in the Treaty. For MS with the debt above 60% GDP, the Commission can only take into account the 'relevant factors' if the double condition that the general government deficit remains close to the reference value and its excess over the reference value is temporary — is met.

5. Plan revisions

a. What is the scope for changing the plan in case of change of government or legislature?

Text of the communication:

- *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.[p8]*

- Member States would submit a revised plan after a minimum period of 4 years, but this period could be lengthened to match the national legislature if Member States so wish.
- Member States can propose a revised plan following elections (or after a change of government). However, as a rule, the Commission will not provide a new reference path as the initial reference path remains relevant.
- Any revision proposed by the Member State would need to be assessed by the Commission against the revised common EU framework and endorsed by the Council, as is the case for the original plan.
- Until a new plan is endorsed by the Council, the previous one remains valid and should be implemented.

b. Clarification of the working of plans over successive versions ('repeated game').

- When a new medium-term plan is presented (after 4 years), Member States with substantial and moderate debt challenges will be expected to have made progress towards ensuring that the debt ratio is put on a downward path or stays at prudent levels, as per the requirements set in the Communication. If the initial adjustment period was longer than 4 years, the remaining fiscal consolidation would need to be covered within the new plan and within the initially foreseen timeline, unless there are objective circumstances that would render this unfeasible. For those without extension, the need for further policy action, if any, will be re-assessed at that moment.
- Until a new plan is endorsed by the Council, the previous one remains valid and should be implemented.

6. The role of IFIs

a. How should IFI's be strengthened in terms of level of resources and legal frame to meet requirements in the reformed governance framework? How would the transition work?

Text of the communication:

- *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.[p16]*
- *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.[p16]*
- *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.[p16]*
- *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.[p16]*

- The Communication suggests that the role of IFIs in the implementation of the EU fiscal framework could gradually be expanded. The additional tasks mentioned in the Communication would imply that many IFIs would have to expand their activities into new areas.
- With expanded tasks comes a need for a commensurate increase in human and budgetary resources. In addition, further action may be needed to safeguard the independence of IFIs as they take on a more prominent role in fiscal surveillance.
- This could involve steps such as improving access to non-public information or putting in place arrangements for increased stability of funds of IFIs.
- These new requirements could be codified in an amendment of Council Directive 2011/85/EU.
- Member States would have to make sure they have an IFI that is able to assess not only macroeconomic forecasts (their current legal task), but also fiscal forecasts. With the link of the expenditure path to debt sustainability analysis, IFIs would also need to be able to assess such national analysis and related issues. As the fiscal-structural plan is backed by investment and reform measures, some capacity to assess the impact of the latter might also be needed, in particular if reform and investment commitments are linked to a request for an extended adjustment period.
- Transposing amendments to the Directive into national law and building up stronger IFIs will need time and, as IFIs currently are quite heterogeneous, some Member States may need more time than others. A transitional period (with a common deadline for all) may therefore be necessary during which the new rules are already in force while the IFIs still grow into their new role.
- While the Communication envisages a more important role for IFIs in the assessment of Member States' fiscal-structural plans, it does not impose a one-size-fits-all model for how this role is to be fulfilled concretely. This leaves room for some variation in approaches among IFIs, just as currently is the case with regard to the production or endorsement of macroeconomic forecasts underlying the fiscal plans of Member States.

DG ECFIN, European Commission
February 2023

Economic Governance Review – Q&A

Questions from Member States focused on the Macroeconomic Imbalance Procedure

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1. Fiscal-structural plans: general approach

Are all Member States obliged to include reforms and investments in their plans?

- *All* Member States would be required to present medium-term fiscal-structural plans that address the priorities identified in country-specific recommendations (CSRs) issued in the context of the European Semester. That of course includes the MIP-relevant CSRs. Hence, for Member States with imbalances, all plans would include reforms and investments to correct macroeconomic imbalances.
- As far as imbalances are concerned, the technical dialogue with Member States over the preparation of the plans would also reflect the insights from the in-depth reviews (IDRs) and the findings of imbalances or excessive imbalances.
- The plans of all Member States 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 Recovery and Resilience Facility, cross references to the Member States' Recovery and Resilience Plans would be needed to ensure policy consistency.
- In case a Member State is requesting an extension of its expenditure path, the Commission will assess whether the proposed reforms and investments justify such an extension of the path, using a pre-defined set of criteria:
  - 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, 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.
  - 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.

How to deal with possibly different timelines of Member States' plans?

- The plans put forward by Member States should adequately address the challenges they are facing. The plans should be comprehensive in describing reform and adjustment needs and should be ambitious in addressing them.

