Review
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Reforming the EU's economic governance:
Opportunities with risks and challenges

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Executive summary

I The EU's economic governance framework is the system of institutions and procedures which the EU has established to achieve its economic objectives, namely to coordinate economic policies. The framework aims to monitor, prevent and correct economic trends that could weaken national economies or negatively affect EU countries, and to prevent spillover to other economies, as well as supporting the stability of the single currency, or enabling the process of the European Banking Union.

II The elements of the current framework are the EU fiscal framework (the Stability and Growth Pact and the national budgetary frameworks), the macroeconomic imbalance procedure, the European Semester for economic and employment policy coordination, and the framework for member states experiencing, or threatened by, serious difficulties regarding their financial stability or the sustainability of their public finances, or otherwise requesting financial assistance.

III This framework builds on the EU legislation packages adopted following the financial and sovereign debt crises. Since then, we have extensively audited the EU's economic governance framework, reported on its main shortcomings and made a number of recommendations to address the:

- use of non-observable indicator (e.g. structural balance), revised frequently and sometimes significantly, which may also affect past estimates, and focus on deficit rather than debt;
- weaknesses in national budgetary frameworks underlying budgetary policies of member states;
- lack of national ownership;
- poor balance between transparency and discretion;
- weak or inexistent enforcement in practice;
- complexity and overlaps in surveillance and monitoring.

IV Most of these shortcomings are also of concern to key stakeholders and the Commission acknowledges the need for a reformed framework. It published backward-looking assessments of the framework in February 2020 and October 2021 and it launched a public consultation process that led, in November 2022, to a communication giving "orientations" and outlining the principles for a reform of the economic governance framework. In April 2023, the Commission presented a package of legislative proposals revising the Stability and Growth Pact and the requirements for budgetary frameworks of the member states. For other aspects like the macroeconomic imbalance procedure or the post-programme surveillance, the Commission proposed evolutions that do not need legislative changes.

V In the context of the scheduled deactivation of the Stability and Growth Pact general escape clause (see paragraph 19) at the end of 2023, member states and the Commission need to reach a consensus on reforming the economic governance framework ahead of member states' next budgetary processes. Without consensus on the reform, these budgetary processes will be subject to the existing legislation.

VI This document is not an audit report. It is a review based mainly on previous audit work and publicly available information or material specifically collected for this purpose. It provides a comprehensive overview of the shortcomings identified in our previous audits and takes into account changes in the socio-economic environment and geopolitical developments. We identify key risks, opportunities and challenges included in the orientations and legislative proposals presented by the Commission.

VII The Commission's proposals are heading in the right direction as they take the opportunity to address most of the key concerns over the current framework, including those raised by the ECA in its previous audits and reports. However, risks and challenges remain for a number of important aspects. The main challenge of the new framework will be to ensure fiscal adjustments promoting debt sustainability while supporting investment and reforms that contribute to growth.

VIII The Commission proposes that member states submit national medium-term fiscal-structural plans that would bring together their fiscal, reform and investment commitments. Each plan would set a country-specific net expenditure reference adjustment path to put the debt ratio on a downward path or stay at prudent levels. This country-specific approach aims to strengthen national ownership and promote debt sustainability. The choice of the observable net expenditure indicator and the Commission's disclosure of its methodology and data to set the reference adjustment path would also increase transparency. The Commission also envisages to strengthen the capacity and widen the role of national independent fiscal institutions.

IX The Commission also aims to increase enforcement by lowering and implementing gradually financial sanctions, and by giving them a reputational impact. The national recovery and resilience plans of the Recovery and Resilience Facility set out specific reforms and investments to be implemented by 2026, which need to address all or a significant subset of the 2019-2020 country-specific recommendations under the European Semester. The link to RRF funding could positively impact the implementation of country-specific recommendations.

X In our view, the recent proposals do not include sufficient measures to mitigate the risks inherent in the EU's exercise of its discretionary power, as the system of national medium-term fiscal-structural plans combine with dialogue between the EU and member states allows for a higher degree of country differentiation. Thus, there is a risk that the Commission's margin of interpretation and discretion will expand, with potential implications for transparency and equal treatment. In particular, the net expenditure reference adjustment path set by member states and included in their plans may depart from the technical trajectory set by the Commission. Notwithstanding that member states have to justify the difference between their expenditure path and the technical trajectory, the risk of postponing necessary fiscal adjustments persists.

XI Although the Commission also proposed to simplify the post-programme surveillance, the EU economic governance framework still involves many actors and layers, leaving broadly unchanged the degree of complexity and overlap in the EU's macroeconomic surveillance and monitoring.

Introduction

01 With the Treaty on European Union in 1992 (the Maastricht Treaty), the EU established the architecture of the economic and monetary union (EMU) as a prelude to the creation of the euro. The EU economic governance framework refers to the system of institutions and procedures established to coordinate economic policies to achieve its objectives in the economic field. The framework aims to monitor, prevent and correct economic trends that could weaken national economies or negatively affect EU countries.

02 An effective economic policy coordination and surveillance across the EU strives towards ensuring the soundness and sustainability of public finances and should promote sustainable economic growth and convergence. It also should address macroeconomic imbalance and promote reforms and investments to enhance growth and resilience.

03 The EU economic governance framework has gradually evolved over time, in response to the financial and sovereign debt crisis, becoming more complex. Today, the European Semester for economic and employment policy coordination aims at an integrated approach combining the EU fiscal framework (the Stability and Growth Pact and the national budgetary frameworks), the macroeconomic imbalance procedure, and the framework for member states experiencing, or threatened by, serious difficulties regarding their financial stability or to the sustainability of their public finances, or otherwise requesting financial assistance.

04 We have produced many reports covering all elements of the EU economic governance framework (see ***Annex I*** for an exhaustive list of our works in the area). These reports identified a number of important shortcomings and made recommendations to address them accordingly.

05 In February 2020, the newly elected Commission presented its review of effectiveness of the EU's economic governance, also relying on the assessment of EU fiscal rules in ECA audits to identify areas for improvement and launched a consultation on its future[1]. Drawing on the outcome of this process, the Commission published "orientations" in November 2022[2] outlining the principles for a reform, followed by a package of legislative proposals in April 2023[3].

06 In the context of the scheduled deactivation of the Stability and Growth Pact general escape clause (see paragraph ***19***) at the end of 2023, member states and the Commission need to reach a consensus on reforming the economic governance framework ahead of member states' next budgetary processes. Without consensus on the reform, these budgetary processes will be subject to the existing legislation.

1 Commission Communication, COM(2020) 55 final, Economic governance review.

2 Commission Communication, COM(2022) 583 final.

3 COM(2023) 240 final 2023/0138 (COD); COM(2023) 241 final 2023/0137 (CNS); COM(2023) 242, final 2023/0136 (NLE).

Scope and approach

07 This document not an audit report. It is a review based on our own previous audit work in the area of EU economic governance and other publicly available information, material specifically collected for the purpose of this review. The objective of the review is to contribute to the debate aiming at a more robust economic governance framework for the EU. More specifically, we:

— summarise the observations, conclusions and recommendations resulting from our past audit work;

— identify the key opportunities, risks and challenges following the recent orientations and legislative proposals of the Commission;

— provide a comprehensive overview of the evolution of the EU economic governance framework since 1992; and

— take into account recent socio-economic and geopolitical developments.

08 We reviewed the EU legislation and publications relevant to the review topic issued by the European Parliament, the Commission, member states, Supreme Audit Institutions, international organisations, academic institutions and think tanks. We interviewed Commission officials and consulted staff from key stakeholders[4] and think tanks[5] publishing relevant studies in the area of EU economic governance.

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[4] International Monetary Fund, Organisation for Economic Cooperation and Development, European Fiscal Board, European Stability Mechanism and the Network of EU independent fiscal institutions.

[5] Centre for European Policy Studies and Bruegel.

The EU economic governance framework since 1992

09 The Economic and Monetary Union established in 1992 involves the coordination of economic and fiscal policies, a common monetary policy and a common currency, the euro. To enter the Economic and Monetary Union, member states must comply with convergence criteria (the "Maastricht criteria")[6] such as a sustainable budgetary position, which means that there is no excessive deficit. An excessive deficit is defined as a budget deficit exceeding 3 % of GDP or a ratio of public debt to GDP that exceeds 60 %[7].

10 For the Economic and Monetary Union to function correctly, it was necessary to introduce a mechanism to safeguard the soundness of public finances and reduce the risk of spillover from member states pursuing unsustainable fiscal policies. This mechanism, the Stability and Growth Pact, was adopted in 1997 and comprises two arms. The preventive arm aims to ensure sound medium term budgetary policies and avoid excessive deficit. The corrective arm is the excessive deficit procedure (EDP) and intervenes when a member state's deficit is excessive.

11 In 2005, a first reform of the Stability and Growth Pact extended the previous approach, for example by taking into account the economic situation whereby member states are expected to undertake more adjustments in good times and do less in bad times.

12 The 2008 financial crisis and the subsequent turmoil in the sovereign debt market demonstrated that, since the launch of the euro in 1999, some member states had not used this economically favourable decade to reduce their public debt significantly. In other words, the Stability and Growth Pact has been partially ineffective.

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[6] Article 140 of the Treaty on the Functioning of the European Union.

[7] Article 126(2)(b) of and Protocol No 12 to the Treaty on the Functioning of the European Union.

13 Moreover, the Stability and Growth Pact alone was insufficient to guarantee economic stability because it was not designed to detect, prevent and correct macroeconomic imbalances, with the consequence that some member states had to ask for financial assistance (see ***Box 1***). Consequently, the EU adopted a range of measures to strengthen its economic governance and build a crisis management framework.

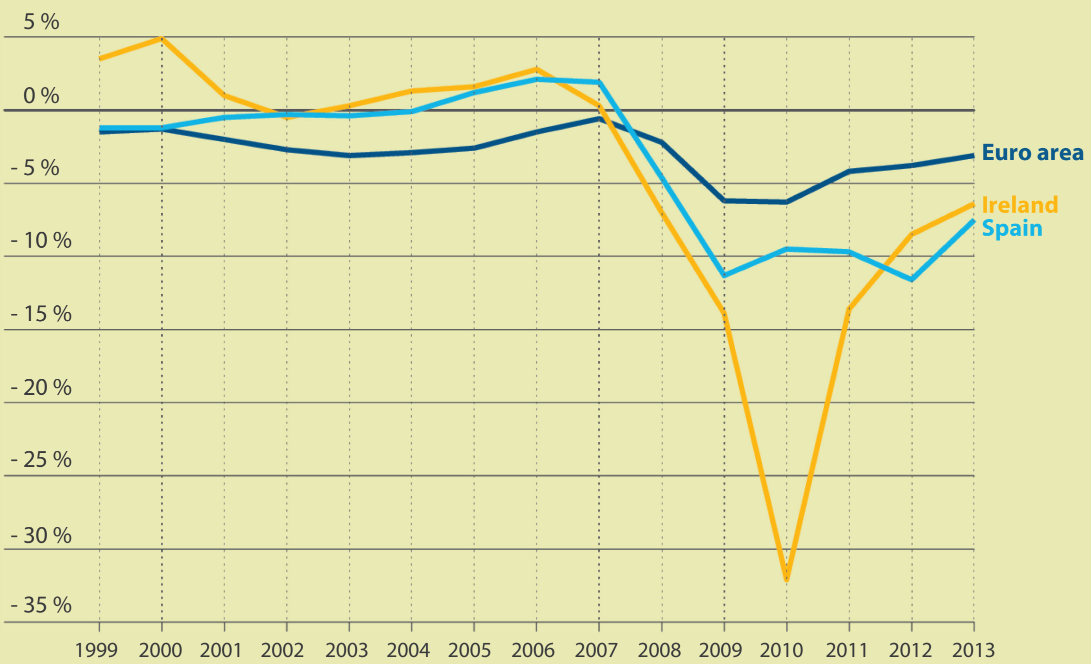
Box 1

The insufficiency of the Stability and Growth Pact to guarantee economic stability

The Stability and Growth Pact was insufficient to detect and prevent the building up of macroeconomic imbalances, as illustrated by the situation in Spain and Ireland.

