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Subject:	Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance

Delegations will find attached Commission document COM(2010) 367 final.

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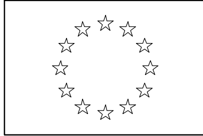

EUROPEAN COMMISSION

Brussels, 30.6.2010
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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance

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

Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance

Europe has learned many lessons from the recent financial and economic crisis. We see very clearly now that in a highly integrated Union, and even more so in a monetary union, our economies and our successes are linked. Although the EU has a number of instruments for the co-ordination of economic policy the crisis has shown that they have not been used to the full and that there are gaps in the current governance system. There is broad political agreement that this has to change and that the EU needs to be equipped with a broader and more effective set of policy instruments to ensure its future prosperity and standards of living.

The EU has taken bold, comprehensive and consistent measures to overcome the crisis and draw lessons for the future. The launch of the European Economic Recovery Programme in 2008 helped cushion the shock of the downturn on our economies. Coordinated support was provided to EU Member States that needed it and to safeguard the stability of the Economic and Monetary Union. A set of measures to strengthen the supervision and regulation of the financial system is under negotiation, in the EU and beyond. Now that the framework of the Europe 2020 Strategy is in place, a series of initiatives will follow, designed to unlock the EU's potential to boost growth and create jobs.

What the EU needs is a well defined policy approach that supports economic recovery, puts public finances back on a sound footing and actively promotes sustainable growth and jobs. This is the policy vision set out in the Europe 2020 strategy that has just been endorsed by the European Council. All relevant instruments need to be brought together to ensure that future policy decisions are coherent, serve these goals and, once decided, are implemented and enforced. By strengthening its economic policy co-ordination the EU can deliver a new and sustainable growth agenda for its citizens.

In this context, the purpose of this Communication is to:

- Develop the proposals for greater economic policy co-ordination and surveillance set out in the Commission's 12 May Communication on reinforcing economic policy coordination into concrete proposals by (i) addressing imbalances through stronger macroeconomic surveillance, including alert and sanction mechanisms; (ii) strengthening national fiscal frameworks by specifying minimum requirements for domestic fiscal frameworks, and notably moving from annual to multi-annual budgetary planning; (iii) strengthening the Stability and Growth Pact, in particular by focusing on the issue of debt dynamic as well as deficits.

- Set out effective enforcement mechanisms to ensure that Member States will act in compliance with the EU framework they have agreed. Where developments in Member State economies pose a risk to the overall development of the Union, a series of preventive and corrective measures are proposed, including a range of sanctions that could be applied where breaches occur.

- Establish a European semester for policy co-ordination and explain the process and timing that will provide a European input to national policy decisions, leading to more effective ex-ante policy co-ordination. This also applies to the structural reforms and the growth enhancing elements of the Europe 2020 strategy.

The proposals in this Communication can all be agreed under the terms of the Lisbon Treaty. They are addressed to all 27 Member States although aspects of some of them will apply only to those Member States that are in the euro area. They are designed to bring together, at the same time, the country monitoring under the Stability and Growth Pact and Europe 2020 and to make sure that the thematic monitoring of the Europe 2020 targets is anchored in sound economic and fiscal policies. These proposals develop further the policy ideas set out in the Commission's Communication of 12 May 2010[1] and build on the orientations agreed at the 17 June 2010 European Council, reflecting the progress to date of the Task Force on economic governance. They respond to the invitation of the European Council to the Task Force and the Commission to develop its orientations further and to make them operational.

Taken together, this combination of proposals will equip the EU and national levels to have confidence in the quality of the policy and decision making process and to have earlier warning of where national situations are going off track. This will enable all Member States to maximise the positive synergies of belonging to the same Union. It will bring greater transparency and mutual confidence through a more collective process. It will also minimise the negative spillover effects where Member States do not stick to agreed limits and ultimately, sanction those who endanger the common good through unsustainable national actions. By bringing the Stability and Growth Pact and Europe 2020 processes together the EU can build on the necessary consolidation measures as essential steps in its longer term growth strategy, building a smarter, more sustainable and more inclusive EU for the future.

1. BROADER MACROECONOMIC SURVEILLANCE

The EU needs stronger macro-economic country surveillance integrating all relevant economic policy areas. Macroeconomic imbalances should be looked at jointly with fiscal policy and growth-enhancing structural reforms. The objective is to ensure macroeconomic stability, prevent occurrence of harmful imbalances and establish broad macroeconomic framework conditions which allow for sustainable and dynamic growth.

1.1. Surveillance of macroeconomic imbalances

The emergence of large macroeconomic imbalances, including large and persistent divergences in competitiveness trends, proved highly damaging to the EU and in particular to the euro when the crisis struck. It is therefore important to develop a new structured mechanism for the surveillance of harmful macroeconomic imbalances and their correction in all Member States. Following a two-stage approach, the Commission is proposing a mechanism comprising:

– a **preventive arm** with regular (annual) assessments of the risk of macroeconomic imbalances, including an **alert mechanism**,

[1] COM(2010) 250 on Reinforcing economic policy coordination.

– a **corrective arm**, designed to enforce the implementation of **remedies** in case of harmful macroeconomic imbalances.

Preventive arm: an alert system

Within the framework of the macro-structural country surveillance under Europe 2020, the Commission would assess macro-structural weaknesses, deteriorating competitiveness and emerging macro-economic imbalances on a country-by-country basis, taking into account the economic and financial interlinkages in particular within the euro area.

