European Fiscal Board

Annual Report

2023

Composition of European Fiscal Board

Niels THYGESEN
Chair
Professor Emeritus of International Economics at the University of Copenhagen and former adviser to governments and international institutions, Denmark

Roel BEETSMA
Member
Professor at the University of Amsterdam and Dean of Economics and Business, the Netherlands, and Visiting Professor at the Copenhagen Business School

Massimo BORDIGNON
Member
Professor and former Director of the Department of Economics and Finance at the Catholic University of Milan, Italy

Xavier DEBRUN
Member
Head of Economics and Research of the National Bank of Belgium

Mateusz SZCZUREK
Member
Former Finance Minister, adjunct Professor at Warsaw University and EBRD Lead EU Economist, Poland

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Comments on the report should be sent to:

Secretariat of the European Fiscal Board
European Commission
Rue de la Loi 200
Office BERL 02/352
1049 Brussels
Belgium

Email: EFB-SECRETARIAT@ec.europa.eu

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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
C-SIFI	Country-specific scope index of independent fiscal institutions
CSR	Country-specific recommendation
DBP	Draft budgetary plan
DSA	Debt sustainability analysis
EB	Expenditure Benchmark
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
HCPF	High Council of Public Finances (France)

HICP	Harmonised Index of Consumer Prices
IFIs	Independent fiscal institutions
IMF	International Monetary Fund
MTO	Medium-term budgetary objective
NAOF	National Audit Office of Finland
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
SGP	Stability and Growth Pact
SPB	Structural primary balance
SURE	Support to mitigate Unemployment Risks in an Emergency
VAT	Value-added tax
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)

The EFB's seventh annual report focuses on the EU's 2022 fiscal surveillance cycle. It systematically catalogues and analyses application of the EU's rules-based fiscal framework.

When, in autumn 2021, EU governments prepared their budgets for 2022, a sense of relative optimism had taken root. Compared to twelve months earlier, the number of people dying from Covid had declined markedly alongside a fast-progressing roll-out of vaccines. As a result, fiscal plans were predicated on a strong economic recovery, anticipating a sharp improvement in budget balances. Most observers still saw a considerable degree of uncertainty surrounding forecasts, but the outlook was definitively turning brighter.

A few months later, when Russia launched its war of aggression against Ukraine and energy prices spiked, hopes of an economic and fiscal recovery crashed at first. However, thanks to swift and forceful measures to secure alternative energy sources and to reduce energy consumption, the energy price hike has had less of an impact than initially feared. The post-pandemic economic recovery continued with an overall robust growth performance in 2022, fairly close to the macroeconomic forecasts on which the original budgetary plans were based in autumn 2021.

As regards fiscal policy outcomes, 2022 was arguably a Janus-faced year. On the one hand, conventional balance-based indicators showed remarkable improvements by around one full percentage point compared to 2021. Coupled with robust nominal GDP growth, this resulted in a considerable reduction in the EU's debt-to-GDP ratio, the strongest on record.

However, these improvements mask unsustainable underlying developments, particularly in very high-debt countries. Net expenditure growth - a more reliable gauge of fiscal policy in turbulent times - significantly exceeded the prudent benchmark rate of medium-term potential output growth. This was not the price to be paid for the wide-spread adoption of energy emergency support measures linked to galloping energy prices: expenditure growth was expansionary even when filtering out temporary measures. Moreover, most of the energy support measures were not targeted at vulnerable groups, and the resulting broad-brush fiscal support implemented in many EU Member States was not the right macroeconomic answer to a negative terms-of-trade shock.

The fiscal surveillance regime did not do enough to guide EU countries towards a more appropriate fiscal policy. The Commission continued to follow an extensive interpretation of the severe economic downturn clause, *de facto* suspending the EU rules, although the conditions for applying the clause were no longer met. The Commission also made a number of ad hoc adjustments to the implementation of the surveillance framework. For example, it used fiscal policy guidance to fine-tune demand and redefined various fiscal indicators, including most notably a modified expenditure benchmark in the final assessment.

The EFB considers many of these adjustments as unwarranted departures from established practice. Although inconsequential for 2022 in terms of surveillance due to the continued reliance on the extensive interpretation of the severe economic downturn clause, the adjustments were not properly communicated and not conducive to transparency and predictability.

Following nearly four years without the normal application of the EU fiscal rules, the long-awaited reform has become urgent. But the effort of finding agreement has also become more challenging; it needs to reconcile emphasis on medium-term sustainability of government debt with room for new government expenditure. Debt ratios have increased to new highs in some countries, interest rates are increasing, and new pressures on expenditure emerged such as those linked to the green and digital transition.

The Commission orientations for an economic governance review of November 2022 tackled this

agenda in a bold and innovative way, based on two principles: emphasis on sustainability, and national ownership of medium-term adjustment plans. The orientations also advocated a stronger role for national independent fiscal institutions (IFIs) in monitoring plans. Finally, simplification of the surveillance through reliance on net expenditure growth as the policy indicator in EU surveillance was proposed.

The EFB strongly supports these elements which since 2018 have been part of our advice to the Commission. But important concerns remained, suggesting to the EFB that the approach to the reform would have been strengthened by recognising that some public goods with an EU dimension are more efficiently supplied through joint, rather than national, efforts. The EFB realises that this is still regarded by most as a premature debate, but it will have to come back to the agenda soon.

In addition, the EFB doubts whether the proposed merge of fiscal and structural surveillance in relation to the national plans is a realistic vision for the future when the one-off NGEU, involving EU funding, fades out. Detailed monitoring of investment and reform projects will hardly permit a quantitative evaluation of their macroeconomic impact, making surveillance less transparent and too intrusive.

The intensive debate in the Council on the Commission's legislative proposal of 24 April reflects doubts whether the reform will offer sufficient assurance in underpinning sustainable public finances. The unfamiliar nature of a medium-term, nationally-differentiated and more bilateral framework has inspired proposals to define additional common minimum benchmarks and safeguards for deficit and debt reductions to help ensuring that government debt will be put on a 'plausibly declining path' or 'maintained at prudent levels'.

The EFB understands these concerns; they should be addressed, but there are other ways to strengthen the qualities of the original proposal while keeping the focus on the medium-term. This report mentions intelligent use of the control account by setting a maximum cumulative deviation from the national plan. Limiting the scope for extending the adjustment plan from four to seven years could be another way of constraining laxity. A stronger role for independent evaluation of the process could also help tighten the framework.

The high level of debt and potentially dangerous debt dynamics make it essential that the basic framework sets firm guidance. Monitoring compliance with the 3% of GDP reference value for the deficit has long been advocated by the EFB as a backstop, but not to divert attention from net expenditure growth and the debt sustainability analysis which underpins it.

One major lesson from the experience over a quarter of a century of an EU rules-based fiscal framework is that implementation is crucial. If the Member States with vulnerable public finances often have not complied with the rule book, while others fail to take action to enforce it, that offers strong evidence that a new start is needed. The EFB plea is to allow for this new start to go ahead by finding convergence of opinion soon on a reform close to what is in the legislative proposal. Despite reservations about some elements, it marks an important advance; postponement into an uncertain future is not an option.

Responsibility for sustainable public finances at a time of massive expenditure challenges cannot be delegated either to hopes for favourable developments in debt servicing costs or to the ECB. Debt stabilisation, not to speak of visible debt reduction, will be highly demanding – but it has to start. The direction is essential, not least to assuage financial markets.

EXECUTIVE SUMMARY

The economic recovery continued in 2022 despite the energy crisis. The EU economy continued to recover from the Covid pandemic in 2022, although the second half of the year saw a deceleration compared to forecasts mainly due to a strong increase in inflation, slower global growth and tighter financial conditions. Real GDP in both the euro area and EU grew on average by 3.5%, with significant differences across EU countries ranging from 12% in Ireland to -1.3% in Estonia. Labour market conditions further improved, pushing the EU's and the euro area's rates of unemployment to record lows.

The rise in energy prices pushed inflation to record highs affecting real incomes. Russia's invasion of Ukraine drove up energy prices and prices of other commodities due to increased supply disruptions. This added to the inflationary pressure that had already started building up at the end of 2021. Annual headline inflation in the euro area increased by close to 6 percentage points to a record-breaking 8.5% in 2022. Since most EU countries are large energy importers, the increase in energy prices gave rise to a significant deterioration in the terms of trade and, in turn, to significant losses in real income for the economy as a whole.

On the face of it, 2022 marked a significant improvement in fiscal positions across the board. Fiscal outcomes in 2022 were influenced by a number of transient elements. The unexpected surge in inflation brought about large increases in nominal incomes and government revenue. Additional windfalls contributed to revenue surprises as the increase in tax intakes (excluding discretionary measures) was stronger than nominal GDP growth. Combined with a withdrawal of Covid support measures, general government deficits improved by more than 1 percentage point to 3.6% and 3.4% of GDP in the euro area and the EU, respectively. Improving primary balances and strong nominal GDP growth brought the debt-to-GDP ratio down by around 4 percentage points in 2022, the strongest decline on record.

Fiscal indicators conceal unsustainable underlying expenditure trends. The improvement in conventional metrics, including the primary structural budget balance, suggests a welcome step towards safer fiscal positions. However, due to the specifics of 2022, headline and cyclically adjusted numbers are misleading. Net expenditure growth – a more stable metric of underlying fiscal trends – paints a completely different picture. It points to a deterioration of underlying expenditure trends especially in high-debt and very high-debt countries (above 60% of GDP and 90% of GDP, respectively), where net expenditure growth continued to significantly exceed the prudent benchmark rate of medium-term potential growth. This trend is particularly clear when excluding Covid and energy support measures, which were meant to be temporary.

In hindsight, 2022 was a missed opportunity to make progress towards safer fiscal positions. The striking contrast between headline numbers and underlying fiscal trends results from a number of countervailing factors. Revenue windfalls linked to unexpectedly high inflation and the phasing out of Covid measures significantly improved balance-based indicators. However, broad-based energy support measures in all Member States and dynamic underlying expenditure growth offset a considerable part of the improvement and bode ill for the coming years. Overall, better targeting of energy support measures coupled with more prudent expenditure policies by national governments would have helped bring about significantly larger deficit reductions in many EU Member States, especially in those with high and very-high government debt ratios.

EU surveillance was characterised by a series of idiosyncrasies that weakened its relevance. The Commission and the Council continued to follow a very extensive interpretation of the severe economic downturn clause although the conditions for doing so put forward and endorsed by the institutions were no longer met. The unexpected energy price hike triggered by Russia's war of aggression was certainly an unexpected and significant shock. EU policy makers were faced with major challenges. However, the policy response to the energy price hike did not necessarily follow economic logic and EU fiscal surveillance turned a blind eye to underlying expenditure trends. In effect, implementation of the framework increasingly departed from a predictable rules-based system aimed at

safeguarding sustainable public finances in the medium term.

A solid economic recovery and the planned reversal of Covid measures set a promising backdrop for EU fiscal guidance. In spring 2021, real GDP was projected to grow by almost 4½% in both 2021 and 2022 in the EU and the euro area. Growth at that rate - well above available estimates of potential growth - would have rapidly closed the negative output gap. The conditions appeared right for discontinuing the severe economic downturn clause, but the Commission, supported by the Council, still extended the clause until the end of 2022 and opened the door for a further extension to 2023. At the same time, the 2021 stability and convergence programmes aimed to discontinue most of the Covid support measures in 2022, reversing much of the crisis support.

EU fiscal guidance aimed to fine-tune aggregate demand; it was multi-layered and conducive to cherry-picking. EU fiscal guidance for 2022 issued in spring 2021 advised Member States supporting the ongoing economic recovery while withdrawing temporary stimulus implemented in response to the Covid pandemic. The recommended fiscal impulse was meant to come from EU-funded expenditure and nationally financed investment, while keeping current expenditure under control. However, this message was open to interpretation: multiple policy objectives encouraged choosing one element over another as a target. EU guidance attempted to fine-tune the aggregate fiscal impulse across Member States, but it paid little attention to the level of fiscal support accumulated in previous years, or to fiscal space. It was formulated in qualitative terms but referred to medium-term potential growth as a prudent benchmark for expenditure plans. The message was largely the same for more indebted Member States as for others.

Draft budgets for 2022 were in line with recommended fiscal support, but not their composition. Budgets for 2022 targeted a rate of expenditure growth above the one envisaged in the 2021 stability programmes – a recurrent feature that leads to deviations from medium-term policy plans. Overall, net expenditure growth in the euro area (excluding the withdrawal of Covid support measures) was expected to exceed nominal medium-term potential growth – indicating a further fiscal expansion in spite of an expected solid economic recovery. Moreover, much of the expansion came from current expenditure as opposed to investment, indicating persistent risks to prudent fiscal planning.

Russia's war of aggression triggered a wave of broad-based, as opposed to targeted, support measures. After the onset of the war, EU Member States introduced new fiscal support measures. Energy prices had started to increase in 2021, but the budgets for 2022 planned limited support at that time. These measures expanded significantly after Russia's full-scale invasion of Ukraine with immediate effect in 2022. In spring 2022, EU fiscal guidance justified targeted support for the most vulnerable households and firms, and cautioned against broad-based fiscal expansions as they would add to mounting inflationary pressure. However, only a quarter of all energy support measures turned out to be targeted.

Higher government debt levels continued to be associated with less sustainable fiscal developments. The analysis of expenditure developments in 2022 confirms previously observed patterns. In more indebted Member States, underlying expenditure trends, i.e. abstracting from both the withdrawal of Covid measures and the introduction of energy support, considerably exceeded estimates of medium-term rates of potential output growth. In contrast, countries with debt below 60% of GDP left some headroom to their nominal benchmark rate. In the end, EU Member States most in need of fiscal adjustment failed to take advantage of sound economic growth and revenue windfalls to improve their fiscal positions.

The Commission's final assessment for 2022 vindicated most of the countries' actions. To justify deviations from the recommended actions, the Commission cited various factors such as high inflation, energy measures and capacity constraints for government investment, which were not planned or foreseen. However, the Commission's justifications also changed the narrative of its original policy guidance. In contrast to initial advice for an overall supportive fiscal policy issued in 2021 for 2022, the final assessment also included elements suggesting that a contractionary fiscal impulse would have been appropriate in a high-inflation scenario. Also, in spring 2022, on the back of the energy price hike, the Commission had asked for targeted as opposed to broad-based energy support measures for 2023. No overall

conclusions were drawn on how the countries' fiscal performance in 2022 measured up against the Council recommendations; only some elements of deviation from the recommendations were noted.

The broad-based fiscal response to the negative terms-of-trade shock was unwarranted. Soaring energy prices in 2022 created an adverse terms-of-trade shock for the euro area and the EU. Such a shock primarily affects aggregate supply, which means a broad-based fiscal expansion is likely to have counterproductive effects on inflation without addressing the problem at its core. Regrettably, the mostly untargeted support measures undermined efforts to reduce the level of discretionary fiscal support injected over the previous two years. Moreover, since most of the energy support measures were not means tested their budgetary costs significantly exceeded those justified by the official objective of supporting vulnerable households and firms.

The euro area fiscal impulse had the right orientation, but underlying trends are a matter of concern. Strong economic growth and a remarkably tight labour market in 2021 and 2022 would have called for a swift dialling back of fiscal support. To be sure, the war in Ukraine and the uncertain economic outlook warranted a gradual approach. However, if the impact of temporary measures taken during the Covid and energy crises are excluded, the underlying net current expenditure growth indicates a significant and unwarranted expansionary fiscal impulse in 2022, in particular in high and very high-debt countries. Thus, more prudent expenditure policies would have allowed for a faster deficit reduction. A more restrictive euro area fiscal impulse would have also helped the European Central Bank in its pursuit of bringing inflation back down towards the target.

Member States' contributions to the euro area fiscal impulse could have been improved. Cyclical conditions were favourable in most very high-debt countries (with debt above 90% of GDP) while their structural deficits tended to be well above the euro area average. This group of countries contributed roughly half of the structural primary deficit reduction in the euro area – equal to their weight in euro area GDP. From a sustainability perspective and taking significant revenue windfalls into account, it would have been desirable for very-high-debt countries to withdraw discretionary fiscal support faster than low/medium debt countries.

The EU altered surveillance practice, including the expenditure benchmark, making it less predictable and less binding. The Commission used ad hoc fiscal indicators for guiding and monitoring in 2022, largely side-lining the established indicators. It applied new definitions of measures, which were clarified only during the implementation phase without prior consultation of the Council. Of particular note, in its final assessment the Commission switched from the established 'nominal' expenditure benchmark to a 'real' approach, by adjusting it for higher inflation. Although inconsequential in terms of surveillance due to the continued reliance on an extensive interpretation of the severe economic downturn clause, this change affects transparency and predictability. The Commission and the Council also did not open excessive deficit procedures even though the Commission's own reporting indicated that many Member States recorded excessive deficit and/or debt levels as defined by the Treaty.

The extensive interpretation of the severe economic downturn clause weakened the role of national independent fiscal institutions (IFIs). As national escape clauses were activated automatically or in lockstep with the SGP's escape clause, IFIs had to adjust their monitoring activity. The overwhelming majority upheld the publication schedule of their standard monitoring reports, but typically repurposed them to analyse topical fiscal issues and/or discuss the implications of suspended fiscal rules. Also linked to the untested nature of many of the triggered clauses, several IFIs pointed to shortcomings in their domestic law, such as insufficiently clear provisions for deactivating the national escape clauses. Others viewed the procedures for repeated extension of the SGP's escape clause as too discretionary.

A review of IFIs' monitoring activities reveals accomplishments but also puzzling patterns. A horizontal analysis of IFIs' monitoring activities over national rules suggests that independent bodies improve the visibility of numerical constraints through their regular compliance assessments, thereby increasing the reputational costs of fiscal trespassing. To investigate the issue empirically, the EFB secretariat calculated two sets of scores for domestic rules in 2013-2019: one based on standard numerical compliance, and

another based on the IFIs' *ex post* public assessments. A systematic quantitative comparison of these two metrics displays often large gaps, with IFIs' compliance scores typically showing the more favourable picture. The differences are particularly large for several high-debt countries. While there could be many reasons explaining the differences, they might also be linked to institutional factors. For example, several IFIs tend to be very cautious in their monitoring reports if their compliance decision comes before the Commission's assessment, particularly for those domestic rules that are tantamount to or mirror SGP rules. In any case, a persistent departure from numerical constraints means that the underlying objective of the rules will not be achieved.

Several aspects of the IFIs' monitoring could benefit from further reinforcement. In the EFB Secretariat's survey, IFIs generally reported non-systematic interactions with the budgetary authorities on their work. Thus, the monitoring activity could be strengthened by more robust comply-or-explain arrangements covering all IFI assessments. Only a few independent monitoring bodies prepare their own fiscal forecast to be used as a numerical benchmark to inform their judgement on the plausibility of the official fiscal targets, pointing to the need for enhancing EU IFIs' analytical toolboxes. In addition, discrepancies between the Commission and IFIs in real-time compliance assessments could arise from not having the same set of information. This calls for a better and more timely flow of information on relevant data, methods and assumptions to avoid unwarranted differences linked only to technical issues.

It was high time, the legislative process reforming the EU fiscal framework started. In its previous reports starting from 2017, the EFB pointed to several shortcomings both in the existing EU fiscal surveillance framework and in its implementation that in and of themselves would have warranted reforms. With the sizeable fiscal impacts of the adverse shocks over 2020-2023, a reform driven by the key principle of medium-term sustainability gained even more relevance. The support measures adopted to respond to the Covid pandemic first and the energy price hike after were necessary to avert an economic collapse, but their largely untargeted nature coupled with unsustainable underlying expenditure dynamics in high-debt countries made the resulting fiscal burden unnecessarily heavy. Moreover, the extensive interpretation of the SGP's severe economic downturn clause by the EU institutions, and in particular the *de facto* suspension of all SGP surveillance procedures raised the risk of fiscal policies drifting toward disproportionate discretion and laxity. A swift return to a rules-based regime is therefore overdue.

The EFB supports the main thrust of the Commission's November 2022 orientations with two caveats. The central elements of the proposed new surveillance regime, i.e. differentiation in debt adjustment strategies across countries, enhanced focus on national ownership, and simplification through establishing net expenditure growth as the single operational target are all in line with the EFB's reform concept developed progressively in past years. Although it is to be acknowledged that the case for a central fiscal capacity remains controversial in the EU, the absence of a scheme capable of supplying selected strategic EU public goods through joint efforts is still an omission in the policy architecture from a medium- to long-term perspective. Furthermore, the envisaged merge of fiscal surveillance with the countries' reform and investment plans to secure an extended adjustment path could prove to be contentious, given the objective difficulty to evaluate the macro-fiscal impacts of national structural policies and the risk of pulling the more quantitative fiscal coordination towards a lower standard of compliance.

There are ways to strengthen the framework beyond additional minimum quantitative safeguards and backstops. Responding to the position of the Council, the Commission's April 2023 legislative package confirmed the minimum annual fiscal adjustment for countries in EDP and included the requirement to reduce the debt-to-GDP ratio below its initial level by the end of the adjustment period. Additional common quantitative benchmarks appear to be the focus of most attention and contention during the ongoing negotiations, indicating a lack of sufficient trust among the concerned parties. The EFB believes that other elements can achieve the desired budgetary discipline. A case in point is a more automatic design of the control account for recording and acting upon deviations from the medium-term adjustment path, defined currently too vaguely in the Commission's legislative proposal. Similarly, it would be advisable to assign a reinforced role for independent oversight of the medium-term fiscal plans, both *ex ante* and *ex post*,

backed by a rigorous enforcement of the IFIs' minimum standards. Finally, doing away with the possibility of extending the adjustment paths by three years could also be considered, as this option in any case is surrounded by a large degree of operationalisation uncertainty.

A reformed EU framework would also benefit from a stronger EFB. The analytically challenging aspects of the proposed fiscal surveillance regime underline the importance of safeguarding an independent assessment at the EU level. In particular, with the larger role of judgement and discretion implied by the prospective EU rules, an impartial view is necessary to ensure transparency and equal treatment. The current EFB mandate should be extended accordingly, and its institutional setup strengthened to attain institutional on top of functional independence. This can be achieved by anchoring the EFB and its main tasks in secondary EU legislation, a precondition for turning the Board into an entity that works in the interest of all EU and national institutions involved in the economic governance framework. The EFB should be able to meet the same standards of independence as suggested for national IFIs.

1. MAIN MACROECONOMIC AND FISCAL DEVELOPMENTS IN 2022

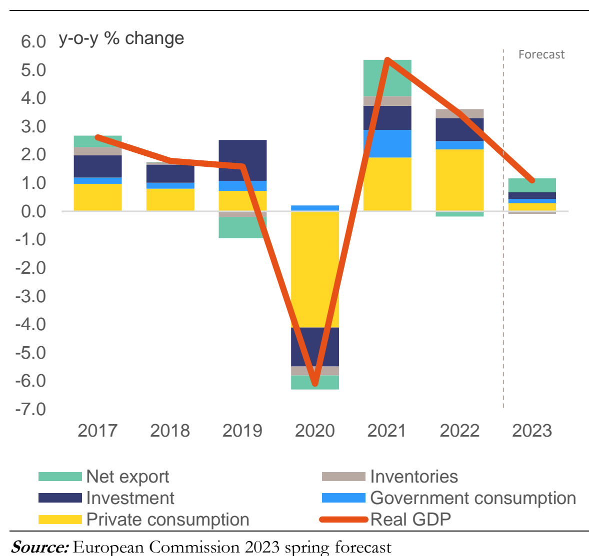
Highlights

- In 2022, real GDP growth slowed compared to the exceptional rebound of the previous year, but remained robust in both the euro area and the EU. The EU economy expanded strongly in the first half of 2022 after having recovered to the pre-Covid pandemic output level. However, it slowed in the second half of the year due to economic repercussions of Russia's invasion of Ukraine. The average annual growth of real GDP was 3.5% in the euro area and the EU.
- Despite the economic slowdown, the labour market remained strong. Unemployment rates in the euro area and the EU reached their lowest levels on record.
- Soaring energy prices and the depreciation of the euro triggered a terms of trade shock that increased inflation rates to record highs in the euro area and the EU. Average annual headline inflation reached 8.5% and 9.2% in the euro area and the EU, respectively.
- In response to persistently high inflation, the ECB started monetary tightening to keep inflation expectations anchored and to prevent second-round effects.
- Furthermore, the Commission prolonged the extensive interpretation of the Stability and Growth Pact's severe economic downturn clause, offering Member States additional flexibility to deal with the energy price hikes. At the same time, it cautioned against broad-based, untargeted fiscal responses. Overall, Member States adopted support measures related to the energy crisis totalling EUR 200 billion (1.2% of EU GDP).
- Fiscal positions improved significantly in 2022. The general government deficit narrowed by more than 1 percentage point to 3.6% and 3.4% of GDP in the euro area and the EU, respectively. This, combined with strong economic growth, reduced the debt-to-GDP ratio by around 4 percentage points, the strongest decline on record.
- On top of favourable cyclical conditions and revenue windfalls stemming from high, unexpected inflation, the phasing out of Covid measures contributed to the improvement of government balances and debt ratios.
- However, headline numbers mask a number of unfavourable aspects. Most importantly, the expenditure benchmark, which abstracts from revenue windfalls, shows a much less positive improvement in the fiscal positions.
- While the inflation shock produced a positive impact on public finances in the short run, mainly thanks to a large and unanticipated increase in nominal GDP and revenue, the impact is likely to be temporary, notably as nominal economic growth normalises and interest payments on government debt and possibly other expenditure items increase.
- Most of the fiscal measures taken by governments in response to the energy price hike were untargeted, producing an unwarranted fiscal impulse on the back of a negative shock on terms of trade. Evidence suggests that fiscal measures only partly compensated the poorest households, which were more affected by the high inflation.
- Net of all temporary measures taken in response to a series of shocks (Covid, the energy price hike and a new wave of immigration from Ukraine), government expenditure expanded at a pace that significantly exceeds medium-term potential growth rates. This bodes ill for fiscal developments in the coming years.

1.1. MAIN MACROECONOMIC DEVELOPMENTS

In 2022, GDP growth in the euro area and the EU continued, albeit at a slower pace compared with 2021 when economic activity posted a sharp rebound. The year was marked by unfavourable developments such as Russia's invasion of Ukraine, supply side bottlenecks, strong increase in inflation, slower global growth and tighter financial conditions. In the year as a whole, real GDP growth averaged 3.5% in the euro area and the EU (Graph 1.1).

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

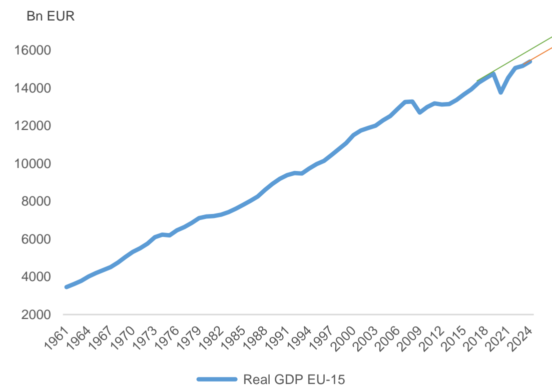


Source: European Commission 2023 spring forecast

In the first half of 2022, economic growth was still dynamic, benefiting from a strong net trade contribution in the first quarter and increased demand for services in the second as Covid-related restrictions were eased. It deteriorated in the second half of the year on the back of weakening global activity and rising inflation. Persisting supply bottlenecks in the external environment and the surge in prices of imported energy slowed trade with countries outside the EU. Consequently, the contribution of net exports to GDP growth declined sharply compared with 2021. However, thanks to positive developments in the labour market and the Recovery and Resilience Facility (RRF), growth in investment and consumption continued. High inflation had an adverse effect on real incomes, led to an increase in interest rates and slowed down investment. Consequently, value added in retail trade, industry and construction sectors fell over the course of the year.

The two major shocks, the Covid-19 pandemic and the war in Ukraine, could have lasting effects on the EU economy. While the growth path was still expected to converge to the level expected before the pandemic hit ([1]), the war in Ukraine set it further away. Recent forecasts ([2]) do not project narrowing of the gap with the pre-pandemic trend of output within the forecast horizon (Graph 1.2).

Graph 1.2: **Parallel shift in real GDP growth after crises**



Note: Straight line represents an extrapolation of the pre-crisis growth trend and the currently expected lower trend following the Covid-19 shock.
Source: European Commission 2023 spring forecast

Growth nevertheless remained very diverse across EU countries. The highest year-on-year real GDP growth was recorded in Ireland (12.0%), followed by Malta (6.9%) and the lowest in Luxembourg (1.5%). By contrast, annual real GDP shrank in Estonia (-1.3%). Technically, in the EU four countries (Czechia, Estonia, Hungary and Finland) were in recession by the end of the year, i.e. their GDP growth had been negative for at least two consecutive quarters. Differences in the growth rates across Member States emerged from differences in vulnerability and exposure to the pandemic crisis and war.

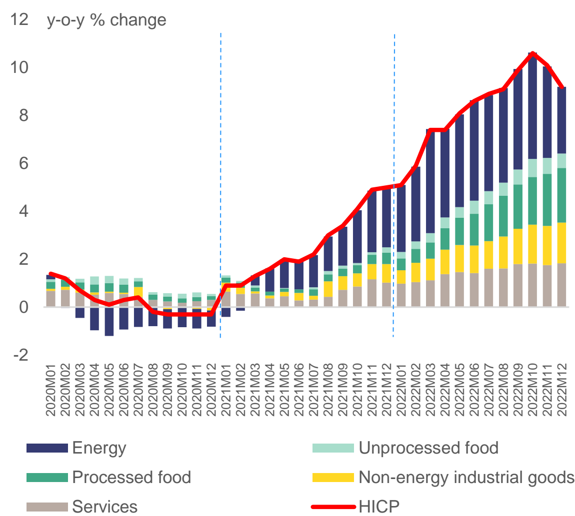
Despite the lower albeit sustained pace of output growth, labour market conditions in the EU further improved. Positive developments observed after the relaxation of pandemic-related restrictions in 2021 and strong labour demand continued also in 2022. Headcount employment rose by 2.3% and 2.0% in the euro area and the EU, respectively. Most of the new jobs were created in the public sector. Higher employment also drove down the unemployment rate by some 0.9 percentage points, to 6.8% and 6.2% in the euro area and the EU,

[1] European Commission 2021 autumn forecast, p. 24.
[2] European Commission 2023 spring forecast, Eurosystem staff macroeconomic projections for the euro area, June 2023, IMF World Economic outlook update, July 2023.

respectively. These figures are below the lowest unemployment rates recorded for the two aggregates since the measurement by labour force surveys began. Despite the strong increase in prices and the tighter labour market, wage growth was only modest, implying lower household real disposable income.

The rise in energy prices, which started in mid-2021, continued and spurred inflation rates. As from February 2022, the war in Ukraine added another inflation push as energy prices rose to new record levels. Soaring energy prices and the depreciation of the euro had a negative impact on terms of trade. Import prices rose by around 20%, not only due to higher energy costs but also because other imported products became more expensive, such as processed food. Such movements have direct and indirect effects on consumer prices. Higher import prices of refined oil pass through directly and have an immediate impact on the harmonised index of consumer prices (HICP). The indirect effect operates through supply chains and is passed on through higher production costs that take longer to pass through to final consumer prices.

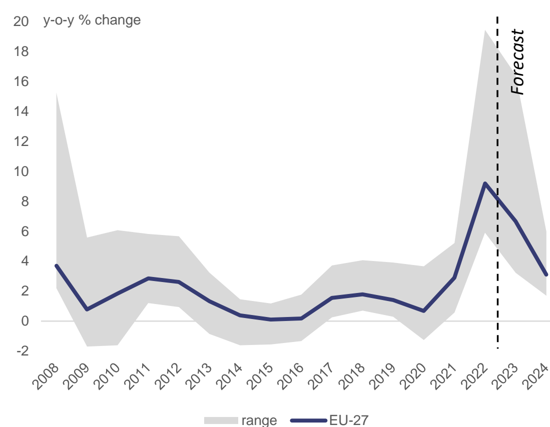
Graph 1.3: **Contributions to the annual HICP inflation, euro area**



Source: European Commission

Headline inflation increased steadily from 5.0% in January to a peak of 10.6% in October, before slowing to 9.2% in December. Annual headline inflation in the euro area increased by 5.9 percentage points to 8.5%, with energy prices being the main contributor. In the first part of the year, the prices of energy continued to rise mainly on account of rising oil prices. As these started gradually to fall before the summer, gas and electricity prices picked up. This sharp increase in energy prices passed through to other items in the consumption basket, increasing the contribution to inflation by food and core components in the second half of the year (Graph 1.3). Moreover, the positive output gap intensified domestic demand pressures. The GDP deflator posted a large increase of 4.6%, mainly on account of private consumption. However, the GDP deflator increased by less than HICP inflation, as the latter also reflected the surge in import prices (e.g. for fossil fuel and other commodities).

Graph 1.4: **The dispersion of annual headline inflation rates across EU Member States**



Source: European Commission 2023 spring forecast

Inflation rates across EU Member States varied markedly in 2022 (Graph 1.4). The highest annual rise in prices was recorded in Estonia (19.5%) and the lowest in France (5.9%). The dispersion of inflation exhibited a geographical pattern, with Central and Eastern Europe recording the highest inflation rates, especially the Baltic countries, followed by Hungary, Czechia and Poland. Their high headline inflation rates were largely explained by faster growth of energy and food prices and by higher weights of these items in the consumption baskets.

After many years of accommodative monetary policy, the ECB started monetary tightening to keep inflation expectations anchored and prevent second-round effects. [3] In 2022, the ECB raised the policy rates four times, in July by 50 basis points (bps), followed by further normalisation in

(3) The European Central Bank (ECB) raised interest rates some months after the Bank of England (16 December 2021) and the Federal Reserve (16 March 2022), which is in line with the different macroeconomic trajectories.

September and October by 75 bps each and in December by 50 bps (4). For consistency purposes, the ECB also decided in October to change the terms and conditions of the third series of targeted longer-term refinancing operations (TLTRO III) in order to support the transmission of policy rate increases to bank lending conditions. The ECB's pandemic emergency purchase programme (PEPP), launched in the wake of the Covid-19 pandemic, was discontinued at the end of March 2022. (5) It was followed by the announcement in July 2022 of a new initiative, the transmission protection instrument (TPI), to counter unwarranted market dynamics as lenders started reassessing sovereign risks.

The Commission invited most Member States to provide a supportive fiscal impulse in 2022, including the impulse of the Recovery and Resilience Fund and other EU funds, and excluding the impact of the temporary Covid-19 measures (Section 2.3). In the draft budgetary plans for 2022, Member States responded with higher expenditure growth than planned in the 2021 stability programmes, indicating an overall supportive fiscal impulse (net of temporary Covid-19 measures) (Section 2.4). In response to the war in Ukraine and the energy price shock, Member States introduced new support measures for households and businesses affected by the energy price increase, with net budgetary costs of close to EUR 200 billion in 2022 (1.2% of EU GDP) and support to people fleeing Ukraine (0.1% of EU GDP). The country-specific recommendations for 2023 asked for energy-price-related measures to be targeted toward the 'most vulnerable' households and firms (low-income groups, specific energy-intensive activities), but the formal guidance for 2022 did not change. In practice, around 60% of energy measures were untargeted price-reducing measures for all, which had limited distributional effect and contributed to fiscal expansion. (6)

(4) Interest rates went on: (i) main refinancing operations from 0 to 2.5%; (ii) the marginal lending facility from 0.25 to 2.75%; and (iii) the deposit facility from -0.5 to 2.0%.

(5) Nevertheless, according to the ECB, the maturing principal payments from securities purchased under the PEPP will be reinvested until at least the end of 2024.

(6) In a recent paper, Amores et al. (2023) provide evidence showing that government measures supported more low-income households, but still did not prevent welfare losses of inflation, which affects poorer households. Higher-income households suffered less or their welfare even increased thanks to higher market incomes and untargeted, broad-based fiscal support measures.

1.2. MAIN BUDGETARY DEVELOPMENTS

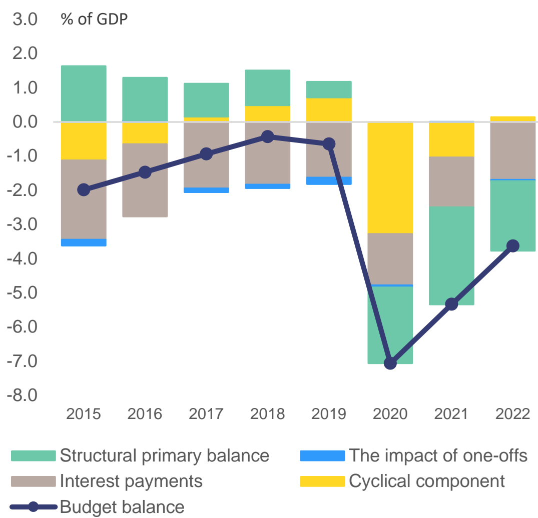
Following substantial improvement of the budget balance in 2021, the aggregate budget deficit further improved by more than 1 percentage point to 3.6% and 3.4% of GDP in the euro area and the EU, respectively, compared with the previous year (Graph 1.5).

Favourable cyclical conditions (i.e. real GDP grew above its potential), tax-rich revenue developments and phasing out of fiscal support related to the Covid-19 pandemic were the main drivers behind the reduction in the deficit. Consequently, at the aggregate euro area level, the structural primary balance improved by 0.8% of GDP. The strong increase in inflation had initially a positive impact on headline balances on account of stronger nominal GDP growth. After 10 years of decline in debt servicing costs, interest payments increased by around 0.2% of GDP. Long-term bond yields rose in 2022, reflecting inflation expectations and changes in the ECB's policy of tightening financing conditions.

The headline and structural budget balances include revenue windfalls that seem to be largely explained by the huge inflation surprise. Looking at the expenditure benchmark however, which abstracts from revenue windfalls, this shows a much lower or even negative change in the underlying fiscal position. Therefore, it is of crucial importance to understand the underlying developments of the discretionary policy measures that underpinned the expenditure dynamics in 2022 (Section 2.5). As indicated above, fiscal measures were largely untargeted, increasing the level of fiscal support. However, withdrawal of the Covid measures (2.5% of GDP) was larger than the newly provided support in response to high energy prices and refugees (1.2% of GDP), contributing to the decline in fiscal deficits.