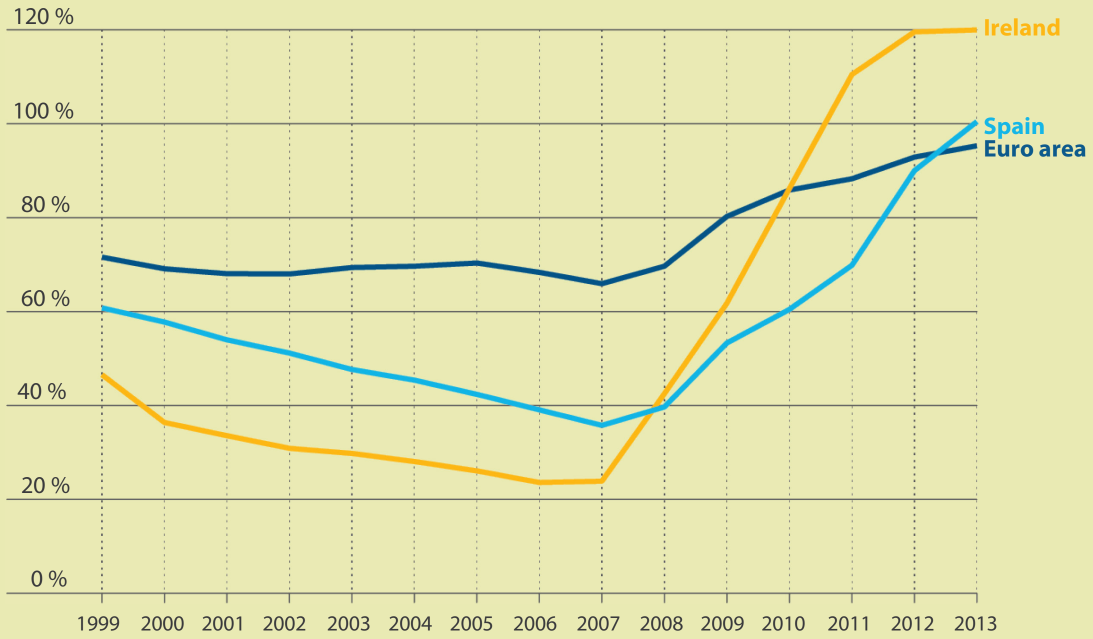
In the decade preceding the 2008 crisis, Spain and Ireland experienced a strong economic growth that allowed them to achieve a flattering fiscal position. As illustrated by Figures A and B, both countries enjoyed fiscal surpluses and a public debt-to-GDP ratio below 40 % before the crisis.

Figure A: Public deficit (percentage of GDP)



Source: ECA, based on AMECO database.

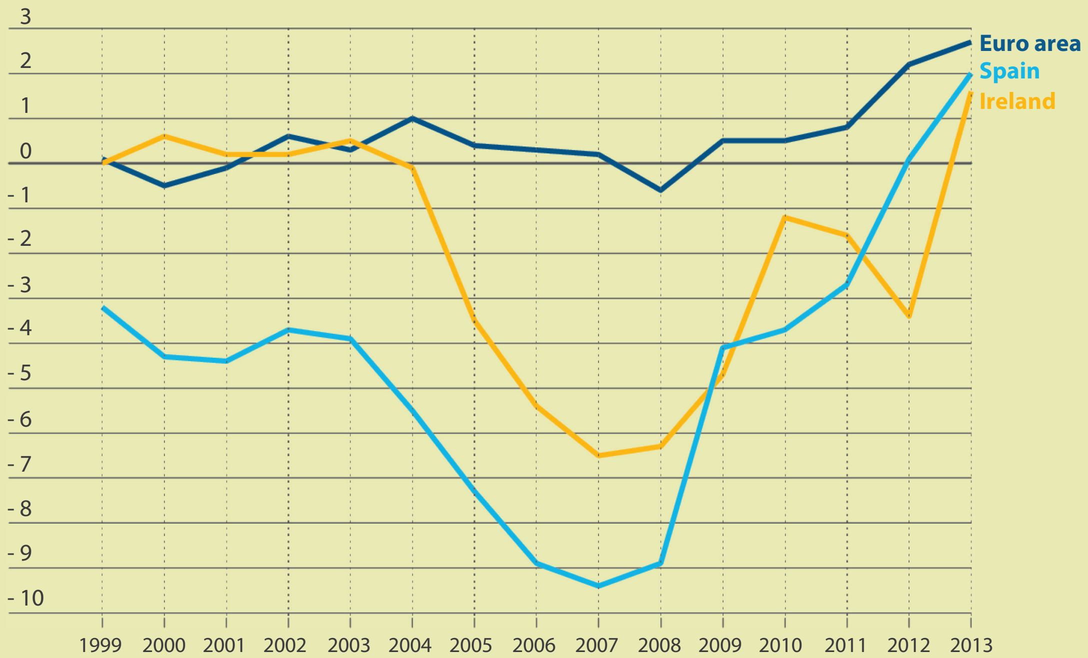
Figure B: Public debt (percentage of GDP)



Source: ECA, based on AMECO database.

In both cases, however, this performance was based on rapid growth, fuelled by easy access to financing, which generated a credit boom and a surge in domestic demand, particularly in the construction sector. This was accompanied, in the run-up to the crisis, by several imbalances. The current account balance, which records a country's transactions with the rest of the world, deteriorated (see Figure C) because of the sharp rise in internal demand and the deterioration of external competitiveness Private debt also rose sharply, in particular because of the steep increase in real estate investment, putting financial stability at risk.

Figure C: Current account balance (percentage of GDP)



Source: ECA, based on AMECO database.

When the housing bubble burst, the resulting banking crisis obliged governments to adopt measures to support the banking sector, which threw public finances into marked decline after 2009 (see Figures A and B). This in turn affected the sovereign debt market, and eventually both Ireland and Spain were forced to seek financial assistance.

14 In 2011, the EU adopted five regulations and one directive in a "six-pack" of legislation reforming both the preventive and corrective arms of the Stability and Growth Pact, adopting measures to enhance national ownership of the EU's fiscal rules, and introducing the macroeconomic imbalance procedure aiming to detect, prevent and correct macroeconomic imbalances[8]. The so-called six-pack also introduced the European Semester (an annual exercise to coordinate fiscal, economic, employment and social policy in the EU) and strengthened sanctions against euro area member states with poor budgetary discipline.

[8] Commission press release MEMO 11/898.

15 In March 2012, 25 of the (then) 27 member states (all but the United Kingdom and the Czech Republic[9]) signed the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG). It contained clauses designed to foster ownership and budgetary discipline. It increases the role of national independent fiscal institutions (IFIs), which are given the task of monitoring compliance with national fiscal rules.

16 Given the higher potential for spillover effects of budgetary policies in a common currency area, there was a need for still stronger mechanisms specifically for the euro area. In 2013 two further regulations (so-called "two-pack") came into force to strengthen euro area budgetary surveillance[10]. The first one addressed the monitoring of budgetary policies in the context of the Stability and Growth Pact. The second regulation contained provisions for strengthening the economic and budgetary surveillance of euro-area member states experiencing, or threatened by, serious difficulties regarding their financial stability or the sustainability of their public finances, or otherwise requesting financial assistance.

17 We summarise all these legislative developments in ***Annex II***[11]. As acknowledged by the "Five Presidents Report[12]", they have increased the complexity of the EU's economic governance framework, both because of a tendency for more technical rules and greater reliance on Commission's discretion and expert judgement, and because of the co-existence/overlapping of EU, national and intergovernmental rules and institutions.

18 Finally, in 2015 the EU established the European Fiscal Board (EFB) as an independent advisory board to the Commission to evaluate the implementation of EU fiscal rules, to advise the Commission on the fiscal stance appropriate for the euro area as a whole and to cooperate with member states' national fiscal councils.

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[9] The Czech Republic ratified the Treaty in April 2019. In addition, Croatia joined the EU in July 2013 and ratified the Treaty in March 2018.

[10] Commission press release MEMO 13/457.

[11] Review 05/2020: "How the EU took account of lessons learned from the 2008-2012 financial and sovereign debt crises''.

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

Recent socio-economic and geopolitical developments

19 The COVID-19 pandemic generated new risks and challenges to EU economic governance because it required significant economic countermeasures from the member states and the EU[13]. In March 2020, the Council agreed for the first time to activate the general escape clause of the Stability and Growth Pact, allowing all member states to depart temporarily from the fiscal rules. This resulted in a general increase of the level of public deficit and debt, often over the reference values of 3 % and 60 %, respectively. ***Annex III*** shows the evolution of the deficit-to GDP and debt-to-GDP ratios from 2000 to 2022.

20 In December 2020, the EU adopted NextGenerationEU (NGEU), a temporary instrument worth around €800 billion in funding, financed by EU debt, to help repair the immediate economic and social damage brought about by the pandemic and build a greener, more digital and more resilient future. The centrepiece of the NGEU is the Recovery and Resilience Facility (RRF), which provides grants and loans to support member state reforms and investments. Member states draw up recovery and resilience plans that had to address a significant subset of 2019 and 2020 country-specific recommendations. The Commission assessed the plans[14] and the Council approved them. They qualify for funding from the facility when they achieve specified milestones and targets. Before making any payments, the Commission assesses that each milestone and target has been reached satisfactorily. The monitoring and reporting of the implementation of the recovery and resilience plans is fully aligned with the European Semester, in particular regarding reporting on the implementation of measures contributing to the country-specific recommendations.

21 In the second half of 2021, geopolitical tensions between Russia and Ukraine led to unrest on the gas market. The situation deteriorated tremendously further in February 2022, due to Russia's war of aggression against Ukraine. In the following months, Russia progressively reduced a significant part of its gas supply to the EU, which drove gas prices to record highs. Because of the nature of the EU's electricity pricing

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[13] See review 06/2020: "Risks, challenges and opportunities in the EU's economic policy response to the COVID-19 crisis".

[14] Special report 21/2022: The Commission's assessment of national recovery and resilience plans – Overall appropriate but implementation risks remain.

mechanism[15], high gas prices also triggered a sharp increase in wholesale electricity prices and a resumption of inflation. In particular, the euro area inflation was dominated by a strong contribution from energy prices.

22 In May 2022, the Commission presented REPowerEU[16], its roadmap towards achieving a more resilient energy system and a true energy union by ending the EU's dependence on fossil fuels, diversifying energy supplies at EU level and accelerating the clean energy transition. Among other things, REPowerEU encourages member states to include new energy measures to their recovery and resilience plans. At the end of June 2023, nine member states had submitted an amendment to their recovery and resilience plan including a REPowerEU chapter.

23 Where they can afford it, member states are keen to protect their businesses and households from rising energy costs. Depending on their duration and degree of implementation, divergent national reactions to the crisis (massive state aid, confinement measures) may persistently distort the level playing field in the single market and pose challenges for economic convergence and competitiveness in the EU[17]. In 2022, the net budgetary cost of measures to mitigate the impact of high energy prices is estimated by the Commission at 1.2% of GDP in the EU[18].

24 To address the pandemic and provide economic support, almost all countries have had to increase their public debt. ***Annex IV*** provides a view of the recent evolution of debt-to-GDP ratios around the world. In the EU, the Commission agreed to maintain the general escape clause until the end of 2023 to allow member states to sustain their economies and continue supporting recovery[19]. For the euro area, the overall debt-to-GDP increase from 2019 to 2021 was moderate (11.7 %) in comparison to other advanced economies (19.0 % in the UK, 19.3 % in the US and 26.2 % in Japan). However, the public debt ratios of EU member states remain heterogeneous. This heterogeneity may undermine the effectiveness of the single monetary policy, especially in a context

[15] Special report 03/2023: "Internal electricity market integration", Box 1.

