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Proposal for a

COUNCIL DIRECTIVE

laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

Reasons for and objectives of the proposal

An unprecedented financial and economic crisis hit the economies of the European Union (EU) a decade ago. While that crisis did not start in the euro area, it laid bare some of its institutional weaknesses. In response, the EU has sought to strengthen the economic governance arrangements for the Union and the euro area, particularly by means of the legislative packages known as the 'Six-pack' (five Regulations and a Directive adopted in 2011) and 'Two-pack' (two Regulations adopted in 2013). These packages helped to ensure the closer supervision of national budgets, establish sounder fiscal frameworks and pay greater attention to debt levels.

However, in seeking to remedy the root causes of the crisis, it became clear that the rules-based fiscal framework at EU level had to be complemented by binding provisions at the national level to foster sound budgetary policies in all Member States and act as a lasting mechanism against the emergence of excessive deficits.

In that context, the use of Union law to underpin such national rules was explored. The Commission was at the time strongly in favour of pursuing further economic governance reforms under the Community method.[1] However, when meeting in December 2011, the European Council failed to agree to take the steps under consideration. In reaction, the Member States that wanted to commit jointly to having such domestic rules went ahead on an intergovernmental basis, leading to the conclusion of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) as a stepping stone towards incorporating its provisions as soon as possible into the Treaties.

The TSCG was signed on 2 March 2012 by 25 Contracting Parties (all Member States except the Czech Republic and United Kingdom[2]) and entered into force on 1 January 2013. The cornerstone of the TSCG is its Title III, which sets out the so-called 'Fiscal Compact'. Its main provision is the obligation for Contracting Parties to enshrine in binding and permanent national provisions, preferably constitutional, a balanced-budget rule in cyclically adjusted terms. The rule mirrors the requirement that is at the centre of the preventive arm of the Stability and Growth Pact (SGP), namely the medium-term budgetary objective. 22 Contracting Parties are bound by the Fiscal Compact (all euro area Member States and, on a voluntary basis, Bulgaria, Denmark and Romania). Other parts of the TSCG aim to reinforce economic policy coordination and governance of the euro area.

The intergovernmental approach used to adopt the TSCG was always understood by all stakeholders as a way to take necessary steps immediately when, at the height of the economic and financial crisis, progress was blocked within the European Council. Hence, the Contracting Parties agreed to seek integration of the core provisions of the TSCG into Union law at most within five years of the date of its entry into force, i.e. by 1 January 2018.

This political agreement is enshrined in Article 16 TSCG, according to which "*Within five years, at most, of the date of entry into force of this Treaty, on the basis of an assessment of the experience with its implementation, the necessary steps shall be taken, in accordance with the Treaty on the European Union and the Treaty on the Functioning of the European Union,*

[1] Statement by President Barroso at the press conference following the meeting of the Heads of State or Government of the euro area, 27 October 2011, SPEECH/11/713.

[2] Croatia was not a member of the European Union at the time of signature and has not signed up to the TSCG to date.

with the aim of incorporating the substance of this Treaty into the legal framework of the European Union."

The Commission's May 2017 Reflection Paper on the Deepening of the Economic and Monetary Union[3] recalled that agreement and referred to the possible integration of the Fiscal Compact into the EU legal framework during the period 2017-2019. Furthermore, in his 2017 State of the Union address and the accompanying Letter of Intent,[4] President Jean-Claude Juncker proposed, among other things, the integration of the substance of the TSCG into EU law, taking into account the appropriate flexibility built into the SGP and identified by the Commission since January 2015.

The European Parliament has also repeatedly asked for the substance of the TSCG to be brought under the Treaties,[5] arguing that, to be effectively legitimate and democratic, the governance of a genuine Economic and Monetary Union (EMU) must be placed within the institutional framework of the Union.

The Fiscal Compact was adopted as a stop-gap solution at a time of deep crisis, but its basic tenet remains entirely valid – it is in the interest of the EU and the euro area to foster responsible policies avoiding excessive deficits. The present proposal is part of a broader and ambitious set of initiatives to reform the EMU put forward by the Commission on 6 December 2017. Recognising the particular relevance for the completion of EMU, the proposal responds to the will expressed by the TSCG Contracting Parties, the calls of the European Parliament for integration into the Union framework and the call for unity, efficiency and democratic accountability made by President Juncker in his State of the Union address in September 2017.