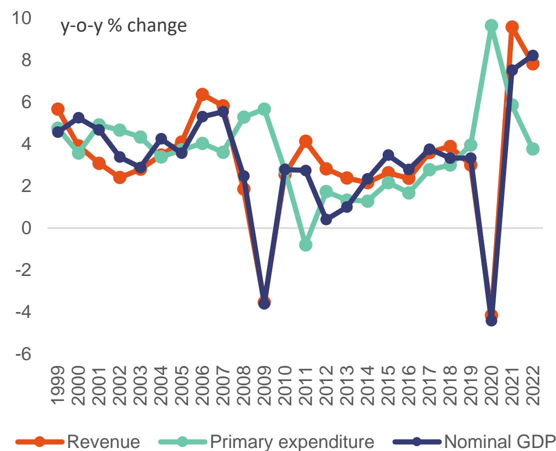
If Covid and energy support measures had been excluded, the net expenditure growth would have increased indicating an expansionary fiscal impulse (Graph 4.4). Hence, assuming that the expenditure benchmark is a better measure of the underlying trends, the signals coming from the headline and structural balance needs to be taken with caution, because they are polluted by short-term developments that are likely to peter out over time.

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



Source: European Commission

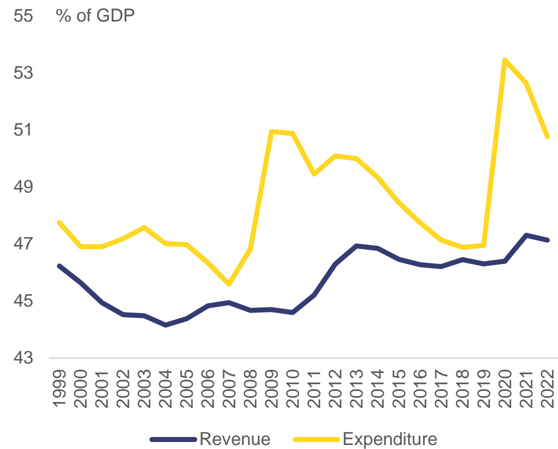
Graph 1.6: **Change in government revenue, primary expenditure and GDP, euro area**



Source: European Commission

Growth in both revenue and primary expenditure was still strong compared with the years before the pandemic. Primary expenditure recorded 3.8% and 4.2% growth in the euro area and the EU, respectively. This was lower than in 2020-2021 due to the withdrawal of pandemic-related government support to households and firms (Graph 1.6). Revenue increased by around 7.8% in both areas on account of strong economic growth. Nevertheless, the growth rates of primary expenditure and of revenue were lower than that of nominal GDP leading to a decrease of their respective ratios (Graph 1.7).

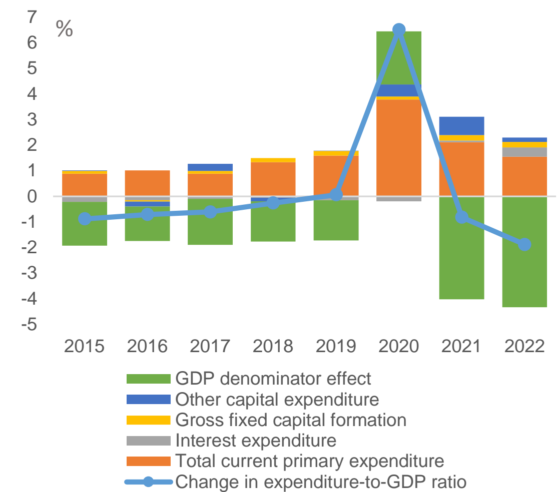
Graph 1.7: **Government revenue and expenditure ratios, euro area**



Source: European Commission

The expenditure-to-GDP ratio fell by 1.9 percentage points to 50.8% of GDP in 2022. The decline in the ratio was driven by two main factors (Graph 1.8). The first is the denominator effect due to higher economic activity and the second is the lower spending related to the pandemic temporary emergency measures. On the other hand, governments on average spent somewhat more on investments and interest payments.

Graph 1.8: **Change in the government expenditure-to-GDP ratio, euro area**

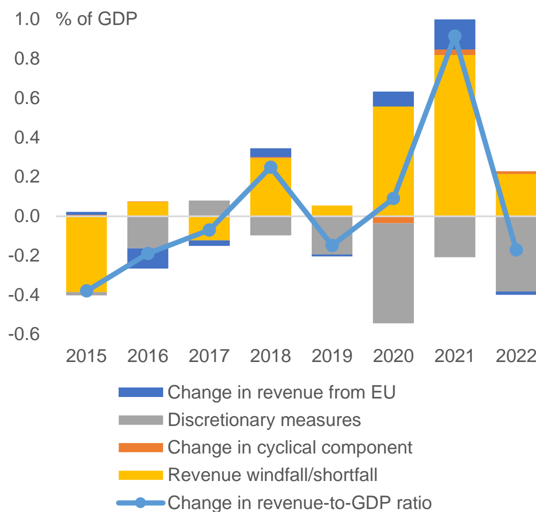


Notes: (1) A positive (negative) denominator effect shows increase (decrease) of the expenditure ratio due to a downturn (upturn) of nominal GDP
(2) Other capital expenditure includes capital transfers payable, changes in inventories and acquisitions less disposals of valuables (e.g. precious metals), and acquisitions of non-financial, non-produced assets.
Source: European Commission

Government investment, measured as government gross fixed capital formation, recorded a strong growth rate of 7.0% in the euro area and 7.1% in the EU. Growth in public investment was

supported by the RRF as well as by nationally financed public investment. Increasing share of government investment in total expenditure will likely stimulate economic growth.

Graph 1.9: **Change in the government revenue-to-GDP ratio, euro area**



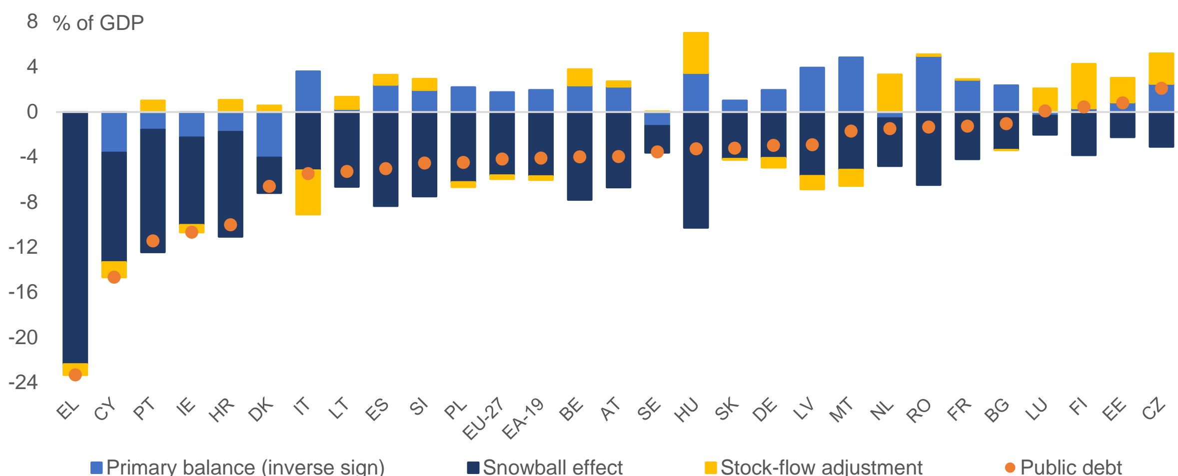
Notes: (1) Revenue windfall or shortfall shows changes in government revenue that are not explained by the standard elasticity of revenue to the economic cycle.
(2) Discretionary measures represent the incremental budgetary impact of adopted or credibly announced measures, as compared with a 'no-policy-change' forecast, estimated based on judgement (bottom-up approach). (3) Revenue from the EU shows changes in the current and capital transfers received from EU institutions.
Source: European Commission

The revenue-to-GDP ratio decreased in 2022 by around 0.3 percentage points to 47.1% and 46.5% of GDP in the euro area and the EU respectively. This slight decrease was mostly driven by two factors (Graph 1.9). First, revenue growth excluding discretionary measures was stronger than nominal GDP growth, suggesting a tax-rich composition of growth. While still positive, this effect shrank in 2022. Second, discretionary measures such as the reduction of VAT and excise duties to limit energy inflation reduced the revenue-to-GDP ratio.

The government debt-to-GDP ratio further declined in 2022 by more than 4 percentage points in both the euro area and the EU to 93.2% of GDP and 85.3% of GDP, respectively. This reduction was driven by strong expansion in GDP, inflation and falling primary deficits. The latter continued to weigh on debt ratio, but less than in the previous 2 years. Specifically, there was a significant debt-reducing contribution from the differential between the interest rate and GDP growth, known as the snowball effect (Graph 1.10). This effect varied across countries with a higher debt-ratio reducing effect for more indebted Member States.

In 2022, the headline government deficit in the euro area and the EU turned out lower than planned in the 2021 stability and convergence programmes, by about 0.5 and 0.7 percentage points of GDP, respectively (Table 1.2). The unexpected surge in inflation in 2022 raised nominal GDP growth above the assumptions underpinning the 2021 stability and convergence programmes and generated more government revenue. While expenditure growth exceeded the plans, it lagged behind that of revenue.

Graph 1.10: **Drivers of the government debt-to-GDP ratio in 2022, by country**



Note: 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

Revenue came in considerably higher than originally expected. These positive revenue surprises were due to higher-than-planned value-added tax returns as prices for energy, food and other commodities increased. Income taxes rose on the back of favourable labour market developments and as some taxpayers moved into higher tax brackets (bracket creep). On the other side of the budget balance, expenditure did not entirely follow the growth in revenue since some spending categories take longer time to adjust (Box 1.1), leading to smaller budget deficits in 2022.

Nevertheless, primary expenditure grew significantly faster than planned in the 2021 stability and convergence programmes. This increase can be explained by the fact that during the planning phase of the programmes governments expected expenditure to decline in 2022 due to the phasing out support measures related to the Covid-19 pandemic and they did not envisage new discretionary policy measures to mitigate the impact of higher energy prices on households and firms.

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	LOW (MEDIUM)
BG	LOW	LOW (MEDIUM)	MEDIUM	LU	LOW	LOW	HIGH
CZ	LOW	MEDIUM	MEDIUM (HIGH)	HU	LOW	HIGH (MEDIUM)	HIGH
DK	LOW	LOW	LOW	MT	LOW	MEDIUM	HIGH
DE	LOW	MEDIUM (LOW)	MEDIUM	NL	LOW	MEDIUM	HIGH
EE	LOW	LOW	LOW	AT	LOW	MEDIUM	MEDIUM
IE	LOW	LOW	MEDIUM	PL	LOW	MEDIUM	MEDIUM
EL	LOW (HIGH)	HIGH	LOW (MEDIUM)	PT	LOW	HIGH	LOW (MEDIUM)
ES	LOW	HIGH	MEDIUM	RO	LOW	MEDIUM (HIGH)	MEDIUM
FR	LOW	HIGH	MEDIUM	SI	LOW	MEDIUM (HIGH)	HIGH
HR	LOW	HIGH (MEDIUM)	MEDIUM	SK	LOW	HIGH	HIGH
IT	LOW	HIGH	MEDIUM	FI	LOW	MEDIUM	MEDIUM
CY	LOW	MEDIUM	LOW (MEDIUM)	SE	LOW	LOW	LOW
LV	LOW	LOW	LOW				

Note: The table compares this year's sustainability risk classification, as published in the 2022 Debt Sustainability Monitor. with the risk classification in the annexes of the 2022 country reports whenever the risk classification has changed (in brackets).
Source: European Commission

According to the Commission's 2022 Debt Sustainability Monitor ([7]), which took on board the results of the Commission's 2022 autumn forecast, sustainability risks have decreased in the short and long term compared with last year's Commission assessment (Table 1.1). Fiscal sustainability risks have declined in the short term due to robust GDP growth in 2022. In the medium to long term, most improvements occurred due to structural improvements or methodological changes in the analysis of longer-term sustainability.

Over the medium term, the risk classification worsened for three countries (Germany, Croatia and Hungary) and improved for three others (Bulgaria, Romania and Slovenia). Revisions reflect worse debt sustainability for Croatia and Hungary due to a weaker growth outlook and tightened financial conditions, and for Germany a worsening of the S1 indicator. The improvement in risk classification for Bulgaria, Romania and Slovenia mainly results from a more favourable fiscal outlook due to improvement in the structural primary balance.

For the long term, five countries were deemed to face less acute risks (Czechia, Greece, Cyprus, Lithuania and Portugal). While Czechia improved from high to medium risk due to improvement in the initial budgetary position, improvement in the other countries from medium to low risk reflects the methodological change using a revised S1 indicator ([8]) instead of the debt sustainability analysis as a complementary indicator to the S2 indicator in the overall risk classification.

Nevertheless, it is important to acknowledge that the improvement in initial budgetary conditions is measured in terms of the structural primary budget balance which embeds some well-known measurement issues. Also, in 2022, this was affected by the revenue windfalls mentioned above, i.e. an increase in government revenue that goes beyond conventional estimates of tax elasticities and which may only be temporary.

([7]) European Commission (2023).

([8]) In previous Fiscal Sustainability Reports and Debt Sustainability Monitors, the S1 indicator informed the medium-term risk classification, when the debt target of 60% of GDP was to be reached in 15 years. In the new design, S1 measures the upfront fiscal adjustment to the structural primary balance required to reach a debt-to-GDP ratio of 60% in 2070, which is the end point of last Ageing Report projections. This is also in line with the approach used in the 2006 and 2009 Fiscal Sustainability Reports. For further details about methodological changes see Box 3.1 in the 2022 Debt Sustainability Monitors (European Commission 2023).

Box 1.1: **The effects of high inflation on government expenditure**

The sharp increase in EU inflation over the last 2 years has significant implications for government balances and policymakers. The effect of inflation on budget categories is manifested through several channels and in most revenue and expenditure items, which, in turn, affects the general government debt. In this box, we focus on the impact of inflation shocks on government expenditure by presenting key transmission channels, analytical findings and policy options.

Key transmission channels

An inflation shock affects public expenditure through the following channels.

- *Effects of inflation on interest payments.* As inflation increases steadily, interest rates also rise since the monetary policymaker raises the policy interest rate to bring inflation back to its target. Therefore, the cost of servicing future debt by increasing nominal yields will rise, suggesting that new government borrowing will be financed at a higher interest rate that, in turn, can increase government debt. Alternatives to yield-increasing bonds are inflation-indexed bonds that protect bond purchasing power by tying the interest rate and/or the principal to an index of prices changes ([1]). Inflation-linked bonds tend to be typically concentrated at the long end of the yield curve, with longer-term maturity (10 years or more) as these bonds offer protection against the effects of (unanticipated) inflation developments ([2]). According to the OECD report (2023), the cost of new borrowing for OECD sovereigns has more than doubled in 2022, rising from an average of 1.4% in 2021 to 3.3% in 2022. Should these financing conditions prevail until 2025, the median OECD country would see its interest payments rise by 0.7% of GDP by the end of 2025.

- *The impact of inflation on non-interest expenditure.* We can distinguish three groups of primary expenditures by the way they are adjusted to inflation.

  - First, government spending categories that are adjusting to changes in prices with indexation. The latter aims at preserving real incomes and it includes public expenditure such as compensation of government employees, pensions and social benefits. According to an ECB survey (2022), there is substantial diversity among indexation schemes across euro-area countries. With respect to nominal wages, automatic price indexation is very limited in the euro area ([3]). However, inflation plays an important role in wage-setting negotiations. In contrast, in almost all euro-area countries, public pensions are indexed automatically (fully or partially) to prices and wages, but mostly with a time lag. Nevertheless, upward revisions most likely account for past inflation, which suggests that it will not have had an impact on expenditure in 2022, but it is having it already in 2023. The pass-through of inflation may not always be complete, also depending on the measure of inflation.

  - Second, discretionary spending, such as intermediate consumption and public investment, is usually set in nominal terms at the beginning of the budgetary process or over the medium-term path. Since these types of spending are partly controlled by lower levels of government, adjustments to prices are done with a time lag and are visible only in the medium term.

  - Third, new discretionary measures. The government can decide on new exceptional measures to be taken to offset the effect of inflation on household purchasing power and corporate performance. In 2022, governments decided on several discretionary expenditure measures including transfers to households, compensation to gas and electricity suppliers, and aid granted to other companies ([4]). More generally, as evidenced by past surveillance cycles, unexpected increases in revenues tend to be spent, either in part or fully, on the assumption or claim used in the public debate that revenue increased due to structural rather than temporary factors.

([1]) For example, the Treasury Inflation-Protected Securities (TIPS) are US government bonds that pay interest based on the current inflation rate (consumer price index). As inflation rises, instead of raising its interest rate, the principal value of TIPS is adjusted for realised inflation over the past half year to maintain its real value. Over the past 20 years, sovereign inflation-linked bond markets also developed in the euro area. In the euro area, France was the first euro-area country, in 1998, to issue inflation-indexed bonds indexed to the French consumer price index (OATi). It was followed by other countries, namely Greece, Italy and Germany (for more details, see Garcia, J.A. and A. van Rixtel (2007)).

([2]) Garcia, J.A. and A. van Rixtel (2007).

([3]) The exceptions are Belgium and Luxembourg where public wages are fully automatically indexed to prices.

([4]) The listed measures take into account only the pure expenditure side and not the revenue side.

(Continued on the next page)

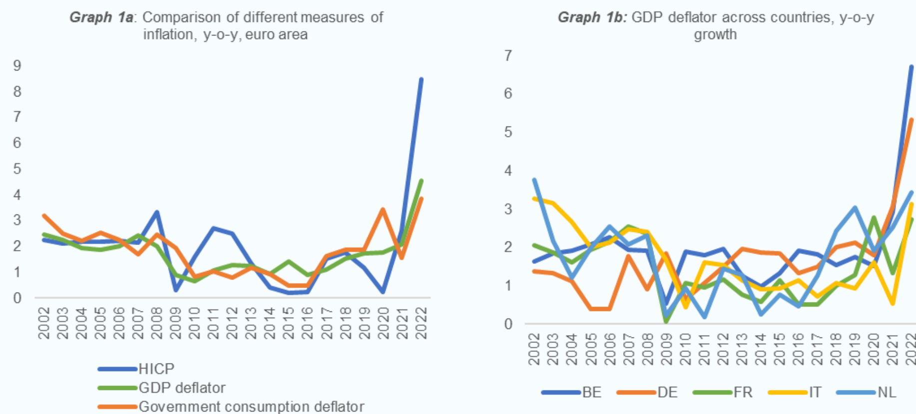
Box (continued)

- *Higher growth in nominal GDP.* The growth rate of GDP in nominal terms, which is the sum of the growth rate of the volume of GDP and the GDP deflator, rises with inflation, which makes it easier for the government in the short term to shoulder the burden of any given nominal government debt.

Measures of inflation

How expenditures respond to inflation depends on how official measures of inflation affect the cost of government operations. The measure of inflation typically used for making such plans is the GDP deflator, a measure of general inflation in the domestic economy. Unlike the harmonised consumer prices index, which is a measure of inflation facing households, it is not based on a fixed basket of goods. Graph 1a shows that GDP deflator typically displays less volatility than other measures of inflation and is therefore more conducive to stable policymaking. From Graph 1b, we see that there exists high diversity across countries pointing to different adjustment and indexation needs of government expenditure across countries.

Graph 1: **Differences in measures of inflation and GDP deflator across countries**



Note: Government consumption deflator is short for price deflator total final consumption expenditure of general government.
Source: European Commission

According to the Vade mecum on the Stability and Growth Pact (2019), the EU governance toolbox on fiscal policy, the expenditure benchmark is computed, among other variables, by using the GDP deflator as a measure of inflation. The expenditure benchmark growth rate is derived from potential real GDP growth, which is thus measured in real terms, while expenditure plans are typically set in nominal terms. Therefore, to convert the expenditure benchmark into nominal terms to enable a comparison, the GDP deflator is used as a measure of inflation. For purposes of surveillance, the GDP deflator from the Commission's spring forecast of the preceding year is used.

Literature findings

It is generally accepted knowledge that inflation surprises have a positive impact on the public finances in the short run due to higher taxes and social contributions on the revenue side and a decrease in the public debt ratio when nominal GDP increases. On the expenditure side, inflation generally feeds through with a time lag, in particular through indexation mechanisms, and it only gradually increases expenditure.

The IMF (2023) showed, using quarterly data, that a sudden rise in inflation improves budget balances in the short term before the introduction of the policy measures. The results imply that for a 1 percentage point initial increase in inflation, budget balances go up by 0.5% of GDP. Barro (1979) argued that, in order to maintain the planned level of government spending, governments should adjust their deficit to unanticipated inflation rate changes. In practice, some additional discretionary measures can be agreed, as we witnessed in 2022, to preserve household incomes and lower costs for companies.

Nevertheless, it is important to acknowledge that the nature of inflation shock matters. Whether a rise in prices is driven by a supply or a demand shock is important in terms of its effect on the budget balance. EU inflation in 2022 was largely supply-driven, increasing the price of imported products, arising from supply bottlenecks due to the pandemic and the war in Ukraine. A recent study by Burriel et al. (2023) finds that, for the euro area, an external oil shock has a very small and short-term positive impact on the budget balance due to an initial increase in revenue and

(Continued on the next page)

Box (continued)

a decline in expenditure. The effect turns negative and reaches a trough in the middle of the second year following the shock. Benassy-Quere (2022) showed that, if there is an increase in oil prices, the primary balance declines due to a decrease in all tax bases in real terms, meaning that the economy becomes less wealthy. In the same vein, the ECB (2023) suggested that the external supply shock has a positive or neutral overall effect on the budget balance in the first year. However, over the following years, spending pressures increase, more than offsetting revenue gains, and leading to a fall of nearly 0.5% of GDP in the budget balance level in 2024.

As regards the impact on government debt-to-GDP ratio, the IMF (2023) showed, based on annual data (1962-2019) for 85 countries, that a sudden rise in the growth of the GDP deflator by 1 percentage point reduces the debt-to-GDP ratio by between 0.2 and 0.6 percentage points of GDP. The drop is larger for countries with a higher initial debt. This positive immediate impact is explained by the combination of an increase in the GDP denominator and the nominal debt-servicing costs being largely predetermined. Over the medium term, due to higher interest payments and lower growth, public debt ratios would rise. For the euro-area countries, ECB (2023) simulations suggest that the increase in the GDP deflator (the denominator effect) by about 6 percentage points would reduce the debt-to-GDP ratio in 2024 by close to 5 percentage points. Nevertheless, the initial positive effect may be reversed, notably if growth falters. The terms of trade shock has negative implications on real output because purchasing power falls, and therefore demand too. Subsequently, the policy response gives rise to additional effects via increases in interest rates and government support to households to withstand the terms of trade shock.

Regarding the impact of inflation on interest payments, Claeys and Guetta-Jeanrenaud (2022) showed that, despite rising interest rates, debt-to-GDP ratios should continue to fall in 2022 and 2023 in the euro-area countries. This is due to the combination of low interest on loans over the last decade and an increase in the average maturity of their debts, when at the same time the nominal interest rate-nominal growth differential (i-g) remains negative. However, after 2023, the situation might become more diverse among countries. While for some the debt-to-GDP ratio might continue to fall, for others it might start increasing, due to increases in interest rates and slower reductions in primary deficits. These results are in line with Akitoby et al. (2014) who find that inflation reduces the debt-to-GDP ratio mainly temporarily, because in the long run higher inflation is fully passed through into higher interest expenditure in the refinancing of existing debt.

Policy options

While the Stability and Growth Pact does not include a specific reference to adverse inflation developments, these are indirectly included in Directive 2011/85 ([5]) on national fiscal frameworks, which specified that medium-term budgetary plans should be built on the most prudent macro-fiscal scenario. The implications of higher inflation crucially depend on the response of expenditure. Based on Member State experiences, different approaches exist for adaption and revision of medium-term budgetary plans and expenditure rules. For illustration purposes, we present two.

Finland has a medium-term budgetary system based on a real-term spending limit rule ([6]). The 4-year expenditure ceiling is annually revisited to correct, for the following year, price-level and cost-level adjustment based on an independent fiscal forecast. Such an approach enables government to make immediate spending adjustments and helps maintain the real expenditure level set at the beginning of the fiscal plan.

The Swedish nominal expenditure ceiling ([7]), introduced in 1997, is defined for 3 years on a rolling basis, and it covers all expenditures except interest payments. The expenditure ceiling can only be changed under new and completely different external circumstances, which only happened during the Covid-19 pandemic. The main principle is that expenditure increases in one expenditure area have to be compensated by expenditure reductions in another area. The advantage of this rule is that it is a powerful tool for consolidation and there is no expenditure drift. The expenditure ceiling creates conditions for achieving the surplus target, ([8]) leading to a long-term sustainable fiscal policy. Hence, the expenditure ceiling promotes budget discipline and strengthens the credibility of economic policy.

([5]) Council Directive 2011/85/EU.
([6]) Ministry of Finance of Finland (2015).
([7]) Ministry of Finance of Sweden (2018).
([8]) The surplus target has been changed over recent years. Originally, the surplus target was 2% of GDP. After Eurostat decided that, as of 2007, savings in the premium pension system could no longer be included in net lending, a technical downward adjustment was made to the surplus target from 2% to 1% of GDP. In 2017, the target was changed to 0.33% of GDP over an economic cycle. The surplus target is reviewed every eighth year.

Table 1.2: Overview of budgetary plans vs outturns for 2022

	Spring 2021		Autumn 2021		Spring 2023		
	Commission forecast (SF21)	Stability and convergence programmes (SCPs)	Commission forecast (AF21)	Draft budgetary plans (DBPs)	Outturn	**Outturn vs SCPs**	**Outturn vs DBPs**
Euro area - 19							
			year-on-year % change				
Real GDP	4.4	4.1	4.3	4.3	3.5	-0.6	-0.9
Nominal GDP	5.9	5.5	6.3	6.0	8.2	2.7	2.2
Potential GDP	1.4	1.6	1.6	1.6	1.3	-0.3	-0.3
Total revenue	4.9	5.0	4.9	4.6	7.8	2.8	3.2
Total expenditure	-3.1	-3.1	-1.4	-1.9	4.4	7.5	6.3
Primary expenditure	-3.0	-3.1	-1.3	-1.8	3.8	6.8	5.5
			billion euro				
Real GDP	11544	11486	11671	11638	11641	1.3	0.0
Nominal GDP	12645	12577	12935	12920	13334	6.0	3.2
Potential GDP	11581	-	11674	-	11614	-	-
Total revenue	5796	5774	5886	5872	6286	8.9	7.1
Total expenditure	6279	6292	6389	6394	6770	7.6	5.9
Primary expenditure	6119	6132	6230	6235	6544	6.7	5.0
Effect of discretionary current revenue measures	*-4.5*	*-0.7*	*-13.8*	*-4.3*	*-2.1*	-	-
one-off on the revenue side	*0.7*	*1.9*	*4.1*	*11.1*	*-48.8*	-	-
one-off on the expenditure side	*-1.3*	*-2.6*	*-3.8*	*-27.4*	*6.6*	-	-
			% of GDP				
Output gap, % of potential GDP	-0.3	-0.7	0.0	1.3	0.3	0.9	-1.0
Budget balance	-3.8	-4.1	-3.9	-4.0	-3.6	0.5	0.4
Primary balance	-2.6	-2.8	-2.7	-2.8	-1.9	0.9	0.9
Structural primary balance	-2.4	-2.4	-2.6	-3.4	-2.0	0.4	1.4
One-off and other temporary measures	*0.0*	*0.0*	*0.0*	*-0.1*	*-5.4*	-	-
EU-27							
			year-on-year % change				
Real GDP	4.4	4.1	4.3	-	3.5	-0.6	-
Nominal GDP	6.0	5.7	6.5	-	8.8	3.1	-
Potential GDP	1.6	1.8	1.8	-	1.5	-0.3	-
Total revenue	5.0	5.7	5.1	-	7.8	2.1	-
Total expenditure	-2.4	-2.6	-0.8	-	4.8	7.4	-
Primary expenditure	-2.4	-2.6	-0.7	-	4.2	6.7	-
			billion euro				
Real GDP	13573	13630	13717	-	13710	0.6	-
Nominal GDP	14904	14915	15263	-	15808	6.0	-
Potential GDP	13628	-	13734	-	13672	-	-
Total revenue	6780	6770	6903	-	7345	8.5	-
Total expenditure	7326	7382	7453	-	7878	6.7	-
Primary expenditure	7144	7201	7273	-	7624	5.9	-
Effect of discretionarycurrent revenue measures	*-6.5*	*0.5*	*-20.4*	-	*-2.1*	-	-
one-off on the revenue side	*1.9*	*2.2*	*4.3*	-	*-53.7*	-	-
one-off on the expenditure side	*-3.2*	*-4.3*	*-5.7*	-	*8.4*	-	-
			% of GDP				
Output gap, % of potential GDP	-0.4	-0.7	-0.1	-	0.3	1.0	-
Budget balance	-3.7	-4.1	-3.6	-	-3.4	0.7	-
Primary balance	-2.4	-2.9	-2.4	-	-1.8	1.1	-
Structural primary balance	-2.2	-2.5	-2.4	-	-1.9	0.6	-
One-off and other temporary measures	*0.0*	*0.0*	*0.0*	-	*-3.9*	-	-

Note: Potential GDP, Output gap and Structural primary balance in the stability and convergence programmes column are as recalculated by the Commission on the basis of information.
Source: European Commission (AMECO - spring 2021, autumn 2021 and spring 2023 forecast editions), 2021 stability and convergence programmes, 2021 draft budgetary plans.

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

Highlights

- As in previous years, recourse to an extensive interpretation of the severe economic downturn clause affected the implementation of the EU fiscal framework. The decision to extend the clause was not consistent with the Commission's own quantitative criteria.
- Fiscal policy guidance for 2022 recommended supporting the economic recovery while withdrawing the fiscal stimulus provided in 2020 and 2021. It was centred on aggregate demand management, as opposed to fiscal adjustment. It was formulated in qualitative terms but referred to medium-term potential growth as a benchmark for expenditure growth rate. It was differentiated by the level of government debt, but differences were small in practice. A multiplicity of conditions for different expenditure elements complicated the guidance and its practical application.
- Draft budgetary plans targeted expenditure growth, net of temporary Covid support measures, beyond medium-term potential output growth. This impulse was largely planned to come from an increase in nationally financed current expenditure, indicating risks to prudent fiscal planning. The Commission noted this issue only for three countries that had previously received a specific recommendation.
- Responding to unanticipated events, in the course of 2022 Member States adopted new measures with the ambition to support vulnerable households and businesses affected by the energy price increases and to help people fleeing Ukraine.
- In spite of these new measures, the EU structural deficit narrowed to 3½% of GDP in 2022. The improvement was achieved thanks to the roll-back of Covid support measures and much stronger-than-planned, but temporary revenue linked to the surge in inflation.
- Excluding the effect of temporary Covid and energy support measures, underlying expenditure growth surpassed the nominal rate of medium-term potential output growth for the EU as a whole – thus indicating a worrying expenditure trend. In countries with government debt above 60% of GDP, net expenditure growth exceeded the benchmark by a wide margin, while those with debt below 60% of GDP left some headroom below their higher nominal benchmark growth rate.
- The Commission's final assessment for 2022 reasoned that most deviations from the original policy guidance were acceptable in the context of high inflation or unplanned energy measures and support to Ukrainian refugees. There was no overall conclusion on compliance in 2022 and no procedural steps were decided. The Commission offered no assessment of underlying expenditure trends.
- The Commission modified the nominal expenditure benchmark by using the actual GDP deflator instead of keeping it fixed at the forecast underpinning fiscal guidance. The standard approach would have set a lower limit on expenditure growth. The new approach was not publicly communicated, undermining transparency and predictability.
- The Commission identified excessive government deficits and debt in many Member States but did not propose opening new EDPs. As in previous years, it motivated this decision with high macroeconomic uncertainty, and the Council accepted the reasoning. At the same time, the Commission regularly informed the Council on the implementation of the EDP for Romania. In spring 2023 the Commission announced its intention to suggest opening EDPs only in spring 2024 based on outcomes for 2023.

The fading Covid pandemic, the war in Ukraine and related energy price increases shaped the implementation of the EU fiscal framework in 2022. Moreover, the continued resource to an extensive interpretation of the severe economic downturn clause in 2023 led to further innovations in the implementation of the EU fiscal rules. These are outlined at the start of this chapter. It continues with a chronological overview of the annual EU fiscal surveillance cycle – from the policy guidance issued in 2021 and fiscal plans for 2022 to the *ex post* assessment in spring 2023. In the absence of regular quantitative fiscal requirements as set out in Stability and Growth Pact (SGP), this chapter offers an economic reading of expenditure trends. It closes with an overview of how the corrective arm of the SGP has been implemented.

2.1. INNOVATIONS IN SURVEILLANCE METHODS AND PRACTICE

In 2021 and 2022, the Commission proposed extending the severe economic downturn clause at first until the end of 2022 and then until the end of 2023, each time broadening the interpretation of a severe economic downturn beyond its meaning under the SGP (EFB, 2022a, Box 1). The country-specific fiscal guidance issued since spring 2020 focused on aggregate demand management, going beyond the SGP's statutory objective of safeguarding sound public finances. The extensive interpretation of the clause also changed established surveillance and reporting practice.

The Council formally accepted the Commission's far-reaching interpretation of the severe economic downturn clause, including its extensions, by adopting the largely qualitative fiscal recommendations on the stability and convergence programmes. However, in the public debate in 2021 and 2022 the finance ministers of euro area countries seemed to distance themselves from their responsibility by simply taking note of the Commission's intention to extend the clause. (9)

The following interpretative and methodological changes to the EU fiscal framework had an impact on the 2022 surveillance cycle:

- the use of fiscal recommendations under the SGP to manage aggregate demand;
- changes to the fiscal surveillance process and reporting by the Commission and the Council;
- the interpretation and use of temporary and targeted measures;
- the commonly agreed method for estimating potential output and the output gap.

Using fiscal recommendations to manage aggregate demand

Up until 2019, country-specific fiscal surveillance recommendations did not guide the fiscal stance of individual countries, focusing instead on monitoring compliance with the EU fiscal rules. This was in line with the stated objective of the SGP, which is to safeguard sound public finances. The SGP does not include references to the stabilisation of output. The underlying assumption is that compliance with the rules creates fiscal buffers for stabilisation at national level. The Commission's European Semester country reports occasionally discussed country-specific fiscal stances as part of the macroeconomic policy mix. (10) The Commission's assessments of the fiscal stance also informed the euro area recommendations, including differentiated policy advice for countries with high levels of public debt. (11)

In 2020, with the onset of the Covid-19 pandemic, all Member States received the same qualitative recommendations for 2020 and 2021 to 'take all necessary measures (...) to effectively address the Covid-19 pandemic, sustain the economy and support the ensuing recovery' (EFB, 2021b).

In 2021, the fiscal recommendations for 2022 explicitly asked for 'a supportive fiscal stance'. (12)

(9) 15 March 2021: Eurogroup statement on the euro area fiscal policy response to the COVID-19 crisis and the path forward; 14 March 2022: Eurogroup statement on the fiscal guidance for 2023.

(10) The European Semester was introduced in 2011, aligning and strengthening budgetary and economic policy coordination at EU level. 'Fiscal stance' or 'fiscal space' were discussed in some European Semester country reports from the inception in 2011, while the topic became more frequently discussed in the years running up to 2020, when it was included in the recommendations for the euro area.

(11) For example, see 2019 Council recommendation on the economic policy of the euro-area.

(12) The Commission uses the two terms 'fiscal stance' and 'fiscal impulse' as synonyms, while actually measuring, in European Fiscal Board terminology, the fiscal impulse of a change in the structural primary balance or the discretionary fiscal effort. The Commission also excludes the effect of Covid-related temporary emergency measures.

The guidance was further specified for certain expenditure aggregates and differentiated for high-debt countries (see Section 2.3). The Commission motivated this approach as averting a 'premature fiscal adjustment'.

While fiscal stabilisation subject to sustainability constraints has an economic rationale, it is not the statutory purpose of the SGP, which, as mentioned above, is centred on fiscal sustainability. The short-term guidance for 2022 ignored the accumulated structural deficits or fiscal space more generally. 'Achieving prudent medium-term fiscal positions and ensuring fiscal sustainability' was referred to for the medium term and 'when economic conditions allow'. At the same time, increases in yield spreads for high-debt countries were contained by the ECB's pandemic emergency purchase programme and the implementation of the Recovery and Resilience Facility. From past experience, the effectiveness of national budgets as stabilisation instruments depends on fiscal space (Larch et al., 2022). For example, in 2012-2013 excessive borrowing costs forced highly indebted Member States to prioritise sustainability during an economic downturn.

The fiscal recommendations for 2022 provided different policy advice for countries with high public debt levels, namely Belgium, Greece, Spain, France, Italy and Portugal. The definition of high-debt Member States was not clearly spelled out, which was also the case in earlier Commission reports and in the euro-area recommendations. It can be inferred from the Commission reports that high-debt countries are those with projected debt ratios above 90% of GDP at the end of a 10-year projection period. ([13]) This categorisation by debt level was only one of the assessment criteria that fed into the assessment of debt sustainability risks in the medium term. The latter considered many more factors in the sensitivity analysis around baseline debt projections. As a result, the categorisation of Member States by debt level was not the same as categorisation by sustainability risk. ([14]) Presumably, the Commission's ambiguity on the definition of high-debt countries left freedom for interpretation, as debt projections and sustainability risk assessments can change over time.

The recommendations for 2022 were worded in qualitative terms, but non-binding explanatory notes (recitals) quantified a reference rate of 10-year average nominal potential growth to be used as a benchmark for the growth rate of net nominal government expenditure. ([15]) The fiscal requirements came with a new typology of indicators: (i) the overall fiscal impulse; (ii) the impulse of the Recovery and Resilience Fund and other EU funds; (iii) the impulse of nationally financed investment; and (iv) the impulse of nationally financed primary current expenditure. Indicators (i) and (iv) excluded the effect of Covid-related temporary emergency measures. High-debt countries (based on the Commission's definition) were grouped separately and were asked to focus only on indicators (ii) and (iii). Indicator (iv) was addressed only to the countries that were projected to significantly exceed (by more than 0.5% of GDP) medium-term potential output growth, based on the Commission's 2021 spring forecast (Section 2.3). Recitals included the indicators calculated based on the Commission forecast and the 2021 stability and convergence programmes.