[16] https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/repowereu-affordable-secure-and-sustainable-energy-europe_en. For our assessment of REPowerEU, see Opinion 04/2022: "REPower EU".

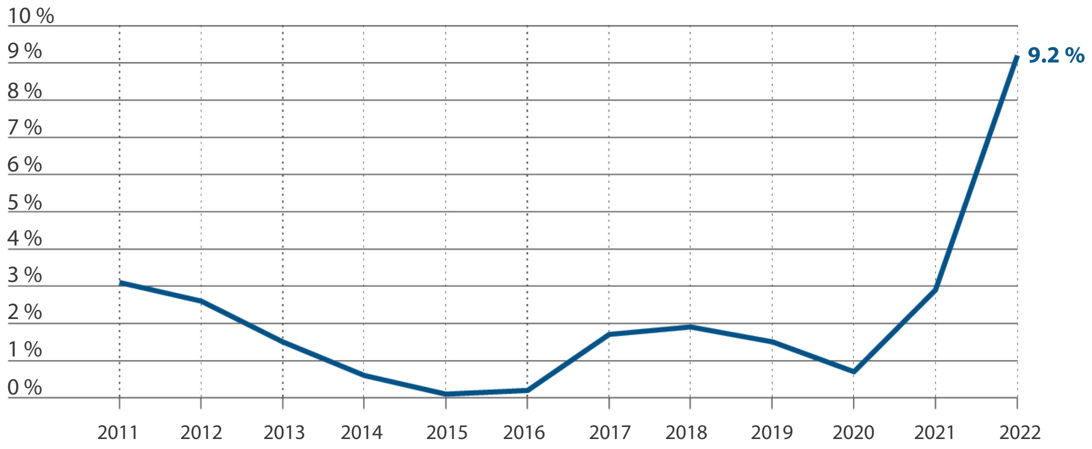
[17] Review 06/2020, p. 49.

[18] European Economic Forecast, Autumn 2022, see Box I.2.4, p. 51.

[19] Commission Communication on the Annual Sustainable Growth Survey 2023.

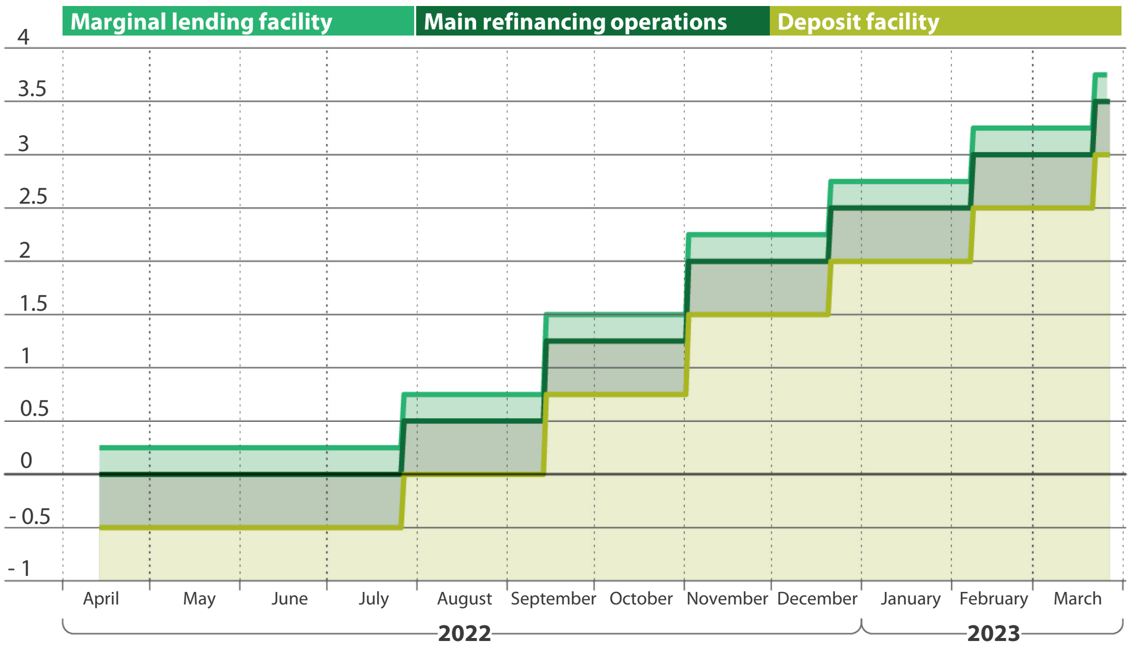
of high inflation (see paragraph ***21*** and ***Figure 1***) which led the European Central Bank to raise its key interest rates (see ***Figure 2***).

Figure 1 – Inflation in the EU (percentage), measured by the harmonised index of consumer prices (2011 – 2022)



Source: ECA, based on Eurostat database.

Figure 2 – Increase in key interest rates of the European Central Bank (April 2022 – March 2023)



Source: ECA, based on ECB database.

The need to reform the EU economic governance framework and the Commission's proposals

25 The Commission must carry out a review of the effectiveness of the framework every five years, as required by six-pack and two-pack regulations. Following this review[20], the Commission launched a public consultation on the future of the EU economic governance in February 2020 (see paragraph ***05***). However, it was put on hold because of the need to address the immediate challenges posed by the emerging pandemic and the ensuing recession. It was reopened in October 2021[21] and the Commission received a total of 225 contributions, mostly from academia and research institutions, but also from citizens and trade unions[22]. The Commission engaged with relevant stakeholders through a series of meetings and spoke to member states through established bilateral contacts and in Council committees.

26 In November 2022, the Commission drew on the outcomes of this process to publish a communication giving "orientations" and outlining the principles for a reform of the economic governance framework. In April 2023, the Commission presented a package of legislative proposals, consisting in two proposed regulations revising the rules on the preventive and corrective arms of the Stability and Growth Pact respectively, and one proposed directive revising the requirements for budgetary frameworks of the member states.

27 For other aspects of the economic governance framework, like the macroeconomic imbalance procedure or the post-programme surveillance, the Commission proposed developments in its November 2022 orientations that do not need legislative changes, like enhanced dialogue with member states and streamlining of procedures.

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[20] Commission staff working documents, SWD(2020) 210 and SWD(2020) 211.

[21] Commission Communication, COM(2021) 662 final, The EU economy after COVID-19: implications for economic governance.

[22] Commission Staff Working Document, SWD(2022) 104 final, Online public consultation on the review of the EU economic governance framework. Summary of responses. Final Report.

28 In the following paragraphs, we touch on the main issues that we have raised in the past, grouped in six thematic areas based on the structure of the Commission's proposal:

- EU fiscal framework: use of non-observable indicator (structural balance), revised frequently and sometimes significantly, which may also affect past estimates, and focus on deficit rather than debt;
- weaknesses in national budgetary frameworks underlying budgetary policies of member states;
- lack of national ownership;
- poor balance between transparency and discretion;
- weak or inexistent enforcement in practical terms;
- complexity and overlaps in surveillance and monitoring.

29 For each area, we summarise our previous observations, conclusions and recommendations of past audit work, identify on that basis how the Commission addresses them in its proposals and analyse the main risks and challenges.

EU fiscal framework

Net expenditure compared with structural budget balance as key indicator

30 One weakness of the current fiscal framework is the use of non-observable indicators for assessing compliance with the Stability and Growth Pact rules. The key indicator in this respect is the structural budget balance, which corresponds to the budget balance cleaned from temporary effects such as the impact of the economic cycle and one-off budgetary measures.

31 The structural balance, which cannot be observed and must be estimated, is the metric used to define the medium-term budgetary objective, a country-specific target that cannot be lower than a minimum calculated by the Commission in line with a methodology agreed with member states. For each member state, the structural balance is considered Stability and Growth Pact-compliant if it is at least equal to the medium-term budgetary objective. Member states that have not yet achieved their medium-term budgetary objective, should improve their structural balance by 0.5 % of GDP per year as a benchmark (more in good times and less in bad times). However, we reported in 2018[23] that the achievement of the medium-term budgetary objective was very poor, that various deviations were accepted.

32 The structural balance estimates are based on many assumptions and are frequently revised. The magnitude of the revisions may be significant. As we observed in our special report on the Excessive Deficit Procedure, and as reported by stakeholders, this makes the assessment of compliance with the rules more complex[24] and prone to policy errors[25], which may undermine the credibility and enforceability of the Stability and Growth Pact[26] and makes it inappropriate for budgetary management.

33 In the November 2022 communication on the orientations, the Commission acknowledges the difficulties associated with designing policy recommendations based on non-observable indicators that are subject to frequent revisions. It proposes to use net expenditure as a single operational indicator for setting the fiscal adjustment path and carrying out annual fiscal surveillance. The Commission claims that this will make the fiscal framework simpler and more transparent.

34 Net expenditure covers nationally financed public primary expenditure (i.e. excluding interest payments) net of discretionary revenue measures. It also excludes cyclical unemployment benefit expenditure and any public expenditure matched by EU-funded projects. Changes in policy that have a permanent impact on revenue, i.e. the so-called discretionary revenue measures, are deducted so that member states can choose the ratio of expenditure to GDP according to their political preferences. This allows governments to permanently increase (or cut) expenditure as a share of GDP if the change is offset by permanent tax increases (or cuts). Interest and cyclical unemployment expenditure are deducted to discount expenditure fluctuations outside direct government control. Consequently, the use of net expenditure as operational indicator increases macroeconomic stabilisation since it allows automatic stabilisers to operate.

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[23] Special report 18/2018, paragraphs 62-70.

[24] Special report 10/2016, paragraphs 91-94 and Box 10.

[25] IMF, staff contribution to the European Commission review of the EU economic governance framework, 2021, p. 1.

[26] ESM, EU fiscal rules: reform considerations, October 2021, p. 7.

Focusing on reducing debt

35 The European Monetary Union threshold for public deficit is 3 % of GDP, and for debt it is 60 % of GDP or a ratio that is "sufficiently diminishing and approaching the reference value at a satisfactory pace", as set in the protocols of the Treaty on the Functioning of the European Union. In its proposal, the Commission keeps those thresholds. In 2022, 14 member states had a debt-to-GDP ratio below the 60 % threshold, whereas for six member states, this ratio was above 100 %.

36 For many years, focusing on the deficit was deemed sufficient to ensure the steady reduction of debt. Thus, it was considered unnecessary to define more precisely the "satisfactory pace" of convergence with the 60 % reference value. The rationale is that with a 5 % annual nominal GDP growth rate, a deficit of 3 % of GDP will eventually stabilise the debt-to-GDP ratio at 60 %. Indeed, if the debt ratio is above 60 %, a 3 % deficit will induce an annual reduction in the ratio of one twentieth of the differential with the reference value of 60 %[27].

37 Since the 2008 crisis and before the recent inflation rise, the 5 % assumption for annual nominal GDP growth was clearly unrealistic[28]. Hence, a deficit of 3 % of GDP no longer automatically meant convergence towards a debt-to-GDP ratio of 60 % (for example, at an annual nominal growth rate of 3 % and a 3 % deficit, the debt-to-GDP ratio will stabilise at 100 %). For this reason, a specific definition of the debt criterion emerged in the six-pack: "the [debt-to-GDP ratio] shall be considered sufficiently diminishing and approaching the reference value at a satisfactory pace […] if the differential with respect to the reference value has decreased over the previous three years at an average rate of one twentieth per year as a benchmark […]"[29].

38 The debt criterion was only operationalized in 2012 and was slowly phased in. It would have been applicable to all member states starting from 2022. However, due to the high prevailing level of economic uncertainty and the subsequent activation of the general escape clause, no excessive deficit procedure has so far been triggered based on the debt rule.

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[27] Special report 10/2016, paragraph 68 and Box 6.

