EUROPEAN
COMMISSION

Brussels, 5.2.2020
COM(2020) 55 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Economic governance review

Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and on the suitability of Council Directive 2011/85/EU

{SWD(2020) 210 final} - {SWD(2020) 211 final}

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[1] Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area, OJ L 306, 23.11.2011, p. 1; Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, OJ L 306, 23.11.2011, p. 8; Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ L 306, 23.11.2011, p. 12; Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, OJ L 306, 23.11.2011, p. 25; Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ L 306, 23.11.2011, p. 33; Directive 2011/85/EU of the Council of 8 November 2011 on the requirements for budgetary frameworks of the Member States, OJ L 306, 23.11.2011, p. 41; Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ L 140, 27.5.2013, p. 1; Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, OJ L 140, 27.5.2013, p. 11.

1. Introduction

The euro is the single currency of over 340 million Europeans in 19 Member States and is one of Europe's most significant and tangible achievements. The euro is more than a monetary project. It provides a basis for our economies to become more integrated with a view to supporting greater stability and prosperity.

The architecture of the Economic and Monetary Union, established by the Maastricht Treaty in 1992, is unique. It combines a single monetary policy that pursues the objective of price stability with decentralised fiscal and economic policies under the responsibility of Member States. The Maastricht Treaty recognised the need for sound fiscal policies and coordination of economic policies to allow for an effective conduct of the single monetary policy and to ensure a stable and successful euro in face of potential risks of spillovers among Member States and possible free-riding behaviour leading to excessive government deficits and debt levels. This, in turn, would threaten price stability and might ultimately force the central bank to use monetary policy to finance budget deficits.

In light of those considerations, the Treaty requires Member States to regard their economic policies as a matter of common concern and to coordinate them within the Council. It also established a requirement for Member States to avoid government deficits exceeding 3 % of GDP and to keep public debt levels below 60 % of GDP. In addition, it establishes elements to maintain market discipline, notably the no-bailout-principle according to which governments should not repay each other's debt, and it prohibits monetary financing of government debt by the central bank. This architecture was influenced by the experiences of high inflation in the 1970s and 1980s, and a strong conviction amongst policy makers that economic and financial integration would be a powerful force of convergence and stabilisation within the monetary union.

Since the early 1990s, when the Maastricht Treaty laid the foundations of the single currency area, the Union has developed a very comprehensive and detailed framework for economic and fiscal surveillance. The framework is laid down in a range of secondary legislation described below, as well as in other documents that provide more details and transparency on how surveillance is carried out in practice. The latter include the Code of Conduct of the Stability and Growth Pact and the Code of Conduct of the Two-Pack. Further details on the implementation of surveillance framework are provided in the Vade Mecum on the Stability and Growth Pact and the Compendium on the Macroeconomic Imbalance Procedure.

The framework has evolved in waves over time, with changes introduced in response to the emergence of new economic challenges, as well as based on the lessons gained in the implementation of the surveillance framework. In brief:

- In 1997, the Stability and Growth Pact (SGP) was established so as to strengthen the monitoring and coordination of national fiscal and economic policies to permanently enforce the deficit and debt limits established by the Maastricht Treaty for all Member States.[2] Notably, it operationalised the deficit criterion of the Maastricht Treaty via the

[2] Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and the Resolution of 17 June 1997 on the Stability and Growth Pact.

corrective arm[3] of the SGP and it established a preventive arm[4] to avoid the build-up of excessive deficits.

- In the early 2000s, adherence to the nominal deficit targets of the SGP proved difficult for some Member States in a recessionary environment. In the light of those early experiences, the SGP was reformed to allow for greater consideration of economic conditions. The reform of 2005 therefore placed greater emphasis on the structural fiscal effort, with the aim to account for the impact of the economic cycle on government finances. In general, the SGP was amended to allow for a better consideration of the country-specific economic and budgetary position and sustainability risks of Member States, including the impact of population ageing.
- In response to the vulnerabilities exposed by the economic and financial crisis that hit the EU and the euro area after 2007, the EU took a series of measures to strengthen its economic governance and surveillance framework. They are relevant for all Member States, but have a number of specific features for those that use the euro. Central to those efforts have been the legislative packages known as the six-pack (2011) and two-pack (2013) (see Box 1 for an overview of the elements of the six-pack and two-pack reforms). These packages aimed at a closer coordination of economic policy and sustained convergence in economic performance by strengthening budgetary surveillance under the SGP, and by requiring Member States to establish national fiscal frameworks. They also broadened the scope of surveillance to include macroeconomic imbalances. To address the specific relevance of spillovers in the euro-area, the two-pack introduced rules on the monitoring and assessment of euro-area Member States' budgetary plans, specific reinforcements for euro-area Member States under the corrective arm of the SGP and a framework for dealing with euro-area Member States experiencing, or threatened with, financial stability difficulties. Those reinforcements were introduced at a time when market confidence and trust among Member States was fragile, and therefore focused essentially on risk reduction in individual Member States and on safeguarding the stability of the euro area as a whole. The two packages were part of a wider set of steps to strengthen the economic and financial stability of the Union and the euro area as a whole, including the establishment of mechanisms to provide conditional financial support to euro-area Member States experiencing, or threatened with, financial stability issues, and the creation of a Banking Union with common supervisory and resolution mechanisms.
- The revamped macroeconomic and budgetary surveillance were integrated into the European Semester, a common timeline for the coordination of economic and employment policies at EU level, and which was established in the same context. Since its introduction in 2011, the European Semester has moved progressively towards more integrated economic surveillance, including the monitoring of Member States' efforts under the Europe 2020 strategy.

[3] The corrective arm of the SGP ensures that Member States adopt appropriate policy responses to correct excessive deficits or debt levels by implementing the Excessive Deficit Procedure, which provides Member States with binding and operational recommendations on the fiscal adjustment needed to correct the excessive deficit situation within a given timeframe.

[4] The preventive arm of the SGP supports Member States in achieving their commitments on sound fiscal policies. It requires that Member States attain a country-specific budgetary objective over the medium-term, which takes into account the economic cycle, thus allowing for automatic stabilisation while it is conducive to sustainable public finances.