The Commission did not specify in advance how the indicators would be monitored. Only in its opinions on the draft budgetary plans for 2022, the Commission provided indications by using three categories (consistent, inconsistent or broadly consistent with the recommended action), allowing for a margin of 0.5% of GDP (for indicators (i) and (iv) listed in the previous paragraph). Starting from the spring 2022 assessment, growth in nationally financed primary current expenditure (indicator (iv)) was allowed to exceed the benchmark growth rate for the effect of the energy measures and displaced people from Ukraine. This assessment in the context of the severe economic downturn clause shared some similarities with the regular assessments under the preventive arm of the SGP, but did not follow a predefined rule book.

([13]) Debt sustainability analysis based on the Commission's 2021 spring forecast projected under the baseline scenario debt-to-GDP ratios to be above 90% of GDP in 2031 (t+10) for Belgium, Greece, Spain, France, Italy and Portugal. See Table3b for each country in the Statistical Annex providing background data relevant for the assessment of the 2021 Stability and Convergence Programmes.

([14]) For example, in spring 2021, further to the previously-mentioned six countries, Romania was also assessed to be at high risk of debt sustainability in the medium term, while its debt ratio was projected to be below 90% of GDP in 2031.

([15]) The net expenditure aggregate represents government expenditure excluding interest expenditure, discretionary revenue measures, cyclical unemployment benefits and one-off expenditure. Expenditure growth is compared to the benchmark of the 10-year average of the real potential output growth rate plus the GDP deflator for the given year. Expenditure growth above the benchmark indicates an expansionary fiscal policy.

Changes in surveillance process and reporting

In 2021, there were no European Semester country reports and structural policies were coordinated as part of the recovery and resilience plans. In 2022, the Commission and the Council returned to the regular economic policy coordination process under the European Semester. The Commission published the European Semester country reports and the Council, upon the Commission's proposal, issued the country-specific recommendations with fiscal and structural policy guidance in a single policy document. In 2022, implementation of the recovery and resilience plans remained at the centre of policy coordination, but the European Semester also identified and addressed new challenges and priorities.

The Commission continued limited reporting on country-specific fiscal developments. Since spring 2021, the Commission has stopped producing staff working documents assessing individual stability and convergence programmes (SCPs) and draft budgetary plans (DBPs) (EFB, 2022b). In the past, those documents described in detail the main macroeconomic and fiscal developments, measures underlying government plans, assessed compliance with the 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 issued under the EU fiscal framework. In 2022, the main analytical conclusions were still reflected in short recitals of the legal acts, but more detailed fiscal assessments were missing. Moreover, the European Semester country reports were streamlined reducing space for country-specific analysis. As a result, much of the Commission's country-specific fiscal analysis remained hidden or was only available in internal documents.

In spring 2022, the Commission reported on compliance with the deficit and debt criteria in line with Article 126(3) Treaty on the Functioning of the EU (TFEU). It followed the same format as in spring 2021 – a single omnibus report for all countries subject to the assessment. While this format was initially announced as a one-off, the Commission continued to use it in 2022.

In autumn 2022, the Commission's public communication on the presence of excessive deficits and debt was limited to one paragraph. (16) It stated that the Commission had reassessed the updated fiscal data and plans, and previous findings of spring 2022 were largely confirmed. This succinct communication was a change compared to no communication at all in autumn 2021. The Commission elaborated on the topic in its usual internal analysis on the implications of its forecast for budgetary surveillance.

Compared to 2020 and 2021, transparency in the Commission's reporting improved somewhat on several accounts in 2022, but still departed from pre-Covid practice. The Commission presented its numerical estimates for Covid-19 related temporary emergency measures, energy measures and support to people fleeing Ukraine. (17) Previously, the effect of temporary emergency measures was visible in graphs or could be inferred from other indicators only. In autumn 2022, the Commission improved the presentation of the fiscal indicators by listing the main indicators for fiscal surveillance in a single table per country and by publishing Excel tables in addition to the regular text documents (18). Moreover, it explained its classification of energy measures in detail, which is an improvement over the limited explanations on the measures adopted in response to the Covid-19 pandemic.

The Commission and the Council stopped using the SGP indicators on the structural balance and the expenditure benchmark for fiscal surveillance purposes after moving to qualitative fiscal guidance at the onset of the Covid-19 pandemic. The Commission still reported both indicators as memorandum items in statistical annexes to provide background to its SCP and DBP assessments.

The Commission calculations of the SGP indicators of the structural balance and the expenditure benchmark did not follow the standard method. (19) For both indicators, the reference point was not fixed, as described in the Vade mecum on the SGP, at the beginning of the surveillance cycle based on the Commission's spring forecast of the preceding year (the reference

(16) Commission Communication: Annual Sustainable Growth Survey 2023

(17) Tables annexed to the Commission Communication on the 2023 Draft Budgetary Plans: Overall Assessment and An Overview of the 2023 Stability and Convergence Programmes

(18) Fiscal Statistical Tables to the assessment of the 2023 Draft Budgetary Plans

(19) The standard method is described in the Code of Conduct of the Stability and Growth (2017) and in the Vade Mecum on the Stability & Growth Pact (2019).

point for 2022 would have been the Commission's 2021 spring forecast). Instead of the fixed structural balance adjustment requirement and the fixed nominal expenditure growth rate, the Commission used updated projections/actual data to measure deviations from the indicators. This move was not publicly communicated, which undermined transparency and predictability. The departure marks an important break in the interpretation of the SGP rules. In particular, the expenditure benchmark provides a fixed nominal expenditure target when both real medium-term potential growth and the GDP deflator are fixed at the beginning of the surveillance cycle. By using the actual/projected GDP deflator, the expenditure benchmark moved towards a real expenditure target, offering more fiscal leeway in times of rising inflation. In that situation, the nominal expenditure target is more restrictive and provides a stronger macroeconomic stabilisation effect, in particular in the event of large inflation surprises.

Temporary and targeted measures

Fiscal guidance for 2022 refers to an indicator that excludes Covid-19 crisis-related temporary emergency measures (see Section 2.3). This subsection reflects on the origin of the concept of temporary emergency measures and compares it to measures under the unusual event clause and one-off measures. Moreover, following the Russia's war on Ukraine in 2022, the fiscal recommendations for 2023 asked to take into account 'temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine'. This created two new groups of measures to be monitored already in 2022.

At the onset of the Covid-19 pandemic, the Commission considered different ways of applying the EU fiscal framework, while asking Member States for a coordinated fiscal response during the crisis. The Commission Communication of 13 March 2020 [20] outlined the possible use of four SGP flexibilities:

1. treat measures closely linked to the crisis as one-off measures;
2. apply the unusual events clause to crisis-linked measures;
3. ask for no country-specific adjustment in case of negative growth or an accumulated loss of output ('exceptionally bad times');
4. activate the severe economic downturn clause.

On 20 March 2020, the Commission asked the Council to endorse the activation of the severe economic downturn clause, as it provides the most far-reaching flexibility under the SGP; the Council agreed on 23 March 2020. [21] Moreover, the Commission committed to keep monitoring health and support measures adopted by Member States, as provided under the unusual even clause of the SGP. [22] For the 2020 SCPs, Member States were reminded to report on the measures taken in response to the Covid-19 pandemic in the context of the 'unusual event/general escape clause'. [23] This guidance also argued against treating the Covid-19 related measures as one-off measures.

In spring 2020, the Commission also took stock of the Covid-related measures adopted by Member States and assessed them all as 'timely, temporary and targeted'. In autumn 2020, in the presence of policy measures other than those linked to Covid-19, the Commission's assessments of the 2021 DBPs established a new definition of temporary emergency measures. The definition was refined and specified in spring 2021 in the Commission's assessments of the 2021 SCPs, and has remained the same since then. [24] Namely, temporary emergency measures are measures introduced since March 2020 to support health systems and compensate workers and firms for pandemic-induced income losses; and budgetary allocation for each measure in 2023 has fallen to below 10% of the initial size of the measure. Measures that are still active for more than 10% of the initial amount are no longer considered temporary. The Commission argued that the temporary measures do not have a signification impact on aggregated demand. It therefore excluded them from its preferred fiscal stance indicator.

As per the Communication of 20 March 2020, the Commission intended to monitor the Covid-linked

[20] Commission Communication on a Coordinated economic response to the Covid-19 outbreak.

[21] The activation and interpretation of the severe economic downturn clause is documented in *EFB Annual Report 2021* (Section 2.5).

[22] Commission Communication on the activation of the general escape clause of the Stability and Growth Pact

[23] Commission guidelines for a streamlined format of the stability and convergence programmes in light of the covid-19 outbreak, 6 April 2020.

[24] For a more detailed account, see *EFB Annual Report 2022*, Section 2.1.

measures in a similar way to those under the unusual event clause. This clause follows the same logic as the severe economic downturn clause. It allows temporary deviations from fiscal requirements, if they result from i) an unusual event; ii) that is outside the control of the Member State; iii) with a major impact on the financial position of the general government; and iv) not endangering fiscal sustainability in the medium term. [25] The Commission and Member States had prior experience with applying the unusual event clause in 2015-2017 (e.g. linked to the exceptional refugee inflows and the security threat in some Member States). In that period, the Commission monitored eligible costs and took them into account when assessing compliance with quantitative fiscal requirements.

The definition of temporary emergency measures mirrored past practice under the unusual event clause by covering costs reasonably linked to the Covid-19 pandemic and for the limited period of a few years. However, their application to fiscal surveillance deviated from past practice. For 2020-2021, in the absence of quantitative fiscal requirements, temporary emergency measures were not used to justify any deviations from quantitative fiscal targets. For 2022-2023, temporary emergency measures were excluded from the fiscal stance indicator, but no such adjustment was applied to the SGP structural balance and expenditure benchmark indicators, which was the case with the unusual event clause in the past.

Treating Covid-crisis measures as one-off measures would have been another potential way of implementing the SGP provisions. The effect of one-off and temporary measures – also called 'one-off measures' or 'one-offs' – is excluded from the structural balance and expenditure benchmark indicators. [26] The definition of one-offs has been well established and thoroughly implemented by the Commission for a number of years. Specifically, classifying budgetary measures as one-offs is determined by a set of guiding principles: [27]

1. one-off measures are intrinsically non-recurrent;
2. the one-off nature cannot be established by a legal act of national authorities;
3. volatile components of revenue or expenditure should not be considered one-off;
4. deliberate policy actions that increase the deficit do not, as a rule, qualify as one-offs;
5. they have a significant impact on the general government balance of at least 0.1% of GDP.

The Commission rejected treating the crisis measures as one-offs in its guidance for the 2020 SCPs. While some of the temporary emergency measures could have qualified as one-offs, other measures would not be considered as one-offs, like support to households and businesses, because they were not directly triggered by the exceptional event and the government had a larger degree of discretion over them. The strict definition of one-offs and close examination of each measure by the Commission has safeguarded the fiscal rules from different interpretations of one-offs over the years. During the crisis, the Commission considered that applying the restrictive concept of one-offs would have hindered a coordinated policy response, which was achieved by *de facto*, not *de jure*, suspending EU fiscal rules with an extensive interpretation of the severe economic downturn clause (EFB, 2021b).

In 2022, the country-specific recommendations for fiscal policy in 2023 asked to take into account 'temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine'. The targeted nature of energy-related measures was motivated by (i) social considerations (to sustain the purchasing power of the most vulnerable); (ii) different fiscal and economic situations across countries (affordability of the measures); and (iii) limiting inflationary pressures from the demand side by keeping the measures targeted. The Commission further clarified the definition of targeted energy measures in its assessment of the draft budgetary plans for 2023. Namely, 'targeted measures are measures from which only the most vulnerable strata of the population will benefit, involve a degree of means-testing and are selective on the basis of the income or specific social needs'. [28] On that basis, the Commission estimated that only one-third (0.5% of GDP) of all energy measures were targeted in

[25] Vade Mecum on the Stability & Growth Pact (2019)
[26] Regulation (EC) 1466/97 Article 5(1).
[27] The guiding principles were published in the 2015 Report on Public Finances in EMU (Chapter II.3), together with examples of frequently occurring one-offs and 'borderline' cases (measures ultimately not considered to be one-off measures).
[28] Commission Communication on the 2023 Draft Budgetary Plans: Overall Assessment.

2022. Fiscal costs to assist people fleeing Ukraine were estimated at 0.1% of GDP in 2022 for the EU as a whole, with somewhat higher costs for some countries.

Conceptually, support to people fleeing Ukraine fits the above-mentioned principles of the unusual even clause and past experience with refugee costs. However, targeted energy measures were not directly and immediately caused by an unusual event (the war and energy price increases), while governments had control over the ways they reacted. The theoretical eligibility of targeted energy measures for the unusual event clause could therefore be disputed.

In practice, the Commission expanded the interpretation of its fiscal stance indicator for the effect of both energy measures and support to people fleeing Ukraine. However, its assessment for 2022 considered all the costs of energy measures, while that for 2023 only considered temporary and targeted energy measures. Moreover, no such measures were anticipated in the fiscal guidance for 2022 (in spring 2021), but they were part of the guidance for 2023.

Overall, the characteristics and application of targeted energy measures and support to people fleeing Ukraine were similar to those of Covid-19 related temporary emergency measures. In all three cases, the measures were excluded from the fiscal targets. [29] The importance of those measures was further reflected in sector-specific policy recommendations (health, energy) issued together with fiscal guidance. At the same time, the Commission was less clear *ex ante* on the definitions of the measures. The Council agreed with the Commission on excluding the measures from the fiscal stance indicator, but not from the established structural balance and expenditure rule.

Potential output and output gap estimates

The sharp economic shock of the Covid-19 pandemic affected the measurement of potential growth and the output gap. To minimise volatility in the estimates, the Commission and the Output Gap Working Group of the Council's Economic Policy Committee agreed on modifications to the commonly agreed method. These ad hoc modifications were first introduced in 2020 and were still applied in 2022:

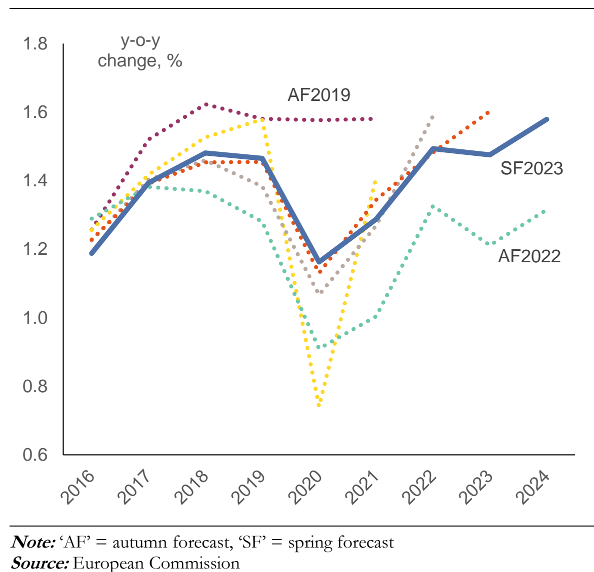
- hours worked data for 2020 were replaced by the mean of the value for 2019 and 2021;
- structural unemployment estimates included dummy variables for some countries for 2020 and 2021 in order to maintain the relationship between unemployment and labour cost indicators in the event of possible labour hoarding. [30]

However, the ad hoc modifications did not prevent notable backward and forward revisions of potential growth (Graph 2.1). The estimates changed with each new Commission forecast, taking into account more recent data and changing views on the economic outlook. The most recent Commission 2023 spring forecast shows a temporary deceleration of potential growth in 2020-2021 and acceleration of growth towards the end of the forecast period – broadly in the range of earlier forecasts. The potential growth estimates in autumn 2022 were substantially lower on the back of the weaker real GDP forecast, but this changed in spring 2023.

[29] The Commission's fiscal stance indicator directly excluded temporary emergency measures, while the effect of targeted energy measures and support to people fleeing Ukraine was demonstrated as a part of the descriptive analysis.

[30] During the Covid-19 lockdowns business activity declined, but companies refrained from lay-offs and received government support for it. This temporary labour hoarding introduced swings in the unit labour cost indicator, but with limited changes in unemployment. These two parameters are used to measure structural unemployment based on the Phillips curve relationship.

Graph 2.1: **EU potential output growth across various Commission forecasts**



Note: 'AF' = autumn forecast, 'SF' = spring forecast
Source: European Commission

In 2022, the Output Gap Working Group continued methodological discussions without changing the commonly agreed method. In particular, the Commission presented to the working group its preliminary results on a new labour hording indicator, which is derived indirectly from the existing EU business and consumer survey data. [31] This indicator was also put forward as an alternative to the existing capacity utilisation rate to determine the trend in total factor productivity (both indicators have similar information content). The working group assessed the application of the labour hoarding indicator as promising and asked the Commission to table the methodological changes and their estimated impact in 2023. Moreover, the Commission suggested a model where hours worked across countries are explained with a trend participation rate, a capital/employment ratio and income inequality. These could replace the currently used autoregressive forecast extension for hours worked. [32] Once implemented, these methodological changes will supersede the above-mentioned ad hoc modifications introduced in 2020.

The working group also discussed possible effects of the commodity price shock and that of the green transition on potential output. The terms of trade shocks linked to the Russia's war of aggression against Ukraine increased inflation and lowered economic growth in the short run, but are also expected to weigh on future economic development, according to the Commission 2022 autumn forecast. While the natural gas supply from Russia collapsed in 2022, alternative gas supplies and reductions in gas consumption (including due to the mild winter of 2022-2023) lessened the economic impact (potential GDP fell by around ¼%). As for policies that mitigate climate change, they are estimated to reduce EU GDP by ½ - 2% by 2050, but the economic costs of climate change would be larger if no action is taken (Varga et al., 2021). Moreover, the costs of moving towards a net zero emissions economy can be significantly contained when carbon taxes are used and recycled to reduce other distortive taxes or for subsidising clean energy. Following these discussions, the working group made no changes to the commonly agreed method.

2.2. MEDIUM-TERM BUDGETARY PLANS

In March 2021, the Commission communicated its considerations for the coming EU fiscal surveillance cycle, i.e. for 2022. [33] In particular, it suggested to continue applying the severe economic downturn clause in 2022 and to deactivate it as of 2023. This was based on the assumption that EU GDP would return to its 2019 level towards the middle of 2022, based on the Commission 2021 winter forecast. [34] Guided by this assessment, the Commission suggested 'an overall supportive fiscal stance in 2022, avoiding a premature withdrawal of fiscal support', but in the meantime indicated that 'Member States with high debt levels should pursue prudent fiscal policies', in view of sustainably risks. Furthermore, it considered a need to move away from emergency relief measures to those that support a resilient and sustainable recovery. The Commission also reiterated the importance of the quality of public finances and fiscal structural reforms. Moreover, it reminded the Member States to present their medium-term fiscal plans in the stability and convergence programmes (SCPs) as an important

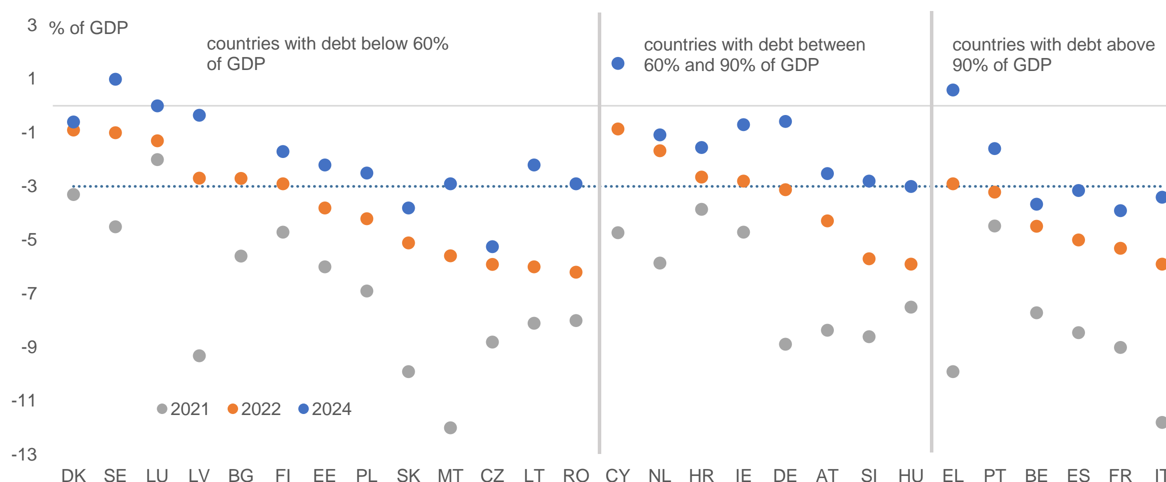
(31) The labour hoarding indicator is calculated from company answers to survey questions on employment and business activity expectations over the next 3 months. If a firm expects no changes in its employment, while demand for its products or services and is expected to decrease, then it suggests labour hoarding.

(32) Trend hours worked are used to calculated potential output. Actual/forecasted hours worked are smoothed to obtain trend hours worked. The proposed model selected determinants for hours worked based on historical observations (Huberman and Minns (2007)).

(33) Commission Communication: One year since the outbreak of COVID-19: fiscal policy response.

(34) This was monitored based on quarterly real GDP estimates (seasonally and calendar adjusted data).

Graph 2.2: **Headline government balances planned in the 2021 stability and convergence programmes**



Source: 2021 stability and convergence programmes

part of economic policy coordination and surveillance. A year earlier, the standard reporting requirements (35) had been temporarily reduced, motivated by high uncertainty and the need to lessen the burden on national administrations, but weakening the medium-term nature of the EU's fiscal surveillance framework (EFB, 2021b).

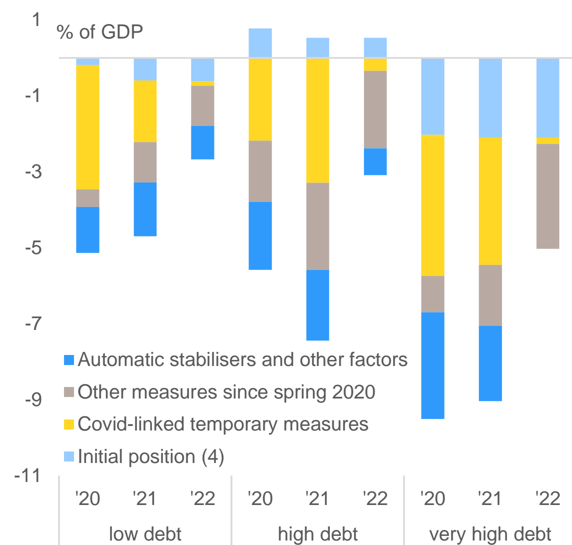
In spring 2021, all Member States submitted their SCPs (Bulgaria, Finland, Romania, Slovakia submitted them after the deadline of 30 April). The SCPs presented the fiscal plans up to at least 2024 (36) and reported on measures and guarantees responding to the Covid-19 crisis and on spending plans under the Recovery and Resilience Facility. (37)

All SCPs targeted headline government deficits to decrease to 4% of GDP in the EU on average in 2022, down from 8% in 2021 (Graph 2.2). The Commission 2021 spring forecast projected a similar decline, assuming further economic recovery in 2022 and a discontinuation of the majority of Covid-linked temporary measures (Graph 2.3). However, other measures introduced since spring 2020 (other than Covid-linked temporary measures), including those supporting economic recovery, were projected to have a permanent and increasing deficit impact in 2022. Comparing groups of countries by their debt levels, more indebted Member States were projected to record a higher deficit of 5% of GDP on average in 2022.

For 2023 and 2024, all SCPs planned a further improvement in government balances (Graph 2.2). However, six Member States did not plan government deficits to be below 3% of GDP by the end of the programme period. In particular, Member States with very high government debt – Belgium, Spain, France and Italy – did not target deficits below 3% of GDP.

(35) Code of conduct of the Stability and Growth Pact.
(36) Bulgaria provided no information on 2024.
(37) In February 2021, the Commission asked for this information to be provided in the SCPs in addition to the regular reporting requirements in line with the Code of Conduct.

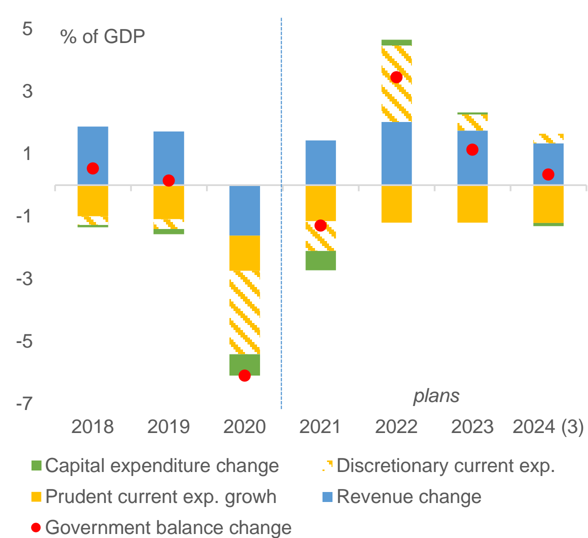
Graph 2.3: **Breakdown of the government balance forecast in spring 2021 by country groups**



Notes: (1) 'Automatic stabilisers and other effects' include automatic revenue decreases, expenditure increases linked to the economic shock, and any other developments.
(2) 'Covid-linked temporary 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.
(3) 'Other measures since spring 2020' represent all other measures included in the Commission forecast since the 2019 autumn forecast.
(4) 'Initial position' is the fiscal balance forecast in autumn 2019, corrected for any revisions for 2019. For 2022, the same level is assumed as for 2021.
(5) Countries are grouped by their average debt-to-GDP ratio over 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: Commission 2021 spring forecast, own estimates.

The EU average headline deficit was planned to be reduced to 2.7% of GDP in 2023 and 2.5% of GDP in 2024. This improvement assumed an increase in government revenue broadly in line with economic growth and growth in nationally financed current expenditure below medium-term nominal GDP growth rate, thus contributing to the deficit reduction (Graph 2.4). Nationally financed capital expenditure was planned to decrease in 2022 as certain capital transfers made in 2021 were not expected to be repeated in 2022 (including those linked to Covid-19). In 2023 and 2024, slight fluctuations in nationally financed capital expenditure were linked to a planned strong upturn in EU-financed investments in 2023 and some retreat in 2024.

Graph 2.4: **Planned change in government balance in spring 2021, breakdown for the EU**



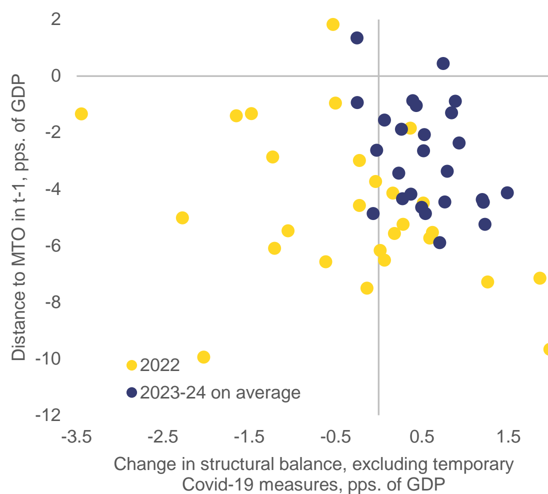
Notes: (1) The graph shows contributions of the planned changes in nationally financed revenue and expenditure (measured as annual changes in EUR billions and then expressed in % of GDP). It excludes EU funded revenue and expenditure flows, as those have no effect on the government balance.
(2) 'Prudent current expenditure growth' = current expenditure growth in line with medium-term nominal GDP growth; 'Discretionary current expenditure' = residual change in current expenditure, excluding prudent expenditure growth.
(3) Numbers for 2024 exclude Bulgaria.
Source: 2021 stability and convergence programmes, own estimates

The standard SGP indicators for the structural budget balance and the expenditure benchmark estimated a strong improvement in 2022, but this was mostly due to the planned discontinuation of the Covid-19 temporary measures. Excluding the effect of those measures, the change in the structural balance varied across countries (Graph 2.5). Irrespective of the size of fiscal imbalances – the distances from the medium-term budgetary objectives (MTOs) in 2021 – Member States had very different plans for their structural balances. The structural balance, excluding the effect of the Covid-19 temporary measures, was estimated to remain unchanged in 2022 for the EU as a whole. Member States with very high debt levels, in particular Italy, planned to increase their structural deficits by 0.6% of GDP on average, while other Member States planned a structural improvement of 0.5% of GDP. The expenditure benchmark, adjusted for the Covid-19 temporary measures, broadly provided the same picture as the change in the structural budget balance.

In 2023 and 2024, most Member States planned to improve their structural budget balances (Graph 2.5). Two Member States planned to exceed their MTOs in 2022 and four more by 2024. Other countries further away from their MTOs planned an adjustment in the structural

balance of around 0.5% of GDP on average in 2023-2024 and an adjustment in the expenditure benchmark of 0.3% of GDP. Graph 2.5 suggests a weak relationship between the distance to the MTO and the size of the planned structural adjustment. Member States with very high debt levels planned somewhat lower adjustment in the structural balance of 0.4% of GDP on average and 0.1% of GDP for the expenditure benchmark of in 2023-2024.

Graph 2.5: **Planned change in structural balance and distance to the medium-term budgetary objective (MTO)**



Note: Change in structural budget balance excludes the effect of the Covid-linked temporary measures as estimated by the Commission.
Source: 2021 stability and convergence programmes, Commission 2021 spring forecast, own estimates

The Commission provided a very succinct assessment of the 2021 SCPs in the recitals of the fiscal recommendations for 2022. It reported on the headline fiscal targets planned by the Member States and on the Commission's estimates of the fiscal stance and its breakdown, but did not explain the reasons for any developments. [38] More data were presented in a statistical annex, including on the SGP indictors for the structural balance and the expenditure benchmark. However, the Commission discontinued the dedicated country reports, which provided a more detailed assessment in the past (see Section 2.1). It also did not produce its analysis on the implications of its forecast for budgetary surveillance. The Commission continued publishing a general overview of the SCPs [39], presenting trends across Member States and for the euro area, in particular.

The preliminary Commission guidance for 2022 invited the Member States to have overall expansionary net expenditure growth [40], excluding the effect of the Covid-19 temporary emergency measures. The 2021 SCPs planned the nationally financed part of that net expenditure aggregate to grow by 2.1% in the EU as a whole. However, this suggested a slight improvement in the underlying budgetary position or a contractionary fiscal impulse, as the medium-term rate of nominal potential GDP growth was estimated at 2.6%, based on the Commission 2021 spring forecast. Moreover, Member States planned only a modest fiscal impulse from EU-funded expenditure, as many recovery and resilience plans had not yet been agreed at that time. Fiscal plans in the SCPs therefore did not meet the Commission's suggestion for an overall supportive fiscal impulse in 2022.

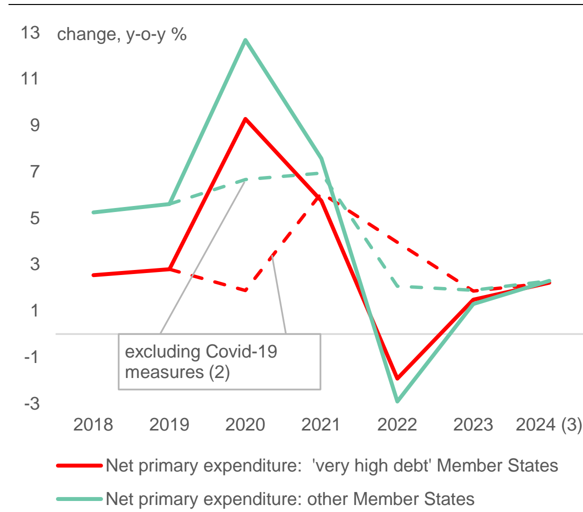
Fiscal plans for 2022 varied across Member States. Around two-thirds of the Member States planned a restrictive fiscal policy in 2022 in terms of net nationally financed primary expenditure as compared to prudent medium-term economic growth. However, considering the sizeable fiscal expansion since 2020, in all but a few cases fiscal policy remained supportive on average in 2020-2022. Countries that planned fiscal expansion in 2022 included Italy and Portugal, while they were advised to focus on prudent fiscal policies and allow only for EU funded support of their economies. The group of Member States with very high debt levels planned nominal growth of net nationally financed expenditure at 4.0% (excluding the Covid-19 temporary emergency measures) – exceeding that of other Member States on average (Graph 2.6). Moreover, the medium-term rate of nominal potential GDP growth was estimated just above 2% for very high-debt Member States, compared to 3¾% for other Member States on average. This suggests that the fiscal plans for very high-debt Member States featured a supportive fiscal impulse in 2022 and the plans of the other Member States had a restrictive fiscal impulse on average – opposite to the preliminary Commission guidance.

[38] 'Fiscal stance' was defined as the change in primary expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures) including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds.

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

[40] Nationally financed expenditure net of discretionary revenue measures, interest expenditure and cyclical unemployment expenditure.

Graph 2.6: **Government expenditure growth planned in 2021 stability and convergence programmes**



Notes: (1) 'Net primary expenditure' = nationally financed expenditure excluding the effect of discretionary revenue measures, interest expenditure and cyclical unemployment expenditure. 'Very high-debt Member States' = BE, EL, ES, FR, IT, CY, PT.
(2) The dashed lines show expenditure growth excluding the effect of the Covid-related temporary emergency measures, based on the Commission definition.
(3) Numbers for 2024 exclude Bulgaria.
Source: 2021 stability and convergence programmes, Commission 2021 spring forecast, own estimates

2.3. POLICY GUIDANCE FOR 2022

On 18 June 2021, the Council adopted, following a proposal from the Commission, the fiscal recommendations for 2022. The recommendations formally enacted the continued application of the extensive interpretation of the severe economic downturn clause in 2022, using the pre-crisis level of economic activity in the EU as the key quantitative criterion (based on seasonally and calendar adjusted quarterly data for real GDP). The Commission 2021 spring forecast projected real GDP reaching its pre-crisis level (in the fourth quarter of 2019) in the fourth quarter of 2021 in the EU as a whole and in the first quarter of 2022 in the euro area. (41) This suggested a sooner economic recovery than anticipated in the March 2021 Commission communication, which established the quantitative criterion and assumed that the pre-crisis real GDP level would be reached towards the middle of 2022, based on the Commission 2021 winter forecast. (42) The decision in June 2021 to extend the severe economic downturn clause until the end of 2022 was not consistent with the projected economic recovery in the EU as a whole in 2021 and 2022 in the euro area. Moreover, the Commission's chosen quantitative criterion implied a broader interpretation of 'severe economic downturn' than that defined under the SGP. (43)

The fiscal recommendations for 2022 were differentiated by the public debt level and were guided by the concept of demand management rather than fiscal adjustment (Section 2.1). Member States with a high level of public debt (according to the Commission definition) were asked to pursue 'a prudent fiscal policy', while other Member States were asked for 'a supportive fiscal stance'. All Member States were asked to use the Recovery and Resilience Facility and 'preserve nationally financed investment'.

The supportive fiscal stance was mainly expected to come from an increase in expenditure financed by the Recovery and Resilience Facility and other EU funds, together with nationally financed investment. While a supportive fiscal impulse from other expenditure aggregates was not excluded, the Commission's Chapeau Communication stated that 'the growth of nationally financed current expenditure should be kept under control, and be limited for Member States with high debt'. (44)

The qualitative formulations of the fiscal recommendations were underpinned by quantitative benchmarks of '10-year average nominal potential growth', noted for each country in the recitals. The recitals also specified that the overall fiscal stance was measured by comparing the medium-term potential growth benchmark with 'the change in primary expenditure (net of discretionary revenue measures and excluding crisis-related temporary emergency measures) including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds' (45). This reflects the Commission's intention to give more prominence in fiscal surveillance to the expenditure benchmark, as net expenditure developments are more under the

(41) Commission Communication on economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy.
(42) Commission Communication: One year since the outbreak of COVID-19: fiscal policy response.

(43) Regulation (EU) 1467/97 (Article 2(2)) describes a severe economic downturn 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'.
(44) Commission Communication on economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy.
(45) The estimate compares the expenditure aggregate with the same aggregate if it were increasing by the benchmark. The benchmark corresponds to medium-term potential GDP growth calculated as the 10-year average of real potential output growth rates plus the GDP deflator for the given year.

control of the budgetary authorities. The preventive arm of the SGP, however, still refers to the structural budget balance as a reference and some Member States have anchored the structural budget balance in national legislation.

The recommendations specifically addressed six countries for which the Commission 2021 spring forecast projected the increase in nationally financed primary current expenditure in 2022 to significantly exceed the medium-term potential growth benchmark, with a budgetary impact of more than 0.5% of GDP (Table 2.1). [46] Formulations of those recommendations were differentiated for three high-debt Member States by asking them to 'limit the growth of nationally financed current expenditure', while the remaining three Members States were asked to keep the latter under control. Apart from different wording, the risk assessment conditions were the same for all countries irrespective of their public debt levels. Moreover, by proposing these recommendations only to a limited group of countries, the Commission passed up the opportunity to ask all Member States to be prudent with their current expenditure growth. The Commission was not so selective on other elements of the recommendations and merely provided uniform guidance on these elements.

([46]) Bulgaria, Croatia, Italy, Latvia, Lithuania, Portugal.

