European Fiscal Board

Annual Report

2022

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ABBREVIATIONS

Member States

BE	Belgium
BG	Bulgaria
CZ	Czechia
DK	Denmark
DE	Germany
EE	Estonia
IE	Ireland
EL	Greece
ES	Spain
FR	France
HR	Croatia
IT	Italy
CY	Cyprus
LV	Latvia
LT	Lithuania
LU	Luxembourg
HU	Hungary
MT	Malta
NL	Netherlands
AT	Austria
PL	Poland
PT	Portugal
RO	Romania
SI	Slovenia
SK	Slovakia
FI	Finland
SE	Sweden
EA	Euro area
EU	European Union
EU-27	European Union, 27 Member States
EA-19	euro area, 19 Member States

Other

CAPB	Cyclically-adjusted primary balance
CFP	Portuguese Public Finance Council (Conselho das Finanças Públicas)
C-SIFI	Country-specific scope index of fiscal institutions
CSR	Country-specific recommendation
DBP	Draft budgetary plan
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EDP	Excessive deficit procedure
EFB	European Fiscal Board
EMU	Economic and monetary union
ERM II	European exchange rate mechanism
ESM	European Stability Mechanism
GDP	Gross domestic product
HFC	Hellenic Fiscal Council
IFIs	Independent fiscal institutions

IMF	International Monetary Fund
MTO	Medium-term budgetary objective
MAE	Mean absolute error
MFE	Mean forecast error
NGEU	Next Generation EU
OECD	Organisation for Economic Co-operation and Development
RRF	Recovery and resilience facility
SB	Structural balance
SCPs	Stability and convergence programmes
SFA	Stock-flow adjustments
SGP	Stability and Growth Pact
SPB	Structural primary balance
SURE	Support to mitigate Unemployment Risks in an Emergency
TEC	Treaty Establishing the European Community
TFEU	Treaty on the Functioning of the European Union

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FOREWORD

Prof. Niels Thygesen

Chair of the European Fiscal Board (EFB)

This is the EFB's sixth annual report. It documents the Board's independent assessment of how the EU's fiscal framework has been applied in 2021, when EU economies recorded an impressive rebound from a deep recession. The report also offers updated thinking on how to improve the EU's fiscal framework.

Starting with the policy guidance issued in spring 2020 and all the way up to the final assessment in spring 2022, the 2021 surveillance cycle was still marked by the application of the severe economic downturn clause of the Stability and Growth Pact (SGP). In contrast to official statements of EU bodies, the extensive interpretation of the clause implied a *de facto* suspension of the EU's commonly agreed fiscal rules. Fiscal guidance for 2021 was purely qualitative. It encouraged governments to contain the economic shock of the pandemic and support the recovery. It included a perfunctory mention of medium-term sustainability but offered no practical indications on how to follow up.

Helped by a very accommodative monetary stance and the announced Recovery and Resilience Facility (RRF), EU Member States implemented unprecedented fiscal expansions in the course of 2020. The forceful response softened the impact of the pandemic and prepared the ground for an economic rebound in 2021 that was stronger than initially expected.

In 2021, rather than adjusting their fiscal policies to the steep economic recovery, many Member States - especially those with a high debt-to-GDP ratio - maintained or even expanded their highly supportive fiscal policies. Windfall revenues were not used to improve budgetary positions. In the euro area, the structural primary budget deteriorated by another ½ % of GDP on top of the 2 ½ % of GDP in 2020. It is to be noted that the additional fiscal expansion included a sizeable share of permanent expenditure increases. That is why growth rates of government expenditure exceed estimates of medium-term potential output growth by a significant margin even when netting out the impact of temporary measures. To be clear, nobody expected governments to launch major consolidation programmes in 2021. But sticking to already generous expenditure plans vetted at the end of 2020 would have delivered significantly better fiscal outcomes.

In hindsight, the 2021 surveillance cycle - with its many deviations from rules and established practice - underscores the need to clarify as soon as possible when and how to return to a rules-based approach. This relates foremost to the use of the severe economic downturn clause, which was extended until the end of 2023 without a sufficient economic case being made. The EFB is on record for criticising this decision as prolonged recourse to the clause may signal a rapidly eroding political support for a rules-based fiscal policy. Especially the reduced attention to the medium term is a matter of concern.

The key justification for EU rules-based fiscal governance is to reduce the risk of harmful spill-overs of fiscal policy in countries that either have paid insufficient attention to the medium-term and allowed public debt to rise to very high levels or do not sufficiently internalise the effects of national fiscal policies on euro area inflation. Unfortunately, the several rounds of reforms of the rules have only partially delivered on this clear and targeted perspective in the Treaty. A complex practice has evolved of trying to assess compliance with guidelines for how to correct often minor budgetary transgressions. The objective in the Treaty of preventing, identifying and correcting gross policy errors has become blurred.

The final chapter of this report pleads for a comprehensive approach to reforming economic governance. In a first stage of simplification the EFB argues in favour of leaving the large majority of Member States with a good record of sound public finances to assume more national responsibility, as long as they meet certain conditions such as transparent budgetary practices, a sufficiently-equipped independent national fiscal council as monitor, national rules close to those in

the EU and compliance with the 3% of GDP reference value for the headline deficit, the one element in the rules that has retained political and public recognition.

Member States with very high debt ratios - six Member States are currently well into triple figures - would be subject to more direct EU surveillance. The key new feature the EFB proposes is to aim for commitments from each country to reduce public debt significantly over a period of 3-5 years in the direction of the 60% of GDP reference value of the Treaty, to be retained as a marker. These numerical commitments, differentiated by country, would replace the current debt reduction rule. However well-intentioned, the rule has never been implemented, partly because it would have implied primary budget surpluses that exceed current assessments of what is politically viable.

Our proposal for a simpler and more decentralised surveillance, combined with more targeted implementation in the case of very-high-debt countries, may seem radical. It aims to combine the original objectives of the EU fiscal framework with the lessons learnt from the sequence of past SGP reforms, which in hindsight turned out to be overly ambitious in certain areas. But the proposal, however useful it would be, does not resolve the issue of how to deal with the multiplicity of objectives that has emerged as a major challenge to rules-based governance.

Agreeing on what we see as the first stage of reforms is already a tall order. But two important gaps would remain beyond agreement. We see a central fiscal capacity for stabilisation and joint initiatives to protect the supply of EU public goods in priority areas as complements to a reformed SGP. These two complements would address the two objectives of strengthening the resilience of the EU and face up to the fact that new challenges can often be met more efficiently at the EU level than by Member States individually. The RRF has taken up these challenges in the green and digital transition, but the initiative is temporary. Debate on how it could be replaced should not be long delayed.

EU economic governance is about more than reforming the SGP. This should become more evident since the complementary steps of filling the two longer-term gaps could at the same time allow a simplified and better targeted implementation of the SGP to focus more on its core task of fostering the sustainability of public finances. The coming reform should be both radical and comprehensive. We hope the Commission Communication will provide the start of designing such a reform.

EXECUTIVE SUMMARY

Exceptional circumstances marked the year 2021 but old patterns started to resurface. Against an initially still uncertain but improving epidemiological environment, the year was characterised by an exceptional economic rebound. From an EU surveillance perspective, 2021 was also special due to the continued application of the severe economic downturn clause, which *de facto* suspended the normal application of the EU fiscal rules. At the same time, unfortunate behavioural patterns made their come-back. While economic growth turned out better than previously expected and more tax-rich than usual, it did not lead to a corresponding improvement in budgetary positions; a significant share of government revenue windfalls was spent.

The EU economy staged a strong rebound, with some notable differences across countries. Real GDP in both the euro area and EU grew by more than 5%, pushing quarterly GDP back to the level observed at the end of 2019. Growth surprised on the upside, as economic activity expanded more rapidly than projected at the beginning of the year. It was also broad-based, with a strong rebound in private consumption and net exports, further supported by solid investment and government consumption. However, the speed of the recovery was not uniform across countries and sectors. Some countries, primarily in Central and Eastern Europe, significantly exceeded the pre-crisis level of real GDP by the end of 2021. Others were still below it, with Portugal, Italy and in particular Spain at the rear.

Improving headline balances masked further fiscal easing. On the back of the strong economic rebound, the general government deficit improved by around 2 percentage points to 5.1% and 4.7% of GDP in the euro area and the EU, respectively. The improvement largely resulted from strong revenue windfalls as the tax content of GDP exceeded normal levels. In several countries, especially those with high government debt ratios, these windfalls went along with an extension or even an increase of Covid-related emergency measures and/or an increase in other expenditure items. As a result, headline deficits decreased less than the economic recovery would have implied, and the structural primary budget balance continued to deteriorate.

From a euro-area perspective, the fiscal stance was, in hindsight, too expansionary. In 2021, the aggregation of national budgets amounted to an expansionary euro-area fiscal impulse of around ½ % of GDP. This came on top of an already very supportive fiscal stance carried over from the preceding year combined with a still very accommodative monetary policy. The Recovery and Resilience Facility (RRF) contributed an additional impulse of around 1/3 % of GDP. In view of the strong recovery and the rapidly diminishing economic slack, the observed expansionary impulse was on the high side, contributing to emerging inflationary pressures in 2021 and aggravating supply bottlenecks.

Government debt ratios started to decline from their peak while some countries kept running high cash buffers. After having ratcheted up to close to 90% and 100% in 2020, the EU and euro-area debt-to-GDP ratio declined by around 2 percentage points. This was mainly because sustained nominal GDP growth exceeded interest rates. A closer look at the evolution of debt shows that stock-flow adjustments were responsible for about one-fifth of the 2020 debt jump in the EU. The debt-increasing impact was chiefly explained by a significant cash accumulation in virtually all Member States, most likely linked to precautionary borrowing taking advantage of the favourable sovereign interest rates and the *de facto* suspension of EU fiscal rules. Some countries continued to build up cash buffers in 2021 and few started reducing them. The decline in debt ratios would have been larger if cash buffers had not been further increased.

Continued recourse to the severe economic downturn clause scarred the 2021 EU surveillance cycle. In line with the relevant legal provisions of the Stability and Growth Pact (SGP), official statements from the Commission and the Council consistently stressed that the severe economic downturn clause had not suspended fiscal rules and procedures. The clause formally allows for flexibility in defining the amount of country-specific fiscal adjustment, provided the sustainability of public finances is safeguarded in the medium term. Nevertheless, the 2021 surveillance cycle was characterised by notable

idiosyncrasies as procedures and established practices were modified or not applied.

EU fiscal guidance to Member States was purely qualitative. The outbreak of the Covid-19 pandemic and its economic consequences had a major impact on the application of the commonly agreed EU fiscal rules. While the Commission and the Council followed the usual calendar defined by the European Semester, the guidance was very different in terms of content and period of reference. Fiscal recommendations issued in spring 2020 were uniform across all EU countries, purely qualitative and centred on the immediate crisis response. The need to safeguard sustainability in the medium term was dutifully mentioned. However, country-specific sustainability risks were not considered, and no practical indications were offered on how to achieve or safeguard sustainability in the medium term.

Budgetary plans targeted a further increase in government expenditure despite a projected economic rebound. Against the backdrop of purely qualitative and undifferentiated EU fiscal guidance, in autumn 2020 many Member States presented draft budgetary plans featuring significant increases in current expenditure unrelated to the Covid-19 pandemic. While the Commission reached the foregone conclusion that the draft budgetary plans had responded to the recommendations issued in spring 2020 to support the recovery, it highlighted the presence of significant non-temporary measures in some Member States.

In countries with very high debt ratios, expenditure growth went beyond plans and medium-term rates of potential output growth. While the need for crisis measures was expected to recede in 2021, governments used the successive Covid-19 waves not only to extend emergency measures launched in 2020 but to increase overall expenditure. In the EU, net expenditure – nominal primary government expenditure net of certain items not directly under the control of government and net of discretionary revenue measures - increased on average by around 5% over the previous year. Growth rates were broadly similar across low, medium and high-debt countries while the benchmark rate of medium-term potential growth is significantly lower in countries with high debt. As a result, countries with high debt ratios recorded expenditure growth well above rates that can be expected to be sustainable in the medium to long run. Moreover, an important part of the 2021 increase in net expenditure is likely to be permanent.

The Commission and the Council eased EU surveillance paying less attention to the medium term. Firstly, in agreement with the Commission, but in contrast to reporting requirements under the SGP, many Member States did not present fully fledged medium-term budgetary plans or even plans for 2021. Secondly, the Commission discontinued the well-established practice of producing dedicated country-specific assessments in the form of staff working documents on the stability and convergence programmes and draft budgetary plans. Also, the Commission relied on *ad hoc* fiscal indicators that corrected for temporary crisis-related fiscal measures. Lastly, at various points in the year, the Commission chose not to report on excessive deficits. These departures from past practice and procedures reduced transparency and weakened the medium-term orientation of fiscal policy.

Reduced attention on the medium term was also reflected in the handling of the corrective arm of the SGP. Excessive deficit procedures (EDPs) are an important instrument to strengthen the medium-term orientation of EU fiscal surveillance for countries with high deficits or debt. They contribute to anchoring expectations in a multi-year context. However, while repeatedly acknowledging the presence of excessive deficits during the 2021 surveillance cycle, the Commission and the Council refrained from taking further procedural steps towards opening EDPs. The decision not to proceed was motivated by exceptional uncertainty. Romania was the notable exception: uncertainty did not prevent the Commission from updating recommendations and defining an adjustment path. As in 2020, the handling of EDPs reflected political considerations rather than established practice and the letter of the SGP. Overall, EDPs would have been an important signal for medium-term budgetary planning, without endangering economic recovery. In practice, the fiscal adjustment path under an EDP can be, and has been, attuned to the country-specific situation and stretched over several years as a function of economic contingencies.

The severe economic downturn clause requires safeguarding fiscal sustainability in the medium term, but its analysis was unusual. In contrast to established practice, the Commission's

assessment of the 2020 stability and convergence programmes did not include a sustainability analysis. The Commission assessments relied on either an analysis predicated on outdated projections or an *ad hoc* sustainability analysis carried out in the context of the European Stability Mechanism's Pandemic Crisis Support instrument and predicated on very favourable policy assumptions. The subsequent Debt Sustainability Monitor of February 2021 eventually reflected fiscal realities and highlighted increased sustainability risks, especially in the short term, owing to the severe impact of the Covid crisis. The Fiscal Sustainability Report of April 2022 further pointed to increased risks in the medium and long term for some Member States. However, only a few weeks later, the Commission published an updated debt sustainability analysis pointing to lower risks in the medium and long term for some countries. This was partly due to better-than-expected initial budgetary positions as measured by the structural budget balance. These fluctuating results underline how sensitive the sustainability analysis is to the re-assessment of underlying budgetary positions.

The EU's severe economic downturn clause also affected the work of independent fiscal institutions. The *de facto* suspension of the SGP coupled with the activation of national escape clauses put independent fiscal institutions (IFIs) in a difficult position, not least because national provisions can depart from EU law. In some Member States the Commission's continued application of the severe economic downturn clause gave rise to inconsistencies with national provisions, which would have suggested a return to national rules. While IFIs followed the regular reporting schedule as per mandate or established practice, compliance assessment lacked a numerical target against which fiscal performance could be evaluated, since there were no fiscal requirements issued at EU level or numerical constraints on the general government balance at the national level. Producing or endorsing macro-economic and fiscal forecasts remained an important task of IFIs but their impact was reduced given the *de facto* suspension of the fiscal rules.

Before the pandemic, euro-area IFIs played a growing role in ensuring the soundness of macroeconomic scenarios underlying fiscal plans. The 2013 Two-Pack Regulation, which applies to euro-area countries, stipulates that the macroeconomic projections underlying fiscal plans must be either produced or endorsed by independent bodies. The formal involvement of IFIs in the forecasting process is associated with a lower over-optimistic bias in real GDP growth projections. There have been only a few cases of outright adjustments in government growth projections or non-endorsement decisions by IFIs since the adoption of the Two-Pack Regulation. However, as the IFI activity may have a preventive impact, these small numbers may understate the actual effect of this obligation.

EU Member States are required to make regular ex-post assessments of their official macro forecasts, but follow-through is mixed. Since 2011, EU law requires governments to carry out a regular ex-post assessment of macro forecasts underpinning budgetary projections. This ex-post assessment comes on top of the independent endorsement or production of macro forecasts underpinning annual budget plans and concerns all EU Member States. Regrettably, few countries have followed through fully on this requirement. Among those who did, the approach and assessor differ significantly. A couple of governments published self-assessments and in several countries such reports are yet to be released. While there is a trend towards mandating national IFIs with the backward-looking evaluation of official macro forecasts, further action is warranted to establish credible reporting on past forecasting performance with a regular schedule in all countries.

The involvement of IFIs in preparing national Recovery and Resilience Plans (RRPs) was limited. During the pandemic, the focus of IFIs shifted away from the formal assessment of compliance towards assessment of fiscal support packages and the long-term sustainability of public finances. The establishment of the Recovery and Resilience Facility (RRF) in early 2021 came with a potentially new task, notably offering opinions to national governments on the RRPs. A dedicated survey suggests that the IFIs' role in drawing up, evaluating and monitoring the implementation of national RRPs has so far remained limited. Very few governments consulted their IFI not least because the possible involvement is mentioned in the preamble of the RRF Regulation, not in its legally binding part.

The continued suspension of the SGP is creating a harmful vacuum and calls for an urgent review of the EU fiscal framework. Since the activation of the severe economic

downturn clause in early 2020, EU Member States have been running fiscal policies without any quantitative goalposts and EU recommendations were largely the same for all countries, regardless of sustainability risks. Although flexibility is an inherent quality of any rules-based system the *de facto* suspension of EU fiscal rules is undermining sound fiscal policy making in the EU. Especially the reduced attention to the medium term and expenditure dynamics in very-high debt countries are a matter of concern. The 2021 surveillance cycle clearly underscored the need to clarify as soon as possible when and how to return to a rules-based approach. The ongoing economic governance review is an opportunity to rethink the EU fiscal framework.

Fiscal monitoring could take place predominantly at national level with an EU-backstop to correct gross policy errors. Shifting fiscal monitoring to the national level may enhance ownership and provides flexibility to Member States in calibrating the rules to national specificities/preferences. However, such a delegation requires an adequate national fiscal framework and independent fiscal institutions that are up to the enhanced role. In any case, the framework should yield budgetary outcomes in line with the EU fiscal rules and have a sound medium-term orientation. EU surveillance continues but only intervenes in case of gross policy errors.

Debt reduction paths should become more differentiated and subject to a firm commitment by governments over the medium term. For countries above the 60% debt reference value, a realistic adjustment path would be defined between the government and Commission, which is then endorsed by the Council. The expenditure benchmark would remain the key variable for very-high-debt countries, while monitoring of others can focus on fiscal outcomes. The stronger medium-term perspective would mean that fiscal performance will be assessed over a 3–5-year horizon, unless gross errors occur in the meantime.

A central fiscal capacity (CFC) should focus on large scale but temporary shocks. The semi-automatic activation of the CFC could be linked to relevant macroeconomic indicators. The CFC should accumulate funds through contributions by Member States. In presence of a relevant shock, governments can draw on their own accumulated contributions. If these do not suffice, governments can also access concessional loans from the CFC, backed by other Member States' contributions or, if needed, by debt issuance. These concessional loans would entail conditionality and access could be assessed by an independent body of experts, while the final decision remains at the appropriate political level. In a reformed fiscal framework, support from the CFC should coincide with the activation of the national escape clause.

An EU budget supplemented by national envelopes is a viable mechanism to strengthen the quality of public expenditures. The subsidiarity principle and varying national preferences caution against heavy-handed intervention at the EU level. However, spending externalities and economies of scale justify a role at the European level. The EU budget already has this function but is not always very effective. The EFB has advocated increasing the EU budget by national envelopes in a net neutral way. Linked to EU spending priorities, such an augmented EU budget could enhance public investment durably. By contrast, special treatment of investment within the fiscal rules, e.g. via a golden rule, have had mixed results, create many potential pitfalls, and may overburden the framework. While the RRF may provide some valuable lessons for fostering investment, the EFB has reservations in seeing the RRF as a longer-term model.

1. MAIN MACROECONOMIC AND FISCAL DEVELOPMENTS IN 2021

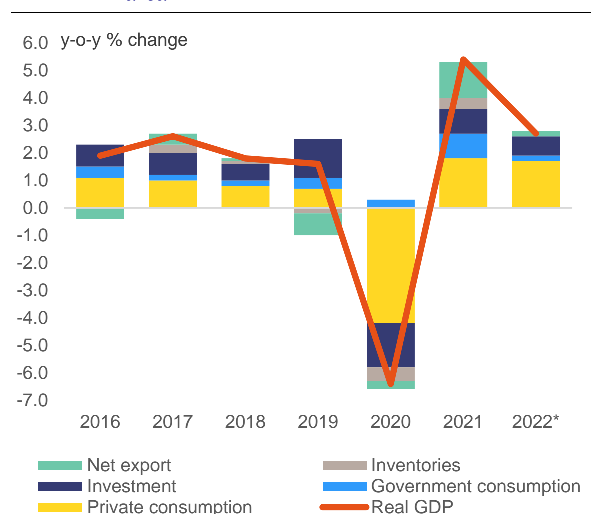
Highlights

- After the severe economic downturn caused by the Covid-19 pandemic in 2020, the EU economy rebounded strongly in 2021, bolstered by a significant progression in vaccination rates and a gradual easing of restrictions. The average annual growth of real GDP exceeded 5% in the euro area and the EU pushing quarterly GDP levels back to the level observed at the end of 2019.
- The speed of the recovery has been uneven across countries and sectors: some countries already reached or surpassed the pre-crisis level in 2021, others were still below it.
- The rebound in economic activity greatly improved labour market conditions, resulting in unemployment rates at record-low levels. While headcount employment returned to pre-pandemic levels, average hours worked per employee were still lower than before.
- Inflation in the euro area and the EU had picked up since the beginning of 2021, primarily due to increasing energy prices and supply bottlenecks. Average inflation under the harmonised index of consumer prices reached 2.6% and 2.9% in the euro area and the EU, respectively.
- General government deficits narrowed considerably in 2021, by around 2 percentage points to 5.1% and 4.7% of GDP in the euro area and the EU, respectively. The improvement largely resulted from higher-than-expected revenues.
- Accounting for cyclical improvements, the structural primary deficit actually worsened by 0.4 percentage points to 2.5% of GDP in the euro area. This was mainly due to the extension of, or additional measures related to the pandemic or to the adoption of new non-temporary measures.
- Government revenues benefited from strong labour markets, leading to higher receipts from personal income tax and social security contributions. In addition, taxes on production and imports were stronger than nominal output growth would have suggested.
- In contrast to past crises, public investment expenditure increased considerably also thanks to the impact of the EU's Recovery and Resilience Facility (RRF).
- After reaching a historical peak in 2020, the debt-to-GDP ratio declined by around 2 percentage points in the euro area and the EU to around 97% and 90%, respectively. The fall was mainly supported by strong economic growth, especially in highly indebted countries.
- Stock-flow adjustments accounted for some one fifth of the 2020 debt jump in the EU. This debt-increasing impact was chiefly explained by the significant cash accumulation across the EU, probably motivated by precautionary borrowing, favourable sovereign interest rates, and the *de facto* suspension of EU fiscal rules, including the debt reduction rule. While there was some normalisation in several countries' cash reserves in 2021, others continued to build up cash buffers.

1.1. MAIN MACROECONOMIC DEVELOPMENTS

In 2021, GDP saw renewed robust growth in both the euro area and the EU, bolstered by the progression in vaccination rates and gradually lifted restrictions. Following a break over the winter months, the recovery resumed in the second quarter of 2021. In the year as a whole, real GDP growth averaged 5.4% in both the euro area and the EU.

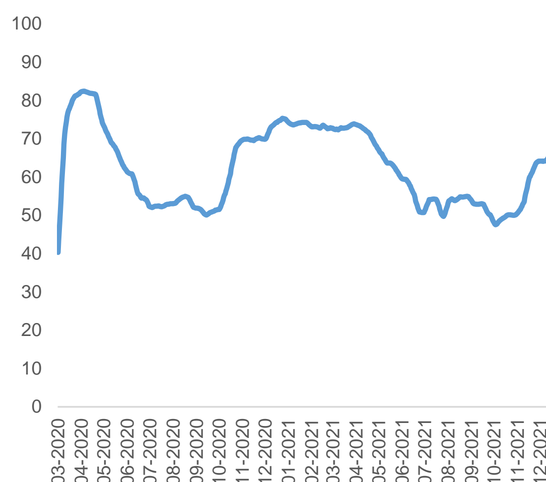
Graph 1.1: **Real GDP growth and its components, euro area**



* Commission 2022 Spring Forecast
Source: European Commission

The recovery of economic activity was broad-based, underpinned by all components of final demand (Graph 1.1). The largest positive contribution, from private consumption, came as labour markets improved and households began spending some of the high savings they accumulated in 2020. Investment, both private and public, also picked up thanks to favourable financing conditions and pre-financing ([1]) received in the context of the Recovery and Resilience Facility (RRF) to support crucial investment. Net exports contributed positively to GDP growth and increased the current account surplus.

Graph 1.2: **Oxford Stringency Index of lockdown policies, EU (simple average)**

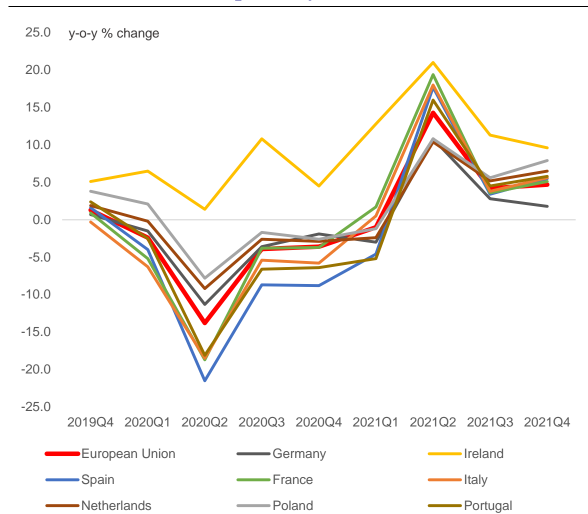


(1) The University of Oxford's stringency index records the strictness of 'lockdown style' policies that primarily restrict people's behaviour. It is a composite measure based on nine response indicators including school closure, workplace closure, and travel bans, rescaled to a value from 0 to 100 (100=strictest).
Source: Oxford Government Response dataset

Looking merely at the recovery on an annual basis might obscure dynamic developments within the year. The tight lockdowns prevalent over the winter prolonged the recession in the EU economy to the first quarter of 2021 (Graphs 1.2 and 1.3). The recovery resumed from the second quarter of 2021, buoyed by relaxation of the containment measures, such as opening schools and leisure activities. As a result, in spring 2021, the stringency of government interventions decreased in most countries, approaching the levels seen in summer 2020. As the health situation worsened at the end of the year, the reins were tightened again, for example by switching back to work-from-home where feasible, increasing the stringency index. While growth slowed down, the economy did not slip back into a recession. The correlation between changes in the Oxford Stringency Index and real GDP growth (quarter-on-quarter), which was relatively strong during the beginning of the pandemic, appears to have weakened subsequently. It seems households and businesses have effectively adapted to new ways of working.

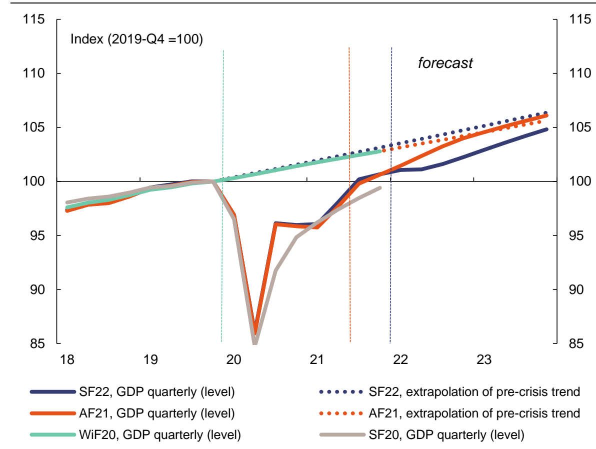
([1]) Pre-financing of 13% of the total amount allocated to Member States was made available when recovery and resilience plans were approved. By the end of 2021, plans were approved for 17 Member States for a total of EUR 54 billion or 0.4% of the 2021 EU GDP.

Graph 1.3: **Real GDP growth in the EU and selected countries, quarterly**



Source: Eurostat

Graph 1.4: **Real GDP growth path in the EU**



(1) The AF21 extrapolation of the pre-crisis trend uses average quarterly growth of 2021 as forecast in WiF20. The SF22 extrapolation of the pre-crisis trend uses average quarterly growth in 2010-2019.
Source: European Commission

In the third quarter of 2021, the euro area and the EU economy were back to their quarterly pre-crisis output levels (2019-Q4) (Graph 1.4). Despite the increasing number of new Covid-19 cases over the winter months, economic growth continued on the back of a further recovery in the contact-intensive service sectors.

On top of using end-2019 levels of GDP as the reference for gauging the rebound from the economic downturn caused by the Covid-19 pandemic, the Commission also produced *ad hoc* estimates of what it called the pre-crisis trend of economic activity. The first such estimate was presented in the spring 2020 forecast and was regularly updated in successive exercises (the latest such estimate is shown in Graph 1.4). Convergence towards the pre-crisis trend was sometimes interpreted as an indication of 'full' recovery. It is to be noted that the Commission services have repeatedly changed the *ad hoc* method of extrapolating the pre-crisis trend. Over successive forecasts, the trend has consistently moved up, widening the gap to actual GDP, which recovered more strongly than originally expected. (2)

The speed of recovery has not been uniform across countries and sectors. By the end of 2021, some countries already reached the pre-crisis level while others were still well below it. The highest year-on-year real GDP growth was recorded in Ireland (13.5%), followed by Croatia (10.2%) and the lowest in Germany (2.9%). While the contact-intensive sectors (e.g., tourism) benefited strongly from the easing of health-related restrictions, supply chain disruptions were a burden for the industry and construction sector, especially on manufacturing activity.

In line with the economic recovery, labour market conditions in Europe improved markedly. With the relaxation of restrictions on contact-intensive sectors in the second quarter, labour demand increased. Moreover, the public sector contributed markedly to employment growth. Headcount employment rose from 2020 by 1.1% and 0.7% in the euro area and the EU, respectively. In line with the evolution of the pandemic, many workers exited job-retention schemes during the summer but returned into these in the last quarter of 2021. As a result, total hours worked increased by 1.1% in 2021, in line with headcount employment. While the pre-pandemic gap disappeared for total employment in the last quarter, it remained 1.1% below pre-pandemic levels for average hours worked per employed person. Positive labour dynamics were also visible in unemployment rates, which fell over the course of the year. In the last quarter, rates fell below those recorded at the end of 2019. Overall, in 2021, the unemployment rate was 0.3 percentage points down, to 7.7% and 7.0% in the euro area and the EU, respectively.

(2) These ad hoc methods are completely unrelated to conventional estimates of potential output, based on either the commonly agreed method used in EU fiscal surveillance or other methods.

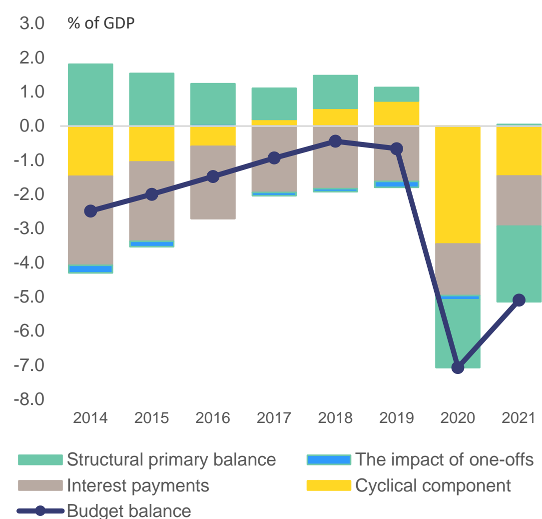
After several years of very low rates, inflation in both the euro area and the EU had picked up from the beginning of 2021. This was well before the energy shock linked to the Russian invasion of Ukraine in February 2022, which added additional fuel to inflation. In 2021, headline inflation in the euro area increased by 2.3 percentage points to 2.6%, mainly due to significantly higher energy prices and growing supply bottlenecks. Nevertheless, supply-side disruptions put an upward pressure also on core items in the harmonised index of consumer prices basket, such as services, and industrial prices. Moreover, closing the output gap also increased demand pressures. Consequently, in the second half of the year, core inflation started to increase reaching 1.5% year-on-year. The GDP deflator posted a higher increase of 2%, on account of greater private consumption, while terms of trade worsened due to an increase in energy prices and the depreciation of the euro.

Monetary policy remained highly accommodative in the euro area and its policy instruments remained unchanged. The European Central Bank (ECB) continued its asset purchases under the pandemic emergency purchase programme in order to preserve favourable financing conditions for governments. Additionally, its targeted longer-term refinancing operations continued to provide liquidity to euro-area banks to support lending to firms and households. In July 2021, the ECB revised its forward guidance on policy rates in light of its new monetary policy strategy. The revised forward guidance indicates that the ECB '*expects the key ECB interest rates to remain at their present or lower levels until it sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term. This may also imply a transitory period in which inflation is moderately above target.*' (3) (4). In line with that statement, the ECB kept its policy rates unchanged through 2021 as it expected inflation to gradually fall to slightly below its target by the end of the projection horizon.

1.2. MAIN BUDGETARY DEVELOPMENTS

After a significant deterioration in 2020, 2021 marked a substantial improvement of fiscal positions on the back of a strong economic recovery. However, deficits decreased less than the economic recovery would suggest as Member States continued to offer a significant amount of fiscal support against the backdrop of the still-evolving pandemic. General government deficit improved by around 2 percentage points to 5.1% and 4.7% of GDP in the euro area and the EU respectively.

Graph 1.5: **Budget balance and its components, euro area**



Source: European Commission

This improvement of headline balances was mainly driven by improved cyclical conditions, while the euro area structural primary deficit (Graph 1.5) further worsened by 0.4 percentage points to 2.5% of GDP in the euro area. This reflects the temporary emergency measures related to the pandemic remained broadly stable at aggregate level, while sizeable non-temporary measures were adopted (Graph 1.6).

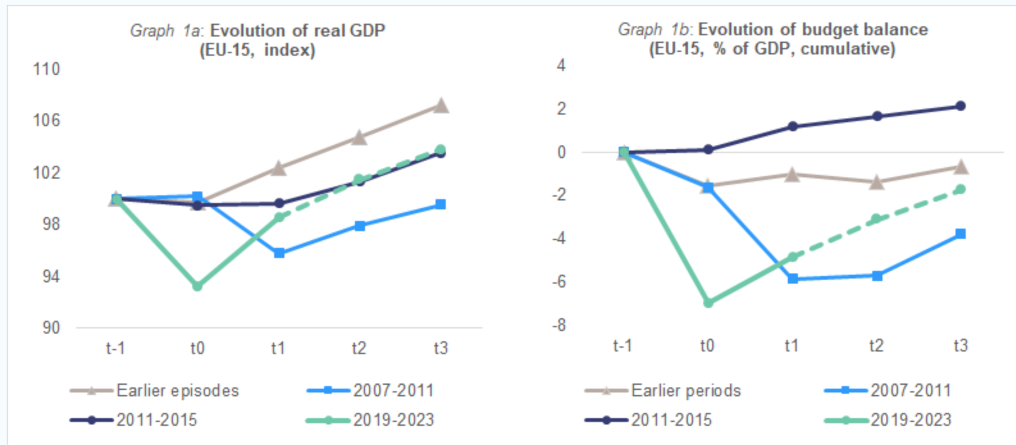
(3) https://www.ecb.europa.eu/press/blog/date/2021/html/ecb.blog210819~c99d1b768d.en.html

(4) The revised forward guidance has changed the definition of the price stability from 'below, but close to, two per cent' to symmetric 'two per cent' meaning that the ECB will treat both deviations, up or down, as equally undesirable.

Box 1.1: **Budgetary impact during economic recovery episodes**

This box examines the evolution of fiscal aggregates during past recovery episodes and compares them with the current situation. Since 1970, EU countries have experienced six major economic crises followed by rebounds in which improvements in budget balances lagged behind increases in real GDP.

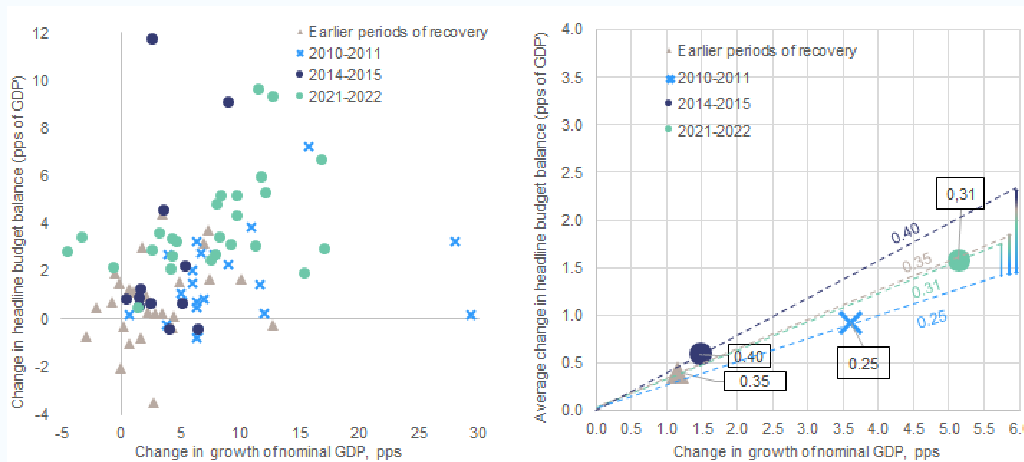
Graph 1: **Evolution of real GDP and headline budget balance from the crisis to recovery periods**



(1) Earlier periods include 1974-1979, 1980-1984 and 1992-1997. (2) The data for 2022 and 2023 represent the Commission's 2022 spring forecast (dashed lines).
Source: European Commission; own calculations

Compared with the previous episodes, the economic recovery in 2021 was characterised by a stronger and steeper rebound of GDP (Graph 1a). Graph 1b shows that deficits decreased in the first year after the crisis, but to different levels. In contrast to previous recoveries, when a decrease in primary expenditure compared with GDP was only partially accompanied by increases in revenues (see EFB annual report - Box 1.2), government revenues increased quite substantially in 2021 (see Section 1.2).

Graph 2: **Government budgets during recovery episodes (1974-2022)**



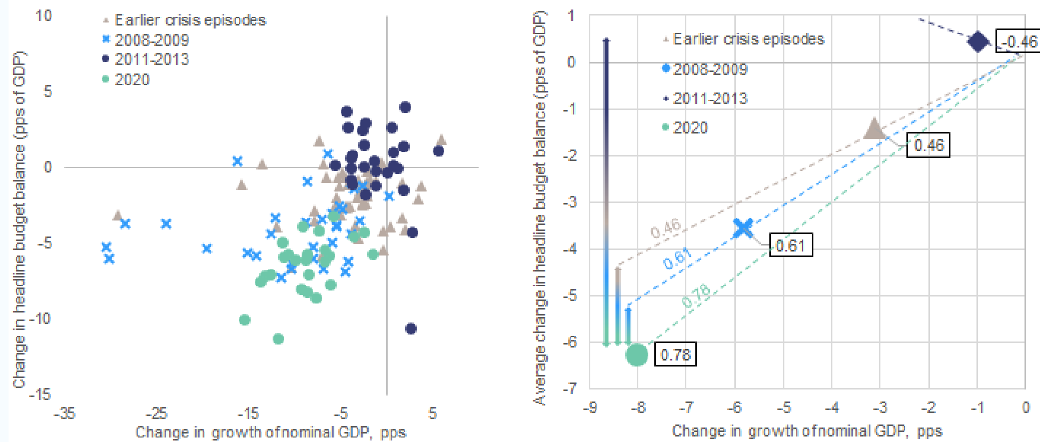
(1) Recovery episodes are defined as 2 years with positive real GDP growth after a recession. (2) Values on the right-hand chart are GDP-weighted averages. (3) Data for 2022 are taken from the Commission's 2022 spring forecast.
Source: European Commission, own calculations

(Continued on the next page)

Box (continued)

Relatively speaking, i.e. in terms of the deficit decrease for a given change in the growth of nominal GDP, the budgetary impact of the Covid-19 recovery phase has been similar to that of previous episodes. Graph 2 shows that the coefficient between the average change in the headline budget balance and the average change in nominal economic growth has been 0.31 during the post-pandemic recovery. It therefore lies within the range of values observed in previous recovery periods (between 0.25 and 0.4).

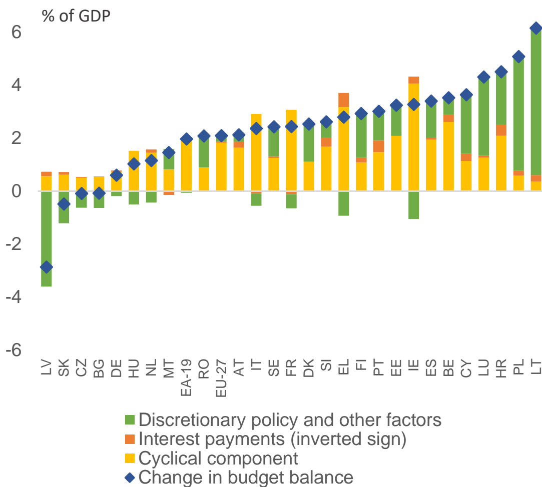
Graph 3: **Government budgets during downturn episodes (1974-2022)**



(1) Crisis episodes are defined as years with negative annual real GDP growth. (2) Earlier crisis episodes refer to the country/year with negative real GDP growth between 1974 and 2008. (3) Values on the right-hand chart are GDP-weighted averages.
Source: European Commission, own calculations

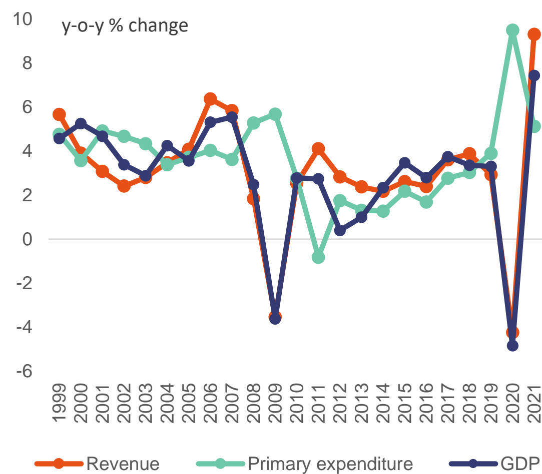
To put these budgetary impacts into perspective, we see that, based on our definition, the deterioration during downturns tends on average to be stronger than the improvement during recoveries. Graph 3 shows that the budgetary impact, i.e. in terms of the deficit increase for a given change in the degree of economic slack, was between 0.5 and 0.8. It also shows that the budgetary impact in 2020 was - relative to the deterioration in nominal GDP growth - more significant than for previous economic shocks (see Box 1.1 of the EFB annual report). Comparing the crisis and recovery periods indicates that, while Member States tend to respond to a shock in quite similar ways, with the exception of 2008-2009 crisis, their recoveries tends to be much more diverse. This was also the case in the Covid-19 crisis when, despite the greater symmetry of the initial shock and the more coordinated response of the Member States, their budget balances have recovered in different ways. One reason for this could be that while the general government deficit improved on the back of the strong revenue windfalls, in several countries, these windfalls went along with an extension or even increase of Covid-related emergency measures and/or an increase in other expenditure items.

Graph 1.6: **Drivers of the change in 2021 government budget balance, by country**



(1) Estimates of the structural primary budget balance are surrounded by uncertainty as they involve forecasts. They are likely to be revised when new data become available. (2) Discretionary policy and other factors are measured as a change in a structural primary budget balance plus one-offs.
Source: European Commission

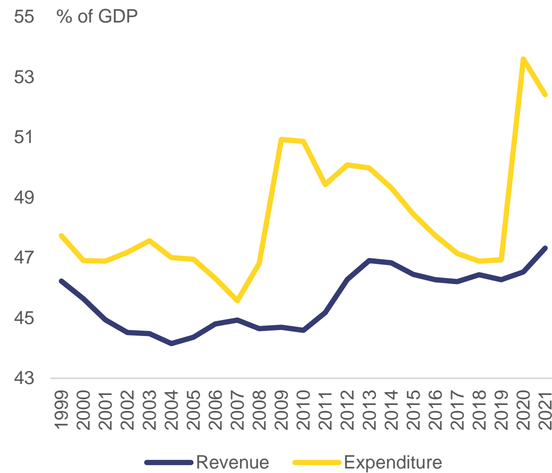
Graph 1.7: **Government revenue, primary expenditure and GDP, euro area (current prices)**



Source: European Commission

After the biggest-ever year-on-year increase in 2020, primary expenditure recorded another year of high growth. With a more than 5% rise in both the euro area and the EU, governments continued to expand their support to households and firms while the economy was rebounding and increased permanent spending (Graph 1.7). The economic recovery had knock-on effects on revenues. Their rate of increase substantially surpassed nominal GDP growth leading to an increase of the revenue ratio (Graph 1.8).

Graph 1.8: **Government revenue and expenditure, euro area (current prices)**

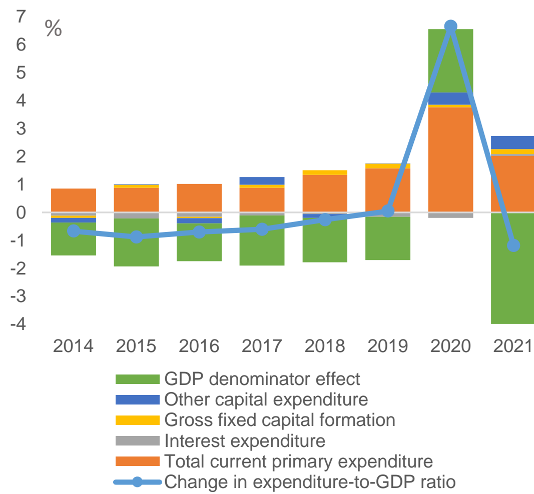


Source: European Commission

The expenditure-to-GDP ratio fell by 1.2 percentage points to 52.4% of GDP in 2021. The reduction was driven by a positive denominator effect from strong nominal GDP growth (Graph 1.9). Total current primary expenditure increased in 2021 recorded another year of a strong growth. While some countries have extended their temporary emergency policy support measures, others have already withdrawn some or all of them (see Section 2.5). Nevertheless, not all support measures were intended to mitigate the consequences of the pandemic and some were of a permanent rather than a temporary nature.

Government investment, measured as government gross fixed capital formation, recorded a growth rate of 6.1% in the euro area and 5.4% in the EU. This increase was for the first time also supported by the Recovery and Resilience Fund (RRF). In contrast to past crises, when investment fell and stayed low for years, the newly established instruments during the pandemic seem to support the recovery of capital expenditure.

Graph 1.9: **Drivers of the government expenditure-to-GDP ratio, euro area**

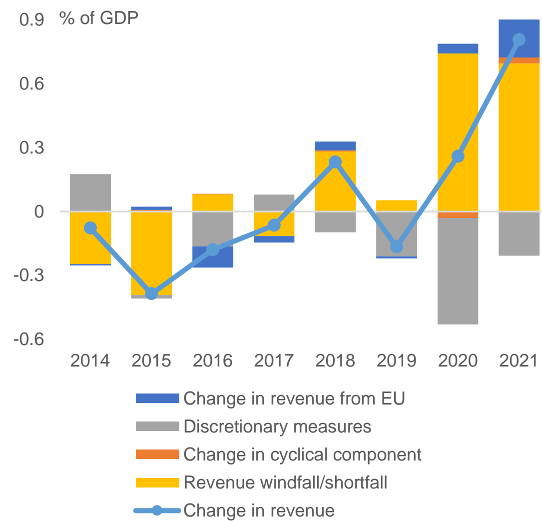


(1) The denominator effect shows a deterioration (improvement) due to the slowdown (acceleration) of nominal GDP growth. (2) Other capital expenditure includes capital transfers payable (i.e. capital taxes, investment grants and other capital transfers), changes in inventories and acquisitions (e.g. finished goods) less disposals of valuables (e.g. precious metals) and acquisitions less disposals of non-financial, non-produced assets (e.g. land and other tangible non-produced assets).
Source: European Commission

The revenue-to-GDP ratio increased by 0.8 percentage points in 2021 due to revenue windfalls ([5]) (see Glossary) (Graph 1.10). Stronger consumer demand and positive labour market developments, increased VAT and personal income tax revenues by more than economic activity would predict. Corporate taxes also increased after the large drop recorded in 2020 but remained below their 2019 level.

([5]) In 2021, revenue windfalls are estimated at around 0.75% of GDP. This outcome is most likely related to the strong recovery in nominal growth of consumption of goods, investment and imports (European Commission, 2022b).