A scoreboard establishing a set of indicators revealing external and internal imbalances combined with qualitative expert analyses will be the basis for an alert mechanism. The use of indicators would provide important guidance, but there will not be a mechanical link between the results of the scoreboard and the policy follow up.

For countries exhibiting significant risks, in-depth country analysis would be conducted. Where emerging risks are confirmed, the Commission will propose country-specific Council recommendations to tackle harmful macroeconomic imbalances. The Commission could also issue an early warning directly to that Member State.

Depending on the nature of the imbalances identified in the Member State(s), the recommendations could address a broad range of policy issues covering macroeconomic policies, wages and labour markets as well as the functioning of goods and services markets and macro-prudential policies. These will be incorporated into the single set of country-specific recommendations that the Commission will propose annually, together with the recommendations issued under the thematic surveillance of structural reforms, as described below.

This mechanism will be the central part of the enhanced (non-fiscal) macroeconomic country surveillance foreseen under Europe 2020. Together with fiscal surveillance under the Stability and Growth Pact, country surveillance aims at ensuring a stable macroeconomic environment conducive to growth and employment creation, taking full account of the interdependence between Member States economies, particularly in the euro area. This will ensure consistency within Europe 2020, in particular by identifying the macro/fiscal constraints within which Member States are to implement structural reforms and can invest in the growth-enhancing policies of Europe 2020.

In particularly serious cases, the Commission would recommend placing the Member State in an "excessive imbalances position". This would trigger the 'corrective arm' of the mechanism described below. In such a case, the Commission could also issue an early warning directly to that Member State.

Main features of the alert mechanism for macroeconomic imbalances

The alert mechanism will identify Member States with potentially problematic levels of macroeconomic imbalances and where further in-depth country-specific analysis is required.

The alert mechanism will consist of a scoreboard of indicators, complemented by more qualitative analysis. These indicators would include measures of the external position and price or cost competitiveness as well as internal indicators. The use of internal indicators is justified on the ground that external imbalances necessarily have internal counterparts. For examples, indicators such as current account balances, net foreign asset positions, real effective exchange rate based on unit

labour costs and a GDP deflator, increases in real house prices, government debt, and the ratio of private sector credit to GDP could be part of this scoreboard.

Alert thresholds will be defined and announced for each indicator. The thresholds could be calculated on the basis of a simple and transparent statistical concept. A possible approach could be to use the 75% and 25% percentile of the statistical distributions of each variable (across countries and time) at the level above or below which a further analysis is warranted. It is however important to bear in mind that absolute threshold levels for individual variables have only limited economic meaning and need to be complemented by economic reasoning as appropriate levels can vary depending on the economic circumstances of the country.

A differentiated scoreboard for euro-area and non-euro area Member States appears warranted. Due to differences in exchange rate regimes and in key economic characteristics, the behaviour of some economic variables in the euro area is quite different from the non-euro-area countries. This argues in favour of using different alert thresholds for euro-area and non euro-area Member States. Moreover, in the absence of nominal exchange rates within the monetary union, the euro area deserves also a special analysis of real effective exchange rate developments.

Corrective action

The imbalances surveillance framework would include an **enforcement mechanism**. A Member State presenting significant risks would be placed by the Council in a position of "excessive imbalances" on the basis of a Commission recommendation. Risk warnings and/or recommendations issued by the European Systemic Risk Board on macro-financial stability would be taken into account.

A Member State in "excessive imbalances position" would be subject to stricter surveillance. The Council would issue **policy recommendations** (based on Article 121(4) and Article 136 TFEU for euro-area Member States) and the Member State would be required to report regularly to the Ecofin Council and the Eurogroup (e.g. within 6 months following the Council recommendation and on a quarterly basis thereafter) on progress in implementing the recommended reforms.

This mechanism would apply to all Member States. As with the EU's fiscal framework, which also applies to all EU Member States, more stringent rules would apply to euro area Member States. Taking account of the deep economic and financial inter-linkages within the euro area and their impact on the single currency, **specific enforcement mechanism could be envisaged for euro-area Member States in case of repetitive non-respect of the recommendations to address harmful macroeconomic imbalances that risk jeopardizing the proper functioning of economic and monetary union**.

Insufficient compliance with the recommendations under the surveillance of imbalances would be considered an aggravating factor in the fiscal assessment under the Stability and Growth Pact.

By end-September, the Commission will make formal proposals for secondary legislation, establishing a framework for dealing with **excessive imbalances** based on Articles 121 and 136 of the Treaty on the Functioning of the European Union. These proposals will specify the role of the alert mechanism; the role and obligations of the Commission, Member States and the Council; the procedure for the adoption of recommendations; and the rules and procedures as well as the enforcement mechanisms for euro area Member States.

1.2. Thematic surveillance of structural reforms

To return their economies to sustainable growth and increase competitiveness, Member States need to restore macroeconomic stability and sound public finances. At the same time they need to focus their efforts on the delivery of Europe 2020 objectives and the five headline targets agreed by the European Council An integrated approach to policy design and implementation is essential given the constraints on public finances. The identification of the bottlenecks which impede or delay the attainment of the Europe 2020 objectives is a key element of the thematic surveillance.

The objective of thematic structural reform surveillance is therefore two-fold:

(i) To facilitate the attainment of the Europe 2020 objectives, in particular the five headline targets[2]. This includes measures in the areas of employment, social inclusion, research and innovation, education, energy and climate change as well as measures to tackle any other factors that hinder Member States' economic development or growth.

(ii) To ensure ambitious implementation of the structural reforms in a manner that is consistent with the macro-fiscal constraints.