[28] Special report 10/2016, Annex V.

[29] Article 1(2)(b) of Council Regulation (EU) No 1177/2011 of 8 November 2011.

39 In 2016, we noted that the excessive deficit procedure over-emphasised the criterion of deficit rather than debt, and we recommended that the Commission focus closely on the reduction of government debt, especially in heavily indebted member states[30]. We also reported that the 1/20th rule was not credible for highly indebted member states, since the compliance with the convergence path would require them to follow an extremely restrictive fiscal policy, at least at the start, which could damage growth and threaten the debt-to-GDP adjustment itself[31].

40 The recent proposals of the Commission put the emphasis on debt sustainability while suppressing the 1/20th rule. At the core of the new framework, national medium-term fiscal-structural plans, submitted by member states, assessed by the Commission and endorsed by the Council, would bring together the fiscal, reform and investment commitments of each member state and ensure that their debt ratio is put on a downward path or stay at prudent levels. These plans would set a net expenditure reference adjustment path for a period of four years, extendable by up to three years to facilitate major investments and reforms. When a deficit exceeds the 3 % of GDP reference value, the net expenditure path shall be consistent with a minimum annual benchmark adjustment of 0.5 % of GDP.

41 To guide member states in the design of their multi-year net expenditure targets, the Commission proposes to provide "technical information" for each member state with a deficit below 3 % of GDP and public debt below 60 % of GDP. This information should ensure that the deficit remains below the 3 % of GDP over the medium term.

42 For each member state with a deficit above 3 % of GDP or public debt above 60 % of GDP, the Commission proposes to issue a country-specific "technical trajectory". This trajectory should ensure that:

- the government deficit is brought and kept below the 3 % of GDP reference value over a 10-year period after the end of the national medium-term fiscal-structural plan;
- the public debt ratio is put or remains on a plausibly downward path or stays at prudent levels over the same 10-year period (meaning a 14 to 17-year time horizon when the Commission issues the technical trajectory). To assess this fundamental point, the Commission would use its debt sustainability analysis;

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[30] Special report 10/2016, paragraphs 68 and 69, and recommendation 8.

[31] Special report 10/2016, paragraphs 70 and 71.

- the debt-to-GDP ratio at the end of the plan is below its initial level;
- net expenditure growth remains below medium-term output growth, on average, as a rule over the horizon of the plan;
- the fiscal adjustment effort is not postponed to the end of the national medium-term fiscal-structural plans.

43 Debt sustainability analysis essentially consists in producing projections of the debt-to-GDP ratio. These projections are based on assumptions regarding the future evolution of the variables explaining how public debt evolves over time, in particular the primary balance, interest rates, the growth rate and the inflation rate.

44 Alternative scenarios are computed, generally for a period of 10 years. The baseline is a 'no-fiscal-policy-change' scenario. It relies on Commission's forecasts for the next two years, after which fiscal policy is assumed to remain unchanged from the last forecast year until the end of the projection period. Alternative fiscal policy scenarios are then carried out to assess the effects of variability in the key assumptions on the projection of debt[32]. Assumptions on the revenue impacts of planned reforms should be also considered. Moreover, the Commission uses stochastic projections to assess whether the risk of a non-decreasing debt-to-GDP ratio in the five years following the adjustment period is sufficiently low.

Our analysis of the main challenges and risks

45 The Commission's logic for introducing a net expenditure indicator is that it is a more observable indicator for assessing compliance with the Stability and Growth Pact than the structural balance. This is in line with our previous observation that the use of non-observable variables are not appropriate for that purpose (see paragraph ***32***). The sole focus on this indicator also reduces the number of monitoring indicators to one, aiming at providing simplification and predictability.

46 The technical trajectory of net expenditure is based on the debt sustainability analysis methodology. Since it has a 14 to 17-year time horizon, the set of underlying assumptions will need to be revised after four years to allow the Commission to calculate a new technical trajectory for the next round of medium-term fiscal-structural plans. Moreover, the net expenditure reference adjustment path set by member states

[32] Commission, Debt sustainability Monitor 2022, Institutional Paper 199, April 2023. See Box 1: Deterministic debt projection scenarios: the main assumptions, pp. 23-25.

may depart from the technical trajectory. Indeed, member states may use assumptions in their medium-term fiscal-structural plans that differ from those applied by the Commission. And even though each member state is required to justify the difference between its expenditure path and the technical trajectory set by the Commission, using verifiable economic arguments, there is a risk that fiscal adjustment will be postponed, as policymakers may have reason to steer the assumptions used in the analysis towards a certain outcome. For example, optimistic growth assumptions would reduce the projected debt ratio and lead to a lower required fiscal adjustment.

National budgetary frameworks

47 The national budgetary frameworks are the arrangements, procedures, rules and institutions that influence how budgetary policy is planned, approved, carried out and monitored. They include, among other things, the medium-term budgetary frameworks and the use of independent fiscal institutions. These are non-partisan public bodies in charge of providing positive and/or normative analysis, assessments, and recommendations in the area of fiscal policy, increasing thus accountability and improved fiscal transparency.

Medium-term budgetary frameworks

48 The medium-term budgetary frameworks are the set of national budgetary rules and procedures that oversee multiannual fiscal policymaking, including the setting of policy priorities and medium-term budgetary objectives. Annual budget legislation should be consistent with the frameworks[33].

49 We reported in 2019 that several requirements in the EU legal framework concerning medium-term budgetary frameworks[34] were less stringent than the international standards and best practices promoted by the International Monetary Fund and the Organisation for Economic Cooperation and Development, often despite the views which the Commission itself had expressed in economic papers[35].

[33] Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, Articles 2(e) and 10.

[34] Council Directive 2011/85/EU, Articles 9-11.

[35] Special report 22/2019, paragraphs 30-33.

50 Following up on our audit on EU requirements for national budgetary frameworks, the Commission carried out an assessment of the effectiveness of the medium-term budgetary frameworks, building on a range of reports and studies[36]. It acknowledged weaknesses and gaps in the provisions for such frameworks, like for example the weak consistency between the annual budgets and the medium-term budgetary plans or the absence of corrective procedures in case of non-compliance or deviation of the annual targets from the medium-term plans.

51 The Commission concluded that, if medium-term budgetary plans were to play a bigger role in the revised EU fiscal framework, measures to improve their effectiveness would be essential. However, the Commission's proposals from April 2023 do not significantly improve national medium-term budgetary frameworks (see paragraph 60).

Independent fiscal institutions

52 Regarding the role played by independent fiscal institutions, we had found that EU law fell short of international standards and best practices. The main issues for these institutions were (i) the characteristics of the mandate of their board members (such as the length of the term and reappointment), (ii) their inability to carry out independent human resources policies, (iii) the difficulty to ensure a sufficient and guaranteed budget, and (iv) their need for external review for example by peer institutions. Also as a result of these differences, we had found that independent fiscal institutions were heterogenous in terms of activities carried out in member states[37].

53 In addition, as noted by the European Fiscal Board, "access to government information by independent fiscal institutions is subject to a vast array of legal limitations in most member states"[38]. Moreover, EU legislation[39] requires independent

[36] ARES(2022)711416 of 31 January 2022.

[37] Special report 22/2019: "EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application", paragraph 36.

[38] European Fiscal Board, Annual Report 2018, p. 47.

[39] Regulation (EU) 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area.

fiscal institutions to produce or endorse macroeconomic forecasts, but not budgetary forecasts (projected revenue and expenditure)[40].

54 In 2023, the network of EU independent fiscal institutions reported on the existing capacity of independent fiscal institutions to undertake a range of tasks. It showed that the majority of its members were adequately equipped to assess or endorse macro and budgetary forecast. However, this was not the case for the assessment of the trajectory of the public finances and public debt in the medium-term[41].

55 In its orientations document of November 2022, the Commission envisages a wider role for independent fiscal institutions in providing an assessment on the design and assumptions underlying the national medium-term budgetary plans. The Commission also considers introducing the task to monitor their implementation and compliance with the net primary expenditure path established in the medium-term fiscal structural plan. The consequence would be more debate at national level and thus a higher degree of political buy-in and ownership of medium-term plans.

56 According to the Commission, this would require improvements to the organisational set-up and performance of independent fiscal institutions. To strengthen their capacity, the EU independent fiscal institutions network called recently for minimum standards regarding their resources, adequate safeguards to their independence, good and timely access to information and the possibility of publishing own-initiative reports on any matter relevant to the sustainability of public finance. These standards would be established in EU law and applied in national law[42].

57 In its April 2023 proposals, the Commission adds two important requirements to the list of minimum standards for independent fiscal institutions included in the two-pack[43]. The Commission proposes that institutions should have adequate and timely access to the information needed to fulfil their mandate and be subject to regular external evaluations by independent evaluators. The proposed directive also envisages to introduce the 'comply-or-explain' principle which means that a member state would

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[40] Special report 22/2019, paragraph 37.

[41] EU IFI network (2023), "EU economic governance proposal reform: issues and insights from EU IFIs", March 2023, p. 9, Figure 1.

[42] EU IFI network, "EU Economic Governance Proposal Reform: issues and insights from EU IFIs" – March 2023, pp. 10-11.

[43] Regulation (EU) No 473/2013, Art. 2 (1a).

have to justify when it does not comply with the assessments of the independent fiscal institution.

58 Regarding the European Fiscal Board, in our 2019 audit of national budgetary frameworks, we found that its independence was limited by its weak statutory regime and scarce resources. We also noted that independent fiscal institutions themselves argued against coordination by the European Fiscal Board because they saw it as going against the goal of increasing national ownership and damaging their own independence. Consequently, we recommended reviewing its mandate to further strengthen the Board's independence and the enforcement of the EU's fiscal rules[44].

59 The Commission has only given some indications regarding the new tasks the European Fiscal Board could perform in the explanatory memorandum of the proposal for the preventive arm. However, the legislative proposals of April 2023 do not include change. The Commission also stressed that any changes to the Board's mandate and role must not affect the institutional balance set by the Treaties[45].

Our analysis of the main challenges and risks

60 The binding nature of the medium-term budgetary frameworks for the annual budgetary plans remains weak, as the Commission did not include significant improvements in its legislative proposals. In our view, there is no corrective procedure in case of non-compliance or deviation of the annual targets from the medium-term plans nor any specific provision requiring governments or those involved in budgetary implementation to be held accountable for any unjustified deviations. Regarding independent fiscal institutions, if the additional requirements are positive, it remains to be seen how they will be implemented in practice. Unlike the Commission, we consider that the proposals only partially address the second recommendation in our special report 22/2019, mainly with regard to strengthening independent fiscal institutions and to a much lesser extent with regard to medium-term budgetary frameworks[46]. Finally, the limited independence due to a weak statutory regime of the European Fiscal Board is unchanged.

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[44] Special report 22/2019, recommendation 3.

[45] Commission, DG ECFIN, Economic governance review – Q&A, January 2023, p. 21.

[46] 2022 ECA annual report, chapter 3, Annex 3.2.

National plans for national ownership

61 National ownership is important to the effectiveness of EU economic governance because it fosters member state's compliance with the EU's fiscal and economic rules. Already in 2011, member states acknowledged the need for an improved economic governance framework that would "built on stronger national ownership of commonly agreed rules and policies and on a more robust framework at the level of the Union for the surveillance of national economic policies"[47].

62 Moreover, national ownership is needed for the successful implementation of adjustment programmes, and winning buy-in from national authorities is a difficult process that requires a solid legal base and sufficient time for negotiation[48]. In 2017, we observed that the high level of detail of the second economic adjustment programme for Greece jeopardised the national authorities' ownership, as conditions were not always sufficiently discussed and agreed at the design stage[49].

63 In 2016, we also reported that the excessive deficit procedure had had limited impact in terms of ensuring the implementation of structural reforms. As structural reforms are neither binding nor enforceable, the Commission is unable to influence or boost their implementation[50]. Consequently, where member states lacked a sense of ownership, governments are likely to postpone important structural reforms.