The proposed Directive strengthens fiscal responsibility and the medium-term budgetary orientation in the Member States and so aims to achieve, along with the existing provisions of the SGP, the underlying objective of the Fiscal Compact, namely, convergence to prudent levels of public debt. Indeed, the high levels of public debt still observable today will take time to be absorbed. Further progress therefore remains imperative, in both the short and long term.

Progress toward prudent debt levels requires annual budgetary decisions to follow a steady orientation towards achieving and maintaining the medium-term budgetary objective. The budgetary path needs to be spelled out in terms of policies under the control of governments and taking into account economic conditions. However, frequent recalibrations of the path undermine the credibility and effectiveness of any strategy for debt reduction. Partly due to the exceptional economic circumstances prevailing when the Fiscal Compact entered into force, such a steady medium-term orientation of budgetary policies has not yet fully materialised. As economic conditions are normalising, the time has come to operationalise and reinforce it so that all Member States effectively converge to the agreed objectives.

As also advocated in the EMU Reflection Paper, the EMU and its completion must remain open to all Member States. What is conceived for the euro area should also be conceived for – and with – those Member States that are expected to join the euro in the foreseeable future. This is key for a well-functioning single currency. Accordingly, the proposed Directive

[3] COM(2017) 291, 31 May 2017.

[4] President Jean-Claude Juncker's State of the Union Address 2017, SPEECH/17/3165, 13 September 2017.

[5] European Parliament's resolution of 12 December 2013 on constitutional problems of a multitier governance in the European Union (P7_TA(2013)0598) and resolution of 24 June 2015 on the review of the economic governance framework: stocktaking and challenges (P8_TA(2015)0238).

should apply to both the Member States whose currency is the euro and other Member States wishing to participate.

Article 3 (which forms part of the Fiscal Compact) is by far the most substantive provision of the TSCG from an EMU perspective as it aims to respond to the need to maintain sound and sustainable public finances and to prevent government deficit and debt becoming excessive. Under Article 3(1), Contracting Parties commit to have their budgetary position in balance or in surplus, with a lower limit for the structural deficit of 0.5% of GDP, which can become 1.0% of GDP for Member States with a debt level significantly below 60% of GDP and with low risks for the long-term sustainability of public finances. That balanced-budget rule must be equipped with a correction mechanism automatically triggered in case of significant deviation. Article 3(2) obliges Contracting Parties to internalise those rules into their domestic legal order. Other provisions of the TSCG have either been already integrated into EU law (in particular via the 'Two-pack', for the euro area), or would require changes to the Treaties, or do not lend themselves to incorporation for various reasons (e.g. some replicate existing EU law). Consequently, the 'substance' proposed for incorporation into the Union legal framework is concentrated in Article 3 TSCG.

The rationale for bringing that 'substance' of the TSCG into the body of the EU fiscal framework is manifold. It would simplify the legal framework and ensure more effective and systematic monitoring of implementation and enforcement of fiscal rules at both EU and national level as part of the overall EU economic governance framework, compared to the current intergovernmental set-up. It diminishes the possible risks of duplications and conflicting actions inherent in the co-existence of intergovernmental arrangements alongside the mechanisms foreseen by Union law. A consolidated framework governed by EU law would also facilitate a consistent and coordinated evolution of the EU and national fiscal rules within the wider process of deepening the EMU. Above all, as argued in the Five Presidents' Report on Completing Europe's Economic and Monetary Union,[6] the integration into the Union legal framework of all inter-governmental instruments created during the crisis would bring greater democratic accountability and legitimacy across the Union.

The proposed Directive builds on the observation that there cannot be an effective enforcement of the EU fiscal framework if only a top-down approach is taken. The particular decentralised nature of fiscal policy-making in the EU and the general need for national ownership of fiscal rules make it essential that the objectives of the EMU budgetary coordination framework are also reflected in the fiscal frameworks of the Member States. While Council Directive (EU) No 2011/85[7] already set minimum characteristics for national fiscal frameworks, in the TSCG Contracting Parties strengthened the basis for responsible fiscal policies amongst them by setting out the obligation to enshrine a balanced-budget requirement through *"[national] provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes"*.