Box 1: The six-pack and two-pack reforms of the economic surveillance framework

The six-pack reform (2011)

The six-pack reform comprised five Regulations and one Directive, which strengthened fiscal surveillance and broadened the scope of economic surveillance to include macroeconomic imbalances.[5] In particular, the six-pack strengthened fiscal surveillance by reinforcing the *preventive arm* of the SGP, as running sound fiscal policies in good economic times strengthens the capacity of Member States to withstand economic shocks, and create the space to use fiscal policy in bad times. To that end, it introduced the concept of a *significant deviation* from the medium-term budgetary objective or from the adjustment path towards it and it established a procedure for Member States to correct such a deviation. For euro-area Member States, an insufficient policy response could eventually lead to the imposition of financial sanctions. To better monitor how Member States implement their budgetary commitments, an *expenditure benchmark* was introduced as a complement to the structural balance. The expenditure benchmark provides more operational guidance to Member States in the conduct of prudent fiscal policies, by focussing surveillance on indicators directly under the control of the government.

The six-pack reform also strengthened the *corrective arm* of the SGP by operationalising the Treaty's *debt criterion*[6]*, thus widening the focus from avoiding excessive deficits to ensuring sustainable debt trajectories.*

In addition, the six-pack intensified the possible sanctions when euro-area Member States fail to comply with the Council recommendations and decisions under the SGP.

The Directive on budgetary frameworks introduced requirements for Member States relative to their national fiscal frameworks. It fostered a stronger emphasis on medium-term planning and transparent budgetary processes. It also promoted the use of unbiased macroeconomic and budgetary forecasts for fiscal plans and independent monitoring of compliance with fiscal rules at the national level.

In addition to strengthening fiscal surveillance, the six-pack reform introduced the Macroeconomic Imbalance Procedure (MIP) to detect harmful macroeconomic imbalances, prevent their emergence and ensure the correction of existing imbalances. The Commission identifies *macroeconomic imbalances* and their severity, including the existence or risk of negative spillovers to other euro-area Member States, and the Council addresses recommendations to the Member States concerned to address them. In case *excessive macroeconomic imbalances* are identified, the MIP allows for the launch of an Excessive Imbalance Procedure (EIP), which focuses on corrective action plans put forward and implemented by Member States and monitored by the Commission and the Council.

The two-pack reform (2013)

The two Regulations of the two-pack reform introduced dedicated surveillance and monitoring procedures for euro-area Member States given potential spillovers within the Economic and Monetary Union.

In particular, the two-pack established a framework for dealing with Member States experiencing or threatened by financial stability difficulties, receiving financial assistance, or exiting a financial assistance programme. Crucially, the two-pack also further strengthened

[5] Cf. footnote 1.

[6] The debt criterion refers to the Treaty provisions that require Member States to achieve a debt-to-GDP ratio of below 60%, unless the ratio is sufficiently diminishing towards that level at a satisfactory pace.

budgetary coordination among euro-area Member States through a multilateral assessment of Member States' budgetary plans that follows a common timeline. It includes Commission Opinions on those plans before their adoption by national parliaments and a discussion of the budgetary situation and prospects in each Member State, as well as for the euro area as a whole in the Eurogroup. The two-pack also reinforced surveillance for euro-area Member States with an excessive deficit.

The start of a new political cycle in the Union is an opportune and appropriate moment to assess the effectiveness of the current framework for economic and fiscal surveillance, especially the six-pack and two-pack reforms, for which the Commission is required to report on their application. The main questions addressed in this review are the extent to which the different surveillance elements, as introduced or amended by the six-pack and two-pack reforms, have been effective in achieving their key objectives, namely (i) ensuring sustainable government finances and growth, as well as avoiding macroeconomic imbalances, (ii) providing an integrated surveillance framework that enables closer coordination of economic policies in particular in the euro area, and (iii) promoting the convergence of economic performances among Member States. The purpose of this Communication is to start a public debate on those questions.

In approaching the review, it is important to note that the economic context has materially evolved. 10 years after the Great Recession, Member States face a combination of challenges which are different compared to when the six-pack and two-pack reforms were adopted. While the recovery since then has been historically long, the growth potential of many Member States has not recovered to pre-crisis levels and interest rates have remained persistently low.[7] The decline in potential growth and interest rates, in a context of ageing population, has gone hand in hand with persistently low inflation. While implementation of structural reforms to strengthen potential growth and support economic adjustment was strong in the aftermath of the crisis, reform momentum has faded and progress has become uneven across Member States and policy areas.

This must be seen against the broader aim spelled out in the Annual Sustainable Growth Strategy[8] to generate a new growth model that will respect limitations of our natural resources and ensure job creation and lasting prosperity for the future. Concretely, this objective has been translated in the European Green Deal[9] and the Communication on a Strong Social Europe for Just Transitions[10], which outline a sustainable growth strategy that aims to make the EU the world's first climate-neutral continent, resource efficient and fit for the digital age, while ensuring social fairness. Achieving such goals will require significant additional private and public investment over a sustained period of time. Those ambitions are in line with Europe's commitment to put the Sustainable Development Goals at the heart of EU's policy-making and action.

The implications of prevailing economic conditions for the economic governance framework deserve careful reflection. First, it needs to be carefully assessed whether those developments have implications for debt sustainability risks. As some recent experiences show, market sentiments can change abruptly and may lead to sudden shifts in interest rates. Even in the

[7] Moreover, the employment and social situation has improved across the board but has not recovered yet to the pre-crisis levels in several Member States.
[8] Cf. Annual Sustainable Growth Strategy 2020; COM(2019) 650 final.
[9] COM(2019) 640 final.
[10] COM(2020) 14 final.

absence of changes in fundamentals, this could increase the fiscal burden, particularly for high-debt countries and endanger the sustainability of their debt. That risk is possibly more acute in a monetary union, where governments with very different debt levels share the same currency and the central bank cannot act as a lender of last resort to governments. This confirms the need for a continued focus on ensuring debt sustainability. At the same time, because monetary policy is increasingly constrained by the effective lower bound on interest rates, the appropriate role of fiscal and economic policy in macroeconomic stabilisation should be assessed. Moreover, national fiscal policies also affect the functioning of financial markets and interact with monetary policies, particularly given the role of national sovereign bonds as benchmark safe assets and the potential impact in case of a relative scarcity of safe assets. Finally, the consequences of climate-related risks on financial markets stability and public finances are gaining more relevance within the EU surveillance processes.

The review takes account of those new challenges. It draws on the assessment of the EU fiscal rules by the European Fiscal Board[11] (EFB), as well as the existing reports by the European Parliament[12], Member States, the European Court of Auditors[13], and other stakeholders and academia.

2. Assessment of the application of the six-pack and two-pack legislation

2.1 The Stability and Growth Pact and national fiscal frameworks

This subsection assesses the fiscal surveillance framework against key objectives, namely to help ensure sustainable public finances, to provide room for economic stabilisation, to recognise the importance of the quality of public finances, and to foster ownership of the EU fiscal rules. Finally, it assesses Directive 2011/85 with regard to its impact on national fiscal frameworks.