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47 Recital 3 to Regulation (EU) No 1173/2011 on the effective enforcement of budgetary surveillance in the euro area.

48 Special report 18/2021: "Commission's surveillance of Member States exiting a macroeconomic adjustment programme: an appropriate tool in need of streamlining", paragraph 81. See also special report 16/2020: "The European Semester – Country Specific Recommendations address important issues but need better implementation", paragraph 13.

49 Special report 17/2017: "The Commission's intervention in the Greek financial crisis", paragraph 28.

50 Special report 10/2016: "Further improvements needed to ensure effective implementation of the excessive deficit procedure", paragraph 124.

64 In 2018, we stressed the importance of effective communication to public understanding and national ownership of the macroeconomic imbalance procedure. We also observed that, to promote national ownership and encourage member states to implement country-specific recommendations, it was essential to clarify how the economic analysis and assessment of macroeconomic imbalances led to specific policy recommendations[51].

65 In 2020, we observed that in-depth regular exchanges as part of the European Semester process could offer the Commission, national authorities, and stakeholders the opportunity to engage in permanent dialogue, which could foster a deeper level of national ownership[52]. We observed that, in the context of the European Semester, EU guidance to member states should leave the choice of specific measures to national authorities, as this could increase national political ownership.

66 In its proposals and orientations, the Commission does emphasise that increasing national ownership of fiscal and economic policies is a key objective of the economic governance reform[53]. To achieve this, the Commission envisages national medium-term fiscal-structural plans as the cornerstone of the revised framework.

67 These plans would be proposed by member states based on a common framework[54] and would have to be discussed and agreed between the EU and the member states within the Council. They would replace the current stability and convergence programmes and national reform programmes[55]. The Commission expects them to be comprehensive documents combining elements of member states' fiscal policies, reforms, and investments. Member states would have to define country-specific fiscal trajectories, priority public investment and reform commitments, and address the country specific recommendations[56].

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[51] Special report 03/2018, paragraphs 35, 75 and 111.

[52] Special report 16/2020: "The European Semester – country Specific Recommendations address important issues but need better implementation", paragraphs 3 and 9.

[53] COM(2023) 240 final 2023/0138 (COD), section V of the Explanatory Memorandum and recital (32); COM(2022) 583, section 1.

[54] COM(2022) 583, section 3.3.

[55] COM(2023) 240 final 2023/0138 (COD), articles 9 and ff; COM(2022) 583, section 3.2.

[56] COM(2023) 240 final 2023/0138 (COD), articles 11, 12 and annex II; COM(2022) 583, section 3.2.

68 Another compulsory aspect of the plans would be a statement of commitment to named reforms; as we indicated in previous reports[57], increasing national ownership in this way would probably help ensure that member states implement reforms timelier and coherently.

69 The Commission suggests improving national commitment and ownership within the macroeconomic imbalance procedure framework by intensifying dialogue with the member state. It also proposes an enhanced role for national independent fiscal institutions in the development and definition of fiscal policies. This could nurture debate and be yet another factor contributing to increased ownership of the plans[58] (see paragraphs ***52*** to ***57***). In 2019 we had reported that national independent fiscal institutions considered that their assessment of the compliance of member states' budgets with the EU fiscal framework could foster national ownership of EU fiscal rules[59].

Our analysis of the main challenges and risks

70 In terms of national ownership, the Commission's proposals address our observations as they envisage that national medium-term fiscal-structural plans would be proposed by member states. The provision of a technical trajectory[60], calculated on the basis of a common methodology, could contribute to the equal treatment of member states and facilitate a transparent assessment of their net expenditure path. This path, not the technical trajectory, will become the sole basis of fiscal surveillance, after its adoption by the Council.

71 However, the proposals do not address the issue of involving local and regional authorities in the European Semester to increase national ownership. In 2020, we had found that a significant share of the country-specific recommendations cannot be fully implemented without local and regional authorities playing an active role[61].

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[57] Special report 10/2016, paragraph 124; Special report 18/2021, paragraph 80.

[58] COM(2023) 240 final 2023/0138 (COD), recitals (27) and (32); COM(2022) 583, section 3.4.

[59] Special report 22/2019, paragraph 48.

[60] COM(2023) 240 final 2023/0138 (COD), article 5; COM(2022) 583, section 4.1.

[61] Special report 16/2020, paragraph 54.

72 Finally, national ownership is a necessary factor for the successful implementation of the national medium-term fiscal-structural plans. However, it cannot be regarded as the only one. In particular, there must be adequate monitoring and enforcement.

Transparency and discretion

73 A necessary feature of the EU's economic governance framework is transparency: the public disclosure of information, data, analyses, policies and methodologies with a view to allowing the public to critically scrutinise the action and decisions of EU institutions and other bodies. The EU institutions have themselves repeatedly emphasised the importance of increasing the transparency of the decision-making process and underlying analyses and democratic accountability, including by properly involving all relevant stakeholders[62].

74 The notion of transparency is closely tied to that of discretion, which refers to the possibility for EU institutions to make use of their professional judgement and, in this case, mould the application of EU economic governance rules to the specificities of each member state. Exercising discretion means allowing flexibility to avoid the downsides of applying the rules strictly in a one-size-fits-all approach. To mitigate any concerns of unequal treatment and undue leniency, EU institutions are expected to exercise the discretion provided by the framework in a transparent manner, disclosing their criteria for their decisions and the reasons for acting in a certain way.

75 In recent years, we reported on several notable shortcomings in the Commission's exercise of transparency and discretion:

- In the context of the excessive deficit procedure, we found in 2016 that the Commission had not made available much information regarding its data assumptions and parameters and its understanding of key concepts. In this regard, we recommended maximising transparency by making public all advice and

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[62] European Parliament resolution of 8 July 2021 on the review of the macroeconomic legislative framework for a better impact on Europe's real economy and improved transparency of decision-making and democratic accountability (2020/2075(INI)); Opinion of the European Economic and Social Committee on '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 – Economic governance review – Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and on the suitability of Council Directive 2011/85/EU' (COM(2020) 55 final).

guidance to member states, applying clear definitions, disclosing all data, calculation and assessment, and promoting the involvement of independent fiscal institutions. The Commission made extensive use of discretion afforded by the Stability and Growth Pact in its assessments of member states. The increased complexity of the rules for assessing the effectiveness of member state action broadened even more the Commission's margin of interpretation and discretion, resulting in a less transparent system[63].

- We also observed in 2018 that more transparency about the measures included in the Commission's forecasts was necessary to determine the credibility of stability and convergence programmes. In other areas transparency was lacking, such as on the use of the structural reforms clause of the Stability and Growth Pact[64].

- We also noted in 2018 that the use of the "margin of discretion" lacked transparency. The Commission can use this margin of discretion when it thinks that the impact of a large fiscal adjustment on growth and employment would be particularly significant. In that case, the margin of discretion allows the Commission to assess a member state as compliant with the fiscal rules, even if it deviates significantly from its fiscal adjustment path[65].

- In assessing compliance with the adjustment requirements for member states that had not yet reached their medium-term objectives, we reported in 2016 that the Commission had made full and extensive use of the discretion granted to it by EU law[66]. Consequently, the Commission was unable to ensure there was convergence towards the medium-term objectives within a reasonable period[67].

- In 2018, we found that the Commission's system of classifying macroeconomic imbalances by severity was based on criteria which lacked transparency and weakened the macroeconomic imbalance procedure. We recommended that the Commission should enhance transparency by adopting, publishing, and applying clear criteria for classifying macroeconomic imbalances, and that, in its in-depth reviews, it clearly characterises the severity of member states' imbalances[68].

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[63] Special report 10/2016, paragraphs VI, IX, 83 and 95.

[64] Special report 18/2018, paragraphs 53 and 143.

[65] Special report 18/2018, paragraph 31.

[66] Special report 22/2019, paragraph 100.

[67] Special report 18/2018, paragraphs 128-129.

[68] Special report 03/2018, paragraphs VII and IX.

- In 2018, we also found that the Commission had never recommended activating the excessive imbalance procedure , without making public clearly its reasons, even though several member states had experienced excessive imbalances for an extended period of time[69].

[69] Special report 03/2018, paragraphs VIII and IX, and recommendation 2.

76 According to the recent Commission proposals and orientations, a key objective of the reform will be to increase the transparency of EU economic governance. The Commission proposes using a single operational indicator, anchored in debt sustainability, as a basis for fiscal adjustments and fiscal surveillance as this would allow greater transparency and simplify the governance framework.

77 To set the technical trajectory for net expenditure to ensure that debt is put on a plausible downward path or stays at prudent levels, the Commission proposes to apply a common methodology based on its debt sustainability analysis risk framework. For greater transparency, it proposes to make public the reports to the Economic and Financial Committee, where the technical trajectories for net expenditure are put forward[70].

Our analysis of the main challenges and risks

78 The Commission's proposals respond to a large extent to our observations in our 2016 report[71], when we recommended that the Commission publishes advice and guidance to member states and requires full disclosure of calculations, underlying data, and methodologies.

79 In our view, however, the recent proposals do not include sufficient measures to mitigate the risks that are linked to the EU's exercise of its discretionary power, as the system of national medium-term fiscal-structural plans combined with dialogue between the EU and member states allows for a higher degree of country differentiation[72].

80 While the RRF Regulation contains the criteria for assessing the recovery and resilience plans[73], the Commission's proposal does not define in the same detail the methodology for assessing the medium-term fiscal-structural plans. Therefore, there is a risk that the Commission's margin of interpretation and discretion will expand, with potential implications for transparency and equal treatment. The same risk also extends

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[70] COM(2023) 240 final 2023/0138 (COD), recital (12).

[71] Special report 10/2016, paragraphs VI and IX.

[72] COM(2022) 583, section 3.2.

[73] Regulation (EU) 2021/241, article 19.

to the assessment of member state reforms and investments underpinning an extension of the adjustment period[74].

Enforcement

81 Enforcement, particularly the eventual use of financial sanctions, has been a persistent and controversial topic within the European and Monetary Union. Although sanctions for non-compliance with the fiscal rules have always been part of the EU's fiscal surveillance framework, the Commission has never applied them.

82 Like the Stability and Growth Pact, the macroeconomic imbalance procedure can lead to sanctions, but for euro area member states only. Indeed, if the Commission considers that a euro area member state experiences excessive macroeconomic imbalances, it should propose to the Council the activation of an excessive imbalance procedure, exposing the member state to stricter requirements and monitoring. Ultimately, if the member state concerned does not take the corrective action recommended by the Council, financial sanctions can be imposed. However, in 2018 we found that the systematic non-activation of the excessive imbalance procedure reduced the credibility and effectiveness of the macroeconomic imbalance procedure and undermined its ability to address imbalances. Several stakeholders shared this view[75].

83 The systematic absence of any financial sanctions could lead member states to assume that they are unlikely, which undermines the effectiveness and credibility of the Stability and Growth Pact and macroeconomic imbalance procedure. Although these procedures do not primarily aim at imposing sanctions, a system in which no sanctions are ever applied will inevitably prove a somewhat vain exercise.

84 Based on several audits that we undertook between 2016 and 2021, we concluded that rule enforcement is not an easy matter, since it relies on a high degree of discretion and expert judgement, first by the Commission and subsequently by the Council, and depends on the political considerations that come into play[76].

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[74] COM(2023) 240 final 2023/0138 (COD), article 15; COM(2022) 583, section 4.1.

[75] Special report 03/2018, paragraph 64.

[76] Review 05/2020, paragraphs 89-90.

85 We also observed in 2021 that in the context of the European Semester the Commission proposed to the Council to address country-specific recommendations to member states. However, these recommendations are not binding on the member states[77]. We noted in the report that the lack of incentives and limited enforcement meant that there was not much evidence that the Commission's surveillance had a significant impact on fostering reforms[78]. Since some important aspects of the country specific recommendations remained unaddressed in member states' recovery and resilience plans[79], it remains to be seen if the new requirement of the RRF that national recovery and resilience plans must address all or a significant subset of recommendations from 2019 and 2020 will better foster reforms.