In the same vein, the present proposal lays down an obligation for Member States to have in place a framework of binding and permanent numerical fiscal rules which, while being consistent with the fiscal rules laid down in the Union framework, can embody specificities relevant to the Member State concerned. That framework should strengthen their responsible conduct of fiscal policy and promote compliance with the budgetary obligations deriving from

[6] Completing Europe's Economic and Monetary Union, Report by Jean-Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, 22 June 2015.

[7] Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p. 41). Council Directive (EU) No 2011/85 is part of the 'Six-pack'.

the Treaty on the Functioning of the European Union (TFEU). It should ensure convergence of public debt to prudent levels (namely, the reference value set out in Protocol No 12 on the excessive deficit procedure annexed to the Treaties), in particular by means of an anchoring medium-term objective in terms of structural balance that is binding on national budgetary authorities in their annual decisions. That objective-based approach reflects a shared goal, to ensure the sustainability of public finances, common to national budgetary rules and mechanisms and to the EU fiscal framework. The medium-term orientation seeks to provide a stronger basis for sound budgetary policies since most fiscal measures have budgetary implications that go well beyond the annual budgetary cycle. In the same vein, the implementation of major structural reforms with a verifiable positive impact on the long-term sustainability of public finances should be properly factored into the medium-term fiscal perspective.

If there is to be medium-term anchoring for budgeting purposes, fiscal planning must include a medium-term path for expenditure net of discretionary revenue measures and consistent with the medium-term objective or the adjustment path towards it. To ensure an enhanced sense of national ownership of fiscal policy and reflect Member States' sovereign specificities, that path should be set for the whole term of the legislature as established by the domestic constitutional legal order, as soon as a new government takes office. Crucially, that path should be respected by the annual budgets throughout the period that it covers.

Effective means to correct non-compliance are needed for the credibility of the medium-term objective and of the associated operational target. While it is the case that exceptional circumstances may lead to a temporary deviation from the medium-term objective or the adjustment path towards it, significant observed deviations must be corrected through the automatic activation of a pre-defined correction mechanism, in particular by compensating for deviations from the medium-term expenditure path.

Long-term sound budgetary policies are jeopardised by the deficit bias and more generally the pro-cyclical policy stance which can be observed across Member States. Fiscal rules and independent fiscal institutions have emerged as complementary devices to address those challenges. Evidence shows that fiscal rules equipped with independent monitoring arrangements are associated with increased transparency, better fiscal outcomes and lower sovereign debt financing costs. For that reason, the proposed Directive foresees involving independent fiscal institutions in monitoring compliance with the framework of numerical fiscal rules, including by assessing the adequacy of the medium-term budgetary orientation, as well as in monitoring how the correction mechanism is activated and applied. When they detect significant deviations from the medium-term objective or the adjustment path towards it, the independent fiscal institutions should call upon the national budgetary authorities to activate swiftly the correction mechanism and should assess the planned corrective measures and their implementation. Public assessments prepared by the independent fiscal institutions in the performance of their tasks, accompanied by a duty for the budgetary authorities of Member States to 'comply-or-justify' in relation to the recommendations of the independent fiscal institutions, would boost the reputational costs of non-compliance and therefore increase the credibility and enforceability of the medium-term orientation. Since the adoption of 'Six-pack', 'Two-pack' and the TSCG[8] have already led to establishing independent fiscal institutions in almost all Member States, the proposed Directive is unlikely to require new

[8] The TSCG invited the Commission to report on the measures adopted by the Contracting Parties bound by the Fiscal Compact to report on the measures adopted by each of them in relation to Article 3(2) TSCG; to that effect, the Commission adopted on 22 February 2017 a Communication and a report assessing the compliance of the relevant national measures (C(2017) 1201 final). It provides details on the independent fiscal institutions in the TSCG Contracting Parties.

structures although amendments to the current remits of existing independent fiscal institutions coupled with improved access to information and some reinforcement of resources may be warranted.