Table 2.1: **Fiscal indicators as defined in the fiscal recommendations for 2022**

	% of GDP	Overall fiscal stance	of which contribution from: Change in net nat.financed primary current expenditure	Change in nat. financed investment	Change in expenditure financed by RRF grants and EU funds
high debt' Member States	BE	-0.4	-0.4	0.1	-0.1
	EL	-2.4	-0.3	-0.9	-0.3
	ES	-0.5	0.4	0.2	-0.6
	FR	0.0	-0.2	-0.2	0.3
	IT	-2.2	-1.3	-0.3	-0.4
	PT	-1.1	-0.7	-0.2	-0.1
other Member States	BG	-1.4	-1.0	0.4	-0.8
	CZ	-0.2	0.0	0.3	-0.5
	DK	1.6	1.0	0.0	0.0
	DE	0.5	0.3	-0.2	0.1
	EE	1.6	1.7	0.2	-0.2
	IE	-0.4	-0.2	0.2	-0.2
	HR	-2.4	-0.8	-0.1	-1.5
	CY	-0.3	0.1	0.1	-0.4
	LV	-0.8	-0.5	0.3	-0.6
	LT	-2.0	-1.8	0.3	-0.5
	LU	-0.2	-0.4	0.1	0.0
	HU	0.7	1.0	-0.1	-0.2
	MT	2.1	0.8	0.2	0.1
	NL	-0.4	-0.2	0.2	-0.1
	AT	0.0	0.0	0.0	-0.1
	PL	0.1	0.2	-0.3	-0.1
	RO	-0.5	0.0	-0.1	-0.4
	SI	-0.1	0.2	0.0	-0.3
	SK	0.9	1.1	0.7	-0.8
	FI	0.5	0.4	0.2	-0.1
	SE	-0.2	-0.1	0.0	-0.1

Notes: (1) Table shows fiscal indicators presented in the fiscal recommendations for 2022 and the accompanying statistical annex. The indicators compare the expenditure aggregates with the same aggregate if it were increasing by nominal medium-term potential GDP growth; and this difference is expressed in % of GDP. A negative sign means that growth of expenditure aggregate exceeds nominal medium-term potential GDP growth.
(2) Highlighted cells represent indicators included in the country-specific fiscal recommendations. Non-colour-filled cells also show numbers in line with the colour code, in the absence of any formal recommendation.
(3) Colour code categorises indicator performance compared with the recommended course of action:
For overall fiscal stance: red = contractionary fiscal impulse (above 0.25% of GDP), yellow = broadly neutral fiscal impulse (between -0.25% and -0.25% of GDP), green = expansionary fiscal impulse (less than -0.25% of GDP);
For change in net nationally financed primary current expenditure: red = expenditure growth significantly exceeds medium-term economic growth by more than 0.5% of GDP, green = expenditure growth does not exceed medium-term economic growth by more than 0.5% of GDP;
For change in nationally financed investments and change in expenditure financed by Recovery and Resilience Facility grants and EU funds: red = contractionary fiscal impulse (above 0.1% of GDP), yellow = boarder line contractionary fiscal impulse (between 0 and 0.1% of GDP), green = expansionary fiscal impulse (less than 0% of GDP).
Source: European Commission 2021 spring forecast, own estimates

Practical application of the recommendations for 2022 was complicated by the number of assumptions shaping the fiscal indicators and by hard-to-decipher messages. The recommendations asked to target underlying expenditure trends accounting for fluctuations induced by the Covid-linked measures and a sharp increase in EU funded projects. While this may be a sensible approach from a prudent budgetary planning perspective, the underlying expenditure trend is not directly observable and relies on assumptions. The recommendations for an overall supportive fiscal stancewere conditioned by the growth of net

nationally financed primary current expenditure not significantly exceeding the medium-term potential growth. (47) This condition was not obvious from a simple reading of the recommendation. As current expenditure is the largest share in government spending, the policy guidance implied a careful calibration of underlying current expenditure growth that was just above prudent medium-term growth, but not significantly above it. Another aspect is linked to the invitation to safeguard nationally financed investment when there is a large increase in EU funded investment. In practice, national authorities and the construction industry may hit capacity limits in implementing investments financed by different sources, making it difficult to fulfil the double condition for nationally and EU-funded investment. Moreover, sources of investment financing can fluctuate over time, considering the aim of front-loading the implementation of the recovery and resilience plans, in particular.

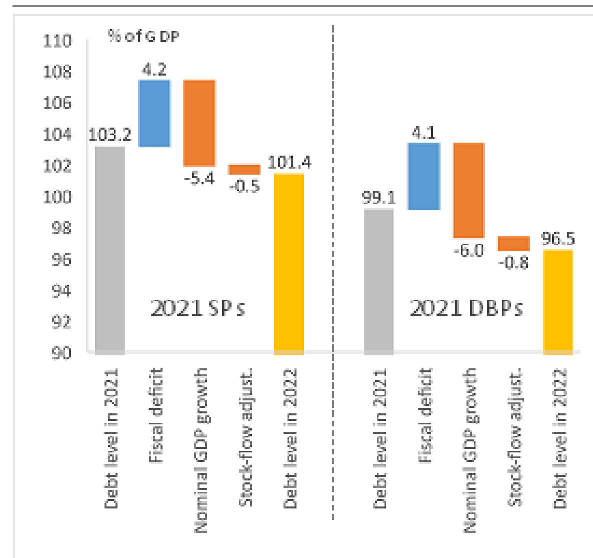
Overall, the policy recommendations for 2022 were centred on aggregate demand management by asking to target a given fiscal impulse (Section 2.1). This contrasts with the conventional application of the SGP, where the focus has always been on fiscal adjustment. Moreover, specific conditions for individual elements of the overall fiscal impulse complicated the guidance and its practical application. From past experience, multiplicity of policy targets led to cherry-picking the most favourable target (EFB, 2019). The fiscal guidance for 2022 was differentiated for Member States with very high debt levels. However, it neglected the large structural deficits, thereby ignoring one of the pillars of the EU fiscal framework.

2.4. DRAFT BUDGETARY PLANS FOR 2022

In autumn 2021, all euro area countries presented draft budgetary plans (DBPs) for 2022. A comparison with earlier GDP-weighted euro-area fiscal targets for 2022 shows a peculiar pattern: while the 2021 DBPs targeted a similar 2022 deficit target as the 2021 stability programmes (around 4% of GDP), the DBPs pointed to considerably lower public debt ratios for 2022 (Graph 2.7). This was mainly due to the stronger-than-expected economic rebound from the depth of the pandemic crisis in the course of 2021, improving the estimated deficit and debt ratios for 2021. For 2022, the DBPs targeted a sizeable reduction in the debt ratio for the euro area as a whole, in particular on the back of further strong economic recovery (Graph 2.7). Only five euro area countries (Belgium, Estonia, Latvia, Lithuania and Luxembourg) planned a slight increase in their debt ratios from 2021 to 2022.

On 24 November 2021, the Commission issued its opinions on the DBPs. It did not adopt an opinion on the Portuguese DBP as the corresponding draft budget proposal was rejected by the national Parliament in late October 2021. (48) Following a general election on 30 January 2022, a new government was formed that then submitted a revised 2022 DBP in mid-April 2022. Germany also submitted an updated DBP in mid-April 2022, after the new government took office in December 2021. The Commission issued its opinions on both updated DBPs on 20 May 2022.

Graph 2.7: **Euro area debt targets for 2022 – SPs vs DBPs**



Note: The graph includes the updated draft budgetary plan of Portugal (submitted on 19 April 2022) and that of Germany (submitted on 27 April 2022).
Source: 2021 stability programmes (SPs), draft budgetary plans for 2022 (DBPs), own estimates

Euro area countries budgeted an improvement in their average structural balance of 1½% of GDP for 2022. However, this improvement mostly reflected the planned discontinuation of the Covid-19 temporary emergency measures (a deficit-reducing effect of 2½ percentage points of GDP). Excluding the effect of the Covid-19 temporary measures, the structural deficit was planned to be raised by around 1% of GDP on average, contrary

(47) Here we refer to the Commission's notion of the fiscal stance describing the change in discretionary fiscal support.

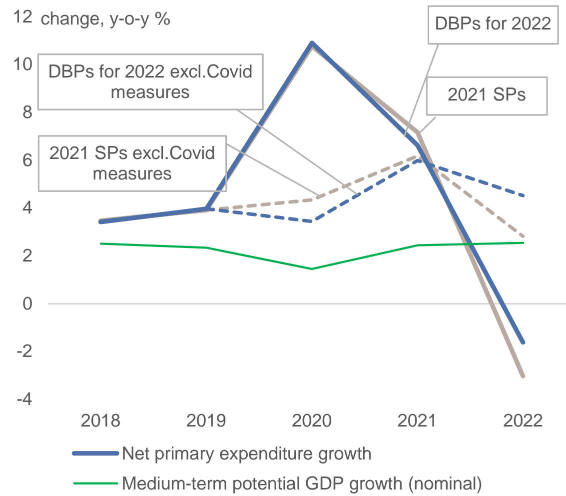
(48) In mid-November 2021, the Commission noted in a letter that the DBP was no longer considered valid and invited the Portuguese authorities to submit a new DBP in due course.

to the SGP's benchmark annual adjustment of 0.5% of GDP. No euro-area country was projected to be at its medium-term budgetary objective in 2021. As a reminder, the severe economic downturn clause allows for temporary deviations from the adjustment path towards the medium-term budgetary objective provided the sustainability of public finances is safeguarded in the medium term.

Government expenditure was planned to decrease in 2022, following a withdrawal of the majority of the discretionary support provided during the Covid-19 pandemic in 2020-2021. However, subtracting the impact of the temporary Covid-19 measures, the DBPs targeted net expenditure growth of 4.5% in 2022 in the euro area, exceeding that of the stability programmes (Graph 2.8). In particular, Member States with debt ratios below 90% of GDP revised their expenditure plans upwards. This increase was largely covered by better-than-expected revenue estimates for 2021, while real and nominal GDP projections for 2022 were only marginally better than in the 2021 stability programmes. Overall, in the euro area net expenditure growth (excluding temporary Covid-19 measures) was set to increase above nominal medium-term potential growth – indicating fiscal expansion.

In the second half of 2021, Member States launched measures to counteract the observed energy price increases. The DBPs planned limited budgetary costs for those measures in 2021 and 2022.

Graph 2.8: **Government expenditure growth planned in 2021 stability programmes (SPs) and draft budgetary plans (DBPs) for 2022, for euro area**



Notes: (1) 'Net primary expenditure' = nationally financed expenditure excluding the effect of discretionary revenue measures, interest expenditure and cyclical unemployment expenditure.
(2) The dashed lines show expenditure growth excluding the effect of the Covid-related temporary emergency measures, based on the Commission definition.
Source: Stability programmes, draft budgetary plans, European Commission, own estimates

Although the Commission regularly stressed that the severe economic downturn clause had not suspended the commonly agreed fiscal rules, it did not assess national plans against the provisions of the SGP. In the Commission's assessment, national plans of euro area countries for 2022 were exclusively compared with the fiscal guidance adopted by the Council in June 2021, which was still mostly qualitative, but included some quantitative indications for net expenditure growth and some limited country differentiation (see Section 2.3). The fiscal recommendations were based on an extensive interpretation of the severe economic downturn clause that *de facto* suspended the rules, rather than allowing for a temporary deviation from budgetary adjustment while safeguarding the sustainability of public finances. [49] The Commission did not publish country-specific staff working documents on the DBPs, repeating the 2021 spring deviation from the well-established Commission practice (see Section 2.1 for details).

As virtually all euro area DBPs extended or introduced new recovery support measures, both from national and EU sources, the Commission found for the euro area as a whole that the fiscal plans for 2022 were in line with the overarching

[49] See Section 2.5 in EFB (2021b) for details on the extensive interpretation of this clause.

policy recommendation for supportive fiscal policy (Table 2.2). ([50]) For Slovakia, the Commission opinion noticed a contractionary fiscal stance, but considered it to be 'broadly as recommended', 'in a context of high output growth and emerging capacity constraints in 2022'. All DBPs were deemed in accordance with the invitation to preserve or broadly preserve (in the case of Cyprus and Slovakia) nationally financed public investments as a share of GDP. Moreover, all high-debt countries envisaged the use of the Recovery and Resilience Facility to finance additional investment (for France, the planned decrease in 2022 was compared against a strong increase in 2021). Growth in nationally financed primary current expenditure (net of discretionary revenue measures and Covid-linked temporary emergency measures) contributed in particular to an overall expansionary fiscal policy in 2022. However, this expenditure growth significantly exceeded (by 0.5% of GDP) the medium-term nominal potential growth in a number of countries, indicating persisting risks to prudent fiscal planning.

([50]) As explained in the previous sections, the policy guidance defined a supportive fiscal stance if the change in primary expenditure (net of discretionary revenue measures but including changes in expenditure financed by the EU grants) exceeds the respective 10-year average potential growth rate.

Table 2.2: **Fiscal indicators used for assessment of the draft budgetary plans for 2022**

	% of GDP	Overall fiscal stance	of which contribution from: Change in net nat.financed primary current expenditure	Change in nat. financed investment	Change in expenditure financed by RRF grants and EU funds
high debt' Member States	BE	-0.7	-0.4	-0.1	-0.2
	EL	-1.8	-0.4	-0.9	-0.2
	ES	0.6	0.8	-0.2	-0.6
	FR	-0.6	-0.5	-0.1	0.2
	IT	-3.0	-1.5	-0.3	-0.6
other Member States	DE	-0.9	-1.1	0.0	0.1
	EE	-1.3	-0.8	-0.1	-0.2
	IE	-0.4	-0.1	-0.1	-0.1
	CY	-0.3	-0.1	0.1	-0.4
	LV	-2.5	-0.8	-0.6	-1.0
	LT	-2.5	-2.2	-0.3	-0.3
	LU	-0.7	-0.7	0.0	0.0
	MT	0.0	0.2	-0.1	-0.2
	NL	-0.5	-0.2	-0.1	-0.1
	AT	-1.3	-0.8	-0.1	-0.1
	SI	-2.5	-0.9	-0.5	-1.0
	SK	0.3	1.4	0.1	-1.3
	FI	-0.1	0.0	0.0	-0.2

Notes: (1) Table shows fiscal indicators presented in the Commission opinions on the draft budgetary plans for 2022 and the accompanying statistical annex. The indicators compare the expenditure aggregates with the same aggregate if it were increasing by nominal medium-term potential GDP growth; and this difference is expressed in % of GDP. A negative sign means that growth in the expenditure aggregate exceeds nominal medium-term potential GDP growth.
(2) Colour-filled cells represent indicators included in the country-specific fiscal recommendations. Non-colour-filled cells also show numbers in line with the colour code, in the absence of any formal recommendation.
(3) Colour code categorises indicator performance compared with the recommended course of action:
For overall fiscal stance: red = contractionary fiscal impulse (above 0.25% of GDP), yellow = broadly neutral fiscal impulse (between -0.25% and -0.25% of GDP), green = expansionary fiscal impulse (less than -0.25% of GDP);
For change in net nationally financed primary current expenditure: red = expenditure growth significantly exceeds medium-term economic growth by more than 0.5% of GDP, green = expenditure growth does not exceed medium-term economic growth by more than 0.5% of GDP;
For change in nationally financed investments and change in expenditure financed by Recovery and Resilience Facility grants and EU funds: red = contractionary fiscal impulse (above 0.1% of GDP), yellow = borderline contractionary fiscal impulse (between 0 and 0.1% of GDP), green = expansionary fiscal impulse (less than 0% of GDP).
Source: European Commission 2021 autumn forecast, own estimates

Only four euro area countries received recommendations for 2022 to limit (in the case of high debt) or control (in the case of medium or low debt) their growth in nationally financed current expenditure. Italy, Latvia and Lithuania were deemed to have exceeded the recommended course of action. ([51]) Only Italy, as a country with 'high sustainability challenges in the medium-term', was invited by the Commission 'to take the necessary measures within its national budgetary process to limit the growth of nationally financed current expenditure'. Given their high sustainability challenges in the medium term even before the outbreak of the COVID-19 pandemic, the Commission opinions emphasised that high-debt countries preserve prudent fiscal policy when taking supporting budgetary measures. It should be

([51]) The fourth country with the same type of recommendation was Portugal, but its DBP was not assessed in autumn 2021.

added that many other euro area countries also planned to exceed the prudent rate of growth for nationally financed current expenditure in 2022 (Table 2.2), but these aspects were not formally assessed by the Commission.

On 6 December 2021, when discussing the Commission opinions, the Eurogroup issued a detailed statement [52] calling for a moderately supportive fiscal impulse in the euro area for 2022, against the backdrop of a balance of risk that was still perceived to be tilted to the downside despite higher-than-expected growth in Q3-2021. Given that the Commission's 2021 autumn forecast projected further budgetary expansion by around 1% of GDP in 2022 as measured by the fiscal metrics corrected for emergency measures, but including EU grants, the Eurogroup's advice on moderate support could be interpreted as a fiscal restriction compared to the draft budgetary plans for 2022. Moreover, the Eurogroup invited Member States to move away from general fiscal support to more targeted policy steps, thereby staying agile to adapt the support measures to changing circumstances while safeguarding fiscal sustainability in the medium term. In addition, the statement highlighted the importance of enhancing investments and the growth-friendly composition of public finances.

2.5. FISCAL DEVELOPMENTS IN 2022 IN RETROSPECT

Underlying fiscal developments in 2022

The EU fiscal guidance for 2022 was still qualitative, while underpinned by the quantitative benchmarks of medium-term potential growth. The Commission and the Council monitored the performance of the ad hoc expenditure-based fiscal stance indicator used in the guidance (Section 2.3), but did not undertake action in case of deviations. The quantitative requirements of the SGP were not used for EU fiscal guidance and monitoring.

In the absence of conventional compliance assessments, this section looks at the fiscal developments in 2022 to help identify patterns and trends beyond the specific provisions of the SGP. Following the approach pioneered in the 2021 Annual Report (EFB, 2021b), we compare actual expenditure developments in Member States with official estimates of medium-term potential output growth. Our analysis disentangles temporary and extraordinary budgetary developments to help identify the underlying budgetary trends and their sustainability. Graph 2.9 summarises the results.

The fiscal developments in 2022 were shaped by counteracting fiscal policy actions. On the one hand, the sizeable fiscal support provided during the Covid-19 pandemic in 2020 and 2021 was largely discontinued in 2022 as the economy recovered. On the other hand, the Russia's war of aggression against Ukraine and the related energy price shock triggered policy support to struggling households and businesses. To explain these developments, we rely on the Commission estimates of discretionary fiscal measures. The Commission defines Covid-19 related temporary emergency measures as those that are aimed at supporting health systems and compensating workers and firms for pandemic-induced income losses and that are set to expire by 2023. It also used them to distinguish other measures adopted since early 2020 and ending by 2023, called 'temporary recovery support measures'. In 2022, the Commission identified 'the measures to address the economic and social impact of the increase in energy prices' – here called energy measures, and 'the costs to offer temporary protection to displaced persons from Ukraine' – here called support to Ukrainian refugees.

Understanding developments in discretionary policy measures helps explain a notable part of the expenditure dynamics in 2022. Governments responded to the Covid-19 pandemic with temporary emergency measures of just above 3% of GDP in 2020 in the EU. They kept the support at a similar level in 2021 and largely withdrew it in 2022 (panel (c)). Some of the remaining temporary emergency measures were set to expire in 2023. Temporary recovery support measures accounted for only 0.1% of GDP in the EU, but were more prominent for the group of high-debt countries. Compared to last year's Annual Report (EFB, 2022), the estimates for temporary recovery support measures had decreased, while those for the residual other measures had increased over the period 2020-2022. This indicates that some of the measures previously considered to be temporary have become more permanent. Moreover, the increase in other measures reflected a discretionary expansion of the budgets for 2022, compared to earlier plans.

[52] Eurogroup Statement on the Draft Budgetary Plans for 2022.

Energy measures gained importance following Russia's full-scale invasion of Ukraine in February 2022. Some smaller measures had already been adopted in 2021 in response to the pick-up in energy prices, but in 2022 the support expanded to more than 1% of GDP in the EU on average, with part of the budgetary costs covered by taxes on windfall profits (panel (d)). The amount of support varied across countries depending on their exposure to the energy price shock. Only part of the measures were targeted to the most vulnerable groups (0.4% of GDP in the EU), as opposed to broad-based support. Support to Ukrainian refugees amounted to 0.1% of GDP in the EU on average, but it was higher in countries receiving more people from Ukraine for temporary protection. According to the Commission 2023 spring forecast, a large share of energy measures was expected to discontinue in 2024 without leaving a lasting impact on public finances.

The nominal net expenditure growth observed in the EU in 2022 decelerated to 5.6% year-on-year from 11.3% in 2020 and 5.9% in 2021 (panel (a)). However, expenditure growth in 2022 was affected by the withdrawal of Covid-related temporary emergency measures and the introduction of new energy measures and support to Ukrainian refugees. Excluding these measures, net expenditure increased by 7.6% in the EU in 2022 – above the benchmark rate of nominal medium-term potential growth of 6.9%. This difference in growth rates amounts to ¼% of GDP. However, these calculations are based on the new approach adopted by the Commission for the fiscal surveillance cycle for 2022. It applies the actual GDP deflator to derive the benchmark rate instead of established practice that freezes the GDP deflator in the year that the fiscal guidance was issued (in this case spring 2021). The standard approach would have resulted in a much smaller benchmark rate and, in turn, in a much larger excess over the sustainable rate of expenditure growth. Specifically, net of crises-related temporary measures, the excess amounted to close to 2% of GDP in 2022.

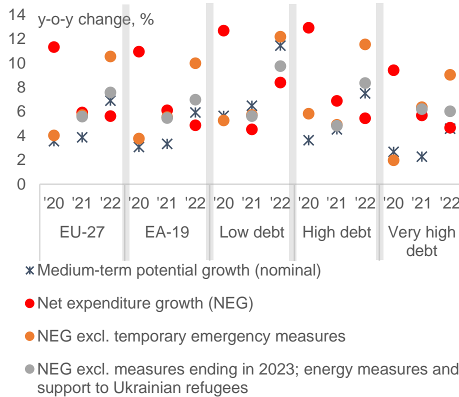
Expenditure growth and the distance to the benchmark varied markedly across government debt levels of countries. Member States with government debt levels below 60% of GDP recorded net expenditure growth rates well above those of the more indebted Member States and still kept a safe distance from their benchmark nominal potential growth. In contrast, Member States with debt above 90% of GDP increased their net expenditure at the rate of the benchmark and exceeded it if we exclude temporary and energy measures. In essence, abstracting from the crisis measures, the EU not only expanded discretionary fiscal support in 2022, but in contrast to its recommendation, very high-debt countries saw a stronger expansion than their peers. The size of the expansion was underestimated by the Commission decision to move from a nominal to a real expenditure benchmark.

The benchmark rate of nominal medium-term potential growth in the EU increased considerably to around 7% from 3¾% in 2020-2021. This increase chiefly reflected price increases across Member States, feeding into the annual estimate of the GDP deflator used for the analysis (panel (f)). At the same time, the 10-year average real potential growth rate remained at 1½% for the EU. Volatility in nominal medium-term potential growth undermines its reliability as a benchmark, but at the same time accounts for price pressures faced by governments, while those might not be confined to a single year (Box 1.1). Moreover, countries with public debt below 60% of GDP recorded a higher GDP deflator than high-debt and very high-debt countries, widening the existing differences in the nominal benchmark rates.

The distance between the growth rate of different expenditure aggregates and that of the benchmark in 2022 are quantified in panel (b). Net expenditure grew at a rate below the benchmark (positive gap) or at the same rate (zero gap) for very high-debt countries. However, excluding the effect of temporary measures and energy measures, underlying expenditure growth exceeded the benchmark, showing a negative deviation for countries with high debt and very high debt levels. In contrast, low debt countries still demonstrated positive deviations, in view of their higher nominal benchmark rate and available fiscal space to the medium-term budgetary objective for Denmark and Sweden.

Graph 2.9: Benchmarking expenditure growth in 2022

Graph a): Net expenditure growth in 2020-2022 (EU, EA and country groups by fiscal positions)

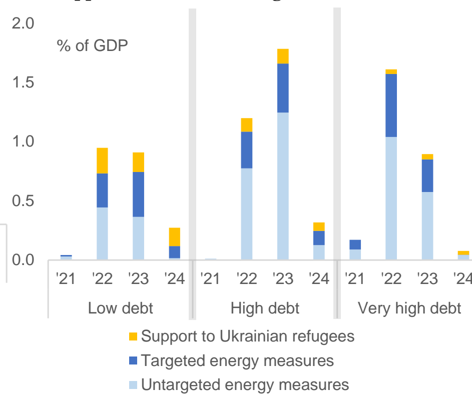


Graph b): Deviations from the benchmark (medium-term potential growth nominal), in 2022, in % of GDP (EU, EA and country groups by fiscal positions)

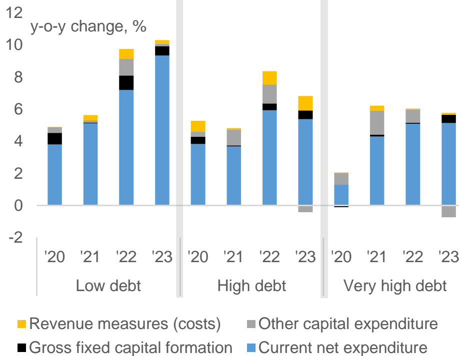
	Government net expenditure growth (NEG)	NEG excl. temporary emergency measures	NEG excl. measures ending in 2023; energy measures and support to Ukrainian refugees
EU-27	0.7	-1.6	-0.2
EA-19	0.4	-2.0	-0.6
Low debt	2.3	0.7	1.6
High debt	0.7	-1.9	-0.5
Very high debt	0.0	-2.2	-0.7

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

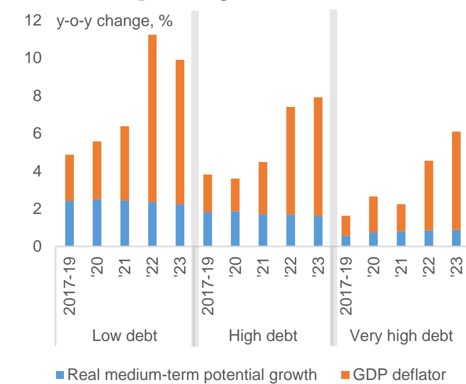
Graph d): Targeted and untargeted energy measures and support to Ukrainian refugees



Graph e): Underlying net expenditure growth, breakdown (excludes measures ending by 2023, energy measures and support to Ukrainian refugees)



Graph f): Breakdown of the benchmark - nominal medium term potential growth



Notes: (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 expenditure is averaged over 4 years.
(3) '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.
(4) 'Temporary recovery support measures' include public investment and other spending focused on ensuring a sustainable recovery and are set to expire in 2023 or earlier.
(5) 'Energy measures' include government support to counter the economic and social impact of the increase in energy prices less new revenue measures on windfall profits by energy producers. 'Targeted energy measures' are specifically designed to support vulnerable households and companies, as opposed to wide and less effective support; the rest of the energy measures are 'untargeted'.
(6) 'Support to Ukrainian refugees' represents the budgetary costs of temporary protection for people fleeing the Russia's war of aggression against Ukraine.
(7) Low debt countries = BG, CZ, DK, EE, LV, LT, LU, MT, PL, RO, SK, FI, SE; high-debt countries = DE, IE, HR, HU, NL, AT, SI; very high-debt countries = BE, EL, ES, FR, IT, CY, PT. The values for country groups are GDP-weighted averages.
Source: European Commission, own calculations

Underlying net expenditure growth – excluding measures ending in 2023, energy measures and support to Ukrainian refugees – accelerated in the EU on average (panel (a) and (e)). It reached 9.6% for the group of low debt countries and 8.4% for high-debt countries, but remained broadly at 6% for very high-debt countries. The increase in expansionary 'other measures' in 2022 (panel (c)) accounted for around a quarter of underlying net expenditure growth in 2022 across the three groups of countries (panel (e)). Underlying expenditure growth was largely driven by an autonomous increase in current expenditure and by other spending decisions that the Commission did not consider to be discretionary. Costs of permanent revenue measures and increases in public investment represented a smaller share of the underlying expenditure increase. The increase in other capital expenditure included government capital injections in strategic companies and the replenishment of natural gas storages. Such lump sum transactions, if not repeated, reduce expenditure growth in the following year, with some reduction already assumed for 2023.

Overall, for the EU as a whole, net expenditure growth in 2022 was slightly above the medium-term rate of potential output growth, net of temporary measures. Across countries, results confirm an entrenched pattern: while the group of countries with debt below 60% of GDP left some headroom for their high nominal benchmark rate, countries with debt above 60% exceeded their medium-term benchmarks. The failure of more indebted Member States to take advantage of favourable conditions to improve their fiscal positions has been documented in earlier reports (e.g. EFB, 2019).

Commission's final assessment of 2022

In spring 2023, all Member States presented their stability and convergence programmes (SCPs), in line with the agreed reporting standards. [53] The SCPs also reflected on the fiscal developments in 2022, but their level of detail varied. Energy measures featured in all SCPs, while the coverage of Covid-linked measures and support to Ukrainian refugees was less thorough. Moreover, some Member States treated all or part of these measures as one-off measures, which are excluded from structural balance and net expenditure calculations. However, the Commission used a more restrictive definition of one-offs (Section 2.1) and assumed a much lower impact of one-off measures. Due to methodological differences between SCP estimates of measures and those of the Commission, the Commission presented only its own estimates of measures and resulting fiscal indictors in the country-specific recommendations for 2024 and accompanying statistical annex. Standard practice was to compare the Commission estimates with those of the SCPs.

The Commission's final assessment of 2022 for each Member State was condensed in a single paragraph in the non-binding part (recitals) of the country-specific recommendations for 2024. It succinctly reported on numerical values of the estimated fiscal indicators and concluded on compliance with the policy recommendations for 2022 (Section 2.3), taking into account factors that justify any deviations from the recommended path (Table 2.3). The Commission evaluated each element of the fiscal recommendations separately without making a single overall assessment:

- The recommendation for an overall supportive fiscal stance was assessed to have been met by all Member States that received it. [54] Countries with high debt levels (based on the Commission's definition) [55] had not been recommended to be overall supportive, but still recorded net expenditure growth above their nominal medium-term potential GDP growth. For this group of Member States, the Commission noted their supportive (expansionary) fiscal impulse but did not reach any conclusions on compliance.

- The change in net nationally financed primary current expenditure was significantly above the benchmark medium-term potential growth (by more than 0.5% of GDP) in 12 Member States, the opposite of what was recommended. However, the Commission concluded that only 5 Member States did not sufficiently keep under

(53) Code of conduct of the Stability and Growth Pact and additional reporting requirements of the Commission communication of 8 March 2023 on fiscal policy guidance for 2024.

(54) The fiscal recommendations for 2022 defined the fiscal stance as the change in primary expenditure net of discretionary revenue measures, excluding Covid-19 related temporary emergency measures and including expenditure financed by EU funds, compared to the quantitative benchmark of 10-year average nominal potential growth.

(55) The Commission categorised Belgium, Greece, Spain, France, Italy and Portugal as high-debt countries. It can be inferred from the Commission reports that these are countries with projected debt ratios above 90% of GDP at the end of the 10-year projection period used in the debt sustainability analysis (see Section 2.1)

control or limit growth in the net expenditure aggregate after considering the impact of energy measures and support to Ukrainian refugees. While the dedicated recommendations on current expenditure growth were addressed to only 6 Member States, the Commission assessed all Member States in an equal manner. Five countries with final negative assessments did not receive the dedicated recommendations (Belgium, Germany, Spain, France and Luxembourg). Belgium, Germany, Spain and France in particular were asked to be prudent in view of their fiscal sustainability risks. Recitals briefly explained the reasons for excessive net current expenditure growth.

- Nationally financed investment was not preserved by 10 Member States, as recommended. The Commission's assessment was solely based on the reading of the relevant indicator, instead of including justifications for other elements of the recommendations. The Commission did not explain the reasons behind the deviations from the recommendations.

- For investments financed by the Recovery and Resilience Facility, the Commission uniformly concluded that they 'continued to support the recovery', as recommended. Although the EU-financed expenditure share in GDP declined in some Member States, the Commission justified it on the grounds of country-specific factors (timing issues, absorption/capacity constraints).

The reading of the indicators was significantly affected by the unexpected pick-up in inflation in 2022, increasing the nominal benchmark of medium-term potential growth. The GDP deflator for 2022, used for the nominal benchmark, turned out at 5.4% for the EU on average, compared to the Commission 2021 spring forecast of 1.5%. [56] If the deflator had been fixed at the beginning of the surveillance cycle for any subsequent compliance assessments, as per the SGP expenditure benchmark method (Section 2.1), this would have imposed much stricter limits on nominal net expenditure growth. It would also have demonstrated that fiscal policy in 2022 was much more expansionary, especially in terms of the increase in net primary current expenditure. More generally, if the fiscal plans had been tied to the lower deflator and had been implemented as planned, budgets would have leaned more against inflationary pressures rather than fuelling demand.

The Commission's final assessment of 2022 demonstrates a change in its interpretation of the fiscal guidance following external and domestic developments. The fiscal guidance asked for a reduction in Covid-related measures, while still supporting the economic recovery. However, the Commission's final assessment treated both the supportive and contractionary fiscal stance of Member States 'as recommended by the Council' or as 'appropriate in a context of high inflation'. In effect, its final assessment did not uphold the fiscal guidance for 2022 and implicitly admitted that in hindsight a restrictive fiscal policy in 2022 would have been appropriate.

The Commission also shifted goalposts when assessing growth in net nationally financed primary current expenditure. It used the estimated cost of energy measures and support to Ukrainian refugees as valid justifications for the deviations, in the absence of any such provisions in the fiscal recommendations for 2022. The recommendations for 2023 allowed for targeted energy measures and support to Ukrainian refugees, without changing the guidance for 2022. In practice, only a quarter of the energy measures were targeted, but the Commission chose to use the total cost of energy measures when reaching conclusions on compliance for 2022. While the Commission demonstrated flexibility in applying its economic judgement in changing circumstances, its use of all and only targeted energy measures for 2022 and for 2023, respectively, was not consistent. Consideration given to these measures responded to developments on the ground rather than serving as conscious policy advice.

[56] The fiscal recommendations for 2022 estimated the 10-year average nominal potential growth for the EU at 3.3%, compared to the estimate of 6.9% used in the Commission's final assessment.

Table 2.3: **Fiscal indicators and the Commission's final assessment of 2022**

	% of GDP	Overall fiscal stance		of which contribution from: Change in net nat.financed primary current expenditure				Change in nat. financed investment		Change in expenditure financed by RRF grants and other EU funds	
			Conclusion		Conclusion	energy measures	support to Ukrainian refugees		Conclusion		Conclusion
'high debt' Member States	BE	-2.0		-1.9	✗	0.8	0.1	0.0	✓	0.0	✓
	EL	-1.0		-0.6	✓	2.0	0.0	-0.6	✓	0.2	✓ transition between two EU programming periods
	ES	-2.5		-2.7	✗	1.5	0.0	-0.3	✓	0.1	✓
	FR	-2.0		-1.7	✗	0.8	0.0	-0.1	✓	0.0	✓ frontloaded implementation in the first two years
	IT	-3.2		-2.4	✓	2.2	0.1	0.0	✓	-0.4	✓
	PT	-1.5		-1.9	✓	2.0	0.0	0.1	✗	0.5	✓ higher RRF use, but lower that of other EU funds
other Member States	BG	-1.2	✓	-0.8	✓	0.9	0.1	-0.5	✓	0.1	✓
	CZ	-0.1	✓	0.3	✓	0.6	0.3	0.0	✓	-0.1	✓
	DK	0.6	✓ appropriate in a context of high inflation	0.7	✓	0.1	0.0	0.2	✗	0.0	✓
	DE	-2.7	✓	-2.4	✗	1.2	0.1	0.0	✓	0.1	✓
	EE	1.3	✓ appropriate in a context of high inflation	0.8	✓	0.7	0.6	0.6	✗	0.2	✓ rapid and unforeseen rise in construction prices
	IE	-0.2	✓ appropriate in a context of high inflation	-0.2	✓	0.5	0.1	-0.1	✓	0.1	✓
	HR	0.2	✓ appropriate in a context of high inflation	0.1	✓	1.6	0.1	0.6	✗	0.0	✓
	CY	0.0	✓ appropriate in a context of high inflation	0.0	✓	0.6	0.1	0.1	✗	0.1	✓ starting phase of the new EU programming period
	LV	0.0	✓ appropriate in a context of high inflation	0.3	✓	1.4	0.2	1.2	✗	0.2	✓ capacity constraints and a rise in construction prices
	LT	0.9	✓ appropriate in a context of high inflation	0.9	✓	1.3	0.3	0.0	✓	0.2	✓
	LU	-0.9	✓	-1.3	✗	0.5	0.1	0.0	✓	0.0	✓
	HU	-0.4	✓	0.6	✓	0.6	0.1	0.2	✗	0.6	✓ lower absorption of the EU structural and investment funds
	MT	-0.2	✓	-0.9	✓	1.9	0.1	0.2	✗	0.2	✓ lower absorption of other EU funds
	NL	-0.5	✓	-0.4	✓	0.6	0.1	0.1	✗	0.0	✓
	AT	-2.8	✓	-1.8	✓	1.5	0.2	0.1	✗	-0.1	✓
	PL	-3.0	✓	-2.3	✓	1.9	0.5	-0.2	✓	0.3	✓
	SI	-1.2	✓	-0.4	✓	1.0	0.1	-0.7	✓	0.1	✓
	SK	1.3	✓ appropriate in a context of high inflation	1.3	✓	0.2	0.1	-0.2	✓	0.1	✓ lower absorption of the structural EU funds and postponements of RRF spending
	FI	-0.1	✓	0.1	✓	0.1	0.1	0.0	✓	-0.1	✓
	SE	0.4	✓ appropriate in a context of high inflation	0.8	✓	0.2	0.2	-0.1	✓	0.0	✓

Notes: (1) Table shows fiscal indicators for 2022 as presented in the country-specific recommendations for 2024 and in the accompanying statistical annex. The indicators compare the change in the expenditure aggregates with the same aggregate if it were increasing by nominal medium-term potential GDP growth; this difference is expressed in % of GDP. A negative sign means that growth in the expenditure aggregate exceeds nominal medium-term potential GDP growth. The expenditure aggregated for the overall 'fiscal stance' excludes interest expenditure, cyclical unemployment expenditure, the impact of discretionary revenue measures and COVID-19-related temporary emergency measures; and includes expenditure financed by Recovery and Resilience Facility grants and other EU funds.
(2) Colour-filled cells represent indicators included in the country-specific fiscal recommendations. Non-colour-filled cells also show numbers in line with the colour code, in the absence of any formal recommendation.
(3) The colour code categorises indicator performance compared with the recommended course of action:
For overall fiscal stance: red = contractionary fiscal impulse (above 0.25% of GDP), yellow = broadly neutral fiscal impulse (between -0.25% and -0.25% of GDP), green = expansionary fiscal impulse (less than -0.25% of GDP);
For change in net nationally financed primary current expenditure: red = expenditure growth significantly exceed medium-term economic growth by more than 0.5% of GDP, green = expenditure growth does not exceed medium-term economic growth by more than 0.5% of GDP;
For change in nationally financed investments and change in expenditure financed by Recovery and Resilience Facility grants and EU funds: red = contractionary fiscal impulse (above 0.1% of GDP), yellow = borderline contractionary fiscal impulse (between 0 and 0.1% of GDP), green = expansionary fiscal impulse (less than 0% of GDP).
(4) Marks for conclusions:
Tick = expenditure aggregate fulfilled the recommendation or its underperformance was justified;
Cross = expenditure aggregate did not fulfil the recommendation.
Source: Country-specific recommendations for 2024

The Commission estimates of discretionary fiscal measures (Covid-related measures, energy measures and support to Ukrainian refugees) helped explain and monitor fiscal developments, but there are limitations to this approach. Estimates of the measures rely on many assumptions, which can differ greatly across countries, and results are not fully disclosed by the Commission. These estimates also do not undergo a validation process by statistical authorities. Any adjustments to official statistical indicators for the estimated impact of discretionary measures therefore carry a risk of unintentionally distorting the picture.

