The reformed fiscal framework of the European Union

Fostering fiscal sustainability

European Commission – Directorate General for Economic and Financial Affairs – Fiscal policy and surveillance

June 12, 2024

Outline

1. Objectives
2. Setting the requirement
3. Single operational indicator
4. Monitoring and enforcement

1. Objectives

The main objectives of the reformed framework are to promote

- ***sound and sustainable public finances***, ***sustainable and***
- ***inclusive growth and resilience*** through reforms and investments and
- ***prevent the occurrence of excessive government deficits***.

From a governance standpoint, the reform promotes ***national ownership*** within a solid framework.

2. Setting the requirements

1. **Medium term and risk-based approach**, with fiscal requirements **differentiated by country**, reflecting macro-fiscal situations, but based on a **common DSA framework;**

2. Basis for fiscal surveillance: **medium-term fiscal-structural plans** prepared by Member States;

3. Net expenditure path needs to **ensure that debt converges to / remains at prudent levels**, applying the Commission DSA methodology;

4. Possibility to **extend the adjustment period**, provided that the extension is underpinned by **investment and reforms;**

5. **Common numerical safeguards** to ensure minimum annual reduction in debt and deficits ex ante;

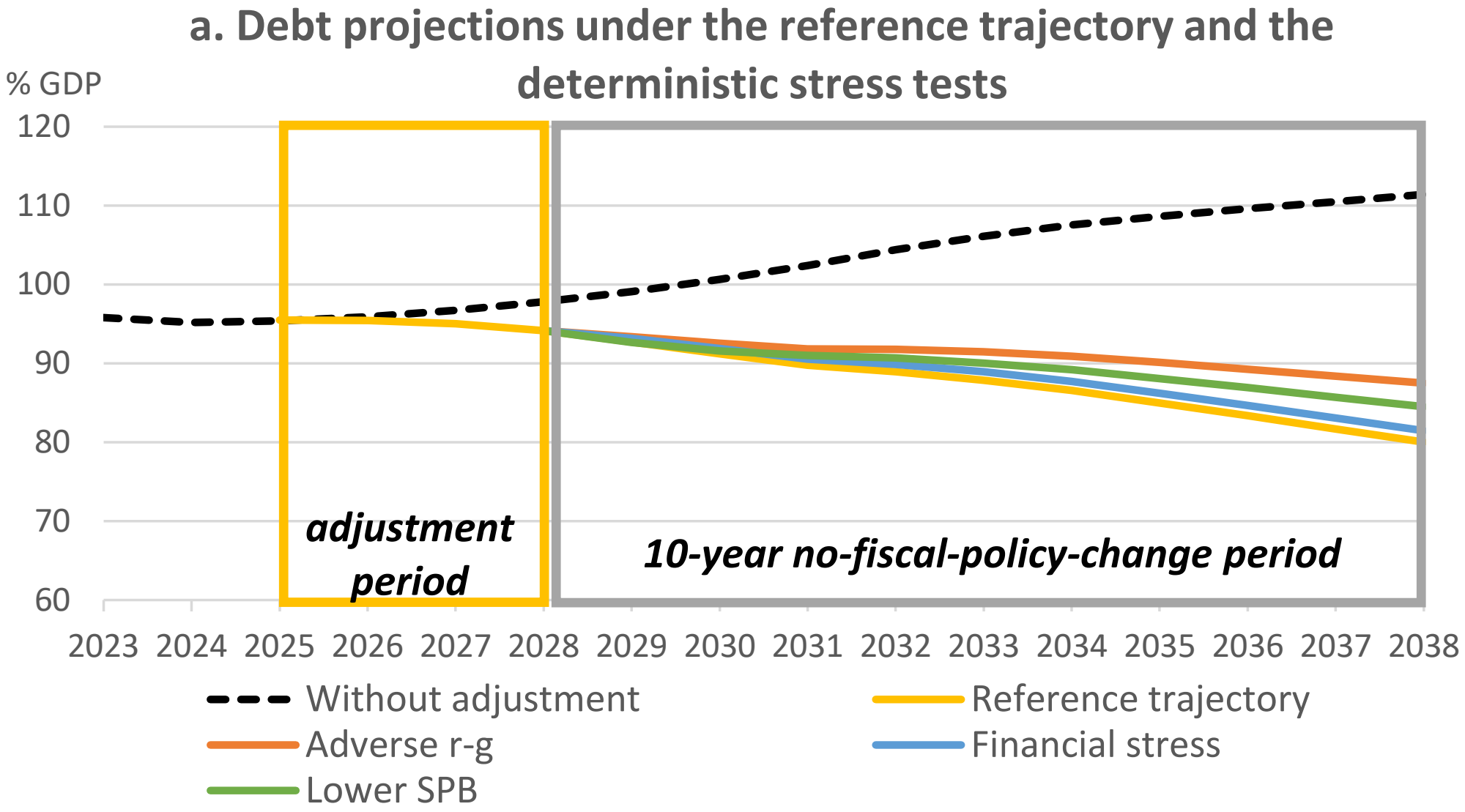
2. Setting the requirements: Fiscal guidance