86 In its recent proposals and orientations[80] and the accompanying questions and answers[81], the Commission proposes that the enforcement triggers are simplified and clarified by focusing on member states' deviations from the medium-term fiscal adjustment paths agreed between the Commission and the member states. The Commission also proposes to reinforce enforcement in several ways:

- Clarifying the conditions for opening and abrogating a debt-based excessive deficit procedure in order to strengthen the credibility of the procedure.
- Lowering and implementing gradually financial sanctions to make them more effective, realistic and credible.
- Strengthening the reputational sanctions. For example, ministers of member states under excessive deficit procedure could be required to present to the European Parliament their measures to comply with the procedure's recommendations.
- Suspending EU financing if a member state does not take effective action to address its excessive deficit.

[77] Special report 18/2021, paragraph 44.

[78] Special report 18/2021, paragraphs VIII and 88.

[79] Special report 21/2022, paragraphs 45-53.

[80] COM(2022) 583, section 4.2, p. 17.

[81] Commission, Economic governance review – Q&A, January 2023, pp. 18-19.

87 The Council agreed in March 2023 that enforcement needs to be improved, including through greater transparency, and asked for initial financial sanctions to be reduced so they are more likely to be used[82].

Our analysis of the main challenges and risks

88 Enforcement remains a complex issue where discretion, expert judgement and political considerations come into play. Increasing transparency and establishing sanctions that, because they are more realistic and graduated over time, are actually implemented, could have a positive effect on enforcement. Other aspects could improve enforcement, such as access to funding subject to respecting conditions, as it is the case for European Structural and Investment Funds or the RRF[83]. Peer pressure is also a factor likely to play a role.

89 The centrepiece of the EU's response to the economic and social impacts of the COVID-19 pandemic is the RRF. Under the RRF, national recovery and resilience plans set out specific reforms and investments to be implemented by 2026, which need to address all or a significant subset of the 2019-2020 country-specific recommendations under the European Semester. The link to RRF funding could positively impact the implementation of country-specific recommendations.

90 In July 2022, the European Central Bank approved the establishment of a new tool, the transmission protection instrument, to purchase sovereign bonds issued by countries experiencing sharp interest rate movements that are unjustified, given their economic situation. Only member states which are not under an excessive deficit procedure are eligible to benefit from this instrument and this therefore serves as an incentive for member states to comply with the established fiscal rules.

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[82] Council of the EU, Press release – Economic governance framework: Council agrees its orientations for a reform, 14 March 2023.

[83] Article 23 of Regulation (EU) No 1303/2013 and the RRF (Article 10 Regulation (EU) 2021/241).

Complexity and overlaps

91 The EU has developed a complex system of economic governance and surveillance that comprises many institutions and bodies – notably the Commission, the European Council and Council of the EU, the member states, and the European Parliament, as well as advisory bodies such as the European Fiscal Board, and the national independent fiscal institutions. Furthermore, national governments and finance ministers are accountable to national parliaments given that budgetary sovereignty lies with the parliaments. In the euro area, the Eurogroup and the European Central Bank are also involved in the economic governance. Moreover, if needed, financial assistance is provided by the European Stability Mechanism. Each of these institutions has its own mandate, objectives, responsibilities, and decision-making processes, which can sometimes overlap or conflict. The resulting systems of checks and balances is also due to the fact that many new rules or bodies have been established in an ad hoc manner over time and often in response to emergencies[84].

92 In 2015, when presenting its proposals to implement the "Five Presidents' Report" for completing the Europe's Economic and Monetary Union, the Commission had acknowledged that the framework of EU economic governance "has deepened and widened in scope over the past years, but has also gained in complexity", and that a first review of the strengthened framework had "identified some areas for improvement, notably concerning transparency, complexity, and predictability of policy-making, which are relevant to the effectiveness of the tools". The Commission had expressed a commitment to pursuing "the full and transparent application of the available instruments and tools", and to improving clarity and reducing complexity, with the aim of making the existing rules more effective. In 2016, we had reported on this as a positive but challenging development[85].

93 However, in our audits on economic and fiscal policy coordination between 2016 and 2019[86], we found that the rules and procedures governing EU economic governance were becoming increasingly complex. The Commission also acknowledged this as a valid concern in 2017 and 2018[87].

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[84] Commission, COM(2017) 291, Reflection paper on the deepening of the economic and monetary union, p. 17.

[85] Special report 10/2016, paragraph 126.

[86] Special reports 10/2016, 03/2018, 18/2018 and 22/2019.

[87] E.g. Commission reply to paragraph I of ECA special report 18/2018; Commission Reflection Paper COM(2017) 291.

94 Our 2016 audit of the excessive deficit procedure reported that reforms had increased the complexity of the analytical process, making it difficult in some cases to establish a clear link between an analysis and the conclusions drawn. We concluded that the increased complexity and wider scope for economic judgement should be balanced by enhancing transparency to facilitate public scrutiny[88].

95 Our 2019 audit of national budgetary frameworks showed that the complexity and overlaps inherent in EU surveillance increased the risk of inconsistency between Commission and independent fiscal institutions' assessments of compliance with the EU's fiscal rules[89].

96 In 2020, we observed that the European Semester brings together several procedures from different policy areas involving multiple coordination arrangements: the preventive arm of the Stability and Growth Pact, the macroeconomic imbalance procedure, and the Europe 2020 strategy for growth and jobs[90]. The resulting architecture is far from simple, and to illustrate this, ***Annex V*** shows the timeline of the European Semester as it was before the COVID-19 pandemic and the establishment of the RRF.

97 This complexity often leads to overlaps and redundancies, overburdening the Commission and the member states. In our 2021 audit on post-programme surveillance, we concluded that there was overlap with the Commission's work in the context of the European Semester. Indeed, as the objectives of post-programme surveillance were only broadly defined and not sufficiently focused on repayment capacity, we found that the Commission had expanded its scope to assess compliance with the policy recommendations covered by country-specific recommendations. This resulted in a number of overlaps[91].

98 Overall, our previous audit work over the years has consistently drawn attention to the overlaps in surveillance and monitoring that result from the many layers of EU economic governance and we have highlighted the need to streamline the framework for greater effectiveness.

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[88] Special report 10/2016, paragraphs 140 and 141.

[89] Special report 22/2019, paragraph 49 and box 3.

[90] Special report 16/2020, paragraph 2.

[91] Special report 18/2021, paragraphs 29, 31, 62, 66 and 68-70.

99 The RRF increases that complexity. The Commission's Secretariat-General (which hosts RECOVER, the Recovery and Resilience Task Force) and the Directorate-General for Economic and Financial Affairs are both responsible for work on the European Semester and the RRF (see paragraph ***20***), meaning they have to assess the implementations of policy recommendations and the achievement of milestones and targets of the national recovery and resilience plans.

Our analysis of the main challenges and risks

100 The recent orientations and proposals communicated by the Commission can potentially simplify the EU's economic governance framework in several ways[92] as it proposed that:

- Fiscal surveillance would focus on a single operational indicator, net primary expenditure.
- Annual monitoring by the Commission would focus on member states' compliance with a medium-term net expenditure path and member states would submit a single annual implementation report.
- Post-programme surveillance would be streamlined, with a sharper focus on member states' repayment capacity, although it remains to be seen how this would be implemented.

101 However, the recent Commission proposals do not significantly alter the number of surveillance layers, nor the complexity and overlaps included in the EU surveillance. In addition, medium-term fiscal-structural plans may also induce some complexity for both member states and the Commission. Member states would have to take account of interactions between the fiscal trajectory, reforms, and investments in their plans. And the Commission will need to evaluate their consistency and compliance with the rules of the Stability and Growth Pact, the macroeconomic imbalance procedure, the country-specific recommendations and the objectives of the RRF.

[92] Commission, Questions and answers: Building an economic governance framework fit for the challenges ahead, 9 November 2022.

Closing remarks: Commission's proposals address most of the key concerns, but risks and challenges remain

102 The EU's economic governance framework, as laid down in the six-pack and two-pack, yields a picture of mixed success. In the decade before the COVID-19 pandemic, the number of member states under procedures for excessive deficit and macroeconomic imbalances decreased substantially. However, just before the COVID-19 outbreak the level of public debt in three member states was above 100 %, and in nine of them it was between 60 % and 100 %. At the same time, 10 member states experienced macroeconomic imbalances and three others had excessive macroeconomic imbalances.

103 These figures reveal some significant shortcomings in the economic governance framework and its implementation. The use of a non-observable indicator based on output gap estimates has led to regular revisions, which have reduced predictability. Deficit rules have been emphasised over debt reduction. The one-size-fits-all criterion for debt reduction did not work as intended, especially for highly indebted member states as member states rarely adhered to paths to sustainable debt. The number of member states with a level of public debt over the 60% increased over the years as the average debt-ratio of the EU. Despite this, no excessive deficit has been triggered so far based on the debt rule (see paragraph ***38***). Not enough has been done to ensure national ownership. A lack of transparency and effective enforcement, coupled with the Commission's discretionary power, has undermined the framework's credibility. Complexity has increased substantially, due in part to the more holistic approach adopted through the European Semester.

104 Most of the shortcomings of the current framework that have been the subject of our observations and recommendations in previous reports and reviews are also of concern to key stakeholders. ***Table 1*** summarises their concerns. More details are reported in some of the sections of this report and in ***Annex VI***.

Table 1 – Key stakeholders' concerns regarding the current framework

	International Monetary Fund	*Organisation for Economic Cooperation and Development*	*European Stability Mechanism*	*European Fiscal Board*
Use of non-observable indicators	✓	✓	✓	✓
Over-emphasis on deficit rather than debt	✓		✓	✓
Weaknesses of independent fiscal institutions	✓	✓	✓	✓
Insufficient national ownership	✓	✓		✓
Discretion & lack of transparency		✓	✓	✓
Lack of incentives and weak enforcement	✓	✓	✓	
Complex surveillance framework	✓	✓	✓	✓
Weaknesses in medium-term budgetary frameworks	✓	✓		

Source: ECA, based on IMF, Reforming the EU fiscal framework – strengthening the fiscal rules and institutions, 2022; IMF, Staff contribution to the European Commission review of the EU economic governance framework, 2021; IMF, Staff discussion note: Second-generation fiscal rules – balancing simplicity, flexibility, and enforceability, 2018; OECD, Economic surveys for the euro area, September 2021; ESM, EU fiscal rules: reform considerations, October 2021; EFB, Annual report, 2022; EFB, Assessment of EU fiscal rules with a focus on the six and two-pack legislation, August 2019.

105 The Commission has proposed to set country-specific debt reduction paths using only net expenditure, an observable indicator that is subject to government control, when setting fiscal adjustment paths and carrying out annual fiscal surveillance. Even though the Commission calculates the technical trajectory for net expenditure, in each case the net expenditure reference adjustment path is set by the member state, and may depart from the technical trajectory if it is based on different assumptions to those used by the Commission. And although any deviation must be justified, there is a risk that fiscal adjustment will be postponed.

106 The Commission's proposals strengthen national budgetary frameworks by additional requirements for independent fiscal institutions but do not fully address the weaknesses regarding the alignment of budgets with the medium-term budgetary frameworks nor the weak statutory regime and limited independence of the European Fiscal Board.

107 National ownership, which is a necessary, but not a sufficient condition for the successful implementation of the plans (see paragraph ***72***), would be increased by the Commission's proposals since it is based on medium-term fiscal-structural plans proposed by member states, tailored to their specific situation, and negotiated with the Commission. The Commission's proposals also promote transparency by disclosing data, methodology and analysis used for setting the fiscal adjustment path. However, these positive evolutions induce the risk of higher discretionary power for the Commission without accompanying measures to mitigate sufficiently the risks that are associated with such discretion.

