IN-DEPTH ANALYSIS

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ECONOMIC GOVERNANCE

The new EU fiscal governance framework

The Stability and Growth Pact (SGP) is the legal framework (based on primary and secondary EU law) that seeks to ensure sustainable public finances in the interest of the stability of the Economic and Monetary Union. The SGP consists of two main building blocks: the preventive arm and the corrective arm. The revised rules on the preventive and corrective arms entered in force in April 2024. This note provides an overview of the reformed framework. A separate forthcoming document will focus on the application of the SGP. This briefing is structured in three main sections: first, it outlines the key new elements in the preventive arm; second, it details the revised corrective arm; and finally, it explains the role of the European Parliament in the new framework. Each section provides a step-by-step explanation of the procedures involved.

The reformed Stability and Growth Pact (SGP) marks a regime **shift in the European Union's fiscal policy framework**, with an augmented emphasis on a country-specific approach safeguarding debt sustainability, while fostering sustainable and inclusive growth. The new framework may be regarded as a shift from a very detailed “rule-based” system to a more “economic analysis-based” one, opting for a more tailored approach per Member State based on their debt sustainability as well as on relevant national reforms and investments needs. Compared to the previous framework, the new preventive arm of the SGP aims to better balance economic growth and investment priorities with fiscal discipline, reflecting the challenges facing European economies.

The **preventive arm of the new SGP** introduces several key changes. Member States are now required to submit national medium-term fiscal-structural plans covering a 4-5 year horizon, aligning with their national executive terms. These plans incorporate fiscal strategies, structural reforms, and investments, with a focus on EU priorities such as green and digital transitions, social resilience, and defence capabilities. **A single country-specific operational indicator, the net expenditure path, replaces the previous complex set of rules**. This path, based on a debt sustainability analysis, serves as the primary tool for monitoring and surveillance. The European Commission provides preliminary guidance in the form of a reference trajectory, which includes safeguards to ensure fiscal discipline and debt reduction. The framework also allows for flexibility, with provisions for extending adjustment periods when significant reforms and investments are proposed.

To facilitate the transition to this new framework**, several transitory arrangements are in place for 2024**. The Commission is expected to transmit prior guidance to Member States by 21 June 2024, with the first set of medium-term fiscal-structural plans due by 20 September 2024, unless otherwise agreed. For this initial

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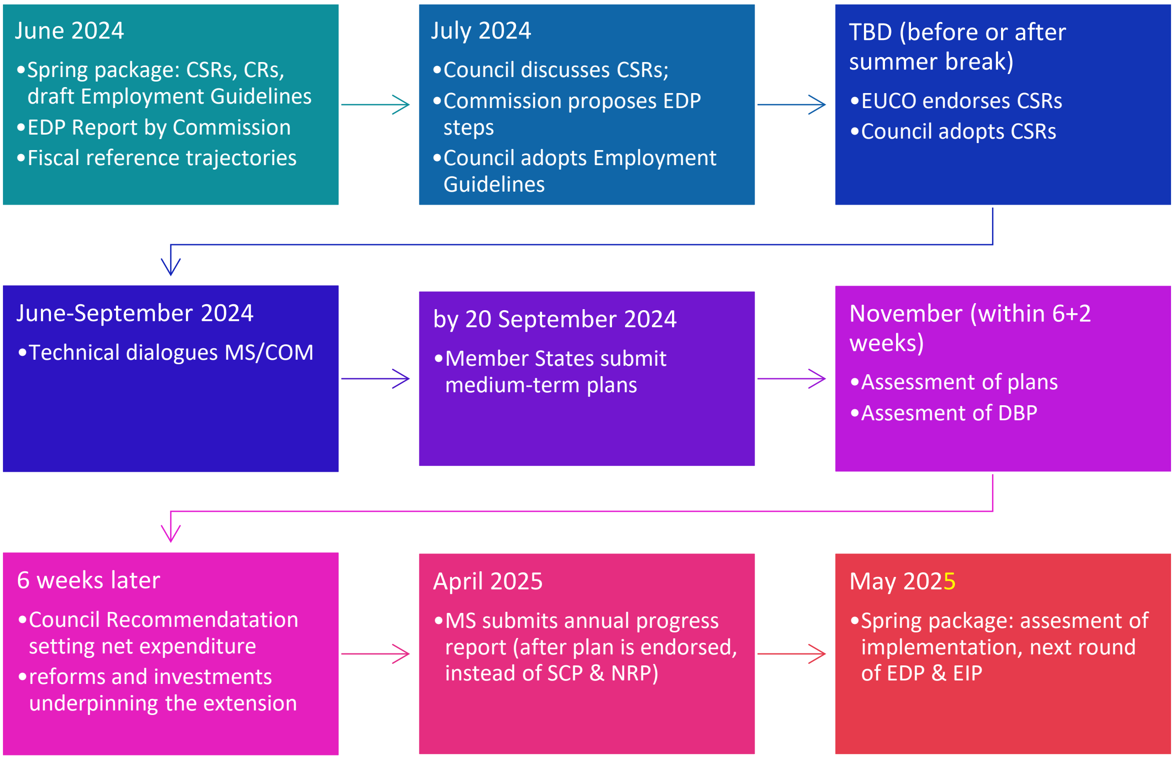
cycle, Member States are exempted from the obligation to consult relevant stakeholders prior to submitting their plans (but still have the possibility to do so if they wish setting shorter deadlines). When assessing extensions of adjustment periods, commitments under the Recovery and Resilience Facility will be taken into account. Additionally, given the exceptional impact of recent economic shocks, Member States may use more stable potential growth estimates than those resulting from the commonly agreed methodology, if duly justified. These transitory measures aim to provide flexibility and ensure a smooth implementation of the new fiscal governance framework in its initial phase.

Figure 1: European Semester 2024 Cycle (transition to the new regime)



Source: EGOV inspired by Commission services.

The changes to the **corrective arm of the SGP** retain the 3% deficit threshold as the backbone of the excessive deficit procedure (EDP), while introducing greater flexibility, nuance, and consideration of country-specific economic factors. At the same time, these changes seek to increase the predictability of the opening of an EDP with an explicit link to the preventive arm by requiring to account for deviations from the agreed expenditure rule as measured by the control account.

While the revised SGP introduces several improvements, it also brings potential challenges. The increased complexity of preparing, submitting, and monitoring the comprehensive fiscal-structural plans, and the need to ensure consistency between the different safeguards at play and the special treatments of some investment and reforms may pose significant demands on Member States and the Commission to establish the country-specific and multiannual fiscal frameworks. On the Commission side, it will be important to strike the right balance between ensuring a consistent and uniform application of the rules, on the one hand, and allowing for flexibility to adapt to country-specific situations, on the other. Ensuring compliance may still prove challenging, particularly in cases where political will is lacking or capacity constraints exist.

Overall, **the European Semester will remain the platform for economic and social policy guidance**, assessment, and monitoring, ensuring that fiscal discipline and growth-oriented reforms are pursued in tandem to achieve the Union's overarching goals of stability, growth, and employment (in accordance with art. 121 and 148 TFEU).

Annual progress reports[1] **are another important component of the revised framework**, requiring Member States to document the implementation of their fiscal-structural plans. These reports are intended to improve transparency and accountability, offering a mechanism for ongoing surveillance and assessment of fiscal policies and their alignment with economic growth and investment goals. They should also report on the involvement of national parliaments and other relevant stakeholder in the developments of the fiscal plans in order to strengthen the ownership at national level.

The enhanced roles of independent fiscal institutions and the European Fiscal Board in assessing compliance and providing advice on fiscal stances represent a move towards greater oversight as well and expertise in fiscal governance. This approach aims to ensure that fiscal policies are grounded in sound economic analysis and contribute to the overall stability and growth of the Union.

As regards **the role of the European Parliament**, the relevant provisions of the new preventive arm reflect and adapt to the new framework existing practices, expanding the current scrutiny toolbox, with the objective of increasing transparency and democratic accountability within the EU's fiscal surveillance processes, particularly through the European Semester.