Technical guidance for Member States' first plans:

- **"Reference trajectories"** for Member States with debt > 60% of GDP or deficit > 3% of GDP:
  - **Risk-based (DSA) requirements** to be met by the end of a 4- to 7-year adjustment period (~COM proposal) :
    - **Debt is put or remains on a plausibly downward path**, or stays below 60% of GDP, over the 10 years following the adjustment period, incl. under adverse stress tests and with sufficient probability, in the absence of further budgetary measures.
    - **Deficit is brought or kept below 3% of GDP** and maintained below over the 10 years following the adjustment period, in the absence of further budgetary measures.
  - **Adjustment effort is linear** as a rule over the planning period, and at least proportional to the total effort.
  - **Consistency with the corrective arm** ("deficit benchmark").
  - **Debt sustainability safeguard**: debt to decrease by a minimum average pace of 1 pp. of GDP/year (when debt > 90% of GDP) or 0.5pp. of GDP/year (when debt > 60% of GDP) over the adjustment period (starting year 1 or after EDP abrogation).
  - **Deficit resilience safeguard**: common margin of 1.5% of GDP relative to the 3% of GDP deficit reference value.

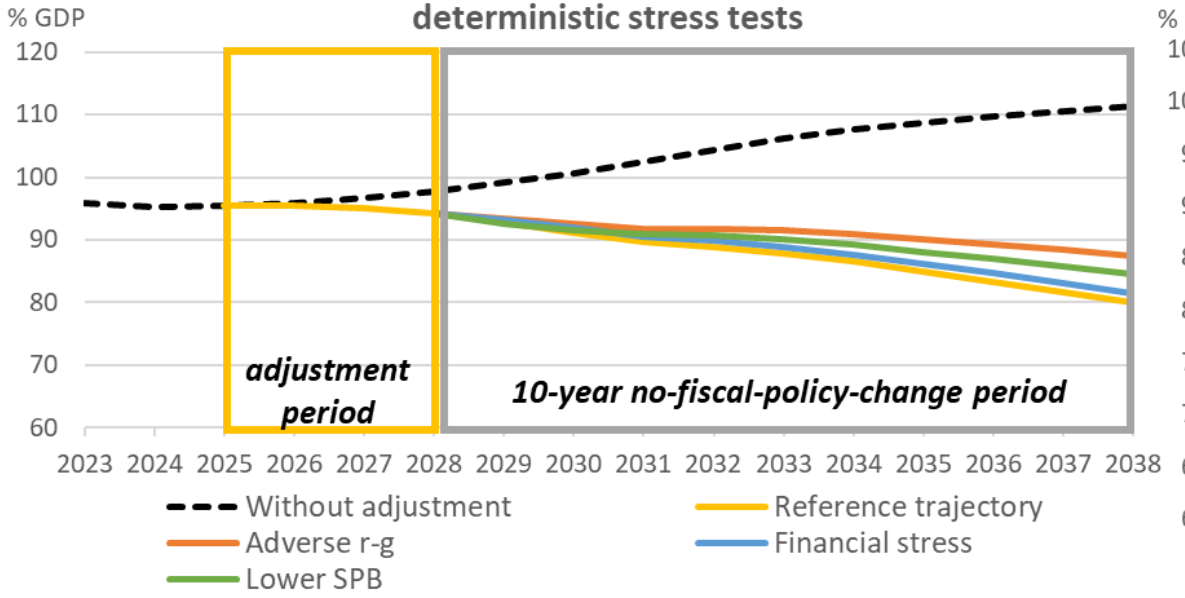
- **"Technical information"** at the request of Member State with debt < 60% and deficit < 3% of GDP: SPB level necessary to keep debt and deficit below reference values over the medium term [in absence of further budgetary measures beyond the adjustment period].