This surveillance will be carried out in accordance with Article 121 and 148 TFEU and on the basis of the Europe 2020 Integrated Guidelines. Based on Member States' National Reform Programmes the Commission will assess the way each country is addressing the bottlenecks it has identified and how it is progressing towards its national Europe 2020 targets.

In case of insufficient progress, or when policies are not sufficiently consistent with the integrated guidelines (i.e. the Integrated Guidelines for economic and employment policies), a country-specific or euro-area recommendation will be issued.

In cases where economic policies are not consistent with the Broad Economic Policy Guidelines, or when they risk jeopardising the proper functioning of the economic and monetary union, the Commission will directly address a **warning** to the relevant Member State(s).

Building on this country-specific monitoring, the Commission will make an overall assessment of progress towards the five EU headline targets, assess performance against that of main (international) trading partners and examine the underlying reasons in case of insufficient progress. In this examination the Commission will also assess how the implementation of the Europe 2020 flagship initiatives is progressing both at EU and at national level as they support and complement the efforts towards these targets.

The Commission will report to the Spring European Council each year, and will propose specific orientations to enhance the implementation of the corresponding reform measures. These orientations will also feed into the single set of country specific recommendations which the Commission will propose in early July.

2. National Fiscal Frameworks

Resilient and effective domestic fiscal frameworks play a crucial role in strengthening fiscal consolidation and sustainable public finances. While Member States' specific needs and

[2] See targets at: http://ec.europa.eu/eu2020/pdf/council_conclusion_17_june_en.pdf

preferences must be respected, a number of features stand out as being needed in terms of ensuring minimum quality and complementarity with EU rules[3]:

(1) First, in order to ensure **quality standards** in all Member States, a consistent approach is essential regarding accounting (ESA95 accounting is required for EU level fiscal surveillance); the capacity of national statistical offices must be sufficient to ensure compliance with EU data and reporting requirements; and forecasting systems must allow for the provision of reliable and unbiased growth and budget projections. Ideally, Commission forecasts should be used as the benchmark.

The Commission proposes to specify clearly the correspondence between national cash data and ESA95 data with monthly data provision on a cash basis with translation in ESA95 terms on a quarterly basis. Forecasting methodologies and macroeconomic assumptions used for budgetary purposes should be the subject of appropriate auditing.

(2) Second, Member States should have in place **national fiscal rules** ensuring that domestic fiscal frameworks reflect the Treaty obligations. Provisions of national fiscal rules should ensure the respect of the Treaty reference values on deficit and debt and be consistent with the Medium-Term budgetary Objective (MTO). Fiscal rules and credible enforcement mechanisms should be codified by national law.

(3) Third, reforms of national fiscal frameworks should promote the switch to **multi-annual budgetary planning**. Yearly budgetary objectives should be underpinned by multi-annual frameworks, including a breakdown for projected revenue and expenditure and indications of where the adjustment towards the objectives is planned to come.

(4) Finally, domestic frameworks must be **comprehensive** and cover the whole system of general government finance. This is particularly important in decentralised economies. The assignment of budgetary responsibilities across levels of government should be clearly specified and appropriate monitoring and enforcement provisions put in place.

The Commission will make formal **proposals in September specifying the minimum requirements for the design of domestic fiscal frameworks** and the procedural (reporting) requirements to allow for verification of compliance. These will take the form of a new regulation based on Article 126(14) TFEU, to foster the application of Treaty Protocol No 12 on the Excessive Deficit Procedure. Infringement proceedings could be instigated in the case of failure to comply.

3. INCREASED FOCUS ON PUBLIC DEBT AND FISCAL SUSTAINABILITY IN THE SGP

The Stability and Growth Pact (SGP) should take greater account of the interplay between debt and deficit to improve incentives to run prudent policies.

As regards the **preventive arm** of the SGP, the Commission proposes that a faster pace of progress towards a general government balance that provides a safety margin with respect to the 3% of GDP deficit limit and that ensures rapid progress towards sustainability, i.e. the so-

[3] See also Ecofin Council Conclusions of 18 May 2010 on Budgetary Frameworks.

called Medium-Term budgetary objective (MTO) be required for Member States with a high level of debt or pronounced risks in terms of future debt developments.

As regards the **corrective arm**, the Commission proposes that the debt criterion of the excessive deficit procedure be implemented effectively **through a clear and simple numerical benchmark** for defining a satisfactory pace of debt reduction: Member States with debt ratios in excess of 60% of GDP could become subject to the EDP if the decline of debt in a given preceding period falls short of this benchmark (fraction of the gap between the debt level and the 60% of GDP threshold). In the same vein, bringing the deficit below 3% of GDP may not be sufficient for the abrogation of the EDP if the debt has not been put on a sustainable declining path. The precise parameters would be set out in the Code of Conduct accompanying the Stability and Growth Pact.

More than the deficit, public debt developments are subject to factors outside the direct control of governments (in particular inflation, interest rates and cyclical growth developments), therefore judgement is necessary before deciding whether they warrant placing the country in EDP. An overall assessment should be made, taking into account a range of parameters. These include the degree of closeness of the debt ratio to the 60%-of-GDP reference value and whether the debt is temporary and/or exceptional; and other relevant factors reflecting risks of future debt increases and financing strains, such as:

– the maturity structure and currency denomination of debt;

– guarantees to corporations, financial institutions and households;

– accumulated reserves and other government assets;

– implicit liabilities, notably related to ageing;

– the level and change in private debt, to the extent that it may represent an implicit liability for the government;

– the factors behind debt change (primary balance, inflation, growth, interest rates, one-offs); and

– stock-flow operations.