1 For detailed information on the content of these annual progress reports please refer to the Commission guidance of 21 June 2024.

1. The preventive arm of the Stability and Growth Pact

1.1. Overview of the main changes

The **introduction of national medium-term fiscal-structural plans** is a central feature of the revised SGP, requiring Member States to articulate their fiscal, reform, and investment commitments over a four or five-year horizon (corresponding to the national legislative term). This requirement signifies a departure from the primarily deficit- and debt-focused approach, incorporating a broader perspective that includes economic reforms and investments. Such plans are expected to support the achievement of the Union's objectives for sustainable and inclusive growth and employment, highlighting a strategic shift towards a more growth-oriented fiscal policy.

A notable innovation within the regulation is the **establishment of one single country-specific operational indicator to serve as a national multi-annual fiscal path** and for carrying out EU and national level monitoring and surveillance of annual budgetary revenues and expenditures for each Member State.

The path is thus a budget constraint for the time horizon of the plan, representing a differentiated ("risk based") debt rule, nationally-owned and anchored to the plan itself. The only operational indicator used to monitor its implementation is **the growth of net expenditure,** which excludes a number of spending items such as interest expenditures, discretionary revenue measures, expenditures on Union-funded programs and national co-financing of such programmes. This net expenditure path will not be affected by automatic fiscal stabilisers (e.g. cyclical elements of unemployment benefit expenditures). To deliver on its commitment to a net expenditure rule, a government may choose between expenditure restraints and/or discretionary revenue increases.

In order to establish a multi-annual net expenditure rule, the European Commission will propose a **reference trajectory for each Member State in breach of the debt/deficit thresholds based on country-specific debt sustainability assessments (and certain safeguards**). The reference trajectory will serve as the starting point for negotiations between the Commission and the concerned Member States for the establishment of **a binding net expenditure path that is expected to guarantee (a plausible) reduction of government debt at the end of the trajectory period**.

The regulation also sets forth **conditions under which the fiscal adjustment period may be extended**, focusing on commitments to reforms and investments that are expected to enhance economic growth, resilience, and fiscal sustainability. This aspect underscores the regulation's emphasis on growth-enhancing structural reforms and investments as pivotal elements of fiscal planning, aligning fiscal targets with broader economic objectives also in the context of the European Semester, aiming to ensure a cohesive and holistic approach to economic governance.

See also **Annex 1** for a visual presentation of the different steps in the procedure under the preventive arm.

1.2. How to establish a country-specific "net expenditure rule"

***Step 1**: Preliminary technical guidance by the European Commission*[2]

Summary

The European Commission initiates the fiscal planning process for EU Member States by assessing their compliance with the numerical debt and deficit thresholds. For countries breaching these limits, the Commission performs a debt sustainability analysis (DSA) to provide preliminary fiscal guidance in the form of a reference trajectory outlining necessary adjustments to the government's net expenditure path. This trajectory complies with key safeguards to ensure fiscal discipline and resilience. Countries meeting the debt and deficit numerical thresholds may request technical information to support fiscal sustainability without additional adjustments over the medium- and the long-term. In addition, for any revisions of national plans, back loading of previously agreed fiscal adjustment is not allowed.

The DSA is a crucial component in determining fiscal adjustment requirements. For the first application of the framework in 2024, the methodology described in the European Commission's Debt Sustainability Monitor 2023 (see **Box 1** below) will be used. A working group has been established to review and potentially revise this methodology for future applications.

All methodological aspects of the above assessments by the Commission shall be made public in order to guarantee an equal treatment among Member States and provide credibility to the country-specific fiscal trajectory (i.e. avoid the perception that the outcome is taken out of a "black box").

Main elements:

- **Assessment of compliance with debt/deficit thresholds:** The European Commission initiates the fiscal planning process by assessing for each Member States if government debt exceeds 60% of GDP and if general government deficit exceeds 3% of GDP.
- **Preliminary Guidance and Debt Sustainability Analysis (DSA)**: For Member States in breach of either debt/deficit reference value, the Commission performs a DSA. This analysis, based on established methodologies, evaluates the sustainability of a Member State's debt by considering future economic and fiscal projections, including growth rates, interest rates, fiscal balances, and inflation. The DSA is the core element to establish a country-specific reference trajectory. In the case of a Member State with deficit and debt levels below the Treaty reference values only technical information for their net expenditure path may be provided upon request.
- **Reference Trajectory and Technical Information distinction:**
    - **Reference Trajectory:** By 15 January of the year of submission of the plan[3], the Commission provides a reference trajectory to Member States with debt levels above 60% of GDP or deficits exceeding 3% of GDP. This trajectory, informed by the DSA, delineates the necessary fiscal adjustments in the form of a net expenditure path to guide debt reduction towards the 60% threshold or deficit correction below 3%, over an adjustment period of 4 years with a possible extension of up to 3 years. It aims to ensure the general government debt ratio is on a plausible downward path or maintained at a prudent level. Up to one month before the European Commission transmits to a Member State the reference trajectory, Member States will have the

[2] Please refer to Articles 2, 5, 6, 7, 8, 9, 10 of the preventive arm regulation

[3] For the first cycle of plans (in a transition to the new regime), the Commission provided a reference trajectory on 19 June 2024.

opportunity to request a **technical exchange** with the European Commission to discuss the latest statistical information and the economic and fiscal outlook of the Member State.

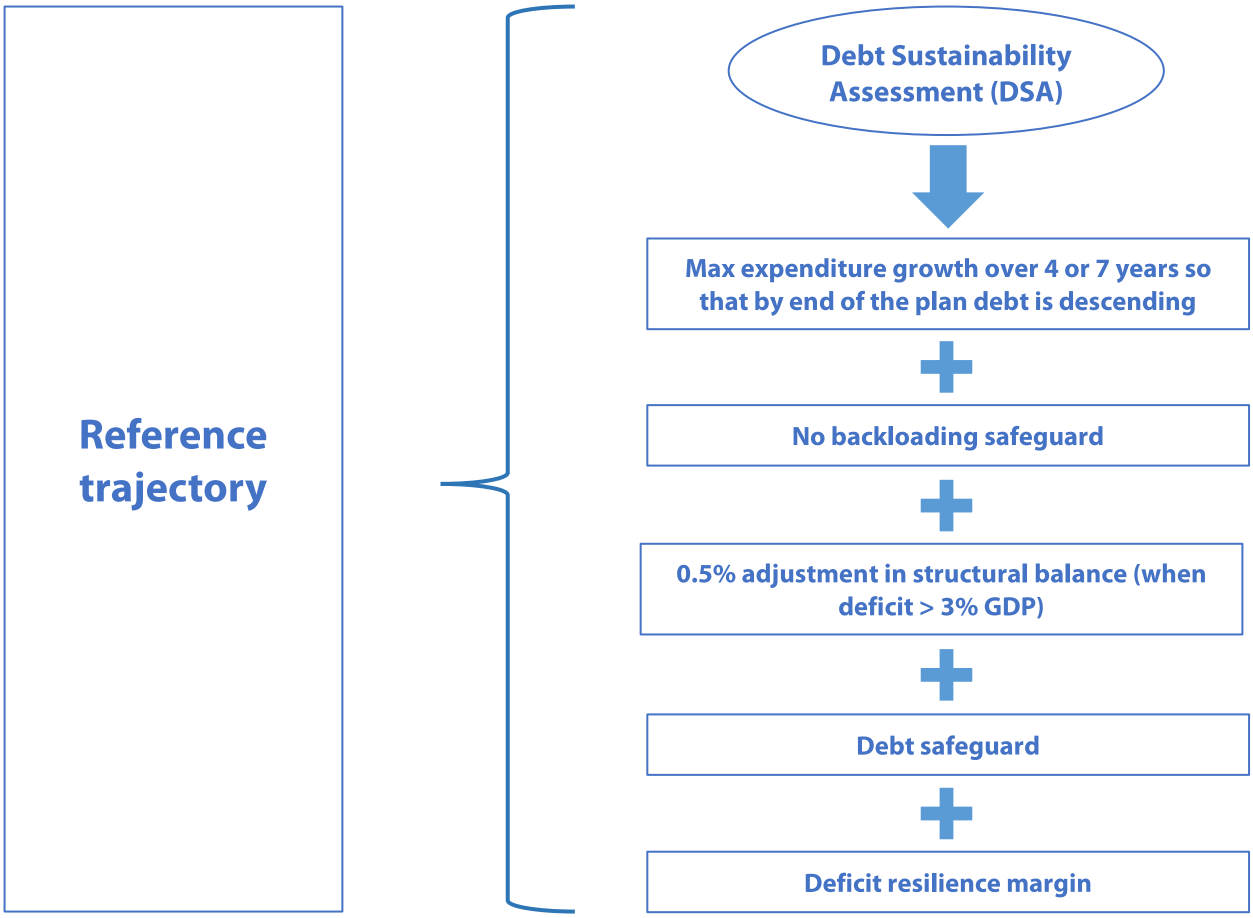
- **Technical Information:** For Member States with debt below 60% of GDP and deficits under 3% of GDP, the Commission offers technical information at the request of the Member States concerned rather than a trajectory. This guidance supports these Member States in maintaining fiscal sustainability, facilitating preventive measures without necessitating fiscal adjustments in the longer term. No safeguards are applied for the definition of technical information, although this needs to be consistent with the deficit resilience safeguard.

