The EU's economic governance explained

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The lessons learned from the recent economic, financial and sovereign debt crises have led to important reforms of the EU's economic governance rules. Surveillance systems have been strengthened for budgetary and economic policies and a new budgetary timeline for the euro area has been introduced.

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

The following are the essential features of the 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 effectively no comprehensive overview of the efforts made at national level, and little 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 before Member States adopt final decisions. The Commission also monitors whether Member States are working towards the jobs, education, innovation, climate and poverty reduction targets of the EU's long-term growth strategy, 'Europe 2020'.

A clear timeline

The cycle starts in November each year with the publication of the Commission's Annual Growth Survey and the Alert Mechanism Report. The Annual Growth Survey sets out general economic priorities for the EU and provides Member States with policy guidance for the following year. The Alert Mechanism Report is the starting point of the annual Macroeconomic Imbalance Procedure (MIP). The MIP aims to identify and address imbalances that hinder the smooth functioning of the economies of Member States, the economy of the EU, or the euro area.

After analysing the reform efforts and commitments made by each Member State, country-specific recommendations published in the spring offer Member States tailored advice on actions for the following year to advance deeper structural and fiscal reforms, which often take more than a year to complete.

Budgetary monitoring intensifies in the autumn for euro area Member States, which must submit draft budgetary plans by 15 October each year. They are then assessed by the Commission by 30 November and discussed among euro area Finance Ministers.

The Commission closely monitors policy implementation, with a focus on Member States with fiscal or financial problems.

RESPONSIBLE BUDGETING

The Stability and Growth Pact was introduced at the same time as the single currency in order to ensure sound public finances across the EU. However, the way it was enforced before the crisis did not prevent the emergence of serious fiscal imbalances in some Member States. These imbalances were exposed during the financial crisis.
The Stability and Growth Pact has been reinforced by the Six Pack (which became law in December 2011), the Two Pack (which became law in May 2013), and also by the Treaty on Stability, Coordination and Governance (became law in January 2013 in its 25 signatory countries[1]).

**Better rules to guarantee budgetary discipline:**

- **Headline deficit and debt limits:** Limits of 3% of GDP for government deficits and 60% of GDP for public debt are set in the Stability and Growth Pact and enshrined in the EU 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 under the Excessive Deficit Procedure if they have debt ratios above 60% of GDP that are not being sufficiently reduced (i.e. the excess over 60% is not coming down by at least 5% a year on average over three years, or the Member State is not making sufficient progress towards the required pace of debt reduction during the three-year transition period[2]).

- **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 budget balance by 0.5% of GDP a year as a benchmark. 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 when economic times are good and less when they are bad.

- **A Fiscal Pact for 25 Member States:** According to the Treaty on Stability, Coordination and Governance (TSCG), from January 2014, medium-term budgetary objectives must be part of 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 Compact. 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 correct the breach over the course of future budgets.

**Flexibility during a crisis:** By focusing on the structural budget balance, which irons out the impact of the economic cycle as well as one-off or temporary measures, the Stability and Growth Pact is 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 fiscal 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 budget targets. These are set out in April each year by euro area Member States in Stability Programmes and by non-euro area Member States in Convergence Programmes. The programmes are published and examined by the Commission and the EU Council of Ministers and feed into the Commission’s country-specific recommendations each spring.

- **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, which must be endorsed by EU Finance Ministers, and which can be made public. The situation is then monitored throughout the year. If a euro area Member State fails to rectify the situation, the Commission can propose a sanction in the form of a deposit of up to 0.2% of GDP to be paid into an interest-bearing account. Any such sanction must be approved by the EU Council of Ministers and can be reversed if the Member State corrects the deviation.
- **Excessive Deficit Procedure (EDP):** If Member States breach either the deficit criterion or the debt criterion, the Commission prepares a report to consider whether or not an Excessive Deficit Procedure (EDP) should be launched. Member States in EDP are subject to extra monitoring (usually every three or six months) and have a deadline for correcting the situation. The Commission checks compliance throughout the year, based on regular economic forecasts and Eurostat data. The Commission can request more information or recommend further action from those at risk of missing their deficit deadlines.

- **Swifter sanctions:** For euro area Member States under 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 up to 0.2% of GDP. These can rise to a maximum of 0.5% if statistical fraud is detected. Penalties can include a suspension of the European Structural and Investment Funds (even for non-Euro area countries, except the United Kingdom). For further details, see info graphic in the Annex.

- **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 EU Council of Ministers unless a qualified majority of Member States overturns them. This was not possible before the Six Pack entered into force. In addition, the 25 Member States that signed the Treaty on Stability, Coordination and Governance have agreed to apply the RQMV mechanism earlier in the process as well, for example, when deciding whether to place a Member State under the Excessive Deficit Procedure.

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

The crisis has shown that difficulties in one euro area Member State can affect neighbouring countries. Therefore, extra coordination and surveillance are needed to contain problems before they become systemic.