The Commission used very different assessment approaches for nationally financed investments and EU-financed expenditure. In all cases where EU-financed expenditure had a contractionary fiscal impulse in 2022, the Commission justified it on the grounds of specific circumstances and assessed implementation as having been carried out as recommended. In contrast, the conclusions on nationally financed investments were strictly based on the reading of the indicator. No explanation was given for underperformance, which inhibits any alternative reasoning. The Commission could conceivably have analysed country-specific factors and made more nuanced conclusions on nationally financed investments.

The limited differentiation of the fiscal guidance for 2022 became even less apparent in the Commission's final assessment. Country assessments followed the same format with subtle differences for high-debt Member States (i.e. no conclusion on the overall fiscal stance, differently worded conclusions on net current expenditure). While recommendations on net primary current expenditure growth were addressed to only 6 Member States, the Commission extended its compliance assessment to all Member States, seizing some of the missed opportunity to ask for prudence on current expenditure growth for all in spring 2021 (Section 2.3).

The Commission did not provide an overall assessment of compliance or non-compliance. This can be explained by the design of the recommendations, which were formulated in qualitative terms and targeted several policy objectives, making it difficult to deliver a consistent policy response. The absence of a concrete overall conclusion also diverted attention from the elements of non-compliance and the lack of any follow-up procedural steps.

The Commission made no assessment of the established SGP's preventive arm indictors: (i) the expenditure benchmark; and (ii) the change in the structural budget balance. While they were replaced by a modified version of the expenditure benchmark in the fiscal guidance for 2022, they were still legally established indicators that ought to be reported and monitored. The Commission reported on the structural budget balance in the statistical annex ([57]), but stopped reporting on the expenditure benchmark in spring 2023 (it was included in standard reporting tables previously). It also broke a long-standing principle of reporting only recalculated output gap and structural balance estimates, using the information of the SCPs. This approach ensured that all potential output and output gap estimates were consistent with the commonly agreed method (Section 2.1), even under different forecast assumptions. In spring 2023, the statistical annex showed both (i) the recalculated output gap, based on the commonly agreed method; and (ii) the gap reported by Member States. This break from past practice signals the Commission's openness to alternative output gap estimation methods.

In spring 2023, the Commission's analysis of country fiscal developments remained limited as it had discontinued dedicated fiscal assessment reports for each Member State in spring 2021 (Section 2.1). Recitals in the country-specific recommendations for 2024 covered only the key developments. The European Semester country reports and in-depth reviews were also short on budgetary analysis, depending on the macroeconomic importance in the individual country. While Member States presented their budgetary plans in great detail, the Commission did not respond with equally comprehensive analysis. It did not provide an analysis of the implications of its forecast for budgetary surveillance. The Commission also changed the format of the fiscal assessment calculations shared with the responsible Council committee, omitting in particular the expenditure benchmark calculations.

The Commission presented its debt sustainability analysis in annexes to the European Semester country reports ([58]) and in its overview of the 2023 SCPs. ([59]) Based on the Commission 2023 spring forecast, the analysis showed a slight improvement in the EU as a whole as the better-than-expected budgetary outturn in 2022 was only partly offset by an increase in public expenditure in the following years. As a result, the debt sustainability risk assessment remained broadly unchanged, compared to the Debt Sustainability Monitor 2022 (see Section 1.2). The Commission did not report the updated results in a standard table in the statistical annex, as the country-specific recommendations for 2024 and fiscal indicators for 2024 were based on the earlier debt sustainability

([57]) Fiscal Statistical Tables providing background data relevant for the assessment of the 2023 Stability or Convergence Programmes.

([58]) 2023 European Semester country reports.

([59]) The 2023 Stability & Convergence Programmes. An Overview, with an Assessment of the Euro Area Fiscal Stance.

analyses using the Commission 2022 autumn forecast.

2.6. EXCESSIVE DEFICIT PROCEDURE

Since the outbreak of the pandemic in Europe in early 2020 and the activation of the severe economic downturn clause, the Commission and the Council have postponed or averted decisions to place Member States under the excessive deficit procedure (EDP). Romania was the only Member State for which an EDP was launched after the severe economic downturn clause was activated, based on an excessive deficit in 2019.

In spring 2021, the Commission confirmed excessive deficits and debt levels in many Member States, but did not recommend further procedural steps. The Council concurred. At the same time, a revised adjustment path was set out for Romania and the deadline for correction was extended from 2022 to 2024.

In autumn 2021, the Commission forecast that in 2022 the headline deficit would exceed 3% of GDP for 14 Member States and the government debt ratio would also exceed 60% for 14 Member States. However, the Commission did not prepare any report under Article 126(3) TFEU, which provides that the Commission 'shall prepare a report' if a Member State does not fulfil the deficit and debt criteria. In fact, for the first time in the SGP's history, the Commission did not provide any explanation for not reporting or not launching EDPs. At the same time, it conducted a procedural assessment of the action taken by the only country in the EDP, Romania. ([60]) It concluded to keep the EDP in abeyance, based on the projected achievement of the required headline deficit target in 2021, while awaiting the budgetary plans for 2022 and for the medium-term from the new government.

In spring 2022, the Commission assessed Member States with actual or planned deficits and debt above the reference values in a single omnibus report (the same reporting format as in spring 2021). It 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. However, it did not propose opening new EDPs. Using an argument put forward in 2020 for the first time, the conclusion was justified on the grounds of the exceptional uncertainty created by the continuation of the Covid-19 pandemic together with the Russia's war on Ukraine. According to the Commission, this uncertainty 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.

In autumn 2022, the Commission also did not prepare reports under Article 126(3) TFEU, but communicated that the conclusion reached in spring 2022 – of not proceeding with the opening of EDPs – was largely confirmed by updated fiscal data for 2021 and more recent estimates for 2022 and 2023. ([61]) It shared its analysis based on the 2022 autumn forecast in an internal note to the responsible Council committee. The note also included the Commission's assessment of the EDP for Romania, which was in abeyance since autumn 2021. Its succinct communication on the EDPs and more thorough internal reporting in autumn 2022 stood in positive contrast to a year earlier, when it did not provide any justification for not producing the reports or for not launching new EDPs.

In spring 2023, the Commission assessed the excessive deficits and debt in 16 Member States in a single omnibus report, in line with Article 126(3) TFEU. ([62]) This format of reporting was used for 3 years in a row, while it was initially intended as a one-off. Previously, there were individual country reports under Article 126(3) TFEU. The single report format summarised common relevant factors affecting all assessed Member States in one place, in particular (i) the increase in energy prices and the war in Europe; (ii) the risk of short-lived improvements in government accounts due to inflation; and (iii) the negative impact of terms-of-trade shocks on households' purchasing power. The assessment of country-specific relevant factors followed a similar approach as in the previous year by assessing fiscal developments in 2022 and 2023 against the fiscal recommendations, debt sustainably risk in the medium term and the existence of any macroeconomic imbalances.

The Commission concluded, after its assessment of all relevant factors, that the deficit and debt criteria

([60]) Assessment of action taken by Romania in response to the Council Recommendation of 18 June 2021 with a view to bringing an end to the situation of an excessive government deficit in Romania.

([61]) Annual Sustainable Growth Survey 2023

([62]) Commission report in accordance with Article 126(3) TFEU.

were not fulfilled by 14 and 3 countries, respectively. However, it did not propose opening new EDPs in spring 2023, justifying it on the grounds of 'the persistently high uncertainty for the macroeconomic and budgetary outlook'. On 8 March 2023, the Commission also recalled its pre-commitment in its fiscal guidance for 2024, stating that 'it would not propose the opening of new excessive deficit procedures in spring 2023'.

The Commission argued that the high uncertainty persisted in 2023 due to the ongoing Russia's war of aggression against Ukraine and its impact on the EU economy, and due to the remaining macroeconomic and fiscal impact of the Covid-19 pandemic. While the justification for not opening the EDPs was similar to that used a year earlier, the level of uncertainty was reduced from 'exceptional' in spring 2022 to 'high' in spring 2023. This was consistent with the less alarming risk assessment in the Commission 2023 spring forecast compared to that in spring 2022. The Commission's use of unobservable macroeconomic uncertainty as a relevant factor stretched the interpretation of that element of the SGP.

As regards Member States that breached the debt criterion, the Commission explicitly stated that 'the compliance with the debt reduction benchmark could imply a too demanding frontloaded fiscal effort that would risks to jeopardise growth' and, therefore, 'compliance with the debt reduction benchmark is not warranted under the prevailing exceptional economic conditions'. This statement was not supported by any analysis. At the same time, the Article 126(3) report concluded that 9 of the assessed countries complied with the debt reduction benchmark and only 3 countries fell short of the requirement (France, Italy, Finland).

Despite the Commission's reluctance to open new EDPs, it continued to monitor the ongoing EDP for Romania, including careful analysis of the fiscal indicators. [63] The Commission presented its assessment in the non-binding notes (recitals) of the country-specific recommendations for Romania and in a dedicated note to the responsible Council committee. In its assessment, Romania complied with its headline deficit target in 2022 but did not meet the required structural adjustment despite strong revenue growth, boosted by steady real GDP growth, high inflation and a favourable composition of economic growth. The Commission therefore carried out a careful analysis based on the expenditure benchmark [64], which showed that nominal net primary expenditure growth was well above the recommended value (14.1% vs 1.3%).

Romania's 2023 convergence programme aimed to reduce the government deficit to below 3% of GDP in 2024. However, based on the 2023 spring forecast, the Commission assessed Romania as being at risk of non-compliance with nominal and structural balance targets for 2023 and 2024. Its careful analysis identified net expenditure growth above the requirements and concluded that there was a risk that Romania would not comply with the EDP targets in 2023 and 2024. Nevertheless, the Commission did not propose to step up the EDP procedure and kept the procedure in abeyance as the headline deficit target in 2022 had been met. The country-specific recommendations for 2023 and 2024 asked Romania to pursue fiscal policies in order to bring an end to the situation of an excessive government deficit in Romania by 2024.

The extensive interpretation of the severe economic downturn clause affected the application of the EDP in 2022. Although the Commission regularly stressed that the clause had not suspended the commonly agreed fiscal rules, no new EDPs were recommended by the Commission based on actual or forecast breaches of the 3% deficit criteria. This is in clear contrast to past practice and the spirit of the SGP (EFB 2022b). In the past, the Commission and the Council have used EDPs to strengthen the medium-term orientation of EU surveillance and have attuned multi-year fiscal adjustment paths to different circumstances. Moreover, the severe economic downturn clause is granted on the condition that public finances remain sustainable in the medium term. With some Member States still planning government deficits above 3% of GDP in their medium-term plans (Section 2.2) and without any recommendations on how to tackle excessive deficits in the medium term, it was difficult to ascertain whether this condition was satisfied or not.

While the Commission reported on the excessive deficits and debt under Article 126(3) TFEU in spring 2022 and 2023, it pre-committed its

[63] The 2023 country-specific recommendation for Romania

[64] The methodology for a careful analysis to assess effective action was established by the Opinion of the Economic and Financial Committee on 29 November 2016 entitled 'Improving the assessment of effective action in the context of the excessive deficit procedure – a specification of the methodology'. It was endorsed by the ECOFIN Council on 6 December 2016.

conclusion in its fiscal guidance communications issued ahead of the regular surveillance packages. Both in March 2022 and March 2023, the Commission announced that 'a decision on whether to place Member States under the EDP should not be taken' in spring of that year, in both cases justifying it on the grounds of high macroeconomic uncertainty already noted above. This conclusion was reached before examining actual and projected deficits and debt and the relevant factors. This marked another deviation from the established fiscal surveillance procedures and from the evidence-based decision-making in the rules-based framework. Moreover, the March 2023 Communication preannounced a possible opening of the deficit-based EDPs only in spring 2024, effectively suspending any procedural steps in 2023.

The Council endorsed the Commission's treatment of the excessive deficit and debt cases in spring 2023 and the Commission's intention to open any new EDPs only in spring 2024.

3. INDEPENDENT FISCAL INSTITUTIONS AND NATIONAL FRAMEWORKS

Highlights

- Under EU law, IFIs have a mandatory role in monitoring the achievement of domestic numerical rules (some of them monitor compliance with SGP rules as well).
- To shed light on the effectiveness of their monitoring activity, a quantitative review was carried out for covering 2013-2019. The numerical compliance records for domestic rules (typically structural budget balance rules) were systematically compared with IFIs' *ex post* compliance assessments collected from their monitoring reports. The legal compliance scores from the IFIs' reports were typically higher than the numerical compliance figures. The gaps turned out to be particularly large for a number of high-debt countries.
- While there could be many reasons explaining the gap, these might be linked to institutional factors, too. IFIs tend to be circumspect with their opinions if their compliance decision comes before the Commission's assessment, in particular for those domestic rules that are tantamount to – or mirror – the SGP rules. In addition, discrepancies between the Commission and IFIs in real-time compliance assessments could arise from not having the same set of information. This calls for a better and more timely flow of information on relevant data, methods, and assumptions: a potentially useful lesson for the ongoing SGP reform process.
- More generally, our survey found that IFIs' monitoring activity could be reinforced by a more genuine dialogue with the budgetary authorities, in part through: (i) more robust comply-or-explain arrangements covering all IFI assessments; and (ii) improving the analytical toolbox of IFIs.
- This chapter also portrays national IFIs in two Member States, Finland and France, also to identify best practices. In both countries, the IFI is institutionally linked to the national supreme audit institution, albeit in different manners. The main findings are:
- In Finland, the central IFI function is fully embedded as an organisational unit in the National Audit Office of Finland. While this arrangement has some advantages (e.g. robust access to information), it is weighing on the independence and public profile of the IFI unit. This being said, in practice it has so far always been provided with the necessary resources.
- Linked to its specific set-up, and beyond the standard monitoring reports on fiscal rules, the Finnish IFI regularly publishes fiscal policy audit reports and *ex post* evaluations of the government's macro-fiscal projections. It has successfully promoted transparency by disclosing the methodology used in its own compliance reports and by encouraging the government to publish more systematic forecast-related information.
- The French IFI, the High Council of Public Finances (HCPF), is administratively attached to the French Court of Auditors. There are several legal provisions to ensure its independence vis-à-vis both the budgetary authorities and its host entity as well. Most notably, its institutional reputation benefits from the nomination rules, according to which members are appointed by six different authorities.
- The HCPF's works are reported to be highly valued by stakeholders, and in general have become reference points in French fiscal policy debates. It once (unsuccessfully) initiated the triggering of the national correction mechanism, and criticised on multiple occasions the government's fiscal plans, in particular the repeated backloading of the target year for achieving the country's MTO.

This chapter is comprised of two main sections. Section 3.1 contains a survey-based analysis of the EU IFIs' role in monitoring national numerical rules, including an empirical investigation of their *ex post* decisions on compliance. Section 3.2 sets out portraits of IFIs in Finland and France, two euro-area countries where the establishment of the national IFI was triggered by the transposition of the Fiscal Compact [65] and where the IFIs are institutionally attached – although in significantly different ways – to the respective national Courts of Auditors. The motivation for including these portraits is to draw possible lessons for other EU IFIs and to share best practices.

3.1. INDEPENDENT MONITORING OF NATIONAL NUMERICAL RULES

Independent fiscal institutions are increasingly considered by both academics and practitioners as complementary pillars to numerical rules in comprehensive fiscal frameworks. The empirical literature has found clear synergies between fiscal rules and IFIs. Specifically, rules equipped with independent monitoring mechanisms were associated with positive impacts (e.g. in terms of improved budgetary outcomes or lowered sovereign borrowing costs).

For instance, based on the IMF's Fiscal Council Dataset, Debrun and Kinda (2017) concluded that the mere existence of IFIs is not by itself conducive to sound public finances. Therefore, they investigated what organisational features of independent bodies support their operation in disciplining budgetary authorities. Overall, they identified the existence of legal mandates to monitor numerical rules as being one of the key characteristics for effective IFIs. [66] In terms of expenditure savings, a study by IMF economists (2017) showed that fiscal rules equipped with independent monitoring arrangements were associated with lower sovereign debt financing costs. This result held even for countries with a mixed track-record of fiscal responsibility. Finally, based on a panel of 25 European countries, Jalles (2019) found a similarly beneficial impact of the quality of fiscal institutions – proxied in the study by the European Commission's Fiscal Rule Index – on government bond yields, supporting the argument that more robust rules give assurance to financial investors that the government will meet its obligations.

Also inspired by this economic literature, the notion that an independent assessor is a necessary ingredient in the design of effective numerical rules has become internalised in EU legal provisions for national fiscal governance frameworks. First, the 2011 Budgetary Frameworks Directive [67] introduced a reference to the need to involve IFIs or 'bodies endowed with functional autonomy' in monitoring compliance with national fiscal rules. Subsequently, the intergovernmental Fiscal Compact obliged the contracting parties to establish a structural budget balance rule, preferably at constitutional level, with a number of design requirements, including the monitoring by a domestic IFI. Finally, in 2013, one of the two-pack regulations for euro-area Member States [68] extended the requirement for monitoring by independent bodies to all domestic numerical rules in force.

As a result of the above developments, EU national fiscal councils are charged with verifying compliance with domestic rules defined for the general government (or occasionally the central government) sector. It is much less common to monitor specific sectoral rules within the general government sector (such as social security or subnational rules). Indeed, only around a quarter of EU IFIs are required by legislation to assess compliance at the subnational level, typically in federal state structures (e.g. the Austrian Fiscal Advisory Council or the Spanish Independent Authority for Fiscal Responsibility).

The large majority of IFIs undertake both forward-looking and backward-looking compliance assessments. In fact, there are only two EU Member States (Denmark and Spain) where the

[65] 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 their 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.

[66] The authors stress that even significantly positive correlations should not be interpreted as causal relations, since these may simply reflect deeper, often unobservable factors. Moreover, the limited time span for many of the IFIs in the IMF database may also affect the empirical results.

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

[68] 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.

Table 3.1: **Overview of compliance scores for national fiscal rules**

Country	Type of rule	Period covered	Commission numerical compliance score (%)	IFI real-time legal compliance score (%)	Comment (if relevant)
Belgium	SBB ('EU Rule')	2013-2019	0%	0%	The national IFI describes its monitoring assessments as 'illustrative compliance checks'.
Czechia	SBB	2017-2019	100%	100%	National fiscal rules were not adopted before 2017.
Germany	SBB	2013-2019	100%	100%	
Estonia	SBB	2013-2019	43%	57%	Following the identified non-compliance in 2018, the national correction mechanism was activated starting from 2019, but it was suspended in spring 2020, linked to the pandemic.
Ireland	SBB ('EU Rule')	2013-2019	100%	86%	
France	SBB ('EU Rule')	2013-2019	14%	86%	2013 was the only year in which the national IFI reached a conclusion of non-compliance, and therefore it proposed to trigger the national correction mechanism.
Croatia	Expenditure rule	2013-2016	50%	50%	Following 2016, the expenditure rule was not separately assessed by the national IFI.
Italy	SBB ('EU Rule')	2015-2019	0%	80%	The assessments of the national IFI equates the national SBB rule with the SGP MTO rule.
Cyprus	SBB	2016-2019	100%	100%	During the period of the EU-IMF financial assistance programme (March 2013-March 2016), the national IFI did not assess the SBB rule, but instead the budgetary targets as set out in the programme's fiscal conditionality.
Latvia	SBB	2013-2019	29%	29%	
Luxembourg	SBB	2014-2019	100%	100%	
Hungary	Debt rule	2014-2019	100%	100%	
Malta	SBB	2013-2017	17%	75%	For 2018-2019, there was no clear national IFI statement on *ex post* compliance.
Netherlands	SBB ('EU Rule')	2013-2019	100%	100%	
Austria	SBB	2017-2019	0%	67%	National fiscal rules were not in effect before 2017.
Portugal	SBB ('EU Rule')	2014-2019	17%	83%	
Romania	SBB ('EU Rule')	2014-2019	33%	33%	
Slovenia	SBB	2017-2019	67%	67%	National fiscal rules were not adopted before 2017.
Slovakia	SBB ('EU Rule')	2014-2019	17%	50%	The national IFI initiated the activation of the national correction mechanism twice (in 2015 and in 2019), but the government concurred only for the second time.
Finland	SBB ('EU Rule')	2013-2019	57%	71%	
Sweden	SBB	2013-2019	14%	14%	

Notes: (1) SBB: structural budget balance rules.
(2) The qualification 'EU Rule' refers to cases where the design of national SBB rules was deemed sufficiently similar to the SGP MTO rule. For these countries, Commission staff calculated the compliance indicator for the national SBB rule with that of the SGP MTO rule (as a proxy).
Source: Belu Manescu et al. (2023), own compilation

independent monitoring mandate calls solely for an *ex ante* perspective.

One possible approach to capture the outcomes of IFIs' monitoring activity of domestic rules is to systematically compare their *ex post* compliance decisions (which are real-time assessments of legal compliance) with the results of a numerical compliance check (which shows in purely quantitative terms whether the targeted fiscal variable – typically the budget balance – evolved within or outside the perimeters laid down by the fiscal rules). There are many reasons why these two types of compliance record could differ, as legal compliance takes into account possible interpretations or margins of discretion allowed by the legal provisions underpinning the national rule. This being said, the observable patterns in the two compliance records might still be instructive or even of concern, especially if the legal compliance assessment systematically deviates from numerical compliance and fiscal imbalances accumulate.

The Commission recently published an analysis based on information it had compiled itself on numerical compliance with national fiscal rules between 1998 and 2019 (Belu Manescu et al. (2023)). ([69]) This analysis covered only around three fifths of all the national rules in place during the period under review, as certain groups of rules have been excluded (e.g. revenue rules, overlapping rules) as well as rules for which compliance information was not available or was too complex to collect (e.g. subnational rules implying varying targets for municipalities). The Commission kindly shared the entire underlying dataset with the EFB Secretariat, including the binary summary variable taking the value of 0 (zero) for non-compliance and 1 for compliance. ([70])

The EFB Secretariat collected the IFIs' *ex post* compliance decisions on national numerical rules from their respective webpages (official statements or monitoring publications) that were also translated into a binary (0 or 1) variable. Some information on numerical compliance is available from the Commission's dataset starting from 1998. However, most IFIs started their operations following the 2011-2013 economic governance

([69]) It is worth pointing out that the EFB compliance tracker also collects information on numerical compliance but in relation to the EU fiscal rules.
([70]) The Commission's analysis investigated empirically the implications of the existence, design and achievement of national fiscal rules on the compliance with EU fiscal rules.

reforms that also led countries to (often completely) overhaul their numerical rules. Thus, comparable scores for the same rules often only began to be compiled starting from 2013. For all countries, we registered information about only one rule. In the few cases where both the compliance scores reported in Belu Manescu et al. (2023) and the ones collected by the EFB Secretariat were available for more than one rule per country, we chose the rule with the longest history of compliance data. The binary scores from both the Commission's numerical compliance calculations and the IFI's real-time assessments were then aggregated into percentage shares, whereby 100% signifies full compliance for the entire period in question (Table 3.1).

Out of the 27 EU Member States, we collected scores for 21. ([71]) Closely linked to the influence of the Fiscal Compact, our sample of national fiscal rules includes predominantly structural budget balance rules (of which half were deemed by the Commission's analysis to be designed in the same way as the SGP structural balance rule, see the 'type of rule' column in Table 3.1). It should be clarified that full compliance for a given year was granted not only for countries that had have attained their MTO, but also for those that complied with the recommended adjustment path towards them.

One could immediately spot that, with the sole exception of Ireland, the compliance score calculated from IFIs' legal assessments are typically greater than the numerical compliance score, with quite a significant degree in some cases. The gap between the numerical and legal compliance indicator seems to be particularly large for the majority of countries with a very high public debt-to-GDP ratio (i.e. above 90% of GDP). Given the heavy presence of structural budget balance rules in our sample, one potential explanation for the differences is linked to the (occasionally sizeable) revisions of output gap estimates: the numerical compliance scores reported in the Commission's study were recently derived retrospectively for all concerned years, while the IFI's opinions were based on real-time estimates. It is worth recalling that IFIs are not obliged to apply the so-called commonly agreed method for cyclical adjustments, and this could also lead to some differences.

As to the more institutional factors at play, most of the national IFIs' assessments are released before the Commission's final assessment. As a result, several IFIs appear to be rather circumspect to present their assessment of compliance because they are anticipating the growing margin of discretion exercised by the Commission, which they cannot influence or predict. From experience, IFIs can find themselves on the defensive in the domestic debate whenever an assessment of non-compliance is subsequently followed by a conflicting conclusion on the part of the Commission. The possibility of this inconsistency is more pronounced if the national IFIs also provide judgements on the SGP rules. In a survey conducted in early 2023 by the EFB Secretariat on EU IFIs' monitoring activity ([72]), around half of them reported that they covered the common rules in their assessment reports, mostly on the basis of an explicit legal mandate. An example of the cautious approach adopted by some national IFIs can be found in the successive opinions of the Italian Parliamentary Budget Office (PBO). In its biannual monitoring reports, the PBO recurrently highlighted that a number of elements relevant for a final compliance decision (e.g. accepted derogations from the required structural adjustment linked to the use of the unusual event and the flexibility clauses) would be decided by the European Commission later on. ([73])

In addition, similar discrepancies could arise when the domestic rule mirrors the SGP rules, which is often the case with the structural budget balance rules. In a prominent episode in 2016, the Slovak

([71]) In Denmark and Spain, the IFI published only *ex ante* compliance assessments during the period in question. For Bulgaria, past compliance reports were not available on the Fiscal Council's webpage. For Greece, the Hellenic Fiscal Council did not cover the structural budget balance rule, but instead reported on the annual nominal fiscal targets set out in the conditionality of the EU/IMF financial assistance programme until 2018, and in the enhanced surveillance afterwards. For Lithuania, there was a data mismatch: the Commission's compliance data were available for the national expenditure rule, while the IFI assessments covered the structural budget balance rule. Finally, Poland was left out from the analysis as it does not have a fully-fledged national IFI.

([72]) The survey was distributed to 26 independent institutions, one per Member State, that are entrusted with a monitoring function over national numerical rules as laid down in EU law (there was no IFI in Poland). All 26 responded to the questionnaire. The survey briefly covered the issue of how the monitoring activity has evolved since 2020, the related discussion is placed in Box 3.1.

([73]) For instance, when assessing compliance with the structural budget balance rule for 2016, the PBO underscored that its assessment had been conditional on assumptions about the Commission's final decisions on the Italian requests to benefit from the flexibility clauses, which were not yet known at the time of the PBO's opinion: '*The European Commission's final conclusions will be prepared after the publication of the Spring Forecast, considering, first, the pre-condition for eligibility for the clause, which as noted requires that aggregate total expenditure not decrease in 2016 as compared with 2015, and, second, the actual amount of expenditure to be taken into account for the purposes of the clause.*' Budgetary Planning Report, May 2017, p. 100.

Council for Budget Responsibility concluded on non-compliance with the domestic structural budget balance rule for 2015, and concomitantly proposed to trigger the national correction mechanism. ([74]) The government did not follow this recommendation, and its communication, *inter alia*, referred to the EU institutions' assessment of Slovakia's 2016 stability programme ([75]) that found broad compliance with the SGP provisions, and in particular determined that the deviation from the country's MTO had not been significant (see OECD 2020 for more details).

The issue of potential inconsistency between the Commission's and national IFIs' conclusions is not limited to the real-time surveillance of structurally defined numerical rules. Inspired by the experiences of the Portuguese Public Finance Council, Marinheiro (2021) argues that monitoring the expenditure benchmark is quite challenging for the national IFIs, as this work relies on the Commission's data inputs and calculations that are typically not available at the time of the IFIs' publication date (to have a meaningful impact, the national IFI's reports must be issued before the Commission's). The issue of reliance on Commission inputs is most notable in the following elements of the expenditure benchmark formula: quantification of the discretionary revenue measures and updated information on EU funds. Marinheiro argues that a different conclusion from the Commission on account of outdated estimates and data could be difficult to explain to stakeholders, and consequently potentially costly for the reputation of the IFI.

Based on a recent survey, the Network of EU IFIs (2023) documents the prevalence of different real-time opinions between the Commission and national IFIs over the last decade. More than one-third of the surveyed IFIs had on at least one occasion arrived at a materially different compliance assessment on numerical rules than the Commission. As to the possible explanatory elements, roughly one-third of the institutions mentioned they had experienced differences in the assessments of discretionary revenue measures and/or one-off measures, while some half of them reported on disagreements between them and the Commission about the output gaps. In this context, Beetsma (2023) calls for better flow of information from the Commission on the implementation of the EU's fiscal regime, also through ensuring early access of the national IFIs to all relevant interpretative details, figures and estimates so that they possess the same information set as the Commission. This issue has already been underscored in the performance audit report of the European Court of Auditors (2019), which pointed to the Commission's use of its discretionary powers as one of the potential factors for diverging assessments and stated that this had negative implications for the effectiveness of the overall EU fiscal framework.

Irrespective of the gaps between the two compliance scores reported in Table 3.1, or the nature of the explanatory factors behind their distances, the fact that for several countries the numerical compliance indicator shows zero or small values for the entire period in question has significant policy consequences. Namely, if fiscal outturns are repeatedly not within the numerical constraints embodied in the fiscal rules, then the fundamental objective of these rules, i.e. debt sustainability, might be weakened.

As was mentioned above, the timing of releasing the *ex post* IFI monitoring reports could have considerable policy significance. The EFB Secretariat's survey also asked IFIs to evaluate the appropriateness of their publication schedules, and in particular whether these allow formulating a timely fiscal corrective action by the government if non-compliance with the domestic numerical rules is established. Close to half of the surveyed institutions stated that their publication date should ideally be brought forward; however, it would necessitate changes in either the national budgetary procedures or in the statistical calendars (or in both).

A regular and genuine dialogue between the fiscal authorities and the IFI on fiscal policy issues, and in particular an official response to the findings of the independent monitoring reports, could benefit greatly the visibility and the transparency of the domestic rules-based framework. For the 22 EU Member States bound by the Fiscal Compact, such a dialogue is facilitated by the so-called comply-or-

([74]) The Council for Budget Responsibility first published its opinion on non-compliance in June 2016 (Evaluation of Compliance with the Balanced Budget Rule in 2015), and subsequently reiterated its position in an updated assessment in December 2016.

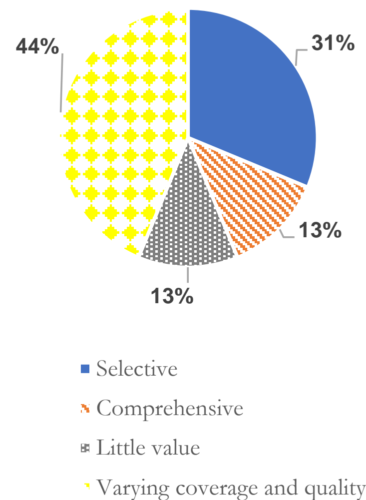
([75]) Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Slovakia and delivering a Council opinion on the 2016 Stability Programme of Slovakia – OJ C 299, 18.8.2016

explain arrangements. ([76]) However, this international requirement covers only a few targeted cases linked to the structural budget balance rule, namely: (i) activation of the national correction mechanism; (ii) monitoring the fiscal adjustment process; and (iii) triggering, extending and exiting escape clauses. This being said, in a few countries, broader coverage for the comply-or-explain requirement has been introduced, responding also to analytical findings and technical issues. These mechanisms are either set out formally in national law (e.g. Spain, the Netherlands) or function on the basis of the government's public commitment (Ireland, Austria). In addition, there are some bespoke provisions in the countries that are not signatories of the Fiscal Compact, e.g. Sweden, where the government committed itself to respond in a detailed manner to the IFIs annual report in the subsequent draft budget bill in the autumn.

The reactions from the governments take variable formats (i.e. open letter, press statement, declaration to Parliament, dedicated section in an official report/budgetary documentation). In the majority of cases, these governmental responses are released timely, i.e. within 2 months following the IFIs' relevant opinions. As to the coverage of the official responses, the IFIs in the EFB Secretariat's survey generally reported a non-systematic approach, while the relevance of the explanations was typically deemed to be varying or of little value (Graph 3.1). These results broadly confirm the picture of the operation of the comply-or-explain principle presented in Horvath (2018), which covers the first years following the transposition of the Fiscal Compact; thus no meaningful progress appears to have been achieved on this front in recent years.

([76]) It establishes that the government must comply with, or alternatively explain publicly why it is not following the assessment of the national IFI.

Graph 3.1: **Content and coverage of the official reactions as assessed by IFIs (share of institutions)**



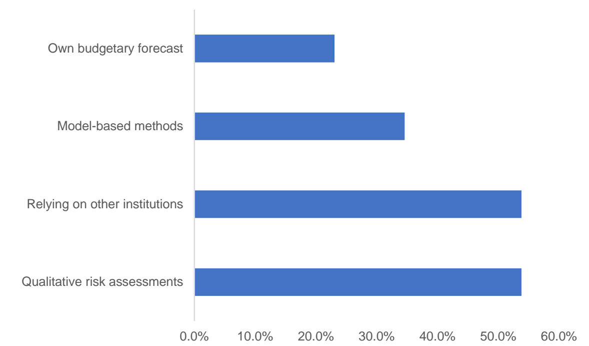
Source: EFB Secretariat

Turning specifically to *ex ante* monitoring, a relatively popular pattern among EU IFIs is to release two main broad assessment reports annually (e.g. Ireland, Greece, Cyprus, Luxembourg). In these cases, the spring edition typically analyses the country's medium-term budgetary plans (linked to the submission date of the stability or convergence programme), and the autumn edition focuses on the compatibility of the budget plan for the forthcoming year with the prevailing numerical rules (albeit an updated medium-term risk assessment could also be included). These IFI reports encompass many aspects of fiscal policy, with the monitoring part usually appearing in a subchapter of the document. Another group of IFIs (e.g. in Estonia, France, Malta, and Portugal) release dedicated opinions on budget planning documents that also contain their *ex ante* assessments as well.

Some heterogeneity is observable among the monitoring IFIs in the methodological approach of their *ex ante* assessments. More than half of EU IFIs, typically those with a small technical support team, apply relatively simple methods, such as qualitative fiscal risk assessments and/or comparison with the budgetary forecasts of other institutions (Graph 3.2). These mentioned reference forecasts are usually those prepared by international institutions (European Commission, IMF, OECD) or other national entities (e.g. central banks, public and private economic research institutes, investment banks). In certain cases, the

analytical input could come from another IFI (e.g. the Dutch Council of State's work relies on the fiscal forecasts of the Netherlands Bureau for Economic Policy Analysis, CPB).

Graph 3.2: **Use of methodological tools for ex ante assessments (share of institutions)**



Note: (1) Respondents were allowed to indicate multiple methods.
Source: Survey of the EFB Secretariat

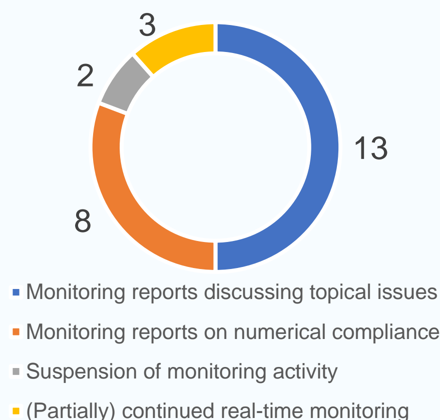
At the other end of the methodological spectrum, some one third of IFIs reported in the survey of the EFB Secretariat that they employ in-house models in their monitoring processes. Around a fifth of EU IFIs (namely, the monitoring bodies in Ireland, Spain, Italy, Austria, Portugal, and Slovakia) prepare their own fiscal forecast as a numerical benchmark to inform their judgement on the plausibility of the official fiscal targets.

Box 3.1: **IFIs' monitoring activity when rules are suspended**

In response to successive crises, escape clauses were activated in 2020, and subsequently extended until 2023 both at the EU and the national levels. As outlined in EFB (2021b), in around one third of EU Member States, legislation renders the domestic rules to be suspended as a function of the EU-level activation of the SGP clauses in exceptional circumstances, such as the severe economic downturn clause. In the majority of countries, there are separate provisions on national escape clauses that follow distinct procedures; nonetheless, these were typically also triggered and subsequently prolonged between 2020 and 2023, broadly in lockstep with the EU decisions on the severe economic downturn clause.

Naturally, the regular *ex post* monitoring of compliance with numerical rules – a key mandate of EU IFIs stemming from EU law – was rendered essentially redundant by the widespread activation of EU and national escape clauses from 2020 onwards. In order to capture the institutional responses to this situation, the 2023 survey of the EFB Secretariat (referenced in the previous section) inquired from IFIs about how their monitoring activity had evolved following the triggering of escape clauses. The overwhelming majority of IFIs upheld the standard publication schedule of their monitoring reports, as only two institutions suspended their surveillance activity (see Graph 1). Around half of the IFIs repurposed their monitoring reports to both analyse topical fiscal issues and discuss the policy and procedural implications of the ongoing suspension of budgetary constraints. A smaller group of IFIs used the monitoring reports to assess numerical compliance chiefly for illustrative purposes, i.e. they showed quantitatively whether the recorded budgetary variables evolved within or outside the numerical perimeters laid down in the fiscal rules.