Safeguards: Four safeguards are embedded in the establishment of the reference trajectory (See **Figure 2**) for those Member states whose debt or deficit are above the Treaty reference values:

- **Minimum annual structural adjustment:** When a Member State is in breach of the 3% deficit reference value, the expenditure path should be consistent with the requirement to have a minimum annual structural adjustment of 0.5% of GDP.
- **No back loading:** The majority of the fiscal adjustment should take place in the first four or five years of the plan (depending on the length of the national legislature), back loading of previously agreed fiscal adjustment is not allowed.
- **Debt sustainability safeguard:** This safeguard requires the reference trajectory to be anchored on specified minimum annual average debt reduction targets, ensuring a sustainable downward trajectory in debt levels. For debt ratios exceeding 90%, a minimum annual average reduction of 1 percentage point of GDP is mandated. For debt ratios between 60% and 90%, the required reduction is 0.5 percentage points of GDP. These targets are pivotal for encouraging disciplined fiscal efforts aimed at achieving and maintaining debt levels below the established thresholds, thereby fostering long-term fiscal health within the EU.
- **Deficit resilience safeguard:** This safeguard ensures that the Commission's reference trajectory continues fiscal adjustments until a Member State reaches a structural deficit level that provides a resilience margin of 1.5% of GDP in structural terms relative to the 3% nominal deficit Treaty reference value[4]. The required annual improvement in the structural primary balance is set at 0.4% of GDP, with a reduction to 0.25% of GDP in case of an adjustment period extension (see below). This mechanism is designed to enhance fiscal resilience through prudent deficit management, ensuring that Member States maintain adequate buffers against potential fiscal shocks. Member States under the Treaty reference values on deficit and debt follow this requirement at their own initiative as they retain discretion on requesting technical information consistent with this safeguard.

[4] The **structural deficit** is the budget deficit net of interest expenditures adjusted for the economic cycle (i.e., it excludes the effects of economic booms and downturns on the budget) and one-off or temporary measures. It aims to show the underlying fiscal position of a government. The **nominal deficit** is the actual budget deficit reported by a government, including all revenues and expenditures within a given year, without adjustments for the economic cycle. Adjusting for the economic cycle means that during periods of economic growth, a government might need to tighten fiscal policy more than nominal figures suggest to achieve a given structural balance. Conversely, in a downturn, it might be able to run a higher nominal deficit without worsening the structural deficit. Achieving structural adjustment can be more complex because it requires changes that affect the economy's structural aspects, such as reforming tax systems, modifying welfare programs, or altering government spending priorities.

Figure 2: Reference trajectory



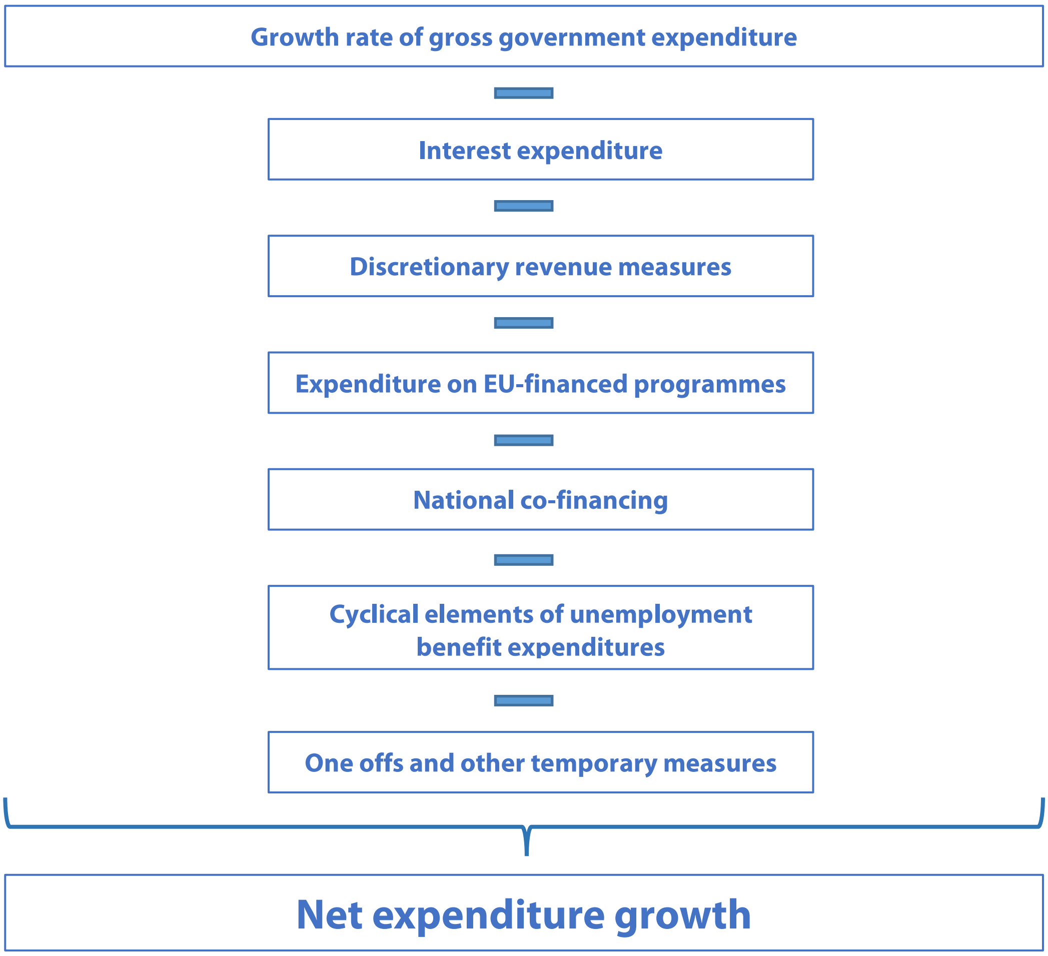
Source: EGOV

Box 1: Computing the reference trajectory

The reference trajectory is computed by means of a DSA as the maximum expenditure growth computed linearly over 4 or 7 years ensuring that by the end of the plan debt is descending, that no backloading takes place (i.e.1/ 4th or 7th of the fiscal effort takes place during the first four or five years of the plan depending on the length of national legislature), that it is consistent with the corrective arm's requirement of an annual 0.5% adjustment in structural balance when deficit is above 3%. The debt sustainability safeguard and the deficit resilience safeguard are added at this stage (only) to provide the anchoring for the reference trajectory and further constrain net expenditure.