Detailed provisions in the proposed Directive set out specific aspects of the correction mechanism and the necessary features related to the set-up of independent fiscal institutions and their specific tasks stemming from this proposal. Those elements incorporate key features of the Common principles on national fiscal correction mechanisms,[9] which were used by the Member States in their adoption of measures in compliance with Article 3(2) of the TSCG.

The proposed Directive does not affect the commitments made in Article 7 of the TSCG by those of the Contracting Parties whose currency is the euro to coordinate their views prior to the voting within the Council on proposals and recommendations made by the Commission in the context of the excessive deficit procedure. Equally, it preserves the practice under Article 13 of the TSCG of discussions in the framework of inter-parliamentary meetings held by the European Parliament and the national Parliaments of the Contracting Parties. Such discussions contribute to enhancing democratic accountability in the context of the Union's economic governance.

- Consistency with existing policy provisions in the EU

The key instrument for fiscal policy co-ordination and surveillance in the EU and the euro area is the SGP, which implements the Treaty provisions on budgetary discipline. The Fiscal Compact corresponds in many aspects to the preventive arm of the SGP. Indeed, the balanced-budget rule in structural terms mirrors to a very large extent the medium-term budgetary objective established under Article 2a of 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.[10]

The proposed Directive puts forward a framework of numerical fiscal rules and accompanying specifications which is not only compatible with the SGP but is specifically meant to complement it. That framework must effectively promote compliance with the Member State's obligations deriving from the TFEU in the area of budgetary policy, meaning, among others, that the medium-term objective envisaged to play within the national budgetary processes the role of an anchor for ensuring sustainable debt levels must be consistent with the medium-term budgetary objective laid down under Article 2a of Council Regulation (EC) No 1466/97. To take into account the appropriate flexibility that is built into the rules of the SGP and in line with its procedural requirements, the proposal includes specific provisions allowing account to be taken of the implementation by Member States of structural reforms that have a positive impact on the long-term sustainability of public finances.

2. RESULTS OF CONSULTATIONS WITH INTERESTED PARTIES

Article 16 of the TSCG and its supporting recital express the firm, unambiguous will of the Contracting Parties to incorporate as soon as possible the substance of that Treaty into the Union legal framework.

The Commission has followed up on that commitment of the 25 Member States who are Contracting Parties by putting forward this proposal. The Commission first announced its

[9] See also Communication from the Commission: Common principles on national fiscal correction mechanisms (COM(2012) 342 final).

[10] 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 (OJ L 209, 2.8.1997, p. 1).

intention to take the initiative and act upon that commitment in the Reflection Paper on the Deepening of the Economic and Monetary Union, which recalled the agreement among the Contracting Parties to integrate the substance of the TSCG into Union law. In his 2017 State of the Union address and the accompanying Letter of Intent, President Juncker announced a proposal on incorporation as part of the 6 December 2017 package on EMU deepening.

The proposed Directive builds on the Commission's in-depth knowledge of the architecture of the Fiscal Compact (including in particular its interactions with the Union fiscal framework) and of how it has been enshrined by the Member States concerned into their domestic legal orders. With a view to preparing its February 2017 report assessing the compliance of national provisions adopted by the Contracting Parties bound by the Fiscal Compact, the Commission engaged in extensive consultations with those Member States. Those bilateral exchanges gave the Commission a thorough and accurate understanding of how the legislative and institutional arrangements put in place by them give effect to the rules enshrined in Article 3 of the TSCG.

Discussions held among the Member States in the ECOFIN Council and its preparatory committees in relation to the Fiscal Compact, notably on assessing the compliance of national transposing provisions, also included the issue of incorporating the Fiscal Compact in Union law and recalled the need to take steps in that direction by 1 January 2018.

3. LEGAL ELEMENTS OF THE PROPOSAL

- Legal basis

The legal basis for the proposed Directive is the second subparagraph of Article 126(14) TFEU. Strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States aims to complement and reinforce the available policy framework to avoid excessive deficits as established under Article 126 TFEU. While the proposed Directive does not alter the substantive and procedural rules set out in the SGP, it increases the effectiveness of those provisions. The proposal applies to all euro area Member States and includes 'opt-in' provisions for non-euro area Member States.