Graph 1: **Approaches to monitoring activity under active escape clauses (number of institutions)**



(1) '*Monitoring reports discussing topical issues*': IFIs upheld the schedule of their regular monitoring publications and used them to discuss topical fiscal policy issues; '*Monitoring reports on numerical compliance*': IFIs upheld the schedule of their regular monitoring publications and used them to report on numerical compliance; '*Suspension of monitoring activity*': IFIs fully suspended their monitoring function, including the publication of monitoring reports; '*(Partially) continued real-time monitoring*': IFIs continued the real-time monitoring of at least one numerical rule for which an escape clause had not been triggered.

Source: *EFB Secretariat*

There were a few IFIs that continued (at least partially) their monitoring function during this period with some adaptations. In Sweden, the designs of neither the surplus target rule, nor the expenditure ceilings contain escape clauses, so the Swedish Fiscal Policy Council followed up on the evolution of these domestic rules. Specifically, the Swedish Council assessed the registered deviations from the surplus target and the upward revisions in the expenditure ceilings in 2020 and 2021 as warranted in view of the crisis. However, while acknowledging the economic uncertainties prevailing at the time, it criticised the government for not fulfilling the requirement laid down in national legislation to present a corrective plan on how to return to the target level. ([1]) While the flagship structural budget balance rules were switched off in both Spain and Slovakia during the period in question, the national IFIs continued

([1]) See in particular the Fiscal Policy Council's 2021 Annual Report.

(Continued on the next page)

Box (continued)

to monitor the non-suspended rules from the domestic framework, i.e. the expenditure ceilings and the debt brake mechanism, respectively.

Several IFIs pointed to some shortcomings in the relevant domestic law. These issues were partly linked to the fact that escape clauses were being used for the first time in virtually all EU Member States. For instance, the Portuguese and Finnish independent bodies warned in their reports that the national provisions for deactivating the clause and subsequently guiding the return to the numerical constraints were insufficiently clear and operational. Moreover, when providing a non-binding opinion on the prolongation of the escape clause to 2023, the Slovenian Fiscal Council labelled the European Commission's approach to the use of the SGP's escape clauses as 'largely discretionary', and argued that this approach in practice tied the hands of national IFIs, and at best limited their room for autonomous decisions when assessing the possible deactivation of their national clauses. (2)

(2) Fiscal Council of Slovenia (2022): Fulfilment of conditions for the existence of exceptional circumstances in 2023.

3.2. INDEPENDENT FISCAL INSTITUTIONS IN FINLAND AND FRANCE

Case studies are a standard way to assess the impact of fiscal councils on budgetary decisions and outcomes. By looking at the set-up and operation of individual IFIs 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 considerably. Continuing the established tradition of the EFB's annual reports, this edition zooms in on the IFIs in Finland and France, two euro-area countries where the national IFIs were organised around a decade ago under the aegis of the national supreme audit institutions.

3.2.1. Finland

Finland has developed a rather idiosyncratic institutional landscape for independent fiscal bodies. The central IFI (and the focus of this subsection), in charge of most EU-mandated tasks, is embedded as an organisational unit in the National Audit Office of Finland (NAOF). Following the legal designation of the audit institution as the official monitoring body of numerical rules in Finland (77), the NAOF in early 2013 established an 'Independent Monitoring and Evaluation of Fiscal Policy Function' by amending its rules of procedure. In the context of the 2019 NAOF reorganisation, it was transformed into a permanent project team within NAOF's Monitoring and Oversight Directorate. More recently in 2023, it became a separate 'Fiscal Policy Supervision and Audit' unit (hereafter: 'the IFI unit', see also Graph 3.3).

The choice to entrust the NAOF in 2012 with the compliance assessments for the then newly adopted national structural budget balance rule was chiefly motivated by the fact that the NAOF had already been monitoring the country's home-grown medium-term expenditure ceilings since 2007. (78) By the early 2010s, the NAOF had accumulated sufficient knowledge and expertise in fiscal-policy audits, in part by presenting to the Finnish Parliament an annual report in each spring on the country's compliance with its multi-year spending limits (OECD 2016a). Moreover, in 2011, a special 'electoral period report' was released on the effectiveness of the expenditure ceilings as a fiscal policy governance tool.

The NAOF is an independent institution under the authority of the Finnish Parliament, constituting one of the elements of its supervisory powers. The Finnish constitution guarantees the independence of the NAOF. In addition, the Act on the National Audit Office provides further safeguards for the functional independence of the institution and for the personal independence of the Auditor General (i.e. the head of NAOF). (79) The NAOF has the

(77) It was specified in the so-called Fiscal Policy Act (Law No. 869/2012), adopted by Parliament in late 2012. The main objective of this law was to transpose the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union into the domestic legislative order, and in particular its Fiscal Compact provisions on an independently monitored structural budget balance rule.

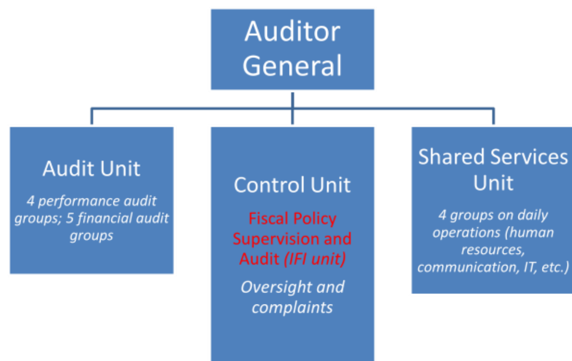
(78) The Finnish spending ceilings in their current form were introduced in 2003. These are expressed in real terms and cover around 80% of the central government budget. To allow automatic stabilisers to work on the expenditure side, several spending items are excluded, most notably unemployment assistance, centrally-funded social assistance, housing allowances, and interest payments (for further details, see e.g. European Commission 2012).

(79) The Auditor General is elected by Parliament for a six-year, renewable term. Candidates are chosen through an open

right to both adopt its own rules of procedure (in the form of a decree issued by the Auditor General) and determine its own working methods.

As regards access to information, the Finnish constitution stipulates the NAOF's right to receive all information and documents from public authorities necessary to carry out its duties. This provision also ensures a robust access to information mechanism for the IFI unit.

Graph 3.3: **The NAOF's stylised organigramme**



Source: Own compilation based on NAOF's website

Concerning the set-up, the final responsibility for the work and organisation of the IFI unit lies with the Auditor General. [80] In practice, the strategic decisions and the day-to-day management are carried out by the responsible director. The IFI unit's size is around 9 persons, but most of the staff members are involved in their individual capacities in non-IFI activities as well. According to OECD (2021), on average, about half of the staff's and the manager's working time is allotted to the IFI function. In terms of resources, the NAOF's rules of procedure [81] state that adequate personnel and other resources should be allocated to the IFI activities within the NAOF's overall endowment envelope. Until recently, the IFI function's budget was not secured in a stable manner (although in practice, the IFI unit had always been provided with the necessary funding). As part of its follow-up of OECD's recent external evaluation (OECD 2021) [82], the NAOF has granted the IFI function its own separate multi-year budget appropriations.

According to the OECD's IFI independence index, the NAOF scores below the OECD average (the scores do not reflect the institutional changes referred in the previous paragraph). This is largely due to the financial and operational independence dimensions, presumably linked to the constraints stemming from its embedded set-up. In general, the average OECD independence index score for IFIs hosted by audit institutions came out considerably worse than standalone fiscal councils or parliamentary budget offices. [83] In fact, the IFI-related literature has traditionally pointed to a risk of incompatibility of hosting an essentially forward-looking IFI in a naturally backward-looking audit institution. [84]

The Finnish constitution confers a broad audit and evaluation mandate on the NAOF in the domain of fiscal policy. The Fiscal Policy Act lays down a more specific task list, centred around NAOF's role as the independent monitoring body of both EU and national numerical rules (for an overview on reporting patterns, see Table 3.2.). Accordingly, the IFI unit regularly reports on compliance with both the SGP rules and the national rules. Beyond the compliance aspects, the monitoring reports also include a conformity assessment of the officially submitted fiscal planning documents, i.e. an assessment of whether all procedural and content requirements are met as prescribed by national legislation. The reports also discuss the past and planned fiscal policy stance, based on both top-down and bottom-up indicators. In 2019, the IFI unit published a dedicated note describing the assessment criteria, methods and data used in its regular fiscal monitoring task; an initiative that could be considered good practice to increase institutional transparency and accountability. [85]

As part of the monitoring of domestic rules, including the medium-term expenditure ceilings, the IFI unit has specific responsibilities in relation

competition organised by the Audit Committee and must possess a higher university degree, strong knowledge of public finances and administration matters, and proven leadership skills and experience.

(80) Until 2020, the Auditor General co-signed all of the fiscal monitoring reports, but this is no longer the case (presumably to signal increased autonomy for the IFI unit).

(81) Section 1 of the NAOF's Rules of Procedure (available only in Finnish).

(82) While the OECD report concluded that the set-up and functioning of the IFI unit was generally aligned with international good practices, it recommended several steps to increase the IFI unit's analytical, operational and financial autonomy.

(83) 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.

(84) See e.g. Kopits (2016), which also raises the issue of potential conflicts of interest if the same institution performs the *ex ante* assessment task of the annual budget bill and subsequently audits it *ex post*.

(85) See for details the methodological note.

to the country's structural budget balance rule. Specifically, the IFI unit is charged to monitor (but not to activate) the correction mechanism under the Fiscal Compact in case of a significant deviation, and provide opinions on the triggering, extending and exiting of its escape clause. In accordance with the Fiscal Compact, Finland's Fiscal Policy Act lays down a comply-or-explain obligation, requiring the government to make a public statement if its views diverge from the IFI's conclusions presented in the compliance reports. ([86])

In the field of macroeconomic forecasts, Finland has a unique institutional model in the euro area: in order to fulfil the two-pack requirements ([87]) on macroeconomic scenarios, the projections underlying Finland's stability programme and annual budget bill are prepared independently by the Economics Department of the Ministry of Finance. ([88]) In turn, the IFI unit's fiscal monitoring reports contain a separate assessment chapter on the plausibility of the official macroeconomic forecast. More importantly, the IFI unit was tasked to carry out the regular and comprehensive *ex post* evaluations of past forecasting performance as required by the Budgetary Framework Directive ([89]), with a view to improving the quality of projections and promoting accountability. Two such evaluation reports were published so far in 2016 and 2018, and the featured statistical analyses were based on an exceptionally long time series, covering 40 years. None of these evaluation reports found any bias in the Ministry of Finance's forecasts for the main macroeconomic variables (GDP growth, inflation, unemployment), and the accuracy of the official projections compared favourably with that of other national and international forecasting bodies. ([90])

In order to supplement the NAOF's monitoring and analytical activities, the Finnish authorities established the Economic Policy Council (EPC) in 2014 by a government decree with a normative mandate, including the provision of policy advice (IMF 2015). The EPC's remit includes opinions on the appropriateness of economic policy goals and institutions, the assessment of targets for economic policy, integrated analysis of different economic policy areas, and the long-term sustainability of public finances. The five members of the EPC - so far exclusively academics - are appointed by the government based on proposals by economics departments in Finnish universities and the Academy of Finland. The founding decree does not provide for separate financing of the EPC: its secretariat works within the functionally autonomous VATT Institute for Economic Research.

([86]) For details, see the Commission's 2017 report on the Finnish transposition arrangements.

([87]) 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.

([88]) To this end, the management of the Economics Department is legally separated from the hierarchical structures of the Ministry as to its forecasting activities. For further details, see Subsection 3.1.1. in EFB (2022b), which presents an overview on how euro-area Member States comply with the two-pack's requirement on the independence of macroeconomic forecasts.

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

([90]) The 2018 report: 'Reliability of macroeconomic forecasts by the Ministry of Finance for the years 1976-2016'

Table 3.2: **Overview of the Finnish IFI unit's key regular reports**

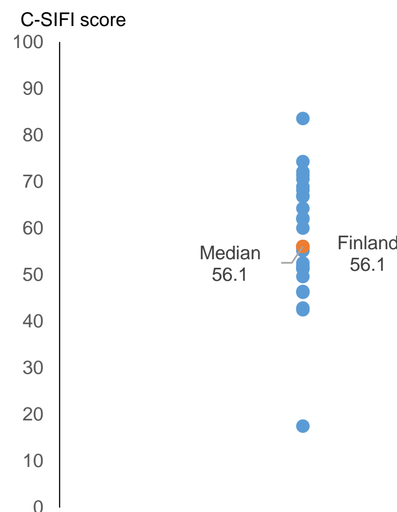
Type of publications	Frequency and timing	Description and comments
Fiscal policy monitoring report	Annual, towards the end of the year (typically in November-December)	The main report of IFI unit that analyses economic and budgetary developments and provides an *ex ante* assessment of the plausibility of meeting the applicable EU and national numerical rules
Fiscal policy monitoring assessment on the management of general government finances	Annual, in May-June each year	Beyond the standard sections on economic and budgetary developments, it contains a conformity and plausibility assessment of the General Government Fiscal Plan (Finland's national medium-term budgetary plan)
Ex post evaluations of the official macroeconomic forecasts	Occasional, since the assignment of this task to the NAOF in 2014, two such reports were published (2016, 2018)	Contains a thorough statistical analysis of the unbiased nature and accuracy of the Ministry of Finance's macroeconomic forecasts underlying fiscal planning
Thematic fiscal policy audit reports (in-depth assessment of the appropriateness of fiscal policy management)	Occasional, on average 2-3 reports a year were published in recent years	The topics include various aspects of public finances, e.g. contingent liabilities, subnational finances, the impacts of tax reforms, medium-term budgeting, and the quality of fiscal statistics.

Note: (1) On the NAOF's webpage, fiscal monitoring reports are also fully available in English (in some cases, posted simultaneously with the original publication), while only the conclusions and recommendations are translated from the fiscal audit reports.
Source: Own compilation

In a broad comparison with other EU IFIs, the extent of the tasks carried out by the NAOF's IFI unit is around the average. This is illustrated by Finland's matching median score on the European Commission's country-specific Scope Index of Fiscal Institutions (C-SIFI), which measures the breadth of IFI mandates ([91]) (Graph 3.4). This position should be seen against the backdrop that – as recalled earlier – some customary IFI tasks, such as the independent production of the macroeconomic forecast and the provision of fiscal-policy advice, are performed by other independent entities in Finland that are not covered by the Commission's database.

It is very difficult to assess the impact of IFIs, especially when fiscal policy is overall disciplined, such as the case for Finland during the period under review. The IFI unit has so far never recommended the activation of the correction mechanism under the Fiscal Compact or assessed the official forecasts as overoptimistic.

Graph 3.4: **Country-specific Scope Index of Fiscal Institutions (C-SIFI): position of Finland in 2021**



Note: (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 explicitly contained in the official mandates. The score ranges from 0 to 100 (full coverage).
Source: European Commission's fiscal governance database

Another complication for gauging its influence is that the IFI unit does not have a distinct public profile from the NAOF, so its activities are widely perceived as simply being part of the institution's overall audit function. This being said, based on many stakeholder interviews, the OECD (2021) concluded that the IFI unit had played a successful role in steering Finnish fiscal policy since its creation and was assessed as a credible and technically able entity overall.

([91]) 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.

Indeed, there were a number of cases where the Finnish authorities made amendments in their fiscal planning and implementation procedures following the IFI unit's advice. For example, in its comprehensive fiscal policy audit of the official macroeconomic forecast in 2016, the IFI unit addressed a number of recommendations to the government to improve the transparency and accountability of the forecasting process. Subsequently, Finland's Ministry of Finance published a technical paper with a detailed description of its fiscal forecasting methods. Moreover, starting in 2017, the Ministry began to publish an annual analysis of the sources of its own forecast errors for key economic variables (i.e. the difference between the official projections and the first-release statistical outcome). (92)

3.2.2. France

Like most EU Member States, France has decided to put a single IFI, the High Council of Public Finances (HCPF) in charge of EU-mandated IFI tasks. The HCPF was established by organic law in 2012 (93) and became operational in spring 2013. The HCPF is an independent body that is administratively attached to the French Court of Auditors (CoA), the country's supreme audit institution. As reported in OECD (2016b), the creation of a standalone IFI was also considered in the domestic policy debate in the early 2010s. When France's signature of the Fiscal Compact necessitated the creation of an independent monitoring body, the final decision was to attach the new entity to the CoA. This was chiefly motivated by the CoA's longstanding track-record in the *ex post* control of public accounts and the certification of budgetary implementation.

The HCPF's governing body is composed of 11 members (non-paid for this function). Two of these are *ex officio* members: the first President of the Court of Auditors (serves as the HCPF's chair) and the Director-General of the National Institute of Statistics and Economic Studies. In addition, four established CoA magistrates are appointed by the first President. The remaining five members must possess qualifications in the field of public finances or macroeconomic forecasting. They are each nominated by the presidents of the following 5 official bodies: (i) the National Assembly (i.e. the lower chamber of Parliament); (ii) the Senate; (iii) the Finance Committee of the National Assembly; (iv) the Finance Committee of the Senate; and (v) the Economic, Social and Environmental Council. It is worth highlighting that there are strict gender-balance requirements in place governing the appointment procedure.

The term of all nine appointed HCPF members is 5 years. The mandate is renewable once for the magistrates of the Court, but not renewable for the other five experts. To ensure staggered mandates, the terms of four members were set at two and half years when the institution was founded in 2013 (selected randomly by drawing lots).

There are a number of safeguards for the HCPF's independence. The organic law stipulates that members of the HCPF must not seek or take instructions from the French authorities or from any public or private person. HCPF's membership cannot be combined with a political office. Dismissal is limited to cases of physical incapacity or serious misconduct. The HCPF's access to information is ensured through the government's legal obligation to reply to its requests for information. It is further strengthened by the HCPF's right to call qualified personnel from public authorities in the area of public finances to testify.

In addition, there are provisions to ensure the HCPF's autonomy from its host entity, the CoA. The HCPF's impartiality is further assisted by the fact that the number of non-CoA affiliated Council members is greater than those hailing from the CoA. In this context, the HCPF's institutional reputation benefits from the nomination rules, according to which members are appointed by six different authorities. (94) This feature could itself strengthen the autonomy of organisations constituted as a college of experts, as was observed in relation to judicial bodies in advanced countries with much longer historical records. (95)

(92) See for details the 'Fiscal Policy Monitoring and Audit Report on the 2015–2018 Parliamentary Term'.

(93) Organic Law No. 2012-1403 of 17 December 2012 on the Programming and Governance of the Public Finances. Its main purpose was transposition of the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union into the French legislative order. The organic law is of a supra-legislative nature and thereby takes precedence over the annual budget bills and social security financing laws.

(94) It is to be recalled that the appointing authorities *de facto* include representatives from the opposition parties as the Finance Committees of both the National Assembly and Senate are traditionally chaired by opposition politicians.

(95) Brinks and Blass (2017) show for judicial bodies (most notably, supreme courts and constitutional courts) that the more

The HCPF's work is supported by a permanent secretariat of nine persons (the size roughly doubled in recent years). The secretariat is headed by a general rapporteur. The secretariat may draw on its budget to secure external expertise for certain matters.

The HCPF's mandate is centred around the core tasks mandated by EU-law , featuring most notably the monitoring of compliance with fiscal rules and the independent endorsement [96] of official macroeconomic forecasts (see also Table 3.3 for the regular reports). As laid down in the organic law, monitoring is carried out both *ex ante* and *ex post*. In the case of the former, the consistency of the multiannual programming law is assessed specifically to verify whether the structural balance targets defined for a five-year horizon are consistent with the rules of the EU fiscal framework, and most notably with the country's MTO. Throughout the programme horizon, the annual budget documents are scrutinised to check whether the budgeted structural balance is in line with the respective deficit trajectory laid down in the programming law.

On *ex post* monitoring, the HCPF has in principle strong privileges. France is one of the few contracting parties to the Fiscal Compact (alongside Belgium and Bulgaria) that in principle make the activation of the national correction mechanism automatic when its monitoring IFI concludes that there is a significant deviation. This responsibility is exercised when the HCPF assesses the budget settlement bill for the previous year. Concerning other potential IFI functions in relation to the national structural budget balance rule (namely the assessment of both the progress with the fiscal corrective actions and the existence of exceptional circumstances to activate the escape clause), the HCPF's opinions are subject to the comply-or-explain principle as demanded by the Fiscal Compact. [97]

Notwithstanding the above-described responsibilities, the only episode so far when the HCPF triggered the French correction mechanism was in May 2014. However, it had ultimately no effect as the HCPF's decision was *de facto* circumvented by the government. Instead of deciding on additional adjustment measures as laid down in the organic law, the French authorities extraordinarily adopted a new multiannual programming law in September 2014 (i.e. 3 years earlier than ordinarily scheduled). The new programme backloaded the necessary fiscal consolidation by roughly halving the planned structural adjustment for the forthcoming years compared to the trajectory set in the 2012 programming law. [98]

The HCPF is tasked with independently endorsing the government's macroeconomic forecasts underpinning the official medium-term and annual fiscal plans. In practice, the endorsement decisions and the related analysis are published as a dedicated section of the HCPF's opinions on the fiscal planning documents. While there has so far not been any precedent for non-endorsement, the HCPF has on a number of episodes expressed reservations about the plausibility of the official economic projections. The most critical remarks in relation to macroeconomic projections to date were arguably on the opinion of the 2017 draft budget bill, where the HCPF stated that the government's GDP growth forecast for 2017 tended '*to deviate from the principle of prudence*'. [99]

Overall, in a broad comparison with other EU IFIs, the extent of the mandate covered by the HCPF is relatively narrow. This is illustrated by France'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 (Graph 3.5). This is largely explained by the reported absence of activities in the areas of long-term sustainability assessments, active promotion of fiscal transparency and normative recommendations. It is also linked to the fact that not all domestic numerical rules are monitored by the HCPF.

institutions participate in the appointment process, the greater is their autonomy.

(96) The organic law tasked the HCPF with 'delivering an opinion' ('rendre un avis') on the realism of the government's macroeconomic forecasts underpinning fiscal plans. Since 2014, the EU Council opinions on the French stability programmes and the Commission opinions on the French draft budgetary plans have consistently treated these HCPF's opinions as fulfilling the independent endorsement requirement set out in the two-pack.

(97) For details, see the Commission's 2017 report on the French transposition arrangements.

(98) Avis relatif au projet de loi de programmation des finances publiques pour les années 2014 à 2019. The new programming law formally replaced the structural deficit targets and the corresponding planned structural adjustments compared to the trajectory laid down in the 2012 December programming law. In its activity report, the HCPF overall concluded that: 'The frequency with which programming bills are passed appears to be too high for the correction mechanism to be able to properly function.' Activity Report 2015-2018.

(99) Opinion 2016-03 of the High Council of Public Finance on the budget bill for 2017.

Table 3.3: **Overview of the HCPF's key regular reports**

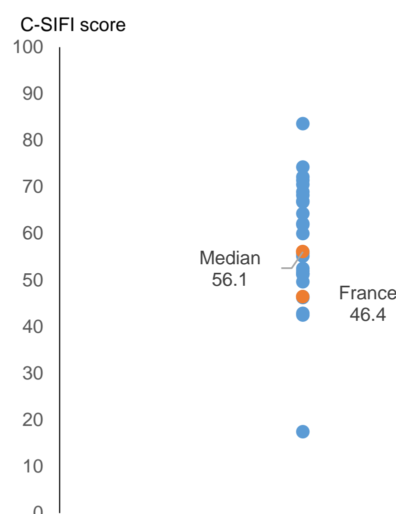
Type of publications	Frequency and timing	Description and comments
Opinion on the annual fiscal planning documents (draft budget and social security financing bills) and their amendments	Annual, in September for the regular draft bills (as needed for the amending budget bills)	It contains the HCPF's decision on the endorsement of the government's macroeconomic scenario and the related analysis. Based on a plausibility assessment of the budgeted expenditures and revenues, it also provides for an *ex ante* compliance check of the planned structural balances against the applicable targets set in the multiannual programming law.
Opinions on the budget settlement bill (prepared for the previous year)	Annual, in late spring, or early summer each year	The purpose of this report is to provide an *ex post* assessment on the achievement of the structural balance target as defined in the multiannual programming law.
Opinion on the French stability programme	Annual, in April each year	The opinion focuses on the plausibility of the underlying medium-term macroeconomic scenario (and the related endorsement decision) and does not discuss the fiscal plans.
Opinion on the public finance programming bill	In principle every 5 years	Beyond the analysis of the underlying medium-term macroeconomic scenario, the opinion assesses the consistency of the government's fiscal targets against the country's MTO or other relevant SGP requirements.
Staff working papers and methodological notes	Occasional, on average 2-3 papers a year were published since the launch of this series in 2020	The topics include various aspects of fiscal policy analysis, e.g. potential growth, budgetary impacts of high inflation, labour market forecasts, state guarantees.

Note: (1) With the exception of the 2013-2015 period, all the opinions on budget planning documents are also available in English, while only the more recent staff working documents are translated.
Source: Own compilation

As a recent extension of the mandate, in December 2021, the HCPF was legally tasked [100] with carrying out regular and comprehensive *ex post* evaluations of the government's macroeconomic and fiscal forecasts as required by the Budgetary Frameworks Directive (see also the related discussion about the Finnish IFI in the previous subsection). To date, no such backward-looking analysis of the official forecasting performance was published by the HCPF.

As reported in Merlo and Fasone (2021), the HCPF's opinions, and in particular the more critical ones typically trigger lively parliamentary exchanges. In general, these opinions have become reference points in domestic fiscal-policy debates. Moreover, some of these reports have even been used by opposition parties to challenge the validity of the adopted annual budget act in front of the French Constitutional Council (so far to no avail). Indeed, in some cases the HCPF expressed strong reservations about the government plans. A prominent episode was in 2017, when it assessed the planned structural adjustments set out in the multiannual programming law for 2018-2022 as insufficiently ambitious. In particular, the HCPF criticised the deferral of the MTO achievement beyond the horizon of the programming law. [101]

Graph 3.5: **Country-specific Scope Index of Fiscal Institutions (C-SIFI): position of France in 2021**



Note: (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 explicitly contained in the official mandates. The score ranges from 0 to 100 (full coverage).
Source: European Commission's fiscal governance database

[100] This was one element of the fiscal governance reforms contained in the French recovery and resilience plan.

[101] Opinion on the public finance programming bill for the years 2018 to 2022.

4. ASSESSMENT OF THE FISCAL STANCE IN 2022

Highlights

- Fiscal guidance for 2022 was issued at a time when a strong economic recovery was under way and the epidemiological outlook improving. The euro area was expected to return to its pre-pandemic levels of real GDP by the first quarter of 2022.

- The severe economic downturn clause remained active, and the Commission only issued qualitative fiscal guidance. In its euro-area recommendation, the Commission and Eurogroup called for a moderately expansionary fiscal impulse for 2022. This guidance seemed counterintuitive given the projected strong economic performance, brightening outlook, and tight labour markets.

- However, the Commission excluded Covid support measures from its estimates of the fiscal impulse. Due to the expected withdrawal of these measures in 2022, the Commission's recommendation was consistent with a contractionary fiscal impulse.

- The EFB uses the unadjusted fiscal impulse, because Covid support measures propped up aggregate demand too. In its recommendation issued in June 2021, the EFB called for a restrictive fiscal impulse in 2022.

- Following Russia's war of aggression against Ukraine and soaring energy prices, EU governments launched new support measures of close to 1% of GDP. As these were largely debt-financed they partly offset the envisaged withdrawal of Covid support measures, leading to an overall restrictive fiscal impulse of close to ¾% of GDP.

- The war in Ukraine triggered a terms-of-trade shock. The war has primarily affected aggregate supply, which means a broad-based fiscal expansion is likely to have counterproductive effects on inflationary pressure without addressing the problem at its core. Any support measures should operate within planned budgets by reallocating funds to vulnerable households and firms. Regrettably, initial fiscal measures were largely untargeted and increased deficits.

- Viewed against the receding economic slack and robust economic performance, the decrease in discretionary fiscal support in 2022 constituted an example of a counter-cyclical fiscal policy response. However, while fiscal deficits declined, the level of fiscal support remained substantial. With the benefit of hindsight, a more restrictive fiscal impulse would have been warranted.

- After years of exceptionally accommodative monetary policy, the ECB reacted to soaring energy prices and high inflation with a steep increase in monetary policy rates in 2022, which continued in 2023. Against this background, a swifter withdrawal of discretionary fiscal support would have helped the ECB in the pursuit of its inflation target.

- Member States' individual contributions to the euro-area fiscal impulse in 2022 could have been improved. Countries with very high levels of debt should have moved decisively towards prudent fiscal positions, thereby contributing proportionally more to the restrictive fiscal impulse of the euro area. In 2022, all Member States adopted a restrictive fiscal impulse.

- Very high-debt countries supported deficit reduction only in proportion to their share of euro-area output, despite having some of the worst deficit starting positions and a conducive economic environment. Excluding Covid-related and energy support measures, very high-debt countries had an expansionary impulse.

This chapter provides a backward-looking assessment of the euro-area fiscal stance in 2022. The first part of this chapter reviews and compares the guidance issued by the Commission, the Council and the EFB in 2021 based on information available at the time. The second part of this chapter uses the latest information to assess 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 must be made between the fiscal stance and the fiscal impulse (EFB, 2021a). The EFB defines the discretionary fiscal stance 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 derived from the expenditure benchmark (see Glossary). 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 recoveries. For instance, a slightly contractionary fiscal impulse might still coincide with a continued supportive fiscal environment (i.e. fiscal stance), when a large part of the fiscal support introduced in the previous years is still carried over. (102) Notably, the fiscal impulse and fiscal stance are only an approximation of the impact of discretionary fiscal policy on aggregate demand due to several uncertainties affecting its measurement (see Glossary). In the following sections of this chapter, the fiscal stance and fiscal impulse are analysed in the context of the extent and dynamics of cyclical conditions.

4.1. GUIDANCE ISSUED IN 2021

EU policy guidance for 2022, issued in 2021, was marked by continued but improving circumstances. The epidemiological outlook brightened over the course of 2021 and Covid-related disruptions to economic activity were receding. Despite persisting uncertainty, most forecasts projected a continued strong recovery in economic growth in 2022. Supply-chain disruptions and labour shortages were viewed as increasingly constraining factors. Mounting inflationary pressures only became apparent during the end of 2021 and intensified over the course of 2022, but these pressures were not anticipated when policy guidance was issued in spring 2021.

According to the Commission's spring forecast issued in 2021, real economic activity in the euro area was projected to expand by 4.4% in 2022, virtually at the same speed as in 2021. Thanks to the strong rebound in economic growth, nearly all EU Member States (103) were expected to exceed their pre-pandemic levels of annual real GDP by the end of 2022. The euro area as a whole was anticipated to return to pre-crisis levels of real GDP as early as by the mid-2022 on a quarterly basis. The continued strong economic expansion was already forecast in 2021 despite the projected halving of the government headline and structural deficits in 2022. Although the fiscal impulse in 2022 was expected to be decidedly contractionary at 2.4% of GDP, the overall fiscal stance was forecast to remain supportive with a structural primary deficit of 2.4% of GDP.

As in the previous year, the EU's recommendations published in spring 2021 only issued qualitative fiscal guidance to Member States for 2022 (Chapter 2). Even earlier in March 2021, the Commission opted to provide fiscal guidelines for the euro area as a whole as part of the Communication '*One year since the outbreak of Covid-19: fiscal policy response*'.

Notably, in autumn 2020, the Commission started to exclude Covid-related temporary emergency measures in its metric of the fiscal impulse. (104) The Commission maintained that Covid-related temporary emergency measures should be separated out from the conventional fiscal impulse metric since those exceptional measures were expected to be temporary and have limited impact on aggregate demand given prevailing lockdowns at the time. (105) However, the impact of any fiscal measures on aggregate demand varies depending on the type of measure, the fiscal multipliers and other factors. Importantly, the fiscal impulse has

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

(103) Except Italy, whose annual real GDP remained 1% below its pre-pandemic level.

(104) Since autumn 2021, the European Commission has assessed the fiscal impulse based on the expenditure benchmark, from which Covid-related temporary emergency measures are excluded, while the impact of the RRF grants on aggregate demand is included (see EFB, 2022a).

(105) European Commission (2020) communication on the 2021 Draft Budgetary Plans: Overall Assessment.

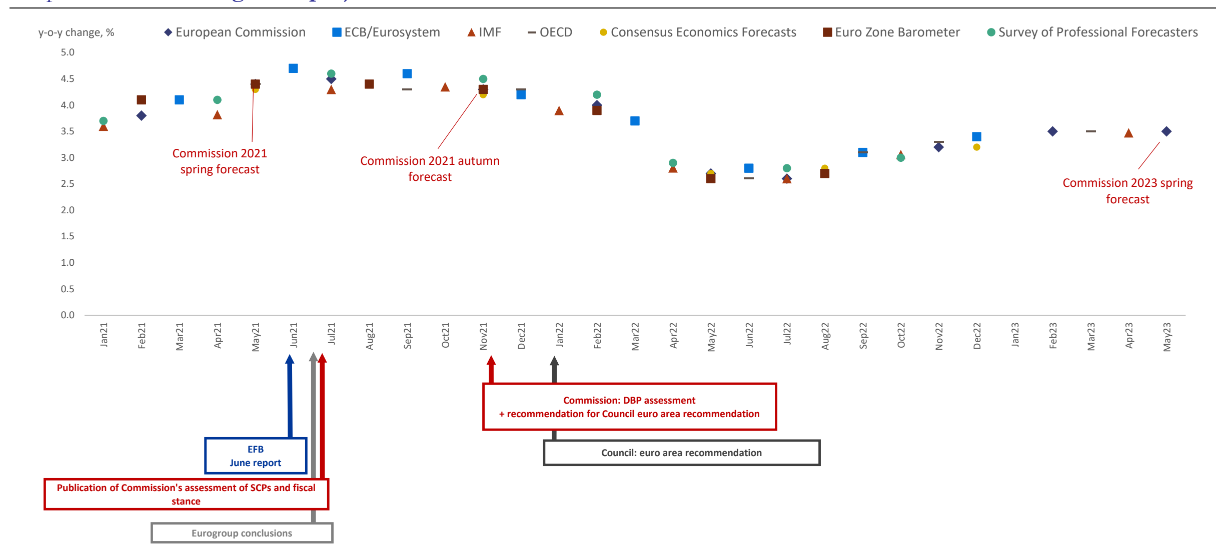
always been only an approximation of the impact of discretionary fiscal measures on aggregate demand. By contrast, the EFB has opted to: (i) use the fiscal impulse metric unadjusted for Covid-related measures as the starting point in its assessment; and (ii) highlighted the impact of Covid-related emergency measures in a subsequent analysis (EFB 2022a). The decision by the Commission to separate out Covid-related measures in its assessment of the fiscal impulse has made comparisons over time and with other institutions, including the EFB, more complex.

Against this background, the Commission's March 2021 Communication called for a supportive fiscal impulse for 2022, after separating out Covid-related emergency measures. This seems counterintuitive in light of the expected strong economic growth and speedy reduction in economic slack. Moreover, at first glance the recommendation seems to clash with the subsequent recommendation of the EFB in June 2021 for a restrictive fiscal impulse in 2022. However, in all likelihood the Commission and EFB advice amount to the same fiscal orientation. This is because Covid-related emergency measures were estimated at close to 4% of GDP in 2021 and projected to decline to around 1% of GDP in 2022. The withdrawal of these measures would exert a large restrictive fiscal impulse by itself. Hence, the Commission's recommended supportive fiscal impulse augmented by this withdrawal would almost certainly lead to an overall restrictive fiscal impulse. And indeed at the time, the fiscal impulse was projected to turn highly restrictive in 2022 by 2.4% of GDP. However, if Covid-related measures are excluded, the fiscal impulse was projected to be slightly expansionary (¼ % of GDP). Thus, both recommendations (that of the Commission and that of the EFB) would have been followed.

As detailed in Chapter 2, the March 2021 Commission Communication started to differentiate fiscal guidance by groups of Member States. Countries with low debt-sustainability risks were encouraged to support their economies further, taking into account the impact of RRF grants on increasing aggregate demand. 'High-debt' countries were advised to implement prudent fiscal policies but not to constrain public investment. This approach was followed in the fiscal recommendations to individual Member States.

In its overview of the SCPs in July 2021, the Commission reiterated the need for a supportive euro-area fiscal impulse in 2022 (excluding Covid-related temporary emergency measures) and asserted that the implied impulse by the SCPs was broadly in line with this recommendation. However, the fiscal guidance for 2022 had also suggested that growth in nationally financed current expenditure should be kept under control and even restricted in the case of 'high debt' countries. Several Member States were in danger of failing to achieve this, as those expenditures were projected to exceed the medium-term growth rate of potential output, based on the Commission's 2021 spring forecast. Moreover, the Commission noted that the composition of Member States'

Graph 4.1: **Real GDP growth projections for the euro area for 2022**



Note: The ECB/Eurosystem and the OECD report working-day adjusted growth rates, while the European Commission and the IMF report unadjusted numbers.
Source: EFB based on European Commission, ECB, IMF and OECD data.

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

- **3 March 2021: Commission Communication on One year since the outbreak of COVID-19: fiscal policy response (excerpts):**

Real GDP is now expected to reach pre-crisis levels in the second quarter of 2022 on average in the EU and the euro area. […] Discretionary fiscal policy support is projected to gradually decline, due to the withdrawal or expiry of emergency measures. […] Member States should as part of a well-sequenced and gradual withdrawal of policy support and, at the appropriate moment, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions, while enhancing investment. […] The overall fiscal impulse, stemming from national budgets and the RRF, needs to remain supportive in 2021 and 2022 ([1]). […] Increased differentiation in fiscal guidance to Member States should go hand-in-hand with an overall supportive fiscal stance in 2022, avoiding a premature withdrawal of fiscal support. […] Member States with low sustainability risks should gear their budgets towards maintaining a supportive fiscal policy in 2022, taking into account the impact of the RRF. […] Member States with high debt levels should pursue prudent fiscal policies, while preserving nationally-financed investment and using RRF grants to fund […] investment.