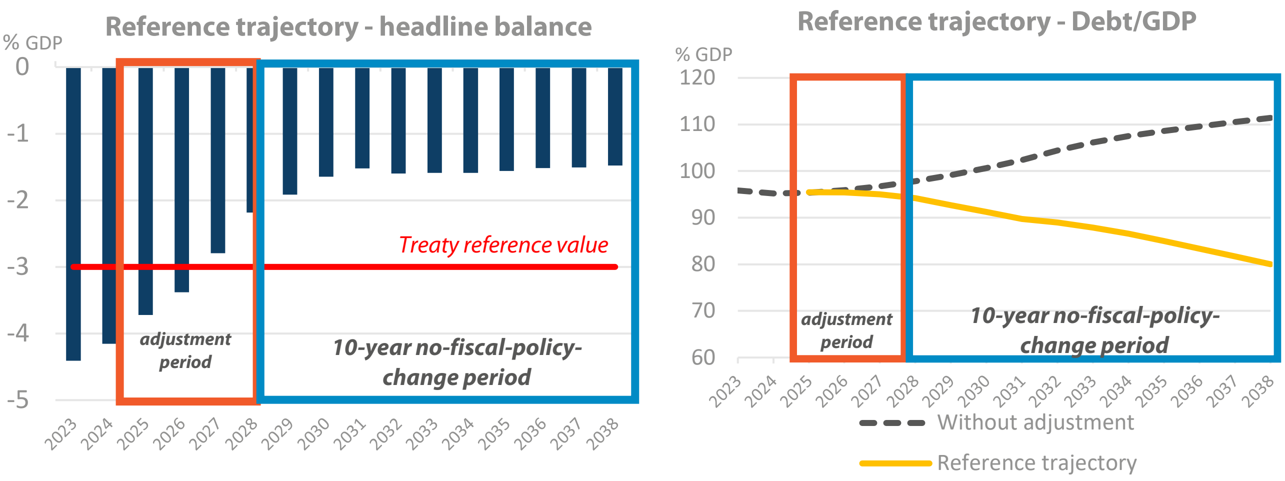
After Member States agree with the Commission their fiscal consolidation path for the next years, the only indicator for compliance monitored by the Commission (*ex post* phase) is the **growth rate of a government's net expenditure (see Figure 3)** relative to the agreed spending targets.

Figure 3: Net expenditure growth



Source: EGOV

Figure 4: Reference trajectory - headline balance and debt/GDP



Source: EGOV (based on Commission data).

Step 2: *Submission of national plans and assessment by the Commission*[5]

Summary

After having received guidance by the Commission, including their reference trajectory or the technical information (if requested), all Member States draft 4-5 year national fiscal-structural plans based on the Commission's guidance. These plans detail strategies, reforms and investments aligned, amongst others, with four defined EU common priorities. After consultations at national level and technical dialogue with the Commission, the plans are submitted by 30 April for the Commission's assessment of feasibility, compliance, and impact on fiscal sustainability and growth.

Main elements:

- **Drafting of national medium-term fiscal-structural plans**[6]**:**
    - The plans are prepared to cover a planning horizon of 4 to 5 years (corresponding to the national term for the executive), detailing fiscal strategies (notably in the form of a net expenditure path translated into annual spending targets), structural reforms, and investments.
    - The national medium-term fiscal-structural plans should include in particular how the concerned Member State addresses **EU priorities** related to a) a fair green and digital transition, including consistency with the European Climate Law, b) social and economic resilience, including the European Pillar of Social Rights, c) energy security, and d) build-up of defence capabilities.
    - Member States use the reference trajectories or technical information provided by the Commission as the basis for their proposed net expenditure path. Member States can be allowed to follow a higher net expenditure path in their plans than the one recommended by the Commission if they are deemed to have provided sound economic arguments to do so. The more favourable assumptions used by the Member States in their own DSAs could have an impact on the safeguards applying to the net trajectory as the safeguards are always computed on top of the DSA-derived adjustment. However, **the adjustment effort over the period of the national medium-term fiscal-structural plan is linear as a rule** and at least proportional to the total effort over the entire adjustment period ("no back loading clause").
    - Prior to the submission of its national medium-term fiscal-structural plan, the Member State concerned may hold with the Commission a **technical dialogue**, with the objective of ensuring that the national medium-term fiscal-structural plan complies with the guidelines provided by the Commission, related in particular to the implementation of the reference trajectory and the related net expenditure path, as well as details on investments and reforms.
    - In drafting the national medium-term fiscal-structural plans, Member States have to establish a **consultation** process of social partners, regional authorities, civil society organisations and other relevant national stakeholders, in accordance with the national legal framework. The plans must contain information on the consultation process.
- **Evaluation of the plans:**
    - **Member State submission of the plan:** By the deadline of 30 April of the last year of the current plan, Member States are required to submit their comprehensive national medium-term fiscal-

[5] Please refer to Articles 11, 12, 13, 16 of the preventive arm regulation

[6] For the first cycle, Member States will have to submit their plans by 20 September 2024.

structural plans to the European Commission and the Council. An extension to the deadline could agree between the Commission and the Member State. Upon submission, the Member State's plan shall also be made public.

- **Commission assessment:** Following submission, the Commission undertakes a thorough assessment of each plan against a set of established criteria within six weeks (extendable by 2 more weeks). The Commission should in particular evaluate the feasibility of the net expenditure path, compliance with debt and deficit guidelines, and the anticipated impact of proposed reforms and investments on enhancing fiscal sustainability and promoting economic growth. The assessment process ensures that all plans are viable, actionable, and aligned with the broader objectives of ensuring fiscal stability and stimulating economic development across the EU. It also assesses if reforms and investments commitments warrant an extension of the adjustment period.

***Step 3**: Adoption of the plans and the fiscal paths*[7]

Summary

Step three starts after the European Commission assesses the submitted plans and, potentially, recommends adjustments. Based on a Commission's recommendation, the Council adopts the net expenditure paths and endorses the plans. Non-compliant or inadequate plans must be revised within a month; otherwise, the Commission's reference trajectory becomes the Member State's net expenditure path by default.

Main elements:

- **Council's role in setting net expenditure paths and endorsing plans:**
    - Upon a recommendation by the Commission, the **Council formally adopts** the multi-annual net expenditure path for each Member State and endorses, where applicable, the reforms and investments commitments included in the national medium-term fiscal-structural plans.
    - In case the Council deems (based on the Commission's assessment) the submitted plan not to be in compliance with the objectives of the reference trajectory and related safeguards or when the set of reforms and investments proposed do not fulfil the conditions for an extension of the plan, it shall **recommend the submission of a revised plan**. Failure to submit the revised plan within one month from the recommendation, unless otherwise agreed, or failure to adequately rectify the plan would result in the Council recommending that the reference trajectory issued by the Commission be as a rule the net expenditure path that the Member State concerned has to follow. This also applies when the Member State fails to submit a new medium-term fiscal-structural plan in time.

[7] Please refer to Articles 17,18 and 19 of the preventive arm regulation

1.3. Implementation and monitoring of the national plans

Step 4: *Implementation, monitoring and review of the plans*[8]

Summary

Once the Council endorses the plans, Member States i**mplement their net expenditure paths and related reforms and investments**. They submit annual progress reports by 30 April, detailing their adherence to the net expenditure path and progress in the implementation of reforms and investments. The Commission closely monitors compliance using a control account to track deviations and conducts a comprehensive review of the progress reports. Based on the review, the Commission and the Council may recommend adjustments to address deviations, challenges, or areas requiring additional efforts to meet the agreed-upon objectives. This dynamic process ensures fiscal policies remain on track to support sustainable growth and stability in the EU.