Sustainability of public finances

In its initial design of 1997, with the 3%-of-GDP deficit threshold as the central anchor, the SGP focused on the prevention of spillovers from excessively high deficits, which could undermine price stability in the Economic and Monetary Union and affect the effectiveness of monetary policy.

With the advent of the economic and financial crisis, the focus of fiscal surveillance shifted to risks arising from unsustainable levels of public debt, and to possible debt crises, which could threaten the financial stability of the euro area as a whole. In a context of heightened market pressure and rapidly rising debt levels, there was a need to decisively strengthen safeguards for debt sustainability. It was in that context that the six-pack and two-pack legislations were designed.

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[11] European Fiscal Board, Assessment of the EU fiscal rules with a focus on the six-pack and two-pack legislation, August 2019.

[12] European Parliament resolution of 24 June 2015 on the review of the economic governance framework: stocktaking and challenges, OJ C 407, 4.11.2016, p. 86.

[13] European Court of Auditors, Is the main objective of the preventive arm of the Stability and Growth Pact delivered?, Special report No 18/2018; Further improvements needed to ensure effective implementation of the excessive deficit procedure, Special report No 10/2016; EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application, Special Report No 22/2019; Audit of the Macroeconomic Imbalance Procedure (MIP), Special report No 03/2018.

The reformed SGP encouraged Member States to return to sound budgetary positions by reducing their deficits and putting debt ratios on a downward path. In particular, the Excessive Deficit Procedure has proven itself an effective tool to correct high deficits: All Member States that entered the Excessive Deficit Procedure during the economic and financial crisis have effectively corrected their high deficits. Whereas all but three Member States registered excessive deficits in 2010, in the aftermath of the economic and financial crisis (with the headline deficit at the aggregate EU level exceeding 6% of GDP in 2009-2010 due to the depth of the recession and bank recapitalisation needs in some Member States), all Member States respected the 3% of GDP deficit criterion in 2018[14]. 16 Member States have also reached, or are close to, their medium-term budgetary objectives, thus providing them with appropriate fiscal buffers and fiscal space to invest.

However, in recent years, the correction of excessive deficits and the subsequent adjustment towards the medium-term budgetary objectives has been driven more by favourable macroeconomic conditions, revenue windfalls and lower interest rates, than by durable fiscal adjustments. The Significant Deviation Procedure, which aims to prevent excessive deficits by giving Member States the opportunity to correct deviations from their medium-term budgetary objectives, or the adjustment path towards it, showed limited effectiveness in the case of non-euro area Member States.[15]

After having risen to almost 90% between 2009 and 2014, the debt-to-GDP ratios of the EU and the euro area began to decline in 2015, on the back of lower primary deficits/higher surpluses, higher economic growth and historically low interest rates on public debt. Overall, the Commission forecasts the debt-to-GDP ratio to continue its declining path of recent years and to fall to around 79% in 2020, a level far below that of the US or Japan (around 114% and 237%, respectively). However, debt dynamics across Member States have been quite divergent since the economic and financial crisis. This reflects large differences in the pace of fiscal consolidation and economic growth, as well as in country-specific fiscal costs related to support measures for the banking sector. Public debt levels are now (again) below 60% of GDP in around half of the Member States, but remain around or (well) above 100% of GDP in some others, accounting for a large share of euro area GDP.

Some Member States' debt ratios have in fact continued to rise or, at best, have stabilised. This has increased divergences between debt levels in the EU. Some highly indebted Member States still have deficits that do not provide a sufficient safety margin towards the 3%-of-GDP reference value, despite favourable economic conditions. They also remain far from their medium-term budgetary objectives.

Those observations underline the importance of an effective preventive arm and the timely and effective implementation of fiscal policy recommendations by all Member States. They also suggest that the enforcement of the fiscal rules did not make a material difference in cases where the enforcement of fiscal discipline was most necessary. Enforcing the debt reduction benchmark during periods of weak real growth and very low inflation has proven politically and economically difficult. In some highly indebted countries, the debt reduction

[14] The only exception is Cyprus, where the general government temporarily recorded a deficit of 4.4% of GDP in 2018 due to one-off support measures related to the Cyprus Cooperative Bank sale. In 2019, the budget balance is expected to have returned to a comfortable surplus of close to 4% of GDP.

[15] So far, the Significant Deviation Procedure has been launched for two non-euro area Member States: Romania in 2017 and Hungary in 2018. They both failed to take effective action to correct the significant deviation and, consequentially, have been subject to repeated procedures since then, which calls into question the effectiveness of the Significant Deviation Procedure for non-euro-area Member States, given the rules do not allow for sanctions in case of non-compliance by them.

benchmark required particularly high fiscal efforts that could actually have aggravated debt dynamics. Therefore, the Commission's assessment of compliance with the debt criterion and the subsequent Opinions issued by the Economic and Financial Committee appropriately took into account all relevant factors, in line with the provisions of the six-pack, including low inflation and weak growth, and in particular compliance with the requirements of the preventive arm.

Economic stabilisation at the level of individual Member States and the euro area

The legislation contained in the six-pack and two-pack reforms recognises the role of macroeconomic stabilisation, in particular the importance of avoiding pro-cyclical policy. It aims to ensure that Member States adjust their fiscal policies during economic good times in order to build fiscal buffers, so that they have sufficient fiscal space to allow automatic stabilisers to play and to provide fiscal support during downturns. Strengthened fiscal coordination also gave more prominence to the aggregate fiscal stance of the euro area as a whole. Subsequent interpretation and implementation of that legislation by the Commission and the Council[16] gradually reinforced elements of short-term stabilisation of economic activity.

Specifically, the design of the preventive arm of the SGP allows Member States to address sustainability and stabilisation needs. Achieving their country-specific medium-term budgetary objective provides Member States with the scope to use fiscal policy for the purpose of macroeconomic stabilisation in bad economic times by allowing automatic stabilisers to operate freely or to increase investment. Moreover, the medium-term budgetary objective itself and a Member State's effort to reach its medium-term budgetary objective is set in structural terms, *i.e.* corrected from the influence of the economic cycle. The required structural effort reflects the Member State's position in the economic cycle (*i.e.* higher in good times, lower in bad times) and the level of debt.

