The EU's economic governance explained

The lessons learned from the recent economic, financial and sovereign debt crisis have led to successive reforms of the EU's rules, introducing, among other things, new surveillance systems for budgetary and economic policies and a new budgetary timeline.

The new rules (introduced through the Six Pack, the Two Pack and the Treaty on Stability, Coordination and Governance) are grounded in the European Semester, the EU's policy-making calendar. This integrated system ensures that there are clearer rules, better coordination of national policies throughout the year, regular follow-up and swifter sanctions for breaching the rules. This helps Member States to deliver on their budgetary and reform commitments while making the Economic and Monetary Union as a whole more robust.

The following are the essential features of the new system.

COORDINATION THROUGHOUT THE YEAR: THE EUROPEAN SEMESTER

Before the crisis, budgetary and economic policy planning in the EU took place through different processes. There was no comprehensive view of the efforts made at national level, and no opportunity for Member States to discuss a collective strategy for the EU economy.

Coordination and guidance

The European Semester, introduced in 2010, ensures that Member States discuss their budgetary and economic plans with their EU partners at specific times throughout the year. This allows them to comment on each other's plans and enables the Commission to give policy guidance in good time, before decisions are made at national level. The Commission also monitors whether Member States are working towards the jobs, education, innovation, climate and poverty reduction targets in the EU's long-term growth strategy, Europe 2020.

A clear timeline

The cycle starts in November each year with the Commission's Annual Growth Survey (general economic priorities for the EU), which provides Member States with policy guidance for the following year.

Country-specific recommendations published in the spring offer Member States tailored advice on deeper structural reforms, which often take more than one year to complete.

Euro area budget monitoring intensifies towards the end of the year, with Member States submitting draft budgetary plans, which are assessed by the Commission and discussed by euro area finance ministers. The Commission also reviews the fiscal stance in the euro area as a whole.
The Commission monitors implementation of priorities and reforms several times a year, with a focus on the euro area and Member States with fiscal or financial problems.

- **November**: The Annual Growth Survey (AGS) sets out overall economic priorities for the EU for the following year. The Alert Mechanism Report (AMR) screens Member States for economic imbalances. The Commission publishes its opinions on draft budget plans (for all euro area countries) and Economic Partnership Programmes (for euro area countries with excessive budget deficits). The budget plans are also discussed by euro area finance ministers.

- **December**: Euro area Member States adopt final annual budgets, taking into account the Commission's advice and finance ministers' opinions.

- **February/March**: The European Parliament and relevant EU ministers (for employment, economics and finance, and competitiveness) meeting in the Council discuss the AGS. The Commission publishes its winter economic forecast. The European Council adopts economic priorities for the EU, based on the AGS. It is around this time that the Commission publishes in-depth reviews of Member States with potential imbalances (those identified in the AMR).

- **April**: Member States submit their Stability/Convergence Programmes (medium-term budget plans) and their National Reform Programmes (economic plans), which should be in line with all previous EU recommendations. These are due by 15 April for euro area countries, and by the end of April for the EU. Eurostat publishes verified debt and deficit data from the previous year, which is important to check if Member States are meeting their fiscal targets.

- **May**: The Commission proposes country-specific recommendations (CSRs), tailored policy advice to Member States based on the priorities identified in the AGS and information from the plans received in April. In May, the Commission also publishes its spring economic forecast.

- **June/July**: The European Council endorses the CSRs, and EU ministers meeting in the Council discuss them. EU finance ministers ultimately adopt them in July.

- **October**: Euro area Member States submit draft budget plans for the following year to the Commission (by 15 October). If a plan is out of line with a Member State's medium-term targets, the Commission can ask it to be redrafted.
MORE RESPONSIBLE BUDGETING

The Stability and Growth Pact was established at the same time as the single currency in order to ensure sound public finances. However, the way it was enforced before the crisis did not prevent the emergence of serious fiscal imbalances in some Member States.

It has been reformed through the Six Pack (which became law in December 2011) and the Two Pack (which entered into force in May 2013), and reinforced by the Treaty on Stability, Coordination and Governance (which entered into force in January 2013 in its 25 signatory countries).

Better rules

- **Headline deficit and debt limits**: Limits of 3% of GDP for deficits and 60% of GDP for debt are set in the Stability and Growth Pact and enshrined in the Treaty. They remain valid.

- **A stronger focus on debt**: The new rules make the existing 60% of GDP debt limit operational. This means that Member States can be placed in the Excessive Deficit Procedure if they have debt ratios above 60% of GDP that are not being sufficiently reduced (where the excess over 60% is not coming down by at least 5% a year on average over three years).