- **15 March 2021: Eurogroup, remarks by Paschal Donohoe following the Eurogroup video conference of 15 March 2021 (excerpts):**

Today, the Eurogroup agreed on the need to keep a budgetary stance in 2021 and in 2022, which will be supportive and which will pave the way for recovery. […] The measures we will take to achieve this will continue to be timely. They will continue to be temporary. And they will continue to be targeted. […] As the health situation improves, the focus of our measures will gradually shift to promoting a resilient and sustainable recovery. Once the recovery is firmly underway, it will be important to address the challenges that are posed by increased debt levels.

- **2 June 2021: Commission Omnibus report under Article 126(3) of the TFEU (excerpts):**

Member States' fiscal policies should become more differentiated in 2022 as economic activity gradually normalises in the second half of 2021. Fiscal policies should take into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. As the recovery takes hold, fiscal policy should prioritise higher public and private investment, supporting the transition towards a green and digital economy.

- **16 June 2021: the EFB's June 2021 report had the objective of reviewing the situation/outlook and providing input to Member States' draft budget plans for 2022 (excerpts):**

The fiscal stance of the euro area is expected to remain supportive in 2022. […] The current economic outlook still warrants a supportive fiscal stance in 2022 ([2]). […] The appropriate fiscal stance in 2022 is compatible with a gradual withdrawal of the large-scale expansion adopted in response to the pandemic […] emergency measures should be withdrawn in lockstep with the ebbing health crisis while total government expenditures still remain above pre-crisis levels. […] Fiscal measures should become more targeted as the health crisis recedes.

- **12 July 2021: Eurogroup, remarks by Paschal Donohoe following the Eurogroup meeting of 12 July 2021 (excerpts):**

Our discussion today showed that ministers and institutions remain in agreement that a supportive fiscal stance is appropriate in the euro area as a whole in the coming year, and that the planned fiscal support seems sufficient at the current juncture. A gradual shift in the focus of measures from emergency to recovery support is underway, and we will need to maintain policy agility going forward. The messages that we outlined in our March fiscal policy statement are still ones that we are committed to and they remain valid.

([1]) In Commission and Council documents, the fiscal stance refers to the change in the level of discretionary fiscal support, measured by the change in the structural primary balance or the expenditure benchmark. However, it excludes Covid-related temporary emergency measures and includes the impact of the RRF grants. In this particular excerpt, the Commission uses the term 'fiscal impulse' synonymously with the term 'fiscal stance'.
([2]) The EFB uses 'fiscal stance' to describe the level of discretionary fiscal support (i.e. the structural primary balance) while the change in the structural primary balance is referred to as the 'fiscal impulse'. Neither the fiscal stance nor the fiscal impulse is adjusted for Covid-related temporary emergency measures and neither include the impact of RRF grants.

(Continued on the next page)

Box (continued)

- **16 July 2021: Commission paper on the 2021 Stability & Convergence Programmes – An Overview, with an Assessment of the Euro Area Fiscal Stance (excerpts):**

Including the fiscal impulse provided at the EU level through the Recovery and Resilience Facility (RRF) and setting aside the phasing out of temporary emergency measures, fiscal policies will provide additional support to aggregate demand in the euro area of […] slightly more than ¼% of GDP in 2022. In 2022, this is partly due to increases in nationally-financed current expenditure, which are expected to continue to exceed the rate of medium-term potential growth. […] The growth of nationally-financed current expenditure (net of discretionary revenue measures) should be kept under control, and be limited for Member States with high debt. […] Fiscal policy needs to remain supportive in 2022. […] While fiscal stances differ significantly across Member States, the projected aggregate fiscal stance in 2022 appears broadly appropriate.

- **24 November 2021: the Commission's overall assessment of the 2022 DBPs (excerpts):**

While the aggregate euro area fiscal stance is supportive in 2022, its composition could be improved. […] [A] further increase in nationally financed current expenditure above potential growth is expected in 2022 in several Member States, including some with high debt-sustainability risks. […] Moreover, for high-debt Member States, limiting the growth of current expenditure will help to pursue a prudent fiscal policy, as recommended by the Council.

- **24 November 2021: Commission Recommendation for the Council Recommendation on the economic policy of the euro area (excerpts):**

The euro area fiscal stance, stemming from national budgets and the EU budget, is projected to remain supportive in 2021 and 2022 (1¾ % and 1 % of GDP, respectively). […] [recommends to] maintain a moderately supportive fiscal stance in 2022 across the euro area, taking into account national budgets and the funding provided by the Recovery and Resilience Facility. […] Keep fiscal policy agile in order to be able to react if pandemic risks re-emerge. Differentiate fiscal policies taking into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial divergences. Once economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

- **24 November 2021: Commission staff working document accompanying the Recommendation for a Council Recommendation on the economic policy of the euro area (excerpts):**

With the economic recovery taking hold, fiscal policy is expected to pivot from temporary emergency measures to recovery support measures in 2022. […] In contrast to the gradual winding down of temporary emergency measures, the cost of recovery support measures (in part funded by RRF grants) is expected to increase […]. [A] fiscal expansion of about 1% of GDP is forecast in the euro area for 2022, with almost all Member States expected to maintain a supportive fiscal stance. While the aggregate euro area fiscal stance appears appropriate in 2022, a better composition and calibration could better contribute to medium-term fiscal sustainability.

- **6 December 2021: 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):**

Thanks to the swift, sizeable, and well-coordinated policy action at the EU, euro-area and national level […] the euro area economy is recovering from the recession faster than expected. […] The euro area economy is expected to return to its pre-pandemic levels already by the end of the year in quarterly terms. […] The strong rebound in economic activity has gone alongside an increase in inflationary pressures. […] The Eurogroup agrees that a moderately supportive fiscal stance in the euro area for 2022 is appropriate for the recovery to maintain traction in the near term, also in light of the downside risks, which remain pronounced and some have already started to materialize. […] We agree with the Commission's assessment that the individual Draft Budgetary Plans are broadly in line with the fiscal policy recommendation adopted by the Council on 18 June 2021. […] The Eurogroup agrees that Member States with low or medium debt should pursue a supportive fiscal stance in 2022, while Member States with high debt should use the RRF to finance additional investment in support of the recovery, while pursuing a prudent fiscal policy. […] The Eurogroup invites those high-debt Member States, where the growth of the nationally financed current expenditure is not planned to be sufficiently limited according to the Commission's assessment, to take the necessary measures within the national budgetary process.

fiscal impulse could be improved by shifting from emergency relief to building long-term resilience, in particular by facilitating the green and digital transition.

The Commission's draft recommendation for the euro-area fiscal stance issued in the autumn of 2021 became more precise as to the scale of the recommended fiscal expansion, once corrected for Covid-related emergency measures. Despite a largely unchanged economic growth outlook, the document specified that the euro-area fiscal impulse for 2022 should be *moderately* expansionary, once corrected for the withdrawal of pandemic-related emergency measures. The Eurogroup statement of December 2021 also called for a moderately expansionary fiscal impulse.

According to the Commission's autumn forecast 2021 real economic growth surprised slightly on the upside while the fiscal impulse pointed to a somewhat slower reduction in the structural primary deficit of around 1 2/3% of GDP. Similarly, once adjusted for Covid-related emergency measures, the fiscal impulse was projected to be more expansionary than previously expected, at close to 1% of GDP.

4.2. FINAL ASSESSMENT

The remainder of this chapter discusses whether, with hindsight, the fiscal stance and fiscal impulse in 2022 were appropriate given the economic circumstances.

Was the guidance on the aggregate fiscal stance appropriate?

Guidance issued for 2022 has to be assessed in the context of the specific circumstances of the surveillance cycle. A strong recovery in the euro-area economy was already underway in 2021, accompanied by new waves of infections the effective roll-out of vaccinations. Subsequently, fiscal guidance for 2022 issued in 2021 was overtaken by the war in Ukraine, which started in February 2022. The war dampened the economic outlook, sent inflation soaring, and called for a recalibration of fiscal and monetary policy. Thus, the full surveillance cycle saw a transition from one crisis to another: an abating Covid-crisis superseded by an energy crisis.

Because the extensive interpretation of the severe economic downturn clause was also applied in 2022, the Commission only issued qualitative guidance with some quantitative underpinnings in spring 2021. This meant that it was not possible to derive an implied numerical fiscal impulse for the euro area. By contrast, the euro-area recommendation of autumn 2021 made a concrete recommendation for a moderately expansionary fiscal impulse, after separating out Covid-related temporary emergency measures. The euro-area recommendation also called on governments to control the growth of nationally financed current expenditure (net of discretionary revenue measures). Taken together, this have implied achieving a supportive impulse by increasing government investment – either nationally financed investment or via investment supported by the RRF grants.

Given the cyclical improvement in the economy that was already visible in 2021 and in light of the expected phasing out of large-scale Covid-related emergency measures, a call for a moderately expansionary impulse from other discretionary measures, particularly investment, was reasonable. This would help to avoid an excessively abrupt withdrawal of overall fiscal support while still putting structural deficits on a substantially declining path. Notably, the crucial specification of a 'moderately' expansionary fiscal impulse was not explicitly ([106]) part of the spring package issue in 2021 but was only introduced in the euro-area recommendation of autumn that same year. With the benefit of hindsight, the Commission, in its final assessment, effectively regarded both an expansionary and a restrictive fiscal impulse as appropriate (Chapter 2).

Was the actual aggregate fiscal stance appropriate?

The energy crisis is a result of an adverse terms-of-trade shock that started with the war in Ukraine. ([107]) Since Russia's invasion of Ukraine in 2022, EU society has seen its disposable income deteriorate, because it is a net importer of energy and energy-related products. Aggregate supply has been curtailed due to soaring energy prices and shortages. In this situation, fiscal policy should not pursue broad-based fiscal expansion since conventional demand management is likely to have counterproductive effects on inflationary pressure

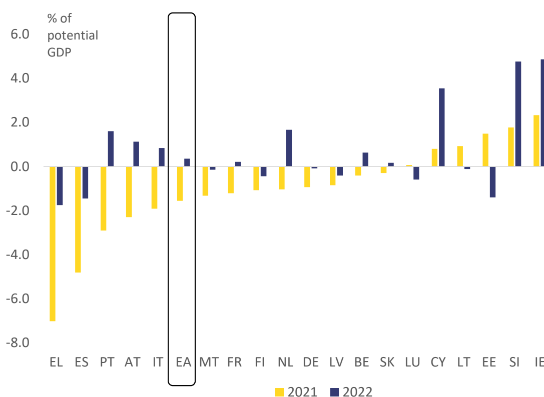
([106]) The upper bound was only implicitly and vaguely set through the reference to controlling nationally financed current expenditure.

([107]) See EFB 2023.

without addressing the problem at its core. Instead, fiscal policy should focus on vulnerable households and adversely affected firms by implementing targeted and temporary measures. Cyclical conditions should remain the guiding principle for the appropriate fiscal policy stance.

Economic slack declined rapidly in 2022 despite the impact of the energy crisis. Real GDP growth at close to 3 ½% remained above the pre-pandemic average. The euro-area output gap turned from excess capacity of close to 2% to economic output slightly above potential (Graph 4.2). Measuring economic slack is particularly challenging following a severe economic downturn and during the subsequent recovery phase. This is due to possible 'scarring effects' that may have reduced potential output; the Covid and the energy price shocks fall into that category. However, other, more observable indicators support the results of the output gap estimation for 2022. The labour market remained exceptionally tight in 2022, with a historically low unemployment rate of 6.8% and a record high vacancy rate, at above 3% in the euro area.

Graph 4.2: **Output gap in 2021 and 2022**

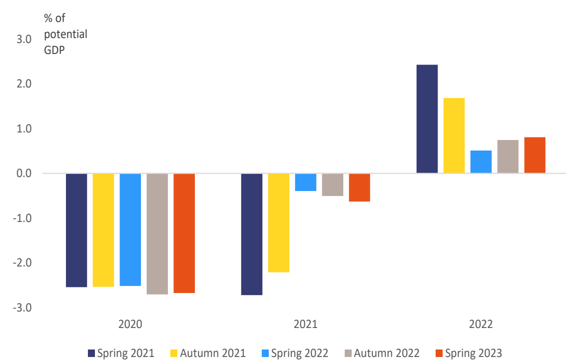


Source: EFB, based on European Commission 2023 spring forecast data.

The interaction between fiscal and monetary policy radically shifted in 2022. The previous decade had been marked by low inflation despite monetary policy having tilted to policy rates at the lower bound. Against these circumstances, expansionary fiscal policy supported monetary policy in pursuit of the inflation target, while low interest rates aided government borrowing – a phase in which fiscal and monetary policy were mutually strategically complementary. The reaction of fiscal policy to the inflation spike that started in 2021 and drastically intensified in 2022 put an end to this complementarity. Fiscal policy subsequently became too expansionary in face of a terms-of-trade shock, which made it harder for monetary policy to rein in rising inflation. At the same time, rising interest rates increased sovereign borrowing costs, which will exert pressure on public finances.

Two countervailing trends drove fiscal policy in 2022: the phase-out of Covid-related measures and the introduction of measures to support households and firms coping with soaring energy prices. The Covid-related support measures were reduced by close to 2.5% of GDP, while energy support measures amounted to 1.2% of GDP (Section 1). Overall, the headline deficit for the euro area shrank by close to 1.5% of GDP in 2022. Given the cyclical improvement in economic growth, this translated into a reduction in the structural primary balance from 2.8% of GDP in 2021 to 2.0% of GDP in 2022 – in other words a sizeable restrictive fiscal impulse. However, the withdrawal of discretionary fiscal support remained less than had been expected before to the energy crisis, but slightly more than thought at the onset of the war in Ukraine (Graph 4.3).

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



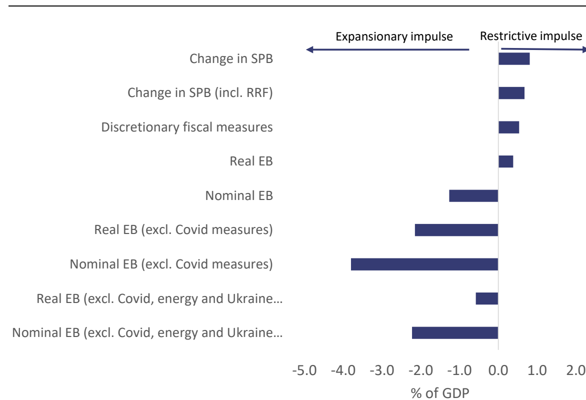
Note: A negative value indicates an expansionary fiscal impulse (i.e. change in structural primary balance).
Source: EFB, based on European Commission forecast data from different vintages.

The special treatment of Covid-related temporary emergency measures and RRF grants by the Commission has resulted in a multitude of metrics that can be considered in the assessment of the fiscal impulse (Graph 4.4). Nevertheless, the impact of the RRF grants on aggregate demand compared to the previous year is marginal.

The conventional metric based on the structural primary balance and the metric based on a summation of discretionary fiscal measures both indicate that there was a sizeable restrictive fiscal impulse in 2022. The fiscal impulse can also be

derived from the expenditure benchmark (EB) (see Glossary). For 2022, the EB approach shows a slightly less restrictive fiscal impulse for the euro area than the other two metrics since the EB approach has a smoothing effect over the business cycle compared with the structural primary balance approach. Overall, all these indicators show a similar orientation in fiscal policy.

Graph 4.4: **Euro-area fiscal impulse in 2022 by different metrics**

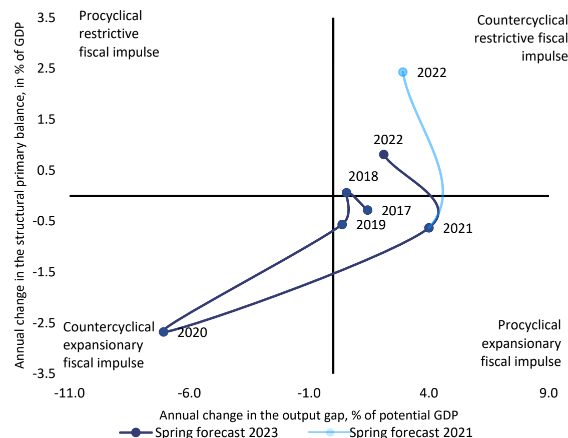


Notes: (1) SPB stands for structural primary balance; EB stands for expenditure benchmark; RRF stands for the Recovery and Resilience Facility.
(2) Discretionary measures represent the incremental budgetary impact of adopted or credibly announced measures, as compared with a 'no policy-change' forecast 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).
(4) The fiscal impulse based on a 'real' EB relies on outturn data for the GDP deflator while a 'nominal' EB relies on a frozen GDP deflator from the spring forecast of the preceding year (2021) to derive the benchmark and uses the outturn GDP deflator for the actual net expenditure growth.
Source: EFB, based on European Commission 2023 spring forecast data.

However, in its final assessment, the Commission switched from a 'nominal' to a 'real' EB approach to lessen the impact of the inflation surprise on the indicator (Chapter 2). Effectively this meant the indicator showed a more restrictive fiscal impulse in 2022 than would have been the case under the previously used methodology. The 'nominal' EB-based fiscal impulse shows a sizeable expansion above 1% of GDP (Graph 4.4). Moreover, the Commission's preferred approach also corrects for Covid-related temporary emergency measures. This indicator shows a highly expansionary fiscal impulse, since the withdrawal of emergency measures that amount to close to 2.5% of GDP is not taken into account. If energy support measures and Ukrainian-refugee support measures were also excluded, as the Commission has implicitly done in its broad assessment of fiscal developments in spring 2023 (Chapter 2), then the EB-based fiscal impulse would have still shown a sizeable expansion of close to ½ % of GDP. And if this EB approach is based on the usual frozen GDP deflator (i.e. a 'nominal' EB), then the expansionary fiscal impulse would exceed 2% of GDP. Consequently, the underlying expenditure trend points to an unwarranted expansion in 2022.

The simultaneous restrictive fiscal impulse and rapid reduction of economic slack – as measured by the change in the output gap – indicate a successful counter-cyclical orientation of discretionary fiscal policy in 2022 (Graph 4.5). At the same time, the level of discretionary fiscal support (i.e. the fiscal stance) remained sizeable at close to 2% of GDP while the euro area economy was estimated to have moved above potential. Despite the improvement in the fiscal stance, underlying expenditure trends point to concerning developments of rising net expenditure above the medium-term potential growth rate. In essence, the direction of the fiscal impulse was certainly appropriate given cyclical conditions, but the speed of phasing out support injected since the outbreak of the pandemic may have been too slow in retrospect – not necessarily in 2022 but more so in 2021 in which there was a pro-cyclical fiscal expansion. This pro-cyclical impulse of 2021 weighed on the structural deficits going into the energy crisis. A restrictive fiscal impulse would have also been warranted from a stabilisation perspective (Graph 4.8).

Graph 4.5: **Euro-area fiscal impulse**



Source: EFB, based on European Commission 2023 spring and 2021 spring forecast data.

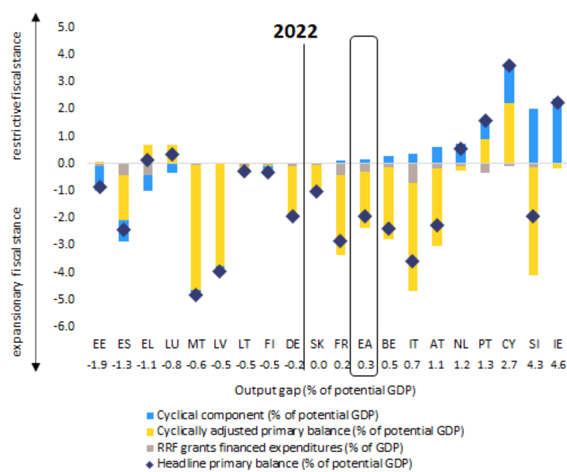
The restrictive fiscal impulse matched the EFB's recommendation for a gradual withdrawal of fiscal support. It also followed the advice issued by the Commission and EFB during the first half of 2021 to maintain an overall supportive fiscal stance. However, the European Commission's subsequent specification for a moderately expansionary fiscal impulse separating out the from Covid-related

temporary emergency measures was not followed. By that metric the impulse of over 2% of GDP went well beyond a 'moderate' expansion.

Was the contribution to the euro area fiscal impulse of different countries appropriate?

The recovery momentum from Covid-19 still elevated growth above pre-pandemic averages, and economic output moved above potential in most countries in 2022. However, the war in Ukraine affected Member States' economic performance to varying degrees given: (i) the varied levels of their dependence on Russian energy imports; (ii) the varied levels of energy intensity of their industrial bases; and (iii) their more general economic exposure to Ukraine and Russia. Some of the most affected countries saw their growth deteriorate by more than two percentage points compared to the Commission's 2021autumn forecast. [108] At the same time, in seven euro-area countries, growth was actually corrected upwards.

Graph 4.6: **Fiscal stance across Member States in 2022**

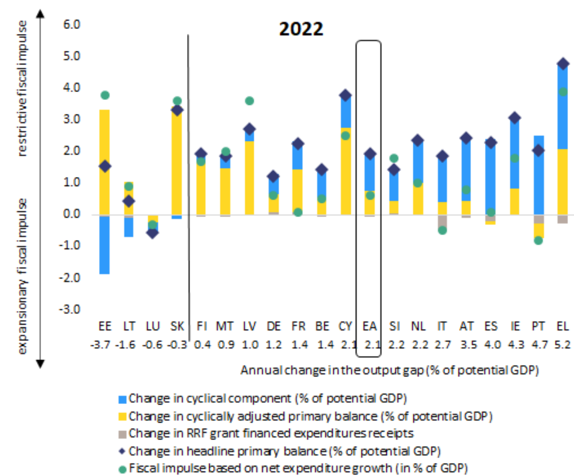


Source: EFB, based on European Commission 2023 spring forecast data.

High deficits inherited from the previous year and newly introduced fiscal measures to ease the impact of the energy crisis meant most countries still exhibited a significant deficit in 2022. The level of discretionary fiscal support (i.e. the fiscal stance) also remained high, with seven countries having a deficit of close to or above 3% of GDP (Graph 4.6). The RRF added sizeable fiscal support to aggregate demand in several countries, most notably in eastern and southern Europe.

In most countries, the improvement in the headline budget balance was driven by the cyclical upswing (Graph 4.7). Despite governments taking new fiscal measures to support households and firms during the energy crisis, discretionary fiscal support also declined during 2022, since the withdrawal of Covid-related emergency measures by far exceeded the costs of adopted energy measures. The level of fiscal support financed by RRF grants did not change significantly at euro-area level, but for some Member States the impact of the RRF on aggregate demand still increased in 2022. Overall, nearly all euro-area Member States exerted a restrictive fiscal impulse in 2022, including all very high-debt countries, except Portugal and Spain, with a near neutral impulse. The fiscal impulse measured by net expenditure growth also points to a neutral/moderately contractionary fiscal impulse in most countries. However, through the Commission's lens of excluding Covid-related measures, and if correcting for energy support-measures, the impulse in very high-debt countries would be expansionary in 2022 – an underlying dynamic counter to what would be fiscally prudent.

Graph 4.7: **Fiscal impulse across Member States in 2022**



***Note*:** The depicted fiscal impulse based on net expenditure growth relies on the European Commission's new estimation method using the actual GDP deflator instead of the one underpinning fiscal guidance.
Source: EFB, based on European Commission 2023 spring forecast data.

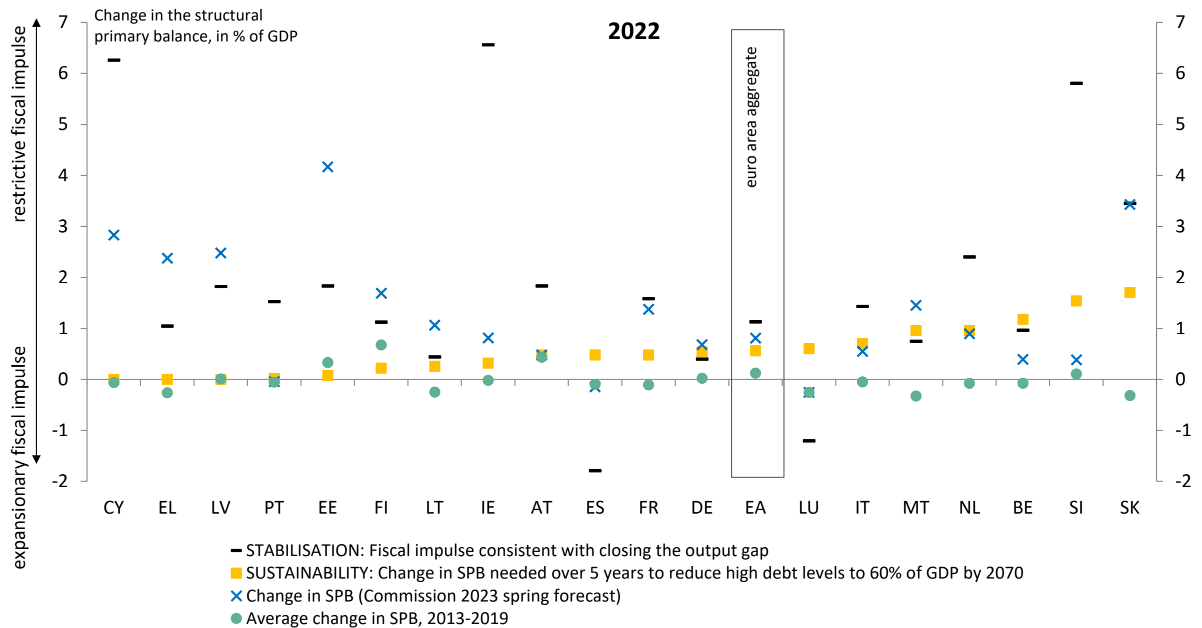
The European Commission's most recent Debt Sustainability Monitor underscored the persistent risks to the sustainability of public finances in some euro-area countries. It flagged eight countries as facing high risks in the medium term. These countries mostly have a debt-to-GDP ratio above 90%. The optimal contribution to the euro-area fiscal stance should take these risks into account. Of the restrictive fiscal impulse of 0.8% of GDP,

[108] Germany, Estonia, Latvia, Luxembourg and Slovakia.

very high-debt countries ([109]) contributed half in 2022, which corresponds roughly to their share of euro-area output. This contribution was largely driven by France and Greece, which reduced discretionary fiscal support faster than the euro area average. Given the substantial debt challenge in this group, a larger contribution to the fiscal impulse would have been desirable. Moreover, the level of discretionary fiscal support (i.e. the fiscal stance) remains on average nearly 1% of GDP larger in very high-debt countries than in the euro area as a whole.

([109]) Defined as countries with a debt-to-GDP ratio above 90% in 2022, namely, Belgium, France, Greece, Italy, Portugal and Spain.

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



Notes:
(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 2021 level, using a uniform fiscal multiplier of 0.8.
(3) The new S1 indicator estimates the adjustment in the structural primary balance relative to a set baseline projection, which ensures that the debt-to-GDP ratio falls below 60% by 2070. The European Commission's S1 indicator has been divided by 5 to stretch the required fiscal adjustment over 5 years. Estimates include the costs of ageing.
(4) In countries where S1 is negative, debt is already below 60% of GDP or expected to fall below it by 2070, and 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) Data for the stabilisation and sustainability indicator is based on the Debt Sustainability Monitor 2022 and the European Commission's spring forecast of 2023.
Source: European Commission, own calculations.

5. FUTURE EVOLUTION OF THE EU FISCAL FRAMEWORK

5.1. TOWARDS ECONOMIC GOVERNANCE REFORM – FINALLY

The European Fiscal Board (EFB) welcomes the revival over the past year of efforts to reform and strengthen the EU economic governance framework. The efforts have long been underway. The present chapter first summarises some recent experience that seems relevant in shaping attitudes to reform (Section 5.1). It then reviews the Commission's Communication on orientations for a reform of the EU economic framework of November 2022, which the EFB strongly supported, though with two significant reservations (Section 5.2). The April 2023 legislative proposal and the subsequent debate have retained most of the approach of the orientations. However, some elements need careful discussion (Section 5.3). A short conclusion follows (Section 5.4).

Since 2017, EFB annual reports have pointed to imperfections and issues in implementation. They have also highlighted improvements of the framework that appeared both desirable and realistic.

A systematic review of the existing rules-based framework was presented in a dedicated report (EFB, 2019) requested by then Commission President Juncker, EFB (2019). It served as input into the Commission's own review of the framework since the governance reform of now a decade ago. Three criteria for the assessment were mentioned: (1) ensuring the long-term sustainability of public finances; (2) stabilising economic activity in a counter-cyclical fashion; and (3) improving the quality of public finances. The EFB concluded that, for most countries, sustainability had been aided under the framework. However, performance had remained mixed for some countries, and the record with respect to the two other objectives was unsatisfactory. Fiscal policies had been pro-cyclical during the financial and sovereign debt crises as sustainability concerns took the front seat and, to a lesser extent, over the 2017-2019 period. Public investment, and more generally growth-friendly expenditure, had borne major cuts as consolidation began; they only recovered alongside the implementation of the NGEU.

This experience should not be surprising in light of the ambitious and multidimensional nature of the political objectives reflected in the implementation of the fiscal framework and the tendency for governments to give greater weight to short-term objectives rather than to medium-term sustainability of public finances. Despite efforts to pay increasing attention to national circumstances in an expanding and complex rule book, compliance with the framework was disappointing for some countries, especially in those of Member States with the highest debt-to-GDP ratios. While these conclusions seemed to be widely shared at the time, there was no visible sense of urgency for reforming the fiscal framework among decision-makers when the Commission launched the debate on economic governance in February 2020.

In particular, it was arguable that sustainability – an objective difficult to translate into quantitative guidelines at any time – had by then become a remote concern: there was a perception that debt-servicing costs would likely remain low for a long period, and the ECB was firmly embarked on purchases of bonds issued by EU sovereign borrowers. In 2018-2019 the ECB was even asking for support from more expansionary fiscal policies to complement its efforts to return to its 2% inflation target as policy interest rates were approaching the zero lower bound.

These circumstances were not propitious for engaging in the difficult debate on how to reform economic governance. Whether agreement could have been found at the time on the main Commission and the proposals of the EFB and other policy institutions seems more doubtful. The proposals were to re-establish the medium-term sustainability of public finances as the dominant objective in the implementation of the Stability and Growth Pact, to focus on gross policy errors, and to simplify surveillance by relying more on the expenditure benchmark as the policy indicator. Furthermore, controversial proposals from global economic institutions and the ECB, shared by the EFB – to set up a central fiscal capacity (CFC)

would certainly not have reached the official EU reform agenda. A CFC can perform two tasks: provide a supplementary effort of stabilisation to that of national automatic stabilisers in the case of major disturbances; and assist in the supply of public goods with an EU dimension. Neither task was seen as worthwhile at the time; the former because it could generate risks of moral hazard, the latter since it was in conflict with the preference of many Member States to keep the EU fiscal framework oriented towards national policies.

The outbreak of the Covid-19 pandemic in March 2020 put a sudden end to the debate on how to reform economic governance; it also radically changed the premises for its eventual resumption. The extensive interpretation of the severe economic downturn clause, by the Commission and the Council effectively opened up near-complete freedom from EU surveillance of national policies. While additional flexibility was initially clearly appropriate, 2021 to 2023 EFB annual reports have provided a number of critical observations on the extent to which normal surveillance procedures were allowed to diminish, as the clause was extended year by year; the experience over the 2022 surveillance cycle is reviewed in detail in Chapter 2 of this report. Together with exceptional further monetary expansion and continuing low inflation until mid-2021, unfortunately the sustainability of public finances slipped further down the list of concerns.

Another major change in the environment for economic governance reform came from the unprecedented joint EU initiatives of 2020. These were: the Next Generation EU (NGEU) and its central element, the Recovery and Resilience Facility (RRF) as an extension of the multiannual financial framework 2021-2027; and Support to mitigate Unemployment Risks in an Emergency (SURE), which allowed Member States to facilitate efforts to keep the labour force employed during the pandemic. These initiatives could be seen as beginning to address two issues in the design of a CFC. Firstly, assistance in national efforts to supply public goods beyond what national public finances could have achieved, even though an EU dimension in the efforts was only modestly present (see Section 5.2); and secondly, help in stabilisation to mitigate the impact of a major common shock. However, as the difficulties of reaching agreement over the spring and summer of 2020 showed, these decisions were contingent on the exceptional size and truly exogenous nature of the pandemic shock, making past allusions to risks of moral hazard inappropriate. The RRF and SURE were only agreed to by several Member States as one-off steps.

As the EU economies recovered with unanticipated vigour, particularly in 2021, other challenges arose. Firstly, inflation began to increase with the strong recovery already in the second half of 2021. Then, from February 2022, the Russian invasion of Ukraine sharply raised energy and food prices, triggering higher public expenditure to accelerate the energy transition, to prepare stronger defence, and to receive the flow of refugees. As efforts to overcome the impact of the pandemic eased, public expenditure and in turn underlying deficits remained high with the aim to mitigate the impact of the energy crisis and other new challenges on households and firms. The severe economic downturn clause will finally be deactivated from the end of 2023, and the Commission has signalled readiness to return to a normal implementation of the rules only in the spring of 2024, based on outcomes in 2023.

The contribution of fiscal support in 2022, in retrospect, was too expansionary compared with the Council's recommendation of 'temporary and targeted' measures and the nature of the challenges.

The swift and massive fiscal response to mitigate and overcome major economic shocks during the prolonged *de facto* suspension of a rules-based fiscal framework has fuelled a broad perception in a number of countries that fiscal policy does not face any constraints. This has further weakened attention to medium-term sustainability, not least where it mattered the most, i.e. in high- and very high-debt countries. This legacy - a high level of confidence in the potential of public expenditure to mitigate crises, a short-term policy orientation and an optimistic outlook on the longer-term financial implications - has made a reform of economic governance politically more difficult. The jump in public debt ratios during the two crises of the pandemic and the energy price inflation which followed in quick succession – together with major further expenditure challenges associated with the green transition and the long-term inexorable rise in the costs of ageing – makes the reform all the more urgent. Keeping the medium-term growth rate of public expenditure in line with that of medium-term potential output growth has become essential for reducing potentially existential risks of public finances becoming unsustainable.

5.2. THE COMMISSION COMMUNICATION ('ORIENTATIONS') OF NOVEMBER 2022

The EFB very much welcomed the orientations presented by the Commission on 9 November 2022 as bold and promising. The EFB could hardly fail to support proposals that had as central elements: increased emphasis on containing risks of public finances becoming unsustainable; differentiation across Member States to reflect their very different starting positions; the objective to offer stronger incentives to comply through greater national ownership of medium-term budgetary plans combined with a firmer base for enforcement; recognition of the need to protect the future growth potential of EU economies; and simplification of the policy indicators in EU fiscal surveillance. These elements have been central in proposals from the EFB proposals and of several other policy institutions over the past five years; as is an enhanced role for national independent fiscal institutions (IFIs), to be reviewed in Section 5.3.

Renewed emphasis on medium-term sustainability in the implementation of the fiscal framework – the formal objective of the Stability and Growth Pact since its inception – is justified by the current outlook for public finances. The main justification for EU rules for national public finances is, as recognised in the Treaty, to limit the risks of harmful spill-overs to partner countries. Sustainability is a very long-term concept that requires focus on the direction of debt, while taking into account the starting level. That requires policy recommendations to be based on the projected medium-term evolution of debt, coupled with annual monitoring rather than necessarily basing procedural conclusions on the snap-shot fiscal developments of one single year.

Debt sustainability analysis (DSA) has advanced considerably in transparency and replicability, not least due to efforts by the Commission (and other international institutions); many of its dimensions have been monitored for a long time by national officials and IFIs. DSA has reached a stage where it can provide an input to the formulation of an operational strategy for national fiscal policy. Nevertheless, one must not forget that it involves long-term projections subject to considerable uncertainty and that it will have to be supplemented by agreement on the main assumptions to which it is sensitive, and on other more judgmental elements. The discussion between the Commission and national governments of the desirable debt strategy and of the policy adjustments required to achieve it, more specifically the comparison of the technical trajectory of the Commission and the net expenditure plans of national governments, might provide the best possible start to implementation, reconciling EU perspectives with national ownership of expenditure plans, recognised as a key element in the reformed framework.

The two central elements in the Commission orientations – differentiation in debt adjustment strategies across countries and national ownership of budgetary plans – provide a novel approach aiming to combine flexibility with compliance, a problem the EU has been unable to resolve for three decades. Two Member States (Belgium and Italy) were already at more than twice of the reference value of public debt of 60% of GDP when the Maastricht Treaty was signed in 1992**.** Therefore, the recommendations to high-debt countries had to be flexible - debt had to be reduced 'at a satisfactory pace' – a notion left undefined for two decades, because high growth rates of nominal GDP, combined with a government deficit of 3% of GDP or less automatically ensured a declining debt ratio. Precision was added in 2011 with the mechanical 'one-twentieth rule' for reducing the excess of the debt ratios over the Treaty reference value of 60% of GDP following a secular decline of economic growth. But this rule was never strictly enforced. The Commission and the Council agreed to an interpretation whereby compliance with the provisions of the preventive arm of the SGP was deemed sufficient for the purpose of 'a satisfactory pace' of debt reduction. This is one of the 'imperfections' noted in the first annual report of the EFB (2017).

The proposal is now to agree on plans for the evolution of net public expenditure between EU institutions and national governments. This is to assure that debt in countries with moderate or substantial debt challenges is put on a 'plausibly declining' path over a decade, following an initial planning period of four years, with the 60% of GDP reference value for the debt ratio retained as a (very) distant marker. This proposal aims to address in a realistic way the need to redefine debt reduction strategies, avoiding the mechanical one-twentieth rule for fiscal adjustment. At the same time, this new approach is expected to strengthen the incentives to comply.