Nonetheless, Member States' fiscal policies have remained largely pro-cyclical. Fiscal policy was already pro-cyclical in the mid-2000s, when economic times were particularly good, and remained largely pro-cyclical during the crisis as consolidation took place in a context of heightened market pressure at a moment of very low growth or even contraction in economic activity. While the reformed fiscal framework allowed automatic stabilisers to work, their effect was offset by discretionary consolidation measures needed to correct unsustainable positions in a context of heightened market pressure. This contributed to the weak economic and employment performance in that period, even if it aimed at bringing public finances on a sustainable path and at regaining market confidence. Fiscal consolidation came to a halt as of 2014, at a moment when the output gap in the euro area was still negative. However, the aggregate fiscal stance in the euro area continued to be broadly neutral even though the euro area's output gap had turned positive by 2017. In addition, the distribution of the fiscal stance across Member States was not appropriate in light of specific sustainability and stabilisation needs. Thus, despite the reinforced preventive arm, many Member States did not make use of the more benign economic times to build up counter-cyclical buffers.

[16] The Commission Communication of 13 January 2015 on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact" introduced new, albeit constrained room for discretionary fiscal stabilisation. That Communication resulted in a commonly agreed position by the Economic and Financial Committee (EFC) in November 2015, which was endorsed by the Council (ECOFIN) on 12 February 2016.

Moreover, the SGP is focused on the correction of high public deficit and debt levels. While the SGP has established procedures for the correction of high public deficits in terms of nominal thresholds, it cannot *compel* fiscal policies in support of economic activity.

The two-pack reform established a common budgetary timeline for the euro area, which provides for a check of the budgetary situation and prospects in the euro area on the basis of Member States' budgetary plans and their interactions across the euro area before budgets are adopted in national parliaments. While the legal framework foresees the possibility for the Commission and the Council to outline measures to reinforce the coordination of budgetary and macroeconomic policy at the euro area level, it does not allow the Union institutions to enforce the appropriate fiscal stance for the euro area as a whole. While the European Semester encourages Member States to take account of the recommendation on the economic policy of the euro area[17] in their Stability Programmes and National Reform Programmes, the euro area dimension is still not central to Member States' policies.

In such a context and in the absence of a central fiscal capacity with stabilisation features, the ability to steer the fiscal stance for the euro area as a whole remains constrained. This limits the scope for fiscal policy to contribute to macroeconomic stabilisation at the level of the euro area as a whole in the event of large shocks that are not policy-induced. As a result, in addition to national fiscal and economic policies, the euro area continues to rely mainly on monetary policy for macroeconomic stabilisation, which acquires a particular relevance at times when monetary policy is close to the effective lower bound. The establishment of a fiscal stabilisation capacity for the euro area, which would complement national fiscal policies, would allow monetary policy to become more effective and with fewer side effects.

Quality of public finances, including the development of public investment

The quality of public finances is a complex and multifaceted issue. It concerns the composition of public revenues and expenditures and whether they adequately support sustainable growth and social inclusion. It moreover relates to the efficiency of tax collection and mechanisms to control and prioritise public expenditure. In this context, spending reviews can contribute to improve expenditure allocation. One issue of particular relevance relates to the observation that, during periods of fiscal consolidation, it is often more expedient to cut public investment or increase taxes rather than rationalising other expenditure items. It is important that the fiscal surveillance framework, which is rules-based, pays sufficient attention to those issues[18], including the role of public investment, as a necessary condition for supporting sustainable economic growth and for long-term sustainability.

The essential role of public investment to deliver public goods and to support sustainable public finances is well recognised in the EU's fiscal framework. First, Article 126(3) of the Treaty on the Functioning of the European Union requires the Commission to take into account government investment spending when considering whether a Member State has an excessive deficit. Second, the SGP, both in its title and content recognises the need to consider the overall quality of public finances in terms of the growth-friendliness of the taxation system and public expenditure. Third, the definition of the medium-term budgetary

[17] In autumn of each year, and following an assessment of the European Fiscal Board in June, the Commission adopts a euro area recommendation with guidance on the appropriate fiscal stance for the single currency area as a whole.

[18] In that regard, Article 6(3)(d) of the Regulation No 473/2013 states that "the draft budgetary plan shall contain […] relevant information on the general government expenditure by function, including on education, healthcare and employment, and, where possible, indications on the expected distributional impact of the main expenditure and revenue measures".

objective refers to room for budgetary manoeuvre and in particular the need for public investment.[19] This has led to provisions in the fiscal framework that have sought to protect the level of public investment during downturns and to incentivise the implementation of structural reforms, which contribute to sustainable public finances, including by raising potential growth.

Overall, however, the current fiscal framework did not prevent a decline in the level of public investment during periods of fiscal consolidation, nor did it make public finances more growth-friendly.[20] This primarily reflects deliberate policy choices in the Member States. Indeed, there is no clear evidence that investment was actually hampered by the fiscal rules. Whilst the operationalisation of the investment clause in 2015 and 2016[21] sought to strengthen the growth orientation of the SGP by protecting investment during downturns, it does not appear to have had a substantial positive impact on public investment. In particular, its focus on protecting investments in the specific situation of a deep downturn entailed overall a limited use of this clause.[22] Similarly, the structural reform clause has been applied five times so far[23] and has had a rather limited success in promoting reforms that improve the quality of public finances and/or increase potential growth.

Those findings require careful consideration, not least in light of the substantial additional investments needed to modernise infrastructure, make the EU economy climate-neutral by 2050 and foster the digital transition. As part of that, the Commission will continue to explore with Member States the greater use of green budgeting tools.

Ownership and governance of the EU fiscal rules

The design of the current EU fiscal governance framework is characterised by multiple rules, associated with different indicators for measuring compliance, and contains various clauses allowing for deviations from the requirements, each of them with their own eligibility criteria.

Those multiple rules do not always yield the same conclusion in terms of compliance, thus requiring the use of economic judgement. In addition, the framework relies heavily on variables that are not directly observable and are frequently revised, such as the output gap and the structural balance, which hampers the provision of stable policy guidance. While the higher degree of sophistication of the SGP is meant to make the framework more adaptable to changing economic conditions, it has also increased its complexity and reduced its transparency, especially of the preventive arm. This has hampered ownership, communication and political buy-in. To some extent, these shortcomings have been addressed by the Commission through its stronger focus on the expenditure benchmark, which provides more stable and operational policy guidance, and focuses on budgetary items directly under the control of the government.

[19] Moreover, euro-area Member States that become subject to an EDP must submit an Economic Partnership Programme describing the policy measures and structural reforms needed to ensure an effective and lasting correction of the excessive deficit. The policy priorities in the programme must also be consistent with the Union's strategy for growth and jobs.