2. Setting the requirements: Illustrative example (DSA)

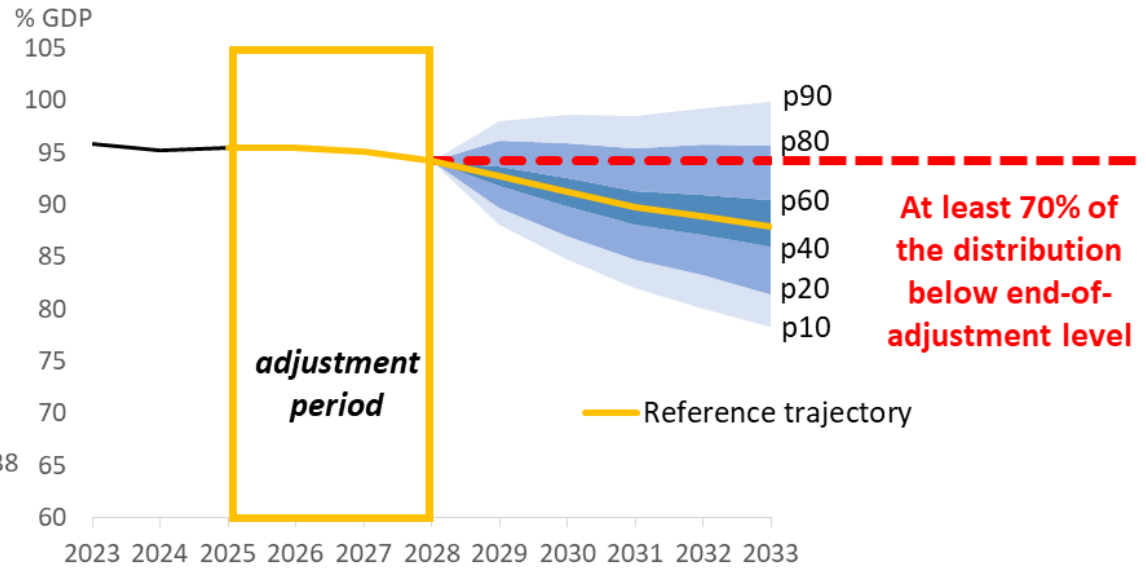


2. Setting the requirements: Illustrative example

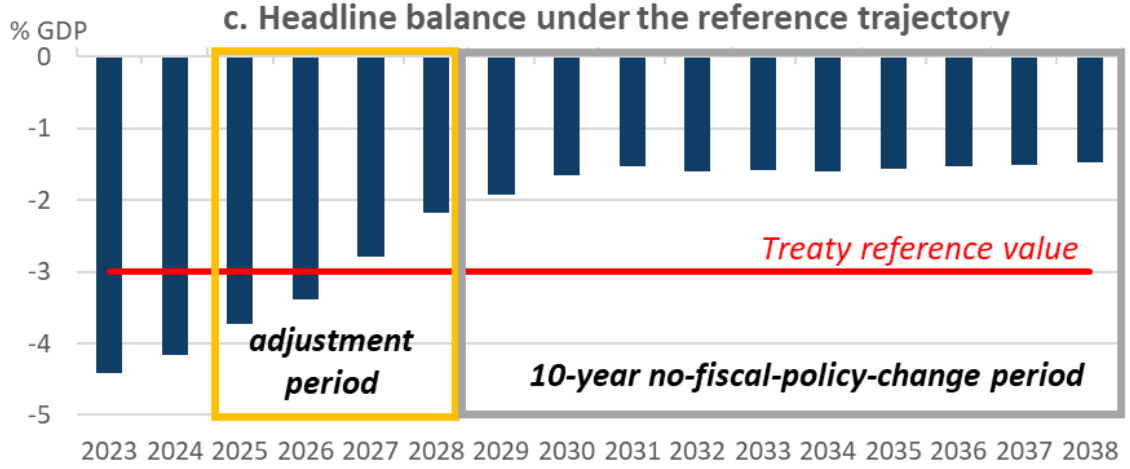
a. Debt projections under the reference trajectory and the deterministic stress tests