- Subsidiarity and proportionality

The proposal is in conformity with the subsidiarity and proportionality principles set out in Article 5 of the Treaty on the European Union. Its objective cannot be sufficiently achieved by the Member States and can be better achieved at Union level. The proposed Directive does not go beyond what is necessary in order to achieve that objective.

2017/0335 (CNS)

Proposal for a

COUNCIL DIRECTIVE

laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the second subparagraph of Article 126(14) thereof,

Having regard to the proposal from the European Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the European Central Bank,

Acting in accordance with a special legislative procedure,

Whereas:

(1) The Treaty on the Functioning of the European Union (TFEU) requires that Member States regard their economic policies as a matter of common concern, that their budgetary policies are guided by the need for sound public finances and that their economic policies do not risk jeopardising the proper functioning of economic and monetary union.

(2) The Stability and Growth Pact (SGP) includes the multilateral surveillance system and the surveillance and coordination of economic policies laid down in Council Regulation (EC) No 1466/97[11] and the procedure for the avoidance of excessive government deficit laid down in Article 126 TFEU and further specified in Council Regulation (EC) No 1467/97.[12] The SGP has been further strengthened by Regulation (EU) No 1175/2011 of the European Parliament and of the Council[13] and Council Regulation (EU) No 1177/2011.[14] Regulation (EU) No 1173/2011 of the European Parliament and of the Council[15] added a system of effective, preventive and gradual enforcement mechanisms in the form of the imposition of sanctions on Member States whose currency is the euro.

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11 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 (OJ L 209, 2.8.1997, p. 1).

12 Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

13 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).

14 Council 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).

15 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).

(3) In order to encourage Member States' compliance with obligations under the TFEU in the area of budgetary policy, detailed rules concerning the characteristics of the budgetary frameworks of the Member States were laid down in the Council Directive 2011/85/EU.[16]

(4) Since there is greater interdependence among the Member States whose currency is the euro and hence susceptibility to spill-over effects from each other's budgetary policies, in order to further enhance economic integration, convergence and coordination among them, a number of improvements to budgetary coordination and surveillance were introduced through Regulation (EU) No 472/2013 of the European Parliament and of the Council[17] and Regulation (EU) No 473/2013 of the European Parliament and of the Council.[18]

(5) With the aim of strengthening the foundations which ensure budgetary discipline throughout the economic cycle, on 2 March 2012 25 Member States signed and ratified the inter-governmental Treaty on Stability, Coordination and Governance (TSCG) in the Economic and Monetary Union. Title III of the TSCG, the "Fiscal Compact", is binding on the Member States whose currency is the euro and, on a voluntary basis, on Bulgaria, Denmark and Romania (hereinafter the 'Contracting Parties'), and sets an obligation to enshrine in the national legal order of those Contracting Parties a balanced-budget rule in structural terms equipped with a correction mechanism automatically triggered in case of significant deviation and monitored by independent institutions. The Contracting Parties expressed their will to use that inter-governmental instrument as a temporary device. That will is reflected in Article 16 of the TSCG which stipulates that, within five years at most following its entry into force, the necessary steps are to be taken with the aim of incorporating its substance into the Union legal framework. Therefore, provisions that allow the substance of the TSCG to take effect should be introduced in the Union's legal framework

(6) In order to maintain sound and sustainable public finances and to avoid excessive government deficits as required by the TFEU, while at the same time improving the resilience of the euro area as a whole, there should be specific provisions in the national law of the Member States whose currency is the euro to strengthen their fiscal responsibility and their medium-term budgetary orientation beyond the provisions of Directive 2011/85/EU.

(7) Since the economic and financial crisis has left a number of Member States with a legacy of high public debt, a framework of numerical fiscal rules specific to each Member State and which aim at strengthening its responsible conduct of fiscal policy while effectively promoting compliance with the budgetary obligations deriving from the TFEU is instrumental in ensuring convergence of public debt to prudent levels. Such a framework should operate in particular by setting a medium-term objective in terms of structural balance that is binding on the national budgetary authorities and their annual decisions. Medium-term objectives for the budgetary position allow the different public-debt-to-GDP ratios and sustainability risks of Member States to be taken into account,

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16 Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p. 41).

17 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).