[20] Public investment in the EU declined from a peak of 3.7% of GDP in 2009 to 2.7% in 2017, while the share of public investment for environmental protection has remained broadly stable at 5-6% of the total, see Eurostat, general government expenditure by function (COFOG).

[21] Cf. footnote 15.

[22] So far, only Italy and Finland benefited from the investment clause in 2016.

[23] The structural reform clause was applied in the cases of Italy in 2016, Latvia, Lithuania and Finland in 2017, and Belgium in 2019.

As a linked issue, while the emphasis on annual fiscal adjustments and compliance assessments has been strengthened, the focus on medium-term budgetary planning has weakened, with many Member States postponing the achievement of their medium-term budgetary objectives.[24] The strong focus on compliance with annual requirements may also have contributed to an insufficient differentiation between Member States that have markedly different fiscal positions and sustainability risks.

The annual examination of euro-area Member States' draft budgetary plans has allowed the Commission to inform Member States' budgetary processes earlier, but has also highlighted the challenges of making Member States change their plans, at the end of the year and of sparking a genuine discussion on the euro area fiscal stance in the Eurogroup.

National fiscal frameworks

The requirements related to national fiscal frameworks[25] in Directive 2011/85 and Regulation No 473/2013 spurred a broad development and strengthening of rules, procedures and institutions underlying the conduct of budgetary policy in Member States. This has led to significantly enhanced national fiscal frameworks, which has increased national ownership of fiscal discipline and promoted compliance with EU fiscal rules. The progress is most noticeable in Member States that had no, or only rudimentary, domestic frameworks before the crisis. The EU requirements served as a basis for them to construct a modern fiscal framework. All elements of fiscal frameworks have seen rapid development, but most of the progress has concerned national fiscal rules and the establishment of independent fiscal institutions. The number and quality of numerical fiscal rules has increased significantly. They are now a central part of fiscal frameworks in all Member States, supporting fiscal discipline and compliance with EU rules.

Independent fiscal institutions have been established, or reinforced, in virtually all Member States and play an increasingly important role in fiscal discussions at the national and EU level. Independent monitoring of fiscal policy, together with improved fiscal statistics and provisions related to the preparation and the publication of forecasts, have greatly improved the transparency of fiscal policy. National stakeholders generally consider strong national frameworks as an effective and efficient tool to promote compliance with the EU fiscal rules.

At the same time, the design and the effectiveness of national frameworks differ significantly across Member States. This is because (i) the Union law sets only minimum requirements for national frameworks and (ii) actual implementation and compliance with national provisions vary. In addition, with the Fiscal Compact[26] and its structural balanced budget rule, the set of provisions for national frameworks has become rather complex, giving rise to inconsistencies between EU and some national rules. This has encouraged some Member States to arbitrage between national and EU rules.

[24] The role of the stability and convergence programmes in the surveillance framework has declined, which has also contributed to repeated postponement of the achievement of the Member States' medium-term budgetary objectives.

[25] A set of rules and institutions governing fiscal policy at national level.

[26] The Fiscal Compact is part of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), which entered into force on 1 January 2013. The main provision of that intergovernmental Treaty is the requirement to have a balanced budget rule in domestic legal orders (the Fiscal Compact). The objective was to complement the EU rules-based fiscal framework by provisions at the national level in order to better achieve sound budgetary policies in the Contracting Parties The Fiscal Compact binds all euro area Member States and, on a voluntary basis, three non-euro area Member States (Bulgaria, Denmark and Romania).

Box 2: Economic governance in the context of the European Semester of economic policy coordination

Since its inception in 2011 by means of the six-pack legislation, the European Semester has become a well-established framework for economic policy coordination. It aims to provide an integrated approach by blending the various strands of economic policy surveillance—fiscal, structural and financial policies—under a common timeline and framework for the annual surveillance cycle.[27] To that end, key steps in the implementation of the SGP and the MIP are organised within the European Semester, both in terms of timing and, where appropriate, in terms of reporting and surveillance requirements. That alignment helps ensure that Member States benefit from an integrated approach as regards economic policies.

In recent years, the focus of the European Semester has widened to better take into account the euro area dimension, as well as employment and social aspects, notably through the integration of the European Pillar of Social Rights. Dialogue with the European Parliament, national authorities and social partners, has also been enhanced. Consistent with the European Green Deal, the environmental dimension of Member States' economic and employment policies is set to gain significantly more prominence in the European Semester, while it will also become the framework for assessing and coordinating the economic policies needed to achieve the Sustainable Development Goals while remaining focused on key challenges for economic and employment policies.

2.2 The Macroeconomic Imbalance Procedure

Widening the scope of macroeconomic surveillance

The Macroeconomic Imbalance Procedure (MIP) widened the scope of the surveillance framework beyond fiscal policies to cover other potential sources of macroeconomic imbalances that had previously been neglected. This entailed, *inter alia*, a greater focus on macro-structural and macro-financial issues relevant to macroeconomic stability, such as external imbalances, productivity, competitiveness, the housing market and private indebtedness. In addition, public finance developments, notably government debt, are also analysed under the MIP given their relevance to overall macroeconomic stability. In that respect, the MIP has complemented other surveillance instruments and provided the basis for prioritising policies not dealt with by the SGP but which are of relevance for the orderly development of public finance. The analytical basis to detect imbalances has been enhanced, and processes to monitor economic developments and policy action have been put in place. While the scope of MIP surveillance has remained anchored on aspects relevant for macroeconomic stability, it has also been gradually expanded to take into account broader implications relating to adjustment, such as those affecting employment and social developments.

However, the links with other surveillance strands have not always been fully exploited. This concerns the interplay between the MIP and the SGP surveillance to address at the same time macroeconomic imbalances, potential growth challenges and risks to public debt

[27] Regulation No 1175/2011 inserted into Regulation No 1466/97 the legal basis for the European Semester, with the aims of ensuring closer coordination of economic policies and sustained convergence of the economic performance of the Member States and of providing integrated and coherent policy advice on economic and employment policies of Member States.

sustainability. Finally, MIP surveillance so far may not have sufficiently encompassed interactions with new emerging economic challenges, notably relating to climate change and other environmental pressures.

Policy responses and effectiveness in terms of correction of macroeconomic imbalances

The MIP has raised awareness and focussed on policy action, with successful results in some cases, even if the Excessive Imbalances Procedure (EIP) has never been activated. The MIP has helped to deepen the dialogue between the EU institutions and national policy authorities about the ways to address the identified challenges, focusing the policy debate at national level, and strengthening policy-making processes. In a number of cases, the MIP provided the framework to prioritise policies to address macro-structural and macro-financial issues in countries severely threatened by the risk of financial instability. In those cases, MIP surveillance was followed by policy responses subject to close and regular monitoring, and by a reduction in financial market tensions without the need to resort to the more intrusive EIP instrument.