Main elements:

- **Submission of annual progress reports:** Each year, by the deadline of 30 April, Member States are required to submit detailed progress reports to the European Commission. These reports provide a comprehensive overview of the implementation efforts over the past year, focusing on adherence to the established net expenditure path and the advancement of structural reforms and strategic investments. The reports are crucial for transparency and accountability in the fiscal planning and execution process, offering insights into how Member States are navigating their fiscal challenges and opportunities. The annual progress report de facto replaces the Stability and Convergence Reports under the previous framework. Member States may discuss the progress report in their national parliaments.
- **Monitor compliance through the control account:** The Commission undertakes a rigorous monitoring process to ensure Member States' compliance with their committed fiscal paths and the effective progression of their reforms and investments agendas. Key to this monitoring effort is the use of a control account, a mechanism that tracks cumulative deviations from the net expenditure path over time. The control account is made publicly available at least once a year. The control account is reset with every new plan. Specifically:
    - The control account records a debit when the observed net expenditure in a given year is above the net expenditure path set by the Council.
    - It records a credit when the observed net expenditure is below the set path.
    - The cumulated balance of the control account is the sum of yearly debits and credits, expressed as a percentage of GDP.
    - Debits and credits are recorded annually based on outturn data.
    - When the Council has adopted a recommendation pursuant to the general or national escape clauses, the control account does not record deviations.
- See part 2 on the corrective arm for a description of the role of the control account in the Excessive Deficit Procedure.
- **Comprehensive review of progress reports:** Upon receiving the annual progress reports, the Commission undertakes an exhaustive review to assess the degree of compliance with the fiscal paths

[8] Please refer to Articles 3, 4, 21 and 22 of the preventive arm regulation

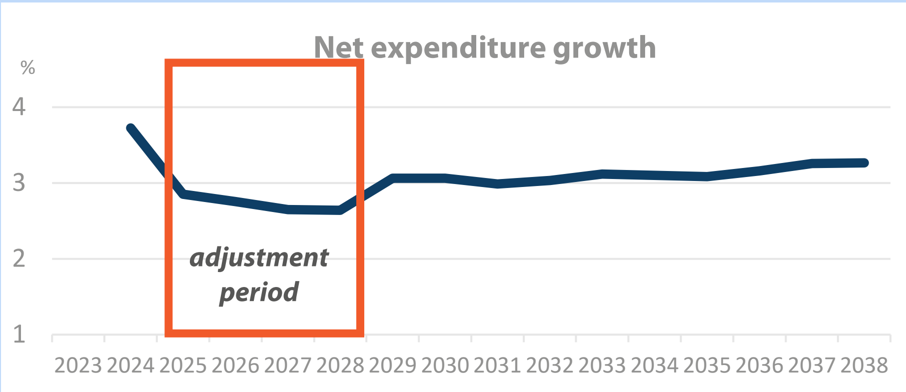
agreed upon and the progress in implementing the planned reforms and investments. This review process is integral to understanding the impact of Member States' fiscal strategies on broader objectives of debt sustainability and economic growth. The Commission evaluates whether the fiscal actions, reforms, and investments align with the content and requirements set out in the national medium-term fiscal-structural plans, ensuring that the initiatives undertaken are conducive to achieving long-term fiscal stability and economic development.

- **Recommend adjustments:** Based on the outcomes of the review, the Commission may suggest to the Council to issue further recommendations to Member States. These recommendations aim to address any identified deviations from the fiscal paths, emerging challenges, or areas where additional efforts are needed to meet the agreed-upon objectives. The process of review and adjustment is a dynamic and ongoing dialogue between the Commission and Member States, designed to adapt to changing economic conditions and ensure that fiscal policies remain on track to support sustainable growth and stability across the EU.

Box 2: A sole operational indicator to monitor compliance

The new preventive arm simplifies the monitoring process by relying on **a single operational indicator**, the growth rate of net expenditure. This means that, by using countries' progress reports and the control account, the Commission will focus merely on the growth of government spending. A number of exclusions from government expenditure are allowed for monitoring purposes to foster growth and cohesion. These exclusions include interest expenditures, discretionary revenue measures, and notably, expenditures on Union-funded programs alongside national co-financing of such programs.

Figure 5: Net expenditure growth



Importantly, such expenditures are only deducted during the monitoring phase of the programme (ex post) rather than being already subtracted at the stage of definition of a fiscal consolidation path (ex ante) which was based on the structural balance. Overall, their inclusion in government expenditure when setting the trajectory has minimum impact on the definition of spending target as it is aggregated over the entire adjustment period. Concretely, as these expenditures are exempted during implementation, this implies that Member States will have a broader margin for spending in the roll-out of the fiscal plans.

Flexibility, adjustments and corrections in the procedure[9]

Summary

The framework includes escape clauses for temporary deviations during economic shocks or exceptional circumstances. A general escape clause addresses EU-wide downturns, while a national clause tackles specific Member State challenges. In terms of other embedded flexibility mechanisms, Member States can request (up to three-year) extensions of adjustment periods for significant reforms and investments, particularly those aligned with EU priorities. Plans can be revised within 12 months of the current plan's end, following the same procedure as regular submissions. Transitory provisions offer flexibility for the first set of plans, including specific timelines, stakeholder consultation exemptions, and accounting for Recovery and Resilience Facility commitments.

The framework also mandates a comprehensive approach to address Member State non-compliance with the criteria for drafting the plans and extending of the adjustment periods, including the possibility to request revisions or have the Commission's reference trajectory become the net expenditure rule for the concerned Member State.

Main elements:

- **Incorporation of escape clauses:**
  - The framework incorporates escape clauses to allow Member States to temporarily deviate from their fiscal paths in the face of economic shocks or exceptional circumstances. These provisions are designed to offer a pragmatic response to unforeseen economic challenges:
    - **General escape clause:** Activated in instances of severe economic downturns affecting the EU or the euro area as a whole, this clause enables a coordinated and temporary relaxation of fiscal constraints to mitigate the downturn's impacts and support a robust recovery. A renewable one-year extension is possible and shall be accompanied by an opinion of the European Fiscal Board.
    - **National escape clauses:** Tailored to address unique challenges faced by individual Member States, these clauses allow for specific adjustments to fiscal paths, providing targeted flexibility to manage exceptional national circumstances effectively. A maximum one-year, renewable extension could be granted.
- **Extensions of the adjustment period:**
  - Acknowledging the critical role of structural reforms and strategic investments in driving sustainable growth and enhancing fiscal sustainability, the framework allows Member States to request extensions of their adjustment periods by up to three years. Such extensions are granted to Member States committed to implementing significant reforms and investments expected to yield substantial long-term benefits, recognising that the realisation of these benefits often requires time. More specifically, when assessing the request for an extension of the adjustment period, the Commission should pay "particular attention" to the green, digital, social and defence EU priorities in its assessment. Transitory provisions provide that commitments included in the approved Recovery and Resilience Plan of the Member State concerned shall also be taken into account for an extension of the adjustment period, thus making it easier to obtain such an extension.

9 Please refer to Articles 13, 14, 15, 18, 19, 20, 25, 26, 36 and recital 24 of the preventive arm regulation.

  - When a Member State has been granted an extension of the adjustment period but fails to comply with its investment and reform commitments, the Council might recommend a revised net expenditure path with a shorter adjustment period.

- **Revision of the plan:**
  - Member States have the opportunity to ask for a revision of their national medium-term fiscal-structural plan as long as it is requested within 12 months before the end of the current plan. An endorsed revised plan shall cover the missing period until the end of the initial plan. New governments will also be able to request a revised plan which shall however cover a new period of 4 or 5 years (depending on the length of the legislature).
  - The revision of the plan, whether requested by a new government or not, follows the same procedure and requirements as the regular submission of the plan. Notably, new reference trajectories or technical information would be prepared, ensuring that there would be no back loading of the fiscal adjustment nor lower efforts as a rule. The endorsement process in Council with related corrective actions in case of non-compliance also mirrors the provision for the regular submission of plans.

- **Transitory arrangements:** A number of transitory provisions are in place for the first set of plans to be submitted to provide further flexibility in the first years of application of the regulation, including:
  - **A specific timeline for the drafting a submission of the plans**, with the Commission expected to transmit prior guidance at the latest by 21 June 2024 to allow for submission of plans by 20 September 2024 (unless otherwise agreed)
  - **An exemption from the obligation to consult relevant stakeholders** prior to the submission of the plan
  - **Accounting for commitments under the Recovery and Resilience Facility** when assessing the extension of the adjustment period as well as creation of a derogation from the no-back loading safeguard for projects linked to RRF loans and national co-financing of EU programmes in 2025 and 2026.
  - **Acknowledging the exceptional impact of recent economic shocks and current uncertainty on estimates of potential growth**, Member States may use more stable series than the ones resulting from the commonly agreed methodology, provided that such use is duly justified by economic arguments and that the cumulated growth over the projection horizon remains broadly in line with the results of that methodology.

