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**Publication status and date:**
Published: 17/03/2023

**Document Version**
Peer reviewed version

**Citation for the published version (APA):**
Markakis, M. (2023). The Commission’s Orientations for Reforming the EU Economic Governance Framework: A Legal Analysis. Web publication/site



Link to publication on the EUR Research Information Portal

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**Erasmus University Rotterdam**
Making Minds Matter

**The Commission's Orientations for Reforming the EU Economic Governance Framework: A Legal Analysis**

Menelaos Markakis[1]

On 9 November 2022, the European Commission published a communication setting out its orientations for a reform of the EU fiscal and economic governance framework.[2] Taking into account the key concerns over the current framework, which are broadly in line with the findings of its economic governance review as well as other studies in the field,[3] these orientations aim to strengthen debt sustainability and promote sustainable and inclusive growth through investments and reforms. The Commission proposes revising the EU fiscal framework and the Macroeconomic Imbalances Procedure (MIP). 'Improving national ownership, simplifying the framework and moving towards a greater medium-term focus, combined with stronger and more coherent enforcement, are key elements in the Commission's orientations' (p. 1).

**The main features of the Commission's orientations**

The Commission proposes moving to *a more risk-based surveillance framework that puts debt sustainability at its core and that differentiates more between countries by taking into account their public debt challenges*, whilst adhering to a transparent and common EU framework. The reference values on which the deficit and debt criteria are based (the famous 3% and 60% rules) would remain unchanged, which would obviate the need to amend Protocol (No 12) on the excessive deficit procedure. The 'debt reduction benchmark' would be adapted to the country-specific debt ratio, while the requirement to maintain budget deficits credibly below 3% of GDP would be preserved (p. 7). It will be recalled that the 'debt reduction benchmark' determines whether the ratio of government debt to GDP shall be considered as sufficiently diminishing and approaching the reference value at a satisfactory pace in accordance with Article 126(2)(b) TFEU. Various reform proposals have highlighted the need that this rule be adjusted. It is enshrined in Regulation 1467/97 (Article 2(1a))[4] and could be amended on the basis of the second subparagraph of Article 126(14) TFEU, which requires that the Council of the EU act unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the ECB.

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[2] European Commission, 'Communication on Orientations for a Reform of the EU Economic Governance Framework', COM(2022) 583 final, 9 November 2022.

[3] See further Menelaos Markakis, *'The EU Fiscal Rules: Principle, Policy, and Reform Prospects'*, pp. 10-12. Forthcoming in Dariusz Adamski, Fabian Amtenbrink and Jakob de Haan (Eds.), *The Cambridge Handbook on European Monetary, Economic and Financial Market Integration*, CUP.

[4] Council Regulation (EC) 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ 1997 L 209, p. 6, as currently in force.

*National medium-term fiscal-structural plans* that bring together the fiscal, reform and investment commitments of each Member State within a common EU framework would form the cornerstone of the proposed framework (p. 6). These plans would merge the stability (for Euro area Member States) and convergence (for non-Euro area Member States) programmes, which contain the necessary information for the purposes of multilateral surveillance, with the national reform programmes (p. 6 fn 7). This single holistic plan would integrate fiscal, reform and investment objectives, including those to address macroeconomic imbalances (where these exist). 'This would ensure consistency and streamline processes and deliverables, while recognising that reforms and investments can have a positive impact on fiscal sustainability' (p. 6).

Member States would have greater leeway in setting their fiscal adjustment path. More specifically, the Commission would present a reference fiscal adjustment path, covering a period of four years, based on its debt sustainability analysis methodology. The revised EU fiscal framework would set the requirements to ensure that the debt ratio is put on a downward path or stays at prudent levels and that the budget deficit is maintained below 3% of GDP over the medium term.[5] Member States would set out their country-specific fiscal trajectories and priority public investment and reform commitments. In this connection, they would be required to address the priorities identified in country-specific recommendations and to put forward initiatives that are in line with strategic EU priorities. During the lifetime of the Recovery and Resilience Facility, cross-references to the national recovery and resilience plans would be needed to ensure policy consistency (pp. 6-7).

The Commission orientations form part of a 'new generation of reform proposals',[6] which rely on expenditure rules with a debt anchor. More specifically, *a single operational indicator (net primary expenditure), which would be defined so as to ensure debt sustainability*, would serve as a basis for setting the fiscal adjustment path and carrying out fiscal surveillance.[7] The use of this indicator would allow for the operation of automatic stabilisers, including revenue and expenditure fluctuations outside the direct control of government. This would ensure, it is hoped, a higher degree of macroeconomic stabilisation. The agreed multiannual net primary expenditure path should ensure that debt is put or kept on a downward path at the latest by the end of the adjustment period or stays at prudent levels, and that the budget deficit is

[5] The structural primary balance creeps back into the framework, insofar as, for each Member State, the multiannual expenditure path would be translated into the corresponding level of the structural primary balance, which would also be used to assess the plans (pp. 11-12). This is surprising, given that the orientations *themselves* speak of '…the difficulties associated with designing policy recommendations on the basis of unobservable indicators that are subject to frequent revisions (such as the "output gap" and the "structural balance")' (p. 4).