However, the MIP has not generated the political traction necessary to sustain reform ambition in Member States where imbalances persist, including with domestic and foreign debt that remains high. While there is evidence that country-specific recommendations under the MIP were initially associated with stronger follow up, reform implementation has over time become comparable to that of other non MIP-related recommendations under the European Semester. Progress in unwinding imbalances has decelerated in recent years, arguably in light of reduced financial market pressure and a slower pace of reforms.

The MIP has been more successful in reducing current account deficits than it has been in reducing persistent and large current account surpluses. The need for policy action was particularly pressing in Member States showing large current-account deficits and competitiveness losses, given the concerns about the sustainability of their external debt and related solvency risks, which are especially worrying if combined with sustained losses of cost competitiveness and export market shares. In turn, the MIP has not been able to foster adjustment of large and persistent current account surpluses, which economic fundamentals cannot fully explain. Large and sustained current account surpluses, while not creating immediate risks to national economic stability, can affect the smooth functioning of the euro area. Adjusting them would help boost real GDP in the Member States concerned, and would have positive spillovers to the rest of the euro area. Finally, as the MIP was introduced in a context where imbalances and excessive imbalances were already present in many Member States, its effectiveness in preventing the accumulation of new imbalances, vulnerabilities and risks remains to be tested. This requires a timely detection of emerging imbalances to allow for adequate preventive policy action.

Ownership of the Macroeconomic Imbalance Procedure

Given the wide scope of potential imbalances, surveillance under the MIP relies on the use of both quantitative and qualitative analysis and does not lend itself to a mechanistic reading of indicators. The Commission has therefore made use of the discretion granted by Regulation No 1174/2011 and Regulation No 1176/2011 in implementing the framework and the Council has always broadly endorsed Commission views on the existence and severity of imbalances. In 2016, the Commission clarified the criteria for identifying and assessing imbalances, and

streamlined their classification.[28] Since the beginning, the implementation of the preventive part of the MIP has been integrated in the European Semester and its application has evolved in light of acquired experience, the evolution of challenges, and as a result of continuous dialogue with Member States and stakeholders.

Despite progress made for a transparent implementation of the MIP, further efforts could be pursued on the link between the MIP analysis and recommendations and the interplay between the MIP and other surveillance procedures. When Member States have been identified with an excessive imbalance, the Commission has used the possibility foreseen in the MIP framework to put in motion a specific and close monitoring of policy implementation, contributing to peer pressure and promoting reform action in the Member States concerned. However, there was no requirement for the Member State concerned to implement specific policy actions set out in an agreed corrective action plan. Such practice has prompted some calls on the Commission to make full use of the MIP instruments, including recommending that the Council activate the EIP, and to enhance transparency in cases where the EIP is not launched for Member States identified with excessive imbalances.[29]

2.3 Euro-area Member States experiencing, or threatened with, serious difficulties with financial stability

Framework for the design and monitoring of macroeconomic financial assistance programmes

During the first decade of the Economic and Monetary Union, there was no framework to provide support specifically to euro-area Member States experiencing, or threatened with, serious financial stability difficulties. Specific mechanisms to provide financial support were developed over the course of 2010 and in subsequent years[30] leading to the establishment of the European Stability Mechanism (ESM). However, Union legislation providing a surveillance framework and a governance structure for that support was still missing. Regulation No 472/2013 established a framework to organise such support so as to ensure transparency and democratic accountability.

That framework applied to the programmes concerning Ireland and Portugal financed by the EFSF and the EFSM; Spain and Cyprus financed by the ESM, as well as Greece (second and third programmes) which received financial assistance from both the EFSF and the ESM. External and fiscal deficits were largely resolved and the stability of the financial sector preserved or restored. Moreover, structural policies under the programmes helped foster potential growth. All euro-area Member States that received financial assistance have successfully returned to markets at reasonable financing rates and are now subject to post-programme surveillance.

[28] In 2016, the Commission published a compendium which documents the implementation of the MIP in a comprehensive and transparent way; European Commission (2016), The Macroeconomic Imbalance Procedure. Rationale, Process, Application: A Compendium.

[29] The Court of Auditors recommended increased transparency whenever the Commission does not recommend the opening of the EIP (European Court of Auditors (2018), "Audit of the Macroeconomic Imbalance Procedure", Special Report 03.)

[30] Such as the Greek loan facility agreement (GLF), European Financial Stability Facility (EFSF), and the European Financial Stabilisation Mechanism (EFSM).

The provisions for framing macroeconomic adjustment programmes have been respected, in particular regarding: (i) the preparation of the programme and the information to stakeholders on progress made; (ii) ensuring consistency between the Memorandum of Understanding signed with the euro-area Member State and the macroeconomic adjustment programme adopted by the Council; (iii) monitoring progress made in implementing the programme through regular reviews and the involvement of social partners and civil society organisations; (iv) the granting of technical assistance to help with the implementation of programme conditionality. Regulation No 472/2013 also allowed to preserve the financial stability of the euro area as a whole by putting those procedures in place.

Concerning the governance arrangements across the institutions involved in macroeconomic adjustment programmes – the Commission in liaison with the European Central Bank and where appropriate the International Monetary Fund – , the framework provides some flexibility as to how the governance arrangements are implemented in practice with the caveat that any specifically assigned roles should be fully respected. Overall, the governance arrangements have worked well.

Regulation No 472/2013 also helped improve the transparency and accountability of the Commission's actions, in particular through the reinforced dialogue with the European Parliament and national parliaments.[31] In addition, the Regulation interacts with the ESM Treaty. The Commission must ensure that any Memorandum of Understanding signed with a euro-area Member State on behalf of the ESM is consistent with such a macroeconomic adjustment programme and Union law. As regards the relationship between the Commission and the ESM, the practical implementation was specified through a Memorandum of Understanding signed on 27 April 2018 and a joint position agreed between them on 14 November 2018, which serve as a basis for the current revision of the ESM Treaty.

Economic performance and coherence with EU surveillance procedures

Regulation No 472/2013 contributed to a closer coordination of economic policies and a sustained convergence of euro-area Member States by ensuring consistency between the normal surveillance cycle of the European Semester and the strengthened surveillance under that Regulation. The Regulation streamlined processes, with a view to ensuring consistency of economic policy surveillance and to avoiding duplication of reporting obligations. Vulnerabilities and imbalances identified under the standard surveillance procedures (SGP and MIP) were explicitly addressed in the macroeconomic adjustment programmes. Any outstanding adjustment after the end of the programme was taken over by the country-specific recommendations in the normal surveillance cycle and the post-programme surveillance. The strengthened surveillance put in place by the Regulation thus contributed to reducing the temporary divergence of the Member States concerned from other euro-area Member States and laid the ground for renewed convergence.