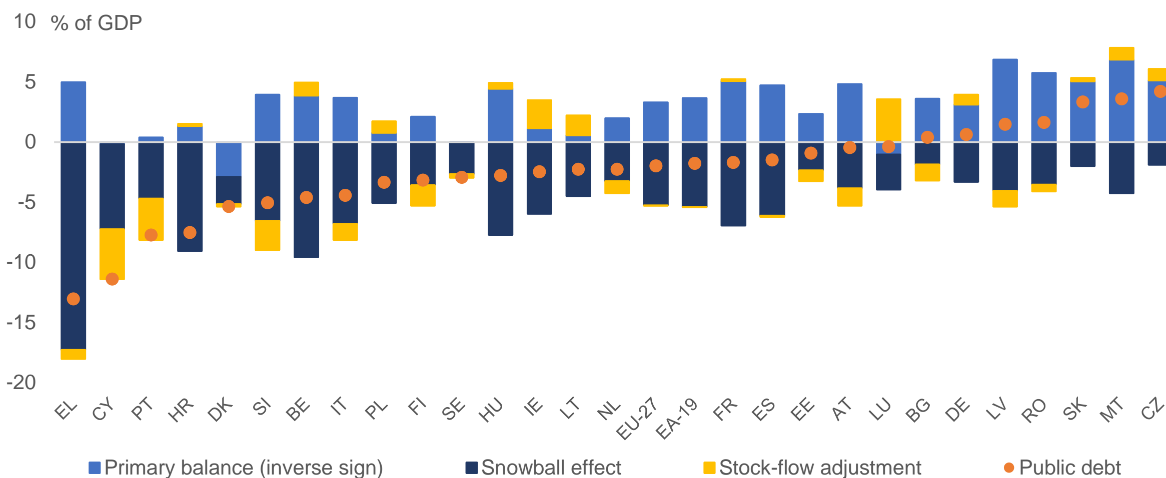
Graph 1.10: **Change in the government revenue-to-GDP ratio, euro area**



(1) Revenue windfall or shortfall shows changes in government revenue that cannot be fully explained by macroeconomic developments or by discretionary fiscal policy measures. (2) Discretionary measures represent the incremental budgetary impact of adopted or credibly announced measures, as compared with a 'no-policy-change' forecast, estimated based on judgement (bottom-up approach).
Source: European Commission

Following a large increase in 2020, the government debt-to-GDP ratio declined by around 2 percentage points in the euro area and the EU to 97.4% of GDP and to 89.7% of GDP, respectively. While the sizeable primary deficit continued to weigh on debt ratio, it was offset by the strong

Graph 1.11: **Drivers of the government debt-to-GDP ratio in 2021, by country**

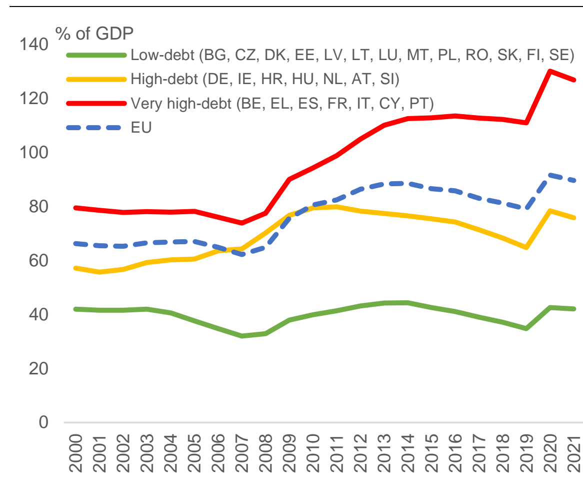


(1) The drivers of the debt-to-GDP ratios are calculated according to the following formula:
$b_t - b_{t-1} = pb_t + \frac{i_t - \gamma_t}{1+\gamma_t} * b_{t-1} + sfa_t$, where the change in the debt-to GDP-ratio $(b_t - b_{t-1})$ between 2 years equals the primary deficit (pb_t), plus the snowball effect calculated on the basis of the difference between the interest paid on the stock of debt (i_t) and the nominal GDP growth rate (γ_t), plus a stock-flow adjustment (sfa_t). Stock-flow adjustments are changes in gross debt that are unrelated to changes in the budget deficit.
Source: European Commission

expansion in GDP. This resulted in a significant debt-reducing contribution from the differential between the interest rate and GDP growth, known as the snowball effect (Graph 1.11). In contrast to 2020, the effect of stock-flow adjustment on average was almost zero, masking divergency among countries (see Box 1.2).

Although the aggregate government debt-to-GDP ratio decreased in the euro area and the EU, the change varied considerably across countries. In 2021, the debt-to-GDP ratios declined in all but seven countries (Graph 1.11). The largest decline was recorded in Greece with 13.1% of GDP while the largest increase was recorded in Czechia with 4.2% of GDP.

Graph 1.12: **Government debt ratio by group of Member States**



(1) The classification of countries by debt level is based on the average debt-to-GDP ratio in 2011-2019. Very high-debt = above 90% of GDP; high-debt =between 60% and 90% of GDP; low-debt = below 60% of GDP.
Source: European Commission

According to the Commission's 2021 Fiscal Sustainability Report ([6]), sustainability risks have decreased in the short term and increased in the medium to long term compared with last year's Commission assessment (Table 1.1). The extraordinary monetary policy interventions together with decisive EU policy actions have contributed to stabilising sovereign financing conditions, lessening risks of short-term fiscal stress.

([6]) European Commission (2022a).

Table 1.1: **Fiscal sustainability risk classification by EU Member State**

	short-term	medium-term	long-term		short-term	medium-term	long-term
	S0	S1	S2		S0	S1	S2
BE	LOW	HIGH	HIGH	LT	LOW	LOW	MEDIUM (LOW)
BG	LOW	MEDIUM	MEDIUM	LU	LOW	LOW	HIGH
CZ	LOW	MEDIUM	HIGH	HU	LOW	MEDIUM	HIGH
DK	LOW	LOW	LOW	MT	LOW	MEDIUM (HIGH)	HIGH
DE	LOW	LOW (MEDIUM)	MEDIUM	NL	LOW	MEDIUM	HIGH (MEDIUM)
EE	LOW	LOW	LOW	AT	LOW	MEDIUM	MEDIUM
IE	LOW	LOW	MEDIUM	PL	LOW	MEDIUM (LOW)	MEDIUM
EL	HIGH	HIGH	MEDIUM	PT	LOW	HIGH	MEDIUM
ES	LOW	HIGH	MEDIUM (HIGH)	RO	LOW	HIGH	MEDIUM
FR	LOW	HIGH	MEDIUM	SI	LOW	HIGH	HIGH
HR	LOW	MEDIUM (HIGH)	MEDIUM	SK	LOW	HIGH	HIGH
IT	LOW (HIGH)	HIGH	MEDIUM (HIGH)	FI	LOW	MEDIUM	MEDIUM
CY	LOW	MEDIUM	MEDIUM	SE	LOW	LOW	LOW
LV	LOW	LOW	LOW				

(1) The table compares this year's sustainability risk classification published in the annexes of the country reports with the risk classification in the Fiscal Sustainability Monitor 2021 whenever the risk classification has changed (in brackets).
Source: European Commission

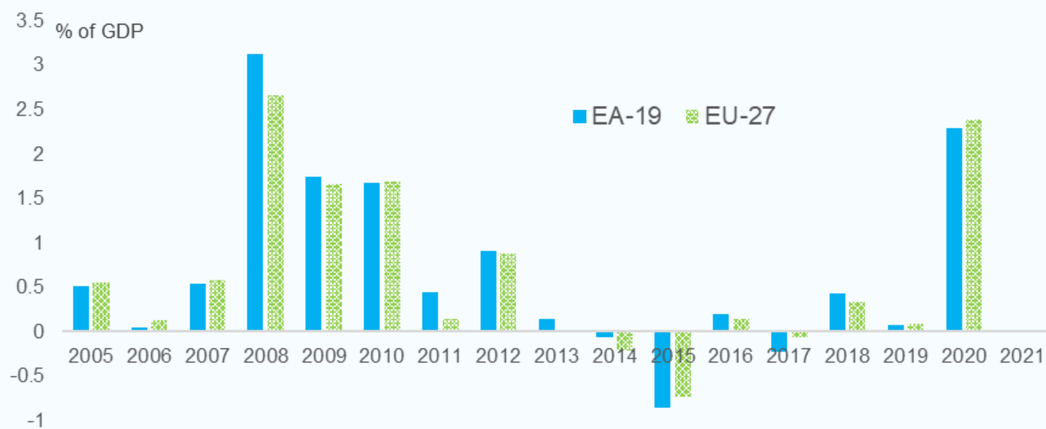
The very latest update of the sustainability analysis, which took on board the results of the Commission's 2022 spring forecast, interestingly led to an improvement of the risks assessment for some countries. ([7]) For instance, the long-term sustainability risks for Italy and Spain moved back to *medium*, down from *high*, on account of improved initial budgetary conditions. In the Commission sustainability analysis, the improvement of the initial budgetary conditions is measured in terms of the structural primary budget balance, which is surrounded by notorious measurement issues. Also, in 2021, this was affected by the revenue windfalls mentioned above, i.e. an increase in government revenues that goes beyond conventional estimates of tax elasticities and that may be temporary is attributed to the structural component of the budget.

([7]) Published at the end of April 2022, the Commission's Fiscal Sustainability Report 2021 (European Commission 2022a) was based on the 2021 autumn forecast. The updated sustainability analysis can be found in the annexes of the country reports of the Commission 2022 spring package: https://ec.europa.eu/info/publications/2022-european-semester-country-reports_en.

Box 1.2: **The evolution of stock-flow adjustments during the Covid-19 crisis**

The EU's statistical system measures the budget balance in accrual terms (i.e. revenues and expenditures are recorded when the underlying transactions occur not when the actual payments are made), but debt is essentially a cash concept (i.e. transactions are recorded when the related payments are made). Moreover, there are valuation effects in relation to debt securities and below-the-line government operations such as privatisations. These elements mean that changes in government debt and the associated deficit/surplus will generally not match in any given period. Stock-flow adjustments (SFA) are defined as the difference between the two. In other words, a positive SFA means that government debt has increased more than the annual nominal deficit (or decreased less than implied by the annual surplus). According to the statistical definition used consistently by Eurostat in its reports, SFA can be broken down into the following three main components: (i) net acquisition of financial assets (e.g. cash deposits, equities, loans); (ii) debt adjustments (e.g. cash-accrual reconciliations, valuation effects); and (iii) statistical discrepancies. This box explains how SFA trends changed during the Covid-19 crisis and analyses the patterns of individual components. ([1])

Graph 1: **Stock-flow adjustments in a longer term perspective, 2005-2021**



Source: *Eurostat*

In a typical business year, SFAs have been a few tenths of a percentage point of GDP for the (weighted) EU-27 and euro area averages (mostly debt-increasing, see Graph 1). In 2020, however, the EU-27's SFA soared to 2.4% of GDP, constituting close to one-fifth of the massive debt jump in that year; so these developments warrant a closer scrutiny. Most countries posted debt-increasing SFAs exceeding 1% of GDP in 2020 and some of them (namely, Denmark, Cyprus, Hungary, Poland and Slovakia) exceptionally large ones of more than 5% of GDP. Greece was a notable outlier with a negative SFA of 4% of GDP. Similar or even higher debt-increasing SFAs were recorded around a decade ago during the global financial crisis. The very high debt-increasing values between 2008 and 2010 are explained by government operations to address the financial crisis, such as accumulating cash deposits (this had a measurable impact only in 2008), and substantial acquisitions of financial assets in the context of the crisis (e.g. government loans and equity injections provided to financial institutions, and establishment of public defeasance structures or 'bad banks'). ([2])

In 2020, almost all EU countries significantly reinforced their cash reserves, which was responsible for around four-fifths of the debt increasing SFA impact. This SFA subcomponent was exceptionally large (i.e. above 5% of GDP, see Graph 2) in Cyprus, Slovakia, Slovenia and Finland. The accumulation of large amounts of funds suggests that debt management agencies were following a precautionary borrowing strategy in order to safeguard their liquidity needs in the context of high uncertainty. Furthermore, they also clearly intended to take advantage of the low or even negative sovereign interest rates against the backdrop of a *de facto* suspension of the Stability and Growth

([1]) The main sources of the analysis are Eurostat's regular monitoring reports (*'Stock-flow adjustment for the Member States, the euro area and the EU'*) prepared as part of the package of documents for the biannual validation of the fiscal notification figures. See the most recent one used from April 2022.

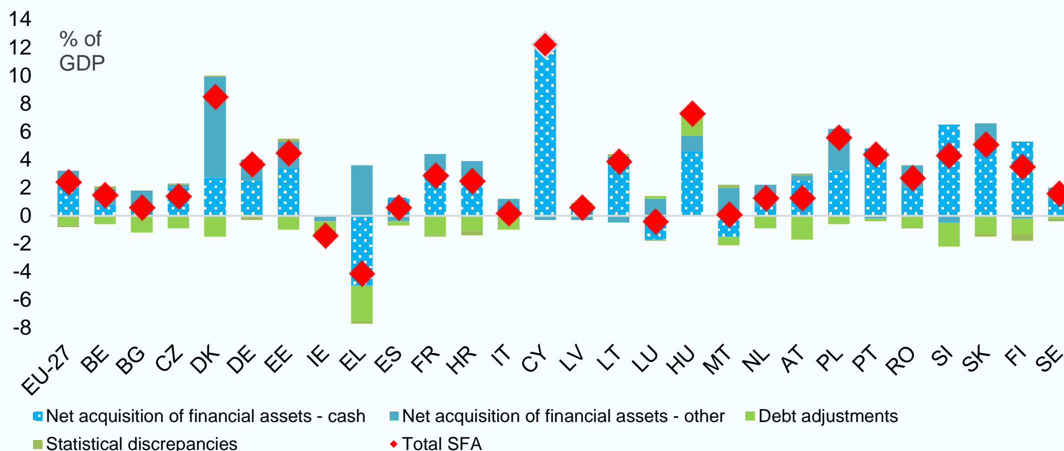
([2]) According to the estimates of Maurer and Grussenmeyer (2015), financial sector support measures accounted for around a fifth of the total increase of 30 percentage points in the euro area's debt-to-GDP ratio between 2008 and 2013. In their calculations, some two-thirds of this was recorded as SFA.

(Continued on the next page)

Box (continued)

Pact, i.e. the absence of binding rules on the pace of debt reduction allowed countries to build up more debt than they needed simply to cover their actual deficits. As a result, the net acquisition of financial assets component dominated the SFA developments in 2020. Within this component, the provision of loans also turned out to be noteworthy for many countries, linked to the financial support provided directly by governments (or indirectly by other units acting on behalf of governments, such as national development banks running liquidity schemes) to entities with liquidity needs due to the adverse effects of the pandemic.

Graph 2: **The components of stock-flow adjustments in 2020**



(1) 'Other' within the net acquisition of financial assets component includes all financial transactions by the general government sector on top of cash management (e.g. loans, equity operations and financial derivatives).
Source: *Eurostat*

The second component of Eurostat's SFA presentation is debt adjustments. These were debt-reducing for the EU-27 in 2020 as governments were typically able to issue their debt securities above face value. In the European system of national and regional accounts, government debt must be computed and shown at face value. In these cases, however, actual proceeds from the bond issues were larger than the face value, so the corresponding difference had to be recorded as a debt-decreasing adjustment. Of note, there have been large increases in yet to be collected revenues with a debt-increasing impact, chiefly explained by the tax deferral schemes introduced in many Member States as part of the crisis-relief packages for the corporate sector. However, the related debt increases were to a large extent counterbalanced by expenditures incurred in relation to Covid-19 policy measures and already recorded in the budget balance, but not yet paid out. Another offsetting development within the debt adjustment component was that a few non-euro area countries faced sizeable debt-increasing SFAs linked to the depreciation of their national currency and the corresponding revaluation of the foreign-currency denominated part of their public debt (most notably, for Croatia, Hungary and Poland, this factor was at 1% of GDP or above in 2020).

Finally, the third component of Eurostat's SFA definition is statistical discrepancies. These typically reflect differences arising from the diversity of statistical sources. The discrepancies were larger than in previous years, but they overall only decreased debt by 0.1% of GDP on average (the country-specific figures range between -0.3 and +0.3).

In 2021, SFAs were almost exactly zero in the EU as a whole, masking diverging country trends. Further debt-increasing SFAs were recorded for around half of the Member States (albeit typically of a much more moderate magnitude than in 2020), while the other Member States saw some reversal of the large 2020 jump. It is to be noted that about half of the countries carried on with the accumulation of cash reserves in 2021 (but typically to a lesser degree than in 2020), against the background of continued favourable financing conditions and the de facto suspension of the SGP. Ireland (3.0% of GDP), Spain (2.8%), Luxemburg (2.5%), Czechia (2.4%), and Slovakia (2.2%) all posted considerable increases. The overall debt-increasing impact of the net acquisition of financial assets component was practically offset by the other main SFA component: debt adjustments. The latter was partly driven by the continued issues of debt securities above their face value in close to two-thirds of the Member States, with a net debt-reducing impact.

2. EX-POST EVALUATION OF THE IMPLEMENTATION OF THE EU FISCAL FRAMEWORK

Highlights

- The Covid pandemic and the severe economic downturn clause continued to have a tangible impact on the implementation of EU fiscal rules in 2021. In spring 2020, on a proposal by the Commission, the Council adopted uniform fiscal recommendations for 2021 without any quantitative goalposts. The recommendations asked Member States to safeguard sustainability in the medium term but offered no practical indications.
- Although the severe economic downturn clause does not suspend the rules - a point repeatedly stressed in official Commission documents - the 2021 surveillance cycle was characterised by notable idiosyncrasies.
  - In spring 2020, after the outbreak of the pandemic, many Member States in agreement with the Commission, did not present complete medium-term budgetary plans, in particular plans for 2021.
  - In contrast to established practice, the Commission assessment of the 2020 stability and convergence programmes did not include a sustainability analysis.
  - In spring 2020, a dedicated sustainability analysis to assess eligibility for the European Stability Mechanism's Pandemic Crisis Support instrument, concluded that debt ratios of all euro area Member States would remain sustainable and did not report any sustainability risks. The analysis was predicated on the optimistic assumption governments would stick to the letter of the Stability and Growth Pact (SGP) from 2022. A couple of days later, the Commission issued new fiscal recommendations, which encouraged Member States to depart from the requirements of the SGP.
  - The Commission discontinued the well-established practice of producing dedicated assessments in the form of staff working documents on the stability and convergence programmes and draft budgetary plans.
  - In autumn 2021, the Commission did not prepare a report under Article 126(3) TFEU on whether Member States met the deficit and debt criteria, and the Economic and Financial Committee did not deliver an opinion on the relevant fiscal developments.
- The purely qualitative guidance for 2021 precluded the conventional assessment of compliance. However, a detailed analysis reveals some problematic features in particular for countries with very high debt.
  - Despite the strong economic rebound in 2021, the fiscal response went beyond measures related to the health crisis.
  - A major part of the 2021 increase in net expenditure is likely to be permanent.
  - Underlying expenditure growth exceeded estimates of medium-term nominal potential growth.
- In spring 2022, because of purely qualitative guidance, the Commission and the Council assessed that all Member States had followed the policy recommendations, noting countries with significant presence of non-temporary measures. Moreover, no EDPs were opened on the ground of uncertainty. As in 2020, this course of action reflects political considerations rather than established practice and the letter of the SGP.
- Overall, the implementation of the EU's fiscal framework focused on the short term and disregarded tools aimed at anchoring fiscal policy in the medium term. The Commission's updated sustainability report, published in April 2022, points to increased sustainability risks in the medium and long term in many Member States.

The Covid-19 pandemic and the severe economic downturn clause very much shaped the implementation of the EU fiscal framework in 2021. This section starts with recent innovations in the application of the EU fiscal framework and continues with a chronological overview of the annual EU fiscal surveillance cycle. In the absence of quantitative fiscal guidance for 2021, which under normal conditions serves as reference for assessing compliance with the provisions of the Stability and Growth Pact (SGP), this section follows a path pioneered in the Annual Report 2021: it juxtaposes fiscal developments against estimates of average potential output growth. The section closes with an overview of how the preventive and corrective arms of the SGP have been implemented.

2.1. INNOVATIONS IN SURVEILLANCE METHODS AND PRACTICE

The EU fiscal framework underwent some methodological and interpretative innovations in 2021. These involve:

- the commonly agreed method for estimating potential output and the output gap;
- changes in the surveillance process and reporting by the Commission and the Council; and
- the interpretation and use of fiscal indicators/analyses.

Potential output and output gap estimates

In view of the sharp economic shock caused by the Covid-19 pandemic, the Commission and the Output Gap Working Group of the Council's Economic Policy Committee agreed on new modifications to the commonly agreed method for estimating potential growth and the output gap. The stated aim of the modifications was to minimise backward and forward revisions on the assumption that the economic downturn would be mostly transitory, with limited scarring effects. [8]

First introduced in 2020, the following two ad hoc methodological adjustments were extended into 2021:

- hours worked data for 2020 were replaced by the mean of the value of 2019 and 2021; and
- structural unemployment estimates included dummy variables for the years 2020 and 2021 in order to maintain the relationship between the unemployment gap and labour cost indicators in the case of signs of labour hoarding.

The Commission and Member States reviewed alternative approaches to the two adjustments but maintained the existing *ad hoc* adjustments in 2021. The Output Gap Working Group plans to work further on possible solutions for extracting trend data from the currently volatile labour market indicators. To this end, the Commission initiated a project for a 'labour hoarding' indicator, based on existing firm-level data from EU business and consumer surveys, which could be then used to adjust the labour market indicators that are used to estimate potential output. Following the completion of a pilot phase in 2021, data for all Member States are expected in 2022.

The Commission and the Output Gap Working Group also worked on other possible methodological changes, notably for total factor productivity, but concluded on retaining the existing commonly agreed method. Moreover, the Commission published a vade mecum on the commonly agreed method and a manual for the freely available software that is used for potential growth and output gap estimates. [9] This facilitates transparency on the commonly agreed method and user-friendly access to estimates.

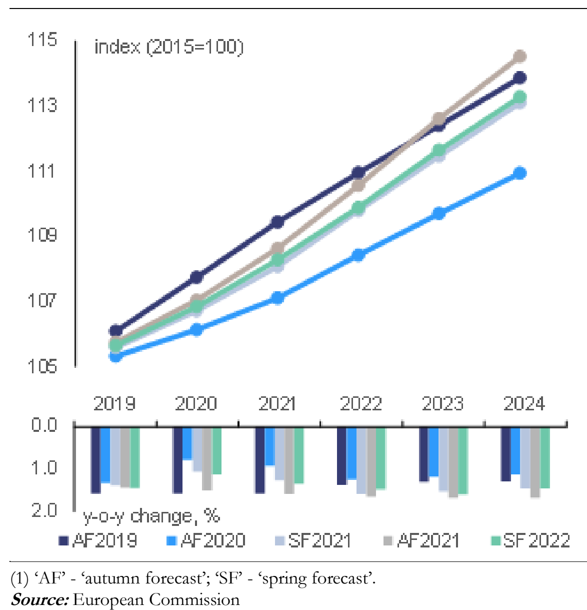
Potential output estimates changed with new information becoming available during the year. In particular, the economic recovery in 2021 turned out to be stronger than previously projected, offering preliminary support to the assumption that the pandemic would have only a temporary impact on potential output. In fact, potential output estimates were revised upwards with each new Commission forecast in 2021 (Graph 2.1). However, more recent estimates released in spring 2022 implied a slight downward revision in view of

[8] Whether this assumption is justified or not is difficult to determine at this stage. Past experience suggests that large negative shocks come with important scarring effects (Larch et al., 2022), i.e. economic growth after recession embarks on a lower growth trend, although the recovery from the Covid-19 crisis has been particularly fast.

[9] Output Gap Estimation Using the European Union's Commonly Agreed Methodology: Vade Mecum & Manual for the EUCAM Software

the unexpected economic shock linked to the war in Ukraine and a slowdown in China.

Graph 2.1: **EU potential output level and growth, various Commission forecasts**



(1) 'AF' - 'autumn forecast'; 'SF' - 'spring forecast'.
Source: European Commission

Changes in surveillance process and reporting

In 2021, there were significant changes in the way the Commission and the Council monitored and reported on fiscal developments. Most importantly, in autumn 2021 the Commission did not report or communicate on excessive deficits and debts and the Council did not issue an opinion on relevant fiscal developments. Moreover, the Commission reduced the scope of its country-specific reporting throughout the year.

In spring 2021, the Commission reported on compliance with the deficit and debt criteria, in accordance with Article 126(3) of the Treaty on the Functioning of the European Union (TFEU), in a single omnibus report for all countries (10). The EDP for Romania had been launched in early 2020 on account of fiscal developments prior to the Covid-19 pandemic and followed the normal EDP reporting schedule.

Previously, EDP reports were prepared for each country individually. Also in 2020, the year in which the severe economic downturn clause was applied for the first time, there were separate reports for each country, following a similar structure – a customary practice for ensuring comparability and equal treatment of similar cases.

According to the Commission Communication accompanying the 2021 spring surveillance package, the omnibus report was a one-off initiative to alleviate the exceptional workload linked to the assessment of the recovery and resilience plans at that time.

The omnibus report under Article 126(3) TFEU concluded that some Member States did not comply with the deficit and debt criteria of the Treaty. However, the Commission considered that, at that stage, a decision on whether to place Member States under the EDP should not be taken, in view of '*exceptional uncertainty*'. This conclusion was presented in the Communication of the 2021 spring package, but not in the report under Article 126(3), as on previous occasions. At the same time, the Commission updated the recommended fiscal adjustment path for the ongoing EDP for Romania.

The Commission stated it would reassess the budgetary situation of Member States vis-à-vis the provisions of the SGP, based on its 2021 autumn forecast and the draft budgetary plans in October 2021. (11) However, in autumn 2021, the Commission did not give any updated views on EDPs, but only factual references to the 2021 spring omnibus report in the Commission opinions on draft budgetary plans (12) and the report on actions taken by Romania (13). This stands in clear contrast to past practice to identify excesses over the Treaty reference values and to report under Article 126(3) TFEU at different times of the year. Article 126(3) TFEU provides that the Commission '*shall prepare a report*' if a Member State does not fulfil the deficit and debt criteria. The same article also provides that the Economic and Financial Committee '*shall formulate an opinion on the report of the Commission*'.

Until then, the Commission and the Council had always assessed fiscal developments vis-à-vis the provisions of the Treaty in Member States, usually linked to the two main EU fiscal surveillance rounds in spring and in autumn (Graph 2.2). This practice had been consistently followed, including

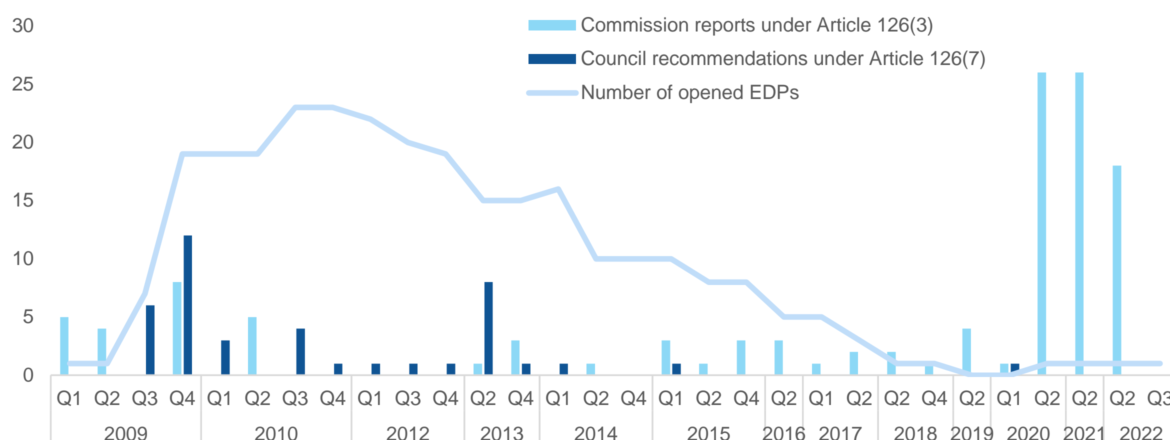
(10) Commission report prepared in accordance with Article 126(3) TFEU

(11) Commission Communication on European Semester 2021 spring package.

(12) Commission opinions of 24.11.2021 on the draft budgetary plans for 2022.

(13) Commission Communication on assessment of action taken by Romania

Graph 2.2: **Number of countries examined for excessive deficits and debts (under Article 126(3)) and number of Council recommendations opening or extending EDPs (under Article 126(7))**



(1) Commission reports under Article 126(3) TFEU (ex Article 104(3) TEC)) provides an initial assessment of existence of excessive deficits and debts. These reports are the first step in opening the EDPs.
(2) Council recommendations under Article 126(7) TFEU (ex Article 104(7) TEC) are issued for new and existing EDPs. They ask Member States concerned to end the excessive deficit situation within a given period. In the aftermath of the global financial crisis, correction deadlines were extended for a number of EDPs, due to weaker economic outlook than planned.
(3) In Q2 2021 and Q2 2022, the Commission presented reports under Article 126(3) TFEU for Member States in one document (omnibus report).
Source: European Commission

in the aftermath of the global financial crisis and also in the initial phase of the Covid-19 pandemic. As a reminder, the severe economic downturn clause does not suspend the SGP provisions; it allows for more flexibility in defining fiscal requirements. Hence, reporting requirements are unaffected.

The Commission communicated on compliance with the deficit and debt criteria more clearly in autumn 2020, by stating that its 2020 spring assessments were still valid. As a reminder, in spring 2020, the Commission reports under Article 126(3) TFEU concluded not to launch any EDPs despite clear departures from the deficit and debt criteria of the Treaty. The conclusion was motivated by exceptional uncertainty ensuing from the Covid-19 outbreak. In autumn 2021, no rationale was provided for not following up on the Treaty provisions.

The approach followed in spring 2022 broadly corresponded that of spring 2021. Although the omnibus report was announced as a one off, the Commission continued to use the new format. As in 2021, the report clearly confirmed previous findings that some countries did not meet the deficit and debt criteria, but a decision on whether to place Member States under the EDP was further postponed.

In 2021, the Commission also discontinued the well-established practice of producing country-specific staff working documents assessing stability and convergence programmes (SCPs) and draft budgetary plans (DBPs). In the past, such analytical documents accompanied Commission proposals/recommendations for legal acts issued under the EU fiscal surveillance. The Commission documents described in detail the main macroeconomic and fiscal developments, and measures underlying government fiscal plans, assessed compliance with SGP rules, and looked at the quality of public finances and the functioning of national fiscal frameworks. The Commission conclusions on SCPs and DBPs were summarised in short recitals of the legal acts. The acts were also accompanied by statistical annexes providing some standard background data relevant for the assessment of SCPs and DBPs. The absence of detailed country-specific reports was noted in the context of multilateral surveillance in the Council committees.

The Commission continued publishing a horizontal overview of SCPs ([14]) and an overall assessment of

([14]) The 2021 Stability & Convergence Programmes: an Overview, with an Assessment of the Euro Area Fiscal Stance. The overview is an own-initiative report of the Commission. It is usually released several months after the submission of the SCPs, sometimes after the summer break.

the draft budgetary plans ([15]), presenting trends across Member States and for the euro area, in particular.

While their content and scope changed over time, the detailed country-specific budgetary assessments used to be among the Commission's main inputs for the EU's multilateral surveillance process in the Council. The staff working documents had already been streamlined in 2020. Commission analysis underpinned the conclusions in the legal documents and contributed to policy discussions in the Council. In particular, assessments of the draft budgetary plans, which are published before the adoption of annual budgets in Member States, can have an impact on policy decisions or be part of the political debate. Alternatives for standardised country-specific fiscal analysis are limited to the European Semester country reports, where budgetary issues feature among many other structural challenges and are at risk of being submerged. In 2021, the country reports were replaced by the assessments of recovery and resilience plans featuring, depending on country priorities, some fiscal structural reforms. ([16])

In spring 2021, the Council opinions on the SCPs covered only fiscal issues. In previous years, fiscal recommendations were a part of the country-specific recommendations (CSRs), which covered a broader set of economic policy issues coordinated under the European Semester process. In 2021, structural issues were addressed in the assessments of national recovery and resilience plans. As a result, only fiscal recommendations were examined by the Economic and Financial Committee before their adoption by the Council, as opposed to a more extensive consultation of the CSRs in four different committees in previous years.

Interpretation and use of fiscal indicators/analyses

Fiscal guidance issued since the Covid-19 outbreak and the activation of the severe economic downturn clause allowed a temporary departure from the adjustment path towards the medium-term budgetary objective of each Member State. ([17]) As a result, a new analytical element of 'crisis-related temporary emergency measures' was introduced with the Commission's assessment of the 2021 DBPs. The Commission defined 'temporary emergency measures' as including support for health systems and compensation for income losses by workers and firms, ([18]) if linked to public health emergencies and restrictions. These emergency measures were, by definition, regarded as temporary and were expected to expire in 2022 or earlier. The Commission argued that 'temporary emergency measures', which are estimated to account for the bulk of the discretionary support in 2020 and 2021, do not have a significant impact on aggregate demand and, by extension, should not be included in conventional indicators gauging the fiscal impulse. ([19])

In its assessments of the 2021 SCPs, the Commission offered a very brief definition of 'temporary emergency measures' and how they would impact the fiscal impulse. The definitions were set out in recitals of the fiscal recommendations for 2022 and in a box in the statistical annex. Moreover, the SCPs overview note ([20]) presented a typology of discretionary measures adopted in response to the pandemic, differentiating between 'temporary emergency measures' and other 'recovery support measures'. The latter can be both temporary (expiring in 2023) and non-temporary. The overview note also clarified that temporary measures are the measures adopted in 2020 or 2021, whose budgetary allocation in 2023 is less than 10% of the original amount. These clarifications stand in a positive contrast to the 2020 surveillance cycle, when the Commission introduced the new concepts and interpretations without providing much background.

([15]) Commission Communication on the 2022 Draft Budgetary Plans: Overall Assessment.

([16]) Commission staff working documents assessing recovery and resilience plans are available in individual country sections on the main page for the Recovery and Resilience Facility.

([17]) On the activation and interpretation of the severe economic downturn clause, see EFB *Annual Report 2021* (Section 2.5).

([18]) See EFB *Annual Report2021*, Section 2.5 for the analysis of the Commission ad hoc approach to 'temporary emergency measures'.

([19]) The Commission Communication on the 2021 draft budgetary plans interpreted the euro area fiscal stance as a discretionary fiscal impulse based on the expenditure benchmark methodology. See glossary and Chapter 4 of this report for the definition of the fiscal stance and the fiscal impulse.

([20]) The 2021 Stability & Convergence Programmes: an Overview, with an Assessment of the Euro Area Fiscal Stance

Box 2.1: Transparency of public sector accounting

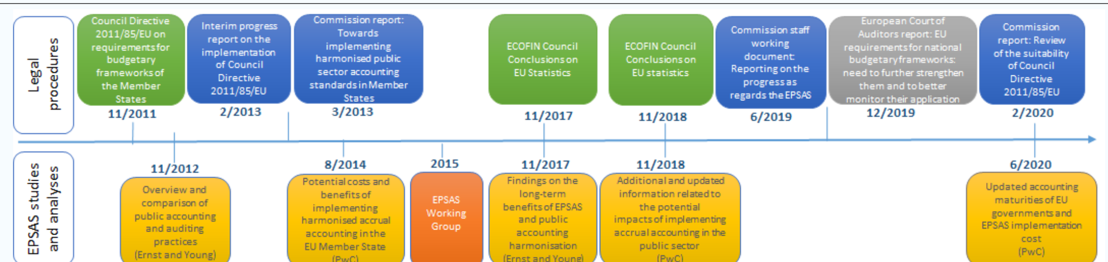
The sovereign debt crisis, which started towards the end of 2009, highlighted the need for robust and transparent government accounting and financial reporting. This message has been further reinforced at other times when government finances have come under pressure, for example during the COVID pandemic.

Legal procedures. The six-pack reform ([1]) in 2011 enhanced transparency. Regulation (EU) No 1173/2011 introduced sanctions for the manipulation of statistics, and Council Directive 2011/85/EU set minimum requirements for Member States' national budgetary frameworks.

The objective of Directive 2011/85/EU is to reinforce fiscal discipline in Member States and to strengthen EU budgetary surveillance in order to ensure compliance with the obligation under Article 126 of the Treaty on the Functioning of the European Union (TFEU) to avoid excessive government deficits. Concerning government accounting and financial reporting, the Directive's particular focus was to ensure that Member States '*have in place public accounting systems comprehensively and consistently covering all sub-sectors of general government and containing the information needed to generate accrual data with a view to preparing data based on the ESA 95 standard*'. The Directive also required the Commission to assess the suitability of International Public Sector Accounting Standards (IPSAS) ([2]) for the Member States. The Directive entered into force in December 2011 and obliged Member States to transpose by 31 December 2013.

Public accounting and auditing systems varied widely within the EU at that time, ranging from cash-based to accrual-based accounting systems and many combinations in between ([3]). To avoid incoherence between fragmented parallel systems, it is crucial to have one single and integrated accrual accounting system in place. As required by Directive 2011/85/EU, the Commission assessed the suitability of the IPSAS for Member States and issued a report to the Council and the European Parliament in March 2013 ([4]). The report concluded that the IPSAS would not be suitable for Member States and identified a need for high-quality harmonised accounting standards in the EU: the European Public Sector Accounting Standards (EPSAS). The Council encouraged the Commission to engage actively with various stakeholders and to provide Member States with technical and financial support for this project. The Commission has therefore taken various steps towards implementing Directive 2011/85/EU and introducing EPSAS (see Graph 1).

Graph 1: **Evolution of the process related to the Directive and the European Public Sector Accounting Standards (EPSAS)**



Progress as regards the EPSAS. In 2013, the Commission launched a project aimed at harmonising public sector accrual-based accounting standards across the EU in two phases. During the first phase (indicatively envisaged to cover 2016-2020), the focus was on increasing fiscal transparency in Member States and developing the EPSAS framework in parallel. During the second phase, which has not yet been launched, the aim will be to ensure comparability within and between Member States by implementing the EPSAS by 2025. Two major benefits of using accrual accounting can be highlighted. First, it reduces the risk of overlooking important issues in public finances in real time because it provides the necessary information in a reliable and timely manner. Second, it provides more efficient ways of producing statistics and controlling revisions and risks. Moreover, common and

([1]) For more details about the historical context and the reform of the fiscal rules, see EFB 2019.
([2]) IPSAS are a set of international accrual-based standards for public sector accounting promulgated by the International Public Sector Accounting Standards Board under the auspices of the International Federation of Accountants (IFAC). IPSAS are used as guidance by many governments around the world to improve public sector financial reporting.
([3]) Ernest & Young (2012) for Eurostat.
([4]) Report from the Commission to the Council and the European Parliament: Towards implementing harmonised public sector accounting standards in Member States: The suitability of IPSAS for the Member States, COM (2013) 114 final of 6.3.2013.

(Continued on the next page)

Box (continued)

consistent accounting standards would make it easier for Eurostat to conduct its monitoring and make it possible to understand the underlying developments of national public finances. The Commission report states that, accrual-based accounting is not meant to abolish or replace cash accounting, but rather to complement it.

The recognition of the importance of accrual accounting in the EU has been confirmed by the continuing modernisation of accrual-based standards in the public sector since 2013 in support of the transition towards the EPSAS. Indeed, the Commission has provided financial support to several Member States since 2014 to help them improve their systems of government accounting. In recent years, projects have been supported under the Technical Support Instrument and three Member States have included the modernisation of government accounting in their recovery and resilience plans. In parallel, Eurostat has, in close cooperation with Member State public accounting experts, provided technical inputs for developing the future EPSAS (in the form of technical issues papers; a draft EPSAS conceptual framework; and by screening the suitability of IPSAS standards). Table 1 shows that most Member States have improved their accounting maturity level ([5]), although progress varies across government levels. On average, the accounting maturity scores per government level increased the most at the central level and the least in the social security funds. The experience of Member States to date indicate that the biggest advantage is to have a single accounting system within a Member State, which also increases the credibility of government financial statements in the eyes of its citizens and other stakeholders. Regardless of reported benefits by countries, the accounting maturity level remained almost unchanged at the central level in Germany and the Netherlands, although they have quite well-developed accrual-based accounting at the local level. While both these Member States predict improvements in their financial reporting ([6]), there was no formally approved strategy to implement accrual accounting in the public sector as a whole ([7]).

Table 1: **Accounting maturity level of EU governments' financial reporting**

	Central			State			Local			Social			General government		
	2014	2018	2025	2014	2018	2025	2014	2018	2025	2014	2018	2025	2014	2018	2025
BE	67	78	79	67	66	76	73	74	74	60	59	59	-	69	72
BG	56	76	76	-	-	-	56	76	76	63	70	70	-	74	74
CZ	75	83	85	-	-	-	75	83	85	77	72	72	-	81	83
DK	72	79	80	-	-	-	65	71	71	58	72	72	-	75	76
DE	22	23	23	29	31	31	58	58	58	42	31	31	-	33	33
EE	92	91	91	-	-	-	92	91	91	86	87	87	-	90	90
EL	12	13	88	-	-	-	12	68	96	12	12	12	-	16	62
IE	54	57	57	-	-	-	71	71	71	57	-	-	-	58	58
ES	70	78	78	61	79	79	68	80	80	58	65	65	-	75	75
FR	89	90	90	-	-	-	84	82	82	92	92	92	-	89	89
HR	34	66	66	-	-	-	34	69	69	55	42	42	-	60	60
IT	31	39	76	-	-	-	30	55	74	14	14	14	-	35	56
CY	14	37	89	-	-	-	75	82	82	17	4	87	-	33	89
LV	73	88	93	-	-	-	73	96	98	55	85	91	-	89	94

	Central			State			Local			Social			General government		
	2014	2018	2025	2014	2018	2025	2014	2018	2025	2014	2018	2025	2014	2018	2025
LT	88	91	91	-	-	-	88	91	91	72	75	75	-	81	87
LU	19	23	23	-	-	-	31	11	11	15	67	67	-	36	36
HU	66	71	71	-	-	-	66	71	71	55	57	57	-	67	67
MT	22	24	92	-	-	-	94	94	94	-	-	-	-	25	92
NL	31	38	38	-	-	-	58	58	58	78	79	78	-	55	55
AT	73	77	77	12	45	73	12	37	73	61	61	61	-	63	72
PL	66	72	72	-	-	-	66	72	72	68	59	59	-	68	68
PT	55	59	100	-	49	95	80	70	99	70	64	64	-	62	91
RO	63	71	75	-	-	-	63	71	75	38	36	37	-	62	65
SI	62	72	72	-	-	-	62	72	72	19	34	34	-	59	59
SK	75	78	83	-	-	-	75	78	83	34	44	68	-	67	78
FI	72	77	77	-	-	-	90	85	85	92	63	67	-	75	77
SE	81	84	84	-	-	-	81	84	84	71	71	71	-	82	82
EU	51	65	76	43	54	59	65	73	77	54	57	59	-	-	-

(1) The green, blue and yellow colours correspond to high (above or equal to 70%), average (between 40% and 70%), and low accounting maturity (below the threshold of 40%).
Source: PwC studies for Eurostat (2014 and 2020).

From a fiscal transparency perspective, accrual-based accounting adds value to fiscal surveillance at the EU level. It reduces the risk of budgetary errors especially in view of the establishment of new extra-budgetary bodies and funds, or increasing the value of existing ones, and therefore makes it easier to ensure that public resources are well spent and that Member States are pursuing prudent fiscal policies. In addition, harmonised accrual-based accounting improves the transparency and comparability of financial reporting and thus the efficiency and effectiveness of public auditing both within Member States (at the national and sub-national levels) and at EU level.

([5]) The accounting maturity reflects the estimated current degree of compliance of the government's accounting rules with an IPSAS-based benchmark. Given that EPSAS do not exist yet, IPSAS have been taken as a proxy for EPSAS.
([6]) For Germany see Coalition agreement for year 2021-2025: koalitionsvertrag-147.pdf__;!!DOxrgLBm!Wbt4JVmEE1E0ivBCL0dzynQqHfje_bbQSRg-6Bt0mZHme6g1lS2-XRHX23h6a4_6uscKOow$ (tagesschau.de). For Netherlands see the Report of the Dutch Parliament (Tweede Kamer) on the central government reporting system: https://zoek.officielebekendmakingen.nl/blg-867441.pdf
([7]) Ernest & Young (2017) on behalf of Eurostat.

In practice, 'temporary emergency measures' are a subset of discretionary budgetary measures monitored by the Directorate-General for Economic and Financial Affairs. The estimates of the measures rely on information provided by Member States and expert judgement, with limited

comparability across countries. The Commission has only disclosed to the Economic and Financial Committee aggregates of 'temporary emergency measures' and aggregate data are reflected in published graphs and indicators.

Last but not least, the 2021 surveillance cycle was also characterised by a particular use of the sustainability analysis. Over the years, the Commission's sustainability analysis has become an integral part of the surveillance process. It usually plays a strong role in the diagnostic phase to underpin the formulation and differentiation of fiscal policy recommendations to Member States. It is also relevant in the context of financial assistance programmes, notably when a Member State requests financial assistance from the European Stability Mechanism.

While formally emphasising the importance of the sustainability of public finances, the Commission and the Council made a comparatively selective use of the instrument in 2020. In theory, the activation of the severe economic downturn clause would have warranted a stronger attention on sustainability. The flexibility allowed by the clause is explicitly linked to the condition of safeguarding sustainability in the medium term. However, country-specific sustainability risks did not play a role in applying the clause (fiscal guidance was the same for all countries). Moreover, sustainability assessments carried out and used by the Commission for 2021 were either predicated on outdated projections or favourable policy assumptions (see Section 2.2).

2.2. MEDIUM-TERM BUDGETARY PLANS

In early 2020, following discussions in the ECOFIN committees, the Commission agreed to radically streamline the standard reporting requirements for SCPs. In view of the Covid-19 outbreak, several Member States strongly argued that standard reporting laid down in EU law would not make much sense in an environment of heightened uncertainty and that it put an unwarranted burden on national administrations. As a compromise, and with a view to still ensuring a minimum degree of fiscal reporting, on 6 April 2020, the Commission sent to Member States guidelines on the expected format and content of the 2020 SCPs. According to the guidelines, the SCPs had to present only the main economic and fiscal estimates for 2020 and 2021 and the budgetary measures taken in response to the crisis. Moreover, the SCPs were expected to describe the general government debt and deficit developments in the medium term, demonstrating their sustainability, as required by the severe economic downturn clause.

Most Member States followed the reduced format and focused on measures taken in response to the pandemic and budgetary estimates for 2020. For 2021, information was less complete. Apart from some qualitative indications, nine Member States (Belgium, Bulgaria, Germany, Spain, France, Poland, Portugal, Romania and Slovenia) did not provide their tentative macroeconomic and fiscal projections for 2021. Nevertheless, the Commission accepted all programmes to be in line with the 'streamlined' guidance, except for Portugal, which only presented the budgetary impact of the crisis measures. For Portugal, the Commission's staff working document noted non-compliance with the streamlined reporting guidelines. At the same time, six Member States (Latvia, Hungary, Netherlands, Slovakia Sweden and the United Kingdom) submitted fully fledged SCPs presenting forecasts up to 2023/2024, while the stability programme for the Netherlands was based on outdated macroeconomic projections. ([21])

All SCPs reported on the crisis-response measures following both the Commission's advice of 13 March 2020 ([22]) to support liquidity to firms and to protect workers against income losses and Eurostat's methodological considerations ([23]). Moreover, the Commission suggested linking the crisis measures to the severe economic downturn clause, rather than treating them as one-off measures ([24]); this was followed in the SCPs. Still, 13 Member States did not detail the budgetary impact of the measures in 2021 ([25]). The Commission assessed the measures reported by Member States and used this information for its 2020 spring forecast. For 2020, the Commission estimated the average budgetary impact of the measures at 3.2% of GDP, significantly lower than the 4.3% of GDP suggested by the SCPs. The

([21]) The stability programme for the Netherlands presented economic and fiscal estimates prepared prior to the major Covid-19 outbreak in Europe.

([22]) Commission Communication on coordinated economic response to the COVID-19 outbreak

([23]) Draft note on statistical implications of some policy measures in the context of the Covid-19 crisis.

([24]) Guidelines on a streamlined format of the 2020 SCPs in light of the Covid-19 outbreak of 6 April 2020.

([25]) Bulgaria, Czechia, Germany, Ireland, Spain, France, Croatia Luxemburg, Austria, Poland, Portugal, Romania, Slovenia,.

difference was explained by treating some pre-existing schemes as automatic stabilisers as opposed to discretionary measures (e.g. existing short-time work schemes in some countries provided an automatic fiscal response during the crisis, while other countries adopted similar schemes as new measures), different cut-off dates and assessments of the impact of the measures. ([26])

Despite the reduced reporting on the part of many Member States, all Commission assessments of the SCPs concluded that the measures taken by national governments were in line with the qualitative advice issued on 13 March 2020, namely to implement '*timely, temporary and targeted*' measures. ([27]) Fiscal sustainability in the medium term was presumed to be preserved based on '*the full implementation of these measures followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow*'.