- Whereas initially the submission of plans will be synchronised across Member States, it is to be expected that over time, different timelines between Member States may emerge (for instance, in the case of revision of plans).
- Even so, all Member States will remain subject to the same annual surveillance cycle under the European Semester, which will also monitor the implementation of the medium-term fiscal structural plans.

Can the Council demand changes to a plan before endorsing it? What happens if a plan is not endorsed by the Council?

- After the Commission has assessed the medium-term fiscal-structural 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. The Commission could only provide a positive assessment of the plan 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. The Commission would assess the 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 transparent methodologies, with the possibility of seeking additional information or requesting a revised plan.
- Should the process not lead to the adoption of the plan put forward by the Member State, the Member State is still expected to comply with the country-specific recommendations (CSRs), which means complying also with the MIP-relevant CSRs. For the purpose of fiscal surveillance and enforcement, the reference multiannual net expenditure path would be used by the Commission, following endorsement by the Council.
- In addition, the Excessive Imbalance Procedure (EIP) remains a possibility for cases of excessive imbalances and thereby the possibility of sanctions for euro area Member States.

What kind of reporting by the Member State and monitoring by the Commission and the Council is envisaged?

- 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, together with a report on the policy action taken to address country-specific recommendations (CSRs). They would be the basis for annual surveillance by the Commission and Council, including possible enforcement decisions.

- Those annual progress reports would be the basis for annual surveillance by the Commission and Council, including possible enforcement decisions.
- The fiscal-structural plan would merge the Stability and Convergence Programmes and the National Reform Programmes.
- 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 medium-term fiscal-structural plan should include sufficient detail as well as a timeline for the implementation of those reform and investment commitments.

How will the new setup transparently cater for continued multilateral surveillance?

- The new framework would include several elements to ensure room for multilateral surveillance:
    - The medium-term fiscal-structural plans are expected to address inter alia challenges identified in the country-specific recommendations (CSRs), which are adopted by the Council following a clear and transparent multilateral exercise.
    - The Commission would assess the plan once a Member State submits it. The assessment would be made public and would be discussed in the relevant Council Committees.
    - It would be for the Council to endorse the plan on the basis of that assessment by the Commission. The Council could also recommend that the Member State resubmits a modified plan.
    - Once endorsed by the Council, the plans would be the basis for surveillance by the Commission and the Council. Non implementation of the plan would trigger enforcement actions, including the possibility of sanctions for euro area Member States.
    - In addition, in the case of the MIP, 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.

2. Implications for the European Semester and interplay with the RRF

What will be the implications for the European Semester, in particular for the issuance of CSRs?

- The European Semester remains the overarching framework for policy coordination. The Commission and the Council would continue to assess the challenges regarding Member States' economic, fiscal and social policies, and help monitoring the implementation of the endorsed medium-term fiscal structural plans on an annual basis.
- While in their plans, all Member States would be required to address the priorities identified in the country-specific recommendations (CSRs) issued in the context of the European Semester, during the lifetime of the plans there could be new CSRs issued if new imbalances or other challenges emerge when the plan is already in place.
- Those CSRs would continue to be proposed by the Commission, discussed by the Council preparatory committees, and finally adopted by the Council after an endorsement by the European Council.
- There would no longer be a need for annual fiscal recommendations for Member States that comply with their agreed net expenditure paths. For euro area Member States, the Draft Budgetary Plans (DBPs) would continue as self-standing documents. In autumn of each year, the Commission would also assess compliance of the DBPs with the agreed multiannual net primary expenditure path and would continue to make an overall assessment of the budgetary situation and prospects for the euro area as a whole.

Will the issuance of new MIP-related CSRs after the agreement on the medium-term fiscal-structural plan lead to a re-opening of that plan?

- Following the identification of new imbalances or other challenges after an in-depth review (IDR), and the possible publication of MIP-related country-specific recommendations (CSRs), under the European Semester cycle, a policy dialogue with Member States would be initiated on the measures needed to address those issues.
- However, the medium-term fiscal-structural plan in place will, as a rule, not be reopened if a new source of imbalances is found during the life of the plan. Instead, and following that technical dialogue with the Commission, the Member State will communicate the policy approach to address those newly identified imbalances through a letter to the Commission and the Council, which will be discussed in the committees. The agreed policy agenda may subsequently be included either in a new national medium-term plan (if not resolved in the lifetime of the original plan), or in an amended medium-term plan (if the original plan is no longer feasible). If the imbalances are excessive and require an immediate change of fiscal policy and new crucial reforms, the Excessive Imbalance Procedure (EIP) would be launched, the plan re-opened and act as a corrective action plan.