- **Proactive approach to addressing non-compliance:** When a Member State is found to be non-compliant with key criteria for the drafting and approval of the plan (including non-compliance with investment and reform programmes granting an extension of the adjustment period), the framework mandates a comprehensive approach to rectify the situation. This includes the issuance of additional recommendations to revise the plan, shorten the adjustment period or recommend that the reference trajectory issued by the Commission be the next expenditure path of the Member State concerned.

2. The corrective arm of the Stability and Growth Pact

2.1. Overview of the changes introduced in the new corrective arm

The changes proposed for the corrective arm of the SGP build upon the revised framework introduced in the preventive arm, aiming to create a more coherent and integrated approach to fiscal surveillance and economic governance within the EU.

One significant departure from the existing corrective arm framework is the **replacement of the long-standing debt reduction benchmark,** which previously required countries with debt above 60% of GDP to reduce their debt by around 1/20th per year. Instead, the new regulation introduces the concept of a "net expenditure path”, as mentioned in the previous section on the preventive arm, which will be tailored to each Member State's specific economic conditions and challenges. This net expenditure path will effectively become the primary metric for assessing compliance with the Excessive Deficit Procedure (EDP), rather than solely focusing on deficit levels relative to the 3% of GDP threshold[10]. Member States will be required to adhere to their prescribed net expenditure path, with deviations from this trajectory serving as a trigger for potential escalation of the EDP.

As in the preventive arm of the SGP, the rationale behind this shift is to allow for a more nuanced approach that accounts for productive investments and structural reforms that may contribute to long-term fiscal sustainability and economic growth. By controlling the growth of expenditures rather than imposing uniform deficit targets, the regulation aims to provide fiscal space for growth-enhancing measures while maintaining overall fiscal discipline.

The Commission's reports invoking the EDP will be required to undertake a "balanced overall assessment" that considers factors beyond just deficit and debt numbers, such as progress on structural reforms, investment levels, alignment with EU growth strategies, and even defence spending. The Council will then weigh these factors as potential mitigating or aggravating circumstances when deciding if an excessive deficit exists and setting associated deadlines for correction.

[10] The corrective arm regulation also foresees that for Member States subject to a deficit-based EDP, “*the corrective net expenditure path shall be consistent with a minimum annual structural adjustment of at least 0,5% of GDP as a benchmark”* for the years in which deficit is forecasted to be above the 3% threshold.

2.2. Steps under the corrective arm of the Stability and Growth Pact

Summary: Steps under the corrective arm of the SGP

The corrective arm process begins with the Commission issuing a report on excessive deficit. This is followed by an opinion from the Economic and Financial Committee. The Commission then makes a proposal to the Council, which decides on the existence of an excessive deficit. The Member State in question reports on actions taken in response to recommendations. If necessary, the Council may adopt revised recommendations. The Council then assesses whether the Member State has taken effective action. In cases of non-compliance, potential sanctions may be imposed, including fines of up to 0.05% of GDP for euro area Member States. These sanctions can be intensified if the excessive deficit persists. Finally, the process concludes with the abrogation of sanctions and the excessive deficit procedure once the issue is resolved.

This sequence ensures a comprehensive approach to addressing excessive deficits, providing both opportunities for correction and consequences for continued non-compliance throughout the process.

See also **Annex 2** for a visual presentation of the different steps in the procedure.

Step 1: *Commission report on excessive deficit*[11]

Main elements:

- **European Commission report under Article 126(3) TFEU,** if a Member State's government debt-to-GDP ratio exceeds the 60% reference value, the budgetary position is not close to balance or in surplus, and the deviations from the predetermined net expenditure path surpass either 0.3 percentage points of GDP annually or 0.6 percentage points of GDP cumulatively as measured by the control account. This provision applies even in the case of the deficit exceeding the 3% of GDP reference value due to a severe economic downturn in the euro area or the EU as a whole, as established by the Council in accordance with Article 24 of the preventive arm regulation, or owing to exceptional circumstances outside the government's control that have a major impact on the Member State's public finances, as defined in Article 25 of the preventive arm, though in these cases the Commission and the Council may decide not to open and EDP.
- **Content of the report:**
    - **Compliance with deb/deficit criteria:** The Commission must comprehensively assess the Member State's compliance with the deficit and debt criteria, reflecting various relevant factors:
        - An analysis of public debt challenges based on a specific methodology, the evolution of the government debt position and its financing, related risk factors such as the maturity structure, currency denomination, and contingent liabilities (including implicit liabilities linked to ageing and private debt).
        - The developments in the medium-term budgetary positions, particularly the size of the actual deviation from the net expenditure path, both annually and cumulatively as measured by the control account.
        - An assessment of the medium-term economic position, including potential growth, inflation developments, and cyclical conditions compared to the assumptions underlying the net expenditure path.
        - The progress in implementing reforms and investments, especially policies aimed at preventing and correcting macroeconomic imbalances and policies to implement the common growth and employment strategy of the Union, including those supported by

[11] Please refer to article 2 of the corrective arm

NextGenerationEU, as well as the overall quality of public finances and the effectiveness of national budgetary frameworks.
  - Where applicable, increases in government investment in defence, taking into account the time of recording of military equipment expenditure.

- **Consideration of country-specific factors:** In its report, the Commission must also give due and express consideration to any other factors that the Member State concerned deems relevant in order to comprehensively assess compliance with the deficit and debt criteria, as put forward by the Member State to the Council and the Commission. In this context, particular consideration shall be given to financial contributions made by the Member State to fostering international solidarity and achieving the common priorities of the Union, as referred to in the preventive arm regulation.
- **Balanced overall assessment:** The Council and the Commission must make a balanced overall assessment of all the relevant factors, specifically determining the extent to which they affect the assessment of compliance with the deficit and/or debt criteria as aggravating or mitigating factors.
- **Key aggravating factors:** Where the Member State faces substantial public debt challenges as referred to in the report, this shall be considered a key aggravating factor. Favourable cyclical economic, budgetary, and financial developments cannot be regarded as mitigating factors, while unfavourable developments may be considered as such.

When assessing compliance with the deficit criterion, the regulation however specifies that relevant factors can be take into account only when:

- Debt is not above 60% of GDP,
- If debt is above the reference value, a double condition must be met that the excessive deficit is close to 3% GDP and only temporarily above this value.

Step 2: *Economic and Financial Committee Opinion*[12]

- Within two weeks of the adoption of the Commission's report issued in accordance with Article 126(3) TFEU, **the Economic and Financial Committee is required to formulate an opinion** as mandated by Article 126(4) TFEU.

Step 3*: Commission Proposal to Council*[13]

- Taking full account of the opinion formulated by the Economic and Financial Committee, **the Commission, if it considers that an excessive deficit exists, shall address an opinion and a proposal to the Council** in line with Article 126(5) and 126(6) TFEU, **and shall inform the European Parliament thereof**.

Step 4*: Council Decision on Excessive Deficit*[14]

- **The Council shall decide on the existence of an excessive deficit** in accordance with Article 126(6) TFEU, typically within four months of the reporting dates established in Article 3(2) and 3(3) of Regulation (EU) 479/2009.

[12] Please refer to Article 3(1) of the corrective arm

[13] Please refer to Article 3(2) of the corrective arm

[14] Please refer to Article 3(3) and (4) of the corrective arm

  - When the Council decides that an excessive deficit exists, it shall simultaneously make recommendations to the Member State concerned in line with Article 126(7) TFEU.
  - These recommendations shall establish a maximum deadline of six months for the Member State to take effective action, although in situations where warranted by the severity of the circumstances, the deadline for effective action may be reduced to three months. The Council's recommendations shall also set a deadline for the correction of the excessive deficit.
  - Furthermore, the Council shall request that the Member State implements a corrective net expenditure path that ensures the general government deficit remains or is brought and maintained below the reference value within the deadline specified in the recommendation.