The Commission assessments of the SCPs were mostly qualitative. Most of the new measures outlined in the programmes were presented as emergency measures. However, at that time there was significant uncertainty about the duration of the measures and their budgetary impact, not least because of the fast changing health situation and frequent updates of containment measures taken by Member States. In some cases, the measures were expected to last for a few months, while in other cases no distinctive endpoint was established and/or no estimates for 2021 were provided. Based on the Commission preliminary estimates, most of the measures were assumed to have a temporary deficit-increasing effect in 2020 (Graph 2.3).

In contrast to established practice, the Commission assessment of the SCPs of 20 May 2020 did not include a sustainability analysis. Instead, a dedicated debt sustainability analysis was carried out and published in the context of the eligibility assessment to the Pandemic Crisis Support instrument for euro-area Member States on 6 May 2020 ([28]). The Pandemic Crisis Support is a precautionary financial assistance instrument of the European Stability Mechanism for euro-area Member States where policy conditions were modified and adapted to the Covid-19 pandemic. One of the preconditions to access the instrument is a sustainable general government debt.

The eligibility assessment carried out by the Commission in liaison with the ECB concluded for all euro-area countries that the debt positions remained sustainable over the medium term. The conclusions, published on 6 May 2020, were predicated on the optimistic assumption that Member States would implement fiscal adjustments from 2022 in line with the letter of the SGP until their medium-term budgetary target was achieved. As a result, the debt ratios were projected to be on a declining path. ([29]) Moreover, the eligibility assessment did not refer to the risks identified in the Debt Sustainability Monitor of January 2020 that – against a more favourable economic outlook – had signalled high sustainability risk in the medium term for five euro-area Member States (Belgium, Spain, France, Italy, Portugal) and Romania.

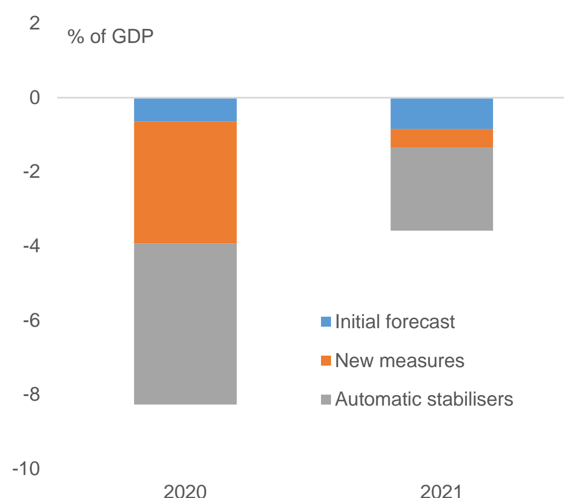
Beyond the SCP process, the Commission also collected and published a list of crisis-response measures introduced by Member States, with a view to monitoring the fast-changing developments for economic and fiscal surveillance. The list was updated almost on a weekly basis between March and July 2020, with less frequent updates thereafter until it was discontinued in 2021. ([30]) In comparison, the SCPs and the Commission forecasts presented a snapshot of the measures at any particular cut-off date. Moreover, the Commission estimates of the budgetary impact of the measures could deviate from those of Member States. The frequently updated list of measures served as an additional source of information for policymakers in a wider policy coordination effort across different domains – public health, travel, transportation, State aid, EU funding and others.

In the absence of detailed SCPs, only the Commission's 2020 spring forecast provided a no-policy-change fiscal forecast for all countries for 2021. The EU's headline government deficit in 2021 was projected to improve to 3.6% of GDP after an estimated deficit of 8.3% of GDP in 2020 (Graph 2.3). The forecast for 2021 assumed a partial economic recovery in 2021 and

([26]) The 2020 Stability & Convergence Programmes: an Overview, with an Assessment of the Euro Area Fiscal Stance
([27]) Commission assessments of the 2020 SCP
([28]) Eligibility assessment for the Pandemic Crisis Support
([29]) Assessment of public debt sustainability and COVID-related financing needs of euro-area Member States (Annex 2 of the eligibility assessment for the Pandemic Crisis Support)
([30]) The last update of the measures was published on 12 February 2021 at: https://ec.europa.eu/info/files/policy-measures-against-spread-coronavirus_en

discontinuation of most of the crisis-related measures.

Graph 2.3: **Breakdown of the government balance forecast for the EU-27 in spring 2020**



(1) 'Initial forecast' is the fiscal balance forecast in autumn 2019, corrected for any revisions for 2019.
(2) 'New measures' are all new measures included in the 2020 spring forecast, mostly linked to the response to the crisis.
(3) 'Automatic stabilisers' reflects automatic revenue decreases, expenditure increases linked to the economic shock, and any other developments.
Source: European Commission, own calculations

The decision of many Member States not to provide a complete SCP, and to deviate also from the reduced reporting requirements agreed with the Commission, was largely predicated on the high degree of uncertainty implied by the spread of the Covid-19 virus and its economic impact. While there is no doubt that the pandemic made assessments of future developments more difficult, it also needs to be stressed that the primary objective of SCPs is not to provide accurate forecasts. The SCPs are meant to be programmatic documents offering indications of the medium-term orientation of budgetary policies. Especially in difficult times such as the Covid-19 pandemic the SCPs could have helped anchor expectations by outlining where governments intend to steer their public finances after responding to the economic shock caused by the pandemic. By forfeiting this programmatic dimension of EU fiscal surveillance, Member States may have averted the difficulty of producing meaningful projections for the short term, but have perhaps increased uncertainty about the medium-term goals of public finances. The medium-term orientation of EU fiscal surveillance was weakened.

2.3. POLICY GUIDANCE FOR 2021

In normal times, EU fiscal guidance issued in spring and autumn of a given year t refers to the subsequent year t+1; implementation is monitored in t+1 and a final assessment of compliance is offered in spring of t+2. However, the Covid-19 outbreak in early 2020 affected the conventional EU fiscal surveillance cycle. In particular, it changed the period of reference and the Commission introduced elements of *ad hoc* guidance in response to changing conditions.

On 13 March 2020, in light of the exceptional nature of the Covid-19 crisis, the Commission issued an *ad hoc* Communication offering advice on a coordinated and immediate response across different policy areas of common interest, including medical purchases, uninterrupted supply of goods, and support for businesses and employees ([31]). Moreover, the Commission outlined ways for accommodating exceptional costs of the crisis-response measures under the SGP. The focus was on the imminent challenges and the need for support measures in 2020, in view of the projected sharp economic downturn.

On 20 March, the Commission followed up with its proposal to activate the severe economic downturn clause of the SGP, to which the Council agreed on 23 March. The agreement to make use of the severe economic downturn clause effectively suspended the CSRs for 2020 issued in spring 2019. These, in line with the provisions of the SGP, require Member States not yet at their medium-term budgetary objective (MTO) to implement a fiscal adjustment.

On 1 July 2020, following recommendations of the Commission, the Council issued new fiscal recommendations that legally implemented the severe economic downturn clause. Rather than looking into 2021 the recommendations were centred on the immediate crisis response. All Member States, except Romania, for which an EDP had been launched earlier in the year, received the same qualitative recommendations. The focus was on '*measures (…) to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery*'. In the absence of any numerical targets, Member States were only asked to do the following: '*when economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal*

([31]) Commission Communication on coordinated economic response to the COVID-19 outbreak

positions and ensuring debt sustainability, while enhancing investment'.

The purely qualitative and uniform nature of the formal recommendations is the most tangible manifestation of the extensive interpretation of the severe economic downturn clause highlighted in the EFB Annual Report 2021. The clause, which does not suspend the SGP, allows a temporary deviation from the normal quantitative adjustment requirements on the condition that the deviation does not endanger fiscal sustainability in the medium term. Since many Member States decided not to offer the usual programmatic outlook for the medium term in their SCPs, and Commission forecasts only cover the current and following year, it is not clear how the assessment of these conditions was effectively ensured.

In September 2020, the Commission offered some updated informal policy advice in the form of letters to Finance Ministers ahead of the draft budgetary plans for 2021. (32) The letters advocated a gradual shift from emergency measures to those supporting the recovery throughout 2021. Moreover, the letters recalled that support measures should be well targeted and temporary.

In spring 2021, the fiscal recommendations focused on 2022, thus suggesting a return to the regular cycle of fiscal guidance, notwithstanding the still qualitative nature of the guidance.

The Commission published an updated and comprehensive sustainability assessment in its Debt Sustainability Monitor in February 2021. Compared with the January 2020 publication, the 2021 edition included the impact of the Covid-19 pandemic and was based on the Commission's 2020 autumn forecast. Compared with a year earlier, the economic recovery, although strong, was projected to be somewhat delayed by the resurgence of the Covid-19 infection rate, while fiscal deficits were projected to be higher for 2021 in view of the stronger policy response (numerator effect). The Debt Sustainability Monitor observed that sustainability risks had increased especially in the short term, owing to the severity and impact of the crisis. For the medium term, eight countries were identified at high risk: Belgium, Spain, France, Italy, Portugal, Romania, Slovenia and Slovakia. (33)

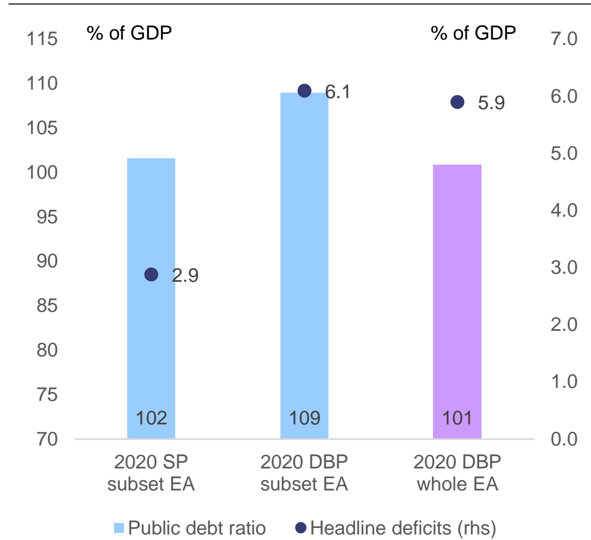
(32) The letters by Executive Vice-President Valdis Dombrovskis and Commissioner Paolo Gentiloni

2.4. DRAFT BUDGETARY PLANS FOR 2021

In autumn 2020, all euro-area countries presented draft budgetary plans (DBPs) for 2021. Lithuania prepared its DBP without including policy plans due to national elections; its updated plan was subsequently submitted on 21 December 2020. The comparison with earlier fiscal targets for 2021 is hampered by the limited reporting in the stability programmes (see Section 2.2). In particular, six euro area countries (Belgium, Germany, Spain, France, Portugal, Slovenia) had not outlined any budgetary targets for the coming year(s) in their stability programmes. Overall, the 2020 autumn edition of DBPs pointed to much higher deficits in 2021 (and even higher revisions for public debt ratios), with almost unchanged projections of a solid economic rebound. The 13 countries that had provided fiscal targets for 2021 in the spring of 2020 now projected an aggregate deficit of 6.1% of GDP, as opposed to 2.9% of GDP 6 months earlier (see Graph 2.4). The deterioration in the fiscal outlook was broad-based across the euro area countries concerned. The main drivers of the significant revisions were: (i) new or extended measures to combat the health crisis; and (ii) deficit-increasing measures unrelated to the health crisis.

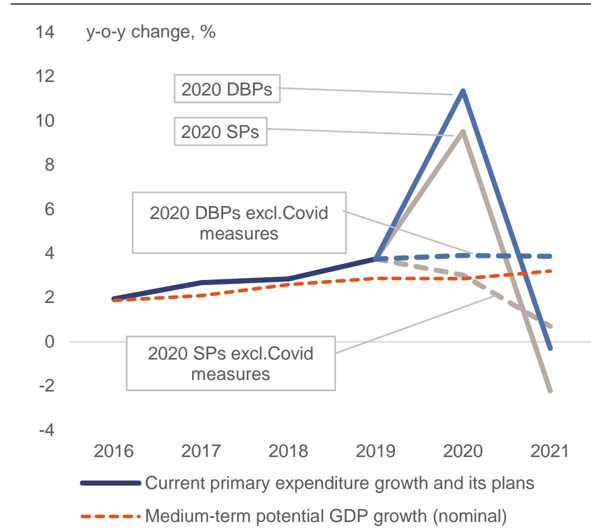
(33) For Greece, the Debt Sustainability Monitor of February 2021 provided no risk classification. The debt sustainability analysis reflected the post-programme commitment to a primary surplus of 2.2% of GDP from 2023 (a much more demanding assumption than for other countries). The pre-pandemic debt sustainability analysis of January 2020 estimated the medium-term fiscal sustainability indicator (S1) for Greece at 5.5pps of GDP, which corresponds to a high sustainability risk in the medium term.

Graph 2.4: **Euro area budgetary targets for 2021 across planning documents – stability programmes (SPs) vs DBPs**



(1) The figures for the first two columns are based on the plans of 13 euro area Member States. A comparison for the EU and the euro area as a whole is not feasible as some countries (i.e. BE, DE, ES, FR, PT, SI) decided not to include deficit and debt targets for 2021 and beyond in their spring 2020 stability programmes. The weighted averages are based on nominal GDP figures for 2021. The third column is the euro area aggregate as reported by the Commission.
Source: Stability programmes, draft budgetary plans, European Commission, own estimates

Graph 2.5: **Planned government expenditure growth in 2020 stability programmes (SPs) and draft budgetary plans (DBPs), for euro area**



(1) In the case of missing data in the 2020 stability programmes, the Commission 2020 spring forecast is used.
(2) Commission estimates of Covid-related measures are used in line with the Commission forecast in spring and autumn 2020.
(3) Medium-term potential GDP growth is in nominal terms, it is calculated as the 10-year average of real potential output growth plus the estimated GDP deflator.
(4) Estimates include government expenditure on EU programmes that is fully matched by EU funds revenue.
Source: Stability programmes, draft budgetary plans, European Commission, own estimates

Government expenditures were set to increase significantly in 2020 and to decrease in 2021, due to the sizeable discretionary policy support in response to the pandemic in 2020 and its planned partial withdrawal in 2021 (Graph 2.5). Compared with the 2020 stability programmes, the draft budgetary plans estimated higher current spending in 2020 carrying over into 2021. These estimates included all measures adopted or credibly announced in response to the Covid-19 crisis. In spring 2020, the Commission did not yet categorise the measures by the duration of their impact. It introduced a more granular definition of 'temporary emergency measures' only from autumn 2020 (see Section 2.1 and Section 2.5).

Subtracting the impact of the measures linked to the pandemic, the draft budgetary plans for euro area Member States envisaged an underlying growth rate in current expenditure excluding interest at 3.9% in 2021, exceeding nominal medium-term potential growth of 3.2% as well as the rate of expenditure growth envisioned in the stability programmes.

Recurrent upward revisions of expenditure plans have been noted in earlier EFB reports, pointing to a limited role of the stability and convergence programmes in EU fiscal surveillance (EFB Annual Report 2021). The significant increase in underlying expenditure growth in the various official publications is also to be seen against the purely qualitative nature of the country-specific recommendations issued in spring 2020, calling for fiscal policies that '*support the ensuing recovery*' (see Section 2.3).

On 18 November 2020, the Commission issued its opinions on the DBPs. Since the fiscal guidance issued in July 2020 was virtually the same for all countries and purely qualitative in nature, the Commission opinions on the DBPs did not feature many country-specific elements and were rather general compared to normal years. All euro-area Member States had launched sizeable fiscal expansions in response to the economic downturn caused by the Covid-19 pandemic, leading the Commission to reach the foregone conclusion that the DBPs were overall in line with earlier policy recommendations. Beyond this rather formalistic finding, and in light of the evident increase in permanent current expenditure unrelated to the

Covid-19 pandemic, the Commission opinions tried to bring back some of the points highlighted in the September 2020 informal letters to Finance Ministers mentioned in the previous section. Specifically, while acknowledging that most measures included in the DBPs to address the pandemic would support the recovery in 2021, the opinions found that some measures set out by France, Italy, Lithuania and Slovakia did not appear to be temporary or matched by offsetting measures. Moreover, for Belgium, Greece, Spain, France, Italy and Portugal the Commission recalled that, given the level of their government debt and high sustainability challenges emerging even before the outbreak of the Covid-19 pandemic, it was important to preserve medium-term fiscal sustainability when designing budgetary support measures. This reference to sustainability challenges in some countries were not brought up in the sustainability assessments made earlier in the year to determine Member State eligibility for the precautionary instruments of the European Stability Mechanism; these assessments uniformly concluded for all euro-area countries that their debt would remain sustainable over the medium term (see Section 2.2 for details).

On 16 December 2020, the Eurogroup issued a statement on the Commission opinions, calling for '*a supportive fiscal stance* [34] *in the euro area throughout 2021*'. [35] Echoing the Commission opinions, the Eurogroup invited Member States to continue '*to provide timely, well-targeted and temporary fiscal support*', while stressing the need for careful calibration and regular review. Moreover, in the context of a call for safeguarding fiscal sustainability in the medium term, the Eurogroup statement highlighted the importance of '*credible medium-term fiscal strategies*'. The particular emphasis on credible fiscal strategies has to be seen against the fact that several Member States had not outlined medium-term budgetary plans in spring 2020 and/or had implemented support measures that were of a permanent as opposed to a temporary nature (see Section 2.2).

(34) The Commission Communication on the 2021 draft budgetary plans interpreted the euro area fiscal stance as a discretionary fiscal impulse based on the expenditure benchmark methodology. See glossary and Chapter 4 of this report for the definition of the fiscal stance and the fiscal impulse.

(35) Eurogroup Statement on the Draft Budgetary Plans for 2021.

2.5. ASSESSING FISCAL DEVELOPMENTS BEYOND THE SGP PROVISIONS

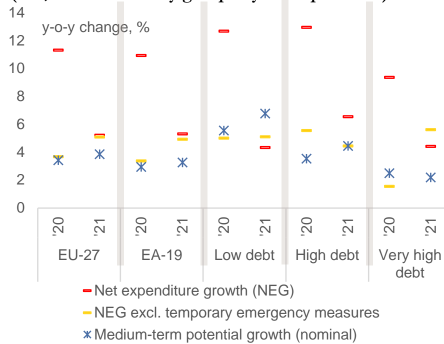
Underlying fiscal developments in 2021

The EU's qualitative fiscal guidance for 2021 precludes the conventional assessment of compliance. In fact, throughout the 2021 EU surveillance cycle, the Commission and the Council did not produce any assessment of budgetary developments vis-à-vis the quantitative requirements of the SGP. Due to the general nature of the EU recommendations, and across subsequent stages of the surveillance cycle, all Member States were found to have provided the necessary support to their economies. In most cases, a perfunctory reminder of the need to ensure sustainability in the medium term was added, however without offering a detailed analysis (see Section 2.2 and 2.3).

Against this backdrop, and following the approach pioneered in last year's Annual Report (EFB, 2021b), this section takes a closer look at fiscal developments in 2021 from an *ex post* perspective. The objective is to identify patterns and trends beyond the specific provisions of the SGP. Concretely, we compare actual expenditure developments in Member States with official estimates of medium-term potential output growth. Such a comparison offers insights into the sustainability of current trends and the size of future adjustment needs.

Graph 2.6: Benchmarking expenditure growth in 2021

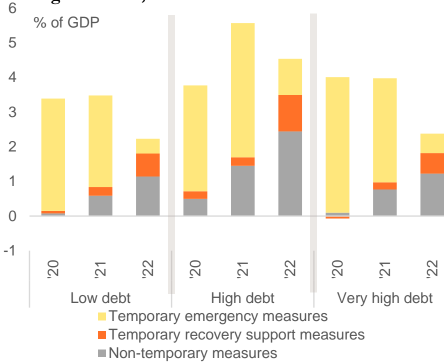
Graph a): Net expenditure growth in 2020-2021 (EU, EA and country groups by fiscal positions)



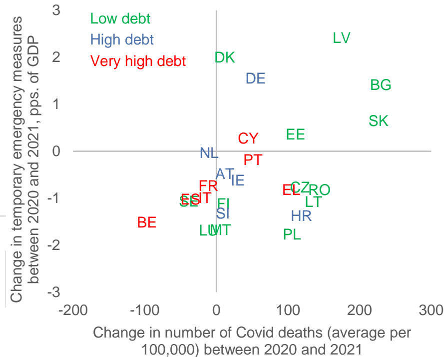
Graph b): Deviations from the benchmark (medium-term potential growth nominal), in % of GDP (EU, EA and country groups by fiscal positions)

		EU-27	EA-19	Low debt	High debt	Very high debt
Government net expend. growth (NEG)	2021	-0.6	-1.0	1.5	-1.0	-1.1
	2020-2021 on average	-1.7	-2.0	-0.1	-1.8	-2.3
NEG excl. temporary emergency measures	2021	-0.6	-0.9	1.2	0.0	-1.7
	2020-2021 on average	0.0	-0.2	1.3	0.2	-0.6

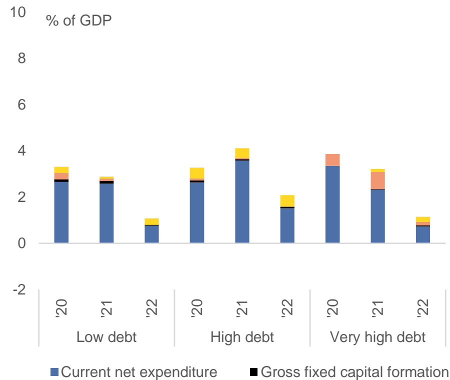
Graph c): Discretionary fiscal measures adopted since March 2020, bottom-up estimates against 'no policy change' forecast, Commission 2021 autumn forecast



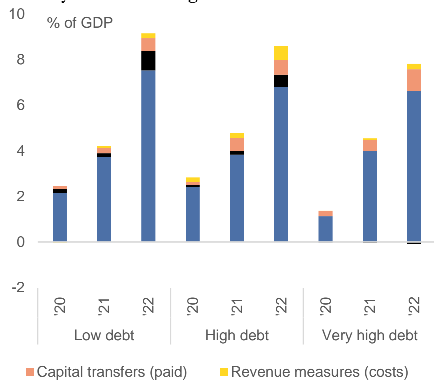
Graph d): Number of Covid deaths and temporary emergency measures across Member States, change between 2020 and 2021



Graph e): Temporary emergency and temporary recovery support measures by economic categories



Graph f): Permanent net expenditure growth since 2019 by economic categories



Current net expenditure ■ Gross fixed capital formation ■ Capital transfers (paid) ■ Revenue measures (costs)

(1) The benchmark of the medium-term rate of potential GDP growth is in nominal terms. It is: (a) the 10-year average of real potential output growth; and (b) the year-on-year rate of change of the GDP deflator.
(2) 'Net expenditure growth' refers to the growth rate of government expenditure, excluding some items (interest expenditure, expenditure on EU programmes fully matched by EU funds revenue, and the cyclical part of unemployment benefit expenditure) and is net of discretionary revenue measures and one-offs. Investment expenditures are averaged over 4 years.
(3) 'Deviation from the benchmark' measures a difference between the benchmark of the medium term economic growth and net expenditure growth. A negative sign corresponds to an excess of net expenditure growth over the benchmark.
(4) 'Temporary emergency measures' support health systems and compensate workers and firms for pandemic-induced income losses; they are set to expire in 2023 or earlier. They exclude public investment.
(5) 'Temporary recovery support measures' include public investment and other spending focused on ensuring a sustainable recovery and they are set to expire in 2023 or earlier.
(6) 'Non-temporary measures' or 'non-temporary recovery support measures' include public investment and other spending for a sustainable recovery and are expected to have a budgetary impact beyond 2023.
(7) 'Permanent net expenditure growth' represents an increase in net expenditure excluding the effect of temporary measures.
(8) In Graph d), average number of Covid deaths represents the annual average of new confirmed cases reported to the World Health Organization per 100 000 population.
(9) Countries are grouped based on their average debt-to-GDP ratio in 2011-2019: Low debt countries (debt ratio below 60%) = BG, CZ, DK, EE, LV, LT, LU, MT, PL, RO, SK, FI, SE; high debt countries (debt ratio between 60% and 90%) = DE, IE, HR, HU, NL, AT, SI; very high debt countries (debt ratio above 90%) = BE, EL, ES, FR, IT, CY, PT.
Source: European Commission (2022 spring forecast), World Health Organization, own calculations

To better understand budgetary trends we match them with information about the temporary or permanent nature of the fiscal measures taken in response to the Covid-19 pandemic. As the EFB secretariat does not have the time and resources to make its own assessment of the many individual measures taken by Member States, we rely on Commission estimates. The Commission defines 'temporary emergency measures' as those 'aimed at supporting health systems and compensating workers and firms for pandemic-induced income losses' that are set to expire by 2023 (see Section 2.1). [36] By their very nature, temporary measures are not expected to affect the medium- to long-term sustainability of public finances. The Commission also distinguishes other crisis-related measures including 'public investment and other spending focused on ensuring a sustainable recovery' – called 'recovery support measures', part of which are considered 'temporary' (expiring in 2023) and the rest 'non-temporary'.

Graph 2.6 summarises our analysis. Net expenditure growth in 2021 decelerated to 5.2% year-on-year, as compared with 11.3% in 2020 in the EU, but still exceeded the medium-term rate of nominal potential growth of 3.8% (panel (a)). The sharp expenditure growth in 2020 was largely driven by sizeable 'temporary emergency measures' as defined by the European Commission. The 'temporary emergency measures' were largely extended into 2021 with major differences across countries. The size of 'temporary emergency measures' can be partly attributed to differences in the epidemiological dynamics (panel (d)). Some countries, experiencing a more acute infection rate and Covid-linked deaths in 2021, staged a stronger fiscal response. However, the association is rather weak across all countries, and factors other than the direct impact on health seem to have played an important role.

Based on current Commission projections, 'temporary emergency measures' and 'temporary recovery support measures' are set to taper off in 2022 and, by definition, they should end in 2023 (panel (e)). The bulk of these temporary measures concern current expenditure, with capital transfers, investments and temporary revenue decreases accounting for a smaller share. Despite the size of temporary measures and their impact on expenditure dynamics, permanent expenditure increases are more decisive for expenditure trends over time. Current expenditure growth was the dominant driver of the permanent expenditure increases in 2020 and 2021 (panel (f)). Nationally financed investment increased more for the group of low debt countries, while in high debt and very high debt countries non-temporary tax cuts and capital transfers were more prominent.

Net expenditure growth was broadly similar across groups of countries, especially when compared with 2020. Member States with a low debt-to-GDP ratio (i.e. below 60% of GDP) and those with a very high debt-to-GDP ratio (i.e. above 90% of GDP) increased their net expenditure by some 4½% in 2021, including a partial reduction in the size of the 'temporary emergency measures'. Member States with a high debt ratio (i.e. above 60% and below 90% of GDP) increased their temporary emergency response in 2021 (notably due to Germany and its large weight in the group), contributing to net expenditure growth of 6½%.

By contrast, groups of countries exhibit major differences in their underlying rate of economic growth. In particular, the Commission's estimates of the medium-term rate of potential output growth, the main reference for the SGP's expenditure benchmark, turn out to be significantly lower in the group with higher debt levels. Moreover, the pickup in inflation in 2021, measured as GDP deflator, increased the nominal reference rate for Member States with a low and a high debt-to-GDP ratio by around 1 percentage point. In contrast, Commission estimates of the nominal benchmark rate of very high-debt countries remained unchanged at around 2½% in 2020 and 2021. As a result, deviations from the benchmark are considerably more negative for Member States with government debt levels in excess of 90% of GDP even when correcting for 'temporary emergency measures' (panel (b)).

This worrying conclusion still holds when looking at 2020 and 2021 combined. Moreover, our analysis confirms the importance of fiscal space highlighted in last year's annual report (EFB, 2021b). Buffers accumulated prior to the crisis go along with a smaller deviation from the expenditure benchmark in 2020-2021. These buffers were significantly higher in countries with lower government debt ratios.

Overall, our analysis of expenditure developments supports several important conclusions. The fiscal response of EU Member States to the Covid-19

[36] Please see definitions of measures in an overview of the 2021 Stability & Convergence Programmes.

pandemic extended into 2021 when the economy recovered. It included measures directly linked to still high infection rates, but also other discretionary increases. In countries with high and very high debt the total amount of discretionary measures exceeded that in 2020. While most of the measures are expected to be temporary, a major part of the 2021 increase in net expenditure is likely to be permanent in nature. Especially countries with very high debt levels seem to have implemented expenditure measures that are not expected to expire in the near term. Absent corrective measures, this bodes ill for the medium term as underlying expenditure trends are well in excess of current estimates of medium term potential output growth.

Final assessment of 2021

In spring 2022, all Member States, except France, submitted stability or convergence programmes (SCPs), in line with the standard reporting requirements of the SGP. As is customary, the 2022 edition of SCPs focused on fiscal estimates for the current year and plans for at least 3 years ahead. They also covered budgetary developments in 2021, including Covid-related measures.

Reporting on Covid-19 support measures and, in particular on their targeted and temporary nature as advised for the 2021 budgetary plans in the letters by Executive Vice-President Valdis Dombrovskis and Commissioner Paolo Gentiloni to Finance Ministers in September 2020, varied widely across Member States. Only around one third of the spring 2022 SCPs (Bulgaria, Germany, Greece, Croatia, Latvia, Austria, Slovenia, Slovakia, Finland and Sweden) supplied detailed material for 2021, usually in a dedicated overview table. While some of these SCPs specified expiration dates or sunset clauses, for others the temporary nature of measures could only be inferred from the budgetary impact estimates presented separately for the years concerned. There was generally less information available on the targeted nature of measures.

The other two thirds of the 2022 SCPs typically discussed briefly the main fiscal developments in 2021. They included some broad references to Covid-19 support and several provided either the aggregate deficit-increasing impact or the fiscal costs by groups of beneficiaries (e.g. households, companies, sectors) or government functions. Traditionally, some countries are parsimonious with the discussion of budgetary developments in the previous year. They upheld this approach in their 2022 SCPs by having a similarly short coverage of the 2021 fiscal outturns, as in their pre-pandemic SCPs. In several cases, national reform programmes provided additional information about Covid-related measures in the tables on CSRs implementation, although without systematic information on their costs, duration and beneficiaries.

Following the precedent established in 2021, the Commission did not present dedicated staff working documents assessing the SCPs. The Commission assessment of 2021 fiscal developments took the form of one paragraph in the recitals (explanatory notes) to the 2022 country-specific recommendations (CSRs). Except for Romania, the very short assessment concluded that '*the measures (..) have been in line with the Council Recommendation of 20 July 2020'.*

However, the Commission's assessment differed somewhat depending on the scale of the non-temporary measures adopted in 2020 and 2021. While all assessments stated that measures '*were mostly temporary or matched by offsetting measures*', for 15 Member States it was added that '*some of the discretionary measures (..) were not temporary or matched by offsetting measures*', naming the main measures.

The Commission's assessment did not detail the analysis underpinning this differentiation. Some details were offered on 13 July 2022, when the Commission published its traditional overview of the 2022 SCPs ([37]). It presented a broad overview of the discretionary fiscal measures over 2020-2023, but with limited country-specific information. It also reconfirmed the previously used definition of 'temporary measures', but did not explain how exactly Member States were differentiated in the assessments for 2021. No estimates were presented of non-temporary measures by country in 2021.

One can draw parallels between the final assessment in spring 2022 and the in-year assessment in spring 2021. The latter identified 13 countries with sizeable non-temporary, deficit-increasing measures of more than 0.5% of GDP (countries to the left from Latvia (including) in Graph 2.7). In spring 2022, the Commission followed a similar approach and highlighted cases

([37]) The 2022 Stability & Convergence Programmes: an Overview, with an Assessment of the Euro Area Fiscal Stance

with significant presence of non-temporary measures, but without providing a specific breakdown by country. The highlighted/ differentiated countries largely correspond to the 2021 spring assessment, with some exceptions.

Earlier in the fiscal surveillance cycle for 2021, the Commission presented estimates of non-temporary measures. The impact of non-temporary measures adopted in 2020 and 2021 increased for some countries and in the EU as a whole between autumn 2020 and spring 2021, while in some instances earlier estimates were revised down (Graph 2.7). However, the estimates are not directly comparable, as they assumed different end points for the temporary crisis measures (2022 vs 2023). Moreover, any estimates of discretionary measures, in particular for expenditure measures, rely on economic judgement (as discussed in Section 2.1). Furthermore, discretionary measures may not capture all policy changes and revisions in budgetary estimates, as observed in the analysis of broader expenditure developments in Graph 2.6.

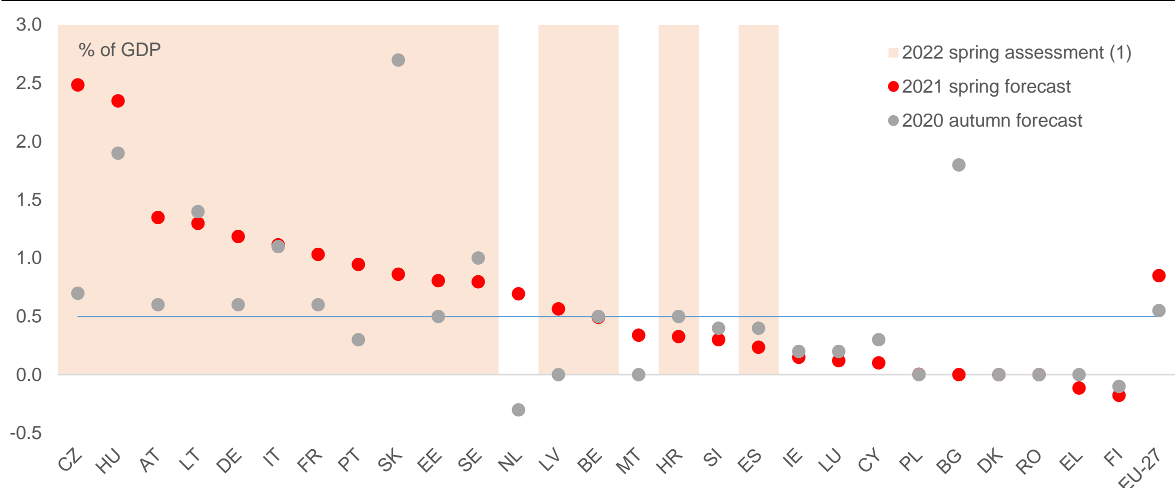
Compared with earlier years, the Commission's final assessment of 2021 lacked granularity. The spring package and the subsequent overview of the SCPs did not sufficiently explain how the Commission arrived at its country-specific assessments for 2021. This was compounded by the absence of dedicated country assessment reports on the 2022 SCPs, discontinued from spring 2021 (see Section 2.1). Previously such reports included a detailed backward-looking assessment of compliance with the quantitative fiscal requirements, which provided background for the legal documents. Despite the qualitative fiscal guidance for 2021, the Commission could have better documented and assessed fiscal developments in Member States, for instance by offering a more detailed and consistent assessment of expenditure developments including the distinction between temporary and non-temporary measures.

Although repeatedly stressing that the severe economic downturn clause does not suspend the rules, the Commission did not prepare the usual analysis on the implications of its forecast for budgetary surveillance. Only a reduced set of calculations of the Commission's preferred indicator of fiscal impulse ([38]) and the expenditure benchmark were shared with the responsible Council committee. ([39])

([38]) The Commission's 2022 spring package measured fiscal impulse as the change in primary expenditure (net of discretionary measures), including EU-financed expenditure and excluding 'crisis-related temporary emergency measures', and called it 'fiscal stance'. For the EFB's definition of the fiscal stance and the fiscal impulse, see glossary and Chapter 4 of this report.

([39]) The format of the files was different from that of the compliance assessment calculations used until 2019.

Graph 2.7: **Estimates of non-temporary measures adopted in 2020 and 2021 over the fiscal surveillance cycle for 2021**



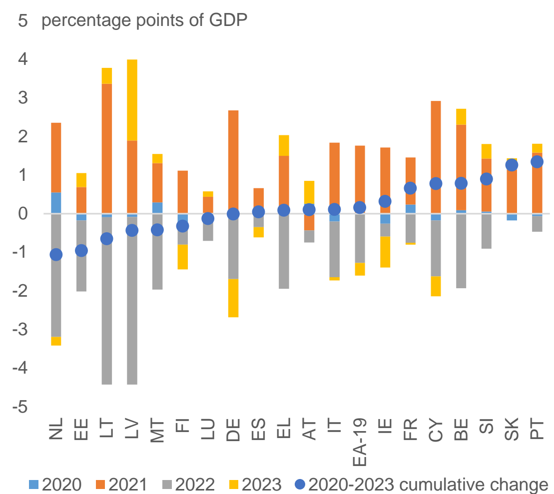
(1) Highlighted countries are estimated to have significant non-temporary measures, i.e. more than 0.5% of GDP, by 2023.
(2) For the 2021 spring forecast, non-temporary measures account for discretionary measures adopted or credibly announced from March 2020 onwards, which are not set to expire in 2023 or earlier.
(3) For the 2020 autumn forecast, non-temporary measures account for discretionary measures adopted or credibly announced since March 2020 and which are not set to expire in 2022 or earlier.
Source: European Commission

Based on the 2022 spring forecast, the Commission updated its fiscal sustainability risk assessment in annexes to the country reports produced as part of the European Semester process. Revisions in the estimates of the initial budgetary position, among other updates, were the reason for notable changes compared with the 2021 Fiscal Sustainability Report published a month earlier (Table 2.1). Fiscal outturns in 2021 were better than previously expected in many countries, mostly thanks to revenue windfalls (see Chapter 1), while the outlook for 2022 had worsened (Graph 2.8).

Looking back, there have been notable revisions in the Commission's fiscal sustainability risk assessment since 2020 (Table 2.1).

Medium and long-term sustainability risks have increased in general since the 2019 Debt Sustainability Monitor was published in January 2020 (Table 2.1). High government debt levels continued to be a major risk for sustainability of public finances (notably for Belgium, Spain, France, and Italy). The Covid-19 crisis worsened the initial government debt and deficit positions, assessed in structural terms, thus increasing sustainability risks for the medium and long term. The projections were also affected by methodological changes between different editions of the reports. Moreover, revised ageing cost estimates were used since the Fiscal Sustainability Report 2021, which contributed to increasing risk status notably for Croatia, Hungary, Malta, the Netherlands, Austria, Slovenia and Slovakia. However, ageing costs are projected to remain low in Estonia and Latvia, thus contributing to their low fiscal sustainability risk in the medium and long term.

Graph 2.8: **Change in structural primary balance between autumn 2021 and spring 2022 forecasts**



Source: European Commission

The debt sustainability analysis relies on information and projections available at the time of the assessment. The Commission forecasts are

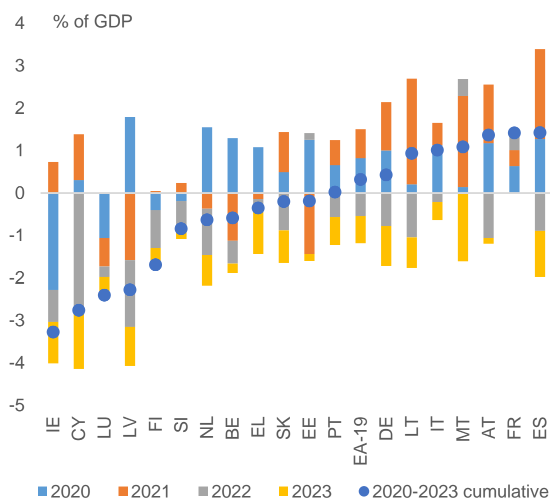
Table 2.1: **Fiscal sustainability risk assessments over time**

	short-term				medium-term				long-term			
	DSM 2019	DSM 2020	FSR 2021	SF 2022	DSM 2019	DSM 2020	FSR 2021	SF 2022	DSM 2019	DSM 2020	FSR 2021	SF 2022
BE	LOW	HIGH	LOW	LOW	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH
BG	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	LOW	MEDIUM	MEDIUM	MEDIUM
CZ	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	HIGH	HIGH
DK	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW
DE	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM
EE	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW
IE	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM
EL			HIGH	HIGH			HIGH	HIGH			MEDIUM	MEDIUM
ES	LOW	HIGH	LOW	LOW	HIGH	HIGH	HIGH	HIGH	MEDIUM	MEDIUM	HIGH	MEDIUM
FR	LOW	HIGH	LOW	LOW	HIGH	HIGH	HIGH	HIGH	MEDIUM	MEDIUM	MEDIUM	MEDIUM
HR	LOW	HIGH	LOW	LOW	LOW	MEDIUM	HIGH	MEDIUM	LOW	MEDIUM	MEDIUM	MEDIUM
IT	LOW	HIGH	LOW	LOW	HIGH	HIGH	HIGH	HIGH	HIGH	MEDIUM	HIGH	MEDIUM
CY	LOW	HIGH	HIGH	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	LOW	MEDIUM	MEDIUM	MEDIUM
LV	LOW	HIGH	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW
LT	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM
LU	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	HIGH	HIGH	HIGH	HIGH
HU	LOW	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	HIGH	HIGH
MT	LOW	LOW	LOW	LOW	LOW	LOW	HIGH	MEDIUM	MEDIUM	MEDIUM	HIGH	HIGH
NL	LOW	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	HIGH
AT	LOW	LOW	LOW	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM
PL	LOW	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM	LOW	LOW	MEDIUM	MEDIUM
PT	LOW	HIGH	LOW	LOW	HIGH	HIGH	HIGH	HIGH	MEDIUM	MEDIUM	MEDIUM	MEDIUM
RO	LOW	HIGH	LOW	LOW	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MEDIUM	MEDIUM
SI	LOW	LOW	LOW	LOW	LOW	HIGH	HIGH	HIGH	MEDIUM	HIGH	HIGH	HIGH
SK	LOW	HIGH	LOW	LOW	LOW	HIGH	HIGH	HIGH	MEDIUM	HIGH	HIGH	HIGH
FI	LOW	HIGH	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM	MEDIUM
SE	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	LOW	MEDIUM	LOW	LOW

DSM 2019 stands for the Debt Sustainability Monitor 2019, which was published in January 2020.
DSM 2020 stands for the Debt Sustainability Monitor 2020, which was published in February 2021.
FSR 2021 stands for the Fiscal Sustainability Report 2021, which was published in April 2022.
SF 2022 stands for the debt sustainability analysis based on the 2022 spring forecast, which was published in the European Semester country reports in May 2022.
Source: European Commission

used as a starting point for the medium and long term. In particular, estimates of the initial budgetary position are measured in structural terms, and are subject to the notorious uncertainty surrounding output gap estimates and budgetary elasticities. The latter is illustrated by sizeable revenue windfalls in 2020 and 2021 (Graph 2.9), which *prima facie* are estimated to contribute to structural fiscal improvements of more than 1% of GDP by 2023 for some countries. While the forecast and the debt sustainability analysis mechanically treat these windfall gains as structural fiscal improvements, their reversal cannot be excluded.

Graph 2.9: **Revenue windfalls and shortfalls, 2022 spring forecast**



(1) Revenue windfalls (+) or shortfalls (-) are measured as the difference between the actual growth of revenues and the revenue growth expected according to nominal GDP growth with an elasticity of 1, corrected for the impact of discretionary revenue measures.
Source: European Commission, own estimates

2.6. EXCESSIVE DEFICIT PROCEDURE

Based on the Commission 2020 autumn forecast, all Member States except Bulgaria were expected to have a headline deficit above 3% of GDP in 2020. In 2021 only six countries (Bulgaria, Denmark, Croatia, Cyprus, Luxembourg and Sweden) were projected to not exceed the deficit of 3% of GDP.

As indicated in Section 2.1, the Commission did not prepare new reports under Article 126(3) TFEU. In the Communication on the 2021 draft budgetary plans [40], it considered that the conclusion reached in spring 2020 – of not proceeding to the opening of EDPs – was still valid. The conclusion was motivated by the exceptional uncertainty created by the pandemic, which, according to the Commission, would have made it difficult to set out a credible path for fiscal policy. In contrast, the Commission and the Council continued to apply the EDP for Romania.

The Commission followed a similar course in spring 2021. While the Commission confirmed excessive deficits and debt levels in many Member States [41], it did not recommend further procedural steps. The Council concurred. In contrast, a revised adjustment path was set for Romania, in line with the deficit targets in its 2021 convergence programme, and the correction deadline was extended from 2022 to 2024.

Like a year earlier, in autumn 2021 the Commission did not prepare new reports under Article 126(3) TFEU for the countries with a deficit in excess of 3% of GDP and/or deviating from the debt reduction benchmark. However, and for the first time in the history of the SGP, it did not provide any justification for skipping the reports or for not launching any EDPs.

As indicated in Section 2.1, the Commission's lack of reporting on excessive deficits and debts in autumn 2021, and its conclusion of not recommending any new EDPs since spring 2020 stands in clear contrast to the letter and spirit of the SGP. First, the Commission consistently clarified that the severe economic downturn clause does not suspend the fiscal rules, including the EDP. Second, since the global financial crisis the Commission and the Council have used EDPs to strengthen the medium-term orientation of EU fiscal surveillance. In particular, rather than imposing immediate fiscal corrections, EDPs became instruments aimed at anchoring expectations for fiscal policy in a multi-year context, taking into account differences in the expected pace of economic recovery, and possible fiscal structural reforms. Moreover, the EDP adjustment paths had been extended and modified in case of unexpected adverse economic events,

[40] Commission Communication on the 2021 Draft Budgetary Plans: Overall Assessment

[41] According to the Commission's omnibus report prepared in accordance with Article 126(3) TFEU Belgium, Czechia, Germany, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, the Netherlands, Austria, Poland, Portugal, Slovenia, Slovakia and Finland failed to meet the deficit criterion. Belgium, Germany, Greece, Spain, France, Croatia, Italy, Cyprus, Hungary, Austria, Portugal, Slovenia and Finland failed to meet the debt criterion.

demonstrating responsiveness of the procedural framework to changing economic circumstances.

The importance of the medium-term orientation of fiscal policy is explicitly recognised in the SGP provisions on the severe economic downturn clause. Specifically, the flexibility under the clause is to be granted on the condition that public finances remain sustainable in the medium term. Without meaningful medium-term plans presented by Member States, and without any recommendations on how to tackle excessive deficits in the medium term, there was no way to assess whether this condition is satisfied or not. Observers, including markets, are left in the dark about how and when fiscal imbalances are to be corrected.

On 14 October 2021, the only country in the EDP, Romania, submitted its EDP report on actions undertaken to address the Council Recommendation. Since Romania had a caretaker government with limited authority, it did not present any new fiscal policy measures for 2022-2024, but it did confirm the political commitment to bring the deficit to below 3% of GDP by 2024. For this reason, the Commission concluded, based on its 2021 autumn forecast, that the excessive deficit procedure should be kept in abeyance.

In spring 2022, the Commission prepared the usual assessment of fiscal developments vis-à-vis the deficit and debt criteria of the Treaty. It followed the same reporting format as in spring 2021 by adopting an omnibus report for all Member States with actual or planned deficits and debts above the reference values [42].The main novelty in the report was the assessment of 'relevant factors' which for the first time covered changes in net nationally-financed primary current expenditure, the new budgetary aggregate introduced as reference in the CSRs issued on 23 May 2022, and nationally-financed investment [43] (Table 2.2). This innovation is likely to foreshadow a change in practice including a de facto transition to a Golden-Rule-like [44] interpretation of existing rules. The Commission's omnibus report concluded, after its assessment of all relevant factors, that the deficit and debt criteria were prima facie not fulfilled by 17 and 5 countries respectively (Table 2.2). However, as on previous occasions, it did not propose to open new excessive deficit procedures. In its Communication the Commission argued that the continuation of the Covid-19 pandemic together with the invasion of Ukraine by Russia '*create exceptional uncertainty, including for designing a detailed path for fiscal policy*'. [45] The Council agreed with the Commission on 21 June 2022 in its endorsement of the 2022 country-specific recommendations [46].