How exactly will climate change be covered?

- Since the introduction of the MIP more than 10 years ago, the European Semester has developed and now covers a wide range of economic and social aspects. Some of those aspects, together with emerging challenges, such as those related to climate and digital transition, and the related reforms and investment, are covered under the broader European Semester.
- In order to be effective, the MIP should focus on issues that can impact the macroeconomic stability of our economies, bearing in mind that imbalances can have various different sources.
- Systemic challenges related to climate change and the digital and social transitions will be covered in the context of the European Semester and should be taken into account under the MIP whenever there are clear links to macroeconomic imbalances.

What will be the interplay between the new setup and the RRF process?

- Lessons learned from the set-up of the Recovery and Resilience Facility (RRF) have provided the Commission with inspiration for its orientations for reform of the economic governance framework. In particular, the Commission has drawn insights from the RRF's commitment-based approach to policy coordination, with strong national ownership of policy design and outcomes, based on upfront guidance to Member States on investment and reform priorities.
- During the lifetime of the RRF, the medium-term fiscal-structural plans would include cross references to the Recovery and Resilience Plans (RRPs) to ensure policy consistency as relevant interactions with the RRPs would be taken into account during the lifetime of the RRF.

3. Forward-looking approach

How will forecasts be used in the MIP and how will their uncertainty be taken into account?

- The review aims at increasing the dynamics of the MIP, in order to ensure that the surveillance under the MIP is able to detect early enough challenges to macroeconomic stability and recognises when the challenges have been addressed in a timely manner. Commission forecasts would be a central element to learn about the prospective evolution of imbalances and risks to macroeconomic stability more broadly.
- Given that objective, forecasts will be used in the AMR and the IDRs mainly for two purposes:

- First, to detect emerging risks of imbalances that may call for a stepping up of MIP surveillance.
- Second, to ensure a timely de-escalation of Member States that have already been identified with imbalances or excessive imbalances.

- In the first purpose, the objective is to better assess the likely evolution of emerging patterns that may be a source of concern. In the case of opening an Excessive Imbalance Procedure (EIP), forecasts can be used to help form a view on the likely evolution of excessive imbalances in light of the no implementation of policy commitments. In the second purpose, forecasts will be used to see if recent reductions of macroeconomic stability risks are expected to continue, indicating that the adjustment is lasting and, on the basis of current information including forecasts, is not expected to halt or reverse.
- Forecasts are naturally marked by uncertainty and will not be used in isolation. They will complement the economic reading of economic indicators, including of course scoreboard indicators and actual outturns of stock and flows data, alongside longer-term prospects for private, government and external debt whenever relevant. Economic judgement will be used in reading all those data and information. Uncertainty around forecasts and the risks of revision of first releases of infra-annual data, especially in times of more volatile outcomes, will be borne in mind when exercising that judgement.
- Forecasts will be used alongside the assessment of whether policy commitments, including those specified in the medium-term fiscal-structural plan, have been implemented.

Which flow variables will be taken into account under the MIP?

- Flow variables have been used in the MIP surveillance since its inception. A greater emphasis on flow variables is motivated by the objective of having a more forward-looking and early detection of risks, as well as being able to more timely detect when a correction of imbalances has occurred. More attention to flow variables, throughout the main stages of MIP surveillance, will be one of the ways of achieving that.
- As the sources of imbalances can be varied and take different forms, a range of variables need to be watched.
- The scoreboard is sufficiently broad and already contains a good mix of flow and stock variables. Those variables can underpin the forward-looking analysis, alongside other data such as in-year and forecast data.
- The flow variables will always have to be analysed against the broader context, including the evolution of related stock variables. For example, assessments of external sustainability can be based on both the evolution of the net international investment position but also the changes to the current account, which represent the flow aspect. Similarly, credit flow data can provide context to changes to household or non-financial corporate debt.

4. The Excessive Imbalance Procedure (EIP)

The Communication suggests that the use of the EIP will be more transparent. How and when will the EIP be launched?