- **Budgetary adjustment requested:**
  - Where the excessive deficit procedure was opened on the basis of the *deficit criterion*, the corrective net expenditure path, for the years when the general government deficit is expected to exceed the reference value, shall be consistent with a minimum annual structural adjustment of at least 0.5% of GDP as a benchmark[15].
  - Where the excessive deficit procedure was opened on the basis of the *debt criterion*, the corrective net expenditure path shall be at least as demanding as the net expenditure path endorsed by the Council under the preventive arm regulation, and shall correct, as a rule, the cumulated deviations of the control account by the deadline set by the Council.

Step 5: *Member State reports on Actions*[16]

The Member State reports to the Council and Commission on actions taken in response to the recommendations within the provided deadline.

- Within the deadline provided for in the Council's recommendation issued under Article 126(7) TFEU, **the Member State concerned is obligated to report to the Council and the Commission on the actions taken in response to the Council's recommendations**.
  - This report must include the targets for government expenditure and revenue, as well as the discretionary measures on both the expenditure and the revenue side that are consistent with the Council's recommendations.
  - The report should also provide information on the measures taken and the nature of those envisaged to achieve the prescribed targets. The Member State is required to make this report publicly available.
  - Additionally, the Member State may invite the relevant independent fiscal institution to produce a non-binding, separate report on the sufficiency of the measures taken and envisaged with respect to the targets.

Step 6: *Potential revised Recommendations*[17]

The Council may adopt revised recommendations under specific circumstances, such as effective action taken by the Member State or the existence of a severe economic downturn.

[15] The Commission may, during a transition period in 2025, 2026 and 2027 adjust the benchmark to take into account the increase in interest payments when setting the proposed corrective path relating to the first medium-term fiscal-structural plan for those years within the EDP.

[16] Please refer to Article 3(5) of the corrective arm

[17] Please refer to Articles 3(6) and 5(2) of the corrective arm

- **The Council may decide, on a recommendation from the Commission, to adopt a revised recommendation** under Article 126(7) TFEU in two specific circumstances.
    - Firstly, if effective action has been taken by the Member State in response to the initial recommendation and the conditions referred to in Article 25 of the preventive arm regulation apply, which pertain to exceptional circumstances outside the government's control.
    - Secondly, if the conditions referred to in Article 24 of the preventive arm regulation apply, which relate to the existence of a severe economic downturn. The revised recommendation may, in particular, extend the deadline for the correction of the excessive deficit by one year as a rule.
- Similarly, the Council may decide to adopt a revised notice under Article 126(9) TFEU if either of the aforementioned conditions (effective action taken and exceptional circumstances apply, or a severe economic downturn exists) are met.

Step 7: *Council assessment of effective action*[18]

The Council assesses whether the Member State has taken effective action based on the submitted report, its implementation, and surveillance mission findings.

- When evaluating if a Member State has taken **effective action** in response to the Council's recommendations made under Article 126(7) TFEU, the Council will base its decision on the report submitted by the Member State as per Article 3(5) of the regulation, the implementation of said report, as well as any other publicly announced and sufficiently detailed decisions by the government of the concerned Member State. Furthermore, the findings of the surveillance mission conducted by the Commission in accordance with Article 10a of the regulation, if carried out, shall also be considered in the Council's assessment.
- In accordance with Article 126(8) TFEU, **if the Council determines that the Member State has not taken effective action**, it shall report this finding to the European Council. Any decision by the Council under Article 126(8) TFEU to make public its recommendations, in cases where it is concluded that no effective action has been taken, shall be made immediately after the expiration of the deadline set in line with Article 3(4) of the regulation.
- **For Member States that are part of the euro area**, if the Council finds that no effective action has been taken, it shall give notice to the participating Member State concerned to take measures for deficit reduction in accordance with Article 126(9) TFEU within two months of the Council decision under Article 126(8) TFEU establishing the lack of effective action. In this notice, the Council shall request that the Member State implements a corrective net expenditure path in accordance with the requirements established in Article 3(4). The Council shall also indicate measures conducive to the achievement of the corrective net expenditure path.

Step 8*: Potential sanctions*[19]

If the excessive deficit persists in a euro area Member State despite the notice given, the Council may impose sanctions, including fines.

- **If an excessive deficit persists in a euro area Member State despite the notice given under Article 126(9) TFEU, the Council may intensify sanctions against that Member State**.

[18] Please refer to Article 4 and 6 of the corrective arm

[19] Please refer to Articles 8, 11 and 12 of the corrective arm

  - Firstly, the Council may impose a fine amounting to up to 0.05% of the latest estimate of the previous year's GDP for a six-month period, and this fine shall be paid every six months until the Council assesses that the Member State concerned has taken effective action in response to the notice issued under Article 126(9) TFEU.
  - Furthermore, in each six-month period following that in which a fine is imposed, until the decision on the existence of an excessive deficit is abrogated, the Council shall assess whether the participating Member State concerned has taken effective action in response to the Council's notice in accordance with Article 126(9) TFEU. In this semi-annual assessment, the Council shall decide, in line with Article 126(11) TFEU, to intensify the sanctions, unless the participating Member State has complied with the Council's notice.

Step 9*: Abrogation of sanctions / Excessive Deficit*[20]

The Council abrogates sanctions and the excessive deficit decision when the deficit is brought below the reference value and projected to remain so, or when the Member State has respected the corrective net expenditure path.

- In accordance with Article 126(12) TFEU, the Council shall **abrogate the sanctions** concerning non-interest-bearing deposits and fines, depending on the significance of the progress made by the participating Member State in correcting the excessive deficit.
- Furthermore, in line with Article 126(12) TFEU, the Council shall abrogate all outstanding sanctions if the decision on the existence of an excessive deficit is itself abrogated. However, it is important to note that any fines imposed in accordance with Article 12 of the regulation will not be reimbursed to the participating Member State concerned.
- Notably, a Council decision shall only be taken pursuant to Article 126(12) TFEU to abrogate the excessive deficit decision where the deficit has been brought below the reference value of 3% of GDP and is projected by the Commission to remain so in the current and following year. Additionally, where the excessive deficit procedure was opened on the basis of the debt criterion, the Member State concerned must have respected the corrective net expenditure path set by the Council in accordance with Article 3(4) or Article 5(1) of the regulation.

[20] Please refer to Articles 8(3), 14 and 15 of the corrective arm

3. The role of the European Parliament[21]

The European Parliament's scrutiny role in the European Semester is exercised through an "Economic Dialogue" at both committee and plenary levels. At the committee level, the Parliament's competent committee invites EU institutions to discuss fiscal plans, assessments, surveillance results as well as relevant actions under the EDP. At the plenary level, the Parliament may invite the presidents of EU institutions to discuss guidance, conclusions, and surveillance results. The Parliament also receives regular reports from EU institutions and has access to a range of information related to the surveillance process, enhancing transparency and accountability.

- **Committee-level Economic Dialogue:**
    - At the core of the scrutiny of the multilateral surveillance outcomes, the EP's competent committee may invite the Commission, the Council and, where appropriate, the President of the European Council or the Euro group to discuss 1) Medium-term fiscal-structural plans submitted by Member States, 2) the Commission's assessments of the plan as well as any information to be provided to the EP, 3) the DSA and its methodology, once published.

      Under the corrective arm, the EP's competent committee can invite the President of the Council, the Commission and, where appropriate, the President of the European Council or the President of the Eurogroup to appear before the committee to discuss recommendations, notices and decisions related to the Excessive Deficit Procedures
    - At least on a biannual basis, the EP's competent committee may invite the Commission to provide information on the results of multilateral surveillance.