Table 2.2: **Overview of countries assessed for excessive deficits and debts**

	Deficit criterion	Debt criterion	Relevant factors: Change in net nationally financed primary current expenditure	Change in nationally financed investments	Debt sustainability analysis	Macroeconomic imbalances
BE	red	red	red	green	red	green
BG	red	green	red	green	yellow	green
CZ	red	green	green	red	yellow	green
DE	red	green	red	green	green	yellow
EE	red	green	red	green	green	green
EL	red	green	red	green	red	red
ES	red	green	red	green	red	yellow
FR	red	red	red	green	red	yellow
IT	red	red	red	green	red	red
LV	red	green	red	green	green	green
LT	red	green	red	green	green	green
HU	red	red	green	green	yellow	green
MT	red	green	red	red	yellow	green
AT	red	green	green	green	yellow	green
PL	red	green	red	green	yellow	green
SI	red	green	red	green	red	green
SK	red	green	green	green	red	green
FI	green	red	green	green	yellow	green
RO*	red	green	green	green	yellow	yellow

(1) The table presents the main elements of the 2022 spring omnibus report under Article 126(3) TFEU, for countries that exceeded the deficit and debt criteria in 2021
(2) * Romania remained under an excessive deficit procedure, but is included in the table for comparison.
(3) For the deficit and debt criteria: 'red' = non-compliance; 'green' = compliance. For change in net nationally financed primary current expenditure, 'red' = significant growth compared with medium-term economic growth in 2022 (over 0.5% of GDP); 'green' = growth compared with medium-term economic growth does not exceed 0.5% of GDP. For change in nationally financed investments: 'green' = no change or increase in nationally financed investments in 2022, 'red' = decrease in nationally financed investments in 2022. For debt sustainability risks: 'red' = high sustainability risk; 'yellow' = medium risk; 'green' = low risk. For macroeconomic imbalances: 'red' = 'excessive imbalances'; 'yellow' = 'imbalances'; 'green' = no in-depth review under the Macroeconomic Imbalances Procedure.
(4) Debt sustainability analysis is based on the debt scenario analysis over the next 10 years. Its risk assessment can differ from the overall sustainability risk assessment for the medium term in Table 2.1, which relies also on the reading of the S1 indicator (see glossary).
Source: European Commission, own estimates

Also, further to the assessment that the debt criterion was not fulfilled in five countries, the Commission explicitly stated that '*the compliance with the debt reduction benchmark would imply a too demanding frontloaded fiscal effort that risks to jeopardise growth*' and,

[42] Commission report prepared in accordance with Article 126(3) TFEU
[43] These two elements replaced the analysis on the size of non-temporary measures and on the changes in government investment levels, which featured in the Commission's omnibus report under Article 126(3) TFEU in spring 2021 (see EFB Annual Report 2021 Section 2.6)
[44] The Golden Rule for the operation of fiscal policy suggests that over the economic cycle, the government should borrow only to invest and not to fund current spending.
[45] Commission Communication on 2022 European Semester - Spring Package
[46] https://www.consilium.europa.eu/en/meetings/european-council/2022/06/23-24/

therefore, '*compliance with the debt reduction benchmark is not warranted under the current exceptional economic conditions*'. This argument was made in the conclusions of the Article 126(3) TFEU report, as another relevant factor, but not discussed in the rest of the document. This quite strong and categorical statement was not substantiated by any analysis. At the same time, the omnibus report repeated the official mantra that the severe economic downturn clause does not suspend the procedures of the SGP, but allows the possibility of a temporary departure from the adjustment path.

The Commission's statement on the supposed effects of the debt reduction benchmark seems to be predicated on the assumption that one would immediately return to the application of the rule and that the Member States concerned would be asked to implement a front-loaded fiscal adjustment. These assumptions seem unwarranted. First, there is a difference between assessing compliance with the rule and the adjustment under an EDP. In practice, fiscal adjustment paths under an EDP can and have been attuned to the country-specific situations and stretched over several years, as was the case during the global financial crisis. Second, due to the backward-looking element of the debt reduction benchmark expecting immediate compliance with the debt reduction rule would amount to an overt inconsistency with the EU's policy recommendations issued under the severe economic downturn clause. A transition period could be envisaged. Third, the current economic circumstances are not characterised by a shortfall of aggregate demand but by supply constraints and very high inflation. In such a context, a negative fiscal impulse would actually help in ensuring an appropriate policy mix in the euro area (see EFB, 2022). Also the Commission evokes complementarity between monetary and fiscal policy when discussing the policy mix in light of the latest set of stability and convergence programmes. (47) Since monetary policy is tightening, complementarity means that fiscal policy would also need to reduce the still very high support.

Finally, despite the proposal to extend the severe economic downturn clause and the economic fallout of the Russian invasion of Ukraine, the Commission continued to apply the EDP for Romania. The Commission assessment was presented in recitals of the country-specific recommendations for Romania (48) and in a dedicated note to the responsible Council committee. Before 2021, when the Commission published staff working documents on the stability and convergence programmes, such assessments were more detailed (see Section 2.1).

The Commission assessed that Romania complied with its nominal deficit target and the required structural adjustment in 2021. Romania's 2022 convergence programme targeted the reduction of the government deficit below 3% of GDP in 2024, but without outlining the necessary consolidation measures. However, based on the 2022 spring forecast, the Commission assessed Romania at risk of non-compliance with nominal and structural balance targets for 2022 and 2023. For this reason, the Commission undertook a 'careful analysis' following the methodology for assessing 'effective action' (49). The 'careful analysis' for Romania assessed the planned fiscal effort for 2022 and 2023 based on the expenditure benchmark. The analysis identified net expenditure growth above the requirement and concluded that there is a risk that Romania does not comply with the EDP targets in 2022 and 2023. Nevertheless, the Commission did not propose to step up the EDP procedure and kept the procedure in abeyance since the headline deficit target and fiscal effort in 2021 had been met. The country-specific recommendations for 2022 and 2023 asked Romania to pursue fiscal policies in line with the required adjustment path.

The Commission's 'careful analysis' of the fiscal indicators for Romania stands in contrast to the inconclusive assessment for other Member States with excessive deficits. The Commission demonstrated that it is possible to draw up an adjustment path and assess compliance with the SGP rules for Romania. By contrast, it did not open new EDPs for other countries arguing the continuation of the Covid-19 pandemic and the war in Ukraine '*create exceptional uncertainty, including for designing a detailed path for fiscal policy*'. As observed in our last year's annual report (see EFB 2021b, Section 2.6), such a decision is based on political

(47) The 2022 Stability & Convergence Programmes: an Overview, with an Assessment of the Euro Area Fiscal Stance

(48) Council Recommendation on the 2022 National Reform Programme of Romania and delivering a Council opinion on the 2022 Convergence Programme of Romania

(49) On 29 November 2016, the Economic and Financial Committee adopted its Opinion entitled 'Improving the assessment of effective action in the context of the excessive deficit procedure – a specification of the methodology', which was endorsed by the ECOFIN Council on 6 December 2016.

considerations rather than the letter or spirit of the SGP and past practice. During past crises, when Member States breached the deficit or debt criterion of the Treaty, the Council, on a proposal of the Commission, typically opened EDPs regardless of the uncertainty present at the specific moment in time. For example, between spring 2009 and 2010, it opened EDPs for 22 countries and followed up with extensions of the deadline or modification of the adjustment paths after unexpected adverse economic events.

3. INDEPENDENT FISCAL INSTITUTIONS AND NATIONAL FRAMEWORKS

Highlights

- Acknowledging the crucial role that realistic macroeconomic forecasts play in budgetary outcomes, EU legislation set a number of requirements for national forecasting processes, including regular *ex post* evaluations. In addition, euro area countries are expected to ensure that the macroeconomic projections underlying fiscal plans are either produced or endorsed by independent bodies.
- A review of the arrangements adopted in euro-area Member States to have official macroeconomic forecasts produced or endorsed by independent bodies reveals some commendable convergence in terms of procedure, reporting and communication. At the same time, still less than half of the independent fiscal institutions (IFIs) base their endorsement decisions on approaches informed by a quantitative model.
- By contrast, taking stock of the application of the almost a decade-old requirement for *ex post* evaluations of official macroeconomic forecasts, one can find an uneven and partial implementation record. While there is a trend in more and more countries for mandating the national IFIs with this task, further action is needed to establish credible reporting on past forecasting performance with a regular schedule.
- Our own statistical analysis of forecast errors in the euro area suggests the involvement of IFIs is associated with a lower optimistic bias in real GDP growth projections. Nonetheless, the optimistic bias has not entirely disappeared in some of the countries where the forecasts are independently endorsed.
- This chapter portrays national IFIs in two Member State, Greece and Portugal, also to identify best practices. In both countries, national fiscal councils were established as an institutional element of a broad fiscal governance reform and started their operation under an EU-IMF economic adjustment programme. The main findings are:
  - The mandate of the Hellenic Fiscal Council (HFC) is relatively narrow and focuses on the core tasks required under EU law. Its role as a monitoring institution for domestic numerical rules has until recently been overshadowed by the surveillance of international creditors.
  - There are further challenges for the HFC, in terms of operational aspects (e.g. staff recruitment, transparency) and in becoming a credible reference point in the domestic policy debate.
  - The Portuguese Public Finance Council (Conselho das Finanças Públicas, CFP) has strong independence safeguards and a relatively wide mandate, including fiscal monitoring at subsector level (i.e. local governments, social security) and periodical long-term sustainability analysis. Its non-partisan status also benefits from the permanent presence so far of foreign experts in the Board.
  - The CFP's activities, and in particular its endorsement competence over the government's official macroeconomic scenario, are analytically underpinned by the biannual preparation of no-policy-change baseline projections, so that the CFP can deploy a numerical benchmark in its assessments.

This chapter includes two main sections: (i) a survey-based analysis of the IFIs' role in macroeconomic forecasting in the EU, with a focus on the requirement for independent forecasts in the euro area; and (ii) portraits of IFIs in Greece and Portugal, two countries where the independent institutions started their operation during a financial assistance programme. The motivation is to draw possible lessons for other EU IFIs and to share best practices.

3.1. THE ROLE OF INDEPENDENT FISCAL INSTITUTIONS IN ENSURING PRUDENT MACROECONOMIC FORECASTS

Prudent macroeconomic forecasting methods and assumptions are among the cornerstones of realistic budgetary planning; they are a prerequisite for sound and sustainable public finances. However, as documented early on by the empirical literature, the track record of many Member States has long been a concern. In particular, for decades there had been a general trend of over-optimism in preparing both the macroeconomic forecasts underlying fiscal planning (Jonung and Larch, 2006) and the corresponding budgetary forecasts (Beetsma et al., 2009). When the reinforcement of national budgetary frameworks had become an integral part of European economic governance reform in the 2010-2013 period, the importance of reliable macro-fiscal forecasts had been explicitly recognised in the new provisions.

Concretely, the Budgetary Frameworks Directive [50] required Member States to ensure fiscal planning is *'based on the most likely macrofiscal scenario or on a more prudent scenario'*. To this end, the Directive set certain content and procedural requirements for the national forecasting processes underpinning budgetary planning, most notably in terms of their transparency (methodologies, assumptions, and sensitivity analyses). As to the potential role of independent fiscal institutions in forecasting, the Directive refers to them as providers of useful numerical benchmarks, so it advises national authorities to compare, if appropriate, their own macroeconomic and budgetary forecasts with those of other independent bodies. [51] More importantly, to improve the quality of projections and promote accountability, the Directive calls for *'regular, unbiased and comprehensive evaluation'* of past forecasting performance, including *ex post* evaluations.

Building partly on these steps, one of the Two-Pack Regulations [52] goes further for euro-area Member States, by introducing the requirement for the macroeconomic forecast underlying both national medium-term fiscal plans and annual budgets to be either produced or endorsed by independent bodies. If a fiscal planning document would be prepared and been adopted without having based on such a macroeconomic forecast, the Commission could initiate legal action – an infringement procedure – against the country in question, in line with the general Treaty provision for breaching EU law. On the other hand, it (only) obliges Member States to declare whether the budgetary forecasts have been produced or endorsed by an independent institution. [53] This provision came into force on 30 May 2013, so the new requirement was first applied (admittedly still in a patchy way) in autumn 2013 on budgetary plans for 2014. The following subsection will take stock of the experience with this arrangement in its nearly first decade, partly on the basis of a dedicated survey of the EFB secretariat with EU IFIs [54] on their role in macroeconomic forecasting and partly on the review of related IFI publications.

[50] Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States – OJ L306, 23.11.2011.

[51] In the same article, the Directive requires national authorities to present comparisons of their forecasts with '*the most updated forecasts of the Commission*' and to provide explanations in case of significant differences.

[52] Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 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 – OJ L 140, 27.5.2013.

[53] There are only two IFIs in the euro area that, on top of the obligatory endorsement of the macroeconomic forecast, formally endorse the official budgetary forecasts as well: the fiscal councils in Greece and Malta. Pursuant to the respective domestic laws, both IFIs have regularly provided endorsement of the government's forecasts of budgetary aggregates contained in medium-term and annual national planning documents; see the portrait of the Hellenic Fiscal Council in the next subsection for details on the Greek practice). Practically all other euro-area IFIs pronounce their views on the plausibility of budgetary forecasts, but in legal and reputational terms, these *ex ante* compliance assessments do not amount to an endorsement decision.

[54] The survey was distributed to 31 institutions in 26 Member States (no IFI in Poland) that are entrusted with a function stemming from EU law. In total, 29 IFIs responded to the questionnaire, covering all concerned countries.

3.1.1. Independent macroeconomic forecasts in the euro area

To comply with the two-pack requirement for safeguarding macroeconomic forecasts, 6 out of the 19 euro-area Member States chose to rely on the 'independent production model' (see details on country-specific arrangements in Table 3.1). For five of these countries (Belgium, Luxembourg, the Netherlands, Austria, and Slovenia), it seemed to be a natural choice as it was a continuation of existing practice. In these countries, delegating the responsibility for macroeconomic forecasts to an independent institution has for long been considered to contribute to greater objectivity. Moreover, all the concerned institutions had already enjoyed a reputation for producing unbiased projections. Finland was the only that newly signed up to this model after the two-pack came into effect, and where a special safeguard mechanism was put in place in spring 2015, ensuring that the official macroeconomic forecasts are produced independently within the Ministry of Finance. (55)

Table 3.1: **Institutional responsibilities for independent production or endorsement in the euro area**

Euro area country	Institution (commonly used abbreviation)
Belgium*	Federal Planning Bureau (FPB)
Germany	Joint Economic Forecast project group
Estonia	Fiscal Council
Ireland	Irish Fiscal Advisory Council (IFAC)
Greece	Hellenic Fiscal Council
Spain	Independent Authority for Fiscal Responsibility (AIReF)
France	High Council for Public Finances (HCPF)
Italy	Parliamentary Budget Office (PBO)
Cyprus	Fiscal Council
Latvia	Fiscal Discipline Council (FDC)
Lithuania	Budget Policy Monitoring Department
Luxembourg*	National Institute of Statistics and Economic Studies (STATEC)
Malta	Fiscal Advisory Council (MFAC)
Netherlands*	Bureau for Economic Policy Analysis (CPB)
Austria*	Austrian Institute of Economic Research (WIFO)
Portugal	Public Finance Council (CFP)
Slovenia*	Institute of Macroeconomic Analysis and Development (IMAD)
Slovakia	Macroeconomic Forecasting Committee
Finland*	Economics Department, Ministry of Finance

(1) * denotes the cases of independent production
Source: Own compilation on the basis of stability programmes and draft budgetary plans

In the remaining 13 euro-area Member States, finance ministries have retained the remit for preparing the official macroeconomic forecasts, which are then validated by fiscal councils/dedicated committees ('independent endorsement model'). In 11 countries this function was attributed to newly created IFIs together with the other task of monitoring domestic numerical rules. As special cases, Germany and Slovakia decided to enlist expert committees for this function, the Joint Economic Forecast project group (56) and the Macroeconomic Forecasting Committee (57), respectively.

In terms of process, in some Member States the endorsement system is set out in a memorandum of understanding between the IFI and the Ministry of Finance, whereas in others it is broadly defined in domestic law or based on established practice. These memorandums (either dedicated ones, such as in Ireland, Italy, and Portugal, or as part of a broader one, as in Greece and Latvia) set out the parameters of the endorsement process in a detailed way. Specifically, the memorandums define the scope of the official forecasts to be submitted for review, the type of additional information that IFIs should be provided with and the calendar of interactions. (58) In Ireland and Latvia, they also provide for a reconciliation mechanism whereby a course of action is set out in the case of divergent forecasting views. As to the IFIs' perceptions about the suitability of the process in their country, roughly half of them signalled in the EFB secretariat survey that they would need more time for a thorough scrutiny of the government's projections, and a quarter indicated that they typically had insufficient knowledge of new fiscal measures and/or planned policy changes.

With the progression of time, there has been a remarkable convergence in the publication and communication patterns related to endorsement decisions across the concerned euro-area countries. At the time of the first applications of this requirement in 2013-2014, the very existence of the

(55) Specifically, the head of the department responsible for the forecasting function has the final say on the macroeconomic projections, and in this respect, cannot be overruled by the Minister of Finance.

(56) The Joint Economic Forecast project group is an independent body that comprises the German Institute for Economic research in Berlin, the IFO institute in Munich, the Institute for World Economy in Kiel, the Economic Research Institute in Halle and the Economic Research Institute in Essen. This entity was tasked with the endorsement function only in 2018, i.e. after a couple of years of delay. It is worth recalling that the project group's traditional activity has been to publish fully fledged biannual macroeconomic forecasts for more than six decades.

(57) The Macroeconomic Forecasting Committee consists of a chairman without a voting right (*ex officio* the Director of the Ministry of Finance's Institute for Financial Policy) and 9 voting members delegated by the following institutions: five commercial banks, the central bank, the Slovak Academy of Sciences, the Institute of Informatics and Statistics, and the Slovakian IFI, the Council for Budgetary Responsibility.

(58) The Italian two-step approach could be considered as the most sophisticated form for the endorsement of the official macroeconomic trajectory. In the first step of the process, the Parliamentary Budget Office endorses the official no-policy change or trend scenario for economic growth. In the second step, the policy scenario as such, which includes the new measures and their impacts, is submitted for endorsement (see for details the portrait of the Italian IFI in EFB (2021b)).

Table 3.2: **Selected key elements for the macroeconomic endorsement process**

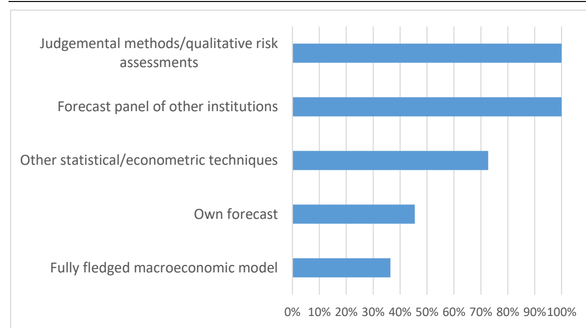
Country	Endorsing institution	Form of endorsement announcement	Analytical document, comments
Cyprus	Fiscal Council	Press statement	A detailed analysis is published as a chapter in the biannual reports (Spring and Autumn Reports)
Estonia	Fiscal Council	Short Council's opinion	Explanatory reports on the spring and summer forecasts of the Ministry of Finance (published simultaneously with the opinion)
France	High Council for Public Finances	A detailed opinion on fiscal planning documents (both annual and medium-term) includes the statement	The opinions on the Stability Programme (spring) and on the draft budget (autumn) (published weeks before the fiscal planning documents are submitted to the EU)
Germany	Joint Economic Forecast project group	Short analytical note	Detailed comparison tables are published together with the note[1]
Greece	Hellenic Fiscal Council	Short analytical note	A detailed analysis is published in the biannual reports (Spring and Autumn Reports)
Ireland	Irish Fiscal Advisory Council	Open letter addressed to the Secretary General of the Department of Finance	A detailed analysis is published as a chapter in the biannual Fiscal Assessment Reports
Italy	Parliamentary Budget Office	Open letter addressed to the Minister of Finance (separately for the trend and the policy scenario)	A detailed analysis is provided in PBO's assessment reports (i.e. 'Budgetary Planning Report' in spring, Budgetary Policy Report' in autumn)
Latvia	Fiscal Discipline Council	Open letter addressed to the Ministry of Finance[2]	Opinions on the Ministry of Finance's forecasts and tables of macroeconomic indicators (published simultaneously with the open letter)
Lithuania	Budget Policy Monitoring Department	Press statement on the Council's webpage (section of the National Audit Office's webpage)	An analytical note ('Opinion on the endorsement of the Economic Development Scenario') is published simultaneously with the statement
Malta	Fiscal Advisory Council	Open letter addressed to the Minister of Finance	Dedicated analytical reports (e.g. 'Assessment of the Stability Programme', 'Assessment of the Draft Budgetary Plan')
Portugal	Public Finance Council	Concluding statement on the Council's webpage	Opinions on the government's macroeconomic forecast (published simultaneously with the statement)
Slovakia	Macroeconomic Forecasting Committee	Minutes of the committee on the Ministry of Finance's webpage	Besides the votes, the views and comments of committee members are included in the minutes[3]
Spain	Independent Authority for Fiscal Responsibility	Press statement	Short assessment reports (published simultaneously with the press statement)[4]

(1) The project group publishes separately its own independent forecast twice a year. (2) Starting from 2021, the submission of the endorsement letter has been abandoned. (3) Each voting member of the Committee assesses whether the government's macroeconomic forecast underlying fiscal planning is 'conservative', 'realistic' or 'optimistic'. (4) To fulfil a requirement set in domestic law, the IFI individually endorses the macroeconomic forecasts of 17 autonomous communities underlying their regional draft budgets.
Source: Own compilation on the basis of the EFB secretariat survey and IFI websites

endorsement could have only been (indirectly) known from the information contained in the respective government planning documents (i.e. stability programmes or draft budgetary plans) in some countries. By now, all IFIs communicate the decision in real time, via press statements or open letters addressed to government representatives (see Table 3.2 for an overview). The press releases or letters typically already include the main rationale for the IFIs' decisions, highlighting some key risks surrounding the official baseline scenario and/or adding some qualifications. About half of the IFIs release a deeper assessment/opinion simultaneously with the endorsing announcement. The other half publish their detailed analysis up to 6-8 weeks later, either in a dedicated document or as a chapter in a broader assessment report.

More heterogeneity is observable among endorsing IFIs in terms of methodological approach. There are simple methods applied by all endorsing institutions, i.e. qualitative risk assessments and comparison with the forecasts of other institutions (see Graph 3.1). The reference forecasts for comparisons are usually those published by international institutions (European Commission, IMF, OECD) as well as national ones (central banks, think tanks, economic research institutes, universities, commercial and investment banks). Mostly due to resource limitations, IFIs with a small support team rely on these techniques, in some cases complemented by other statistical/econometric methods. In turn, these IFIs generally characterised their staff endowment as challenging or clearly in need of more resources. On the other end of the spectrum, close to half of the euro-area endorsing IFIs (i.e. Ireland, Greece, Spain, Italy, Portugal) employ their own forecast as a numerical benchmark in the endorsement process, supported generally by in-house macroeconomic models.

Graph 3.1: **Use of methodological tools by endorsing IFIs (share of institutions)**



Source: EFB secretariat survey

Given the absence of specific EU legislative provisions, the role of national IFIs is more diverse in relation to macroeconomic forecasts outside the euro area. ([59]) IFIs typically assess the realism of official macroeconomic forecasts underlying the draft annual budget, but without any legal or institutional consequences in the case of a negative opinion (notably, in Croatia, Hungary, Bulgaria, and Romania, in the latter two countries, it also covers the macroeconomic scenario for medium-term fiscal planning). The Danish Economic Council produces its own twice-yearly macroeconomic forecasts but does not publish dedicated assessments on the government's projections. In Czechia, an independent expert committee (Committee on Budgetary Forecasts) is tasked with assessing the plausibility of the government's macroeconomic forecasts and its tax projections. The committee consists of at least seven members from the private, public, and academic sectors who are all appointed by the government on a proposal of the Czech Fiscal Council.

3.1.2. *Ex post* forecast evaluations

Whereas in policy debates the real-time prudency assessments of official economic projections, such as the endorsement decisions by the euro-area IFIs, understandably carry a lot of significance, preparing regular evaluations on forecasting performance is important, too. First, analysing how outturns have evolved relative to the respective forecasts represents a systematic way of measuring the performance of forecasting assumptions and models in use, and thereby helps to improve future forecasts. Second, transparently reporting on the reasons for differences between projections and statistical outcomes establishes the accountability of the forecasting institutions. Also inspired by these considerations, the 2011 Budgetary Frameworks Directive requires all Member States to ensure that their macroeconomic and budgetary forecasts underpinning fiscal planning are subject to '*regular, unbiased and comprehensive*' backward-looking or *ex post* evaluations. Moreover, if such evaluations detect a significant bias affecting macroeconomic forecasts over a period of at least 4 consecutive years, the Member State concerned is required to follow it up by taking the necessary corrective action and make it public.

As reported by IFIs in the EFB secretariat survey, there are some differing practices in fulfilling this Directive's provision (see Graph 3.2). The most typical solution has been to delegate the evaluation function to an IFI. This was a natural choice in Member States where such a practice had started even before the adoption of the Directive. For example, since its establishment in 2007, the Swedish Fiscal Policy Council periodically (every 3-4 years) included in its annual report a dedicated section with *ex post* evaluations of the government's forecasts. In the majority of these Member States, the IFI had already started to produce such reports in the sense of the Directive. In Luxembourg, Austria, and Slovenia, it implies that the national fiscal councils are tasked to evaluate the forecasting performance of the national independent forecasting institutions. ([60])

There are still a number of countries where the domestic transposition has generally taken place quite recently ([61]) and where the first report by the national IFI is yet to appear (moreover, in Portugal and Slovakia, the legislative process was reported still to be ongoing in early 2022). The protracted national transposition processes and the slow take-up was explained in the Commission's suitability review by some possible misinterpretations of the Directive respective provisions, insofar as some Member States seem to have initially considered that the standard (forward-looking) forecast plausibility assessments by IFIs fulfil this function (European Commission, 2020a). In its audit report,

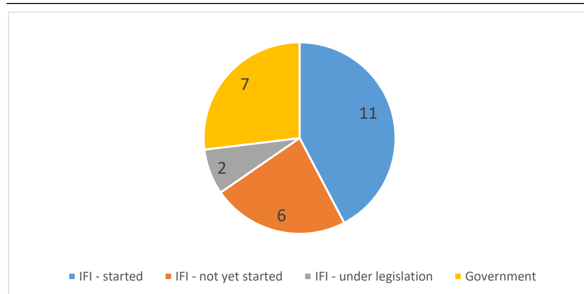
([59]) Moreover, it is worth recalling that in the United Kingdom, the Office for Budget Responsibility is mandated by law to produce the official macroeconomic forecasts twice a year since 2010.

([60]) In this context, it should be mentioned that the traditional EU forecasting institutions together with the Dutch CPB and the Belgian FPB have long established a tradition to periodically prepare a statistical evaluation on their own forecast performance.

([61]) In France, the extension of the mandate of its IFI, the High Council of Public Finances, to cover *ex post* forecast evaluations was included in the national Recovery and Resilience Plan as a reform measure (already adopted). See also Box 3.1. for an overview on the national IFIs' role in the RRF process.

the European Court of Auditors (2019) noted the delayed transposition processes, and criticised the Commission for not taking proactive measures (such as guidelines or explanatory documents serving as compliance promoting tools) to help Member States in transposing the Directive. Indeed, the overall uneven implementation record for the provision on *ex post* evaluation by 2022 (i.e. more than 8 years after the Directive came into effect) suggest that the Commission could have exercised more timely and stringent checks on Member States.

Graph 3.2: **Institutional responsibilities for ex post evaluations (number of countries)**



(1) IFI – started (an IFI is mandated to perform *ex post* evaluations, and at least one such report has already been published: AT, BE, DE, ES, FI, IT, LU, NL, RO, SE, SI); IFI – not yet started (an IFI is mandated to perform *ex post* evaluations, but the first report is yet to appear: BG, CY, EL, FR, HR, MT); IFI – under legislation (legislation is ongoing to charge an IFI with this function: PT, SK); Government (the government is mandated to perform *ex post* evaluations: CZ, DK, EE, HU, IE, LV, LT).
Source: Survey of the EFB secretariat

As can be seen from Graph 3.2, a number of Member States decided not to mandate their IFIs with the forecast evaluator function, and in most of these countries, the Ministry of Finance prepares a self-assessment study. This is done in practice either as part of legislative documentations (linked to the draft budget bill or the final accounts for the past budget year), or as a self-standing evaluation study. As a subgroup, Ireland's and Latvia's arrangement is worth mentioning: the two governments eventually outsourced this task to the private sector by commissioning a study from independent economists/consultancy firms. ([62])

Given that, even in several countries that have already launched this function, only one such report per country has been released so far, it is difficult to establish clear patterns in terms of regularity or frequency. The already published *ex post* evaluations (by some two thirds of Member States) typically cover both macroeconomic and budgetary forecasts in the same document. The retrospective time span is generally chosen to be the last 4 statistical years (the required minimum set by the Directive), but some evaluations covered a much longer period that is admittedly more appropriate for econometric methods. ([63]) As regards potential forecasting errors in the official macroeconomic projections, none of the evaluation studies reported by IFIs detected a significant bias in the headline real GDP trajectories, so did not trigger the remedial action provided for in the Directive. ([64]) This stands in some contrast to the empirical literature on the forecasting performance of EU Member States, which will be reviewed in the next subsection.

([62]) See the 2018 Irish evaluation report (Evaluation of the Department of Finance's Macroeconomic and Fiscal Forecasts 2013-2016) and the 2019 Latvian one (available only in the national language).

([63]) In particular, the 2018 Finnish study investigated the macroeconomic forecasting accuracy of the government over 40 years between 1976 and 2016, while the Luxembourgish report covered 20 years (Evaluation de la fiabilité des prévisions macroéconomiques et budgétaires, available only in French).

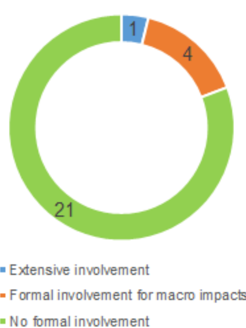
([64]) In its first evaluation study in October 2017, the Spanish IFI concluded that the government's forecasts for one of the GDP components, namely for the real growth rate of public consumption showed a significant bias as measured by the absolute forecast error. The relevant part ('*Ex post* analysis of the 2013-2016 forecasts') was published as a subchapter of the Report on the Macroeconomic Forecasts in the 2018 Draft Budgetary Plan by Spain's Independent Authority of Fiscal Responsibility.

Box 3.1: The role of IFIs in the operation of the Recovery and Resilience Facility

The Recovery and Resilience Facility (RRF) is the flagship scheme of the Next Generation EU initiative and entered into force in February 2021. ([1]) The large majority of Member States had already submitted their recovery and resilience plans (RRPs) by summer 2021, and the remaining ones by mid-2022. The RRF Regulation obliges Member States to conduct stakeholder consultations and provide in their RRPs a summary of the discussions. One RRF Regulation recital ([2]) indicates an optional involvement of national IFIs in the RRF process. This box maps and reviews the role of national IFIs in this domain, chiefly on the basis of a dedicated survey conducted by the Secretariat of the EFB. ([3])

Graph 1 shows that the involvement of IFIs was very limited. In particular, none of them were formally mandated to undertake an independent scrutiny of the government's cost estimates. Less than a fifth were involved in some official manner in the preparatory works, and most of those assignments concerned the macroeconomic aspects of the draft RRPs. Concretely, the Estonian Fiscal Council, the Greek Hellenic Fiscal Council, and the Latvian Fiscal Discipline Council were asked to provide plausibility assessments on the macroeconomic impacts of planned reforms and investments as estimated by the government. The Slovenian Institute of Macroeconomic Analysis and Development was tasked to provide simulations on the effects of the planned investment projects, as part of the national RRP. Finally, the Belgian Federal Planning Bureau received the most extensive mandate. First, it was charged to provide an assessment on both the macroeconomic and fiscal impacts of the draft programme ([4]), and for the implementation phase, it was tasked to oversee the verification of the application of the 'Do No Significant Harm' principle. ([5]) It is of note that the Dutch IFIs could not provide an answer in the survey as their national plan was only submitted in early July 2022; the Netherlands Bureau for Economic Policy Analysis (CPB) was officially charged to provide a macroeconomic and fiscal impact assessment on the RRP. ([6])

Graph 1: **Groups of IFIs according to their involvement in preparing the Recovery and Resilience Plans (number of IFIs)**



Source: *Survey of the EFB Secretariat*

Nonetheless, even without formal involvement, most of the EU IFIs expressed their views on the expected budgetary impact of at least the most significant RRP components, either via dedicated assessments ([7]) or more typically in their regular reports on draft budgets or draft medium-term fiscal plans. Moreover, albeit EU IFIs were not officially asked to monitor the implementation of the RRPs or to produce an *ex post* assessment, more than one

([1]) Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility – OJ L57, 18.02.2021.
([2]) Ibid. recital 59: 'Member States should be encouraged to seek the opinion of their national productivity boards and independent fiscal institutions on their recovery and resilience plans, including possible validation of elements of their recovery and resilience plan.'
([3]) See information on the survey at the beginning of Section 3.1.
([4]) See the Belgian IFI's study 'Macroeconomic and fiscal effects of the draft National Recovery and Resilience Plan' of April 2021.
([5]) The RRF Regulation provides that no measure (i.e. no reform and no investment) included in a national Recovery and Resilience Plan should lead to significant harm to the environment. Member States are asked to provide a substantive explanation and justification of their reasoning.
([6]) The results are reported in the Dutch RRP, and the analysis was released separately at the website of the CPB.
([7]) For instance, following the submission of the Italian RRP, the Parliamentary Budget Office published an own initiative flash report on the budgetary impacts of the plan.

(Continued on the next page)

Box (continued)

third reported their intention in our survey to publish an own-initiative RRF-related analysis. Responding to an earlier survey of the Network of EU IFIs, IFIs in some one-third of Member States have expressed reservations about the plausibility of the assumptions underlying the RRPs, raised question marks around the implementation strategies and pointed to a general lack of information about the envisaged structural reforms. ([8])

Finally, according to the European Commission's overview report ([9]) on the implementation of the RRF, relatively few national plans contain fiscal governance reform measures. Of note, the French RRP included some remarkable legislative changes to the national IFI, the High Council of Public Finances: (i) revamped the appointment procedure of High Council members, also by introducing gender balance requirements; (ii) extended its mandate to cover *ex post* evaluations of the government's macroeconomic and fiscal forecasts (these reforms have already been adopted in December 2021).

([8]) Network of EU IFIs, 2021: European Fiscal Monitor, June.
([9]) Report from the Commission to the European Parliament and the Council on the implementation of the Recovery and Resilience Facility, COM(2022) 75 final.

3.1.3. Evolution of the quality of macroeconomic forecasting

Since the introduction of the two-pack requirement for independent macroeconomic forecasts underpinning fiscal planning in the euro area, there have been several episodes when IFIs expressed reservations, even in strong terms, as part of their endorsement decisions. However, there were only few publicly known cases when following an IFI intervention, the authorities adjusted their official forecasts in the preparatory phase, i.e. before the formal IFI decision, and even fewer non-endorsement decisions (concretely, two such cases occurred in Italy). Nonetheless, these episodes of explicit revisions may not fully capture the impact of this requirement, as governments could have internalised the independent scrutiny by producing more prudent initial estimates.

In terms of empirical evidence, the relevant studies during the 1990s and 2000s generally found an optimistic bias in official economic growth projections: for example, Jonung and Larch (2006) identified it for large EU Member States, while Frankel (2011) did so for a larger panel of 33 mostly advanced economies. A more recent study by Cronin and McQuinn (2021) covering the 2013-2018 period and based on a panel of 23 Member States found a pessimistic bias for the current year and year-ahead real GDP growth forecast. In fact, previous studies (e.g. Annett, 2006) found that Member States tend to be more optimistic in good economic times, while forecasting more cautiously in bad times. The slow and protracted recovery after the depths of the global financial crisis may therefore have played a role in mitigating the optimistic bias of the previous period. Another possible explanation for the waning optimistic bias in macroeconomic projections could be the emergence of IFIs in virtually all EU countries in 2012-13, in line with the finding of Beetsma et al. (2019) that presence of an IFI is associated with more accurate and possibly less optimistic forecasts. Based on a uniquely large dataset, the results in Beetsma et al. (2022b) confirmed for EU countries that the main explanatory factor behind missed budgetary targets had been forecast errors for GDP growth, calling for delegating the preparation of macroeconomic projections to adequately equipped national independent fiscal institutions.

In order to shed some new empirical light on this issue, this subsection presents some statistical calculations attempting to capture the possible impact of the implementation of the above-explained two-pack provision by IFIs on the prudence of official forecasts. This is done through the aggregation of the sign and size of the year-ahead forecast errors in line with related empirical literature. The year-ahead real growth projection plays a prominent role in fiscal policy debates, and it is very much at the focus when IFIs endorse the plausibility of government macroeconomic forecasts, an approach confirmed by respondents to the EFB secretariat survey. The mean forecast error (MFE) captures the extent of forecasting bias in official projections over a given time period. In the most commonly used setting, the forecast is deducted from the outcome: in this case, a negative forecast error shows an optimistic bias, while a positive forecast error signals a conservative bias. In turn, the absolute error measures the absolute deviation of real GDP growth rates from its

predicted value, thus the mean absolute error assesses forecasting accuracy.

The dataset is compiled using Member States' stability and convergence programmes (SCPs) generally available for years 1998-2019, and the draft budgetary plans (DBPs) for euro area countries, available for the 2013-2019 period. [65] Specifically, for year t, the forecast is taken from SCP/DBP in t-1, while the outturn comes from SCP/DBP in t+1. Calculating the so-called first-release forecast errors by choosing the official programmes in the proximity of year t as the data source also for the outcomes is done not only for the sake of consistency. It is also to avoid the distorting impact of potentially large methodological changes in national accounts that took place during the overall time period under review.

Over the entire period 1999-2019, the 1-year-ahead growth forecasts exhibit an optimistic bias, while the absolute errors indicate lacklustre performance on accuracy (see Table 3.3). Breaking the errors down to the euro area and non-euro area shows similar results. However, the reported large standard deviations point to much variance in the observed data.

Table 3.3: **Forecast errors in the EU 1999-2019 (unweighted averages)**

Country groups	Mean forecast error, MFE (standard deviation)	Mean absolute error, MAE (standard deviation)
EU-28	-0.46 (0.49)	1.61 (0.66)
Euro area	-0.44 (0.56)	1.65 (0.67)
Non euro area	-0.50 (0.29)	1.48 (0.39)

(1) Forecast errors were calculated by subtracting the forecast from the outturn, thus a negative (positive) error indicates an optimistic (conservative) bias. (2) In the samples, the number of observations per Member State ranges from 5 to 21, depending on when a country joined the EU and subsequently submitted its first stability or convergence programmes. The EU sample covers 28 countries (including the UK), the euro-area sample covers the current 19 euro-area countries, while the non-euro area includes the remaining 9 countries.
Source: Own calculations on the basis of successive vintages of stability and convergence programmes

The mean forecast errors are very much influenced by the Global Financial Crisis and the concomitant double-dip recession in the EU. In fact, the four largest cumulative annual mean forecast errors were registered in the six years over 2008-2013. Consequently, a case could be made to perform the calculations without these years which alone could change even the sign of the aggregated mean forecast error for various subgroups of countries.

Attempting to gauge the impact of the two-pack provisions on macroeconomic forecasts for euro-area Member States, two distinct groups could usefully be formed as explained and enumerated in the previous subsection: independent producers (5 Member States, where the macroeconomic forecasts have been supplied by an independent body for the entire period) and independent endorsers (13 Member States, where the Ministry of Finance has prepared the forecasts for the entire period). Starting the second period from 2014 is also motivated by the fact that this was the first budget year for which the two-pack provision on independent macroeconomic forecasts had been in place. From a comparative point of view, Finland should be excluded as it is the only euro area country where during the period under review the institutional responsibility for preparing the forecast was changed (see Subsection 3.1.1. for details).

Table 3.4: **Forecast errors for independent producers and endorsers**

Country groups	Mean forecast error (MFE)	Mean absolute error (MAE)
p.m. All euro area 1999-2019	-0.44	1.65
Independent producers 1999-2019	-0.30	1.41
Independent producers 1999-2007	0.32	1.23
Independent producers 2014-2019	0.14	0.89
Independent endorsers 1999-2019	-0.49	1.75
Independent endorsers 1999-2007	0.75	0.94
Independent endorsers 2014-2019	0.24	0.77

(1) Forecast errors were calculated by subtracting the forecast from the outturn, thus a negative (positive) error indicates an optimistic (conservative) bias. (2) Independent producers: Belgium, Luxembourg, the Netherlands, Austria and Slovenia; independent endorsers: Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Latvia, Lithuania, Malta, Portugal, and Slovakia.
Source: Own calculations based on successive vintages of stability and convergence programmes.

A comparison of the two groups' forecast errors for the entire period (1999-2019), as shown in Table 3.4, is in line with the findings of the relevant economic literature as discussed above: the group of independent producers is characterised by slightly less biased and more accurate macroeconomic forecasts than the independent endorsers. At the same time, for certain sub-periods, these relationships do not hold: most

[65] It should be recalled that the timing of SCP preparations changed after 2009 as the submission date was moved forward from December to April. This shift, other things being equal, would have implied a worsened accuracy as the year-ahead GDP forecasts have to be prepared 6 months earlier, based on a more provisional set of information. The related informational disadvantage could be of a non-negligible magnitude. For example, analysing the Commission's own forecasting track-record in 1969-2011, Cabanillas and Terzi (2012) show that for the EU-average real growth in a given year the improvement in the spring forecast compared with the autumn forecast in the previous year (representing roughly 6 months difference between the respective cut-off dates) is close to 0.4 in terms of the mean forecast error, and almost 0.5 in terms of the mean absolute error.

notably, in 1999-2007, the ministries of finance in the endorsing country group turned out to be more conservative and outperformed the producers in terms of accuracy. This is even more puzzling in view of the fact that, during the period in question, there were no IFIs in these countries, and certainly no independent institutional scrutiny was carried out on government macroeconomic scenarios. However, this is largely resulting from the contribution of those euro-area Member States that acceded to the EU in 2004 (i.e. Estonia, Cyprus, Latvia, Lithuania, Malta, and Slovakia), and have only three data points from this period (i.e. 2005-2007) in the dataset. Specifically, some of these countries, in particular the Baltics, enjoyed a particularly strong credit-fuelled and arguably unsustainable economic boom during these years, which led to repeated and significant underestimations of real GDP growth. Removing these Member States from the sample would have the additional advantage that all statistical variables could then be calculated from a balanced panel, i.e. based on the same number of observations. Greece could also be taken out from the sample on account of being under an economic adjustment programme, followed by enhanced surveillance for the entire post-reform period, which certainly exercised a more effective constraint on the official macroeconomic scenario than the endorsement competence of its IFI.

With the above adjustments in the sample, two groups are formed from the remaining 11 euro area countries: independent producers (5 Member States, same as above); and independent endorsers (6 Member States): Germany, Ireland, France, Spain, Italy, and Portugal. For these two groups, the 'before reform' and 'after reform' forecasting performances are compared in Table 3.5.

Table 3.5: **Comparing the two periods for independent producers and endorsers**

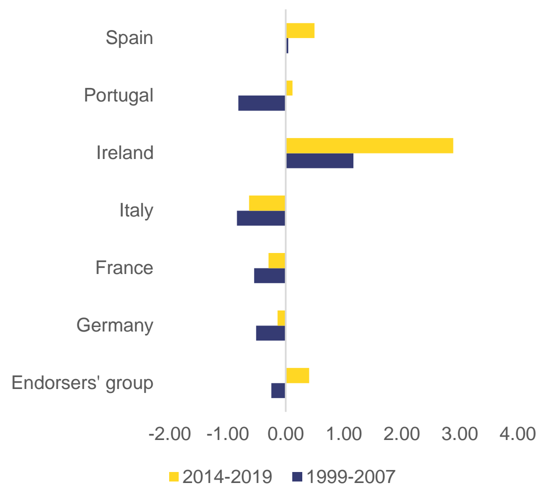
	'Before reform' (1999-2007)		'After reform' (2014-2019)	
Country groups	*Producers*	*Endorsers*	*Producers*	*Endorsers*
Mean forecast error, MFE (standard deviation)	*+0.32 (0.69)*	*-0.25 (0.90)*	*+0.14 (0.64)*	*+0.40 (1.16)*
Mean absolute error, MAE (standard deviation)	*1.23 (0.56)*	*0.93 (0.32)*	*0.89 (0.48)*	*0.54 (0.26)*

(1) Forecast errors were calculated by subtracting the forecast from the outturn for each concerned year, thus a negative (positive) error indicates an optimistic (conservative) bias. (2) Independent producers: Austria, Belgium, Luxemburg, the Netherlands and Slovenia; adjusted set of independent endorsers: Cyprus, Estonia, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Malta, Portugal, Slovakia, and Spain.
Source: Own calculations based on successive vintages of stability and convergence programmes.

The MFE showed a slight conservative bias in both periods for independent producer countries (and the recorded reduction for the second period is statistically not significant ([66])). At the same time, a small optimistic bias was found in the first period (1999-2007) for the endorsing group, as demonstrated by the negative MFE (-0.25), which turned towards a conservative stance (+0.40) in the later period for which IFIs have received endorsement responsibilities. This change is statistically significant at the commonly used 95% confidence level. It is worth highlighting that the improvement was broad-based: all six countries in question have moved towards more prudency, albeit to varying degrees and MFEs remained negative in a few of them, with Portugal posting the most remarkable turnaround (from -0.82 to +0.11, see Graph 3.3 for more details). This being said, without the Irish figures linked to the admittedly quite irregular Irish GDP trajectory, the group's MFE would still have improved, but would not have reversed its sign. Based on absolute forecast errors, accuracy improved to a similar degree for both producers and endorsers.

([66]) Statistical significance was checked with paired two-tailed t-tests. However, given the relatively small sample sizes in both country groups, the results should be interpreted with caution.

Graph 3.3: **Country-specific comparisons for the endorsing group: evolution of MFEs in the two periods**



(1) Negative numbers indicate an optimistic bias.
Source: Own calculations based on successive vintages of stability and convergence programmes.

Overall, it can be concluded that while the EU provisions could not be associated with meaningful changes in the performance of independent forecaster countries, countries with a functioning endorsing IFI seem to have opted for a more conservative forecasting approach since 2013.

The above calculations could be cross-checked with the incorporation of the DBP dataset for the 2014-2019 period, when similar first-release errors are calculated. Under this exercise, the 1-year-ahead forecasts taken into account in the computations are prepared six months later. The DBP-based analysis basically confirms the association established on the basis of SCPs, with an even more spectacular and statistically significant reversal to a (large) conservative bias in the case of endorser countries (the MFE goes from -0.25 to +1.08). Interestingly, the accuracy of forecasts as measured by the MAE worsened for endorsers, in contrast to SCP-based calculations. However, it is important to recall the caveats to the presented calculations linked mainly to the small sample size and the relatively short time period since the introduction of the requirement to rely on independently produced or endorsed macroeconomic forecasts in the euro area. Moreover, other developments could also have contributed to the observed patterns, such as the slow European recovery in the aftermath of the global financial crisis, as the tendency for more cautious forecasting in bad economic times is regularly cited in the literature.

3.2. INDEPENDENT FISCAL INSTITUTIONS IN GREECE AND PORTUGAL

Case studies are one of the standard ways to assess the impact of fiscal councils on budgetary decisions and outcomes. By looking at the experiences with the set-up and operation of individual institutions in the EU, it is possible to identify examples of good practices. These portraits also illustrate the wide spectrum of IFIs, as administrative regimes, task allocations and resources differ greatly. The IFIs in Greece and Portugal exemplify this diversity, while also sharing some common traits (most notably, genesis in the context of an EU-IMF financial assistance programme, and co-existence with a parliamentary budget office).

3.2.1. Greece

As is common in most Member States, Greece chose to put a single IFI, the Hellenic Fiscal Council (HFC), in charge of the EU-mandated tasks. (67) The HFC was established as a stand-alone public entity by the organic budget law in mid-2014, which was part of the EU-IMF financial assistance programme's policy conditionality. (68) Its first leadership was appointed in late 2015 and it became operational in the second half of 2016. (69) HFC's independence is safeguarded in several legal ways. Pursuant to the organic budget law, the HFC enjoys operational autonomy and financial independence. It is not subject to control by government bodies or any other administrative authority. Its leadership must not receive instructions from any public or private body. Moreover, the organic budget law obliges all public authorities and public law entities to provide the HFC with any information required.

Setting up an independent fiscal institution in Greece had featured prominently in the crisis management programme from its early stages in

(67) For a description of the requirements for an IFI mandate stemming from supranational legislation in the EU, see Jankovics and Sherwood (2017).

(68) Officially called as Law No 4270 on Fiscal Management and Supervision Principles, which defines the principles and procedures for public financial management in Greece. In Greek legal parlance, the term 'organic' indicates a law that the Constitution stipulates as necessary to be adopted rather than a law of higher hierarchical status/requiring higher quorum than other legislation.

(69) The first call of interest started in August 2014 was not completed before the January 2015 snap parliamentary election, hence it had to be relaunched subsequently. According to Triantopoulos and Chymis (2017), the close to 18 months delay between the adoption of the law and the appointment of the first leadership could be linked to the lacklustre political support from the parliamentary parties.