- **A new expenditure benchmark**: Under the new rules, public spending must not rise faster than medium-term potential GDP growth, unless it is matched by adequate revenues.

- **The importance of the underlying budgetary position**: The Stability and Growth Pact focuses more on improving public finances in structural terms (taking into account the effects of an economic downturn or one-off measures on the deficit). Member States set their own medium-term budgetary objectives, updated at least every three years, with the goal of improving their structural balance by 0.5% of GDP a year. This provides a safety margin against breaching the 3% headline deficit limit, with Member States, particularly those with debts over 60% of GDP, urged to do more in economic good times and less in economic bad times.

- **A fiscal pact for 25 member states**: Under the Treaty on Stability, Coordination and Governance (TSCG), as of January 2014 medium-term budgetary objectives must be enshrined in national law and there must be a limit of 0.5% of GDP on structural deficits (rising to 1% if the debt-to-GDP ratio is well below 60%). This is called the Fiscal Pact. The treaty also says that automatic correction mechanisms should be triggered if the structural deficit limit (or the adjustment path towards it) is breached, which would require Member States to set out in national law how and when they would rectify the breach over the course of future budgets.

- **Flexibility during a crisis**: By focusing on the underlying budgetary position over the medium term, the Stability and Growth Pact can be flexible during a crisis. If growth deteriorates unexpectedly, Member States with budget deficits over 3% of GDP may receive extra time to correct them, as long as they have made the necessary structural effort. This was the case in 2012 for Spain, Portugal and Greece, and in 2013 for France, the Netherlands, Poland and Slovenia.
Better enforcement of the rules

- **Better prevention**: Member States are judged on whether they meet their medium-term targets. Progress is assessed each April when Member States present their Stability/Convergence Programmes (three-year budget plans, the former for euro area countries, the latter for the EU). These are published and examined by the Commission and the Council within, at most, three months. The Council can adopt an opinion or invite Member States to make adjustments to the plans.

- **Early warning**: If there is a "significant deviation" from the medium-term target or the adjustment path towards it, the Commission addresses a warning to the Member State, to be endorsed by the Council and which can be made public. The situation is then monitored throughout the year, and if it is not rectified, the Commission can propose an interest-bearing deposit of 0.2% of GDP (euro area only), which must be approved by the Council. This can be returned to the Member State if it corrects the deviation.

- **Excessive Deficit Procedure (EDP)**: If Member States breach either the deficit or debt criteria, they are placed in an Excessive Deficit Procedure, where they are subject to extra monitoring (usually every three or six months) and are set a deadline for correcting their deficit. The Commission checks compliance throughout the year, based on regular economic forecasts and Eurostat debt and deficit data.

- **Swifter sanctions**: For euro area Member States in the Excessive Deficit Procedure, financial penalties kick in earlier and can be gradually stepped up. Failure to reduce the deficit can result in fines of 0.2% of GDP. Fines can rise to a maximum of 0.5% if statistical fraud is detected and penalties can include a suspension of Cohesion funding (even for non-euro area countries). In parallel, the 25 Member States that signed the TSCG can be fined 0.1% of GDP for failing to properly integrate the Fiscal Pact into national law.

- **New voting system**: Decisions on most sanctions under the Excessive Deficit Procedure are taken by Reverse Qualified Majority Voting (RQMV), which means that fines are deemed to be approved by the Council unless a qualified majority of Member States over-turns them. This was not possible before the Six Pack entered into force. In addition, the 25 Member States that have signed the Treaty on Stability, Coordination and Governance have agreed to replicate the Reverse QMV mechanism even earlier in the process, for example, when deciding whether to place a Member State in the Excessive Deficit Procedure.

**STEPPED-UP SURVEILLANCE IN THE EURO AREA**

The crisis has showed that difficulties in one euro area Member State can have important contagion effects in neighbouring countries. Therefore, extra surveillance is warranted to contain problems before they become systemic.

The Two Pack, which came into force on 30 May 2013, introduced a new cycle of monitoring for the euro area, with the submission of Member States' draft budgetary plans every October (except for those under macroeconomic adjustment programmes). The Commission then issues an opinion on them
This also allows for more in-depth monitoring of euro area countries in excessive deficit, and for tighter surveillance of those facing more serious difficulties.