      The preventive arm retains the power for the EP's competent committee to invite a Member State to an exchange of views once it is subject to a Council's recommendation due to its economic policies being not consistent with the broad guidelines issued or could jeopardise the functioning of the EMU. A Member State subject to a recommendation, notice or decision related to an EDP may also be invited to an exchange of views under the corrective arm.
- **Plenary-level Economic Dialogue:** The EP may also invite the Presidents of the EU institutions (Commission, Council and, where appropriate, European Council and Euro group) to discuss the guidance issued to Member States, the conclusions of the European Council as well as results of multilateral surveillance. This high-level nature of this Dialogue complements the already existing scrutiny powers entrusted at committee-level providing a new platform to Members to scrutinise the application of the framework.
- **Reporting requirements:**
    - Both the **President of the Council and the Commission shall regularly inform the EP** on the results of the surveillance, with an explicit requirement to further outline such results in their reports to the EP.
    - **The President of the Euro group is also subject to an obligation to report on an annual basis** to the European Parliament on euro area developments in the area of multilateral surveillance. This allows to acknowledge the unique nature of the Euro group and underscores the need for enhanced transparency.

[21] Please refer to Articles 3, 10, 24, 27, 28, 29, 30, 35, 36 of the preventive arm and Article 2a of the corrective arm.

- **The European Fiscal Board (EFB) is required to report annually** on its activities to the European Parliament, as well as to the Commission or the Council.
- The **Commission shall report to the EP and Council on the application of the regulation** (preliminary findings by end-2028, regular report to be prepared by end-2030 and every five years thereafter).

- **Transparency:** The Regulation provides a list of minimum information that should be prepared by the Commission, transmitted to the Council and made available without undue delay to the EP. At least eight types of (ex post) information are outlined:
  1. The DSA and related methodology,
  2. The medium-term fiscal-structural plans transmitted by the Member States, including the reference trajectories and net expenditure paths,
  3. Member States' annual progress reports,
  4. Commission's assessment and recommendations (i.e. endorsement of plans and extensions, recommendations on reforms and investments to correct imbalances as part of MIP, revisions, non-compliance by the Member States),
  5. Relevant economic and social development analysis published as part of the Semester,
  6. Revised medium-term fiscal-structural plans submitted by Member States,
  7. Commission's warnings that a Member States' economic policies might not consistent with the broad guidelines issued or could jeopardise the functioning of the EMU,
  8. Commission's analysis that the triggering of escape clause should not endanger medium-term fiscal sustainability.
- **Role in the appointment procedure of the EFB:** The Commission shall selects the Chair and the Members of the EFB only after consulting the EP (and the Council).

Box 3: The role of independent fiscal institutions (IFIs)

- The text foresees that Member States may request their national IFI to provide two different opinions in the multilateral surveillance cycle on:
- The macroeconomic forecasts and assumptions underlying the net expenditure path, both for the submission of a new plan and in the case of revision. In case of failure to provide this opinion, it should not prevent a Member State from submitting its plan. After 8 years, it would be mandatory for IFIs to provide such opinion, provided that they have built up sufficient capacity in the meantime. The compliance of the budgetary outturn data in annual progress reports with the net expenditure path and the factors underlying a deviation from the net expenditure path.

Box 4: Establishment of an independent European Fiscal Board (EFB)

Previously set up only by means of a Commission Decision, the **advisory role of the EFB to the Commission and the Council is now codified in the preventive regulation**. It shall be composed by a Chair and four Members appointed for a renewable 3-year term by the Commission upon consultation of the Council and the European Parliament, based on their track record and expertise in the analysis of public finances and in macroeconomics.

Full independence is recognised. The EFB shall not seek nor take instructions from Member States, EU institutions/bodies nor any other public/private body. It is also specified that it should be impartial and act in the interest of the Union. The EFB shall also establish its own rules of procedure and report on annual basis to the Commission, Council and the EP. Transparency is ensured by mandating that all its reports and advice should be made public.

The text provides for the **key competences of the EFB**:

- ex post evaluation of the implementation of the framework,
- advice on euro area's fiscal stance as well as on national fiscal stance consistently with the SGP's rules,
- advice on implementation of the SGP and extension of general escape clause provided that it has been requested by the Commission or Council and on the extension of general escape clause,
- cooperation with IFIs to exchange best practices,
- provision of suggestions on the future evolution of the fiscal framework.

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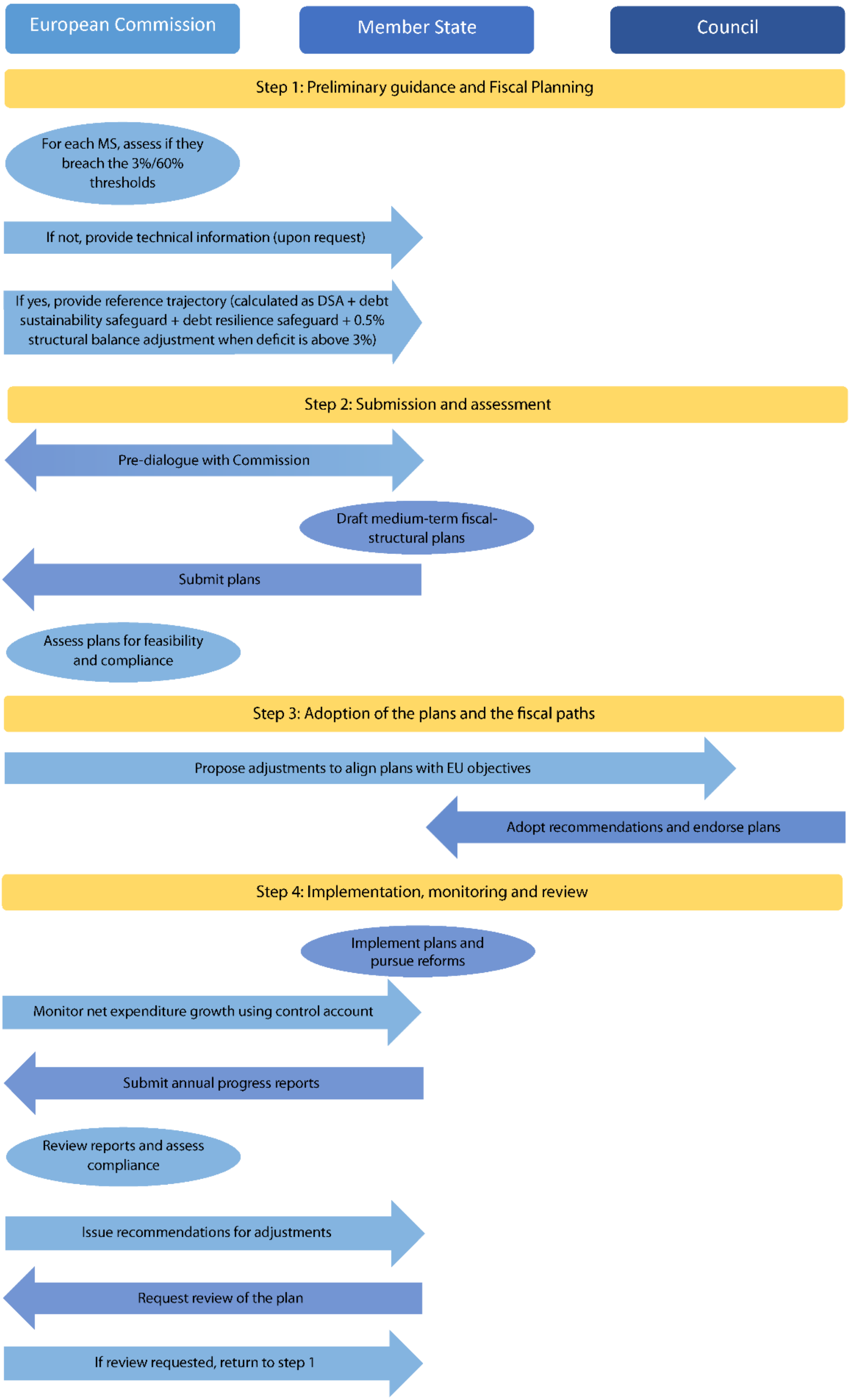
This document is available on the internet at: www.europarl.europa.eu/supporting-analyses

ANNEX 1: Steps in the preventive arm of the SGP



ANNEX 2: Steps in the corrective arm of the SGP