2010. (70) The recurrent high general government deficits and the exploding debt ratio had been partly attributed to the weak fiscal framework characterised by shortcomings at all stages of budgetary policy-making, i.e. planning, approval and execution (Kaplanoglou – Rapanos (2011)). In addition, the existence of many extra-budgetary funds and the fragmentation of the budget into multiple accounts and lines were not conducive to transparency. In 2010, a comprehensive fiscal responsibility law revamped the domestic fiscal governance system with the aim to support the fiscal consolidation strategy included in the first memorandum of understanding with international creditors. (71) It also established the Parliamentary Budget Office (PBO), embedded administratively in the Parliament's permanent secretariat which provides for the financing of around 10 staff members. The PBO was mandated to offer independent advice and expert scrutiny on fiscal issues, monitor the budgetary plans and execution of the general government, and assess the plausibility of the macroeconomic assumptions underlying the budget.

In 2013-2014, when the country had to transpose the IFI-related supranational legal provisions stemming from the intergovernmental Fiscal Compact and the Two-Pack Regulations, the Greek authorities, although they initially considered to align the PBO with the new requirements, eventually decided to create a new institution, the HFC. (72) Although the two bodies operate in different capacities, their activities have overlapped to a certain extent over recent years. In particular, both institutions assess compliance with ceilings and targets set in fiscal planning documents and assess the prudence of macroeconomic and fiscal forecasts. However, it is important to clarify that IFI responsibilities with possible policy consequences for the budgetary process are all assigned to the HFC. According to Moretti et al. (2019), a duplication of activities could be addressed through more clearly delineated roles whereby the PBO focuses on evaluating the government's assessments of the budgetary impact of new policy initiatives and/or providing independent policy costings.

The main decision-making body of the HFC is the Board of Directors comprising a President and four members. All Board members need to meet a set of eligibility criteria related to educational background, linguistic skills and professional experience, such as a doctoral (PhD) degree and at least 15 years of professional experience in areas related to HFC responsibilities. Based on an open competition process, an Evaluation and Selection Committee, composed of the Minister of Finance, the Bank of Greece's Governor and the President of the Hellenic Court of Audit, draws up a short list. Subsequently, the members are nominated by the Cabinet of Ministers, and are finally confirmed by a Parliamentary Special Standing Committee on Institutions and Transparency. The mandates are set for non-renewable 5-year terms. (73)

The Council's work is supported by a technical staff of a maximum of 20 people. (74) The law stipulates that the HFC is entitled to draw up its own cost-based budget, which is to be made public on its website and must respect all the principles defined in the organic budget law. Despite the potentially available funding, HFC could fill only around three quarters of its employment quota over recent years. This has chiefly been owing to the unattractive levels of salaries in the public sector, considering the specialised skills and the legally prescribed qualification requirements for HFC positions, while no wage differentiation was allowed from other public employees with mainly administrative tasks (Moretti et al. (2019)).

The HFC's mandate is centred around the core EU-mandated tasks, including most notably the endorsement of official macroeconomic forecasts and the monitoring of compliance with national

(70) Von Hagen (2013) argued that the European Commission or the IMF could not substitute a national fiscal watchdog in Greece, as they lack the capacity for detailed budget monitoring which is essential in the Greek context given the widespread transparency issues with public finances.

(71) The 2010 Fiscal Responsibility and Management Act (3871/2010). This Act, most notably, established for the first time a set of comprehensive and integrated new principles for budget preparation and medium-term fiscal planning, as well as for budgetary execution and monitoring, including enhanced reporting requirements.

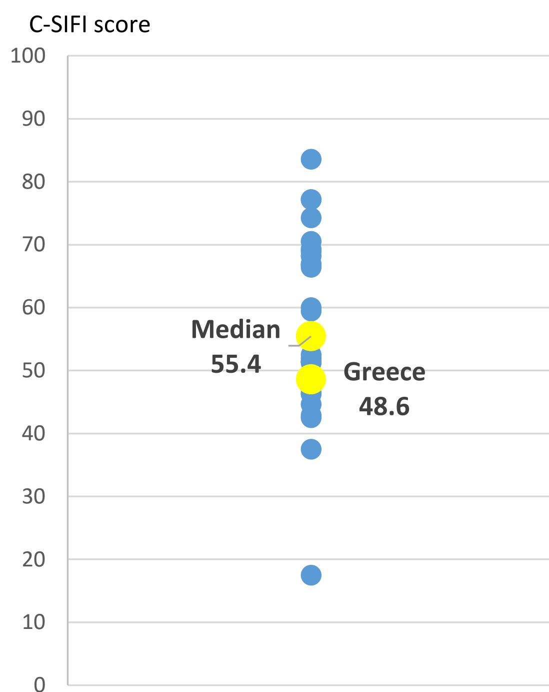
(72) One possible explanation for this choice was put forward by Kaplanoglou (2019): the PBO was perceived as bi-partisan (as its coordinator and members of the Scientific Committee had been appointed on the basis of party affiliation), and not as a non-partisan institution.

(73) In order to ensure staggered mandates, the term of office for the first President and one member was six years, it was five years for two other members, and four years for the remaining one. Following an open call for application launched in late 2021, the second President and three other Board members were appointed in March 2022 for the standard five-year term, all with a background of university professorship.

(74) Quite uniquely in the EU, the organic law also specifies the breakdown for the support staff: nine posts are reserved for special scientific staff with at least a postgraduate diploma in economics, five posts are for scientific staff with a university degree in economics, and six posts are for administrative personnel.

fiscal rules (for an overview of the main reports, see Table 3.6). In a broad European comparison, the extent of the mandate covered by the HFC is relatively narrow. It is illustrated by Greece's below median score on the European Commission's country-specific Scope Index of Fiscal Institutions (C-SIFI), which measures the breadth of the mandate of IFIs (see Graph 3.4). (75) This is largely explained by the reported absence of HFC activities in long-term sustainability assessments, active promotion of fiscal transparency and normative recommendations.

Graph 3.4: **Country-specific Scope Index for Fiscal Institutions (C-SIFI): position of Greece in 2019**



(1) The country-specific Scope Index of Fiscal Institutions (C-SIFI) shows the coverage of tasks performed by national IFIs in a Member State. The relevant scores are adjusted with a 'legal force coefficient' in order to capture the elements of the official mandates. The score ranges from 0 to 100 (full coverage).
Source: European Commission's fiscal governance database.

As explained above in Subsection 3.1.1., the EU's two-pack reform introduced the requirement for the macroeconomic forecast underlying both national medium-term fiscal plans and annual budgets in euro-area Member States to be either produced or endorsed by independent bodies. In Greece, the Ministry of Finance has continued to produce the official macroeconomic forecasts, which are assessed in a short analytical note by way of comparison with other independent national (Bank of Greece) and international institutions (European Commission, IMF, OECD). It is of note that although the HFC prepares its own macroeconomic forecasts, it appears to chiefly use them for internal reflection. They are at best broadly referenced, but the projections are not made public in HFC reports, and, in particular not shown in comparative assessments. Starting from the first endorsement decision (released for the 2017 draft budget), the above-mentioned short note highlights the main risks to the forecasts. Most notably, the officially projected growth rates of private investment were recurrently identified by the HFC as subject to downside risks. Since the outburst of the Covid-19 crisis, the endorsement opinions repeatedly underlined the exceptional uncertainty around the projected figures. Around a month after the decision, a detailed technical assessment of the macroeconomic issues is published in HFC's biannual reports (i.e. spring and autumn reports).

It is important to recall that the two-pack regulation only obliges Member States to declare whether the budgetary forecasts contained in national planning documents have been produced/endorsed or not by an independent body. Greece is one of the two countries in the euro area where the IFI formally endorses the official budgetary forecasts. (76) Endorsement of the government's budgetary forecasts is conducted subsequently following the endorsement of the macroeconomic forecasts, and placed in HFC's opinions on national planning documents (i.e. the spring national medium-term fiscal strategy and the autumn draft budget bill).

(75) An important disclaimer is that the results simply reflect the extent of the mandate, hence they should not be read as a proxy for the effectiveness of the institution.

(76) As was explained in Subsection 3.1.1., the other country is Malta.

Table 3.6: **Overview of Hellenic Fiscal Council's (HFC) key regular reports**

Type of publications	Frequency and timing	Description and comments
Trimester report	Quarterly	Discusses macroeconomic developments and monitors budgetary execution
Biannual report	Twice a year	Contains a detailed analysis on the macroeconomic and budgetary trends and outlook, including financing conditions
Annual report	Pursuant to the organic budget law, must be issued within six months from the end of last year	Presents an overview on the activities and interinstitutional relations; it must contain HFC's audited financial statements
Opinion on the government's macroeconomic forecasts	Twice a year before the Stability Programme and the Draft Budgetary Plan submitted	Contains HFC's endorsement decision on the basis of a short comparative analysis
Opinion on the annual draft budget bill	Annual, in the autumn budgetary season	Based on a brief risk assessment, contains HFC's endorsement decision on the annual budget plans
Opinion on the Medium-Term Fiscal Strategy Framework	Annual, in late spring (the national medium-term fiscal plans are consistent with the Stability Programme)	Based on a brief risk assessment, contains HFC's endorsement decision on the medium-term budget plans

(1) Most of the reports are available only in Greek; typically for the biannual reports an English language executive summary is provided.
Source: Own compilation

In line with the provisions of the Fiscal Compact, the organic budget law, inter alia, specifies a structural budget balance rule as the main domestic numerical signpost for fiscal policy and entrusts the HFC to be the independent monitoring institution of this rule, including its activation and the corresponding correction mechanism. However, until summer 2018, the binding constraint on fiscal policy had effectively been the distinct nominal budgetary targets defined by the conditionality of the EU-IMF financial assistance programme. For the subsequent period, the Greek authorities made commitments in 2018 to continue and complete all key reforms adopted under the programme, including the achievement of a nominal primary surplus of 3.5% of GDP in the years until 2022 (monitored in the enhanced surveillance process between 2018-2022 ([77])). Naturally, the HFC's watchdog role has been heavily influenced by these international agreements. Hence, monitoring reports have so far focused on the nominal targets, and largely omitted any discussion of the structural figures. Indeed, during the first years of its existence, the HFC's work has been overshadowed by international creditors, as also exemplified by the HFC's comparatively low media visibility. ([78])In March 2020, when EU institutions decided to activate the severe economic downturn clause to allow a robust policy response to the pandemic, an agreement was made to suspend the primary surplus target for Greece (European Commission, 2020b).

A relatively unique feature of the HFC's flagship biannual publications is that they regularly report on developments of overdue liabilities in the general government sector. ([79]) In addition, they report on contingent liabilities, in particular the issuance of, and calls on, state guarantees. It appears to be warranted in view of the historical experience with huge statistical revisions leading up to the 2009-2010 Greek crisis, which was partly linked to non-transparent quasi-fiscal operations. The close monitoring of these budgetary domains is a commendable practice that could usefully be adopted by other EU IFIs as well.

As the main outlet of its research activity, the HFC publishes working papers (some 2-3 per year). They typically cover the suite of models used by the HFC staff for preparing its internal macroeconomic forecasts and econometric analysis on the Greek economic and budgetary trends.

([77]) The enhanced surveillance framework (introduced by the two-pack regulation for euro area Member States with financial stability issues) facilitates support for the completion of committed reforms. Greece's adherence to the commitments are incentivised by the Eurogroup's policy-contingent debt relief measures that have been made conditional on continuous implementation of the reform agenda.

([78]) The media visibility figures compiled on IFIs as reported in European Commission (2021) show that Greece ranks among the bottom cohort of countries in the EU, and has the lowest score among those countries that have two independent entities.

([79]) E.g. outstanding tax refunds or arrears of budgetary institutions.

3.2.2. Portugal

Portugal's official IFI, i.e. the entity in charge of mandatory tasks set down in EU legislation for IFIs, is the Conselho das Finanças Públicas (CFP) or the Public Finance Council. The Council was established in 2011 (and became operational in 2012) as part of a reform package to strengthen long-term fiscal sustainability and modernise budget management. ([80]) To create a new independent body was to a large extent a home-grown policy initiative: as part of a response to the global financial crisis, the Portuguese authorities started its respective deliberations already in 2010, and a dedicated working group was set up to prepare draft legislation in early 2011 (OECD, 2019). The adoption of the resulting amendment to the Budget Framework Law ([81]) and its implementation were subsequently included in the policy conditionality of the EU-IMF financial assistance programme agreed with international creditors in May 2011 (European Commission, ECB, IMF). To set up a new, organisationally stand-alone institution instead of upgrading the already existing Parliamentary Technical Budget Support Unit (discussed below in more detail) was reportedly seen as signalling an additional commitment to fiscal discipline. ([82])

The CFP was established as an independent administrative entity. Its statutes provide for an important safeguard that Council members are to refrain from requesting or receiving any instructions from the Parliament, the government or any other public or private entity. ([83]) In terms of financial independence, the CFP prepares its own budget plan, which is reviewed by the President of the Court of Auditors and the Governor of the Bank of Portugal before it is transmitted to the Ministry of Finance for inclusion in the draft budget bill as a separate line. As documented by OECD (2019), there were only small downward adjustments (in the range of 2-4% of the originally requested amounts) from the annual funding sought by the Council to arrive at the finally approved budgetary appropriation. These relatively minor revisions indicate that the review procedure imposes an effective self-restraint on the CFP as its submitted funding requests were deemed to be broadly acceptable by the budgeting authorities. To ensure some stability for financial resources over time, the CFP statutes stipulate that its funding *'can only be reduced in duly justified exceptional circumstances'*.

As to the CFP's internal organisation, the main decision-making body is the Senior Board. It is a collegial body of five members: a President, a Vice-President, one executive member and two non-executive members. All members are appointed by the Council of Ministers following a joint proposal from the President of the Court of Auditors and the Governor of the Bank of Portugal. The term for all members is 7 years ([84]), non-renewable except for the non-executive members who are eligible for re-appointment once. The Board is supported by a secretariat with a staff of close to 20 in line with its budgetary appropriation; the related recruitment procedures are set in internal regulations. The Executive Committee is charged with the CFP's day-to-day management and comprises the President, the Executive Member of the Senior Board and the head of the secretariat.

Starting from the appointment of the first Board in 2012, the Vice-President and one non-executive member have always been foreign citizens as permitted explicitly by law. The statutes set minimum professional qualifications for membership: candidates should be individuals of acknowledged merit with experience in economics and public finances, and a high degree of independence. ([85]) All members appointed so far have had extensive experiences in public finances, with backgrounds working for the Bank of Portugal, other independent fiscal institutions, international organisations and/or in academia. The foreign members have so far been employed part-time, whereas the three Portuguese members have been full-time. Having in every CFP configuration two non-Portuguese distinguished Board members seems to have been an asset that has likely enhanced the non-partisan reputation of the published assessments and opinions. The

([80]) See European Commission (2014) for a description of the overall fiscal framework reform package.

([81]) This is the Portuguese national law defining the principles and procedures for public financial management, and in particular, the preparation and implementation of the annual budget.

([82]) See the stakeholders' interviews about the genesis of CFP as reported in Raudla and James (2022).

([83]) It was approved as an amendment to the Budgetary Framework Law in autumn 2011 (Law No. 54/2011 of 19 October). The CFP published an unofficial English translation of the statutes.

([84]) During the initial 5-year transition period between 2012 and 2017, members' terms were staggered: the first President was appointed for 7 years, the Vice-President and the executive member for 5 years, and the two non-executive members for 3 years (the mandates of the latter two were renewed in 2014).

([85]) Moreover, the statutes (Article 15) list the reasons that trigger the end of the term of office for Board members, and importantly, specify that the procedure to determine a dismissal for serious misconduct has to be agreed upon jointly by the President of the Court of Auditors and the Governor of the Bank of Portugal.

possibility to appoint foreign member(s) is currently moderately used among EU IFIs, so it could be positively considered by other countries, in particular by smaller ones that are confronted with the challenge of a limited local pool of qualified professionals.

The statutes (Article 8(1)) provide for CFP's general access '*to all the economic and financial information necessary for the accomplishment of its mission*'. They further clarify that all public entities are bound to supply the requested information in good time, and also to provide '*additional clarification in response to requests*'. Pursuant to this competence, in 2017, the CFP has become a signatory of a multi-party memorandum of understanding ('Institutional Cooperation in the field of General Government Statistics' ([86])), joining other traditional public bodies in this domain, such as the government, the Bank of Portugal, and the Court of Auditors. This memorandum lays down the institutional cooperation mechanisms among the signatories, ensuring not only CFP's access to relevant data, but also its involvement in methodological discussions concerning statistical treatment of certain operations and transactions, and in analysing the consistency of statistical results.

The broad competence for access to information was further reinforced by stipulating a naming and shaming procedure for non-compliant bodies (a comparatively rare feature in the EU) in the statutes (Article 8(5)): '*Should any public entity not fulfil the duty of providing the information in good time, this shall be stated on the Council's webpage*'. The CFP has resorted to this tool only once so far in 2017, when following repeated inquiries by various ways concerning monthly data on pensions contributions and outlays, the Ministry of Labour, Solidarity and Social Security failed to provide the necessary information. As the requested information was finally supplied, this reservation was subsequently revoked in July 2021. Establishing a public repository of IFI information requests, or alternatively listing the rejected/partially fulfilled ones, seems to be a promising avenue for ensuring the public pressure for fiscal transparency.

The original mission of the CFP as laid down in the 2011 amendment to the relevant national legislation, was already quite broad. The provisions asked the Portuguese IFI to provide an opinion on the government's objectives for its macroeconomic and fiscal scenarios, its compliance with the country's fiscal rules, and on the long-term sustainability of public finances. The CFP's statutes further define that the scope of the analysis should go beyond the central government budget, and encompass subnational governments, public-private partnerships, concessions, and even public enterprises. Subsequently, as a reflection of EU economic governance reforms between 2011-2013, the CFP's mandate was extended with tasks stemming from the transposition of supranational law. Most notably, it was designated to be the independent endorser for the government's macroeconomic scenarios underpinning the national medium-term fiscal plans and draft annual budgets. ([87])

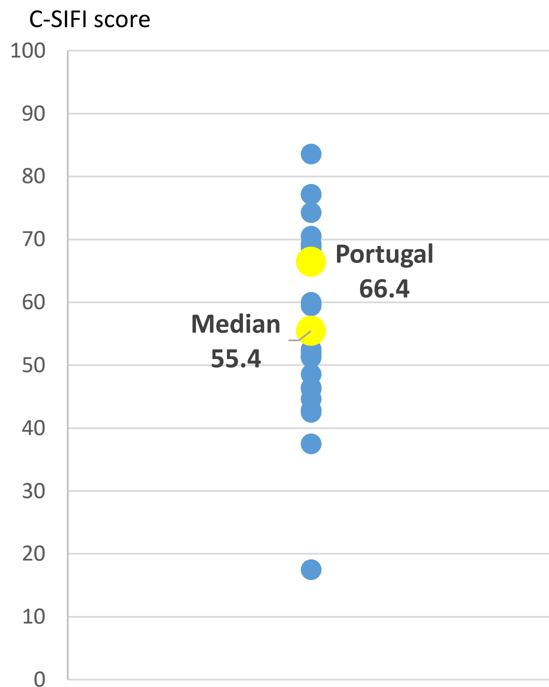
Overall, the range of tasks covered by the CFP is relatively wide in European comparison. As described in the previous subsection, the Commission's country-specific C-SIFI-index measures the breadth of the mandate of EU IFIs. On this gauge, Portugal has a relatively high ranking (at the bottom of the top third, see Graph 3.5), exceeded generally by those countries where IFIs are the producers of official macroeconomic forecasts (e.g. Luxembourg, the Netherlands, Austria) or have some more atypical responsibilities (e.g. policy costings, issuing normative policy advice). Based on the OECD's IFI independence index, following the United Kingdom, Portugal has the second most independent fiscal council in the OECD. The CFP scores consistently high in all surveyed independence dimensions. ([88])

([86]) The memorandum on statistical cooperation is available on the CFP's website.

([87]) As laid down in one component of the Two-Pack Regulations (referenced earlier).

([88]) The OECD index covers 16 variables under four main pillars (all with equal weights in the computations): (i) leadership independence; (ii) legal and financial independence; (iii) operational independence; and (iv) access to information and transparency. See von Trapp and Nicol (2018) for details.

Graph 3.5: **Country-specific Scope Index of Fiscal Institutions (C-SIFI): position of Portugal in 2019**



(1) The country-specific Scope Index of Fiscal Institutions (C-SIFI) shows the coverage of tasks performed by national IFIs in a Member State. The relevant scores are adjusted with a 'legal force coefficient' in order to capture the elements of the official mandates. The score ranges from 0 to 100 (full coverage).
Source: European Commission's fiscal governance database

The CFP's mandate, and in particular the fact that it is not attributed a policy costing role, should be seen in conjunction with the Parliament's Technical Budget Support Unit functions. The latter was created earlier in late 2006, and it chiefly provides technical works and calculations to legislators on fiscal planning documents, or on other initiatives of budgetary significance. Despite some overlap in their analytical activities, the Budget Support Unit essentially complements CFP's work, and the complementarity could be further improved if the Unit's profile would move towards an institution with clear responsibilities for policy costings.

As referenced above, the EU's 2013 two-pack reform introduced the requirement for the macroeconomic forecast underlying both national medium-term fiscal plans and annual budgets to be either produced or endorsed by independent bodies. In Portugal, the Ministry of Finance has retained the remit for producing the official macroeconomic forecasts underpinning the government's fiscal plans, which are then formally validated by the CFP. The endorsement process was first applied to the 2015 draft budget, i.e. the first budget proposal following the country's exit from the EU-IMF financial assistance programme (OECD, 2016). In terms of process, in February 2015, the CFP concluded a bilateral memorandum of understanding with the Ministry of Finance dedicated to the endorsement function that defines the scope, timetable and information to be supplied by the government for the analysis of the macroeconomic projections. [89] CFP employs its own macroeconomic projections as a numerical benchmark in the endorsement process, alongside relevant forecasts of other national and international institutions. Its verdict on the plausibility of the government's macroeconomic forecasts is communicated on its website in a concluding statement, accompanied by an opinion published simultaneously presenting the detailed technical analysis underlying the decision.

Although there has not been a precedent for a rejection so far, there were a number of episodes when the CFP expressed strong reservations about the plausibility of the official forecasts. Most notably, the two endorsements issued in the course of 2019 included quite critical remarks: regarding the spring 2019 stability programme, CFP endorsed the macroeconomic forecasts therein for the years 2019-2020, but not for the period 2021-2023. [90] Subsequently, it issued – in its own wording – a 'qualified endorsement' for the macroeconomic scenario underlying the 2020 draft budgetary plan (prepared on a no-policy-change basis linked to the national elections in October 2019). [91] In both cases, the CFP considered that the government's macroeconomic forecasts constituted neither the most likely, nor the most prudent scenario. Given the procedurally relevant affirmative endorsement decisions by CFP, and despite reservations, the government did not need to adjust its projections.

[89] The memorandum on the endorsement process is available in Portuguese in the Council's website.
[90] While the government projected sustained real GDP growth of around 2% beyond 2020, the CFP forecast a decelerating medium-term growth trajectory, reaching 1.4% in 2023. See for details: Macroeconomic forecasts underlying the 2019-2023 Stability Programme: Opinion of the Portuguese Public Finance Council.
[91] The government's 2020 growth projection of 2% was above the CFP's own 1.7% forecast, and there was an absence of comparable macroeconomic forecasts produced by other international and domestic institutions. See for details: Macroeconomic forecasts underpinning the Draft Budgetary Plan for 2020: Opinion of the Portuguese Public Finance Council.

Table 3.7: **Overview of the Portuguese Fiscal Council's key regular reports**

Type of publications	Frequency and timing	Description and comments
Economic and Fiscal Outlook	Twice a year in spring and autumn	No-policy-change baseline macro-fiscal forecasts in a 4-year horizon
Endorsement reports for the government's macroeconomic forecasts	Twice a year before the Stability Programme and the Draft Budgetary Plan submitted	A detailed technical analysis is released together with the concluding statement (labelled as an opinion on the government's macroeconomic forecast)
Analysis of the stability programme	Annual, in April-May each year	Discusses fiscal risks in a medium-term horizon and ex ante assesses the plausibility of meeting the applicable numerical rules
Analysis of the annual budget	Annual, in the autumn budgetary season	The analysis is first issued on the basis of the draft budget proposal, and subsequently on the approved budget bill as well
Various reports on budgetary execution	Half-yearly for subnational governments (covering 308 municipalities); annual for the general and regional governments, social security subsystems, and state-owned enterprises	The annual budgetary implementation report for the general government includes an ex post compliance check with fiscal rules (until 2018, it was called: Analysis of the General Government Account). The quarterly reporting on the general government sector was recently discontinued.
Analysis on fiscal sustainability	Updated in every 2-3 years	It covers the analysis of major fiscal risks and debt sustainability in a 15-year horizon.

(1) Not all reports are available in English; for the Portuguese-only documents an English language executive summary is generally provided. The data underlying the charts and tables in the reports are published separately.
Source: Own compilation

In accordance with the Fiscal Compact ([92]), CFP is the independent monitoring institution for the country's structural balanced budget rule, formulated in consistency with the SGP. In particular, it is mandated to provide an opinion on the need to activate the national correction mechanism (both for its own-initiative reports and for the government's *ex post* reports on rule compliance), the suitability of the fiscal corrective plan aimed at returning to a balanced position, and the existence of exceptional circumstances to suspend the rule. However, none of these assessments legally bind the government, although the actions by the Portuguese authorities are subject to the comply-or-explain principle. ([93]) As for many other contracting parties of the Fiscal Compact ([94]), the automaticity of the national corrective mechanism is linked to an EU Council decision (i.e. early warning recommendation under Article 6(2) of Regulation 1466/97 ([95])), while the national IFI could only issue non-binding opinions on this matter. ([96])

CFP regularly releases fiscal monitoring reports on the various subsectors of the general government (for an overview of the main publications, see Table 3.7). Most notably, since 2018, the CFP publishes twice a year an analysis of the subnational sector's budgetary execution, which also includes a detailed assessment at municipality level with regards to the arrears of local governments and their compliance with a legal debt limit. Moreover, in spring 2022, separate annual reporting on state-owned enterprises was launched.

Turning to forward-looking analytical products, in 2018, in line with its mandate, CFP released a new major publication with a medium- to long term horizon, entitled: 'Fiscal Risks and Public Finance Sustainability' (scheduled to be updated every 2-3 years, the second edition was published in late 2021). The report catalogues the main risks to

([92]) The Fiscal Compact is Title III of the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed in March 2012. It requires euro-area countries to introduce in the national legislation a balanced budget rule in structural terms with pre-defined characteristics. Three non-euro-area countries, Bulgaria, Denmark and Romania, are also bound by the same requirements on a voluntary basis.

([93]) For some of the mentioned cases, the comply-or-explain requirement is not laid down explicitly in the national law, but based on a public commitment undertaken by the national authorities. For details, see the Commission's 2017 report on the Portuguese transposition arrangements.

([94]) See the related analysis in EFB (2021b).

([95]) COUNCIL REGULATION (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies - OJ L 209, 2.8.1997, p. 1.

([96]) Specifically, if such an early warning is adopted by the Council of the EU, the activated correction mechanism obliges the government to present to Parliament within 30 days a corrective plan with adjustment measures aimed at restoring the targets from the balanced budget rule in a maximum of two years.

public finances in the following five dimensions: (i) macroeconomic trajectory; (ii) public revenues; (iii) age-related public expenditures (pensions, health-care); (iv) contingent liabilities; and (v) public debt. The second edition also considered climate change-related risks.

In terms of research activities, the CFP publishes a series of working papers and occasional papers authored by the staff of its secretariat and Board members. The topics covered so far are quite diverse; these include modelling and forecasting methods, growth determinants, public finance management, local and regional finances, and fiscal indicators.

Portuguese legislation provides for national fiscal rules to be suspended automatically as a function of the SGP clause on exceptional circumstances. [97] Consequently, the activation of the SGP's severe economic downturn clause, which is formally one case of exceptional circumstance, 'switched off' the numerical constraints imposed by the domestic rules for Portugal between 2020 and 2022. The CFP supported the fiscal stimulus initiated by the government, which was comparatively restrained in comparison with the EU, in view of the pandemic-induced sharp recession. Nevertheless, it expressed some concerns related to specific aspects of the adopted crisis-relief policies. Most notably, it regretted the lack of transparent and detailed information about the costs of COVID-19-related measures. More recently, it underlined the need to provide clarity about the government's medium-term fiscal strategy to guide the return to a sounder fiscal position. Finally, the CFP pointed to the historically weak degree of implementation for investment projects financed from EU funds (55% over the 2015-2020 period). [98] It pointed to an urgent need to increase the absorption capacity of the country to implement a 'critical mass' of the planned public investments included in the national recovery and resilience plan.

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[97] Exceptional circumstances cover both unusual events and severe economic downturns.

[98] See General government budget outturn in 2020.

4. ASSESSMENT OF THE FISCAL STANCE IN 2021

Highlights

- In spring 2020, the Commission issued only qualitative fiscal guidance for 2021, encouraging Member States to take necessary measures to contain the pandemic and support the recovery.

- The Commission justified the qualitative approach with the uncertainty around the economic outlook while asking Member States to achieve prudent medium-term fiscal positions. Due to its very general and qualitative nature, the Commission's guidance was bound to be appropriate.

- The EFB cautioned against a rapid reversal of the fiscal support put in place in 2020 and encouraged Member States to focus on growth-enhancing government expenditure, while some emergency discretionary measures should be extended in a targeted manner.

- Following a new surge in Covid-19 infections in the autumn of 2020, the Commission reiterated its guidance for 2021 of a supportive fiscal policy. It qualified its advice by recommending measures to be timely, temporary and targeted.

- Looking back, in 2021 the structural primary deficit of the euro area worsened by close to 1/3 of a percent of GDP, indicating an expansionary fiscal impulse. The RRF grants had an additional expansionary impact on aggregate demand of close to 1/3 percent of GDP. The fiscal stance therefore remained highly supportive.

- The Commission estimates that the output gap shrank rapidly in 2021 by nearly 2/3 of its 2020 value of close to 6% of potential GDP. Moreover, the euro area as a whole was approaching its pre-pandemic level of annual real GDP by the end of 2021.

- Against this background and with the benefit of hindsight, the euro-area fiscal impulse in 2021 has been on the high side. The expansionary fiscal impulse has contributed to inflationary pressures and aggravated supply bottlenecks.

- The depth of the downturn varied significantly across Member States, largely due to the varied intensity of lockdowns and the structure of the economy. At the end of 2021, 11 out of 19 euro-area countries had surpassed their pre-pandemic levels of annual real GDP.

- Countries that were more affected by the crisis provided more extensive fiscal support in 2020 and 2021. Unfortunately, high debt countries were among those most severely affected, which causes tensions from a sustainability perspective. As the euro area economies recover, the balance has to shift again more toward a fiscal sustainability perspective.

- In autumn 2020, the Commission introduced a modified metric of the fiscal stance, which excludes crisis-related emergency measures taken during the pandemic. The decision was motivated on the debatable ground that the emergency measures have a limited impact on aggregate demand.

- The EFB favours the conventional metric, which encompasses all expenditure and revenue items, including emergency measures (see EFB 2021a). In the end, the difference between two metrics turned out to be limited for the fiscal impulse since crisis-related emergency measures were extended well into 2021. However, it had an impact on the estimate of the level of fiscal support.

This chapter provides a backward-looking assessment of the euro-area fiscal stance in 2021. The first section summarises and compares the guidance issued by the Commission, the Council and the EFB in 2020 based on information available at the time. The second section uses the latest information to discuss whether the observed fiscal stance was in line with the guidance and whether it was appropriate.

The EFB's assessment of the fiscal stance considers the need for fiscal stabilisation subject to sustainability constraints on public finances. A clear distinction has to be made between the fiscal stance and the fiscal impulse (see EFB, 2021). The discretionary fiscal stance is defined as the structural primary balance in a given year, which approximates the overall level of fiscal support provided by governments on top of automatic stabilisers. The annual change in the fiscal stance is referred to as the fiscal impulse; the fiscal impulse can also be measured by the expenditure benchmark. The difference between the fiscal stance and the fiscal impulse is particularly important for clear messaging when the level of economic activity undergoes significant swings, i.e. during major economic downturns and subsequent rebounds. For instance, a neutral fiscal impulse might still secure a highly supportive fiscal environment, as a large part of the fiscal support introduced in the previous year is carried over. (99) Notably, the fiscal impulse is only an approximation of the impact of discretionary fiscal policy on aggregate demand due to a number of uncertainties affecting its measurement (see Glossary). In the following, the fiscal stance and fiscal impulse are analysed in the context of the extent and dynamics of the cyclical conditions.

4.1. GUIDANCE ISSUED IN 2020

EU policy guidance for 2021 issued in 2020, was marked by very special circumstances. It was published after the Covid-19 pandemic hit Europe and against the backdrop of an uncertain outlook characterised by successive waves of infections and countermeasures. To contain the pandemic and dampen the socio-economic effects on the population, governments engaged in a massive discretionary fiscal expansion. Most crises-related fiscal measures were initially planned to expire in 2020 but a surge in infections in the autumn of 2020 led to an adjustment of job-retention schemes, the extension of other support measures, and the introduction of new measures.

In spring 2020, the Commission forecast economic growth to rebound by 6% in 2021, after the record contraction of 7.5% in 2020. The growth perspective for 2021 hinged on the assumption of the effectiveness of the large-scale fiscal measures in containing the negative economic effects, the easing of confinement measures as of summer 2020, and a receding pandemic impact for the following year. The strong rebound factored in withdrawal of fiscal support in 2021. As most pandemic-related emergency measures were projected to expire by 2021, the budget deficit was forecast to decrease by nearly 5 percentage points of GDP and the structural primary deficit to shrink by close to 2% of GDP. All Member States were expected to reduce their deficit by at least 2.7 percentage points and up to 5.8 percentage points. The structural primary balance was also expected to improve across the board and settled for most countries between -1% and 1% of GDP, though some countries fell outside this range. (100)

The Commission only issued recommendations for qualitative fiscal guidance in its spring surveillance package. (101) It motivated the decision by the high uncertainty around the economic outlook. Moreover, the fiscal recommendations were not differentiated across countries. All Member States were encouraged to take necessary measures to address the pandemic and support the recovery. The Commission assessed that continued fiscal support was needed to safeguard the projected recovery, while calling upon Member States to aim for prudent medium-term fiscal positions once the economic conditions allowed for it (see Box 4.1). However, in contrast to normal practice, the Commission was not in a position to assess the medium-term prospects of public finances, as several Member States did not follow the usual reporting requirements in their stability and convergence programmes (see Chapter 2).

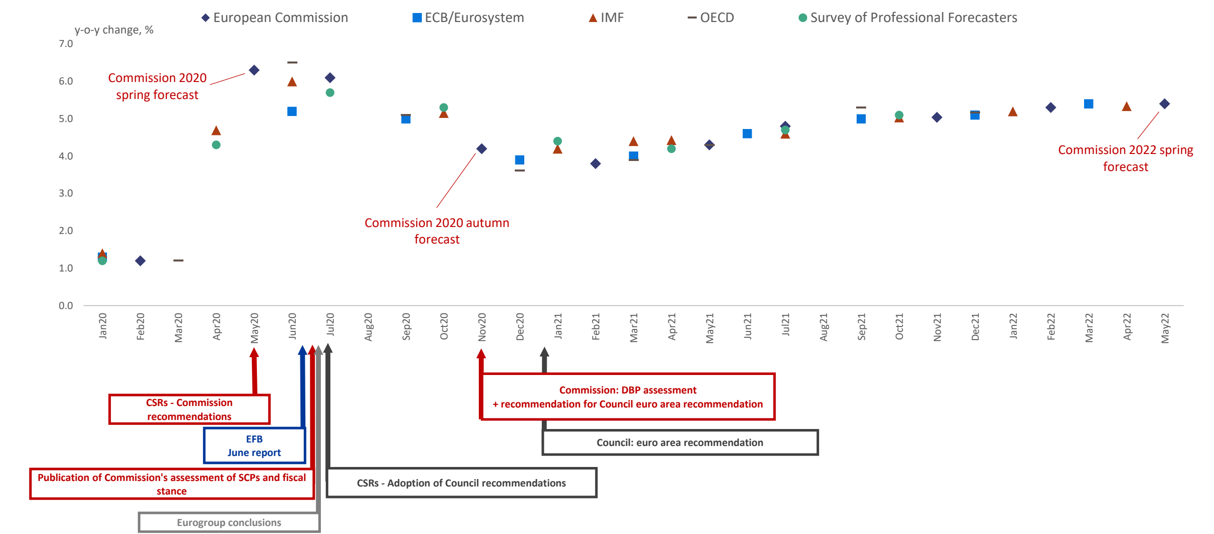
Echoing the Commission recommendations, in July 2020, the EFB cautioned against a premature withdrawal of fiscal support and encouraged Member States to focus on growth-enhancing

(99) For a more detailed discussion, see the EFB's report on the assessment of the euro-area fiscal stance (EFB, 2021a), Box 1.

(100) Greece and Portugal were expected to achieve a structural primary surplus above 2% of GDP in 2021 while Spain, Latvia and Slovakia were projected to still face a structural primary deficit of more than 3% of GDP.

(101) See European Commission (2020c).

Graph 4.1: **Real GDP growth projections for the euro area in 2021**



(1) The ECB/Eurosystem and the OECD both report working-day adjusted growth rates, while the Commission and the IMF report unadjusted numbers.
Source: European Commission, ECB, IMF, OECD.

government expenditure, including investment, to provide stabilisation in the short term while bolstering growth potential. Specifically, for 2021, the EFB recommended providing further fiscal support to face the slower than expected in spring 2020 easing of lockdown measures and continued uncertainty on the epidemiological developments. Moreover, the EFB expected only a partial recovery for 2021 and therefore suggested the extension of some discretionary fiscal support measures in a targeted manner in order to avoid a rapid reversal in the fiscal impulse.

In its assessment of the stability and convergence programmes conducted in July 2020, the Commission noted that the euro-area fiscal impulse was expected, in 2021, to turn contractionary by around 2¼ percentage points of potential GDP due to the expected withdrawal of crisis-related emergency measures. This estimate was based on a no-policy-change assumption and did not yet include a possible positive fiscal impulse stemming from the Next Generation EU initiative.

Prospects of a withdrawal of fiscal support faded in autumn 2020 when Covid-19 infections surged once more, triggering an extension of existing budgetary measures and the introduction of new ones. In its November 2020 recommendation on the euro area, the Commission reiterated the need for fiscal policy to remain supportive in 2021 to effectively address the pandemic, sustain the economy, and support the recovery. Fiscal measures were meant to be timely, temporary and targeted. When the epidemiological and economic conditions sufficiently improved, the measures were to be gradually removed. The Commission also noted the need to achieve prudent medium-term fiscal positions and ensure debt sustainability, while enhancing government investment.

In its Communication on the 2021 Draft Budgetary Plans, published on 18 November 2020, the Commission started to express the fiscal impulse differently from past practice. The focus shifted to a measure of the fiscal impulse that excluded so-called crises-related temporary emergency measures while including the expansionary impact of the RRF grants on aggregate demand. ([102]) This meant that most (4/5) of the fiscal support provided in 2020 would not be included, leaving only 0.8% of GDP of non-crisis-related fiscal measures. Through this lens, the Commission expected a positive fiscal impulse of 1.4% of GDP in 2021, while the conventional approach would have pointed to a negative fiscal impulse of 1% of GDP, more in line with the expected rebound of economic activity.

([102]) While the RRF is budget-neutral in the accounting framework, it may nonetheless have an impact on aggregate demand (see EFB, 2021a, Box 2).

Box 4.1: Guidance issued by the Council, the Commission and the EFB

- **20 May 2020: Commission Communication on country-specific recommendations accompanying the Commission's proposal on country-specific recommendations – Spring Package (excerpts):**

The Spring 2020 Economic Forecast projects that the EU economy will contract by a record 7.5% in 2020 before rebounding by 6% in 2021. […] The potential easing of confinement measures in the coming months should set the stage for a solid recovery. However, the EU economy is currently not projected to fully make up this year's losses by the end of 2021, with uncertainty and risks to the economic outlook being very high. […] Member States have reacted decisively with fiscal measures to limit the economic damage caused by the pandemic. As a result, the aggregate government fiscal deficit of the euro area […] is expected to surge from just 0.6% of GDP in 2019 to around 8½% in 2020, before falling back to around 3½% in 2021. […] The fiscal elements of the country-specific recommendations reflect the activation of the general escape clause, recommending to take all necessary measures to effectively address the pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, fiscal policies should aim at achieving prudent medium term fiscal positions and ensuring debt sustainability, while enhancing investment. […] The fiscal guidance in the spring package aims to coordinate fiscal policies in the immediate crisis phase as well as during the economic recovery phase. In order to facilitate the recovery, a supportive fiscal stance ([1]) is currently warranted in all Member States.

- **1 July 2020: the EFB's June 2020 report, which had the objective of reviewing the situation and outlook, and providing input to Member States' draft budget plans for 2021 (excerpts):**

In light of the partial and fragile recovery expected for 2021, the Board cautions against a premature withdrawal of fiscal support measures at the Member State level and looks forward to a swift and effective implementation of recent EU proposals. It advocates a strong focus on growth-enhancing government expenditure including investment, to provide stabilisation in the short-term while bolstering prospects of stronger future growth. […] For 2021, the European Fiscal Board recommends providing further fiscal support. […] Against the background of heightened uncertainty, the fiscal stance would turn very restrictive in 2021 in the absence of new measures ([2]). Reversing the fiscal stance rapidly is not advisable given the way in which the crisis is expected to evolve. The assumed withdrawal of discretionary fiscal support measures explains the swift reversal of budgetary positions in 2021. However, a larger and longer fiscal support will be needed also in 2021 […]. Even in the most benign scenario, the recovery in 2021 will only be partial. Therefore, an extension of some discretionary fiscal support measures launched in 2020 is desirable.

- **6 July 2020: the Commission's overview of the 2020 Stability and Convergence Programmes (SCPs) submitted by Member States 'The 2020 Stability and Convergence Programmes: an Overview, with an Assessment of the Euro Area Fiscal Stance' (excerpts):**

The euro area fiscal stance is forecast to turn contractionary by around 2¼ pps. of potential GDP in 2021. This forecast is based on a no-policy-change assumption and reflects the expected withdrawal of most of the crisis-related temporary measures. This aggregate stance does not yet include the possible support measures financed by grants under the Next Generation EU initiative […]. An autonomous recovery in aggregate demand is projected to reduce the very large negative output gap by some 5 pps. (from -7¼% of potential GDP in 2020 to -2½% in 2021). […] Given the high uncertainty surrounding the forecast for 2021, it is premature to assess the fiscal stance for 2021. The appropriate fiscal stance for 2021 will depend crucially on the macroeconomic outlook. […] [W]hile a supportive fiscal stance is currently warranted in all Member States in order to facilitate the recovery, fiscal sustainability in the medium term should continue to be safeguarded. In particular, it should be ensured that, when economic conditions will allow, Member States pursue fiscal policies to achieve prudent medium-term fiscal positions and ensure debt sustainability, while enhancing investment.

- **9 July 2020: Eurogroup, remarks by Mario Centeno preceding the ECOFIN Council where the 2020 country-specific recommendations were pre-approved before the formal adoption in July after the European Council's endorsement (excerpts):**

([1]) In this box the term fiscal stance follows Commission language and refers to the change in the structural primary balance. This is in contrast to the rest of the report, where it refers to the level of the structural primary balance.
([2]) The fiscal stance refers here to the change in structural primary balance. Consequently, while the fiscal stance was expected to turn restrictive, the overall level of fiscal support was expected to remain very supportive.

(Continued on the next page)

Box (continued)

While everybody focused on the COVID-19 situation, something remarkable has happened – we ended up with a fiscal policy consensus. The EFB, the Commission, the ECB and Eurogroup ministers all support timely and targeted policies to combat the pandemic and to protect the fabric of our economies and societies. This translates into a strongly supportive fiscal stance in the euro area, which complements the supportive monetary policies of the ECB. This is our focus for 2020. […] For next year, uncertainty remains very high. As ministers gear up their budget preparations for next year, there is broad consensus on supportive policies for next year as well.

- **18 November 2020: The Commission's overall assessment of the 2021 DBPs (excerpts):**

The euro area fiscal stance in both 2020 and 2021 appears supportive when adjusted for the unwinding of temporary emergency measures as planned in the Draft Budgetary Plans (+1.1% of GDP in 2020 and +1.4% of GDP in 2021). However, in light of the recent resurgence of the pandemic in Europe, the envisaged withdrawal of emergency measures in 2021 is subject to increased uncertainty. Member States are expected to extend further emergency support to provide a necessary lifeline to the economy, on top of the current budgetary plans already reflected in the Commission forecast. […] Individual fiscal stances, very accommodative in 2020, appear still supportive in almost all Member States in 2021, once corrected for the phasing out of temporary emergency measures. While emergency measures represent over one third of total measures foreseen for 2021 in the Draft Budgetary Plans, the majority of measures aim at supporting the economic recovery. Expenditure financed via grants under the Recovery and Resilience Facility can be expected to provide a significant additional fiscal impulse without having an impact on Member States' deficit and debt levels.

- **18 November 2020: Commission Recommendation for the Council Recommendation on the economic policy of the euro area (excerpts):**

As the health emergency persists, fiscal policies should remain supportive in all euro area Member States throughout 2021. […] The fiscal stance is forecast to be highly expansionary in 2020 and to remain supportive in 2021 at both euro area and national level. Coordination of national fiscal policies, in full respect of the Stability and Growth Pact, is crucial for the effective response to the COVID-19 shock and the proper functioning of the Economic and Monetary Union (EMU). […] The economic fallout from COVID-19 is having a large negative impact on public finances. When health and economic conditions allow, a refocusing of fiscal policies towards achieving prudent medium-term fiscal positions, including by phasing out support measures to firms and citizens, will contribute to ensuring fiscal sustainability in the medium term.

- **18 November 2020: Commission staff working document accompanying the Recommendation for a Council Recommendation on the economic policy of the euro area (excerpts):**

The fiscal stance is forecast to be highly expansionary in 2020 and to remain supportive in 2021 at both euro area and national level. Overall, the debt sustainability assessment of the euro area leads to the conclusion that the debt position remains sustainable over the medium-term, notwithstanding risks and significant uncertainty. […] The fiscal stance in 2021 is expected to remain supportive at both euro area and national level. Given the current high level of uncertainty, withdrawing fiscal support too early is a primary source of concern, as it could put the still-fragile recovery in jeopardy. The estimated decline in the structural primary deficit of around ½% of GDP in 2021 reflects the phasing out of temporary support measures introduced in 2020 […]. After excluding the emergency measures, the underlying fiscal stance would appear to remain supportive in 2021, also thanks to measures announced in the 2021 draft budgetary plans. In addition, the implementation of Recovery and Resilience Plans, which is only partially reflected in the Autumn 2020 Forecast, should contribute to a more supportive fiscal stance in the euro area in 2021.

- **16 December 2020: Eurogroup Statement following the Commission's adoption of the opinions on the Draft Budgetary Plans and Commission communication on its overall assessment of the DBPs (excerpts):**

In light of the second wave of the pandemic, it may be necessary […] to extend (these) [emergency fiscal] measures and additional support could be needed. […] Excluding the temporary emergency measures, which are forecast to expire next year, the underlying fiscal stance is also expected to be expansionary in 2021. […] The Eurogroup agrees that a supportive fiscal stance in the euro area for 2021 is appropriate given the output loss to date and downside risks. Fiscal policies should remain supportive in all euro area Member States throughout 2021. Member States should continue to provide timely, well-targeted and temporary fiscal support, while safeguarding fiscal sustainability in the medium term.

4.2. *EX POST* ASSESSMENT

The remainder of this chapter discusses whether, with hindsight, the fiscal stance and fiscal impulse in 2021 were appropriate given the economic circumstances.

Was the guidance on the aggregate fiscal stance appropriate?

Real economic output rebounded strongly in 2021. Forecasts made in 2020 did not expect real GDP to return to pre-crisis levels until 2022 (see Chapter 1) but due to better-than-expected growth, a return was already nearly achieved by the end of 2021. At the same time, the epidemiological situation had been extremely volatile. Against this background, governments retained many containment measures and decided to extend job-retention schemes in 2021 and contemplated new support measures.

Fiscal guidance for 2021 was marked by the special circumstances of the Covid-19 pandemic. The European Commission chose not to issue any quantitative fiscal guidance for 2021, while qualitative fiscal guidance was not differentiated across Member States. Guidance for the euro area was issued in broad terms and not pinned down to a firm and clearly delineated fiscal impulse. Instead, the Commission cautioned against a premature withdrawal of fiscal support and called for more timely, targeted and temporary fiscal support. It added that support measures should be phased out once the conditions allowed.

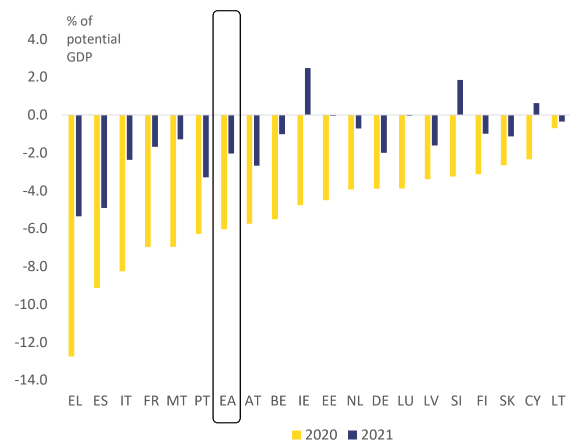
Abstracting from crisis-related measures, the Commission expected an overall highly supportive fiscal impulse, which would be further enhanced by grant-financed expenditures under the RRF. At the same time, the Commission stressed the need to achieve prudent medium-term fiscal positions.