[6] European Fiscal Board, *'Annual Report 2021'*, 10 November 2021, p. 76.

[7] Net primary expenditure is defined as expenditure net of discretionary revenue measures and excluding interest expenditure and cyclical unemployment expenditure (p. 8).

maintained below 3% of GDP over the medium term (p. 8). Nationally-financed expenditure should stay within the agreed multiannual net primary expenditure path, with no deviation possible due to cyclical conditions (pp. 15-16).

*The Commission would assess the Member States' medium-term fiscal-structural plans* against the revised common EU framework. Member States could request an extension of the adjustment period by a maximum of 3 years, provided that the fiscal adjustment path is underpinned by a set of reforms and investments that support sustainable growth and debt sustainability. The common EU framework would also establish the criteria for assessing those reforms and investments. The plans would be adopted by the Council of the EU on the basis of the Commission assessments. The Council could also recommend that a Member State submit a modified plan (pp. 9, 14-15).

*The monitoring of the implementation of the medium-term fiscal-structural plans* would be undertaken by the Commission and Council under the European Semester. Member States would submit annual progress reports. The national plans should commit the annual national budgets for the whole adjustment period, with a possibility for Member States to revise them after a minimum of four years.[8] The plan could be revised earlier in case of objective circumstances making its implementation infeasible, in agreement with the EU institutions (pp. 8-9, 13).

For major shocks to the Euro area or the EU as a whole, *a general escape clause* would be maintained to deal with a severe economic downturn, thereby allowing for a temporary deviation from the fiscal path. Moreover, *an exceptional circumstances clause* would allow for temporary deviations from the fiscal path in the case of exceptional circumstances outside the control of the government with a major impact on the public finances of an individual Member State (p. 16). This is all familiar from the current Stability and Growth Pact (SGP).

While more scope would be given, per the Commission's orientations, to Member States for the design of their fiscal trajectories, *a more stringent EU enforcement* would underpin multilateral surveillance. There would no longer be annual fiscal recommendations for Member States that comply with their plans. The Commission/Council could issue recommendations with early warnings if they see strong risks of breaching the 3% rule or in case of deviations from the agreed fiscal path (p. 17). The excessive deficit procedure (EDP) would remain unchanged for breaches of the deficit criterion, and would be strengthened for breaches of the debt criterion. For Member States with a *substantial* public debt challenge, departures from

[8] The minimum adjustment period 'could be lengthened to match the national legislature, if Member States so wish' (p. 8). But how about *shorter* periods, following a change of government? While Member States would remain free to undertake additional reforms or investments, new policy initiatives would *not* imply a reopening of the agreed multiannual net primary expenditure path (p. 16).

the agreed fiscal path would by default lead to the opening of an EDP.[9] For Member States with a *moderate* public debt challenge, deviations could lead to the opening of an EDP, if they give rise to 'gross errors' (pp. 9 and 17).

The Commission also proposes broadening the range of available *sanctions*. It envisions an admixture of *financial sanctions*, which, according to the argument, would be rendered more effective by lowering their amounts; *reputational sanctions*, such as requiring national ministers to present to the European Parliament their plans to comply with the EDP recommendations; and *macroeconomic conditionality*, *i.e.*, EU financing could also be suspended when Member States have not taken effective action to correct their excessive deficit (p. 17). Furthermore, *a new enforcement tool* would ensure the implementation of reform and investment commitments. We have seen that Member States could request a more gradual adjustment path by putting forward a specific set of priority reforms and investments. In case those commitments were not implemented, the proposed tool would result in a more restrictive adjustment path, as well as financial sanctions for Euro area Member States (pp. 9-10, 18).[10] Arguably, one would expect a reference to the possible establishment of a central fiscal capacity (or, at least, a reform support programme) at this juncture, perhaps even *in lieu of* such an 'enforcement tool', but no such reference is made. This is with the exception of an annex to the orientations, outlining the views of stakeholders on different aspects of EU fiscal and economic governance.

It is further proposed that a greater role be accorded to *independent fiscal institutions* (IFIs) in the monitoring and implementation of the fiscal rules. IFIs would play an important role in assessing the assumptions underlying the plans, and the adequacy of the plans with respect to debt sustainability and country-specific medium-term goals; and in monitoring compliance with the plans. This would entail improving the set-up and performance of IFIs. It is hoped by the Commission that this would lead to greater debate at national level and thus a higher degree of political buy-in and ownership of the plans. The Commission will further reconsider the mandate and role of the European Fiscal Board (pp. 10 and 16).[11]

Last but definitely not least, various reform proposals focus on the relationship between the fiscal rules and the MIP. The Commission's orientations are no exception to this, in that they seek to establish *a more effective framework to detect and correct macroeconomic imbalances*. The Commission aspires to achieve better implementation and greater ownership by the Member States though an enhanced dialogue, leading to a better common understanding of the challenges identified under the MIP and the policies needed to

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[9] In case the original path is no longer feasible, due to objective circumstances, the Commission could propose to the Council an amended path (p. 17).

[10] The precise modalities and legal basis of this instrument will need to be elaborated (p. 10 fn 11).