18 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).

anchoring debt developments towards the reference value set out in Article 1 of Protocol No 12 on the excessive deficit procedure annexed to the Treaty on European Union and to the TFEU.

(8) In order to achieve and maintain the medium-term objective in structural terms, it is necessary for Member States to set out a consistent adjustment path, based on variables under the control of the budgetary authorities. National fiscal planning underpinned by a government expenditure path adjusted for the impact of discretionary revenue measures favours effectiveness, transparency and accountability when monitoring fiscal developments. In order to tightly connect plans with the overall fiscal outcomes in the medium-term and to ensure an enhanced sense of national ownership of fiscal policy, a medium-term growth path of government expenditure net of discretionary revenue measures should be set for the whole term of the legislature as established by the constitutional legal order of each Member State. That path should be set as soon as a new government takes office and annual budgets should adhere to it so as to bring about resolute convergence towards the medium-term objective.

(9) Due to their future positive effects, the implementation of major structural reforms fostering long-run sustainability could justify changes in the adjustment path towards the medium-term objective, provided that they have a verifiable positive budgetary impact which is confirmed by the assessment conducted according to the procedural requirements of the SGP. In order to facilitate economic stabilisation, exceptional circumstances – in the form of severe economic downturns for the euro area or the Union as a whole or unusual events outside the control of the Member State concerned which have a major budgetary impact – should allow for a temporary deviation from the medium-term objective or the adjustment path towards it, where such a deviation does not endanger fiscal sustainability in the medium-term.

(10) If they are not adequately addressed, significant deviations from the medium-term objective or the adjustment path towards it hamper the credibility of the budgetary plans and risk derailing government debt developments. To enhance the credibility of the Member States' commitment to the medium-term objective, a correction mechanism should be automatically activated in the event of a significant observed deviation. A credible correction mechanism should set out the measures which need to be implemented to correct the deviation over a defined period of time, taking account of the nature and size of the deviation. In particular, the correction mechanism should compensate for deviations from the medium-term growth path of government expenditure net of discretionary revenue measures.

(11) Independent bodies charged with monitoring public finances in the Member States are an essential building block of effective fiscal frameworks. In order to foster fiscal discipline and strengthen the credibility of fiscal policy, such bodies should carry out independent assessments of the framework of numerical fiscal rules, including notably the medium-term budgetary orientation, and should monitor compliance with that framework and the activation and operation of the associated correction mechanisms.

(12) Strengthened national fiscal responsibility and a binding multi-annual orientation of fiscal policy requires fiscal institutions to be independent and have their own resources for actively monitoring fiscal developments and providing recommendations throughout the medium-term bugdetary cycle, including in particular where a significant deviation from the medium-term objective or the adjustment path towards is observed. In order to boost the credibility and enforceability of the medium-term objective, its underlying government expenditure path and the related correction mechanism in case of

significant deviations, the budgetary authorities of the Member States should comply with the recommendations put forward in the assessments of the independent bodies or publicly justify the decision not to comply with them. Anchoring that principle in the national legal order can play a crucial role in that respect.

(13) For greater efficacy of the shared goal of the national budgetary rules and mechanisms and the Union's fiscal framework, namely the convergence of public debt to prudent levels, Member States should give effect to the rules provided for in this Directive through provisions of binding force and permanent character, of constitutional nature or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes.

(14) The European Council on 19 October 2012 concluded that the process towards deeper economic and monetary union should build on the Union institutional and legal framework and be characterised by openness and transparency towards Member States whose currency is not the euro. National measures to strengthen fiscal responsibility in those Member States would facilitate their adoption of the euro and therefore the mechanisms established by this Directive should be open to all Member States wishing to participate. Therefore, provision should be made for this Directive to be applicable to Member States whose currency is not the euro where those Member States so decide.

(15) It should be noted that Article 7 of the TSCG lays down that the Contracting Parties whose currency is the euro have committed to supporting the proposals or recommendations submitted by the Commission where it considers that a Member State whose currency is the euro is in breach of the deficit criterion in the framework of an excessive deficit procedure unless a qualified majority of them, calculated by analogy with the relevant provisions of the Treaties on which the Union is founded, without taking into account the position of the Contracting Party concerned, is opposed to the decision proposed or recommended.