Due to its very general and qualitative nature, guidance was bound to be appropriate. The general warning against a premature withdrawal of fiscal support was a particularly clear case in point, as withdrawals should never be untimely. Insisting on targeting sustainable public finances in the medium term was equally obvious but ultimately unverifiable, even from an *ex ante* point of view, as the Commission had suggested to reduced reporting under the stability and convergence programmes and adjusted its sustainability assessments (see Chapter 2).

Was the actual aggregate fiscal stance appropriate?

In hindsight, cyclical conditions in 2021 were straightforward. Economic slack had ratcheted up in 2020 as real economic output collapsed by close to 6%. The output gap for 2020 is currently estimated at -6% of potential GDP despite an extremely supportive fiscal environment at the time. With restrictions on economic activity being gradually lifted, economic output recovered and mechanically narrowed the output gap in 2021. On the back of a continued, strongly supportive fiscal stance, the output gap rapidly shrank by 2/3 in 2021 to -2% of potential GDP (see Graph 4.2).

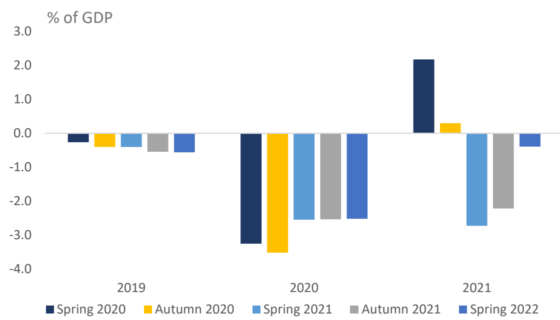
Graph 4.2: **Output gap in 2020 and 2021**



Source: European Commission

Estimates made during the course of 2021 suggested that euro-area governments undertook additional discretionary fiscal expansion in 2021 of similar or even larger size than in 2020. The Commission 2021 autumn forecast projected an expansionary fiscal impulse of close to 2.5% of GDP for 2021. However, revenues rebounded much stronger than expected in 2021 (see Chapter 1). This led to a significant downward revision of the government deficit but also to the fiscal impulse (see Graph 4.3). In the end, outturn data showed an expansionary fiscal impulse of close to 1/3% of GDP – far below what had been expected in the course of 2021. The RRF commenced its activity in earnest in 2021 and grant-financed cash disbursements augmented the impact on aggregate demand in the euro area by around 1/3 % of GDP.

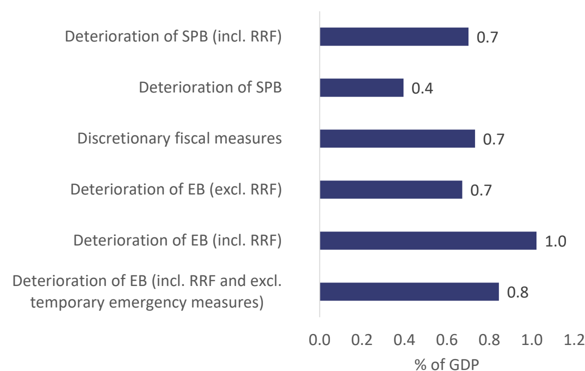
Graph 4.3: **Evolution of euro- area fiscal impulse estimates by vintage**



(1) A negative value indicates an expansionary fiscal impulse.
Source: European Commission

During the pandemic, the European Commission had started to use a modified metric of the fiscal impulse, taking into account RRF grant-financed expenditures and excluding emergency-related measures. Even before the crisis, the fiscal impulse was not only analysed as the change in the structural primary balance but also via the expenditure benchmark. The different metrics of the fiscal impulse all point in the same direction for 2021. However, as not affected by revenue windfalls, the expenditure benchmark indicates a more expansionary fiscal impulse (see Graph 4.4).

Graph 4.4: **Euro- area fiscal impulse in 2021 by different metrics**

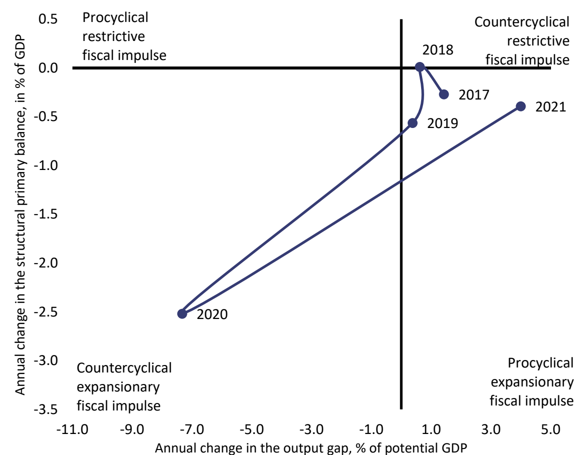


(1) SPB stands for structural primary balance; EB stands for expenditure benchmark; RRF stands for Recovery and Resilience Facility.
(2) Discretionary measures represent the incremental budgetary impact of adopted or credibly announced measures, as compared with a 'no policy-change' forecast estimated based on judgement (bottom-up approach).
(3) While the RRF is budget-neutral in the accounting framework, it may nonetheless have an impact on aggregate demand (see EFB, 2021a, Box 2).
Source: European Commission, own calculation.

Overall, and with the benefit of hindsight, the euro-area fiscal impulse in 2021 has been on the high side. The rebound of economic activity following the gradual easing of strict lockdown measures was stronger than expected, especially towards the end of the year, contributing to an upturn in inflation and increasing supply bottlenecks in the economy and labour market. [103] The rise in inflation was originally thought to be the result of a mechanical base-effect but turned out to be more persistent, even before the energy price shock linked to the war in Ukraine kicked in.

Graph 4.5 maps the aggregate fiscal impulse against the change in the output gap over time. The output gap is estimated to have shrunk swiftly in 2021, although actual output remained below its potential. The combination of the new fiscal impulse and a rapid improvement of the cycle points to a pro-cyclical fiscal expansion in 2021.

Graph 4.5: **Euro area fiscal impulse**



Source: European Commission

The conventional assessment of the fiscal impulse against the change in the output gap has to be viewed with caution at the current juncture. Firstly, the pandemic-induced economic shock may have caused scarring effects that are still unaccounted for. Such effects were constrained in the Commission's output gap estimation method at the beginning of 2020 when ad hoc adjustments had been introduced to smooth the estimate of potential GDP, i.e. by assuming the impact of the Covid-19 shock to be largely temporary. [104] Moreover, supply chain bottlenecks [105] and terms-of-trade supply shocks are likely to affect potential output, which is not captured well in the model used in EU fiscal surveillance. [106] Consequently, current estimates of the euro-area output gap may overestimate economic slack.

In 2021, the focus of policymakers still very much lay on stabilising the economy and supporting the

[103] ECB (2022).
[104] See EFB (2021b).
[105] ECB (2022).
[106] See EFB (2022).

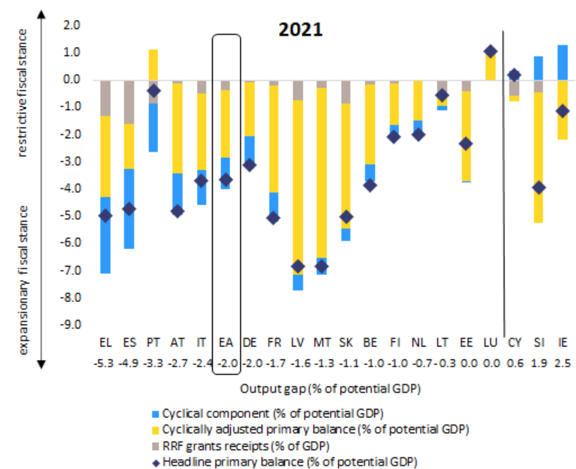
recovery. Graph 4.8 shows that a restrictive fiscal impulse of close to 1% of GDP may have sufficed to halve the output gap and would have incidentally coincided with the fiscal impulse needed from a conventional sustainability perspective (see S1 indicator in the Glossary). By contrast, the actual fiscal impulse was slightly expansionary. In normal times, narrowing the output gap by 50% may be considered a swift pace. However, the large output gap at the start of 2021 (6% of GDP), the expected mechanical recovery, and uncertainty, all triggered higher ambitions as regards stabilisation with sustainability considerations being of secondary importance.

Was the country differentiation appropriate?

The Covid-19 pandemic affected all euro-area Member States but the depth of the downturn varied significantly. Countries that by the end of 2020 had experienced the largest fall in real GDP tended to provide more extensive discretionary fiscal support during that year and further expanded fiscal support in 2021. The supportive fiscal stance contributed to a recovery that took hold across all euro-area countries in 2021, but differences in the speed of recovery still emerged. In 11 out of the 19 euro-area countries, real economic output surpassed the pre-crisis level by the end of 2021, while others still exhibited shortfalls. The distance to pre-crisis output largely depended on the initial fall in output rather than the fiscal response.

Except for Luxembourg and Portugal, all countries exhibited a supportive fiscal stance in 2021 (see Graph 4.6). In most cases, the level of discretionary fiscal support, as measured by the structural primary balance and taking into account the impact of the RRF, exceeded 2% of GDP.

Graph 4.6: **Fiscal stance across Member States in 2021**

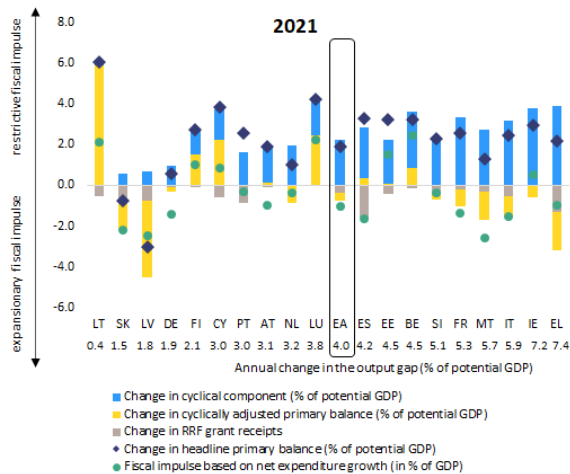


(1) RRF based on cash disbursements.
Source: European Commission

At the same time, around half of euro-area countries dialled back nationally financed discretionary fiscal support in 2021, albeit from a very high starting point. The implementation of projects financed from RRF pre-payments exerted a moderately expansionary impact on aggregate demand in some Member States, thereby offsetting part of the negative impulse generated at the national level.

The fiscal impulse can also be measured by the expenditure benchmark, which is based on a net expenditure growth principle (see Glossary). The expenditure benchmark-based fiscal impulse is expansionary in most Member States. By this metric, the fiscal impulse exceeded 1% of GDP in 9 out of the 19 countries (see Graph 4.7). The stronger fiscal expansion as measured by the expenditure benchmark is largely due to sizeable windfall revenues, which are excluded from the expenditure benchmark indicator.

Graph 4.7: **Fiscal impulse across Member States in 2021**

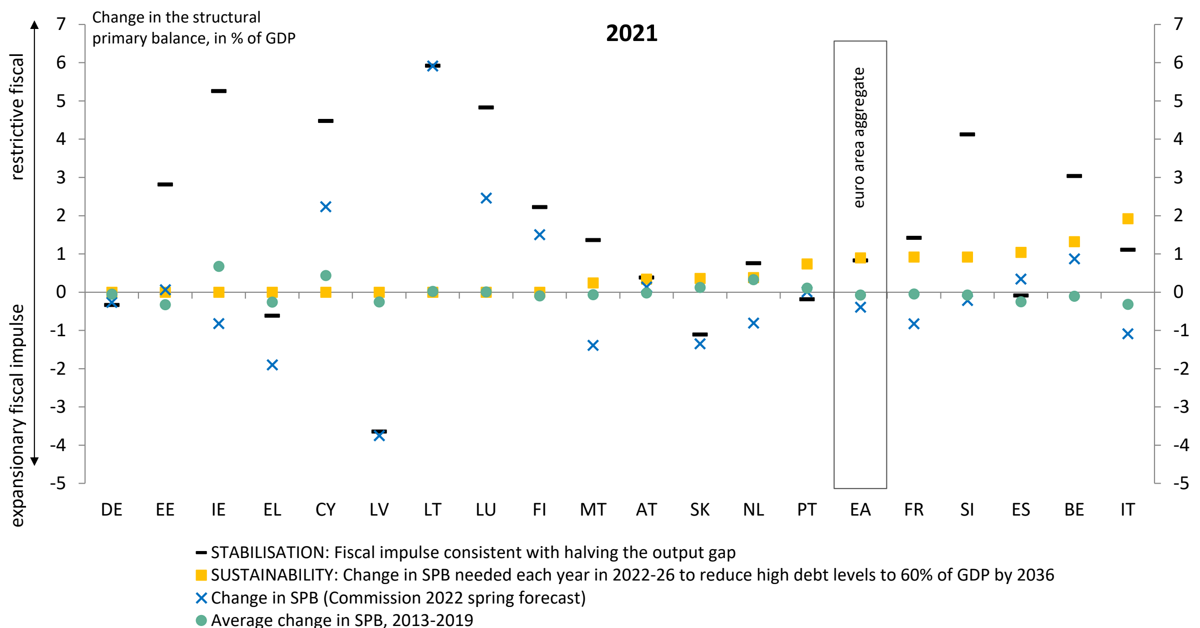


(1) RRF based on cash disbursements.
Source: European Commission

In normal times, high-debt countries are generally supposed to pursue more prudent fiscal policies than lower-debt countries. Consequently, the former group is asked to contribute less to a supportive euro-area fiscal stance during a downturn and contribute more to a restrictive stance during an upturn. Given the size of the economic shock caused by the Covid-19 pandemic, all governments focused on stabilisation objectives to dampen the impact of the crisis. An accommodative monetary policy (and by extension low sovereign borrowing costs) and the use of the severe economic downturn clause emphasised this shift. Unfortunately, those countries (economically) most affected by the crisis were already marked by high-debt ratios prior to the pandemic. Overall euro-area debt rose to nearly 100% of GDP in 2021 and seven Member States have a debt burden significantly above that marker. ([107])

([107]) Belgium, Greece, Spain, France, Italy, Cyprus, and Portugal.

Graph 4.8: **Overview: Expected national and aggregate fiscal impulse, stabilisation, and sustainability**



(1) Countries are ordered by increasing sustainability needs.
(2) Stabilisation: a neutral fiscal impulse (i.e. letting automatic fiscal stabilisers operate without any additional discretionary measures) is appropriate when the output gap recently changed signs or is expected to narrow at a sufficient pace. If not, the stabilisation point shows the fiscal impulse consistent with a reduction of the output gap by 50% compared with its 2020 level, using a uniform fiscal multiplier of 0.8.
(3) Sustainability needs are assessed using the Commission's S1 indicator. S1 measures the total cumulative adjustment needed in 2022-2026, with the last structural primary balance being maintained for another 10 years, to bring the debt-to-GDP ratio to 60% by 2036. For countries where S1 is positive, we assume that sustainability needs are addressed by implementing S1 in a uniform manner over 5 years, i.e. one fifth of S1 is implemented in 2022.
(4) In countries where S1 is negative, debt is already below 60% of GDP or expected to fall below it by 2036, therefore no additional consolidation is needed.
(5) The sustainability estimate for the euro area is approximated by weighing countries by debt levels (in euro).
(6) While under the adjustment programme, Greece achieved a very high structural primary surplus but since the high surplus was already established in 2012 the figure indicates an average expansion for the given period.
(7) Data for the stabilisation and sustainability indicator is based on the Fiscal Sustainability Report 2021 and the Commission's spring forecast 2022.
Source: European Commission, own calculations.

5. FUTURE EVOLUTION OF THE EU FISCAL FRAMEWORK

5.1. OBJECTIVE AND INSTRUMENTS OF EU ECONOMIC GOVERNANCE

Economic governance reform is, finally, back on the EU agenda. The Commission will soon publish a Communication with its proposals. At this stage, the European Fiscal Board is pleading for a comprehensive and ambitious approach to reforms.

In earlier reports, the EFB envisaged a two-stage reform process ([108]): first a simplification and update of the rules-based framework of the Stability and Growth Pact (SGP); sometime thereafter efforts to supplement national fiscal policies through joint initiatives to improve resilience and growth in the EU. That remains the EFB's vision. However, two considerations have sharpened the EFB's approach to both stages of reforms: a more ambitious perspective on the scope for simplifying surveillance through enhanced national responsibilities seems desirable and feasible, while a growing sense of urgency in addressing the second part of the EFB's agenda is justified.

The EFB's more radical perspective on reforms is inspired by its assessment of what can realistically be achieved by rules-based fiscal governance in a multilateral setting. The legitimacy of the Maastricht architecture rests heavily on the risk that (i) unsustainable public debt dynamics in one or more countries may spill over into financial instability in partner countries as well; and (ii) overly expansionary national fiscal policies would hamper the ECB's task to achieve its inflation objective. Surveillance was to focus on preventing and addressing risks of such spill-overs, correcting gross (policy) errors and to avoid what, after three decades of experience, the EFB considers to be needlessly intrusive surveillance.

A few years later, the SGP implemented the relevant provisions of the Treaty with secondary EU legislation to deliver more continuously a degree of fiscal prudence desirable as an underpinning of a joint monetary policy. After the Council unduly departed from the provisions of the SGP in 2003 rejecting recommendations to France and Germany to correct an excessive deficit, fuller allowance for national circumstances was applied and surveillance started to focus on policy efforts rather than outcomes. Following the financial and sovereign debt crises surveillance was once more tightened and complemented with a strengthening of national frameworks. A couple of years later the Commission introduced more flexibility in its implementation, as in some countries the economic recovery from crises was slow. Finally, during the Covid-19 pandemic unprecedented joint fiscal efforts were undertaken and the SGP was virtually suspended. Section 5.2 traces these long swings in the framework and implementation of fiscal governance arguing in favour of more differentiation and more focus in surveillance: better use of national monitoring of medium-term performance in the large majority of Member States where public debt has remained below or close to 60% of GDP, combined with strategies for reducing debt at a satisfactory pace in countries that are well above this long-term threshold. This differentiated strategy is outlined in sections 5.3 and 5.4.

However, the reform of economic governance envisaged in this chapter goes beyond updating the rules-based framework of the SGP, bringing it closer to the original focus. Two remaining gaps in governance need to be filled to complement a reformed SGP: a Central Fiscal Capacity (CFC) for stabilisation against major shocks and joint support for the provision of EU public goods, would otherwise leave the framework inadequate. This chapter outlines proposals in these two areas in sections 5.5 and 5.6. Both the Global Financial Crisis of a decade ago and the pandemic have generated shocks that some Member States found difficult to handle domestically, despite the sizeable automatic stabilisers built into their budgets, also when supplemented by joint monetary policy. The ability of the latter to support the economy has been limited over extended periods. A need to retain a capacity to assist temporarily in containing major economic disturbances is an important public good that the EU can provide – and did supply in limited measure recently or subject to

([108]) See EFB (2021b).

macroeconomic conditions after the Global Financial Crisis.

The provision of European public goods has taken on wider significance as a result of the contrast observed between the need for growth-enhancing (or growth-defending) public expenditure and the squeezing of such items in the public budget over long periods, but notably over the past decade. Past EU efforts to mitigate this contrast by making special allowances - golden rules - for privileged expenditures in the rules for national policies have not had any major impact. The NGEU with its core element, the RRF, represents a bold joint approach by national governments and the EU to underpin growth-friendly public investment, particularly in the green and digital transition. It still seems too early to evaluate this more centrally-financed and monitored approach to the provision of EU public goods and its potential role in future economic governance.

The EFB believes that the balance between EU and national efforts needs further reflection. It does not see either liberal use of golden rules, or extensions of the detailed procedures of the RRF beyond the current expiry date of 2027 as ideal. This chapter offers some preliminary ideas for future elements of economic governance targeted at strengthening the resilience of EU economies.

5.2. EU ECONOMIC GOVERNANCE – LEARNING FROM VISIONS AND EXPERIENCE

The Maastricht Treaty focused on monetary unification. Tensions caused by differences – real or perceived – between national monetary policies were seen as a threat to the deep integration of the single market then underway. A process to make central banks accountable for how they achieved inflation targets and, hence, become more independent of national political processes, facilitated the move towards a single currency and one central banking system to manage it.

The situation with respect to fiscal policy was quite different: general support, on both economic and political grounds, for preserving national decision-making to a maximum extent. However, the risk of national fiscal policies affecting euro area inflation and some participants creating a destabilising impact on their partners provided a legitimate argument for defining constraints on national fiscal policy making.

The Treaty approach to national fiscal policies rests on two pillars. First, it sets upper reference values for government deficits and debt as practical means to identify and correct gross policy errors; this pillar forms the basis of what would later become known as the corrective arm of the SGP. Second, it regards national economic policies as a matter of common concern and outlines a process of coordination aimed at averting the risk that national policies jeopardise the proper functioning of the Economic and Monetary Union; this pillar forms the basis of what would later become known as the preventive arm of the SGP. The purposeful, way in which the Treaty defined the fiscal underpinnings of a monetary union remains relevant also today. The approach was purposeful in preventing and correcting gross errors in economic aggregates, and restrained by leaving the desirable process of coordination of national policies to recommendations accepting the limits of surveillance in a union where fiscal policy was to remain a national responsibility.

But soon opposing views emerged around the Maastricht principles. Some found excessive risk of laxity in interpreting departures from the reference value of 3% of GDP for deficits; such a view may be explained by the perspective, very topical in 1997, that compliance with the deficit and other convergence criteria were about to be used in assessing the eligibility for entry of participants into monetary union by 1999; the firm upper limit to deficits defined in the Treaty was seen as crucial. Others found reliance on the actual, or headline, deficit as a key policy indicator too constraining; it might push countries into pro-cyclical policy hard to justify, particularly if ultimately bolstered by sanctions.

While the 1997 adoption of the SGP made the role of the deficit in EU fiscal surveillance operational, the attention given to public debt seemed to fade. The reference value of 60% of GDP defined in a Protocol to the Treaty, had represented an average for the then 12 EU Member States which covered great national variations. Belgium and Italy were at more than twice the reference value; this had already been the case around 1990, so the Treaty referred to "a satisfactory pace of reduction" as the only realistic recommendation in such cases. But this notion was left undefined, because at the time high nominal rates of economic growth ensured a

decline of the debt ratio with deficits at or below the 3% of GDP reference value.

Another reason for the reluctance to implement guidelines for how to monitor debt was the broadly parallel rise in the debt ratios of the two largest economies, France and Germany. On this background there was simply no constituency for translating the principles of the Treaty into implementable guidelines for debt levels or for the pace of adjustment towards them.

Hence, the SGP focussed on assessing deficit developments as an operational proxy for long-term sustainability. The exceptional circumstances in which the rules should not, or might not, be applied were narrowly designed. Simplicity was largely preserved, but at the cost of somewhat constraining the flexibility with which the Council can exercise discretion in adopting policy recommendations.

Two further modifications gained support in the early years after 1999 under the general heading of allowing better for differences in national circumstances by increasing the scope for more differentiated advice. These reforms were implemented in 2005, following a major clash in November 2003 when France and Germany found a majority in the Council for not accepting the Commission's recommendations to reduce their deficits as required by the SGP.

The first was to shift attention from observed outcomes towards policy efforts, identified by discretionary changes in public expenditures and/or revenues. Emphasis on cyclically adjusted, or structural, deficits is well-justified conceptually; preventing undesirable policy steps is to be preferred to subsequent corrective action. Governments should be held accountable through their policy actions rather than outcomes. But tailoring advice in this more targeted way comes with the cost of relying on indicators observable with considerable uncertainty in real time.

The second modification of the SGP in 2005 was to aim to give credit to countries for reforms that strengthen the long-term sustainability of public finances. This ambition, once more well-intentioned and analytically appropriate, aimed to respond to the criticism that EU economic governance had become preoccupied with setting up an overly short-term nominal framework – a "snap-shot photo" of the state of public finances – rather than with evaluating the contribution of the latter to the longer-term features of an economy that determines its growth potential and its convergence towards best international practice. Modification of surveillance in this direction would finally begin to address failures in living up to the criteria for being in a monetary union with major trading partners, familiar from the literature on "optimum currency areas".

While the two elements of the 2005-reform in principle modified surveillance by introducing more national differentiation and more scope for long-term perspectives. The reform did not visibly help in monitoring and containing major macroeconomic imbalances that built up in the relatively prosperous 2005-8 period. The view at the time was that intra-EU current account imbalances were not a concern in a monetary union – and they could anyway best be corrected by structural rather than macroeconomic policies. Yet these imbalances unwound abruptly and amplified the financial crisis of 2009-10, followed by the sovereign debt crisis of 2010-13.

The potential impact of EU financial integration on macroeconomic and fiscal vulnerabilities had been greatly underestimated by most observers. Compared to pre-1999, deeper financial integration and a common currency with a formal no-bail-out clause raises the risk of instability for high debt countries themselves, as the outflow of capital to government bonds deemed safer is easier and free of exchange-rate risk. A crisis management function was set up in a monetary union where the central bank plays no formal role as a lender-of-last-resort to governments. The conditional lending that was provided by a new institution, the European Stability Mechanism (ESM) emerging in 2012, took a central role in the adjustment programmes of four countries. In parallel the ECB introduced instruments dealing with dislocations in sovereign debt markets.

The initial response to the outbreak of the financial crisis in 2008 was a joint fiscal expansion, recommended by the Commission, of about 2% of euro area GDP, with about two thirds of the impact in 2009. This was a clear departure from the rule book of the SGP; no escape clause existed at the time. [109] It was uncoordinated in the sense that the observed differentiation between countries was modest. It might nevertheless have been

[109] The severe economic downturn clause was introduced in 2011 with the Six-Pack reform.

broadly appropriate if the downturn had been temporary, as most expected at the time. Instead, a sovereign debt crisis took centre stage from mid-2010, extending the financial crisis.

The set-up of a mechanism for crisis management and the early steps towards a Banking Union, starting from more joint supervision and agreement on processes for resolution of banks, significantly lowered the risks to public budgets of financial instability. But the initiatives have remained incomplete, notably because of delays in agreeing on common deposit insurance. Nor should they be regarded as a substitute for more direct reforms of the fiscal governance framework; elements of public risk sharing can complement the private risk sharing and reduction which occurs through bringing down non-performing loans and increasing capitalisation.

The Commission embarked on two major and distinct efforts to update the framework in the light of the lessons from the sovereign debt crisis: the first to improve the transparency and reliability of the macroeconomic and budgetary information supplied by national governments; the second to go further in making rules-based governance more precise, but also more closely tailored to national circumstances by being more specific about how to allow for shorter-term stabilisation subject to the sustainability constraint. Beyond either of these efforts, the reforms introduced the Macroeconomic Imbalance Procedure (MIP). However, the MIP was seen as an exercise parallel to the surveillance through the SGP, and it never developed a truly macroeconomic perspective.

A lasting contribution from the reforms of a decade ago to the efficiency of a rules-based framework has come from the first, more procedural, part of the efforts. Assuring access to more reliable data on national government finances for Eurostat and other EU institutions was a prerequisite; see the overview in Box 2.1. Streamlining the sequence and the calendar of the surveillance process in an integrated European Semester was another important step, as was anchoring the rules-based framework in national legislation. Finally, setting up independent national fiscal councils was a significant and durable contribution to improving EU economic governance. Section 5.3 discusses whether the potential of these institutional innovations contains underexplored elements to be considered in the upcoming reform.

The second set of reform efforts was also multidimensional. In the nervous climate of financial fragility brought by the financial crisis and intensified by the sovereign debt crisis, efforts to make the implementation of rules more precise and predictable and improving compliance were inevitable. That included, finally, an attempt to operationalise the "satisfactory pace of debt reduction": a requirement to reduce the excess of the national debt ratio over the 60% of GDP reference value in the Treaty by on average one twentieth annually over three consecutive years. Section 5.4 below, reviews why this particular effort, despite its long-drawn-out adjustment period and nationally differentiated approach, goes beyond what seems economically necessary and politically feasible. The section also outlines an alternative, but still a numerically based and differentiated strategy.

After consolidation was introduced at a time of recession in 2012-13, the Commission and the Council in 2015 agreed to apply a flexible approach to avoid excessively pro-cyclical fiscal tightening subject to sustainability constraints. Such flexibility took the form of extended timelines for adjustment in the light of estimates of national output gaps and debt levels - the matrix approach. Still, the requirements of the Pact were in several critical cases not complied with, and no consequences were drawn. In the exceptional cases in 2016 when the conditions for enforcement were met for Spain and Portugal, the financial sanctions under the SGP were set at zero. At the same time, macroeconomic conditionality linked to the implementation of European Structural and Investment Funds did exert pressure on Member States concerned.

The sustainability of public finances did improve over the slow recovery up to 2019, as measured by a decline in the debt ratio by, on average for the euro area, 8 percentage points from its 2014-peak. Low and falling costs of servicing public debt helped greatly. On the other hand, the decline was slowed down by comparatively modest nominal growth of GDP, notably due to persistently low inflation.

Progress was, however, very uneven between countries, sharpening the contrast between three clusters of Member States: six with very high debt, i.e. well into triple figures, nine with ratios fluctuating mostly in the 60-80% of GDP range, but typically reverting towards the lower level, and

the remaining twelve EU Member States mostly well below 60%. The first group had accounted for the largest upward jump during the crises of a decade ago; most of them also turned out to be the least successful in putting debt on a downward course during the 2014-19 recovery.

Looking back at the pre-pandemic period the record of the more flexible implementation was mixed. In some Member States, there was a failure to build up buffers, which would have served well in the subsequent crisis. And, as to achieving the underlying objective of a more flexible implementation, perceptions of national ownership of a rules-based framework did not improve.

On top of the flexibility built into the rules, there was an increasing tendency towards bilateral negotiations between the Commission and the country concerned, tolerated by the Council without much debate. Acquiescence developed in part because it had become difficult to assemble a qualified majority to block Commission recommendations involving the new sanctions introduced in 2011; reverse qualified majority voting (RQMV) had been introduced to achieve this result but had failed to anticipate that the Commission was in the process of assuming a more political role, rather than that of the Guardian of the Treaty. In fact, the RQMV may have accelerated this process. A growing number of exceptions from compliance were accepted and the cumulative experience codified in an ever more complex rule book.

Flexibility is inherent to any well-designed system of fiscal rules. However, implementing it in discretionary piecemeal national allowances implied a cost of opacity and a gradual erosion of the standing of rules-based governance in the domestic policy process which prepares budgets.

Most importantly, the capacity of very-high-debt countries to react to future crises weakened, as the Commission and the Council agreed to apply the new flexibility provisions to them (EFB, 2019). Assuring sustainability in critical cases *de facto* receded further into the background during the final years of the pre-pandemic period.

Some of these lessons and the reforms that could improve the future framework had become evident by 2019: simplify implementation of the SGP by relying less on short-term and partly unobservable indicators; strengthen the EU requirements of national budgetary frameworks with emphasis on a medium-term rather than overwhelmingly annual orientation; make budgetary processes more transparent, in part through an active role for the IFIs. Last but not least, intensify efforts to avoid and correct gross policy errors and on designing operational strategies for Member States with very high debt.

The net result of implementing these mostly pragmatic reforms would not be to eliminate flexibility or even to reduce it sharply. One main impact would be to roll back efforts that seem ineffective and to allow scope for a greater national responsibility in monitoring fiscal policy. Section 5.3 develops how such a reform might look. It raises the question of how the ideas of the reforms initiated a decade ago could be better advanced in such a reformed framework. The other main impact would be to target reformed and differentiated strategies for debt reduction in the Member States that are the most vulnerable.

There was no sense of urgency in the reform debate which had barely started when it was interrupted in March 2020 by the outbreak of the Covid-19 pandemic. The Commission proposed, and the Council agreed, to activate the severe economic downturn clause, to allow for flexibility in national fiscal responses. The initial decision was very much supported also by the EFB; rules-based governance has to allow for exceptions in extreme circumstances. Keeping the clause active was essential in 2020-21, but doubts whether to extend it to 2022 were triggered by the initially strong recovery from the crisis. The Russian invasion of Ukraine severely dented the economic outlook since early 2022, prompting a further extension this year to 2023.

The EFB has been critical of these extensions, partly on formal grounds – the new criteria for deactivation put forward in spring 2021 were expected to be met in 2022, see EFB (2022) – partly because of the longer-term consequences of muddling through without a framework. Chapter 2 of this report analyses in some detail the state into which surveillance was drifting in 2021 in such an environment. The EFB is concerned that a period of more than three years during which the impression that the rules were fully suspended had spread widely - despite the Commission's denials – will make it more difficult to fully return to rules-based governance - even in the lighter, more liberal and streamlined version the EFB proposes, not to

speak of designing debt reduction strategies in the cases where they are needed. More specifically, the EFB regrets that since 2019 EDPs have only been found applicable in the case of Romania. The EFB notes that a revival of the corrective arm in late 2022 is an option considered by the Commission; the EFB recommends it be used. That seems especially important in a context where monetary policy tightening is accelerating the decompression of risk premia. The EFB further recommends that a comprehensive review of economic governance be completed, at least, the first stage of it "well in time" for the 2024 European Semester, which starts in spring 2023.

The pandemic triggered joint EU responses of great significance – the Next Generation EU (NGEU) with the Recovery and Resilience Facility (RRF) at its core, as well as initiatives to strengthen the stabilising properties of national finances through joint facilities, notably SURE. A strong commitment to the one-off nature of the NGEU marked the agreement of 2020. However, the experience cannot yet be adequately evaluated.

The EFB sees the multiplicity of objectives pursued with the SGP - in addition to the primary one of safeguarding sustainability also the promotion of more effective economic stabilisation in the shorter term and better protection of growth-enhancing public expenditures – as a major source of the inadequacies of past efforts. It has been overambitious to pursue three objectives in occasional mutual conflict with a single instrument, namely the rules-based fiscal framework, see EFB (2019). It was therefore a highly promising feature of the 2020 initiatives that pointed to a more comprehensive approach. Unlike in the past, one should not only try to resolve trade-offs between objectives through detailed exemptions from national implementation of rules-based governance. Joint action to provide funding through lending or the EU budget to address exceptional stabilisation challenges and the protection of public investment of high priority in providing EU public goods may at times be a potentially superior approach by filling the two remaining gaps in EU economic governance. Sections 5.5 and 5.6 below argue that this approach would improve on past efforts, clarify the scope and responsibility for sustainability, and strengthen the prospects for compliance with the update and simplification reforms of the EFB.

The pandemic has led to a 2–3-year hiatus in the reform debate. The expected deactivation of the severe economic downturn clause with effect from 2024 makes it urgent to resume the debate. Early reactions to the pandemic crisis pushed up debt ratios to new highs, while widening the gap between the three clusters of Member States. But the environment for reducing debt has been more favourable in 2021-23 than after the crises a decade ago. Due to first a rapid recovery of real growth, then to unexpectedly high inflation – the GDP deflator is the relevant indicator – not yet reflected in nominal interest rates, the debt ratio for the EU is currently projected to be only 6 percentage points higher by the end of 2023 than four years earlier, before the surge in spending during the pandemic. However, in several very-high-debt countries this increase is forecast to be at least twice that of the average. Moreover, the relief from inflation is bound to be temporary.

The outlook for sustainability must be a source of concern at a time when the conditions for observing it beyond 2023 are set to worsen due to several factors in addition to the outlook for real interest rates: expenditures to protect vulnerable households and firms against the full impact of energy prices appears to be less "targeted and temporary" than intended. The planned investment into the green and digital transitions may serve as an insurance against future downside risks. However, it may not increase economic growth as measured by GDP. The long-term challenge of keeping the rise of public expenditures broadly in line with the capacity to generate revenues is likely to reappear, making sustainability concerns more urgent.

Furthermore, this challenge could come back with a vengeance. A long period of circumstances propitious for reliance on debt financing and the growing confidence of policy makers as to the essential role of public expenditures, both in compensating for the impact of unfavourable events and in improving economic outcomes more generally, raise the difficulties in designing the future economic governance framework, not to speak of finding agreement among Member States. It may seem tempting to postpone the effort and muddle through the current uncertainties, and to concentrate on the more urgent challenges linked to the war in Ukraine with its energy security and defence implications.

However, postponing a comprehensive economic governance reform would, in the EFB's view, be a mistake. The EFB believes the reform task has become one of urgency. Lessons from the long evolution reviewed above offer guidance that looks less controversial than before 2020. More predictable fiscal policies, anchored in critical cases in nationally differentiated strategies for debt reduction, in other cases in stronger medium-term national frameworks, should be key elements. Leaving expectations of fiscal policies unmoored after three years of a *de facto* rules-free regime would undermine the ability of the EU to counter coming shocks and meet other challenges.

5.3. MAKING THE EU AND NATIONAL BUDGETARY FRAMEWORKS WORK TOGETHER

The conduct of fiscal policy in EU Member States is subject to a complex web of objectives and constraints. Policies are shaped not only by Member States' political preferences but also (i) the EU fiscal rules (i.e. the SGP and the related surveillance), (ii) national fiscal rules that may not always be fully aligned with the SGP, (iii) assessment by national independent fiscal institutions (IFIs), and (iv) medium-term budgetary frameworks. Even though it may promote an appropriate fiscal policy (i.e. sustainable, stabilising and growth-friendly), the overall policy framework is generally seen as needlessly complex and plagued with overlaps and inconsistencies. The latter increase the scope for arbitrage among the potentially conflicting constraints by national authorities.

The ultimate objective of EU fiscal rules is to ensure fiscal sustainability with high probability, while allowing fiscal space to be put to good use, including in particular, macroeconomic stabilisation alongside monetary policy. So far, results have been mixed due to design flaws and weak implementation (e.g. EFB, 2019a). Fixing those issues should be at the core of a reform.

5.3.1. A common surveillance framework for different countries

From the very beginning, the SGP has been perceived as a one-size-fits-all arrangement oblivious to the diversity of macroeconomic conditions and political realities among Member States. Indeed, the latter have often struggled to own the common fiscal framework despite the fact that the flexibilities embedded in the SGP - notably those related to the state of the business cycle or the size of the public debt - have allowed for meaningful tailoring to country circumstances. It remains that the intensive surveillance from the centre implied by the SGP and the graduated enforcement framed in the EDP are blind to the political fabric of countries, including the effectiveness of democratic checks and balances, the weight of well-established practices or even the role of symbolic thresholds for debt, deficit or government size.

Because fiscal policy is inherently political and a product of national governance, a fiscal recommendation from the centre can easily be cast as a diktat from Brussels, and the launch of an EDP, as a case of unequal treatment. To resolve the tension between local policy making and adherence to supranational objectives, greater reliance on national frameworks to promote those common objectives has been proposed. The idea is that effective national frameworks aimed at similar goals alleviate the need for high frequency intervention from the centre (Debrun and Reuter, 2022). One concrete avenue to get there is to establish some basic standards for national fiscal rules and to mandate national IFIs to assess compliance and apply flexibilities.

However, a shift towards more national responsibility should not be seen as a panacea: in the period before the EMU, Member States were entirely responsible for their own budgets, and often ran very high deficits; while failing to conduct counter-cyclical policies. At the time, though, public debt was on average lower than it currently is, inflation was on average higher than since the start of the SGP, while countries had a certain amount of monetary autonomy, allowing them to deal with potentially unsustainable debt levels. Reverting to inflationary practices of dealing with excessive debt build-up is not an option, given the common currency. As stated before, highly integrated financial markets can lead to severely harmful cross-border spill-overs if some country's fiscal policy spins out of control.

5.3.2. Weak compliance

Political considerations taint the enforcement of the SGP. In the period before the 2011 revision of the Pact, all Council decisions about the different steps in the Excessive Deficit Procedure (EDP)

were based on a qualified majority vote (QMV). The idea was that countries would discipline each other by exerting peer pressure. However, as argued above, this mechanism was not particularly effective. Finance ministers interact on a regular basis and, hence, are reluctant to cast a negative vote on another colleague's policy, as at some future moment they may need the support of this very colleague. In fact, a vote against a profligate colleague is like providing a public good: all other ministers benefit from it, while the cost falls on the minister that casts the negative vote. The problem was thought to be addressed in the 6-pack revision of 2011 with the replacement of QMV by reverse qualified majority voting (RQMV) to impose the new sanctions added to the package. However, as argued above, this switch may even have been counterproductive, as it effectively shifted much of the responsibility for decisions to the Commission, which seems to have shied away from making politically sensitive proposals. Besides these complications caused by strategic calculations, the surveillance process is becoming increasingly bilateral, thereby adding to its lack of transparency. There is an increasing tendency for governments to strike a deal with the Commission before cases go to the Council, which undermines the role of peer pressure from other finance ministers.

5.3.3. A possible way forward

With these considerations in mind, what could be a good way forward towards more effective fiscal surveillance? First, EU-level surveillance should be tighter in cases that pose a greater risk to the financial stability of the euro area, thus focusing on the prevention and correction of gross policy errors. The EFB would not consider such gross errors exclusively in the context of the EDP but also in such cases as loose fiscal policy in good times augmenting sustainability risks when crisis strikes again. By concentrating on gross errors only, it is also easier to find a coalition supporting a tough stance on these errors. The clearest example was that of the Italian government's initial refusal to revise the 2019 draft budget rejected by the Commission (see EFB, 2019b). The latter received broad support from the other countries on its tough stance. It is easy to imagine that in other situations in which a large fraction of the countries commits only minor transgressions of the SGP rules, a coalition could emerge that allows also those running a policy that endangers the collective stability to escape (further steps in) an EDP. Second, and consistent with the first point, fiscal surveillance could be partially delegated to the national level, provided that an adequate national fiscal framework is in place and budgetary outcomes remain broadly in line with the EU fiscal rules. Such a delegation would allow the Commission to concentrate on those violations that run clearly against the objective of the SGP and harm the collective interest. In these latter cases, current EU-surveillance practice would be continued. Apart from making it easier for the Commission to gather Member States' support for a forceful response, this has the advantage that day-to-day surveillance at the national level could be tailored more accurately to a country's specific situation, including its stabilisation needs.

How far should decentralisation of fiscal surveillance go? As mentioned, the basic principle should be that EU-level surveillance would be lighter in cases that pose less risk to the financial stability of the euro area and tighter for those that pose more of such a risk, in particular when countries have debt ratios that threaten their fiscal sustainability. This principle is in line with the idea that surveillance ought to be located at the level where externalities across countries can be most effectively addressed.

5.3.4. Conditions for delegation

EU fiscal surveillance could be partially substituted by stronger monitoring at the national level. For this several conditions would need to be fulfilled, both institutionally and through a record of good fiscal performance. Second, the national IFI needs to meet certain minimum requirements (EU Network of Independent Fiscal Institutions, 2022). Its independence requires a solid legal anchoring, it should be assured of sufficient resources and have access to all relevant information. An adequate comply-or-explain procedure should be in place, with the IFI appearing in Parliament to comment on the budget and the government obliged to respond to these comments in sufficiently concrete terms. The minimum requirements need to be raised to a level that guarantees adequate functioning of the IFIs (see Arnold et al., 2022). This implies a substantial strengthening of the IFIs in many, if not all, countries. Further, the fiscal framework should feature a sufficiently strong medium-term orientation, so that the fiscal outcomes over time remain in line with the EU-level requirements. Hence, when effective fiscal policy monitoring takes place at the national level, EU surveillance could focus on validating the

adequacy of the national fiscal frameworks and on addressing gross policy errors.

Importantly, imposing minimum requirements on IFIs and medium-term fiscal frameworks is not the same as forcing a harmonisation of national fiscal frameworks, which could generate political resistance and would therefore be counterproductive. If the above conditions are met and medium-term outcomes remain compatible with the benchmarks set by the EU fiscal rules, any fiscal model would in principle be acceptable. In such case, the EU-level surveillance would be limited to verifying the absence of excessive deficits. The national framework could be based on the structural balance, nominal targets, on full discretion of a debt-averse political system, or it could directly apply the EU benchmark rules (the opt-in option - see Debrun and Reuter, 2022). Ultimately, what matters are the outcomes.

To leave room for counter-cyclical stabilisation, and to take into account short-term divergences in the national and EU fiscal rules' intermediate targets, the evolution of the fiscal outcomes would be assessed over a period of, for example, five years. However, if during this period the Member State starts to follow a policy that clearly endangers the stability of the entire area, then it would be immediately put back under the surveillance of the Commission and the Council in line with the SGP. Hence, although fiscal monitoring would take place mainly at the level of the countries, their actions and fiscal outcomes would continue to be monitored by the Commission.

5.3.5. Delegation under a revised Pact

It is essential to reduce overlaps and to increase transparency in the current EU rules. Recent EFB annual reports explored desirable contours of reform: a focus on a single long-term debt anchor, supported by a spending rule and a general escape clause, which would be invoked based on independent analysis and advice. A comply-or-explain procedure would accompany the assessment.

Among researchers and policy experts, a consensus seems to have been building up towards the proposals made by the EFB. Some Member States may resist such a shift, though, and prefer to hold on to the structural balance as indicator rather than the spending rule, for example because the former is written in domestic law. Such an opposition could be overcome by the hybrid nature of the preventive arm in the form described here: countries that fulfil the conditions for delegation of surveillance and prefer to retain the structural balance would be allowed to do so. After all, a well-constructed national rule based on the structural balance should yield similar medium-term outcomes as the new EU benchmark rule.

5.4. HOW TO IMPROVE COMMITMENT TO A DEBT REDUCTION STRATEGY

After the financial crisis, the jump in debt ratios and the experience of financial spill-over effects across borders that were much stronger than anticipated brought public debt into focus. The Six-Pack reform included an effort at finally operationalising what seemed an acceptable definition of a satisfactory pace of debt reduction, the one twentieth rule. But the innovation had already been overtaken by events and the rule was not complied with by the Member States with the highest level of debt.

The rule was both gradualist and nationally differentiated; the most indebted had to provide the largest effort in the short term. Yet it was not implemented - a debt-based EDP has never been launched - for three main inter-linked reasons. First, the Commission and the Council considered the adjustment required under the preventive arm of the Pact sufficient. Second, some Member States had reached such levels of debt and recorded very low rates of economic growth that reductions at the pace seen as satisfactory would have required primary surpluses of a size and duration well beyond past experience in the EU or in the global economy. Third, as interest rates continued to edge down after the crises, some saw fading risks in maintaining or even increasing borrowing. Had the safe level of debt not risen well above the 60% of GDP reference value set in a very different environment, making the pace of reduction too fast? The evolution of ECB policy in an ever-more accommodating direction since 2014-5, asset purchases and forward guidance supporting historically low policy rates, added force to the second view and helped explain why the debt rule was not applied and why there is a growing debate on adjusting debt reduction strategies as part of a reformed EU governance. These arguments raise major challenges for a reform.

As regards the first point, the notion that there is an upper limit to how strong the primary balance can realistically become - and for how long it can remain sufficient for keeping debt on a clearly downward path - is prominent in the political debate. An upper constraint on the feasible size of the primary balance is tighter the slower the nominal growth of the economy relative to which debt is assessed. This made the pre-pandemic years difficult for some countries where real growth was low and inflation drifted down. Inflation is very high in 2022-3, providing substantial help through the denominator effect, but this effect will then weaken considerably. Real growth is not projected to accelerate beyond pre-pandemic rates; despite higher investment, pressure on budgets comes primarily from expenditures that hardly add to the productive capacity of EU economies.

The capacity of some Members States to sustain balances sufficient for debt reduction is one element in the design of a strategy; the size needed is the other element. It depends on the persistence of the factors outlined in the second argument which directly impact the risks to sustainability: interest-rate expectations, the reactions in financial markets to them and monetary policy, factors to some extent beyond the control of individual countries, although scope for a positive feed-back from debt reduction to servicing costs obviously exists. Borrowing costs for all EU governments are bound to rise relative to most of the recent decade, ending the easing of servicing costs - the positive snowball effect. Awareness in markets of refinancing risks is also likely to sharpen further, despite the ECB's commitment to support the effective transmission of monetary policy.

The central issues behind the two arguments - the limits to fiscal endurance and the financial environment - need to be carefully evaluated by both the EU institutions and the highly-indebted governments as essential background for a reformed strategy for debt reduction. Both point to two key features in such a strategy: (even) more national differentiation in terms of the pace of adjustment than the one-twentieth rule, and firm commitments by the governments concerned vis-a-vis EU institutions to a realistic path of adjustment.