The **Two Pack**, which became law on 30 May 2013, introduced a new cycle of monitoring for the euro area, with Member States submitting by 15 October to the Commission **draft budgetary plans covering the following year** (except for those countries with macroeconomic adjustment programmes). The Commission then issues an opinion on them by the end of November.

The Two Pack also introduced the following:

- **Member States receiving new recommendations under the Excessive Deficit Procedure** must submit Economic Partnership Programmes, which include details of fiscal and structural reforms they intend to carry out (for example, on pension systems, taxation or public healthcare) to correct their deficits in a lasting way.

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

- **Financial assistance programmes:** Member States with difficulties that 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 EU Council of Ministers, 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:** After exiting an economic adjustment programme, Member States undergo post-programme surveillance until they have repaid 75% of the financial assistance extended to them.
The **Six Pack** introduced a system to monitor broader economic policies, so as to detect problems such as real estate bubbles, issues in external sustainability or falling competitiveness early on. This is called the **Macroeconomic Imbalance Procedure**, and it contains a number of sequential steps:

- **Alert Mechanism Report (AMR):** 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/13/970](#)). The report identifies Member States that require further analysis (an In-Depth Review), but does not draw any conclusions on the existence of imbalances and does not provide policy recommendations.

- **In-Depth Reviews:** The Commission carries out an In-Depth Review of those Member States identified in the AMR in order to examine in further detail the accumulation and unwinding of imbalances, and the related risks for growth, jobs and financial stability. The In-Depth Reviews are published in the spring and identify whether there are imbalances or excessive imbalances. This analytical work feeds into the country-specific policy recommendations (CSRs) at the end of May or early June.

- **Excessive Imbalance Procedure:** If the Commission concludes that excessive imbalances exist in a Member State, an Excessive Imbalance Procedure can be launched. In this case, the Member State concerned must draw up a corrective action plan, including deadlines for new measures. This corrective action plan must be endorsed by the Commission and the EU Council of Ministers. The Commission checks throughout the year whether the policies in the 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 imbalances themselves. For example, if the Commission repeatedly concludes that a corrective action plan is unsatisfactory, it can propose that the Council of Ministers levy a fine of 0.1% of GDP a year (for euro area Member States only). Penalties also apply 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.

**ECONOMIC GOVERNANCE REVIEW**

The Commission has today published a review of various pieces of legislation that make up the "Six Pack" (see [MEMO/11/898](#)) and the "Two Pack" (see [MEMO/13/457](#)). The review examines to what extent the new rules have been effective in their aim of achieving closer coordination of economic policies.

Although only in operation for a limited period of time, the reformed framework of fiscal surveillance has already played a role in correcting excessive deficits. In the EU-28 average fiscal deficit has been falling from 4.5% of GDP in 2011 to a forecast of around 3% of GDP in 2014. The number of countries in Excessive Deficit Procedure has decreased from 23 out of 27 Member States to 11 out of 28.

The Macroeconomic Imbalances Procedure has contributed to a shared understanding of Member States’ policy challenges and imbalances are being corrected. However, growth is still fragile and economic challenges remain significant.

While the regulations have significantly strengthened the EU’s economic governance framework, the review also reveals possible areas for improvement, concerning the transparency and complexity of the rules-based framework, and its impact on growth and imbalances. The Commission plans to discuss these with the European Parliament and the Council in the coming months.

**A DEEPER ECONOMIC AND MONETARY UNION**

The reforms undertaken in recent 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. A Deeper and Fairer Economic and Monetary Union is one of the top priorities of the
Juncker Commission as detailed in its Political Guidelines. This means continuing the reform of the Economic and Monetary Union to preserve the stability of the single currency and to enhance the convergence of economic, fiscal and labour market policies between the Member States that share the single currency.

At the last Eurozone Summit on 24 October, the Commission was invited to develop, in cooperation with Member States, concrete mechanisms for stronger economic policy coordination, convergence and solidarity. The Eurozone Summit invited the President of the Commission, in close cooperation with the President of the Euro Summit, the President of the Eurogroup and the President of the European Central Bank, to prepare next steps on better economic governance in the euro area. President Juncker has announced that he will present to the December European Council how he intends to take forward the work on the basis of the Commission's Blueprint for a Deep and Genuine Economic and Monetary Union, published on 28 November 2012 (see IP/12/1272). This will be the basis for launching further legislative and non-legislative initiatives to deepen the Economic and Monetary Union.

FURTHER INFORMATION

On the European Semester:
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)
http://ec.europa.eu/economy_finance/economic_governance/macroeconomic_imbalance_procedure/index_en.htm

ANNEX

Overview of Member States
The Excessive Deficit Procedure at a glance

[1] All Member States except the Czech Republic, the United Kingdom and Croatia.

[2] Countries that were in EDP on the date that the Six Pack amendments to the Stability and Growth Pact were adopted – that is 8 November 2011 – will be subject to transitional arrangements for the three years following the correction of their excessive deficit. During those three years, the debt requirement will be judged according to whether the Member State in question makes sufficient progress towards compliance.

General public inquiries:
Europe Direct by phone 00 800 67 89 10 11 or by email