108 Establishing sanctions that can be actually implemented, as proposed by the Commission, could play a positive role on enforcement. However, expert judgement and political considerations will continue to play the more significant role on the decision to trigger financial sanctions.

109 Finally, the Commission's proposals contribute to simplifying the EU economic governance framework. Increased transparency and a focus on net primary expenditure to assess compliance with the fiscal rules are positive developments in this respect. However, even if the Commission proposes a streamlined post-programme surveillance, EU macroeconomic surveillance still involves many actors and layers, leaving broadly unchanged the degree of complexity and overlap.

110 Overall, the Commission's proposals for a reform of the economic governance are heading in the right direction as they take the opportunity to address most of the key concerns over the current framework. However, risks and challenges remain for a number of important aspects. The main challenge of the new framework will be to ensure fiscal adjustments that promote debt sustainability.

This review was adopted by Chamber IV, headed by Mr Mihails Kozlovs, Member of the Court of Auditors, in Luxembourg at its meeting of 26 September 2023.

For the Court of Auditors

Tony Murphy
President

Annexes

Annex I – ECA audits, reviews and opinions related to EU economic governance

Special report 18/2015: Financial assistance provided to countries in difficulties

Special report 19/2015: More attention to results needed to improve the delivery of technical assistance to Greece

Special report 10/2016: Further improvements needed to ensure effective implementation of the excessive deficit procedure

Special report 17/2017: The Commission´s intervention in the Greek financial crisis

Special report 03/2018: Audit of the Macroeconomic Imbalance Procedure (MIP)

Special report 18/2018: Is the main objective of the preventive arm of the Stability and Growth Pact delivered?

Special report 22/2019: EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application

Opinion 06/2020 concerning the proposal for a regulation of the European Parliament and of the Council establishing a Recovery and Resilience Facility

Review 05/2020: How the EU took account of lessons learned from the 2008-2012 financial and sovereign debt crises

Review 06/2020: Risks, challenges and opportunities in the EU's economic policy response to the COVID-19 crisis

Special report 16/2020: The European Semester – Country Specific Recommendations address important issues but need better implementation

Special report 18/2021: Commission's surveillance of Member States exiting a macroeconomic adjustment programme: an appropriate tool in need of streamlining

Opinion 04/2022 concerning the proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulation (EU) 2021/1060, Regulation (EU) 2021/2115, Directive 2003/87/EC and Decision (EU) 2015/1814 [2022/0164 (COD)]

Special report 21/2022: The Commission’s assessment of national recovery and resilience plans - Overall appropriate but implementation risks remain

Annex II – Evolution of the EU's economic governance framework

1992

Treaty of Maastricht

- Establishes economic and monetary union
- Member States must coordinate their economic policies and submit to multilateral surveillance in this regard (Article 121 TFEU)
- Member States undertake to observe financial and budgetary discipline and may be placed under the EDP if in an excessive deficit situation (Article 126 TFEU)

1997

Stability and Growth Pact (SGP)

- Member States must submit stability or convergence programmes (SCPs) disclosing their medium-term budgetary plans
- Member States must pursue a nominal medium-term objective (MTO) for their budgetary position
- Definition of temporary and exceptional excess deficit compared with a reference value
- Rules to speed up the EDP
- Sanctions (for euro-area Member States only) in the form of a non-interest bearing deposit

2005

Reform of SGP

- MTO is redefined in structural terms (cyclically adjusted balance net of one-off and temporary measures) and made country-specific
- Deviations from the MTO or adjustment path are allowed in the event of major structural reforms
- Structural effort
- New definition of "severe economic downturn"
- Non-exhaustive list of "other relevant factors", including pension reforms
- Extension of deadlines for the correction of excessive deficits

2011

"Six-pack"

- European semester for economic policy coordination
- More detailed requirements on the content of SCPs; new expenditure benchmark: expenditure to grow less than potential GDP
- Requirements for budgetary frameworks in the Member States
- Macroeconomic imbalance procedure and sanctions
- Operationalisation of the debt criterion (average annual reduction of 1/20th of the excess over 60% for three years); three-year transitional period from the end of the EDP for the 23 Member States under an EDP as of November 2011
- Structural effort to be adjusted annually
- Reports on action taken
- Sanctions in the form of fines, to be approved by the Council

2012

Treaty on Stability, Coordination and Governance (Fiscal Compact)

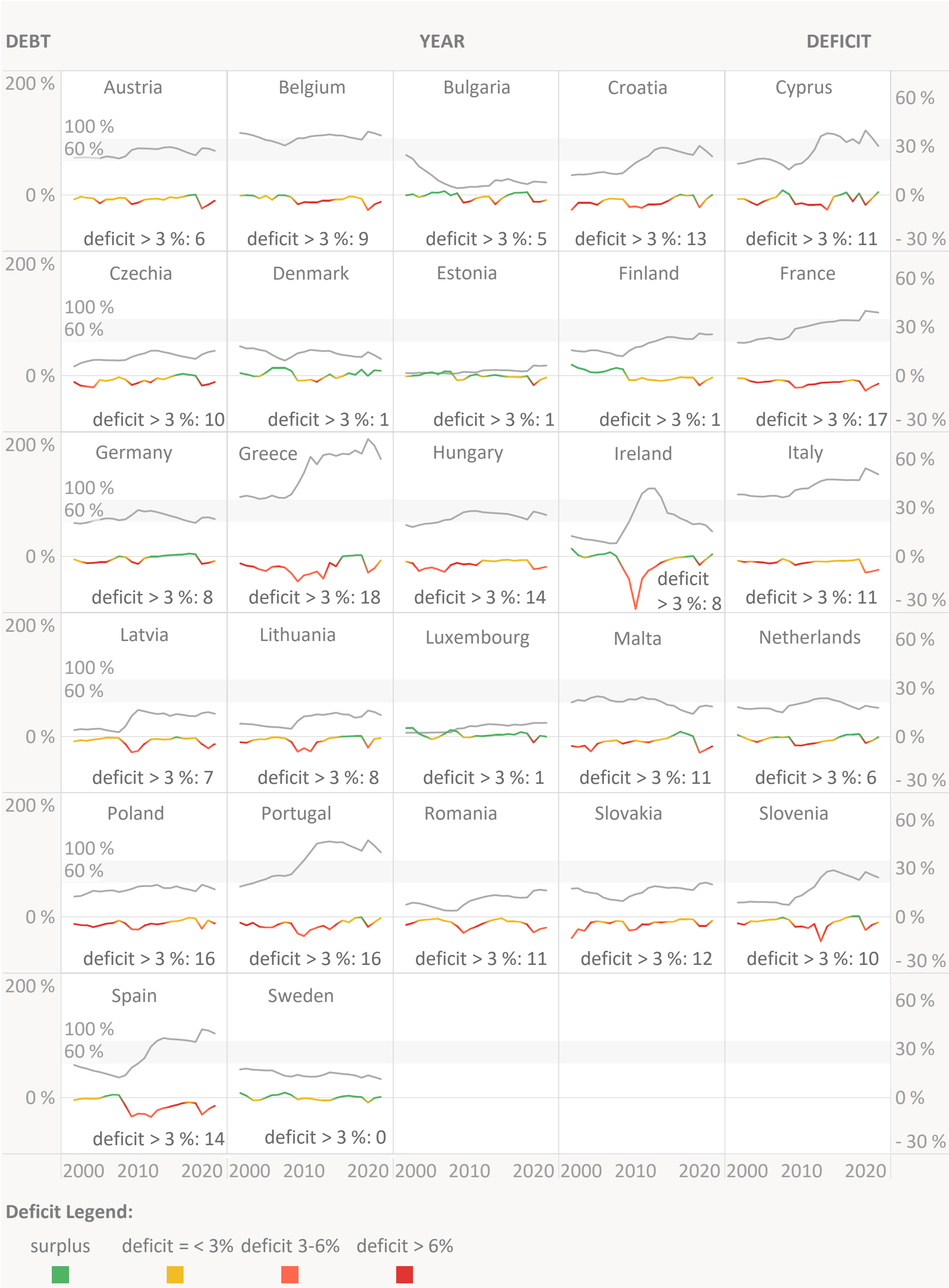
- "Golden rule" of a structural deficit rule not exceeding the MTO, with a national automatic correction mechanism in the event of deviation. To be enshrined in national constitutions, national fiscal councils to monitor compliance.

2013

"Two-pack" (euro-area Member States only)

- Assessment of draft budgetary plans by national fiscal councils
- Enhanced surveillance of Member States experiencing or likely to experience serious financial stability difficulties; macroeconomic adjustment programmes; post-programme surveillance
- Road map for structural reforms: economic partnership programmes
- Closer monitoring of Member States under an EDP: regular reporting (in-year budgetary execution report)
- Early-warning mechanism against risk of non-correction of the excessive deficit by the EDP deadline: autonomous Commission recommendations
- Swifter sanctions

Annex III – Evolution of deficit-to-GDP and debt-to-GDP ratios from 2000 to 2022



Note: Def > 3 % shows the number of years the deficit exceeded 3 % of GDP

Source: ECA based on AMECO database.

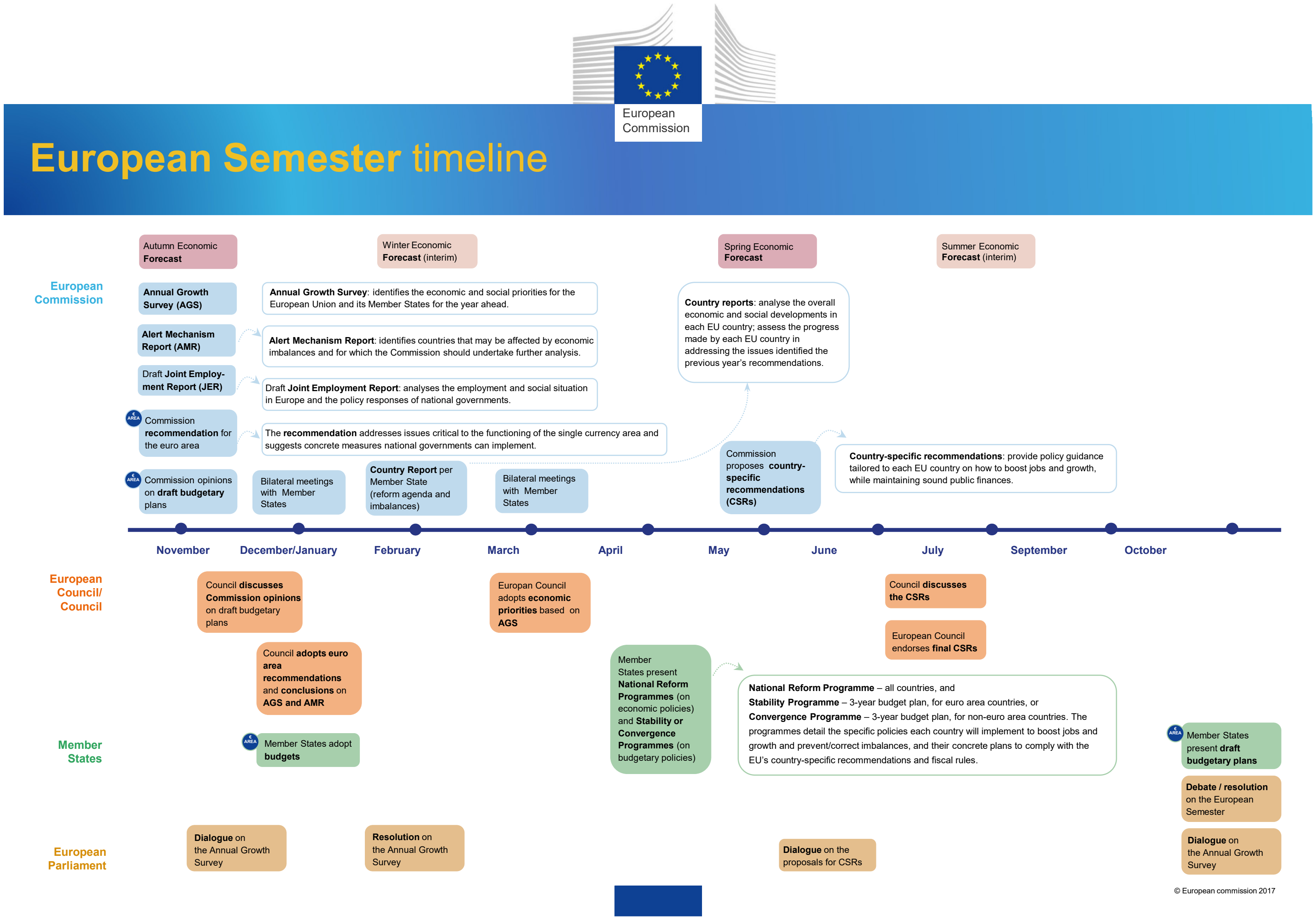
Annex IV – Global public debt

Global public debt (percentage of GDP, weighted averages)