The EFB recommends a debt reduction strategy for Member States with a debt ratio well above 60% of GDP based on two elements: additional scope for national differentiation, paired with commitments by governments to move in the direction of the reference value by defining an adjustment path towards a debt-to-GDP ratio over the medium term well below current levels. The EFB does not see any strong case for raising the reference value to reflect the present average of public debt ratios and favour retaining the current debt rule; that would hardly be an acceptable signal to the majority of Member States that continue to find the 60% of GDP an acceptable threshold. Nor does the EFB see a case for trying to eliminate the reference value altogether. Pragmatism suggests retaining the 60% of GDP reference value as a distant marker for the most indebted countries, while putting all the emphasis on starting them in that direction or to continue the reduction that some have already achieved in the temporarily more benign environment of 2021-22 created by unexpected high inflation. Non-compliance with the targets at the end of a 3–5-year period would trigger an EDP. There would not necessarily be any annual monitoring reports documenting fiscal outcomes by EU institutions, underlining the medium-term nature of the commitment, but governments concerned may find it useful to monitor departures through a compensation account.

A few independent economists have made proposals from which the EFB have drawn inspiration for a revised debt reduction strategy. Blanchard (2019) greatly clarified both the need to bring into such a strategy an evaluation of the upper domestic limit to the pace of the reduction, and the parameters of the external environment, notably the relationship between trend growth and debt servicing costs. Wyplosz (2021) outlined the process of medium-term commitments by governments to move towards safe debt level; he was followed up by Martin et. al (2021).

While the EFB wants to recognise these contributions as promising analysis, it does not fully share the conclusions their authors draw. Blanchard et al. (2021) propose to replace fiscal rules by standards - more specifically by the general prescription in the Treaty (Art. 126.1) that "Member States shall avoid excessive government deficits". The EFB does not believe – quite apart from the issue of the institutional set up to adjudicate on this basis – that relying only on a qualitative guideline could become an operational procedure.

Nor is the EFB confident that debt sustainability analysis (DSA) can be refined to the point where

one could, with the help of state-of-the-art stochastic simulations, determine the highest level of debt for which the risk of becoming unsustainable is below an agreed threshold with a probability of at most a low percentage, say 5%, as envisaged by Martin et al. (2021) and Arnold et al. (2022). DSA will certainly have to play an important part in future risk assessments; major analytical refinements have been made, not least by EU and global institutions (the Commission, the ECB and the IMF), and further progress may come from more involvement by IFIs, using an agreed common methodology, validated at the EU level, will be important (Arnold et al., 2022). But it remains the problem that DSA is very sensitive to modest changes in assumptions, raising the risk of reverse engineering.

Although DSA can be an important and useful input, the decisive element in the EFB's perspective is the political commitment to implement a medium-term national debt reduction strategy, prepared by a government, adjusted in negotiations with the Commission, and endorsed by the Council.

Would compliance be assured by such a process? Over time experience has inspired modesty as to what can be achieved through rules-based governance in a union where fiscal policy remains largely a national responsibility. Full assurance cannot be offered. But there are a couple of reasons for believing that the incentives to comply would be much reinforced.

The major impact will come from the reputational costs to a government for reneging on a commitment it has agreed with the EU. Those costs will be seen as much more significant than transgressing rules that governments have had little difficulty in the past to label as arbitrary and externally imposed. Any debt reduction strategy will have an arbitrary element, but it will be much harder to reject it when it does not only come out of a rule book, however well-intentioned the latter may be. Behind this first line of defence against non-compliance would lie the certainty that EU institutions are ready to start an EDP in case of departures from commitments as the medium-term approaches; the Commission and the Council breaking with their past acquiescence in departures would be duly noted. It would be noted not least by financial markets and by the ECB; signals about fiscal policies and, especially, sustainability have been in short supply, leaving excessive scope for interpreting short-term indicators and political events in the analysis of how to identify underlying economic performance – i.e. the so-called fundamentals. The EFB notes that sustainability of public finances will be one of the criteria to be used by the ECB in its evaluation of a country's eligibility for the new Transmission Protection Instrument (TPI), another reason for paying attention to DSA.

In earlier EFB reports a key instrument in achieving a downward trend in the debt ratio was to set a benchmark for public expenditure growth, adjusted for discretionary revenues changes, a little below the estimated growth in potential output. Such an indicator was seen not only to assure a desired evolution of debt, but also to enhance the role of the expenditure benchmark, as a reliable indicator than the structural deficit in designing and communicating policy. The benchmark would retain its role in a reformed framework for debt reduction in countries with very high debt. For other Member States the EFB has advocated relying on fiscal outcomes rather than on the instruments with which they are achieved; see 5.3 above.

Relying on the expenditure benchmark in very-high debt countries to guide their differentiated debt reduction strategies seems advisable also on the grounds that public expenditure ratios are particularly high in the most indebted Member States.

5.5. CENTRAL FISCAL CAPACITY

Substantial shocks have hit the EU economy since the turn of the century. First, there was the burst of dot.com bubble at the beginning of this century. The global financial crisis struck at the end of 2008 and during 2009, while a sovereign debt crisis severely hurt the euro area in the years 2010-2012. Then, there was Covid-19 pandemic which started at the beginning of 2020 and the Russian invasion of Ukraine in February 2022. While these were or are likely to be temporary crises, there is also a permanent climate crisis and there will be permanent budgetary pressures from healthcare spending and spending on pensions, which are largely driven by medical progress and increasing longevity. The latter need to be dealt with in a structural way, which is the theme of the next subsection.

This section focuses on a central fiscal capacity (CFC) to deal with major temporary shocks. ([110]) Individual countries may have insufficient capacity to handle such shocks, even when they are symmetric, because the ECB may be constrained by the nominal lower bound on interest rates. However, a CFC's response to a major shock is not only in the interest of the country or countries hit by such a shock. The macroeconomic stabilisation provided by the CFC also serves as a public good for the wider area. First, more aligned business cycles improve the monetary transmission mechanism, because in stabilising the business cycle the ECB is not held back by parts of the euro area out of sync with the rest of the area. Second, better functioning EU economies protect trade links. In addition, outside the direct economic sphere, there is the benefit of reducing political discontent and feelings of neglect from mitigating the consequences of adverse economic shocks.

5.5.1. Design features of a CFC

The CFC discussed in this section will be a revolving fund to which countries make contributions and provide guarantees. The CFC is compartmentalised in the sense that countries can draw from their own accumulated savings within the fund in the case of a severe shock. To the extent that these savings do not suffice, they can obtain a loan from the CFC, which in turn may need to go to the capital market if the total loan demand exceeds total savings within the CFC. The possibility to obtain a loan that is collectively guaranteed against potential default is justified by the solidarity among the countries participating in the CFC. The CFC is not an automatic stabiliser at the euro area or EU level. That would require centralisation of the tax-transfer system as in the US, where, for example, part of the income taxes would be paid to the central level and part of the unemployment benefit payments would automatically come from the central level. Notwithstanding this, disbursement decisions from the CFC can to some extent be made semi-automatic in that shocks that exceed a certain magnitude lead to a loan subject to certain scrutiny.

How can one design a well-working CFC that is acceptable to all EU Member States? There is a set of design features to be decided upon. ([111]) First, the capacity would need to deal with large adverse shocks only. Only central support in response to substantial shocks will make a material difference. Moreover, shocks can never be identified with (complete) precision. This is evidenced by the fact that macroeconomic figures are usually revised ex post and sometimes even by a substantial amount. Hence, it will generally be unclear whether a small slowdown in growth observed in real time is a true slowdown caused by some shock that is beyond the government's control. For a CFC to be widely acceptable, there should be no doubt that it responds only to truly adverse shocks outside a government's control. This can only be established beyond reasonable doubt for large shocks.

Second, the design of the capacity may need to be tailored to the type of shock. An important distinction is between asymmetric and symmetric shocks across EU Member States. The distinction is not always that clear-cut, though: a symmetric shock can work out asymmetrically across countries, as was the case for the Covid pandemic. The type of the shock is relevant for the financing of the capacity. Generally speaking, the more asymmetric are the shocks, the less the CFC needs to rely on funding from the capital market and the easier it is to meet its needs out of accumulated contributions. In the case of a severe symmetric negative shock the CFC may thus need to borrow funds on the world market.

Governments are free to decide on the resources received from the CFC. An easy way to deploy these resources, and with a swift effect on the economy, is to reduce the VAT or to simply send cheques to households.

Several further design issues need to be addressed. CFC loans are likely to be made available against a below-market interest rate for individual sovereign borrowers (otherwise countries would not apply for such loans) and there is a risk of non-repayment of the loans. Hence some regular contribution as well as guarantees from countries participating in the CFC may be needed. Several considerations may govern the allocation of the guarantees. First, countries with relatively stable economies, which is typically the case when they are relatively diversified, would be insuring less stable economies. The latter group would have a better deal than the former. Second, small

([110]) The discussion in this section builds on the growing literature on the central fiscal capacity, see e.g. Arnold et al. (2018), Bara et al. (2017), Beetsma et al. (2022a), and Buti and Messori (2022), and also on earlier EFB reports, see in particular section 5.2 in EFB (2020b).

([111]) A detailed discussion of desirable features is found in Beetsma and Kopits (2022).

countries would run relatively large risks compared to large countries and, hence, their liability should be limited.

Support from a CFC is most beneficial if it is made available with the shortest possible delay following a shock. However, macroeconomic data become available with a lag and they may be revised later. Real-time data, such as financial transactions data, may contribute to the early detection of a shock. Such data need to be interpreted with care, though. For example, they can be prone to seasonal influence. The time lag between the shock hitting and support becoming available is magnified by decision lags. Some form of semi-automaticity in response to macroeconomic (and other) indicators falling below certain levels would therefore be desirable. (112)

A final issue concerns the question whether the CFC should be limited to the euro area or potentially cover the entire EU. While the loss of monetary autonomy makes euro-area Member States the primary candidates for participation, it should be realised that monetary policy freedom elsewhere in the EU is limited, because the other countries generally aim at keeping their exchange rates vis-à-vis the euro stable. This argues in favour of a CFC in principle covering all Member States. Complications with decision making for a subset of EU countries strengthens the argument.

5.5.2. How to design conditionality?

Conditionality will be an important design feature to make a CFC acceptable to all Member States and their populations. Conditionality linked to the access to concessional loans is needed to contain moral hazard.

One way to assess conditionality could be to assign the task of analysing and advising on whether and to what extent support is justified to an independent body of experts; see for instance EFB (2020b). This body could be located within the Commission or outside the Commission as a standalone body. It would also be part of a reformed SGP along the lines proposed by the EFB discussed below. The ultimate decision about the allocation of concessional loans would, of course, be taken by the appropriate political level.

5.5.3. Positioning the CFC within the wider institutional framework

The CFC needs to be embedded within the wider institutional framework. First, its position relative to the ESM needs to be clarified. The ESM was set up to manage the sovereign debt crisis a decade ago by providing loans with strong conditionality when, in extremely adverse circumstances, a country loses access to the capital market or such loss seems imminent. Four countries were put under a macroeconomic adjustment program which required substantial reform of the economy and/or the public sector. This approach contrasts with the light conditionality approach during the Covid crisis when ESM loans were made available for spending on pandemic-related expenditures. However, no country applied to borrow. Those with relatively high borrowing costs feared the perceived stigma and those with relatively low borrowing costs would only see their own costs rise. It is conceivable that when these exaggerated perceptions change and national borrowing costs rise sufficiently above those of the ESM, the latter could become a CFC. However, for the ESM to play that role, it would need to be reformed. For one, it would need to become an EU institution, rather than remain an intergovernmental institution that can potentially cover all EU countries. (113)

Second, the CFC's position relative to the SGP needs to be determined. However, one needs to be careful in linking support to a country to it not being in an EDP. First, this could politicise EDP decisions. Second, support would be most beneficial when a shock is so large that it takes the deficit above the 3% of GDP reference value. Hence, the nature of the transgression of the SGP is crucial. Under the current SGP eligibility for CFC support would require the country to obey the structural balance rule (being at the medium-term objective or having moved at a sufficient speed towards it or having demonstrated sufficient steady progress in terms of debt reduction. For a Pact revised along the lines proposed by the EFB (2019) the decision whether or not to invoke the general escape clause at the national level should

(112) The time needed to establish whether the conditions for CFC support are fulfilled should be limited. This is relatively straightforward for a severe shock, which is the eventuality that the CFC is meant to cover. In this sense, the CFC can be thought of as a semi-automatic arrangement

(113) In December 2017, the Commission adopted a proposal for a Council regulation aimed to incorporate the European Stability Mechanism in the Community framework: https://ec.europa.eu/info/sites/default/files/economy-finance/com_827.pdf. At the time, the idea was not endorsed by the EU legislators.

coincide with the decision whether or not to provide CFC support. This way, the reformed Pact and the CFC are put under a common umbrella: the conditions for invoking the escape clause and for support from the CFC need to be identical.

5.6. THE EU DIMENSION OF THE QUALITY OF PUBLIC SPENDING

The quality of public spending has been an area of the EU economic governance its architects have been cautious to address. The subsidiarity principle and varying political preferences of national taxpayers to fund public spending do not provide a fertile ground for a centrally-planned composition of Member States' public spending.

At the same time, there remain three substantial arguments in favour of coordinated spending. The first is linked with the economies of scale of EU-wide purchases. The second argument relates to the immediate spending externalities, while the third concerns about the viability of the EU as a whole.

This section claims that while these three arguments for coordinating spending should influence the EU fiscal architecture and its financing, they do not necessarily speak for implementing coordination by means of special derogations from the fiscal rules themselves.

Common EU spending allows for economies of scale in some areas. Large-scale science, industrial or transport projects provide typical examples; common purchases of Covid vaccines another. The logical instrument through which such spending could be delivered is the EU budget - it indeed already covers many such areas, though not always in a very effective way and not with enough attention to EU public goods. ([114]) For large spending items explicit one-off coordination of national spending might be necessary, likely with own rules making sure the necessary critical mass is achieved. The spending areas could include the needs arising from the challenges of 2022 - the common purchases of gas, creating EU quasi-monopsony of energy purchases, as well as common defence procurement.

Specific spending externalities are the second powerful argument for spending coordination. As with the economies-of-scale spending items above, the list of high-externality areas of expenditure has been growing. Energy source diversification and security, defence, and the green transition are the recent big areas where the EU-wide benefits of national spending are potentially large, which is likely to result in a sub-optimal level of spending at the national levels if such external effects are not taken into account.

Finally, there are negative externalities of a broadly defined failure by Member States to pursue sustainable policies that could weigh on the EU as a whole. The best-known example is a potential debt crisis, which, through banks or financial markets or ECB channels, propagate through the EU as a whole. However, there are others with major consequences for the rest of the EU community. Inadequate efforts at climate mitigation could end in an environmental disaster on a national level that might threaten the functioning of the common market. Similarly, being overrun by foreign armed forces is an existential threat not just for the Member State that is not spending enough on border control or on defence.

The three arguments for common or coordinated spending may overlap, as shown in the cases listed above. For example, a Member State's defence can be more efficient when benefitting from common EU purchases; it would strengthen other Member States' security and reduce the risk of a catastrophic security failure exposing the entire EU.

How should the suboptimal composition of spending resulting from non-internalisation of these factors be addressed? The tools to achieve such coordination can be ranked in order of increasing subsidiarity and freedom given to the Member States' spending composition.

The first-best mechanism addressing economies of scale and externalities is a bigger EU budget capable of covering the growing list of the EU common goods, to be achieved by transferring responsibilities from the Member State level. This would mean direct spending by the EU in new major expenditure areas, or with the money directly allocated by the EU to be spent on such areas in specific Member States. This would not be a conceptual change, but rather a major change in the decades-long policy of keeping the EU budget very small, compared to federal states (MacDougall

([114]) European Parliamentary Research Service (2020) and Heinemann et al. (2017).

Report, 1977). It would require new own resources or much bigger contributions.

As an alternative, a hybrid mechanism, proposed in EFB (2020b) could be applied, in which the agreed EU budget contribution is increased for every single member state. At the same time this increase would be neutral in the sense that for every country, this contribution would translate one-to-one into a country-envelope increase. The extra envelope would have to be spent on eligible elements within the Multiannual-Financial-Framework (MFF) period. The extra envelope that is not correctly spent in a set period, would then be redistributed among the Member States in proportion to current national contributions to the EU budget.

On the other side of the spectrum of subsidiarity there are variants of a golden rule, which exclude parts of the public spending from the fiscal rules. A golden rule would provide an incentive to reshape public spending, but it only works in particular political conditions. The experience with preferential treatment of public investment in fiscal rules has been mixed at best (EFB, 2020a).

The most important argument against golden rules is that public investment, like any other spending needs to be financed. Fiscal sustainability still needs to be taken into account. However, this argument concerns only the numerator of the budget balance ratio. Public investment can (or at least should) aim at improving potential GDP growth. What is more, some kinds of government spending can deliver direct fiscal revenues (e.g. tax administration IT improvements). Finally, outlays on capital maintenance or frontloading of CO2 reduction reduces future spending. All of the above can potentially make public investment neutral or even positive from the point of view of fiscal sustainability.

Another argument against golden rules is that preferential treatment of investment encourages creative accounting - classifying all sorts of spending as investment. Such misclassification increases the risk to fiscal sustainability. To address this problem, EFB (2019) proposed a limited golden rule, which attempts to utilise the classification and review mechanisms already present in the EU budget. The rationale was to limit the misclassification of spending without introducing new mechanisms of monitoring and compliance.

This mechanism has several drawbacks, which, in the view of the EFB make it unsuitable for extension to a larger set of EU spending priorities. First, the original golden rule related to investment is based either on the concept of unchanged net worth of the general government or on the higher potential output that counterbalances the effect of increased spending on fiscal sustainability. This was the argument behind EFB's advocacy of a version of such a mechanism as part of the fiscal framework in the past. However, the logic of stronger potential output does not apply to a range of EU common goods. And while energy security, or national defence are increasingly worthy priorities, they are all subject to the binding overall constraint of fiscal sustainability, without which no priority can be pursued at all. The proposals to treat differently debt related to specific types of goals, such as investment, green spending, or Covid vaccines (Giavazzi et al., 2021), show how far a different treatment of expenditure categories could take us from overall fiscal sustainability as the basis for a rules-based framework. If one believes in the growth-enhancing nature of such preferred spending, there would be no reason to be afraid of accepting the resulting debt/GDP dynamics.

Introducing spending floors on related expenditure in addition to the fiscal sustainability-based rules agreed is the correct response to the critical nature of some of the new priorities. One could argue that climate mitigation or national defence are not just priorities, but are also binding constraints, given the risk of critical outcomes if left unaddressed. In line with the broader sustainability implications for the EU as a whole, a mechanism similar to the 2% of GDP NATO defence spending lower limit could be contemplated. However, given the long-term nature of the critical spending needs, there is no reason to ignore the normal fiscal sustainability in the process.

This section does not refer to the experience of the RRF as a potential model for raising the quality of public expenditure and, more generally, for reinforcing the EU future governance framework. It is still too early to evaluate this experience, which is obviously in some respects promising not least because it also supports structural reforms. The RRF aims to combine protection of high priority EU public goods, notably in setting minimum spending aims for the green and digital transitions, with more traditional regard for maintaining sustainable public finances by introducing joint

financing, a grants element and redistributive features. However, the RRF is temporary and the ratification of this major 2022 initiative took place on the premise that it was to be a one-off. Nevertheless, reflections on what is to replace it should not be long postponed.

Even if it were possible to find agreement to prolong some main features of the RRF beyond the current MFF period, the EFB has reservations in seeing the RRF as a longer-term model. It marks a departure from established EU expenditure programmes by giving a stronger role to the Commission. This may be justified by the crisis that triggered the RRF initiative. However, this is temporarily shifting the established balance of responsibilities between the EU and the Member States.

The EFB would ideally prefer a model where there is clearer demarcation between national, joint and EU responsibilities for improving the resilience and longer-term growth potential. That would imply a narrower EU focus on limited set of major investments which clearly meet the criteria for a more centralised approach listed above - economies of scale and cross-border externalities; such expenditures could find a place directly in the next MFF. They would be flanked by larger decentralised efforts in most other areas of growth-friendly investment, possibly supplemented by the national envelopes to enlarge the EU budget, as mentioned above; this last category could be monitored jointly, but with less detailed EU intervention than in the RRF, in view of the drawing rights that the individual countries have on their own envelope. Such a model for underpinning the quality of public expenditures would, provide the best way of taking this important objective of economic governance into account without overloading a revised SGP.

GLOSSARY

Automatic fiscal stabilisers: Features of the tax and spending regime of a government budget that react automatically to the economic cycle and reduce its fluctuations. As a result, the government budget balance in per cent of GDP tends to improve in years of high economic growth and deteriorate during economic slowdowns.

Budget semi-elasticity: The change in the *budget balance-to-GDP ratio* to a cyclical change in GDP. The estimates of budget semi-elasticity used in EU fiscal surveillance are derived from a methodology developed by the OECD and agreed by the competent Council committee. The average semi-elasticity for the EU as a whole is 0.5.

Corrective arm of the Stability and Growth Pact: The part of the *Stability and Growth Pact* that deals with preventing the risk of and/or correcting an excessive budgetary imbalance. Under the SGP an excessive budgetary imbalance is (i) a government deficit exceeding 3% of GDP and (ii) government debt in excess of 60% of GDP that is not approaching 60% at a satisfactory pace (see also *debt reduction benchmark*).

Commonly agreed method (for estimating potential output): Under the EU fiscal surveillance framework, the European Commission estimates potential output and the output gap with a commonly agreed methodology endorsed by the ECOFIN Council back in 2002. The *commonly agreed method* is based on a production function approach, which brings together the potential levels of labour, capital and total factor productivity. For more details, see Box 4.2 of the EFB Annual Report 2017.

Country-specific recommendations (CSRs): Policy guidance tailored to each EU Member State based on Treaty provisions and secondary EU legislation aimed at coordinating national economic policies. The recommendations are put forward by the European Commission in May each year, then discussed among Member States in the Council, endorsed by EU leaders at a summit in June, and formally adopted by finance ministers in July.

Debt reduction benchmark: The reduction of a country's government debt above 60% of GDP by 1/20th per year on average. This is the criterion used to assess whether excessive government debt is sufficiently diminishing and approaching 60% of GDP at a satisfactory pace. The pace of reduction is assessed over both the past 3 years and the next 3 years, and after correcting for the cycle. Compliance in at least one of the three cases is sufficient to ensure compliance with the debt criterion (see *corrective arm of the SGP*).

Discretionary fiscal policy: A government decision that leads to a change in government spending or revenue above and beyond the effect of existing fiscal policies. Its effect is usually measured as the change in the budget balance net of the effect of *automatic fiscal stabilisers*, one-off measures and interest payments (see also *structural balance* and *structural primary balance*).

Draft budgetary plans (DBPs): Governments submit DBPs to the Commission and the Council to ensure the coordination of fiscal policies among Member States who have the euro as their currency. They submit their DBPs for the following year between 1 and 15 October. The requirement was introduced in 2013 with the *two-pack* reform of the Stability and Growth Pact.

Enhanced surveillance: Tighter surveillance introduced by the two-pack reform for countries experiencing financial difficulties or under precautionary assistance programmes from the European Stability Mechanism. Under the enhanced surveillance, they are subject to regular review visits by the Commission and must provide additional data, for example on their financial sectors.

European Semester: A framework for the coordination of economic policies across the European Union. It is organised around an annual timeline that allows EU countries to discuss their economic and budgetary plans and monitor progress at specific dates throughout the year.

Excessive deficit procedure (EDP): A procedure under the corrective arm of the SGP to correct an excessive deficit, i.e. a deficit that lastingly exceeds the 3% of GDP Treaty threshold by a margin, or a debt ratio that is not diminishing sufficiently.

Expenditure benchmark: One of the two indicators used to assess compliance with the *Stability and Growth Pact*, along with the change in the *structural balance*. It specifies a maximum growth rate for public expenditure that: (i) is corrected for certain non-discretionary items, such as interest expenditure; (ii) includes a smoothed measure of public investment; and (iii) is adjusted for discretionary revenue measures. The growth rate may not exceed *potential GDP* growth over the medium term and is further constrained for Member States that have not yet achieved their *medium-term budgetary objective*.

Fiscal Compact: The fiscal chapter of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (*TSCG*), which is an intergovernmental treaty aiming to reinforce fiscal discipline in the euro area. The *TSCG* was signed on 2 March 2012 by all Member States of the European Union except Czechia, the United Kingdom and Croatia (which did not join the EU until 2013). Of the 25 contracting parties to the TSCG, 22 (the 19 euro-area Member States plus Bulgaria, Denmark and Romania on a voluntary basis) are formally bound by the Fiscal Compact. They are required to have enacted laws of binding character for their national budgets to be in balance or in surplus. These laws must also provide for a correction mechanism overseen by a national independent fiscal institution to avoid lasting deviations from a balanced budget position. The remaining three countries, Hungary, Poland and Sweden, have been exercising from the beginning their right of exemption from the Fiscal Compact provisions of the Treaty. In a similar vein, Czechia and Croatia, when they recently became signatories to the TSCG, decided not to be bound by the Fiscal Compact.

Fiscal impulse: A measure of the impact of *discretionary fiscal policy* on aggregate demand. In practice, the impact cannot be precisely measured as it is influenced by the composition of fiscal measures, the fiscal multiplier and other factors. In this document, the fiscal impulse is measured as the annual change in the structural primary budget balance, i.e. the change in the *fiscal stance*. When the change is positive, fiscal impulse is restrictive; when the change is negative, it is expansionary.

Fiscal space: Leeway to run an expansionary fiscal policy. While there is no generally accepted definition, in this document, a country is considered to have fiscal space in year t if its structural balance in year t-1 is estimated above its *medium-term budgetary objective* (MTO).

Fiscal stance: A measure of the degree of support offered by fiscal policy to aggregate demand. It is proxied with the *structural primary budget balance*. When the balance is positive, the fiscal stance is considered not to be supportive; when the stance is negative, it is considered be supportive.

Flexibility clauses: Provisions under the preventive arm of the SGP allowing a temporary and limited deviation from the *MTO*, or the adjustment path towards it. Flexibility clauses can be granted, subject to pre-defined eligibility conditions, to accommodate the budgetary impact of major structural reforms or government investment.

Golden rule: A policy to constrain government borrowing to resources needed for government investment. It allows governments to only incur deficits to finance (net) government investment and otherwise mandates that current expenditure be balanced by revenues. See Box 3 of the EFB fiscal stance assessment report (2020a).

Matrix of adjustment requirements: A double-entry table detailing the structural adjustment required under the *preventive arm of the Stability and Growth Pact* since 2015. It modulates the benchmark annual adjustment of 0.5% of GDP depending on: (i) cyclical conditions, as indicated by the level of the *output gap* and whether GDP growth is above or below potential; and (ii) the level of government debt and sustainability risks as measured by the *S1 indicator*.

Medium-term budgetary objective (MTO): The *Stability and Growth Pact* requires Member States to specify every 3 years a medium-term objective for their budgetary position in the *stability and convergence programmes*. The MTO is country-specific in order to take account of the diversity of economic and budgetary developments and the diversity of fiscal risks to the sustainability of public finances. It is defined in structural terms (see *structural balance*). The MTO should not be lower than the *minimum MTO* calculated by the Commission (see below).

Minimum benchmark: The lowest value of the structural balance that provides a sufficient margin against the risk of breaching the Treaty deficit threshold of 3% of GDP during normal cyclical fluctuations. For each Member State, the

Commission provides an annual update of the *minimum benchmark*, by taking into account past output volatility and the budgetary responses to output fluctuations. Since 2019, the volatility is measured as the simple average between the country-specific standard deviation of the cyclical component of the budget balance and the one based on all available observations for all Member States since 1985. A Member State with a greater output volatility and a larger budgetary semi-elasticity will need a more demanding structural balance to ensure a *safety margin* with respect to the threshold of 3% of GDP.

Minimum MTO: The country-specific lowest limit for the MTO, which corresponds to the lowest MTO (i.e. the most demanding value) of the following three components: i) the *minimum benchmark* (see above); ii) the implicit liabilities and debt component, reflecting medium- and long-term sustainability needs; and iii) the -1% lower limit for Member States of the euro area and the European exchange rate mechanism. Member States are free to set a more ambitious MTO in their *stability and convergence programmes*.

Net expenditure: Primary government expenditure net of certain items not directly under the control of government (expenditure backed by EU funds and the cyclical component of unemployment benefit expenditure) and using investment expenditure smoothed over 4 years. It is also net of discretionary revenue measures and revenues mandated by law, and corrected for the impact of one-offs. This expenditure aggregate is used for the *expenditure benchmark*.

Output gap: The difference between actual output and estimated potential output at a particular point in time. A business cycle typically includes a period of positive output gaps and a period of negative output gaps. When the output gap is closed, the economy is in line with its potential level (see *potential GDP*). A standard business cycle usually lasts up to 8 years, suggesting that the output gap is typically expected to close roughly every 4 years.

Overall assessment: The analysis of the information conveyed by the two indicators used to assess compliance with the *preventive arm of the SGP*, namely the change in the *structural balance* and the *expenditure benchmark*. An overall assessment is conducted whenever at least one of the two indicators does not point to compliance with the requirements. It is meant to clarify: (i) whether and how specific factors may affect one or both indicators; and (ii) which indicator would provide a more accurate assessment in the given context if the two indicators do not support the same conclusions.

Potential GDP (or potential output): The level of real GDP in a given year that is consistent with a stable rate of inflation. If actual output rises above its potential level, constraints on capacity begin to bind and inflationary pressures build; if output falls below potential, resources are lying idle and inflationary pressures abate (see also *commonly agreed method*, *production function approach* and *output gap*).

Preventive arm of the Stability and Growth Pact: The part of the *Stability and Growth Pact* that aims to prevent gross policy errors and excessive deficits. Under the preventive arm, Member States are required to progress towards their *medium-term budgetary objective* and maintain it once reached.

Production function approach: A method of estimating an economy's sustainable level of output, compatible with stable inflation based on available labour inputs, the capital stock and their level of efficiency. *Potential output* is used to estimate the *output gap*, a key input in estimating the *structural balance*.

Revenue windfalls and shortfalls: Changes in government revenue that are not explained by the standard elasticity of revenue to the economic cycle. Unusually buoyant revenue leads to revenue windfalls while unusually weak revenue leads to revenue shortfalls.

S0 indicator: A composite indicator published by the European Commission to evaluate the extent to which there might be a risk of fiscal stress in the short term, stemming from the fiscal, macro-financial or competitiveness sides of the economy. A set of 25 fiscal and financial-competitiveness variables proven to perform well in detecting fiscal stress in the past is used to construct the indicator.

S1 indicator: A medium-term sustainability indicator published by the European Commission. It indicates the additional adjustment, in terms of change in the *structural primary balance*, required over 5 years to bring the general government debt-to-GDP ratio to 60% in 15 years' time, including financing for any future additional expenditure arising from an ageing population.

S2 indicator: The European Commission's long-term sustainability indicator. It shows the upfront adjustment to the current *structural primary balance* required to stabilise the debt-to-GDP ratio over an infinite horizon, including financing of expenditure arising from an ageing population.

Safety margin: The difference between the 3%-of-GDP deficit threshold and the *minimum benchmark*.

Severe economic downturn clause: In public debate, misleadingly referred to as the 'general escape clause'. It was created in 2011 as part of the *six-pack* reform of the *Stability and Growth Pact*. It provides for additional and temporary flexibility vis-à-vis the normal requirements of the preventive and corrective arm of the Pact in the event of a severe economic downturn in the euro area or the EU as a whole, provided that this does not endanger fiscal sustainability in the medium term. A severe economic downturn is defined as 'a negative annual GDP volume growth rate' or 'an accumulated loss of output during a protracted period of very low annual GDP volume growth relative to its potential'.

Six-pack: A set of European legislative measures – five regulations and one directive – to reform the *Stability and Growth Pact*. The six-pack entered into force on 13 December 2011. It aims to strengthen the procedures for reducing public deficits and debts and to address macroeconomic imbalances.

Stabilisation: Economic policy intervention to bring actual output closer to *potential output*. In the Economic and Monetary Union this is expected to be achieved, in normal economic times, through the ECB's monetary policy (for common shocks) and national *automatic fiscal stabilisers* (for country-specific shocks). When this is not sufficient, *discretionary fiscal policy* can also play a role.

Stability and convergence programmes (SCPs): Every year in April, Member States are required to set out their fiscal plans for the next 3 years and to submit them for assessment to the European Commission and the Council. This exercise is based on the economic governance rules under the *Stability and Growth Pact*. Euro-area countries submit stability programmes; non-euro-area countries submit convergence programmes.

Stability and Growth Pact (SGP): A set of rules designed to ensure that countries in the European Union pursue sound public finances and coordinate their fiscal policies. The SGP is based on an agreement reached by Member States in 1997 to enforce the deficit and debt limits established by the Maastricht Treaty.

Structural (budget) balance: The headline budget balance net of cycle component, one-offs and other temporary measures. The structural balance gives a measure of the underlying trend in the budget balance.

Structural primary (budget) balance: The *structural (budget) balance* net of interest payments (see also *fiscal stance*).

Sustainability of public finances: The ability of a government to service its debt. From a purely theoretical point of view, this basically assumes that the government debt level does not grow faster than the interest rate. While conceptually intuitive, an agreed operational definition of sustainability has proven difficult to achieve. The European Commission uses three indicators of sustainability with different time horizons (*S0*, *S1* and *S2*), which are complemented by a debt sustainability analysis that includes sensitivity tests on government debt projections and alternative scenarios.

Two-pack: Two European regulations adopted in 2013 to introduce stronger fiscal surveillance, including under the *Stability and Growth Pact*. The new mechanisms aim to increase the transparency of Member State budgetary decisions, strengthen coordination in the euro area starting with the 2014 budgetary cycle, and recognise the special needs of euro-area countries under severe financial pressure.

Zero or effective lower bound (ZLB): When the short-term nominal interest rate is at or near zero, the central bank is limited in its capacity to stimulate economic growth by lowering policy rates further. To overcome the constraint imposed by the ZLB, alternative methods to stimulate demand are generally considered, such as asset purchase programmes. The root cause of the ZLB is the issuance of paper currency, effectively guaranteeing a zero nominal interest rate and acting as an interest rate floor. Central banks cannot encourage spending by lowering interest rates, because people would hold cash instead.

ANNEX A: OVERVIEW TABLES

Table A1: **Application of EU fiscal rules in the 2021 surveillance cycle - the preventive arm of the SGP (see Box A1 on how to read the table)**

	Spring 2020			Autumn 2020	2021	Spring 2022			
	Distance to MTO in 2020 % of GDP	Country-specific recommendation (CSR) for 2021		Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2021 Spring Package)	Observed fiscal performance in 2021 (% of GDP)		Final Commission assessment	Conclusion of the overall assessment and procedural steps after the reference period
		Requirement	Flexibility clauses (granted ex ante)			ΔSB	NEG		
BE	-4.7	Take all necessary measures, in line with the general escape clause of the Stability and Growth Pact, to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.	Severe economic downturn clause	Overall in line with the CSR. Measures appear to be (mostly) temporary; asked to ensure that fiscal sustainability in the medium term is preserved when taking supporting budgetary measures	Measures appear to be (mostly) temporary	**1.2**	**2.4**	**No assessment of compliance**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
BG	-0.3	idem	idem	-	Meeasures appear to be (mostly) temporary	**-0.9**	**-2.7**	**No assessment of compliance**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
CZ	-3.8	idem	idem	-	Some measures do not appear to be temporary (around 2% GDP)	**-0.8**	**-0.9**	**No assessment of compliance**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
DK	-1.4	idem	idem	-	Measures appear to be (mostly) temporary	**1.3**	**1.1**	**No assessment of compliance**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
DE	-3.3	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Some measures do not appear to be temporary (around 1% GDP)	**-0.2**	**-1.4**	**No assessment of compliance**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
EE	-5.3	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Some measures do not appear to be temporary (around 1% GDP)	**0.1**	**1.6**	**No assessment of compliance**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
IE	-1.0	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Measures appear to be (mostly) temporary	**-0.6**	**0.9**	**No assessment of compliance**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures

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Table (continued)

	Spring 2020			Autumn 2020	2021	Spring 2022		
	Distance to MTO in 2020 % of GDP	Country-specific recommendation (CSR) for 2021		Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2021 Spring Package)	Final Commission assessment		Conclusion of the overall assessment and procedural steps after the reference period
		Requirement	Flexibility clauses (granted ex ante)			Observed fiscal performance in 2021 (% of GDP)		
						ΔSB	NEG	
EL	-0.3	Take all necessary measures, in line with the general escape clause of the Stability and Growth Pact, to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.	Severe economic downturn clause	Overall in line with the CSR. Measures appear to be (mostly) temporary; ensure fiscal sustainability in the medium term when taking supporting budgetary measures	Measures appear to be (mostly) temporary	**-1.4**	**-1.2**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
						No assessment of compliance		
ES	-5.6	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary; ensure fiscal sustainability in the medium term when taking supporting budgetary measures	Measures appear to be (mostly) temporary	**0.4**	**-1.3**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		
FR	-4.3	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary; ensure fiscal sustainability in the medium term when taking supporting budgetary measures	Some measures do not appear to be temporary (around 1% GDP)	**-0.9**	**-1.2**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		
HR	-3.4	idem	idem	-	Measures appear to be (mostly) temporary	**1.4**	**0.6**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		
IT	-6.8	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary; ensure fiscal sustainability in the medium term when taking supporting budgetary measures	Some measures do not appear to be temporary (around 1% GDP)	**-1.6**	**-1.1**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		
CY	-5.2	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Measures appear to be (mostly) temporary	**2.5**	**0.8**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
						No assessment of compliance		
LV	-4.2	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Some measures do not appear to be termporary (around 1% GDP)	**-3.6**	**-2.5**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		

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Table (continued)

	Spring 2020			Autumn 2020	2021	Spring 2022		
	Distance to MTO in 2020 % of GDP	Country-specific recommendation (CSR) for 2021		Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2021 Spring Package)	Final Commission assessment		Conclusion of the overall assessment and procedural steps after the reference period
		Requirement	Flexibility clauses (granted ex ante)			Observed fiscal performance in 2021 (% of GDP)		
						ΔSB	NEG	
LT	-3.4	Take all necessary measures, in line with the general escape clause of the Stability and Growth Pact, to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.	Severe economic downturn clause	Overall in line with the CSR. Some measures (exceeding 0.5% of GDP) do not appear to be temporary	Some measures do not appear to be temporary (around 1% GDP)	**6.2**	**2.1**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		
LU	-3.1	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Measures appear to be (mostly) temporary	**2.5**	**2.2**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
						No assessment of compliance		
HU	-1.6	idem	idem	-	Measures appear to be (mostly) temporary	**-0.4**	**-0.3**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		
MT	-4.2	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Measures appear to be (mostly) temporary	**-1.2**	**-2.7**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
						No assessment of compliance		
NL	-1.9	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Some measures do not appear to be temporary (around 1% GDP)	**-0.7**	**-0.4**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
						No assessment of compliance		
AT	-2.9	idem	idem	Overall in line with the CSR. Measures appear to be (mostly) temporary	Some measures do not appear to be temporary (around 1% GDP)	**0.4**	**-1.1**	Measures in line with the CSR. Some measures were not temporary or matched by offsetting measures.
						No assessment of compliance		
PL	-7.5	idem	idem	-	Measures appear to be (mostly) temporary	**4.1**	**3.0**	Measures in line with the CSR. Measures were mostly temporary or matched by offsetting measures
						No assessment of compliance		

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<table>
<tr><th rowspan="4"></th><th colspan="3">Spring 2020</th><th>Autumn 2020</th><th>2021</th><th colspan="3">Spring 2022</th></tr>
<tr><th rowspan="3">Distance to MTO in 2020 % of GDP</th><th colspan="2">Country-specific recommendation (CSR) for 2021</th><th rowspan="3">Commission assessment of draft budgetary plan (DBP)</th><th rowspan="3">In-year assessment (Commission 2021 Spring Package)</th><th colspan="2">Final Commission assessment</th><th rowspan="3">Conclusion of the overall assessment and procedural steps after the reference period</th></tr>
<tr><th rowspan="2">Requirement</th><th rowspan="2">Flexibility clauses (granted ex ante)</th><th colspan="2">Observed fiscal performance in 2021 (% of GDP)</th></tr>
<tr><th>ΔSB</th><th>NEG</th></tr>
<tr><td rowspan="2">PT</td><td rowspan="2">-3.2</td><td rowspan="2">Take all necessary measures, in line with the general escape clause of the Stability and Growth Pact, to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.</td><td rowspan="2">Severe economic downturn clause</td><td rowspan="2">Overall in line with the CSR.
Measures appear to be (mostly) temporary; ensure fiscal sustainability in the medium term when taking supporting budgetary measures</td><td rowspan="2">Some measures do not appear to be temporary (around 1% GDP)</td><td>0.5</td><td>-0.2</td><td rowspan="2">Measures in line with the CSR.
Some measures were not temporary or matched by offsetting measures.</td></tr>
<tr><td colspan="2">No assessment of compliance</td></tr>
<tr><td rowspan="2">SI</td><td rowspan="2">-4.1</td><td rowspan="2">idem</td><td rowspan="2">idem</td><td rowspan="2">Overall in line with the CSR.
Measures appear to be (mostly) temporary</td><td rowspan="2">Measures appear to be (mostly) temporary</td><td>0.1</td><td>-0.3</td><td rowspan="2">Measures in line with the CSR.
Measures were mostly temporary or matched by offsetting measures</td></tr>
<tr><td colspan="2">No assessment of compliance</td></tr>
<tr><td rowspan="2">SK</td><td rowspan="2">-5.6</td><td rowspan="2">idem</td><td rowspan="2">idem</td><td rowspan="2">Overall in line with the CSR.
Some measures (exceeding 0.5% of GDP) do not appear to be temporary</td><td rowspan="2">Some measures do not appear to be temporary (around 1% GDP)</td><td>-1.3</td><td>-2.2</td><td rowspan="2">Measures in line with the CSR.
Some measures were not temporary or matched by offsetting measures.</td></tr>
<tr><td colspan="2">No assessment of compliance</td></tr>
<tr><td rowspan="2">FI</td><td rowspan="2">-3.7</td><td rowspan="2">idem</td><td rowspan="2">idem</td><td rowspan="2">Overall in line with the CSR.
Measures appear to be (mostly) temporary</td><td rowspan="2">Some measures do not appear to be temporary (around 1% GDP)</td><td>1.7</td><td>0.9</td><td rowspan="2">Measures in line with the CSR.
Measures were mostly temporary or matched by offsetting measures</td></tr>
<tr><td colspan="2">No assessment of compliance</td></tr>
<tr><td rowspan="2">SE</td><td rowspan="2">-1.1</td><td rowspan="2">idem</td><td rowspan="2">idem</td><td rowspan="2">-</td><td rowspan="2">Some measures do not appear to be temporary (around 1% GDP)</td><td>0.9</td><td>1.1</td><td rowspan="2">Measures in line with the CSR.
Some measures were not temporary or matched by offsetting measures.</td></tr>
<tr><td colspan="2">No assessment of compliance</td></tr>
</table>

Source: European Commission

Table A2: **Application of EU fiscal rules in the 2021 surveillance cycle - the corrective arm of the SGP; countries not in EDP (see Box A1 on how to read the table)**

	Spring 2020		2021	Spring 2022		
				Final assessment		
	Deficit Rule	Debt Rule (DR) / Transitional Arrangement (MLSA)	Procedural steps during the reference period	Deficit Rule	Debt Rule (DR) / Transitional Arrangement (MLSA)	Procedural steps after the reference period
BE	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Belgium did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Belgium's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that given the level of Belgium's government debt and high sustainability challenges in the medium term before the outbreak of the Covid-19 pandemic, when taking supportive budgetary measures, it is important to preserve prudent fiscal policy in order to ensure sustainable public finances in the medium term.	Non-compliant	Non-compliant	**23.5.2022 –** The Commission confirmed that Belgium did not fulfil the deficit and debt criteria. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
BG	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Bulgaria did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Bulgaria did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
CZ	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Czechia did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Czechia did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
DE	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Germany did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Germany's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Germany did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
EE	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Estonia did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Estonia's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Estonia did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.

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Table (continued)

IE	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Ireland did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Ireland's DBP. The Opinion did not include an assessment of compliance with fiscal rules.			
EL	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Greece did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Greece's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that given the level of Greece's government debt and high sustainability challenges in the medium term before the outbreak of the Covid-19 pandemic, when taking supportive budgetary measures, it is important to preserve prudent fiscal policy in order to ensure sustainable public finances in the medium term.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Greece did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
ES	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Spain did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Spain's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that given the level of Spain's government debt and high sustainability challenges in the medium term before the outbreak of the Covid-19 pandemic, when taking supportive budgetary measures, it is important to preserve prudent fiscal policy in order to ensure sustainable public finances in the medium term.	Non-compliant	Compliant	**23.5.2022 –** The Commission issued confirmed that Spain did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
FR	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that France did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on France's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that given the level of France's government debt and high sustainability challenges in the medium term before the outbreak of the COVID-19 pandemic, when taking supportive budgetary measures, it is important to preserve prudent fiscal policy in order to ensure sustainable public finances in the medium term.	Non-compliant	Non-compliant	**23.5.2022 –** The Commission confirmed that France did not fulfil the deficit and debt criteria. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
HR	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Croatia did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths.			

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Table (continued)

IT	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Italy did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Italy's DBP. The Opinion did not include an assessment of compliance with fiscal rules. The Commission invites Italy to take the necessary measures within the national budgetary process to limit the growth of nationally financed current expenditure. It stated that given the level of Italy's government debt and high sustainability challenges in the medium term before the outbreak of the Covid-19 pandemic, when taking supportive budgetary measures, it is important to preserve prudent fiscal policy in order to ensure sustainable public finances in the medium term.	Non-compliant	Non-compliant	**23.5.2022 –** The Commission confirmed that Italy did not fulfil the deficit and debt criteria. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
CY	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Cyprus did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Cyprus' DBP. The Opinion did not include an assessment of compliance with fiscal rules.			
LV	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Latvia did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Latvia's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Latvia did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
LT	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Lithuania did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Lithuania's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Lithuania did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
LUX	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Luxembourg did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Luxembourg's DBP. The Opinion did not include an assessment of compliance with fiscal rules.			
HU	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Hungary did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths	Non-compliant	Non-compliant	**23.5.2022 –** The Commission confirmed that Hungary did not fulfil the deficit and debt criteria. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.

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Table (continued)

MT	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Malta did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Malta's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Malta did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
NL	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that the Netherlands did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on the Netherlands' DBP. The Opinion did not include an assessment of compliance with fiscal rules.			
AT	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Austria did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Austria's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Austria did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
PL	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Poland did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths.	Non-Compliant	Compliant	**23.5.2022 –** The Commission confirmed that Poland did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
PT	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Portugal did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **11.11.2021** – The Commission published a letter to Portugal. It stated that the Commission will not adopt an opinion on Portugal's DBP due to the rejection of the State Budget for 2022, on which was based the DBP.			
SI	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Slovenia did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Slovenia's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Slovenia did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.

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Table (continued)

SK	Non-compliant	Compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Slovakia did not fulfil the deficit criterion. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Slovakia's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Non-compliant	Compliant	**23.5.2022 –** The Commission confirmed that Slovakia did not fulfil the deficit criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.
FI	Non-compliant	Non-compliant	**2.6.2021 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Finland did not fulfil the deficit and debt criteria. However, the report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the high degree of uncertainty and the difficulty with defining fiscal adjustment paths. **24.11.2021** – The Commission published its opinion on Finland's DBP. The Opinion did not include an assessment of compliance with fiscal rules.	Compliant	Non-compliant	**23.5.2022 –** The Commission confirmed that Finland did not fulfil the debt criterion. The Commission's report did not contain conclusions on what steps to take next. In its chapeau communication the Commission suggested postponing any decision on EDPs in view of the exceptional uncertainty, including for designing a detailed path for fiscal policy.