In case of failure to comply with recommendations, sanctions should be applied.

In September the Commission will propose **amendments to both the preventive** (Regulation (EC) No 1466/97) **and corrective arm of the SGP** (Regulation (EC) No 1467/97) to make these principles operational.

4. EFFECTIVE ENFORCEMENT OF ECONOMIC SURVEILLANCE THROUGH APPROPRIATE SANCTIONS AND INCENTIVES

The common rules and co-ordination procedures enshrined in the Treaty and the Stability and Growth Pact have not prevented a number of Member States from implementing fiscal policies in defiance of the existing framework. There is clearly a need to strengthen the credibility of the EU's fiscal surveillance framework through a more rules-based application of sanctions. To increase their effectiveness in the future, a wider range of sanctions and

incentives should be used more preventively and kick in at an earlier stage. The deterrent effect of financial sanctions should constitute a real incentive for compliance with the rules.

Several types of sanctions are foreseen in Article 126(11) TFEU in cases where a Member States fails to comply with EU guidance. These comprise the requirement to publish additional information, an invitation to the European Investment Bank to reconsider its lending policy towards the Member State concerned, the requirement to make a non-interest-bearing deposit of an appropriate size until an excessive deficit has been corrected, and the possibility to impose fines of an appropriate size.

In refining the functioning and scope of possible financial incentives, it is important and necessary to seek effectiveness and equal treatment between Member States. To ensure proportionality, financial sanctions linked to the EU budget could be defined as a percentage of the GNI or GDP of the relevant Member State up to an identical upper limit for all Member States. This upper limit will ensure that all Member States can de facto be subject to sanctions. Moreover, the amounts of commitments and payments concerned by suspension and/or cancellation would be set on a pro-rata basis for the eligible funds up to this upper limit.

The new sanctions "toolbox" would therefore contain different types of sanctions and incentives, which will be activated depending on the set of circumstances and gravity of the situation. The proposed improvements to the existing enforcement mechanisms would require amending the preventive and corrective arms of the SGP (Regulations 1466/97 and 1467/97) as well as through an appropriate mechanism based on the various legal acts on which EU expenditure programmes are based.

As regards the **preventive arm**, (i.e. when a Member State is not making sufficient progress towards its Medium term budgetary Objective) in good economic times) two sets of incentives/sanctions will be proposed.

First, for euro-area Member States, the incentive will consist **of an interest-bearing deposit** temporarily imposed on a Member State which is making insufficient progress with budgetary consolidation. One option would be to define a simple expenditure-rule consistent with the adjustment towards the country-specific MTO. A significant deviation from the agreed expenditure path would be judged as imprudent fiscal policy-making and give rise to a warning from the Commission in line with the provisions of Article 121(4) TFEU. In case of persistent violations, an interest-bearing deposit would be imposed by the Council until the violation has been corrected. The deposit would be released once the situation giving rise to its imposition had come to an end.

Second, still within the preventive arm, the Commission will propose to establish ex-ante conditionality linking disbursement of cohesion policy support to **structural and institutional reforms** directly linked to the operation of cohesion policy with a view to improving its effectiveness and efficiency.

As regards the corrective arm, (i.e. when a Member State is subject to an excessive deficit procedure) the Commission proposes a new system of financial sanctions and incentives to complement the use of deposit and fines. This would deploy the EU budget as complementary leverage in terms of ensuring respect of the key macro economic conditions of the SGP. Sanctions should not affect end beneficiaries of EU funds but rather payment to Member States or payments for which Member States act as an intermediary. The following criteria

will be proposed to establish which EU spending categories and programmes could be considered:

- effectiveness of the funds concerned is dependent on sound fiscal policies,
- clearly attributable to the Member State found not to comply with the SGP or other conditions,
- programmed and implemented under shared management, i.e. where Member States have the main responsibility or representing reimbursements of EU funds to Member States,
- sizeable enough to create credible sanctions or incentives,
- with an impact (potentially) on the quality of public spending and structural adjustment.

These criteria are met in the case of most expenditures related to cohesion policy, Common Agricultural Policy (EAGF and EAFRD) spending and fisheries fund (EFF) expenditures. With regard to the CAP and EFF, a situation in which a reduction of EU spending would lead to a reduction of farmer's and fisherman's income would be excluded. Conditionality on payments should therefore target the EU reimbursements to the national budgets only: Member States would have to continue to pay the farm subsidies, but the reimbursement of this expenditure by the EU budget could be (partially) suspended.

In cases of non-compliance with the rules, incentives can therefore be created by suspending or cancelling part of current or future financial appropriations from the EU budget. Resources cancelled should remain within the EU budget.

As a complement to the provisions of Article 126(11), two types of financial sanctions could be envisaged earlier in the EDP process.

• Step 1 – the establishment of an excessive deficit (Article 126(6) TFEU) would result in the suspension of commitments related to multiannual programmes. This suspension would not have an immediate impact on payments and would therefore allow time for effective remedial action to be taken. Member States could be asked to redirect funds to improve the quality of public finances. Similarly, for CAP reimbursements (EAGF), an announcement of the decision to cancel payments by a set deadline would be made. Re-budgeting would be foreseen as soon as the Member State meets the Council recommendations.

• Step 2 – non-compliance with the initial recommendations to correct the excessive deficit Article 126(8) TFEU) would result in cancellation of commitments of year n. Similarly, CAP reimbursements (EAGF) for year n would be cancelled. This would lead to a definitive loss of payments for the Member State concerned.