- The Excessive Imbalance Procedure (EIP) will remain part of the framework. It is the tool to enforce policy action in Member States with excessive macroeconomic imbalances, including those that jeopardise or risk jeopardising the proper functioning of the economic and monetary union.
- The EIP will be considered for Member States that are facing excessive imbalances and that are not taking appropriate policy action, including not implementing the policies in their medium-term fiscal-structural plan to correct their excessive imbalances.
- The inclusion in the plan of the reforms and investment needed to address the imbalances and excessive imbalances will increase transparency and clarity about what are the policies needed to address the imbalances. That will facilitate monitoring of the implementation of those policies, help transparency and foster multilateral surveillance, including in the application of the EIP.
- If an EIP is launched, this will lead to the re-opening of the medium-term 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 in order to ensure consistency with the commitments taken in the plan. Such a single plan will allow for a coherent and integrated macro-fiscal monitoring process.
- All legal provisions on the EIP remain as they are currently set in Regulation (EU) No 1174/2011 and Regulation (EU) No 1176/2011.

5. The MIP scoreboard

How will the aggregate EU and euro area values for the MIP scoreboard indicators feed into the MIP analysis? Will they be used as a referential or a desirable value?

- Preventing and addressing risks to the proper functioning of the EU and of the euro area economy is one of the purposes of the MIP. The revised framework will place more emphasis to the EU and euro area dimensions of imbalances.
- The inclusion of EU and euro area values for all indicators in the scoreboard will provide context to analysis as well as signal the importance of systemic developments:
    - First, they can inform on whether challenges are country-specific or shared across the EU and the euro area. For instance, where both the Member State and the euro area or EU indicator are outside the scoreboard threshold, this signals a development that may be important on a systemic level.

- Second, they can provide context to the respective contribution of the various Members States to those vulnerabilities and allow to better understand possible spillovers.
- Third, they can highlight vulnerabilities that affect the euro area as a whole and can feed into the euro area recommendations.

Are the MIP scoreboard indicators and thresholds being changed?

- The MIP scoreboard will be complemented with the inclusion of values for the EU and the euro area for all its indicators. This should help in reinforcing the macroeconomic focus and the EU and euro area dimensions in the MIP surveillance.
- The Commission proposal does not require further adjustment of the MIP scoreboard. The scoreboard already contains a sufficient range of stock and flow indicators. Those variables can underpin the forward-looking analysis too.
- The benchmark values, or thresholds, of the indicators in the scoreboard are periodically reviewed as part of the implementation of the MIP, with the EPC and its LIME working group playing a role in it. This will continue to be the case, but there is no element of the Commission proposals that require a re-calibration of the thresholds as part of this governance review process.

6. Classification of imbalances, policy traction, enforcement and sanctions

Will the categories of imbalances stay the same?

- Yes, the categories of imbalances will stay the same, namely, 'imbalances' and 'excessive imbalances'. At the same time, like now, it may happen that an IDR is carried out and the conclusions are that a Member State is not affected by imbalances.

How will the new proposal increase the policy traction of the MIP?

- The cornerstone of the Commission's orientations for the MIP is an enhanced dialogue with Member States to achieve higher policy traction through national ownership and commitment.
- Greater ownership by Member States would be achieved by reaching a better common understanding between Members States and the Commission of the challenges identified under the MIP and the policies needed to address them, following a dialogue on the basis of the in-depth review (IDR) and, where applicable, country-specific recommendations (CSRs). That should lead to a commitment from Member States to include the reforms and investment to prevent or correct imbalances in their medium-term fiscal-structural plan.

The outcome is expected to be a higher degree of political buy-in and ownership of the reform and adjustment agenda.

- The inclusion in the plan of reforms and investment needed to address the imbalances will also increase transparency and clarity about what are the policies needed to address the imbalances, which should also contribute to increase the traction of the MIP. This will also facilitate monitoring of the implementation and foster multilateral surveillance.

What are the new sanctioning possibilities and how does the Commission intend to implement them?

- Once the medium-term fiscal-structural plan has been endorsed by the Council, Member States are expected to implement it as planned. The focus of surveillance by the Commission will be to ensure adherence to the plan over its lifetime. These commitments would be monitored annually in the context of the European Semester.
- The Excessive Imbalance Procedure (EIP) would be considered for Member States that are facing excessive imbalances and which are not taking appropriate policy action, in particular not implementing the MIP-relevant reform and investment commitments outlined in their plans. As already the case, that can lead to financial sanctions for euro area Member States under the EIP.
- The existing provisions related to macroeconomic conditionality also remain unchanged.

7. Legal changes

Is the Commission going to propose changes to the legal framework of the MIP?

- The Commission is not proposing changes to the MIP Regulations (Regulations (EU) No 1174/2011 and No 1176/2011).
- As stated in the Commission Communication, 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 adjusting the criteria to decide on the existence and classification of imbalances and their correction could be accommodated within the current legal framework. The current legal provisions give enough leeway to implement that approach.