Source: European Commission

Table A3: **Application of the EU fiscal rules in the 2021 surveillance cycle - the corrective arm of the SGP; countries in EDP (see Box A1 on how to read the table)**

	2020			2021			Spring 2022		
	Procedural steps before the reference period	Targets/Requirements for 2021 % of GDP		Procedural steps during the reference period	Revised targets/requirements for 2021 % of GDP		Procedural steps after the reference period	Final assessment % of GDP	
		Headline budget balance	Structural adjustment		Headline budget balance	Structural adjustment		Headline budget balance	Change in the structural budget balance
RO	**14.02.2020** – After the Romanian government itself announced that it would breach the deficit criterion in 2019 by a large margin, the Commission prepared a report under Article 126(3) TFEU. **4.03.2020** – The Commission issued a Recommendation for a Council Recommendation to end the excessive deficit situation. **3.4.2020** – The Council recommended to put an end to the present excessive deficit situation by 2022 at the latest **15.9.2020** – The Romanian authorities sent a report on effective action. **18.11.2020** – Communication from the Commission to the Council on the Fiscal situation in Romania.	-3.4	0.8	**2.6.2021** – The Commission issued a Recommendation in accordance with Article 126(7) TFEU for a Council Recommendation to bring an end to Romania's excessive government deficit. In its recommendation, the Commission took into account the country's changed fiscal situation, including budgetary developments in 2020 and the new budgetary strategy put in place by the Romanian government. It concluded to extend the deadline for correcting the excessive deficit to 2024 and provided a new adjustment path for the rate of nominal growth of net primary government expenditure and an annual fiscal adjustment to the structural balance. It also stated that growth rates of net primary government expenditure would be the primary indicator used to assess Romania's fiscal effort if necessary. **18.6.2021** – The Council adopted a revised EDP recommendation for Romania, to put an end to the excessive deficit situation by 2024 at the latest. **24.11.2021** – Communication from the Commission to the Council on the Fiscal situation in Romania In its assessment, the Commission recognised the commitment of the Romanian authorities to ensure a correction of the excessive deficit. However, it signalled that the report contained only measures adopted with the aim of delivering compliance with the 2021 intermediate deficit target. Based on the projected achievement of the required headline deficit target in 2021, it kept the excessive deficit procedure in abeyance. It expected the Romanian government, when formed, to present a budget for 2022 and a medium-term fiscal strategy in line with the June 2021 Council recommendation as a matter of urgency.	-8.0	0.7	**23.5.2022** – The Commission issued an assessment of Romania's compliance with its EDP targets in the recitals of the country-specific recommendations. Based on its 2022 spring forecast, the Commission assessed that Romania complied with its nominal deficit target and the required structural adjustment in 2021. For this reason, it has kept the procedure in abeyance.	-7.1	1.5

Source:

Box A1: **Reading the overview tables A1, A2 and A3**

The tables in Annex A provide an overview of the various Stability and Growth Pact (SGP) procedures for all Member States in the 2021 reference period. All the tables are divided into columns covering the main steps of the annual cycle of EU fiscal surveillance. Explanations of the column headings are set out below.

Table A.1. Application of EU fiscal rules in the 2021 surveillance cycle: preventive arm

Distance to the medium-term budgetary objective (MTO): The difference between the country-specific MTO and the 2020 structural balance, on the basis of the Commission 2020 spring forecasts underpinning the Council's July 2020 country-specific recommendations (CSRs).

Requirement: In 2021, fiscal guidance was qualitative and no quantitative requirements were issued. In normal times, the annual adjustment requirement is expressed in terms of the two quantitative indicators of the SGP's preventive arm: (i) the expenditure benchmark (EB) and (ii) the change in the structural budget balance (ΔSB). The EB limits the year-on-year increase in government spending unless funded by new revenue measures. It is expressed using the annual growth rate of aggregate expenditure (net of interest payments) on EU programmes paid for by EU funds and the cyclical component of unemployment benefits, while nationally financed government investment is smoothed over 4 years. The ΔSB is defined on the basis of a country's cyclical conditions, taking into account the sustainability needs of its public finances ([1]). The required structural adjustment is net of any flexibility clauses granted *ex ante*.

Flexibility clauses granted *ex ante*: In 2021, the severe economic downturn clause was applied.

Commission overall assessment of the 2021 draft budgetary plan (DBP): In 2021, the assessment was qualitative in the absence of quantitative requirements. In normal years (in line with Regulation (EU) 473/2013), all euro-area countries submit their DBPs by 15 October, except in the case of a macroeconomic adjustment programme. Plans are assessed for compliance with the SGP. The Commission's overall conclusion can be: (i) compliant, (ii) risk of (some) deviation ([2]); or (iii) risk of significant deviation. If there is a risk of some deviation, the DBP is considered to be broadly compliant. However, if there is a risk of significant deviation, the DBP is considered to be non-compliant. For a comprehensive presentation of the assessment of compliance with the preventive arm of the SGP, see section 1.3.7 of the Vade Mecum.

In-year assessment: The Commission's assessment presented in the 2021 spring package.

Observed fiscal performance in 2021: Presents the underlying fiscal developments on the basis of two indicators: (i) the change in the structural budget balance (ΔSB); and (ii) excess net expenditure growth over the medium-term rate of potential GDP growth (i.e. NEG). Both indicators are expressed as a percentage of GDP.

Conclusion of the overall assessment and procedural steps after the reference period: Records procedural or other steps (if any) taken following the final assessment of fiscal performance for a given year. In 2021, the Commission did not provide the usual compliance assessment, in the light of the activation of the severe economic downturn clause and provided only qualitative fiscal guidance.

Table A.2. Application of EU fiscal rules in the 2021 surveillance cycle - the corrective arm: countries not subject to the EDP

Deficit Rule: The Commission's assessment of a country's fulfilment of the 3% of GDP deficit criterion.

Debt Rule (DR)/Transitional Arrangement (MLSA): The Commission's assessment of a country's fulfilment of the debt criterion. A Member State is considered to fulfil the debt criterion if its general government consolidated gross debt is below 60% of GDP or is sufficiently diminishing and approaching 60% of GDP at a satisfactory pace. For Member States subject to the EDP on 8 November 2011 (the date the six-pack legislative package was adopted), special provisions apply under a transitional arrangement for the 3 years following the correction of their excessive deficit. For a comprehensive presentation of both cases, see sections 2.2.1.2 and 2.2.1.3 of the Vade Mecum (2019 edition).

Procedural steps taken during the reference period: Records procedural or other steps under the corrective arm of the SGP during the year under assessment. For 2021, this column presents a single report written pursuant to Article

([1]) The *'Required Structural Adjustment based on matrix'* is based on the matrix for specifying the annual adjustment required to achieve the MTO under the preventive arm of the SGP, as presented in the Commonly Agreed Position on Flexibility in the SGP endorsed by the ECOFIN Council of 12 February 2016: http://data.consilium.europa.eu/doc/document/ST-14345-2015-INIT/en/pdf

([2]) 'Some deviation' refers to any deviation that is not significant, namely below 0.5 – as stated by Articles 6(3) and 10(3) of Regulation 1466/97.

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Box (continued)

126(3) TFEU, the first step in the EDP, and analysing compliance with the Treaty's deficit and debt criteria for 26 Member States.

Deficit Rule: See above.

Debt Rule (DR) / Transitional Arrangement (MLSA): See above.

Procedural steps after the reference period: Records procedural or other steps (if any) taken following the final assessment of fiscal performance for a given year.

Table A.3. Application of EU fiscal rules in the 2021 surveillance cycle - the corrective arm: countries subject to the EDP

Procedural steps before the reference period: This column presents all steps taken in 2020 and presents a Member State's status in the EDP procedure.

- **Headline budget balance:** The Council recommends that Member States subject to the EDP should meet annual headline deficit targets in order to ensure the correction of the excessive deficit by a set deadline. This column presents the required headline budget balance for 2021 as set in spring 2020.
- **Structural adjustment:** The required annual improvement in the structural balance consistent with the nominal target recommended by the Council in spring 2020.

Procedural steps taken during the reference period: Covers all steps taken under the corrective arm of the SGP in 2021.

- **Headline budget balance:** This column presents the required headline budget balance for 2021 as recommended by the Council in spring 2021.
- **Structural adjustment:** The required annual improvement in the structural balance consistent with the nominal target recommended by the Council in spring 2021.

Procedural steps after the reference period: Records procedural or other steps (if any) taken following the final assessment of fiscal performance for a given year.

- **Headline budget balance**: Presents the headline budget balance out-turn in 2021 or information attesting the correction of the excessive deficit.
- **Structural adjustment**: The estimated structural adjustment made in 2021, together with the corrected figure for unanticipated revenue windfalls/shortfalls and changes in potential growth compared with the scenario underpinning the EDP's recommendations. For the latter, see section 2.3.2.1 of the Vade Mecum.

ANNEX B: STATISTICAL ANNEX

Table B1: **Gross domestic product at 2015 reference levels (annual percentage change, 2004-2023)**

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
BE	3.6	2.3	2.6	3.7	0.4	-2.0	2.9	1.7	0.7	0.5	1.6	2.0	1.3	1.6	1.8	2.1	-5.7	6.2	2.0	1.8
BG	6.5	7.1	6.8	6.6	6.1	-3.3	1.5	2.1	0.8	-0.6	1.0	3.4	3.0	2.8	2.7	4.0	-4.4	4.2	2.1	3.1
CZ	4.8	6.6	6.8	5.6	2.7	-4.7	2.4	1.8	-0.8	0.0	2.3	5.4	2.5	5.2	3.2	3.0	-5.8	3.3	1.9	2.7
DK	2.7	2.3	3.9	0.9	-0.5	-4.9	1.9	1.3	0.2	0.9	1.6	2.3	3.2	2.8	2.0	2.1	-2.1	4.7	2.6	1.8
DE	1.2	0.7	3.8	3.0	1.0	-5.7	4.2	3.9	0.4	0.4	2.2	1.5	2.2	2.7	1.1	1.1	-4.6	2.9	1.6	2.4
EE	6.8	9.5	9.8	7.6	-5.1	-14.6	2.4	7.3	3.2	1.5	3.0	1.9	3.2	5.8	4.1	4.1	-3.0	8.3	1.0	2.4
IE	6.8	5.7	5.0	5.3	-4.5	-5.1	1.8	1.1	-0.1	1.3	8.7	25.2	2.0	8.9	9.0	4.9	5.9	13.5	5.4	4.4
EL	5.1	0.6	5.7	3.3	-0.3	-4.3	-5.5	-10.1	-7.1	-2.5	0.5	-0.2	-0.5	1.1	1.7	1.8	-9.0	8.3	3.5	3.1
ES	3.1	3.7	4.1	3.6	0.9	-3.8	0.2	-0.8	-3.0	-1.4	1.4	3.8	3.0	3.0	2.3	2.1	-10.8	5.1	4.0	3.4
FR	2.8	1.7	2.4	2.4	0.3	-2.9	1.9	2.2	0.3	0.6	1.0	1.1	1.1	2.3	1.9	1.8	-7.9	7.0	3.1	1.8
HR	4.1	4.3	4.9	4.9	1.9	-7.3	-1.3	-0.1	-2.3	-0.4	-0.3	2.5	3.5	3.4	2.9	3.5	-8.1	10.2	3.4	3.0
IT	1.4	0.8	1.8	1.5	-1.0	-5.3	1.7	0.7	-3.0	-1.8	0.0	0.8	1.3	1.7	0.9	0.5	-9.0	6.6	2.4	1.9
CY	5.0	4.9	4.7	5.1	3.6	-2.0	2.0	0.4	-3.4	-6.6	-1.8	3.4	6.5	5.9	5.7	5.3	-5.0	5.5	2.3	3.5
LV	8.3	10.7	12.0	9.9	-3.2	-14.2	-4.5	2.6	7.0	2.0	1.9	3.9	2.4	3.3	4.0	2.5	-3.8	4.5	2.0	2.9
LT	6.6	7.7	7.4	11.1	2.6	-14.8	1.7	6.0	3.8	3.6	3.5	2.0	2.5	4.3	4.0	4.6	-0.1	5.0	1.7	2.6
LU	4.2	2.5	6.0	8.1	-0.3	-3.2	3.8	1.0	1.6	3.2	2.6	2.3	5.0	1.3	2.0	3.3	-1.8	6.9	2.2	2.7
HU	5.0	4.3	3.9	0.3	1.0	-6.6	1.1	1.9	-1.3	1.8	4.2	3.7	2.2	4.3	5.4	4.6	-4.5	7.1	3.6	2.6
MT	0.1	3.4	2.5	4.8	3.8	-1.1	5.5	0.5	4.1	5.5	7.6	9.6	3.4	11.1	6.0	5.9	-8.3	9.4	4.2	4.0
NL	2.0	2.1	3.5	3.8	2.2	-3.7	1.3	1.6	-1.0	-0.1	1.4	2.0	2.2	2.9	2.4	2.0	-3.8	5.0	3.3	1.6
AT	2.7	2.2	3.5	3.7	1.5	-3.8	1.8	2.9	0.7	0.0	0.7	1.0	2.0	2.3	2.5	1.5	-6.7	4.5	3.9	1.9
PL	5.0	3.5	6.1	7.1	4.2	2.8	3.7	4.8	1.3	1.1	3.4	4.2	3.1	4.8	5.4	4.7	-2.2	5.9	3.7	3.0
PT	1.8	0.8	1.6	2.5	0.3	-3.1	1.7	-1.7	-4.1	-0.9	0.8	1.8	2.0	3.5	2.8	2.7	-8.4	4.9	5.8	2.7
RO	10.4	4.7	8.0	7.2	9.3	-5.5	-3.9	1.9	2.0	3.8	3.6	3.0	4.7	7.3	4.5	4.2	-3.7	5.9	2.6	3.6
SI	4.4	3.8	5.7	7.0	3.5	-7.5	1.3	0.9	-2.6	-1.0	2.8	2.2	3.2	4.8	4.4	3.3	-4.2	8.1	3.7	3.1
SK	5.3	6.6	8.5	10.8	5.6	-5.5	6.3	2.6	1.4	0.7	2.7	5.2	1.9	3.0	3.8	2.6	-4.4	3.0	2.3	3.6
FI	4.0	2.8	4.0	5.3	0.8	-8.1	3.2	2.5	-1.4	-0.9	-0.4	0.5	2.8	3.2	1.1	1.2	-2.3	3.5	1.6	1.7
SE	4.3	2.9	4.7	3.4	-0.5	-4.3	6.0	3.2	-0.6	1.2	2.7	4.5	2.1	2.6	2.0	2.0	-2.9	4.8	2.3	1.4
EA-19	2.3	1.7	3.2	3.0	0.4	-4.5	2.1	1.7	-0.9	-0.2	1.4	2.0	1.9	2.6	1.8	1.6	-6.4	5.4	2.7	2.3
EU-27	2.5	1.9	3.5	3.1	0.6	-4.3	2.2	1.8	-0.7	0.0	1.6	2.3	2.0	2.8	2.1	1.8	-5.9	5.4	2.7	2.3

Notes: (1) EA and EU aggregated figures are weighted in common currency.
Source: Commission 2022 spring forecast

Table B2: **Harmonised index of consumer prices (percentage change on preceding year, 2004-2023)**

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
BE	1.9	2.5	2.3	1.8	4.5	0.0	2.3	3.4	2.6	1.2	0.5	0.6	1.8	2.2	2.3	1.2	0.4	3.2	7.8	1.9
BG	6.1	6.0	7.4	7.6	12.0	2.5	3.0	3.4	2.4	0.4	-1.6	-1.1	-1.3	1.2	2.6	2.5	1.2	2.8	11.9	5.0
CZ	2.6	1.6	2.1	2.9	6.3	0.6	1.2	2.2	3.5	1.4	0.4	0.3	0.6	2.4	2.0	2.6	3.3	3.3	11.7	4.5
DK	0.9	1.7	1.8	1.7	3.6	1.0	2.2	2.7	2.4	0.5	0.4	0.2	0.0	1.1	0.7	0.7	0.3	1.9	5.1	2.7
DE	1.8	1.9	1.8	2.3	2.8	0.2	1.1	2.5	2.2	1.6	0.8	0.7	0.4	1.7	1.9	1.4	0.4	3.2	6.5	3.1
EE	3.0	4.1	4.4	6.7	10.6	0.2	2.7	5.1	4.2	3.2	0.5	0.1	0.8	3.7	3.4	2.3	-0.6	4.5	11.2	2.5
IE	2.3	2.2	2.7	2.9	3.1	-1.7	-1.6	1.2	1.9	0.5	0.3	0.0	-0.2	0.3	0.7	0.9	-0.5	2.4	6.1	3.1
EL	3.0	3.5	3.3	3.0	4.2	1.3	4.7	3.1	1.0	-0.9	-1.4	-1.1	0.0	1.1	0.8	0.5	-1.3	0.6	6.3	1.9
ES	3.1	3.4	3.6	2.8	4.1	-0.2	2.0	3.0	2.4	1.5	-0.2	-0.6	-0.3	2.0	1.7	0.8	-0.3	3.0	6.3	1.8
FR	2.3	1.9	1.9	1.6	3.2	0.1	1.7	2.3	2.2	1.0	0.6	0.1	0.3	1.2	2.1	1.3	0.5	2.1	4.9	3.1
HR	2.1	3.0	3.3	2.7	5.8	2.2	1.1	2.2	3.4	2.3	0.2	-0.3	-0.6	1.3	1.6	0.8	0.0	2.7	6.1	2.8
IT	2.3	2.2	2.2	2.0	3.5	0.8	1.6	2.9	3.3	1.2	0.2	0.1	-0.1	1.3	1.2	0.6	-0.1	1.9	5.9	2.3
CY	1.9	2.0	2.2	2.2	4.4	0.2	2.6	3.5	3.1	0.4	-0.3	-1.5	-1.2	0.7	0.8	0.5	-1.1	2.3	5.2	2.7
LV	6.2	6.9	6.6	10.1	15.3	3.3	-1.2	4.2	2.3	0.0	0.7	0.2	0.1	2.9	2.6	2.7	0.1	3.2	9.4	3.5
LT	1.2	2.7	3.8	5.8	11.1	4.2	1.2	4.1	3.2	1.2	0.2	-0.7	0.7	3.7	2.5	2.2	1.1	4.6	12.5	3.0
LU	3.2	3.8	3.0	2.7	4.1	0.0	2.8	3.7	2.9	1.7	0.7	0.1	0.0	2.1	2.0	1.6	0.0	3.5	6.8	2.3
HU	6.8	3.5	4.0	7.9	6.0	4.0	4.7	3.9	5.7	1.7	0.0	0.1	0.4	2.4	2.9	3.4	3.4	5.2	9.0	4.1
MT	2.7	2.5	2.6	0.7	4.7	1.8	2.0	2.5	3.2	1.0	0.8	1.2	0.9	1.3	1.7	1.5	0.8	0.7	4.5	2.6
NL	1.4	1.5	1.6	1.6	2.2	1.0	0.9	2.5	2.8	2.6	0.3	0.2	0.1	1.3	1.6	2.7	1.1	2.8	7.4	2.7
AT	2.0	2.1	1.7	2.2	3.2	0.4	1.7	3.6	2.6	2.1	1.5	0.8	1.0	2.2	2.1	1.5	1.4	2.8	6.0	3.0
PL	3.6	2.2	1.3	2.6	4.2	4.0	2.6	3.9	3.7	0.8	0.1	-0.7	-0.2	1.6	1.2	2.1	3.7	5.2	11.6	7.3
PT	2.5	2.1	3.0	2.4	2.7	-0.9	1.4	3.6	2.8	0.4	-0.2	0.5	0.6	1.6	1.2	0.3	-0.1	0.9	4.4	1.9
RO	11.9	9.1	6.6	4.9	7.9	5.6	6.1	5.8	3.4	3.2	1.4	-0.4	-1.1	1.1	4.1	3.9	2.3	4.1	8.9	5.1
SI	3.7	2.4	2.5	3.8	5.5	0.8	2.1	2.1	2.8	1.9	0.4	-0.8	-0.2	1.6	1.9	1.7	-0.3	2.0	6.1	3.3
SK	7.5	2.8	4.3	1.9	3.9	0.9	0.7	4.1	3.7	1.5	-0.1	-0.3	-0.5	1.4	2.5	2.8	2.0	2.8	9.8	6.8
FI	0.1	0.8	1.3	1.6	3.9	1.6	1.7	3.3	3.2	2.2	1.2	-0.2	0.4	0.8	1.2	1.1	0.4	2.1	4.5	2.3
SE	1.0	0.8	1.5	1.7	3.3	1.9	1.9	1.4	0.9	0.4	0.2	0.7	1.1	1.9	2.0	1.7	0.7	2.7	5.3	3.0
EA-19	2.2	2.2	2.2	2.2	3.3	0.3	1.6	2.7	2.5	1.3	0.4	0.2	0.2	1.5	1.8	1.2	0.3	2.6	6.1	2.7
EU-27	2.5	2.3	2.3	2.4	3.7	0.8	1.8	2.9	2.6	1.3	0.4	0.1	0.2	1.6	1.8	1.4	0.7	2.9	6.8	3.2

Notes: (1) National index if not available.
Source: Commission 2022 spring forecast

Table B3: **Net lending (+) or net borrowing (-), general government (as a percentage of GDP, 2004-2023)**

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
BE	-0.2	-2.7	0.2	0.1	-1.1	-5.4	-4.1	-4.3	-4.3	-3.1	-3.1	-2.4	-2.4	-0.7	-0.9	-2.0	-9.0	-5.5	-5.0	-4.4
BG	1.8	1.6	2.7	0.0	1.4	-4.4	-3.7	-1.7	-0.8	-0.7	-5.4	-1.9	0.3	1.6	1.7	2.1	-4.0	-4.1	-3.7	-2.4
CZ	-2.4	-3.0	-2.2	-0.6	-2.0	-5.4	-4.2	-2.7	-3.9	-1.3	-2.1	-0.6	0.7	1.5	0.9	0.3	-5.8	-5.9	-4.3	-3.9
DK	2.1	5.0	5.0	5.0	3.2	-2.8	-2.7	-2.1	-3.5	-1.2	1.1	-1.3	-0.1	1.8	0.8	4.1	-0.2	2.3	0.9	0.6
DE	-3.3	-3.3	-1.7	0.3	-0.1	-3.2	-4.4	-0.9	0.0	0.0	0.6	1.0	1.2	1.3	1.9	1.5	-4.3	-3.7	-2.5	-1.0
EE	2.4	1.1	2.9	2.7	-2.6	-2.2	0.2	1.1	-0.3	0.2	0.7	0.1	-0.4	-0.5	-0.6	0.1	-5.6	-2.4	-4.4	-3.7
IE	1.3	1.6	2.8	0.3	-7.0	-13.9	-32.1	-13.6	-8.5	-6.4	-3.6	-2.0	-0.8	-0.3	0.1	0.5	-5.1	-1.9	-0.5	0.4
EL	-8.8	-6.2	-5.9	-6.7	-10.2	-15.1	-11.3	-10.5	-9.1	-13.4	-3.6	-5.9	0.2	0.6	0.9	1.1	-10.2	-7.4	-4.3	-1.0
ES	-0.1	1.2	2.1	1.9	-4.6	-11.3	-9.5	-9.7	-11.6	-7.5	-6.1	-5.3	-4.3	-3.1	-2.6	-3.1	-10.3	-6.9	-4.9	-4.4
FR	-3.6	-3.4	-2.4	-2.6	-3.3	-7.2	-6.9	-5.2	-5.0	-4.1	-3.9	-3.6	-3.6	-3.0	-2.3	-3.1	-8.9	-6.5	-4.6	-3.2
HR	-5.0	-3.5	-3.1	-2.2	-2.9	-6.2	-6.4	-7.9	-5.5	-5.5	-5.5	-3.4	-0.9	0.8	0.0	0.2	-7.3	-2.9	-2.3	-1.8
IT	-3.5	-4.1	-3.6	-1.3	-2.6	-5.1	-4.2	-3.6	-2.9	-2.9	-3.0	-2.6	-2.4	-2.4	-2.2	-1.5	-9.6	-7.2	-5.5	-4.3
CY	-3.7	-2.2	-1.0	3.2	0.9	-5.4	-4.7	-5.7	-5.8	-5.6	-8.8	-0.9	0.3	1.9	-3.6	1.3	-5.8	-1.7	-0.3	-0.2
LV	-1.2	-0.5	-0.5	-0.6	-4.3	-9.5	-8.6	-4.3	-1.4	-1.2	-1.6	-1.4	0.0	-0.8	-0.8	-0.6	-4.5	-7.3	-7.2	-3.0
LT	-1.4	-0.3	-0.3	-0.8	-3.1	-9.1	-6.9	-8.9	-3.2	-2.6	-0.6	-0.3	0.3	0.4	0.5	0.5	-7.3	-1.0	-4.6	-2.3
LU	-1.4	-0.2	1.9	4.4	3.4	-0.2	-0.3	0.7	0.5	0.8	1.3	1.3	1.9	1.4	3.0	2.3	-3.4	0.9	-0.1	0.1
HU	-6.6	-7.8	-9.3	-5.1	-3.8	-4.7	-4.4	-5.2	-2.3	-2.6	-2.8	-2.0	-1.8	-2.5	-2.1	-2.1	-7.8	-6.8	-6.0	-4.9
MT	-4.2	-2.8	-2.5	-2.0	-4.1	-3.1	-2.2	-3.0	-3.4	-2.2	-1.5	-0.8	1.1	3.3	2.1	0.6	-9.5	-8.0	-5.6	-4.6
NL	-1.8	-0.4	0.0	-0.2	0.1	-5.2	-5.3	-4.5	-4.0	-3.0	-2.3	-2.1	0.0	1.3	1.4	1.7	-3.7	-2.5	-2.7	-2.1
AT	-4.8	-2.5	-2.5	-1.4	-1.5	-5.3	-4.4	-2.6	-2.2	-2.0	-2.7	-1.0	-1.5	-0.8	0.2	0.6	-8.0	-5.9	-3.1	-1.5
PL	-5.0	-3.9	-3.5	-1.9	-3.6	-7.3	-7.4	-5.0	-3.8	-4.2	-3.6	-2.6	-2.4	-1.5	-0.2	-0.7	-6.9	-1.9	-4.0	-4.4
PT	-6.2	-6.1	-4.2	-2.9	-3.7	-9.9	-11.4	-7.7	-6.2	-5.1	-7.4	-4.4	-1.9	-3.0	-0.3	0.1	-5.8	-2.8	-1.9	-1.0
RO	-1.1	-0.8	-2.1	-2.7	-5.4	-9.1	-6.9	-5.4	-3.7	-2.1	-1.2	-0.6	-2.6	-2.6	-2.8	-4.3	-9.3	-7.1	-7.5	-6.3
SI	-1.9	-1.3	-1.2	0.0	-1.4	-5.8	-5.6	-6.6	-4.0	-14.6	-5.5	-2.8	-1.9	-0.1	0.7	0.4	-7.8	-5.2	-4.3	-3.4
SK	-2.3	-2.9	-3.6	-2.1	-2.5	-8.1	-7.5	-4.3	-4.4	-2.9	-3.1	-2.7	-2.6	-1.0	-1.0	-1.3	-5.5	-6.2	-3.6	-2.6
FI	2.2	2.7	4.0	5.1	4.2	-2.5	-2.5	-1.0	-2.2	-2.5	-3.0	-2.4	-1.7	-0.7	-0.9	-0.9	-5.5	-2.6	-2.2	-1.7
SE	0.2	1.8	2.1	3.3	1.9	-0.8	-0.1	-0.3	-1.1	-1.5	-1.5	0.0	1.0	1.4	0.8	0.6	-2.7	-0.2	-0.5	0.5
EA-19	-2.9	-2.6	-1.5	-0.6	-2.2	-6.2	-6.3	-4.2	-3.8	-3.1	-2.5	-2.0	-1.5	-0.9	-0.4	-0.7	-7.1	-5.1	-3.7	-2.5
EU-27	-2.7	-2.3	-1.4	-0.5	-2.0	-6.0	-6.0	-4.1	-3.7	-3.0	-2.4	-1.9	-1.4	-0.8	-0.4	-0.6	-6.8	-4.7	-3.6	-2.5

Source: Commission 2022 spring forecast

Table B4: **Interest expenditure, general government (as a percentage of GDP, 2004-2023)**

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
BE	4.9	4.4	4.1	4.0	4.0	3.9	3.6	3.5	3.5	3.3	3.2	2.9	2.7	2.4	2.1	2.0	1.9	1.7	1.4	1.4
BG	1.8	1.6	1.3	1.1	0.8	0.7	0.7	0.7	0.8	0.8	0.9	0.9	0.9	0.8	0.7	0.6	0.5	0.5	0.5	0.5
CZ	1.1	1.1	1.0	1.1	1.0	1.2	1.3	1.3	1.4	1.3	1.3	1.1	0.9	0.7	0.7	0.7	0.8	0.7	0.9	0.9
DK	2.5	2.1	1.8	1.6	1.4	1.9	1.9	2.0	1.8	1.7	1.5	1.6	1.3	0.8	0.8	0.7	0.5	0.5	0.6	0.5
DE	2.8	2.8	2.7	2.7	2.7	2.6	2.5	2.5	2.3	1.8	1.6	1.4	1.2	1.0	0.9	0.8	0.6	0.6	0.5	0.5
EE	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
IE	1.1	1.0	1.0	1.0	1.3	2.0	2.8	3.4	4.2	4.3	3.9	2.6	2.3	2.0	1.6	1.3	1.0	0.8	0.8	0.7
EL	4.8	4.7	4.4	4.5	4.8	5.0	6.1	7.7	5.3	4.1	4.0	3.6	3.2	3.1	3.4	3.0	3.0	2.5	2.4	2.3
ES	2.0	1.7	1.6	1.6	1.6	1.7	1.9	2.5	3.0	3.6	3.5	3.0	2.8	2.5	2.4	2.3	2.2	2.2	2.1	2.0
FR	2.8	2.7	2.6	2.7	2.9	2.5	2.5	2.7	2.6	2.3	2.2	2.0	1.8	1.7	1.7	1.4	1.3	1.4	1.4	1.5
HR	1.8	1.8	1.6	1.6	1.8	2.2	2.4	2.6	3.0	3.1	3.4	3.4	3.1	2.6	2.3	2.2	2.0	1.6	1.4	1.3
IT	4.6	4.5	4.4	4.7	4.9	4.4	4.3	4.6	5.2	4.8	4.6	4.1	3.9	3.8	3.6	3.4	3.5	3.5	3.5	3.2
CY	3.0	3.2	3.0	2.8	2.6	2.3	2.0	2.1	3.3	3.2	3.3	3.1	2.6	2.5	2.4	2.2	2.1	1.8	1.6	1.3
LV	0.7	0.5	0.5	0.4	0.6	1.5	1.8	1.8	1.7	1.5	1.3	1.2	1.0	0.9	0.7	0.7	0.7	0.5	0.6	0.6
LT	0.9	0.8	0.7	0.7	0.7	1.2	1.8	1.8	2.0	1.8	1.6	1.5	1.3	1.1	0.9	0.9	0.7	0.4	0.3	0.3
LU	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.3	0.2	0.2	0.1	0.1
HU	4.3	4.1	3.8	4.0	4.1	4.5	4.1	4.1	4.5	4.5	4.0	3.4	3.1	2.6	2.3	2.2	2.3	2.3	2.7	3.0
MT	3.7	3.8	3.7	3.5	3.3	3.2	3.0	3.2	3.0	2.8	2.7	2.3	2.1	1.8	1.5	1.3	1.3	1.2	1.1	1.1
NL	2.3	2.2	2.0	2.0	2.0	2.0	1.8	1.8	1.7	1.6	1.5	1.3	1.2	1.0	0.9	0.8	0.7	0.6	0.4	0.4
AT	3.0	3.2	3.1	3.1	2.9	3.1	2.9	2.8	2.7	2.6	2.4	2.3	2.1	1.8	1.6	1.4	1.3	1.1	1.0	1.0
PL	2.7	2.5	2.4	2.2	2.1	2.5	2.5	2.5	2.7	2.5	2.0	1.8	1.7	1.6	1.4	1.4	1.3	1.1	1.5	1.8
PT	2.6	2.6	2.8	3.0	3.1	3.0	2.9	4.3	4.9	4.8	4.9	4.6	4.1	3.8	3.4	3.0	2.9	2.4	2.2	2.2
RO	1.5	1.2	0.8	0.7	0.7	1.4	1.6	1.7	1.9	1.9	1.8	1.6	1.5	1.3	1.0	1.1	1.4	1.4	1.5	1.6
SI	1.7	1.5	1.4	1.2	1.1	1.3	1.6	1.9	2.0	2.5	3.2	3.2	3.0	2.5	2.0	1.7	1.6	1.3	1.2	1.1
SK	2.2	1.7	1.5	1.4	1.3	1.5	1.3	1.5	1.8	1.9	1.9	1.8	1.7	1.4	1.4	1.2	1.2	1.1	1.1	1.0
FI	1.7	1.6	1.5	1.4	1.4	1.3	1.3	1.4	1.4	1.3	1.2	1.2	1.1	1.0	0.9	0.8	0.7	0.5	0.5	0.5
SE	1.9	1.8	1.8	1.7	1.6	1.3	1.1	1.3	1.0	0.9	0.7	0.5	0.5	0.4	0.5	0.4	0.3	0.2	0.1	0.2
EA-19	3.0	2.9	2.8	2.9	3.0	2.8	2.8	3.0	3.0	2.8	2.6	2.3	2.1	1.9	1.8	1.6	1.5	1.5	1.4	1.3
EU-27	3.0	2.8	2.7	2.7	2.8	2.7	2.7	2.9	2.9	2.7	2.5	2.2	2.0	1.8	1.7	1.5	1.4	1.4	1.3	1.3

Source: Commission 2022 spring forecast

Table B5: **Structural budget balance, general government (as a percentage of GDP, 2012-2023)**

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
BE	-3.5	-3.1	-3.0	-2.6	-2.4	-1.4	-1.9	-3.0	-5.8	-4.6	-4.5	-4.2
BG	-1.1	-0.6	-1.7	-1.5	0.4	1.6	1.5	1.4	-2.9	-3.8	-3.5	-2.7
CZ	-1.5	-0.1	-0.8	-0.6	0.9	0.7	-0.1	-0.9	-4.1	-4.9	-3.1	-3.5
DK	0.0	-0.7	-0.2	-1.3	0.6	2.1	1.1	4.3	2.3	3.5	1.9	2.2
DE	-0.1	0.4	0.9	1.1	1.0	0.7	1.3	0.7	-2.4	-2.6	-1.8	-1.0
EE	1.0	0.8	0.9	0.7	-0.1	-1.3	-1.5	-0.8	-3.4	-3.3	-3.8	-3.0
IE	-7.4	-5.5	-4.8	-4.0	-1.9	-1.3	0.0	2.3	-2.6	-3.2	-2.0	-0.9
EL	2.2	4.0	4.0	3.7	5.8	5.5	5.3	2.7	-4.1	-5.5	-3.0	-0.9
ES	-3.4	-1.4	-0.6	-1.8	-2.7	-2.6	-2.8	-3.9	-4.3	-3.8	-3.5	-4.3
FR	-4.0	-3.0	-2.7	-2.6	-2.7	-2.8	-2.9	-3.3	-4.4	-5.3	-4.5	-3.3
HR	-4.0	-3.6	-3.7	-2.3	-0.8	0.1	-1.2	-1.4	-4.4	-3.1	-2.7	-2.3
IT	-1.5	-0.6	-0.7	-0.4	-1.4	-2.0	-2.4	-2.0	-5.2	-6.3	-5.8	-4.8
CY	-4.1	-0.8	4.4	2.8	1.1	1.3	2.4	-0.3	-4.6	-2.1	-0.4	-0.7
LV	-0.9	-1.0	-1.2	-1.9	-0.7	-1.6	-2.1	-1.5	-3.3	-6.9	-6.6	-2.7
LT	-2.2	-1.8	-1.2	-0.6	-0.3	-0.7	-0.8	-1.0	-7.0	-0.9	-4.0	-1.5
LU	1.8	1.7	2.1	1.9	1.6	1.6	3.2	2.2	-1.6	0.9	0.1	0.4
HU	-1.0	-1.1	-2.2	-2.2	-2.1	-3.8	-3.8	-3.8	-6.2	-6.6	-5.8	-4.4
MT	-2.6	-1.9	-2.5	-2.6	1.0	1.1	-0.3	-1.7	-6.2	-7.4	-5.2	-4.3
NL	-2.4	-1.7	-0.8	-1.0	0.3	0.6	0.7	0.7	-1.3	-2.0	-3.2	-2.5
AT	-1.7	-1.0	-0.5	0.1	-1.1	-1.0	-0.8	-0.6	-4.8	-4.4	-3.0	-1.6
PL	-3.7	-3.2	-2.5	-2.1	-2.1	-1.9	-1.5	-2.3	-5.9	-1.8	-4.0	-4.0
PT	-4.1	-3.3	-1.9	-2.2	-1.9	-1.6	-1.0	-1.2	-1.8	-1.3	-1.9	-1.5
RO	-3.1	-1.4	-0.8	-0.2	-1.8	-3.1	-3.1	-4.9	-7.8	-6.3	-6.5	-5.4
SI	-1.3	-11.1	-1.4	-0.6	-0.6	-0.3	-0.6	-1.1	-6.2	-6.1	-5.5	-4.5
SK	-3.6	-1.6	-2.4	-2.6	-2.4	-1.3	-2.0	-2.4	-4.5	-5.7	-3.3	-2.6
FI	-1.1	-0.9	-1.2	-0.7	-1.0	-1.0	-1.0	-1.2	-3.7	-2.0	-1.7	-1.4
SE	0.0	-0.1	-0.6	-0.3	0.8	1.0	0.6	0.4	-0.4	0.5	0.0	1.2
EA-19	-2.1	-1.2	-0.8	-0.7	-0.9	-1.0	-0.9	-1.2	-3.6	-4.0	-3.4	-2.6
EU-27	-2.0	-1.2	-0.8	-0.8	-0.8	-0.9	-0.8	-1.2	-3.6	-3.6	-3.3	-2.5

Source: Commission 2022 spring forecast

Table B6: **Gross debt, general government (as a percentage of GDP, 2004-2023)**

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
BE	97.2	95.1	91.5	87.3	93.2	100.2	100.3	103.5	104.8	105.5	107.0	105.2	105.0	102.0	99.8	97.7	112.8	108.2	107.5	107.6
BG	35.7	26.6	20.9	16.3	13.0	13.7	15.3	15.2	16.6	17.0	27.0	25.9	29.1	25.1	22.1	20.0	24.7	25.1	25.3	25.6
CZ	28.4	27.7	27.6	27.3	28.1	33.4	37.1	39.7	44.2	44.4	41.9	39.7	36.6	34.2	32.1	30.1	37.7	41.9	42.8	44.0
DK	44.2	37.4	31.5	27.3	33.3	40.2	42.6	46.1	44.9	44.0	44.3	39.8	37.2	35.9	34.0	33.6	42.1	36.7	34.9	33.9
DE	65.2	67.5	66.9	64.2	65.7	73.2	82.0	79.4	80.7	78.3	75.3	71.9	69.0	64.6	61.2	58.9	68.7	69.3	66.4	64.5
EE	5.1	4.7	4.6	3.8	4.5	7.2	6.7	6.2	9.8	10.2	10.6	10.1	10.0	9.1	8.2	8.6	19.0	18.1	20.9	23.5
IE	28.1	26.1	23.6	23.9	42.5	61.8	86.2	110.5	119.7	120.0	104.3	76.7	74.3	67.8	63.1	57.2	58.4	56.0	50.3	45.5
EL	102.9	107.4	103.6	103.1	109.4	126.7	147.5	175.2	162.0	178.2	180.3	176.7	180.5	179.5	186.4	180.7	206.3	193.3	185.7	180.4
ES	45.4	42.4	39.1	35.8	39.7	53.3	60.5	69.9	90.0	100.5	105.1	103.3	102.8	101.9	100.5	98.3	120.0	118.4	115.1	113.7
FR	65.9	67.4	64.6	64.5	68.8	83.0	85.3	87.8	90.6	93.4	94.9	95.6	98.0	98.1	97.8	97.4	114.6	112.9	111.2	109.1
HR	40.0	40.9	38.5	37.2	39.1	48.4	57.3	63.7	69.4	80.3	83.9	83.3	79.8	76.7	73.3	71.1	87.3	79.8	75.3	73.1
IT	105.1	106.6	106.7	103.9	106.2	116.6	119.2	119.7	126.5	132.5	135.4	135.3	134.8	134.2	134.4	134.1	155.3	150.8	147.9	146.8
CY	64.8	63.4	59.3	54.0	45.5	54.3	56.4	65.9	80.3	104.0	109.1	107.2	103.1	92.9	98.4	91.1	115.0	103.6	93.9	88.8
LV	14.6	11.9	10.0	8.4	18.5	36.7	47.7	45.1	42.4	40.4	41.6	37.1	40.4	39.0	37.1	36.7	43.3	44.8	47.0	46.5
LT	18.7	17.6	17.3	15.9	14.6	28.0	36.2	37.1	39.7	38.7	40.5	42.5	39.7	39.1	33.7	35.9	46.6	44.3	42.7	43.1
LU	7.8	8.0	8.2	8.1	14.6	15.3	19.1	18.5	20.9	22.4	21.9	21.1	19.6	21.8	20.8	22.3	24.8	24.4	24.7	25.1
HU	58.8	60.5	64.4	65.5	71.7	78.0	80.0	80.3	78.1	77.2	76.5	75.7	74.8	72.1	69.1	65.5	79.6	76.8	76.4	76.1
MT	71.3	69.9	64.3	61.9	61.8	66.3	65.5	70.0	66.6	66.4	62.1	56.2	54.7	47.7	43.7	40.7	53.4	57.0	58.5	59.5
NL	50.3	49.8	45.2	43.0	54.7	56.8	59.2	61.7	66.2	67.7	67.9	64.6	61.9	56.9	52.4	48.5	54.3	52.1	51.4	50.9
AT	65.2	68.6	67.3	65.0	68.7	79.9	82.7	82.4	81.9	81.3	84.0	84.9	82.8	78.5	74.1	70.6	83.3	82.8	80.0	77.5
PL	45.1	46.6	47.3	44.5	46.7	49.8	53.5	54.7	54.4	56.5	51.1	51.3	54.2	50.6	48.8	45.6	57.1	53.8	50.8	49.8
PT	67.1	72.2	73.7	72.7	75.6	87.8	100.2	114.4	129.0	131.4	132.9	131.2	131.5	126.1	121.5	116.6	135.2	127.4	119.9	115.3
RO	18.9	15.9	12.4	11.9	12.3	21.8	29.6	34.0	37.1	37.6	39.2	37.8	37.3	35.1	34.7	35.3	47.2	48.8	50.9	52.6
SI	26.9	26.4	26.1	22.8	21.8	34.5	38.3	46.5	53.6	70.0	80.3	82.6	78.5	74.2	70.3	65.6	79.8	74.7	74.1	72.7
SK	41.7	34.7	31.4	30.3	28.6	36.4	40.8	43.3	51.9	54.9	53.7	51.8	52.4	51.6	49.6	48.1	59.7	63.1	61.7	58.3
FI	42.6	39.9	38.1	33.9	32.6	41.5	46.9	48.3	53.6	56.2	59.8	63.6	63.2	61.2	59.8	59.6	69.0	65.8	65.9	66.6
SE	48.5	48.7	43.6	38.9	37.5	40.7	38.1	37.2	37.5	40.3	45.0	43.7	42.3	40.7	38.9	34.9	39.6	36.7	33.8	30.5
EA-19	69.7	70.4	68.4	66.0	69.7	80.3	85.9	88.3	92.9	95.3	95.5	93.4	92.5	89.9	87.8	85.7	99.2	97.4	94.7	92.7
EU-27	66.9	67.1	64.9	62.2	65.0	75.7	80.5	82.3	86.7	88.7	88.9	86.9	86.0	83.4	81.3	79.1	91.7	89.7	87.1	85.2

Source: Commission 2022 spring forecast

Table B7: **Debt dynamic components (as a percentage of GDP)**

	Primary balance						Snowball effect (1)						Stock-flow adjustment (2)					
	average 2013-2018	2019	2020	2021	2022	2023	average 2013-2018	2019	2020	2021	2022	2023	average 2013-2018	2019	2020	2021	2022	2023
BE	0.7	0.0	-7.1	-3.9	-3.5	-3.1	-0.3	-1.8	6.6	-9.6	-5.3	-3.5	0.1	-0.3	1.5	1.1	1.1	0.5
BG	0.1	2.7	-3.5	-3.6	-3.1	-1.9	-0.4	-1.4	0.6	-1.9	-2.1	-1.1	1.4	1.9	0.6	-1.3	-0.8	-0.4
CZ	0.9	1.0	-5.0	-5.1	-3.4	-3.0	-0.8	-1.4	1.3	-1.9	-2.7	-2.0	-0.4	0.4	1.4	0.9	0.2	0.2
DK	1.4	4.8	0.4	2.9	1.5	1.1	0.1	-0.2	0.4	-2.3	-1.5	-0.9	-0.5	4.6	8.5	-0.2	1.2	1.0
DE	2.3	2.3	-3.7	-3.1	-2.0	-0.5	-1.1	-1.1	2.5	-3.3	-4.0	-3.3	0.2	1.0	3.7	0.8	-0.9	0.9
EE	0.0	0.1	-5.6	-2.3	-4.3	-3.5	-0.5	-0.5	0.3	-2.3	-1.5	-1.0	0.2	1.0	4.6	-0.9	0.0	0.0
IE	0.6	1.8	-4.1	-1.1	0.3	1.1	-6.2	-4.1	-1.5	-6.0	-4.5	-3.3	-2.6	0.0	-1.4	2.3	-0.9	-0.4
EL	0.1	4.2	-7.2	-5.0	-1.9	1.3	4.9	-0.8	22.6	-17.3	-12.6	-6.9	-0.8	-0.8	-4.1	-0.7	3.0	3.0
ES	-1.8	-0.8	-8.0	-4.7	-2.8	-2.4	0.4	-1.0	13.0	-6.1	-6.6	-4.3	-0.5	-1.9	0.6	-0.1	0.5	0.5
FR	-1.5	-1.6	-7.6	-5.1	-3.2	-1.7	0.0	-1.5	6.6	-7.0	-4.3	-3.6	-0.3	-0.4	2.9	0.2	-0.5	-0.2
HR	0.5	2.4	-5.3	-1.3	-0.9	-0.5	0.9	-1.6	8.4	-9.0	-4.0	-2.6	0.2	1.8	2.5	0.2	-1.3	-0.1
IT	1.6	1.8	-6.1	-3.7	-2.0	-1.1	2.2	1.5	14.8	-6.8	-4.5	-2.9	0.7	0.0	0.2	-1.3	-0.5	0.7
CY	0.0	3.5	-3.6	0.2	1.3	1.1	0.9	-3.8	8.0	-7.1	-5.1	-4.6	2.1	0.0	12.3	-4.1	-3.3	0.7
LV	0.2	0.1	-3.8	-6.8	-6.7	-2.4	-0.7	-1.1	2.1	-4.1	-3.3	-2.9	0.0	0.8	0.6	-1.3	-1.2	0.1
LT	1.0	1.3	-6.6	-0.6	-4.2	-2.0	-0.6	-1.4	0.2	-4.5	-3.4	-2.0	0.6	5.0	3.9	1.7	-2.4	0.3
LU	2.0	2.6	-3.2	1.0	0.0	0.2	-0.5	-0.4	-0.3	-2.9	-1.3	-1.0	2.5	4.5	-0.4	3.6	1.7	1.7
HU	1.0	0.1	-5.5	-4.4	-3.3	-1.9	-1.5	-3.8	1.3	-7.7	-3.9	-2.2	1.1	0.4	7.3	0.5	0.2	0.0
MT	2.5	1.9	-8.2	-6.8	-4.4	-3.5	-3.1	-2.1	4.4	-4.3	-2.6	-2.5	1.8	1.0	0.2	1.0	-0.3	0.0
NL	0.5	2.5	-3.0	-2.0	-2.3	-1.7	-0.5	-1.8	1.5	-3.3	-3.1	-2.0	-1.3	0.3	1.3	-1.0	0.2	-0.2
AT	0.8	2.0	-6.7	-4.8	-2.1	-0.5	-0.4	-0.8	4.7	-3.9	-4.8	-2.9	-0.1	-0.6	1.3	-1.4	-0.1	-0.1
PL	-0.6	0.6	-5.6	-0.8	-2.5	-2.6	-0.5	-2.3	0.4	-5.1	-5.2	-3.3	-1.1	-0.3	5.5	1.0	-0.3	-0.4
PT	0.6	3.1	-2.9	-0.4	0.3	1.2	0.0	-2.3	11.2	-4.7	-8.1	-4.4	-0.7	0.4	4.4	-3.4	0.9	0.9
RO	-0.5	-3.2	-8.0	-5.7	-6.0	-4.7	-1.3	-2.4	1.4	-3.6	-3.8	-2.5	0.4	-0.3	2.6	-0.6	-0.1	-0.5
SI	-1.3	2.1	-6.2	-3.9	-3.2	-2.3	-0.2	-2.0	3.7	-6.6	-3.8	-3.7	1.7	-0.6	4.3	-2.4	0.0	0.0
SK	-0.5	-0.1	-4.3	-5.0	-2.6	-1.5	0.0	-1.2	2.2	-2.0	-4.1	-4.2	-0.9	-0.3	5.1	0.3	0.2	-0.7
FI	-0.7	-0.1	-4.8	-2.1	-1.7	-1.2	-0.4	-0.8	1.1	-3.6	-2.9	-2.0	0.7	0.5	3.4	-1.7	1.3	1.5
SE	0.6	1.0	-2.4	0.0	-0.3	0.7	-1.2	-1.3	0.7	-2.7	-2.2	-1.5	2.0	-1.7	1.6	-0.3	-1.1	-1.0
EA-19	0.5	1.0	-5.6	-3.6	-2.3	-1.1	-0.3	-1.2	5.8	-5.4	-4.7	-3.5	-0.1	0.0	2.1	0.0	-0.3	0.5
EU-27	0.5	1.0	-5.3	-3.3	-2.2	-1.2	-0.3	-1.3	5.0	-5.3	-4.4	-3.4	-0.1	0.1	2.3	0.0	-0.4	0.3

Notes: (1) The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator); (2) The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.
Source: Commission 2022 spring forecast

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