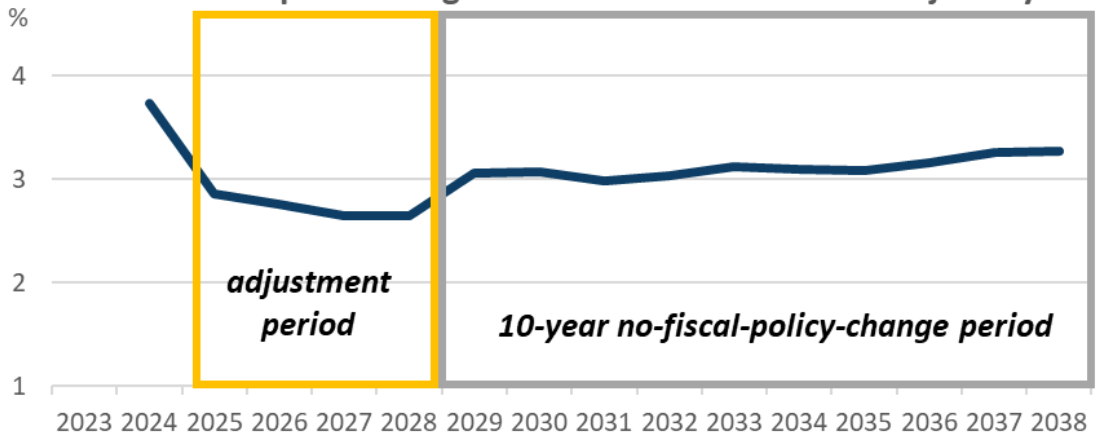
b. Stochastic debt projections around the reference trajectory



c. Headline balance under the reference trajectory



d. Net expenditure growth under the reference trajectory



2. Setting the requirements: Extension of the adjustment

The set of reforms and investments underpinning extension of the adjustment period should fulfil the following criteria "as a rule":

- Be growth- and resilience-enhancing;
- Support fiscal sustainability;
- Address common EU priorities (green and digital transition, social and economic resilience and the implementation of the European Pillar of Social Rights, energy security, build-up of defence capabilities where applicable);
- Address relevant country-specific recommendations, including under the macro-economic imbalances procedure if applicable;
- Ensure that the overall level of nationally financed public investment over the lifetime of the plan is not lower than the medium-term level before the period of the plan.

3: Single operational indicator

Net expenditure path

- To be set out in growth rates of nominal net expenditure
- Will be the single fiscal indicator for monitoring
- Counter-cyclical properties

Net expenditure aggregate:

$$NE_t = G_t - I_t - U_t - EU\ funds_t - Cof.nat.exp._t - one\ offs_t^G - DRM_t$$

Where:

- G_t is general government total expenditure;
- I_t is interest expenditure
- U_t is the cost of (cyclical) unemployment benefits;
- $EU\ funds_t$ is expenditure (or lower revenue) financed by the EU budget (RRF and other funds) fully matched by Union funds revenue
- $Cof.nat.exp._t$ is national expenditure on co-financing of programmes funded by the Union
- $one\ offs_t^G$ are one-offs on the expenditure side
- DRM_t are discretionary revenue measures net of one-offs

4. Monitoring: Annual progress report and control account

Each year, Member States need to **report on implementation** of their plan by 30 April

- Implementation of the net expenditure path
- Implementation of reforms and investments under the European Semester
- Implementation of the set of reforms and investments underpinning an extension of the adjustment period
- Member States may request national IFI to assess compliance of outturns with the plan and to analyse factors underlying a possible deviation

Commission sets up a **control account** to keep track of deviations from the endorsed net expenditure path

- Recording both positive and negative deviations, in annual and cumulative terms
- Based on outturn data
- Numerical thresholds for deviations from the net expenditure path to trigger a Commission Article 126(3) report and possible opening of debt-based EDP
- No recording when escape clause is active

4. Monitoring: Enforcement

- **Deviation from the net expenditure path may lead to opening of debt-based EDP** for MSs with debt-to-GDP ratios above 60%;
  - > 0.3 percentage points of GDP annually
  - > 0.6 percentage points of GDP cumulatively
  - Unless budgetary position close to balance (general government deficit < 0.5% of GDP) or in surplus
- **Deficit-based EDP** for breaches of 3% of GDP reference value largely unchanged
- Balanced assessment of relevant factors, with **substantial public debt challenges** a key aggravating factor

Thank you

European Commission

Background