Other incentives could also be created by modulating co-financing rates or introducing a **performance Union reserve** to reward sound fiscal policies. Such a reserve could be funded with cancelled commitments under the above-mentioned step-2-procedure.

The financing side of the EU budget also contributes to reinforcing compliance. The present Own Resources system provides that fines paid by the Member States in the context of the EDP automatically reduce the contribution of participating Member States without a deficit that is excessive to the budget (according to their share in the total GNI of the eligible Member States). This system ensures that the contribution of the fined Member State to the

budget would effectively increases and the contribution to all other Member Sates decreases. The Commission will also assess whether the EU budget revenue side can be adequately used as an incentive for compliance.

The required changes will be incorporated in the Commission's 2011 proposals for the next multi annual financial framework. In the meantime, a regulation based on Article 136TFEU creating a new sanction toolbox having similar effects will be proposed for the euro-area Member Sates by end-September. The Commission will explore ways of extending these sanctions and incentives toolbox to all Member States as soon as possible.

5. THE CO-ORDINATION CYCLE UNDER THE EUROPEAN SEMESTER

The setting up of a European Semester will integrate the different strands of economic policy coordination and allow for better and ex-ante coordination of economic policies.

Ex ante coordination of economic policies. The core objective of the proposal is to give a clear ex ante-dimension to economic policy coordination in the EU and the euro area. Under the European Semester, complementarity of national economic policy plans will be ensured at European level through policy guidance before final decisions on the budget for the following year are taken in Member States. For the euro area a horizontal assessment of fiscal stance should be carried out on the basis of the national Stability Programmes and the Commission forecasts. Special consideration to the aggregate stance should be given in the cases of serious economic stress in the euro area, when sizeable fiscal policy measures taken by individual Member States are likely to produce important spill-overs. In case of obvious inadequacies in the budget plans for the following year, a revision of the plans could be recommended.

Better integrated surveillance. The European Semester will cover all elements of economic surveillance, including policies to ensure fiscal discipline, macroeconomic stability, and to foster growth, in line with the Europe 2020 strategy. Existing processes – e.g. under the Stability and Growth Pact and the Broad Economic Policy Guidelines – will be aligned in terms of timing while remaining legally separate. Stability and Convergence Programmes (SCPs) and National Reform Programmes (NRPs) will be submitted by Member States at the same time and assessed simultaneously by the Commission.

The content of Stability and Convergence Programmes (SCPs) has to be adapted to the rationale of having a European semester. The intention is obviously not to require Member States to submit full-fledged budgets to the EU for "validation" before they present them to their national Parliaments. However, these Programmes should include the necessary information for meaningful ex-ante discussions on fiscal policy. The minimum requirements should include:

- a full-fledged updated macroeconomic scenario;
- concrete indications on plans for year t+1;
- a description of the envisaged policies;
- medium-term projections for the main government finances variables;
- an assessment of fiscal developments in year t-1;

- an update of the fiscal plans for the current year.

The European Semester. The cycle starts in January with an "Annual Growth Survey" (AGS) prepared by the Commission, reviewing economic challenges for the EU and the euro area as a whole. By end February, the European Council provides strategic guidance on policies, which is taken into account by Member States in their SCPs and NRPs which will be submitted in April. The Council issues country-specific policy guidance as mentioned in section 1 in early July. In the second part of the year, Member States finalise national budgets. In its AGS of the following year, the Commission assesses how Member States took EU guidance into account.

Policy guidance under the European Semester. Recommendations will be candid and concrete. In the area of fiscal policy, there will be a strong focus on year t+1, and surveillance will give clear indications on whether the envisaged targets and underpinning policies are appropriate. Regarding policies to foster growth and address macro-financial risks, recommendations will focus on a limited number of key reforms and deadlines will be set for their implementation.

Stronger involvement of the European Parliament. Every year in January the Commission will present its AGS to the European Parliament.

National Parliaments. This enhanced economic governance of the EU would benefit from an early and strong association of national parliaments to the European semester process and from greater dialogue with the European parliament.

Early implementation. The Commission proposes to implement the European Semester as of 2011. Amendments to the existing Code of Conduct for SCPs[4], including inter alia the new date of submission of SCPs will be presented to the ECOFIN Council for endorsement. Immediate legislative changes do not appear to be necessary.

Transition to the European Semester. The Commission will provide guidance on the contents of the future National Reform Programmes in July. It will also propose bilateral dialogue with Member States in autumn 2010 to discuss:

- A medium term national macro economic scenario to frame policy programmes for the period up to 2015, including growth expectations and broad budgetary orientations;

- Confirmation of national targets in line with the five agreed Europe 2020 targets. Member States should indicate for each target the policies they will pursue to meet their national targets and the public investment needed to meet them;

- How to remove the bottlenecks preventing Member States from meeting their targets and the broader "Europe 2020" objectives.

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[4] Full title is ‘Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of Stability and Convergence Programmes’.

6. CONCLUSIONS AND NEXT STEPS

The Commission will make the necessary formal proposals contained in this Communication by end-September – see annex for details.

In the meantime, the Commission invites the Ecofin Council of 13 July to confirm the launch of the surveillance cycle under the European Semester as of January 2011 and to endorse the revised Code of Conduct for the Stability and Growth Pact SCPs as annexed to the Communication.