(16) While the incorporation of the substance of the TSCG into the Union legal order as it currently stands does not extend to the alteration of arrangements laid down by the provisions of the TFEU for decision-making, this Directive should leave unaffected the commitments established between the Contracting Parties pursuant to Article 7 of the TSCG.

(17) Article 13 of the TSCG lays down that budgetary policies and other issues covered by that Treaty will be discussed in the framework of inter-parliamentary meetings held by the European Parliament and the national Parliaments of the Contracting Parties under Title II of Protocol No 1 on the role of national Parliaments in the European Union attached to the Treaties. This Directive should apply without prejudice to that practice, since such dialogue contributes to enhancing democratic accountability in the context of the Union's economic governance.

(18) This Directive should strengthen the effectiveness of the SGP by increasing the extent to which it is embedded in the legal orders of the Member States while at the same time diminishing the possible risks of duplications and conflicting actions inherent in the co-existence of intergovernmental arrangements alongside the mechanisms foreseen by Union law. The substantive and procedural rules set out in the SGP should not be affected by this Directive.

(19) In accordance with the Joint Political Declaration of 28 September 2011 of Member States and the Commission on explanatory documents,[19] Member States have

[19] OJ C 369, 17.12.2011, p. 14.

undertaken to accompany, in justified cases, the notification of their transposition measures with one or more documents explaining the relationship between the components of a directive and the corresponding parts of national transposition instruments. With regard to this Directive, the legislator considers the transmission of such documents to be justified.

(20) Since the objective of the action to be taken, namely to strengthen fiscal responsibility by adopting a more binding medium-term budgetary orientation at national level, cannot be sufficiently achieved by the Member States and can be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve that objective,

HAS ADOPTED THIS DIRECTIVE:

Article 1
Subject matter and scope

1. This Directive lays down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States to ensure compliance with obligations relating to the avoidance of excessive government deficits.

2. This Directive applies to the Member States whose currency is the euro and other Member States in accordance with Article 4.

Article 2
Definitions

For the purposes of this Directive, the definitions of 'government', 'deficit' and 'debt' set out in Article 2 of Protocol No 12 on the excessive deficit procedure annexed to the TEU and to the TFEU shall apply.

In addition, the following definitions shall also apply:

a) 'exceptional circumstances' means an unusual event outside the control of the Member State concerned and which has a major impact on the financial position of the general government, or a severe economic downturn for the euro area or the Union as a whole;

b) 'independent bodies' means bodies that are structurally independent or bodies endowed with functional autonomy vis-à-vis the budgetary authorities of the Member State, and which are underpinned by national legal provisions ensuring a high degree of functional autonomy and accountability.

(c) 'structural balance' means the cyclically-adjusted balance of the general government, net of one-off and temporary measures.

Article 3
Fiscal responsibility and medium-term budgetary orientation

1. Each Member State shall set up a framework of binding and permanent numerical fiscal rules which are specific to it, strengthen its responsible conduct of fiscal policy and effectively promote compliance with its obligations deriving from the TFEU in the area

of budgetary policy over a multiannual horizon for the general government as a whole. That framework shall include in particular the following rules:

(a) a medium-term objective in terms of structural balance shall be set in order to ensure that the ratio of government debt to gross domestic product at market prices does not exceed the reference value set out in Article 1 of Protocol No 12 on the excessive deficit procedure or approaches it at a satisfactory pace.

(b) fiscal planning shall include a medium-term growth path of government expenditure net of discretionary revenue measures and consistent with the medium-term objective or the time-frame for convergence towards it. That path shall be set as soon as a new government takes office in the Member State, for the term of the legislature as established by the constitutional legal order of that Member State, and shall be respected by the annual budgets throughout that period.

2. The framework referred to in paragraph 1 shall include the following specifications:

(a) annual budgets shall ensure compliance with the medium-term objective referred to in point (a) of paragraph 1 or convergence towards it, specifically by ensuring adherence to the government expenditure path referred to in point (b) of that paragraph. When defining the adjustment path towards the medium-term objective and acting in line with the procedural requirements of the Union framework, Member States may take into account the implementation of major structural reforms which have direct long-term positive budgetary effects, including by increasing potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances.