The provisions for post-programme surveillance have been fully implemented by the Commission. With regard to the effectiveness of enhanced surveillance, the respective requirements apply to Greece as of August 2018 (the end of a financial assistance programme). An initial assessment based on the limited experience with the specific provisions is positive. However, while enhanced surveillance was initially conceived as a pre-

[31] This was confirmed by the European Court of Auditors' performance audit, see Special report No 17/2017: The Commission's intervention in the Greek financial crisis.

emptive framework to help Member States at risk of requiring financial assistance, to date it has not been activated for such a purpose.

At the same time, it is important to retain adequate national ownership of the programmes, particularly at the time of programme exit or programme discontinuation. Issues of transparency and accountability also persist, including in view of the fact that the ESM remains to date an intergovernmental body.

2.4. Overall findings

This review reveals strengths as well as possible areas for improvement. It confirms that the six-pack and two-pack reform, together with the roll out of the European Semester, have strengthened the framework for economic surveillance in the EU and euro area and guided Member States in achieving their economic and fiscal policy objectives. They have also led to a broader and more integrated approach to surveillance that better assures the overall consistency of policy advice within the European Semester (see Box 2). The establishment of a common budgetary timeline and the policy guidance issued on the basis of Member States' draft budgetary plans has led to closer coordination within the euro area. The measures introduced by the six-pack and two-pack reforms thus have contributed to ensuring closer coordination of economic policies.

The implementation of the recommended policies by Member States has contributed, among other factors, to the gradual strengthening of EU economies and strong job creation recorded in recent years. Furthermore, by supporting the correction of existing macroeconomic imbalances, the prevention of the build-up of new imbalances and the reduction of government debt levels, the surveillance framework has helped to create the conditions for sustainable growth, strengthened resilience, reduced vulnerabilities and lowered the risk of potentially harmful spillovers. The six-pack and two-pack reforms have thus contributed to achieving the Union's strategy for growth and jobs.

The strengthened surveillance framework has also fostered convergence in the economic performance of Member States, with an overall return to economic growth and declining unemployment rates in all Member States, reduced macroeconomic imbalances, and falling public deficits and debt levels, with all Member States having exited the excessive deficit procedure. Furthermore, the framework put in place to support euro-area Member States experiencing, or threatened with, difficulties with respect to financial stability contributed to reducing the temporary divergence of the Member States concerned from the rest of the euro area and laid the ground for renewed convergence.

The recovery since the financial crisis has been long by historical standards, but there has also been a decline in trend growth, accompanied by persistently low inflation. At the same time, public debt levels remain high in some Member States, which are also far from their medium-term budgetary objectives while their reform efforts are waning. Some Member States' economies remain vulnerable to an economic slowdown with risks of spillovers that would affect the functioning of the euro area as a whole.

The fiscal stance at Member State-level has frequently been pro-cyclical. Moreover, the composition of public finances has not become more growth-friendly and national governments have revealed their preference for increasing current expenditure rather than protecting investment. In the event of large shocks that are not policy-induced, the ability to steer the fiscal stance for the euro area as a whole, with the appropriate differentiated fiscal effort among Member States, is hampered by the lack of prudent policies in good times and remains constrained as long as it rests exclusively on coordination of national fiscal policies

in the absence of a central stabilisation capacity. The current framework and its implementation thus has not fostered macroeconomic stabilisation.

Furthermore, the current surveillance framework and its implementation did not ensure a sufficient differentiation between Member States that have markedly different fiscal positions, sustainability risks or other vulnerabilities. The interplay between Union fiscal rules and national fiscal frameworks is another area of improvement.

The fiscal framework (which includes the secondary legislation and other documents that provide more details and transparency on how surveillance is carried out in practice) has grown excessively complex. This complexity results from the framework pursuing multiple objectives and the need to cater for a wide variety of evolving circumstances, including by the use of flexibility, in a context of divergences of views among Member States. It is reflected in a very detailed codification, encompassing several operational indicators of which a number are non-observable and frequently revised, as well as a variety of escape clauses. As a result, the fiscal rules have become less transparent, hampering predictability, communication and political buy-in.

Other imbalances accumulated during the economic crisis are receding, but in many instances only slowly. The MIP has been more successful in reducing current account deficits than it has been in reducing persistent and large current account surpluses. While this may be explained by the more pressing needs to correct large current account deficits given the concerns about sustainability, persistent current account surpluses can also affect the smooth functioning of the euro area. The traction of policy recommendations is suboptimal and has been declining over time as the momentum for reform has faded. Moreover, while the interaction between the specific surveillance strands has been adequate, there is further scope to make them work better together. Important links between individual surveillance instruments are not sufficiently taken into account, in particular where public debt sustainability issues are intrinsically linked to wider macroeconomic imbalances or low potential growth.[32]

Finally, thought should be given to the need for the surveillance framework to help tackling today and tomorrow's pressing economic, demographic and environmental challenges. Currently, one of the key economic challenges is that growth may remain subdued for a longer period unless policy action is taken to boost potential growth. With an already highly accommodative monetary policy, it is important to consider whether and how Member States' fiscal and structural policies could contribute to the policy mix in the euro area and to raising potential growth, and to reflect on the potential role of the EU economic governance framework therein. Furthermore, it should be considered to what extent the framework can support economic, environmental and social policy needs related to the transition towards a climate-neutral, resource efficient and digital European economy, complementing the key role of the regulatory environment and structural reforms.

3. Issues for public debate

Based on the experience with the legislation so far, a number of issues for a public debate can be established:

[32] In addition, the surveillance of sovereign-bank spillovers has not played a central role within the framework, although their relevance for macroeconomic and financial stability remains.

How can the framework be improved to ensure sustainable public finances in all Member States and to help eliminate existing macroeconomic imbalances and avoid new ones arising? In the light of experience, effective delivery on the objectives of ensuring sustainable public finance positions and avoiding macroeconomic imbalances is key. Effective economic coordination and surveillance is a cornerstone for ensuring resilience in the EU and the Economic and Monetary Union in view of potential negative spillovers resulting from the building up of unsustainable positions. While there has been progress overall in terms of debt sustainability and correction of macroeconomic imbalances, that progress has not always been sufficient, with large differences across Member States. Therefore, an effective framework needs to ensure the sustainability of public debt, including where it is most necessary, and the prevention and correction of macroeconomic imbalances. In this context, risks related to climate change are to be considered.