Annex 1: Roadmap

Topic	*Action*	*Expected delivery date*
Broader Macroeconomic Surveillance	Proposal for legislation under Art. 121(6) and Art. 136 establishing a framework for dealing with excessive Imbalances	End-September
Thematic Surveillance of Structural Reforms	Issue specific recommendations to enhance the implementation of reform measures	Starting with the Annual Policy Cycle of Europe 2020: first report to the 2011 Spring European Council
Fiscal Surveillance: national fiscal frameworks	Proposal for a Regulation under Art. 126(14) specifying the minimum requirements for the design of domestic fiscal frameworks and the reporting requirements to allow for verification of compliance	End-September
Fiscal surveillance: increased focus on public debt and sustainability in the SGP	Proposals for amending both the preventive (Regulation 1466/97) and corrective arm of the SGP (Regulation 1467/97). Revise Code of Conduct (expenditure rule for implementing adjustment toward MTO; numerical benchmark for minimum pace of debt reduction)	End-September
Enforcement of economic surveillance (sanctions/incentives): Interest-bearing deposit temporarily imposed on a euro area Member State	Proposal for a Regulation under Art. 121(6) and Art. 136(1)(a).	End-September
Enforcement of economic surveillance (sanctions/incentives): deploy the EU budget as additional leverage	Introduce specific provisions in the legal acts underpinning certain EU expenditure programmes Proposal for a Regulation under Art. 136(1)(a) for euro-area Member Sates introducing sanctions having similar effects	To be included in the Commission's 2011 proposals for the next multi annual financial framework End-September
Setting up of a European Semester	Revise the Code of Conduct for the Stability and Growth Pact (SCPs)	Launch of the surveillance cycle under European Semester as of January 2011

ANNEX 1

SPECIFICATIONS ON THE IMPLEMENTATION OF THE STABILITY AND GROWTH PACT

AND

GUIDELINES ON THE FORMAT AND CONTENT OF STABILITY AND CONVERGENCE PROGRAMMES

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INTRODUCTION

This Opinion updates and replaces the opinion of the Economic and Financial Committee on the content and format of the Stability and Convergence Programmes, endorsed by the Ecofin Council on 10 July 2001.

The Stability and Growth Pact fully entered into force on 1 January 1999 and consists of a rules-based framework with both preventive and corrective elements. It initially consisted 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, Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and the Resolution of 17 June 1997 on the Stability and Growth Pact. On 20 March 2005 the Council adopted a report entitled “Improving the implementation of the Stability and Growth Pact”. The report was endorsed by the European Council in its conclusions of 22 March 2005, which stated that the report updates and complements the Stability and Growth Pact, of which it is now an integral part. On 27 June 2005 the Pact was complemented by two additional Regulations amending the Regulations 1466/97 and 1467/97.

The Stability and Growth Pact is an essential part of the macroeconomic framework of the Economic and Monetary Union, which contributes to achieving macroeconomic stability in the EU and safeguarding the sustainability of public finances. A rules-based system is the best guarantee for commitments to be enforced and for all Member States to be treated equally. The two nominal anchors of the Stability and Growth Pact - the 3% of GDP reference value for the deficit ratio and the 60% of GDP reference value for the debt ratio - and the medium-term budgetary objectives are the centrepiece of multilateral surveillance.

Member States, the Commission and the Council are committed to deliver on their respective responsibilities, applying the Treaty and the Stability and Growth Pact in an effective and timely manner. In addition, since effectiveness of peer support and peer pressure is an integral part of the Stability and Growth Pact, the Council and the Commission are expected to motivate and make public their positions and decisions at all appropriate stages of the procedure of the Stability and Growth Pact. Member States are expected to take into account guidance and recommendation from the Council in particular when preparing national budgets., and to properly involve national Parliaments in the various steps of procedures.

In order to enhance ownership of the EU budgetary framework, national budgetary rules should be complementary to the Stability and Growth Pact. Without prejudice to the balance between national and Community competences, their implementation could be discussed at European level in the context of the Stability and Convergence Programmes. In the same vein, governance arrangements at national level should complement the EU framework. National institutions could play a more prominent role in budgetary surveillance to enhance enforcement through national public opinion and complement the economic and policy analysis at EU level. In particular, Member States could establish an economic council of wise people who would advise on the main macro-economic projections.

These Guidelines for the implementation of the Stability and Growth Pact consist of 2 sections. The first section elaborates on the implementation of the Stability and Growth Pact. The second section consists of guidelines on the content and format of the stability and convergence programmes.

SECTION II

GUIDELINES ON THE FORMAT AND CONTENT OF STABILITY AND CONVERGENCE PROGRAMMES

The Stability and Growth Pact requires Member States to submit Stability or Convergence Programmes and updates thereof, which are at the basis of the Council's surveillance of budgetary positions and its surveillance and co-ordination of economic policies. The Council may, on a recommendation from the Commission, and after consulting the Economic and Financial Committee, deliver an opinion on each of the updated programmes and, if it considers that its objectives and contents should be strengthened, invite the Member State concerned to adjust its programme.

Member States are expected to take the corrective action they deem necessary to meet the objectives of their Stability or Convergence Programmes, whenever they have information indicating actual or expected significant divergence from those objectives.

The submission and assessment of Stability and Convergence Programmes is a fundamental component of the "European Semester" of economic policy coordination and surveillance. Under the European semester, the Commission and the Council assess Stability and Convergence Programmes before key decisions on the national budget for the following year are taken, to provide ex ante policy advice on fiscal policy. The timing of submissions and assessments of Stability and Convergence Programmes and National Reform Programmes is aligned.