(b) a correction mechanism shall be automatically activated in the event of a significant observed deviation from the medium-term objective or the adjustment path towards it. That mechanism shall include the obligation to implement measures to correct the deviation over a defined period of time and taking account of the nature and size of the deviation, in particular by compensating for deviations from the government expenditure path referred to in point (b) of paragraph 1.

3. Member States shall ensure that a temporary deviation from the medium-term objective or the adjustment path towards it, with the corresponding adjustment of the government expenditure path referred to in point (b) of paragraph 1, is allowed only in case of exceptional circumstances and provided that any such deviation does not endanger fiscal sustainability in the medium-term. A temporary deviation resulting from exceptional circumstances shall not be deemed significant for the purposes of point (b) of paragraph 2 and shall not have the effect of activating the correction mechanism referred to in point (b) of that paragraph.

4. Member States shall designate independent bodies for monitoring compliance with the provisions in paragraphs 1 and 2. The independent bodies shall provide public assessments to ascertain:

(a) adequacy of the medium-term objective under point (a) of paragraph 1 and of the government expenditure path referred to in point (b) of paragraph 1. That assessment shall take into account in particular the plausibility of the underlying macroeconomic forecast, the degree of specification of the planned government expenditure and revenue and the potential direct long-term positive budgetary effects of major structural reforms;

(b) compliance with the medium-term objective and the government expenditure path, including the existence of a serious risk of occurrence of a significant deviation from the medium-term objective or the adjustment path towards it;

(c) occurrence or cessation of any exceptional circumstances as referred to under paragraph 3.

5. Member States shall ensure that, in the event of a significant observed deviation as referred to in point (b) of paragraph 2, the independent bodies shall call upon the budgetary authorities to activate the correction mechanism. After the correction mechanism is activated, the independent bodies shall provide public assessments to ascertain:

(a) consistency of the planned measures with the established correction mechanism, having regard in particular to whether deviations from the government expenditure path set in accordance with point (b) of paragraph 1 are adequately compensated for;

(b) the progress of the correction over the defined time-frame;

(c) occurrence or cessation of any exceptional circumstances which may allow a temporary deviation from the correction path.

6. Member States shall ensure that the budgetary authorities of the Member State concerned comply with the recommendations of the independent bodies made in the assessments required under paragraphs 4 and 5 or publicly justify the decision not to comply with those recommendations.

7. Member States shall ensure that the independent bodies referred to in paragraph 4:

(a) are established by a statutory regime grounded in national laws, regulations or binding administrative provisions;

(b) do not take instructions from the budgetary authorities of the Member State concerned or from any other public or private body;

(c) have the capacity to communicate publicly in a timely manner;

(d) are made up of members who are nominated and appointed on the basis of their experience and competence in public finances, macroeconomics and budgetary management, and by means of transparent procedures;

(e) have adequate and stable own resources to carry out their mandate in an effective manner;

(f) have extensive and timely access to information to fulfil their given tasks.

Article 4

Participation by Member States whose currency is not the euro

1. Any Member State whose currency is not the euro shall be bound by this Directive provided that it notifies the Commission of its decision to that effect. That notification shall include the date as of which the Member State concerned requests to be bound by this Directive.

2. The notification referred to in paragraph 1 shall be published by the Commission in the *Official Journal of the European Union*. It shall take effect as from the date notified

thereof by the Member State concerned or the date of adopting the euro as the single currency of that Member State, whichever is the earlier.

Article 5
Reports

By 30 June 2024, and every five years thereafter, the Commission shall present a report to the European Parliament and to the Council on the implementation of this Directive, which shall be prepared on the basis of relevant information from the Member States.

Article 6
Final provisions

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 30 June 2019. They shall immediately inform the Commission thereof.
2. When Member States adopt those measures, they shall contain a reference to this Directive or be accompanied by such reference on the occasion of their official publication. The methods of making such reference shall be laid down by Member States.
3. Member States shall communicate to the Commission the text of the main measures of national law which they adopt in the field covered by this Directive.

Article 7
Entry into force

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Article 8
Addressees

This Directive is addressed to the Member States in accordance with the Treaties.

Done at Brussels,

For the Council
The President