[11] See, most recently, EU Independent Fiscal Institutions, *'EU Economic Governance Proposal Reform: Issues and Insights from EU IFIs'*, 2 March 2023.

address them. The preventive role of the MIP would be strengthened, in a macroeconomic environment characterised by new and evolving risks. Both the first screening for imbalances in the Alert Mechanism Report and the assessment of whether imbalances exist in the in-depth reviews would be made more forward-looking with a view to detecting and addressing imbalances early on. The reformed framework would place more weight on the evolution of risks and policy implementation, and highlight vulnerabilities that could possibly affect the EU and the Euro area as a whole. This would help internalise spillovers and feed into Euro area recommendations (pp. 10-11, 18-19).

The Commission's orientations foresee a number of links between the MIP and fiscal surveillance. For Member States experiencing imbalances, their medium-term fiscal-structural plans should also include reforms and investments to correct those imbalances. In case of non-implementation of MIP-relevant reforms and investments underpinning a longer adjustment period, an Excessive Imbalances Procedure could be launched for countries with excessive imbalances. The Member State concerned would be asked to present a revised fiscal-structural plan, which would act as the corrective action plan currently provided for in Regulation 1176/2011, Article 8 (pp. 10-11).[12]

**Further steps and outlook for the future**

At the time of writing, it is unclear whether the EU's fiscal and economic governance framework will be reformed, or what the reformed framework will look like. On the basis of these orientations and the ensuing discussion, the Commission will *consider* tabling legislative proposals (p. 21). It is forcefully argued that a swift agreement on revising the EU fiscal rules and other elements of the economic governance framework is a pressing priority at the current critical juncture for the EU economy. Member States and the Commission should reach a consensus on the reform of the existing framework ahead of the Member States' budgetary processes for 2024 (p. 20).[13]

It is rightly argued by the Commission that a thorough reform of the EU fiscal and economic governance framework would require legislative change. This '…would follow the ordinary legislative procedure, involving on most aspects the Council and the European Parliament on an equal footing' (pp. 20-21). Whilst this is true for amendments to the *preventive* arm of the SGP, as well as to Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances (Article 121(6) TFEU), it is not true with respect

[12] Regulation 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, OJ 2011 L 306, p. 25.

[13] The Ministers exchanged views on the economic governance review at the ECOFIN Council of 14 February 2023. The Presidency concluded that further work was needed in order to find an agreed way forward. The March ECOFIN Council will provide another opportunity to move forward.

to the *corrective* arm of the SGP (second subparagraph of Article 126(14) TFEU). Does this mean that no changes are envisaged to the corrective arm of the SGP? That surely cannot be the case, insofar as changes are foreseen for the 'debt reduction benchmark', which is enshrined in Regulation 1467/97. Furthermore, the Commissions argues that '[m]ost of the objectives of the proposed reform to the MIP could be pursued within the existing legal provisions' (p. 21). 'In particular, pursuing a more forward-looking approach to better assess risks and the adjustment of the criteria followed to decide on the existence and classification of imbalances and their correction could be accommodated within the current legal framework' (ibid). It is indeed true that the scoreboard of indicators, their indicative thresholds (where these exist) and the methodology used could be changed by the Commission, in close cooperation with the European Parliament and the Council (Regulation 1176/2011, Article 4(7) and recital 12), without the need to amend Regulation 1176/2011, provided that such changes would not contradict its provisions.[14]

One last point on transparency and accountability is warranted, since they are, again, given short shrift. According to the orientations, '[m]ultilateral discussions in the relevant committees of the Council would ensure transparency and accountability, with the Council endorsing the adequacy of the plan. This model would strengthen national ownership. Based on a better integration of the requirements of the revised common EU framework in domestic policy debates, it would strengthen multilateral fiscal surveillance' (p. 9). This quote confirms what has been noted earlier in the relevant literature, namely that high-level reports on the reform of the Economic and Monetary Union only discuss accountability as an afterthought and that they often conflate different issues, such as accountability, transparency, national ownership, effective implementation, and so on.[15] Some issues of transparency and accountability are highlighted in the orientations with respect to post-programme surveillance (Regulation 472/2013, Article 14),[16] with reference to the work of the European Court of Auditors (pp. 19-20).[17] Given the ever-increasing significance of fiscal rules for Member States, the degree of discretion that the EU institutions concerned would still enjoy under the revamped framework, and the proposed stricter enforcement mechanisms, such limited references to accountability and transparency are highly unsatisfactory.

[14] Leo Flynn, *'Non-Fiscal Surveillance of the Member States'* in Fabian Amtenbrink and Christoph Herrmann (Eds.), assisted by René Repasi, *The EU Law of Economic and Monetary Union*, OUP, 2020, p. 859 fn 39.

[15] Paul Craig and Menelaos Markakis, *'EMU Reform'* in ibid, p. 1447.

[16] Regulation 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 2013 L 140, p. 1.

[17] European Court of Auditors, *'Special Report 18/2021: Commission's Surveillance of Member States Exiting a Macroeconomic Adjustment Programme: An Appropriate Tool in Need of Streamlining'*, 15 September 2021.