Under the European Semester the policy surveillance and coordination cycle starts early in the year with a horizontal review under which the European Council, based on analytical input from the Commission, identifies the main economic challenges facing the EU and the euro area and give strategic guidance on policies. Member States are expected to fully take into account the horizontal guidance by the European Council when preparing their Stability and Convergence Programmes. Similarly, the Commission and Council are expected to take into account guidance from the European Council when assessing the programmes.

In view of the strengthened role of the Stability and Convergence Programmes in the process of multilateral surveillance under the European Semester, it is important that their information content is suitable and allows for comparison across Member States. Whilst acknowledging that the programmes are the responsibility of national authorities and that the possibilities and practices differ across countries, Council Regulation (EC) No 1466/97 as amended by Council Regulation (EC) No 1055/05 sets out the essential elements of these programmes. In particular, Stability and Convergence Programmes include the necessary information for a meaningful discussion on fiscal policy for the short and the medium term, including a full fledged macroeconomic scenario, projections for the main government finances variables and their main components, and a description of envisaged policies.

The experience gathered during the first years of implementation of the Pact with the Stability and Convergence Programmes shows that guidelines on the content and format of the programmes not only assist the Member States in drawing up their programmes, but also facilitate their examination by the Commission, the Economic and Financial Committee and the Council.

The guidelines set out below should be considered as a code of good practice and checklist to be used by Member States in preparing Stability or Convergence Programmes. Member States are expected to follow the guidelines as far as possible, and to justify any departure from them.

1) Status of the programme and of the measures

Each programme mentions its status in the context of national procedures, notably with respect to the national Parliament. The programme also indicates whether the Council opinion on the previous programme has been presented to the national Parliament.

The state of implementation of the measures (enacted versus planned) presented in the programme should be specified.

2) Content of Stability and Convergence Programmes

In order to facilitate comparison across countries, Member States are expected, as far as possible, to follow the model structure for the programmes in Annex 1. The standardisation of the format and content of the programmes along the lines set below will substantially improve the conditions for equality of treatment.

The quantitative information should be presented following a standardised set of tables (Annex 2). Member States should endeavour to supply all the information in these tables. The tables could be complemented by further information wherever deemed useful by Member States.

In addition to the guidelines set out below, the programmes should provide information on the consistency with the broad economic policy guidelines of the budgetary objectives and the measures to achieve them, as well as on the measures to enhance the quality of public finances and to achieve long-term sustainability.

Objectives and their implementation

Member States will present in their Stability and Convergence Programmes budgetary targets for the general government balance in relation to the MTO, and the projected path for the debt ratio. Convergence programmes shall also present the medium-term monetary policy objectives and their relationship to price and exchange rate stability.

Member States, when preparing the first update of their Stability or Convergence Programme after a new government has taken office, are invited to show continuity with respect to the budgetary targets endorsed by the Council on the basis of the previous update of the Stability/Convergence Programme and - with an outlook for the whole legislature - to provide information on the means and instruments envisaged to reach these targets by setting out its budgetary strategy.

Member States will provide in their Stability or Convergence Programme an update of the fiscal plans for the year of submission of the programme, based on the April notification. The Stability or Convergence Programme will explain revisions of fiscal targets set in the programmes submitted in year t-1 (with a special focus on developments in government expenditure).

To permit a fuller understanding of the path of the government balance and of the budgetary strategy in general, information should be provided on expenditure and revenue ratios and on their main components, as well as on one-off and other temporary measures. To permit a fuller understanding of the path of the debt ratio, information should be provided, to the extent possible, on components of the stock-flow adjustment, such as privatisation receipts and other financial operations.

The budget balances should be broken down by sub-sector of general government (central government, state government for Member States with federal or quasi-federal institutional arrangements, local government and, social security).

Assumptions and data

Stability and Convergence programmes should be based on realistic and cautious macroeconomic forecasts. The Commission forecasts can provide an important contribution for the coordination of economic and fiscal policies. Member States are free to base their Stability/Convergence Programmes on their own projections. However, significant divergences between the national and the Commission services' forecasts should be explained in some detail. This explanation will serve as a reference when forecast errors are assessed ex post.

The programmes should present the main assumptions about expected economic developments and important economic variables that are relevant to the realisation of their budgetary plans, such as government investment expenditure, real GDP growth, employment and inflation. The assumptions on real GDP growth should be underpinned by an indication of the expected demand contributions to growth. The possible upside and downside risks to the outlook should be brought out.

Furthermore, the programmes should provide sufficient information about GDP developments to allow an analysis of the cyclical position of the economy and the sources of potential growth. The outlook for sectoral balances and, especially for countries with a high external deficit, the external balance should be analysed.

As regards external macroeconomic developments, euro area Member States and Member States participating in ERM II in particular should use the "common external assumptions" on the main extra-EU variables used by the Commission in its spring forecast or, for comparability reasons, present sensitivity analysis based on the common assumptions for these variables when the differences are significant. The assumptions are to be provided in due time by the Commission services (after consultation with national experts), on the basis of the final table in Annex 2, for discussion by the EFC.

Assumptions about interest rates and exchange rates, if not presented in the programme, should be provided to the Commission services to allow for the technical assessment of the programmes.

In order to facilitate the assessment, the concepts used shall be in line with the standards established at European level, notably in the context of the

European system of accounts (ESA). The programmes should ensure the formal and substantial consistency of the required information on budgetary aggregates and economic assumptions with ESA concepts. This information may be complemented by a presentation of specific accounting concepts that are of particular importance to the country concerned.