How to ensure responsible fiscal policies that safeguard long-term sustainability, while allowing for short-term stabilisation? Fiscal policy guidance supports Member States in ensuring the long-term sustainability of public finances and in pursuing counter-cyclical fiscal policies to contribute to a better macroeconomic stabilisation in both good and bad times. While an effective framework should aim to be counter-cyclical in good and bad times, it has often not been achieved in practice. An appropriate fiscal effort and debt reduction in good economic times helps to create the space to use fiscal policy in bad times. Appropriate medium-term policy planning, both regarding fiscal targets and structural reforms to promote productivity and investment, and an appropriate policy anchor help in that regard.

What is the appropriate role for the EU surveillance framework in incentivising Member States to undertake key reforms and investments needed to help tackle today and tomorrow's economic, social, and environmental challenges while preserving safeguards against risks to debt sustainability? The framework should be consistent with today and tomorrow's challenges. It needs to be discussed what the appropriate role of the EU surveillance framework is in helping to promote a composition of public finances conducive to sustainable growth and for Member States to sustain adequate levels of investment. In particular, significant investment will be requiredto meet the broader ambition of the European Green Deal. This raises the question of the extent to which the fiscal framework can support the reforms and investments, including in human capital and skills, needed for the transition to a climate-neutral, resource-efficient, and competitive economy fit for the digital age, in a manner that leaves no one behind. This includes re-assessing the appropriateness of the current flexibility clauses in terms of their scope and eligibility, in order to facilitate the right type and level of investment while preserving debt sustainability. In addition, thought should be given to the role of the fiscal framework in greening national budgets.

How can one simplify the EU framework and improve the transparency of its implementation? Whereas the current fiscal surveillance framework has included elements of flexibility and discretion through a complex set of provisions adopted against a background of lack of trust amongst key stakeholders, an effective application of economic judgement within a rules-based framework needs to be done in an objective and transparent manner. This includes, for example, considering whether a clear focus on gross policy errors as set out in the Treaty, based on clearly defined objectives and operational policy targets, could contribute to an effective implementation of the surveillance framework. A simpler framework and implementation could contribute to increased ownership, better communication, and lower political costs for enforcement and compliance.

How can surveillance focus on the Member States with more pressing policy challenges and ensure quality dialogue and engagement? Surveillance should be commensurate to the gravity of the situation, with a stronger focus on the most pressing cases and less-intrusive procedures where overall risks are low. Therefore, it is to be considered whether the surveillance framework, in order to be effective, should focus more on 'identifying gross errors'[33], i.e. on Member States whose policy strategy puts public debt on a potentially unsustainable trajectory or leads to other macroeconomic imbalances. Moreover, a strong policy dialogue with Member States and stakeholders is key, especially in a multilateral setting, but also bilaterally with the Commission.

How can the framework ensure effective enforcement? What should be the role of pecuniary sanctions, reputational costs and positive incentives? The appropriate balance between pecuniary sanctions and tools incentivising macroeconomic stability and sustainable growth, such as a Budgetary Instrument for Convergence and Competitiveness or the Convergence and Reform Instrument, has to be carefully considered as an element to ensure an effective implementation of the framework.

Is there scope to strengthen national fiscal frameworks and improve their interaction with the EU fiscal framework? It has to be considered whether a stronger role for national fiscal frameworks, in particular independent fiscal institutions, would contribute to better compliance with EU fiscal rules and improve ownership of the framework at the same time. Moreover, given that high quality statistics are key for a transparent fiscal framework, it has to be assessed what further improvements in data quality would be needed.

How should the framework take into consideration the euro area dimension and the agenda towards deepening the Economic and Monetary Union? There are a number of concrete links between the economic governance framework and the broader agenda to complete the Economic and Monetary Union. First, both the SGP and the MIP focus exclusively on national policies, in particular on the prevention and correction of high public debt levels and current account deficits. In such a context and in the absence of a central fiscal capacity with stabilisation features, the ability to steer the fiscal stance for the euro area as a whole remains constrained. The introduction of a stabilisation capacity of appropriate size would allow fiscal policy to contribute more to macroeconomic stabilisation at the level of the euro area as a whole. Second, the completion of the financial union (Banking Union and Capital Markets Union), the introduction of a common safe asset and the review of the regulatory treatment of bank sovereign exposures, could – depending on the specific design – facilitate market discipline and allow further simplification of the design of an effective fiscal surveillance framework. Third, a vibrant and resilient Economic and Monetary Union, resting on solid foundations, is the best means to increase financial stability in Europe. It is a prerequisite to strengthening the international role of the euro, which in turn is a tool to enhance Europe's clout in the world and on global markets, thereby promoting European values and supporting the interests of European firms, consumers and governments.

Within the context of the European Semester, how can the SGP and the MIP interact and work better together, so as to improve economic policy coordination among Member States? The European Semester successfully aligns the different surveillance strands under one common timeline. It also helps synchronise national procedures and contributes to convergence within the EU. Nevertheless, there may be scope to further strengthen it as a tool for policy coordination in view of a better integrated surveillance and in the context of new

[33] Cf. Article 126(2) of the Treaty on the Functioning of the European Union.

emerging challenges. While the individual strands focus on their own objectives, it is to be assessed whether they could be implemented together more effectively when the challenges are interlinked. This can, for instance, be done by making use of the existing links between the MIP and the SGP in cases where public debt sustainability issues are related both to fiscal discipline and structural impediments to potential growth.

The effective functioning of the surveillance framework is the collective responsibility of all Member States, European institutions and other key stakeholders. A high degree of consensus and trust amongst all key stakeholders is crucial for the effectiveness of economic surveillance in the Union. The Commission invites all stakeholders to engage in a public debate to provide their views on how to strengthen the implementation of the economic governance framework.

The public debate should provide an opportunity for stakeholders to provide their views on the functioning of surveillance so far and the possible ways to enhance the effectiveness of the framework in delivering on key objectives. The Commission looks forward to an inclusive debate, involving the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions, national governments and parliaments, national central banks, independent fiscal institutions, national productivity boards, social partners, civil society organisations as well as academic institutions, with the aim of collecting feedback within the first half of 2020. The Commission will engage with these stakeholders in the coming months through various means including through dedicated meetings, workshops and an online consultation platform. The Commission will consider all views and on that basis complete by the end of 2020 its internal reflections on the scope for any possible future steps.