	2007	2008	2009	2010	Average 2011-18	2019	2020	2021	Change 2007-21	Change 2019-21
World	**61.2**	**64.1**	**74.8**	**76.9**	**80.9**	**84.1**	**99.8**	**95.7**	**+ 34.5**	**+ 11.6**
Advanced economies	**71.8**	**78.5**	**91.8**	**98.2**	**105.2**	**105.3**	**124.6**	**119.5**	**+ 47.7**	**+ 14.2**
Euro area	66.0	69.7	80.4	86.0	92.1	85.8	99.0	97.5	+ 31.5	+ 11.7
United States	64.6	73.4	86.6	95.1	104.7	108.8	134.5	128.1	+ 63.5	+ 19.3
United Kingdom	43.0	50.7	64.6	75.7	85.2	84.8	103.6	103.8	+ 60.8	+ 19.0
Japan	172.8	180.7	198.7	205.7	229.1	236.3	259.4	262.5	+ 89.7	+ 26.2
Emerging market economies	**35.0**	**32.9**	**38.4**	**37.4**	**43.3**	**54.2**	**64.5**	**64.0**	**+ 29.0**	**+ 9.8**
China	29.2	27.2	34.6	33.9	42.6	57.2	68.1	71.5	+ 42.3	+ 14.3
Low-income developing countries	**29.2**	**27.3**	**29.6**	**28.0**	**34.8**	**42.9**	**48.6**	**48.7**	**+ 19.5**	**+ 5.8**

Source: IMF, Global Debt Database, 2022.

Annex V – European Semester timeline



Source: European Commission; translation: European Court of Auditors.

Annex VI – Key stakeholders' concerns regarding the current framework

	International Monetary Fund	***Organisation for Economic Cooperation and Development***	***European Stability Mechanism***	***European Fiscal Board***
Use of non-observable variables	Using a non-observable variable like the output gap estimate necessitates significant ex-post revision and thus is prone to policy errors (2021, p. 1)	Main problem with cyclically adjusted fiscal balance is use of different estimation methods yielding varying results and, possibly, error-prone forecasts requiring significant revision (2021, p. 39)	It is hard to estimate potential GDP and the growth needed to compute structural balance; frequent revisions undermined credibility and enforceability (2021, p. 7)	Metric for structural balance hinges on output gap estimates that largely failed to capture the economy's overheating in the run-up to the global financial crisis (2019, p. 12)
Over-emphasis on deficit rather than debt	While existing fiscal framework has contributed to fiscal discipline, it lacks incentives for sufficient debt reduction in relatively good times to buffer shocks in bad times (2022, p. 4)	"[D]ebt sustainability should be assessed in a longer run perspective, while the current European fiscal settings tend to be primarily driven by shorter-term objectives" (2021, p. 43)	Original link between deficit and debt anchor is no longer valid; debt criterion came into operation only in 2011; excessive deficit procedure never applied on the basis of the debt rule (2021, pp. 9, 24)	Role of 3 % of GDP deficit value as a debt-stabilising indicator has become less important; given the changed economic environment, that reference value is effectively no longer a constraint on debt development (2019, p. 92)
Weaknesses of independent fiscal institutions	IFIs increase likelihood of compliance with fiscal rules, yet coupled with other second-generation reforms they have complicated the rules system (2018, p. 4)	IFIs have varying degrees of independence; most do not provide costing of fiscal measures for short and medium term (2021 p. 46)	IFIs lack appropriate mandates and resources (2021, p. 29)	Persistent risk that even when an IFI is in line with best practice, it can be weakened by the government (degree of independence, resources, mandate) (2019, p. 50)

	International Monetary Fund	*Organisation for Economic Cooperation and Development*	*European Stability Mechanism*	*European Fiscal Board*
Insufficient national ownership	Weak national implementation is main reason for failure to contain debt risks (2022, pp. 1, 10)	Poor track record of compliance with increasingly prescriptive rules due to insufficient ownership of rules at the national political and citizens' level (2021, pp. 43, 46)		Fiscal rules alone may be ineffective in correcting policy biases, especially when countries' fiscal frameworks lack ownership (2019, p. 50)
Discretion & lack of transparency		Monitoring fiscal imbalances is too complex and contentious, resulting in dissatisfaction among Member States and weakened capacity to predict fiscal dynamics (2021, p. 39)	Increasingly political role of the Commission made assessments subject to political considerations and judgement, while technical discussions diverted attention from key policy issues (2021, pp. 8-9)	Low transparency and compliance due to weak or unclear link between the economic analysis, MIP and European Semester (2019, p. 54)
Lack of incentives and weak enforcement	Continued debt accumulation as result of lack of implementation, focus on short-term (annual) budgets and weak enforcement (2022, pp. 4, 15)	Ineffective sanctions in a highly prescriptive setting lacked complementary incentives rewarding the achievement of fiscal targets (2021, p. 46)	Fiscal rules had limited effectiveness when faced with higher spending needs and weak enforcement mechanisms based on peer pressure (2021, p. 6)	

	International Monetary Fund	***Organisation for Economic Cooperation and Development***	***European Stability Mechanism***	***European Fiscal Board***
Overly complex surveillance	Current rules aimed at being less procyclical and more flexible, but are too complex, making them difficult to communicate, monitor, comply with and enforce (2021, p. 1)	Added complexity through a proliferation of different numerical targets, procedures, contingency provisions and compliance indicators (2021, p. 39)	Current framework has become highly complex and more difficult to operate, undermining compliance and credibility (2021, p. 2)	Complexity and opacity of Stability and Growth Pact rules outweigh expected benefits (2019, p. 18)
Weaknesses in National budgetary frameworks	Medium-term fiscal frameworks are not sufficiently robust and clearly articulated to guide the annual budget process (2022, p. 17)	National medium-term budget frameworks differ quite significantly between countries in terms of political commitment, planning horizon, coverage and detail, formulation of targets and their binding nature (2021, p. 45)		

Source: ECA, based on IMF, Reforming the EU fiscal framework – strengthening the fiscal rules and institutions, 2022; IMF, Staff contribution to the European Commission review of the EU economic governance framework, 2021; IMF, Staff discussion note: Second-generation fiscal rules – balancing simplicity, flexibility, and enforceability, 2018; OECD, Economic surveys for the euro area, September 2021; ESM, EU fiscal rules: reform considerations, October 2021; EFB, Annual report, 2022; EFB, Assessment of EU fiscal rules with a focus on the six and two-pack legislation, August 2019.

Abbreviations

CSR: Country-specific recommendation

DSA: Debt sustainability analysis

ECB: European Central Bank

EDP: Excessive deficit procedure

EFB: European Fiscal Board

EMU: Economic and monetary union

ESM: European Stability Mechanism

GDP: Gross domestic product

IDR: In-depth review

IFI: Independent fiscal institution

IMF: International Monetary Fund

MIP: Macroeconomic imbalance procedure

MTO: Medium-term objective

NGEU: NextGenerationEU

PPS: Post-programme surveillance

RRF: Recovery and Resilience Facility

SGP: Stability and Growth Pact

TSCG: Treaty on Stability, Coordination and Governance in the EMU

Glossary

Budget deficit: Situation where government spending exceeds income in a financial year.

Economic and monetary union: Union of EU member states that adopted the euro as a common currency. It involves the coordination of economic and fiscal policies and a common monetary policy.

European Fiscal Board: Advisory body to the European Commission that is responsible for evaluating the implementation of EU fiscal rules, proposing changes to the fiscal framework and performing economic assessments.

European Semester: Annual cycle which provides a framework for coordinating the economic policies of EU member states and monitoring progress.

Excessive deficit procedure: Corrective mechanism applied when an EU member state has a budget deficit of more than 3 % of GDP and/or government debt of more than 60 % of GDP.

Fiscal Compact: A chapter of the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, in which the signatory EU member states agreed to improve their budgetary discipline and management.

Fiscal stance: Annual change in the structural primary budget balance. It is an estimate of the direction and extent of the voluntary impulse induced by fiscal policy. When the change is positive (negative) the fiscal stance is said to be restrictive (expansionary).

Macroeconomic imbalance procedure: Surveillance mechanism which aims to detect, prevent and correct macroeconomic imbalances that affect, or could affect, the proper functioning of a member state's economy, the euro area or the EU as a whole.

National medium-term fiscal-structural plan: Document setting out a member state's fiscal, reform and investment commitments.

National medium-term budgetary plan: Medium-term fiscal planning document that includes projections for each major expenditure and revenue item for the current budget year and beyond.

National recovery and resilience plan: Document setting out a member state's intended reforms and investments under the Recovery and Resilience Facility.

NextGenerationEU: Funding package to help EU member states recover from the economic and social impact of the COVID-19 pandemic.

Public debt: Cumulative amount of outstanding government borrowing.

Recovery and Resilience Facility: The EU's financial support mechanism to mitigate the economic and social impact of the COVID-19 pandemic and stimulate recovery, while promoting green and digital transformation.

Six-pack: EU economic governance package introduced in 2011, in response to the 2008 financial crisis, comprising five regulations and a directive.

Stability and Growth Pact: Set of rules designed to safeguard financial stability in the EU by ensuring that member states pursue sound public finances and coordinate their fiscal policies.

Structural budget balance: Budget balance adjusted for cyclical fluctuations and one-off and other temporary measures.

Treaty on Stability, Coordination and Governance in the Economic and Monetary Union: Intergovernmental agreement among EU member states, building on the **Stability and Growth Pact**, to further strengthening their budgetary discipline following the 2010 sovereign debt crisis.

Two-pack: EU economic governance package introduced in 2013 comprising two regulations that extend the **six-pack** and are applicable in the euro area only.

ECA team

This report was adopted by Chamber IV Regulation of markets and competitive economy, headed by ECA Member Mihails Kozlovs. The task was led by ECA Member François-Roger Cazala, supported by Dirk Pauwels, Head of Private Office and Stéphanie Girard, Private Office Attaché; Juan Ignacio Gonzalez Bastero, Principal Manager; Giuseppe Diana, Head of Task; Stefano Sturaro, Athanasios Koustoulidis, Alexander Kleibrink and Eduardo Muratori, Auditors. Thomas Everett provided linguistic support.

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The EU's economic governance framework is the system of institutions and procedures established to coordinate member states' economic policies, monitor, prevent and correct economic trends that could weaken national economies or negatively affect EU countries, and prevent economic spillover. Over the years we have extensively audited this framework, reported on its main shortcomings, and made recommendations to address them. The Commission recently made proposals to reform the framework. These are a step in the right direction, as they address most of the key concerns we have reported, e.g. in relation to transparency and ownership. However, risks and challenges remain in a number of key areas, in particular the need to ensure timely and effective fiscal adjustments that promote debt sustainability.

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