Measures, structural reforms and long-term sustainability

The programmes should describe the budgetary and other economic policy measures being taken or envisaged to achieve the objectives of the programme, and, in the case of the main budgetary measures, an assessment of their quantitative effects on the general government balance. Measures having significant 'one-off' effects should be explicitly identified. The further forward the year of the programme, the less detailed the information could be. For instance, the outer years of the programmes the authorities may provide a menu of possible measures considered to reach the targets in the programme, with an estimation of their impact.

However, to allow a meaningful discussion the programmes should provide concrete indications on policy intentions for year t+1, including preliminary projections and/or targets for the general government balance, expenditure and revenue and their main components, and a description of the policies envisaged to reach the fiscal targets. Should this not be the case, the Member State concerned should be invited to submit a revised programme, in line with the provisions of Articles 5(2) and 8(2) of regulation 1466/97.

Structural reforms should be specifically analysed when they are envisaged to contribute to the achievement of the objectives of the programme. In particular, given the relevance of 'major structural reforms' in defining the adjustment path to the medium-term objective for Member States that have not yet reached it and allowing a temporary deviation from the MTO for Member States that have already reached it (see Section I), the programmes should include comprehensive information on the budgetary and economic effects of such reforms. Programmes should notably include a detailed quantitative cost-benefit analysis of the short-term costs – if any – and of the long-term benefits of the reforms from the budgetary point of view. They should also analyse the projected impact of the reforms on economic growth over time while explaining the used methodology.

The programmes should also provide information on measures envisaged to improve the quality of public finances on both the revenue and expenditure side (e.g. tax reform, value-for-money initiatives, measures to improve tax collection efficiency and expenditure control).

The programmes could further include information on the implementation of existing national budgetary rules (expenditure rules, etc.) as well as on other institutional features of the public finances, in particular budgetary procedures and public finance statistical governance.

Finally, the programmes should outline the countries strategies to ensure the sustainability of public finances, especially in light of the economic and budgetary impact of ageing populations.

The Working Group on Ageing (AWG) attached to the Economic Policy Committee (EPC) is responsible for producing common budgetary projections on: public spending on pensions; health-care; long-term care; education; unemployment transfers; and where possible and relevant, age-related revenues, such as pension contributions. These common projections will provide the basis for the assessment by the Commission and the Council of sustainability of the Member States' public finances within the context of the SGP. They should be included in the programmes.

The programmes should include all the necessary additional information, both of qualitative and quantitative nature, so as to enable the Commission and the Council to assess the sustainability of Member States of public finances based on current policies. To this end, information included in programmes should focus on new relevant information that is not fully reflected in the latest common EPC projections. For example, Member States might want to include information on the latest demographic trends and major policy changes in pension and health-care systems. Programmes should clearly distinguish between measures that have been enacted and measures that are envisaged.

Given the uncertainty surrounding long-term projections, the assessment by the Commission and the Council should include stress tests that provide an indication of the risks to public finance sustainability in the event of adverse demographic, economic or budgetary developments.

In addition to the requirements mentioned above, Member States may present different projections, based on national calculations. In such a case, Member States should explain in detail the underlying assumptions of these projections, the used methodology, the policies implemented or planned to meet the assumptions, and the divergences between the national projections and the common projections

produced by the Working Group on Ageing attached to the Economic Policy Committee.

These national projections and their assumptions, including their plausibility, will enter the basis for the assessment by the Commission and the Council of sustainability of the Member States' public finances within the context of the SGP.

Sensitivity analysis

Given the inevitability of forecast errors, Stability and Convergence Programmes include comprehensive sensitivity analyses and/or develop alternative scenarios, in order to enable the Commission and the Council to consider the complete range of possible fiscal outcomes.

In particular, the programmes shall provide an analysis of how changes in the main economic assumptions would affect the budgetary and debt position and indicate the underlying assumptions about how revenues and expenditures are projected to react to variations in economic variables. This should include the impact of different interest rate assumptions and, for non-participating Member States, of different exchange rate assumptions, on the budgetary and debt position. Countries that do not use the common external assumptions should endeavour to provide a sensitivity analysis also on main extra-EU variables when the differences are significant.

In the case of 'major structural reforms' (see section I), the programmes shall also provide an analysis of how changes in the assumptions would affect the effects on the budget and potential growth.

Time horizon

The information about paths for the general government surplus/ deficit ratio, the expenditure and revenue ratios and their components as well as for debt ratio and the main economic assumptions should be on an annual basis and should cover, as well as the current and preceding year, at least the three following years (Article 3(3) and Article 7(3)), leaving it open to Member States to cover a longer period if they so wish.

The horizon for the long-term projections on the budgetary implications of ageing should cover the same period as the EPC projections.

Updating of programmes

In order to ensure proper ex ante coordination and surveillance of economic policies, submissions of SCP updates should take place each year in the first 15 days of April. [5][6][7]The whole process should be completed with the adoption of Council Opinions on the programmes as a rule before the end of July each year.

Annual updates of Stability and Convergence Programmes should show how developments have compared with the budgetary targets in the previous programme or update. When applicable, they should explain in detail the reasons for the deviations from these targets. When substantial deviations occur, the update should mention whether measures are taken to rectify the situation, and provide information on these measures.

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[5] In the case of the UK, which has a different fiscal year, submission should be as close as possible to the presentation of the autumn pre-Budget report.

[6] Austria and Portugal cannot comply at this stage with this schedule, but they will submit their Stability Programmes no later than 15 December.

[7] Ireland will be regarded as meeting this commitment by submitting its Stability Programme update on its annual Budget day, which traditionally takes place on the first Wednesday of December.

ANNEX 2