- **Member States in the Excessive Deficit Procedure** must submit regular progress reports on how they are correcting their deficits. The Commission can now request more information or recommend further action from those at risk of missing their deficit deadlines. Euro area Member States with excessive deficits must also submit Economic Partnership Programmes, which contain plans for detailed fiscal-structural reforms (for example, on pension systems, taxation or public healthcare) that will correct their deficits in a lasting way.

- **Member States experiencing financial difficulties or under precautionary assistance programmes from the European Stability Mechanism** are put under "enhanced surveillance", which means they are subject to regular review missions by the Commission and must provide additional data on their financial sectors.

- **Financial assistance programmes**: Member States whose difficulties could have "significant adverse effects" on the rest of the euro area can be asked to prepare full macroeconomic adjustment programmes. This decision is taken by the Council, acting by a qualified majority on a proposal from the Commission. These programmes are subject to quarterly review missions and strict conditions in exchange for any financial assistance.

- **Post-programme surveillance**: Member States will undergo post-programme surveillance as long as 75% of any financial assistance drawn down remains outstanding.

**MONITORING EXTENDED TO MACROECONOMIC IMBALANCES**

Drawing on the experience of the crisis, the Six Pack reforms introduced a system of monitoring for economic policies, adding to the normal surveillance under the European Semester. This is called the Macroeconomic Imbalances Procedure, and contains a number of sequential steps:

- **Better prevention**: All Member States continue to submit National Reform Programmes – this is now done every year in April. These are published by the Commission and examined to ensure that any planned reforms are in line with the EU's growth and jobs priorities, including the Europe 2020 strategy for long-term growth.

- **Early warning**: Member States are screened for potential imbalances against a scoreboard of 11 indicators, as well as auxiliary indicators and other information, to measure economic developments over time. Each November, the Commission publishes the results in the Alert Mechanism Report (see [MEMO/12/912](#)). The report identifies Member States that require further analysis (an in-depth review), but does not draw any conclusions.

- **In-depth reviews**: The Commission undertakes an in-depth review of those Member States identified in the AMR that are potentially at risk of imbalances. The in-depth review is published in the spring and confirms or denies the existence of imbalances, and whether they are excessive or not. Member States are requested to take the findings of the in-depth review into account in their reform plans for the following year. Any follow-up is integrated into the advice the Commission gives to each Member State in the country-specific recommendations at the end of May.
• **Excessive Imbalances Procedure**: If the Commission concludes that excessive imbalances exist in a Member State, it may recommend to the Council that the Member State draw up a corrective action plan, including deadlines for new measures. This recommendation is adopted by the Council. The Commission and Council monitor the Member State throughout the year to check whether the policies in the corrective action plan are being implemented.

• **Fines for euro area Member States**: Fines apply only as a last resort and are levied for repeated failure to take action (not on the correction of the imbalances themselves). For example, if the Commission repeatedly concludes that a euro area Member State's corrective action plan is unsatisfactory, it can propose that the Council levy a fine of 0.1% of GDP a year. Penalties can also be levied and stepped up if Member States fail to take action based on the plan (starting with an interest-bearing deposit of 0.1% of GDP, which can be converted to a fine if there is repeated non-compliance). The sanctions are approved unless a qualified majority of Member States overturn them.

**A BLUEPRINT FOR THE FUTURE**

The reforms undertaken over the last three years are unprecedented, but the crisis has demonstrated how much the interdependence of our economies has increased since the foundation of the Economic and Monetary Union. There is a particular need for euro area countries to work closer together to make policy decisions that take into account the wider interest of their fellow euro area members.

The European Commission’s ideas for the future are set out in the Blueprint on a Deep and Genuine Economic and Monetary Union, published on 28 November 2012 (see [IP/12/1272](http://ec.europa.eu/economy_finance/economic_governance/macroeconomic_imbalance_procedure/index_en.htm)). The Blueprint sets out how to build on the architecture we have, step-by-step, in the coming months and years.

The Commission has already developed its ideas on a framework for the ex-ante coordination of major structural reforms and on a convergence and competitiveness instrument to encourage and support Member States that are implementing difficult reforms (see [IP/13/248](http://ec.europa.eu/economy_finance/economic_governance/macroeconomic_imbalance_procedure/index_en.htm)). These proposals will be developed following discussions at the European Council.

**FURTHER INFORMATION**

**On the European Semester:**
[http://ec.europa.eu/europe2020/making-it-happen/index_en.htm](http://ec.europa.eu/europe2020/making-it-happen/index_en.htm)

**On the Excessive Deficit Procedure** (including ongoing EDPs by country):

**On the Macroeconomic Imbalances Procedure** (including in-depth reviews by country)

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