Compliance is assumed to improve when a plan developed by a government and agreed to by the Council, on the recommendation of the Commission, replaces what has, in domestic debates often be referred to as externally-imposed guidelines; the expectation is that the reputational costs to a government that reneges on an agreement with the Council would hardly be negligible. Still, incentives to comply may prove only an aspiration. However, if that aspiration turns out to be unfulfilled, the EU institutions should find it politically easier to enforce the recommended tailor-made adjustment. The proposal now envisages a lowering of the financial sanctions which is expected to make them a more credible threat. Political reluctance to impose even modest financial sanctions on a country in difficulties may persist, but the mutually reinforcing commitments at both national and EU level may mark a new element in EU surveillance. This also requires a stronger involvement of the Council.

A major upgrade of structural surveillance to protect growth-friendly public expenditure also signals an innovation. The EFB has concerns about the feasibility of merging fiscal and structural surveillance as some of the quantitative elements, essential in a rules-based fiscal framework may be lost. An alternative approach to protecting growth-friendly expenditure is taken up below in a review of two general EFB reservations about the Commission orientations. But there can be no doubt that, if consistently implemented, the proposal is better than relying on extending golden rules to protect public investment.

Simplification of the fiscal framework

Simplification of the EU's rule book has long been an objective of the governance reform. It may be an unrealistic assumption that a rules-based framework capturing all possible contingencies and serving 27 diverse economies could ever become 'simple'. However, a major step in that direction, is outlined in the proposal, i.e. a dominant role for the expenditure benchmark as the policy indicator in EU surveillance. With this, there will be no reliance on annual changes in structural deficits, and the matrix of adjustment requirement in the preventive arm of the SGP and other flexibility provisions are now to be put aside.

Indicators of underlying economic performance based on 'normal' high capacity utilisation – zero output gap – remain, in principle, the most appropriate tools in fiscal policy analysis. However, frequent and sizeable revisions of real-time estimates as forecasts are updated, make them less suitable as policy indicators, particularly in designing annual recommendations. At this stage, the net expenditure benchmark is not free of ambiguities because it also incorporates forecasts and implicit assumptions about the prevailing level of potential output, and the Commission has not yet provided a detailed description of the relevant budgetary aggregates; transparency could be increased by making it easier for the general public to replicate how this policy indicator is estimated by the Commission.

Four corrections to expenditure are envisaged to get to the 'net' measure; two of them are generally accepted: to the extent that a government finances higher expenditure through grants from the EU or discretionary revenue measures, the fiscal framework should have no objections. The policy indicator must not be seen as simply an effort to constrain the level of public expenditure; the relative size of the public sector remains a choice by domestic political authorities. The other two corrections are of lesser importance, but in view of the interest in keeping the indicator simple, some critical comments seem justified.

Excluding cyclical unemployment benefit payments, may seem a logical effort to enable as much scope for stabilisation as possible beyond the cyclical swings in revenues. However, two objections can be made. First, estimating the cyclical element in unemployment benefits will prove complex and controversial, requiring an estimate of the structural unemployment rate (NAWRU). Second, the correction seems unlikely to make a great difference relative to the total change in public expenditure; it is an example of unwarranted perfectionism; and might be scrapped.

Finally, the costs of servicing the public debt are taken out of the relevant aggregate of the expenditure benchmark, on the grounds that they are beyond the influence of the national government. This argument is only strictly true for debt costs in the short run, not over the medium and long – term horizons central to the reform. EU surveillance and financial market participants take a considerable interest in how debt-servicing costs impact expenditure growth and the crowding-out effects of higher costs. This perspective is not neglected in the reform proposals; the DSA embodies simulations to illustrate the sensitivity of

the debt adjustment to alternative interest rate scenarios, albeit only after the adjustment period. On the one hand, including interest expenditure would give a more complete picture of debt developments. On the other hand, it would commit Member States to control a potentially volatile item that in the short run is outside the control of government.

One potentially significant issue, not referred to in the proposals, in using the expenditure benchmark is whether it is set in nominal or real terms. This issue did not attract attention over the past decade when inflation remained low and fairly stable, but the higher and less predictable rates since 2021 make the distinction between nominal and real budgeting important. A natural understanding would be that budgets should be drawn up and monitored in nominal terms; that is also the practice in most EU Member States. If inflation subsequently deviates within a given margin from the Commission's or the government's earlier estimate, the act of having budgeted in nominal terms will contribute to stabilise inflation by dampening swings in demand. Arguably, a national or EU/euro area-wide escape clause should be triggered when there are large exogenous supply shocks with a major impact on inflation. An illustration of such a situation, analysed in Chapter 2 above, was provided when the energy price hike pushed up inflation in 2022. Applying the extensive interpretation of the severe economic downturn clause, in its final assessment the Commission decided to lift the benchmark rate of expenditure growth in line with actual price increases. However, this happened without any prior communication.

Focusing on the single policy indicator of net expenditure growth in EU surveillance will remove the scope for cherry-picking of the preferred indicator – expenditure or structural deficit, an ambiguity that has led to diverging assessments of compliance in the past. The framework is now being redesigned to move from an annual to a more medium-term perspective. One advantage of the expenditure benchmark is that it seems easier to communicate in the domestic policy debate; and ample room is left for the automatic stabilisers through swings in public revenues over the cycle. Of course, there are many practical issues that have not been clarified and will have a sizable impact on the implementation of the prospective framework.

Reservations on the Commission's orientations

While the EFB evaluation of the proposals, as they appeared in the orientations, fully recognised their bold and appropriate approach to EU economic governance reform, the EFB had two significant reservations. They were signalled to the Commission as the legislative version of its proposals was in preparation. The first was an unsurprising omission: the focus exclusively on a country-by-country approach to EU fiscal governance. The second was the ambitious merger of fiscal and structural surveillance. Since both issues seem likely to impose themselves on the EU agenda in a relatively near future, it could, in the view of the EFB, have been beneficial to take them up in the current governance reform debate.

On the first point – the omission of any reference to joint initiatives to underpin or complement the rules-based framework for national fiscal policies - the Commission announced its orientations as 'addressing the key economic and policy issues that will shape the EU's economic policy coordination and surveillance for the next decade'. This is an optimistic claim since a gap of governance, unaddressed in the proposals, had long been identified by the ECB, the IMF, the OECD and the EFB: the absence of a CFC, to assist in supplying public goods with an EU dimension and to supplement national stabilisation efforts at times of a major economic shock.

It is perfectly understandable, also to the EFB, why the Commission decided not to mention joint initiatives at the EU level in its orientations; that could well have made agreement on reforming a nationally-based framework impossible. The emphasis in several Member States on the one-off nature of the 2020 initiatives makes it difficult to consider less ambitious joint efforts, e.g. with more limited redistribution between countries. Still, as the recently launched debate on new expenses in the current EU MFF shows, it is becoming increasingly difficult to separate the roles of the EU budget and national public expenditure; they are becoming increasingly complementary. The EU had the good fortune in 2021-23 of being in the initial years of an MFF that allowed flexibility over a longer period of time in reallocating expenditure under it. However, that flexibility is now becoming inadequate to deal with increasing costs of debt servicing and of new policy areas.

Should the debate on the division of responsibilities between national and EU level be

postponed? The Treaty introduced the general principle of subsidiarity, with major implications not least for budgetary policies: the tasks of EU institutions should be limited to those that cannot be adequately performed nationally. The constraints on centralised decision-making are tight: 'In areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, and the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaty, (TFEU Article 5). The burden of proof rests squarely on those who argue in favour of joint action; they have to make a convincing case that coordinating national efforts is insufficient.

The deterrent impact of the subsidiarity principle has proved durable. However, a number of challenges to the resilience of the EU have, from the perspective of the EFB, made a reassessment of the principle hard to postpone. These challenges are: the green and digital transitions, the pandemic, the expenses required to face up to the consequences of the Russian invasion of Ukraine – developing new supplies of energy, stronger defence capabilities, integration of refugees, ultimately the reconstruction of Ukraine – and, most recently, the appropriate response to US initiatives in the energy transition. All these challenges raise the issue of supplementing the coordination of national efforts by joint actions.

It has become easier to demonstrate that joint action will sometimes constitute an approach, sufficiently more efficient than even well-coordinated national efforts. To the EFB a reassessment of the subsidiarity and proportionality principles as they apply to budgetary policies now seems overdue; the EU would be more effectively able to face common challenges, internal as well as external, by moving towards a general, rather than a case-by-case approach. Issues of transparency and accountability in the EU institutions would have to be addressed at an early stage for this process to develop.

A move towards more joint efforts as an integral part of EU economic governance will be controversial and time-consuming to find agreement on it. However, this does not justify presenting a strictly national approach as meeting the economic issues of the next decade. Even the best proposals are not well served by excessive claims of what they can achieve.

The second area where the EFB had reservations on the Commission approach is the proposed merger of fiscal and structural surveillance. Such a merger, even including the macroeconomic imbalance procedure (MIP), understandably looks attractive to those responsible for the European Semester. It also reflects the perception that the policy recommendations after the financial crises overemphasised fiscal consolidation relative to structural reforms and investments to better protect the longer-run performance of EU economies.

However, it will be an unenviable task for the Commission, and ultimately the Council and the Committees serving it, to have to evaluate national fiscal-structural plans, and, in particular, the impact of the detailed investment projects and reforms contained in them on economic growth and/or the sustainability of public finances. These are the criteria by which a government could find agreement with the EU on its plan, and possibly obtain an extension of its adjustment period from four to seven years.

There is a basic difference between the SGP on the one hand and structural surveillance on the other hand. The former is a macroeconomic framework with fiscal aggregates largely controlled by the government – debt and deficits – as policy indicators; the variables underlying the structural recommendations are primarily microeconomic. Structural reforms and selected public investment projects should usually have a positive impact on macroeconomic performance, and hence on medium-term sustainability of public finances. But the impact will only exceptionally become quantifiable, for example if a general pension, labour market or tax reform is implemented. Beyond such cases, could judgement and good will of the EU institutions be regarded as sufficient for preserving the credibility of the proposed framework?

The experience of monitoring the national recovery plans with RRF backing has yet to be evaluated. So far, the Commission views it as raising the quality of its structural surveillance, hence improving the prospects for merging the latter with a revised SGP. The EFB sees a risk that compliance with the more quantitative SGP could shrink to the lower standards that have marked past compliance with

structural policy recommendations (including the MIP). The Commission will be challenged to clarify how it plans to take the evaluation and monitoring of the reforms and investments submitted by a government beyond the qualitative level. This could be essential for creating general confidence in the proposed new process of agreeing on national fiscal-structural plans, not least, when a government is asking for an extension of its adjustment path.

Since 2021, the prospect of EU funding has provided clear incentives to carefully prepare and implement reforms and investments. However, the detailed targets and milestones required to release RRF funds seem(s) more akin to what is asked for by a Court of Auditors than to an ex post economic evaluation. Anyway, the incentives of governments to fully implement the plans will weaken in a few years as the RRF fades out. Furthermore, tactical behaviour could become more frequent among governments, encouraged also by the likelihood that political power will have changed well before the end of an extended seven-year horizon for getting onto the plausibly declining path for its public debt.

There is an additional political-economy argument that makes the EFB question how appealing the features of national ownership, advanced in support of the proposed model for detailed fiscal-structural surveillance, will turn out to be to the domestic political audience. National budgetary debates focus on the composition of expenditure, more than on their total amount and their impact on debt. The more detailed the reform and investment plans to which a government commits, the more they risk being seen as controversial in a domestic context, and the greater the likelihood that external policy makers will be blamed, no matter how well intentioned they are. Making commitments to detailed reforms and investments a key element in EU surveillance may well end up being seen as too intrusive and as eroding national ownership.

A key objective of the reform proposals is to protect growth-friendly public expenditure at a time when medium-term sustainability has to be given high priority. The EFB fully accepts this objective. There are broadly three ways to achieve it: (i) a fully country-by-country approach with allowances for investment expenditure under national golden rules and limited EU monitoring; (ii) an intermediate path represented by the current proposals that retains a decentralised approach, while extending surveillance of national policies deeply into national reforms and investment projects planned by governments; and (iii) an approach assigning to a CFC the supply of a limited range of strategic public goods with a cross-border EU dimension that is difficult or impossible to sustain in the two other approaches.

The choice between the three options is heavily restricted. The national experience with golden rules in some countries that tried and abandoned them, notably Germany and the UK, suggested that they are difficult to monitor and open to reclassifications. In the EU, partly due to restrictions on the scope for claiming allowances, golden rules never became a significant facility in the years after the financial crises in protecting public investment. The EFB at first favoured wider scope for targeted golden rules to better achieve this objective while considering them a second-best solution to jointly supply strategic public goods with an EU perspective. In more recent reports the EFB's preference for the first-best option of joint efforts, became stronger, on the grounds mentioned above - detailed and typically smaller, investment projects to be left entirely in national hands (see EFB, 2019 and 2022).

As recognised above, a more centralised approach to the provision of EU public goods seems, regrettably from an EFB perspective, politically unrealistic in the nearer term. Hence, the intermediate path outlined in the proposal seems a workable temporary compromise in which national governments retain full responsibility for the composition of their public expenditure – and, after the RRF ends, their financing – subject to differentiated and careful planning and (a) more intensive monitoring by EU institutions. That should mark progress relative to the past, particularly in reconciling scope for growth-friendly expenditure with continuing deference to sustainability.

Still, the drawbacks of this intermediate approach seem sufficiently clear – excessively detailed surveillance – for the EFB to prefer the third option. The EFB favours this approach because there is a huge need for investment in specific areas characterised by large spill overs and economies of scale. Detailed national reforms and investment projects could then be left to more informal surveillance as in the past. Any guidance which emerging EU policies in particular sectors, notably

the green transition, may provide, could obviously be taken into account even in a more informal setting. However, the EFB recognises the substantial backing for giving the intermediate and decentralised option for underpinning growth-friendly public expenditure the benefit of the doubt – at least for the time being.

5.3. THE LEGISLATIVE PROPOSAL OF 26 APRIL 2023 – AND OUTSTANDING ISSUES

After five months of intensive debate among national officials to clarify details omitted in the November orientations and to distinguish areas of convergence for those that required further negotiations, the Commission on 26 April 2023 published a legislative reform proposal. It incorporates a number of specific extensions and modifications, not least to reflect the Conclusions of the Council of 14 March. The Commission has been praised for readiness to seek compromise in order to facilitate agreement.

The EFB does not have the resources for making detailed suggestions in the several areas where debates on the reform have not yet been concluded. However, a few comments on what appears to be the trend of the debate may still be timely. They relate to the search for common benchmarks and safeguards in the light of what can be expected from a rules-based framework.

Common benchmarks and safeguards

Much of the exchange among officials has been marked by the doubts of a number of Member States: do the proposals in the orientations offer sufficient assurance that sustainability will, in fact, improve, putting public debt on a downward path? The reformed framework looks to many not only unfamiliar, but less reassuring than the existing one – mostly as a result of stated main qualities: emphasis on domestic ownership**,** differentiated objectives and a medium-term perspective. These features, it is feared, might raise temptations to backload efforts and evade budgetary discipline, more generally weaken the transparency and the multilateral nature of the framework. Hence procedures for deficit-based common quantitative benchmarks and safeguards have received particular attention. The Commission's legislative proposals aimed to recognise these concerns (see Box 5.1) by specifying elements the technical trajectory is expected to satisfy. However, several Member States still question whether the new approach built around tailor-made, medium-term adjustment paths for government debt can effectively ensure sustainability. The underlying concerns are understandable; they should - and they can - be addressed by several elements aimed to tighten the framework and assuage the concerns of several Member States.

A central premise of the reform is that medium-term sustainability is the main objective of the EU fiscal framework. Retaining the reference value for the deficit of 3% of GDP as a backstop - and emphasising that it should be seen as a ceiling to stay safely below rather than a target - seems reassuring and has long been supported by the EFB. Furthermore, there is the 'at least 0.5% of GDP' adjustment for countries in EDP carried over from the current fiscal framework in line with (i) the Commission's pledge in its orientations of November 2022 to keep the EDP unchanged, and (ii) the Council conclusions of March 2023. It is defined as a minimum quantitative benchmark and is to be used when setting the expenditure benchmark for countries in EDP.

Ways of strengthening the fiscal rules

The central element in the reformed framework is the net expenditure plan agreed between a government and the EU institutions on the basis of a common understanding of the need to reduce the risks associated with high and/or rising debt. If the discipline implied in the proposed reform is thought to be insufficient, there are also other ways of making the framework tighter than additional common benchmarks and safeguards. In view of the central role of the fiscal-structural plans and the elaborate care devoted to agreeing on them, a weakness of the reform proposals is that reactions to deviations from expenditure plans by themselves do not mandatorily trigger an EDP.

The most obvious way to improve compliance with the plan is already mentioned in the new Regulation 1466/97. Article 21 provides for the Commission to monitor the implementation of medium-term fiscal-structural plans, in particular the net expenditure path, through a control account. Such monitoring would have the double advantage of focusing on the central policy indicator and not being tied to an annual perspective. The control account seems to the EFB to be the natural benchmark through which

Box 5.1: **The minimum benchmark and safeguards in the Commission's legislative proposal for an SGP reform**

The Commission's legislative proposal of 26 April 2023 includes a number of provisions that in the public debate are identified as benchmarks and safeguards for fiscal adjustment. They complement the overarching requirement whereby the government debt ratio needs to be put on a plausibly downward path or stay at a prudent level, which in itself is a central safeguard to ensure sustainability of public finances. With the more detailed provisions on fiscal adjustment, the Commission reacted to discussions in the Council where several governments were seeking assurance that the reformed rules built around country-specific adjustment paths would effectively ensure sound public finances. The media also reported on the demands from some governments for additional safeguards that are based, e.g. on a minimum annual reduction in the debt-to-GDP ratio.

The minimum quantitative benchmark

Following the Council conclusions of 14 March 2023, which explicitly asks for the excessive deficit procedure (EDP) to remain unchanged, the Commission's legislative proposal of 26 April 2023 includes the minimum annual adjustment of 0.5% of GDP already present in Article 3 of Council Regulation (EC) No 1467/97. Hence, this benchmark should not be considered a novelty.

Safeguard 1: The debt-to-GDP ratio at the end of the planning horizon to be below the one at the start of the plan

This safeguard is set up to ensure that public debt ratios are lower at the end of the planning period compared to the start of the technical trajectory. Without this safeguard it would be possible for the government debt-to-GDP ratio to increase during the planning period and start declining only at the end.

Safeguard 2: No back-loading of fiscal adjustment

This safeguard is meant to avert a situation in which governments defer the required fiscal adjustments to the outer years of the adjustment period. The legislative proposal states that fiscal adjustment during the (four-year) planning period should be at least proportional to that over the entire adjustment period including a possible extension. This is not a requirement of an annual proportional adjustment but only that the effort in the four-year planning period should on average not be less than on average in the additional three years in case of an extension. Backloading within the first four years is not explicitly excluded but would need to be assessed against the yet unspecified provisions of the control account.

Safeguard 3: Net expenditure growth below the medium-term rate of output growth

According to the legislative proposal, this safeguard only applies to the technical trajectory but not mentioned in the assessment criteria for the national medium-term fiscal-structural plans – unlike the other two safeguards that feature in both. The safeguard ensures that national net expenditure growth does not exceed the medium-term output growth. However, the legislative proposal states that this requirement is to be fulfilled 'on average' and 'as a rule', thereby allowing some flexibility in its application.

compliance with the fiscal-structural plan can be monitored with the degree of granularity sought. However, the Regulation and the associated Annex IV do not clarify the consequences of cumulative (upward or downward) deviations from the agreed path. Clarification could consist of threshold values for such deviations over a time span shorter than four years, linked to size, rather than time. [110] Clarifying policy reactions to transgressions of thresholds could provide a substitute for additional common benchmarks.

A second reinforcement would be to tightly constrain – or even eliminate - the scope for extending the planning period prior to bringing the debt ratio on a plausible downward path from four to seven years, as discussed in the previous section. The difficulties for the Commission in evaluating the grounds for such extensions, combined with the very long horizon of seven years as a period of commitment, convey an impression that the framework could drift towards excessive discretion and laxity. Constraining such tendencies should improve the rules-based elements in the proposed framework.

A third, more purely institutional reinforcement would consist in enhancing further the role of national IFIs in assessing both the national plans and the annual progress reports of governments on the implementation of their fiscal structural plans (Article 22), to be discussed further below.

[110] Switzerland provides a good example of a well-defined control account and how to operate it; see Gesley, 2016.

A combination of some (or all) of these ways of tightening the framework and making it more transparent would have the advantage of focusing on the central policy indicator in reform - the agreed expenditure path. If a quantitative benchmark is seen as desirable, it should logically be through monitoring cumulative deviations from the expenditure path.

Some countries are proposing additional benchmarks for the reduction of the deficit and the debt ratio which can, give rise to inconsistencies across requirements. One policy indicator, defined over a medium-term horizon, is preferable to two or more with different horizons, and not only for reasons of simplicity.

Potential issues with benchmarks and safeguards

However, even with a minimum annual benchmark of 'at least 0.5% of GDP' to be implemented through the prime indicator of net expenditure, for countries in EDP, any benchmark can bring to the open a conflict with shorter-term stabilisation. In that case, the opportunity of resorting to national or EU or euro area wide escape clauses would need to be carefully considered. Pursuing the sustainability objective systematically in itself creates room for stabilisation; past frustrations over national policies becoming pro-cyclical have usually been attributable to inadequate attention to sustainability in the preceding years the pre-pandemic period offers an illustration. Having both policy objectives of sustainability and stabilisation implicitly in play simultaneously seems likely to divert attention from the focus on net expenditure. This argument strengthens the need to look carefully at the alternative ways of countering the perception that the reformed system, because unfamiliar, is likely to be too lax.

A less important example of the role given to the deficit reference value in the legislative text is to trigger a Commission obligation to develop a technical trajectory for debt reduction when a country's deficit exceeds 3% (and/or the debt ratio is beyond 60%). As intended in the orientations, such a step should be triggered by the risk, according to DSA, of unsustainable public finances which takes into account both the current level and the projected dynamics of a country's debt. Unless there are other objective reasons, with debt below 60% of GDP a government should not be expected to engage in a debt reduction strategy whenever; if for a year or more, it exceeds a 3% deficit, for example, to meet the need for a rapid defence build-up or an acceleration of the green transition.

The Commission's legislative proposal of April 2023 modified the requirement for debt reduction in one further, apparently minor way: the debt ratio should, at the end of the planning horizon, be below that in the year before the start of the technical trajectory (Article 6(d)). While concerns are understandable, it may turn out to be inconsequential for most countries.

Different benchmarks and safeguards may give rise to conflicting guidance, indicating a low level of confidence in the basic thrust of the reform and in the mutual confidence among Member States and in the Commission's implementation. This is therefore a more general reason for restraint in adding onto the Commission legislative reform proposal of April 2023.

The long and varied experience with EU fiscal governance suggests that there is little point in trying to implement a framework unless there is likely to be both a shared willingness of all Member States to comply and of the common institutions to consistently enforce the rules of the framework in cases where national deviations nevertheless become observable and even reach the level of 'gross errors'. A framework that has neither been complied with by an important group of countries, nor consistently backed up by those responsible for applying agreed procedures, needs a new start.

The reformed framework should shun the pretentions of a very tight system with emphasis on common rules for all without drifting into a bilateral and discretionary framework with limited transparency. Neither extreme is in the end likely to survive; a balance has to be found. It may lie less in implementing more elaborate rules in the shape of common annual benchmarks than in improving the institutions that have a responsibility for implementing and independently monitoring of the framework, a theme well developed in the literature (see for example Wyplosz, 2005). That also seems to be what the term 'governance' implies.

Independent assessment: national and EU level

Could more elements of independent assessment of policies within the framework help in finding a balance? An essential and durable improvement in the framework following the reforms of a decade

ago was a firmer basis for conducting surveillance, achieved by raising the reliability of both the statistics submitted by national governments on their public finances and of the macroeconomic and budgetary forecasts available. In this process the set-up of national independent fiscal institution (IFIs) in a number of EU countries that did not already have them, took on an important role in the monitoring of macroeconomic forecasts on which government budgets are based and of compliance with national fiscal rules. An optimistic bias in forecasts that had marked the years before the financial crises seems to have weakened; preliminary evidence is reviewed in publications by the Network of IFIs and in several EFB reports, most recently EFB (2022b). Some IFIs have spoken up boldly at times when the willingness to comply seemed to be fading, especially when aligned with EU institutions.

The issue in the economic governance reform is to what extent IFIs could contribute to surveillance based on the fiscal-structural plans. The Commission sees such contributions as potentially important, and the proposed directive on requirements for budgetary frameworks of the Member States significantly expands in Article 8 the number of tasks for an IFI: (i) to produce or endorse the forecasts on which the government's medium-term plan is based; (ii) the debt sustainability analysis, the impact of policies on sustainability; and (iii) to monitor compliance with national and EU rules. The budgetary authorities will be obliged to comply with the assessments and opinions of the IFI, or explain why they do not. Performing all of these tasks requires a stronger independence of the IFIs and autonomous budgetary resources.

The EFB strongly supports the proposals for an extended role for independent policy evaluations. However, it remains unclear whether agreement can be reached in the Council. The Council conclusions of 14 March stated that 'IFIs should not play a role in the design phase of the national plans.' That does not exclude that IFIs could perform the monitoring envisaged in the Commission's subsequent legislative proposal, once a plan has been prepared - an interpretation that the Commission obviously relies on. But why is it controversial?

It is not a new experience that in some countries the political authorities as well as the staff in economic ministries that prepare policies have limited appreciation of the need for monitoring by IFIs. The technical staff perceives itself as already providing independent advice, and the government may see a second view on policies primarily as a help to its political opponents in the domestic debate. However, a strictly national perspective overlooks the general interest of all countries in having the policies of their partners monitored by their respective IFIs, since that would promote fiscal policies in better correspondence with agreed objectives and reduce the risk of undesirable spill-overs.

The institutions charged with representing the general EU interest – most importantly the Commission and Parliament – have a role in overcoming the inferior outcome arising from the tendency of many governments to see their national interest in having a weak IFI at home. The Commission will benefit directly from the inputs provided from the independent monitoring by a body deeply familiar with its national scene, as argued for example by Kopits (2010), (2023). The European Parliament will benefit from the greater transparency of national budgetary information from which it remains at some distance.

Nevertheless, the issue of a greater role for IFIs remains a delicate one. If governments are told that a strong IFI is the main prerequisite for recognising national ownership in a reformed EU economic governance, there will be a negative reaction, with efforts to curtail the independence of IFIs by politicising nominations and other means. Allowing tensions between a government and its IFI to build up, for example by giving the impression that the IFI is asked to take on a role aligned more with the Commission than with the national government, would undermine the central purpose of improving the level of the domestic debate on economic policy. A distinction between the responsibility of a government to design its fiscal-structural plan – a truly political task, assuring a firm medium-term budgetary horizon – and that of the IFI to monitor the assumptions behind the plan and its impact on the economy and on sustainability would seem to set an appropriate division of labour.

A second issue to address is the need to raise the capacity of all IFIs to the level required for the demanding role envisaged in particular through an effective enforcement of existing standards. In several Member States, including some of the largest ones, the structure, resources and independence of the national IFI do not match

these requirements. The inability of some IFIs to fulfil their mandate provides their governments with an excuse to reject an expanded role for IFIs in the reformed framework. Raising the capacity of all IFIs to the high level already achieved by many of them and raising that level further have accordingly become prerequisites for monitoring economic governance; the Commission has listed, in its draft directive (Article 8.4 (a)-(e)), elements that mostly already apply to euro area countries. In the view of the EFB, progress in implementing and enforcing these steps could provide a potentially superior alternative to additional numerical benchmarks and safeguards, despite the apparent precision and greater familiarity of the latter.

How could an independent advisory institution at the EU-level provide further underpinnings of the implementation of the proposed framework? The EFB believes that monitoring a new framework which is more nationally differentiated, analytically demanding and difficult to interpret relative to the past, will become both increasingly challenging and warranted. Recalling the EFB's current mandate, Article 2.2 of Commission Decision (EU) 2015/1937 says: the EFB 'shall provide to the Commission an evaluation of the implementation of the Union fiscal framework, in particular regarding the horizontal consistency of the decisions and implementation of budgetary surveillance, cases of particularly serious non-compliance with the rules, and the appropriateness of the actual fiscal stance at euro area and national level. In this evaluation, the EFB may also make suggestions for the future evolution of the Union fiscal framework.' The current members of the EFB see the mandate as having provided a suitable agenda over the past seven years – and as requiring more time and effort to sustain the advisory role in the now emerging framework.

The mandate contains two other elements: cooperation with national IFIs and *ad hoc* advice at the request of the President of the Commission; the latter assignment has materialised once when President Juncker asked the EFB for advice on the upcoming governance reform in 2019. The EFB has very much welcomed in the past the regular exchange of information with the IFIs and their network; it will no doubt intensify in a reformed framework.

The IFIs have become significant actors in the national political debate; they improve transparency and generally raise the level of the debate on economic policy. The tasks of the EFB are broadly analogous, but at the EU level. Like a national IFI challenges its government's policies to become more transparent by producing independent analysis, the EFB is engaged in offering a second opinion on how the Commission is implementing economic governance. Since such opinions should by default become available to all EU institutions – including the Council and the Parliament - at the same time when expressed; and to a broader EU and national public, the current formal status of adviser to the Commission does not fully convey the envisaged role of the EFB.

In the debate, national officials from some Member States have argued for a stronger future role for the EFB; the Council conclusions of 14 March 2023 stated that such a role 'should be explored'. It is logical that most of the substantive issues in the reform would have had to find some convergence of opinion prior to considering the role of the EFB, the latter issue does need to be addressed in the context of the reform now, hopefully, about to be settled.

The Commission did include a list of past and possible future roles for the EFB in the Explanatory Memorandum to the proposed new Regulation: 'New tasks for the EFB could include informing the periodic evaluation of the future framework and providing assessments on the implementation of central elements of the reformed governance system. The EFB could also provide an opinion to inform the Council decision on activating (or extending) the general escape clause.' (COM/2023 240 final).

These considerations are unobjectionable; in addition to the past tasks for the EFB, the new ones would provide an agenda to stretch the capacity of the present resources of the EFB, Board members and Secretariat. Evaluating the Commission's preparation of technical trajectories, significant departure from them, and cross-country consistency would be natural parts of the agenda.

But an important prerequisite for the future functioning, hinted at above, is left aside. The EFB notes that its independence from the Commission is occasionally questioned by Member State officials and others. Our personal experience over the past seven years, does not justify this view; the EFB has at all times been able to form and publish its view in full independence. We have also been able to obtain the information on which we rely,

primarily from DG ECFIN. Still, we well understand why the perception persists and we are concerned that it weakens whatever impact the EFB may hope to have in our role as advisers to the Commission, but particularly beyond the latter. Full integration, financially and administratively, into the Commission is not appropriate for a body that depends on being perceived as independent. If the EFB is meant to be an independent advisor analogous to national independent fiscal institutions, it needs to have functional and institutional independence, with adequate resources to carry out its mandate, key criteria for judging the status and independence of a national IFI.

The EFB's focus would be better served by not continuing to exist solely as the result of a decision of the Commission. Integrating the EFB into the legislative texts that form the economic governance reform, as is the case for the IFIs, would seem to be an appropriate way of recognising that the EFB is meant to work in the interest of all the EU institutions - including Council and Parliament - involved in economic governance.

5.4. CONCLUSIONS

The long process of preparing and agreeing on a reform of EU economic governance is, hopefully, reaching its final stage. One conclusion is clear to the EFB: the process should come to an end soon. The contours of a compromise seem sufficiently clear to make failure to conclude an outcome inferior to that of an agreement, even one that currently, in some important respects, appears less satisfactory than the EFB had hoped.

In particular, the EFB regards its two main reservations, already identified at the time of the orientations - the omission of any reference to joint EU initiatives to take up the agenda of a CFC, and the possibly over-ambitious merger of fiscal and structural surveillance – as potentially significant weaknesses.

Both of these topics seem bound to come back to the EU agenda under the pressure of events within a relatively short time frame, well before the envisaged five-year horizon for evaluation of the reform, but there can be no guarantee that the issues will be resolved later. In the case of the former, common challenges that cannot be dealt with adequately in a solely national framework, even if well-coordinated, will impose considerations of joint EU initiatives. In the case of the latter, debate on a modified balance between different approaches to protecting growth-friendly expenditure will have to start well before support from the RRF fades away over the next few years.

The recent negotiations on the reform have not focused on these more general issues, but on the adequacy of the proposals to ensure that sustainability will be given sufficient attention in the countries that pose high risks. Fiscal discipline has reached a low point after 3-4 years when major public expenditure efforts had to be undertaken, and the rules-based framework was in effect suspended. A return to a reformed framework has become more urgent simply for these reasons. The prospect that the previous rules would otherwise have to be reapplied did not seem reassuring. But it is obvious that many governments still find it difficult to see medium-term sustainability as a sufficiently serious risk to justify major consolidation efforts. The pace of the 'plausibly declining' debt paths will be modest.

The argument that the responsibility for past disappointments does not lie in the original rules is occasionally made. Had the agreed fiscal framework been fully complied with over the past quarter of a century, sustainability would, indeed, have been ensured to a very high extent. However, the experience that the unwillingness to comply in several of the most vulnerable economies has been matched by the acquiescence of other countries and of the EU institutions to avoid trying to enforce the framework strongly suggests that a new approach has now become desirable. A (partial) return to rules that have not worked for some countries in the past does not look helpful to the EFB. It seems preferable to limit reliance on common benchmarks and safeguards, however familiar and simple they may appear, and to concentrate on exploring the potential of the new and differentiated framework.

The latter would benefit further, if independent economic analysis were to become an integral part of surveillance. National IFIs should play a key role in evaluating the assumptions and the impact of the fiscal-structural plans submitted. IFIs that are seen to lack the resources and independence to perform these tasks should be supported through national steps to undertake them.

GLOSSARY

Automatic fiscal stabilisers: Features of the tax and spending regime of a government budget that react automatically to the economic cycle and moderate its fluctuations. As a result, the government budget balance as a percentage 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 in response to a cyclical change in GDP. Estimates of budget semi-elasticity used in EU fiscal surveillance are derived from a methodology developed by the OECD and agreed on by the relevant 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 Pact, an excessive budgetary imbalance is: (i) a government deficit exceeding 3% of GDP; and (ii) government debt of over 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 using a commonly agreed methodology endorsed by the ECOFIN Council in 2002. This 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's 2017 Annual Report.

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 target, for a country with government debt above 60% of GDP, of reducing its debt 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 the past 3 years, over the next 3 years, and after correcting for the cycle. Compliance on at least one of the three measures is sufficient to meet 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 for the coordination of fiscal policies among Member States that use 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 enhanced surveillance, countries 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 EU. It follows 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 among EU Member States aiming to reinforce fiscal discipline. The TSCG was signed in 2012 by all EU Member States except Czechia, the United Kingdom and Croatia (which did not join the EU until 2013). Of the 25 initial contracting parties to the TSCG, 22 (the 19 euro-area Member States plus Bulgaria, Denmark and Romania on a voluntary basis) It commits them to having binding domestic laws requiring 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 contracting countries, Hungary, Poland and Sweden opted out of the Fiscal Compact from the outset. When Czechia signed the TSCG in 2019, it also opted out of the Fiscal Compact. Croatia signed the TSCG in 2018, and the Fiscal Compact provisions became automatically binding when it adopted the euro 1 January 2023.

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, the 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 to be above its *MTO*.

Fiscal stance: A measure of how strongly fiscal policy supports 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 applied, 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. Under the rule, governments can only incur deficits to finance (net) government investment; otherwise current expenditure must 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): A country-specific target for the *structural balance* that takes account of the diversity of economic and budgetary developments and the diversity of fiscal risks to the sustainability of public finances. The *Stability and Growth Pact* requires Member States to set a medium-term objective for their budgetary position every 3 years in the *stability and convergence programmes*. The MTO should not be lower than the *minimum MTO* calculated by the Commission.

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, taking account of past output volatility and budgetary responses to output fluctuations. Since 2019, volatility has been defined as the simple average between the country-specific standard deviation of the cyclical component of the budget balance and the standard deviation based on all available observations for all Member States since 1985. A Member State with greater output volatility and greater 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 limit for the MTO, which is the most demanding of the following three values: i) the *minimum benchmark* (see above); ii) the implicit liabilities and debt component, reflecting medium- and long-term sustainability needs; and iii) the lower limit of -1% of GDP for euro-area and European exchange rate mechanism countries. 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*.

Numerical compliance: An assessment of fiscal performance against the core elements of a numerical fiscal rule, typically measured as the pure *ex post* deviation of a fiscal outcome from the limit implied by the rule. Numerical compliance thus excludes any flexibility, allowances, waivers and escape clauses that would be considered in the legal compliance assessment.

Output gap: The difference between actual output and estimated potential output at a given 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: Analysis of the change in the *structural balance* and the *expenditure benchmark* – the two indicators used to assess compliance with the *preventive arm of the SGP*. An overall assessment is done whenever either indicator points to non-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*.

Recitals: The non-binding part of the EU legislative act that sets out concise reasons for the enacting terms.

Revenue windfalls and shortfalls: Changes in government revenue that are not explained by the standard elasticity of revenue in response 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 measuring the risk of short-term fiscal stress from the fiscal, macro-financial or competitiveness perspective. The indicator uses a set of 25 fiscal and financial-competitiveness variables proven to perform well in detecting fiscal stress.

S1 indicator: a long-term sustainability indicator used by the European Commission in its debt sustainability analysis. It measures the permanent adjustment in the structural primary balance relative to a set baseline projection, which ensures that the debt-to-GDP ratio falls below 60% by 2070.

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*. In the event of a severe economic downturn in the euro area or the EU as a whole, it provides for additional and temporary flexibility beyond what is normally allowed under the preventive and corrective arm of the Pact, provided 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 EU legislative measures – five Regulations and one Directive – to reform the *Stability and Growth Pact*. The six-pack entered into force in 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 euro area, in normal economic times, this is expected to be achieved 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 EU countries 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 set by the Maastricht Treaty.

Structural (budget) balance: The headline budget balance net of the cyclical effect, 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: A government's ability to service its debt. From a purely theoretical point of view, sustainability means government debt 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 frames (*S0*, *S1* and *S2*). These 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 tools for euro area countries. These aim to make Member State' budgetary decision-making more transparent, strengthen coordination in the euro area, 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 this constraint, alternatives for stimulating 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 2022 surveillance cycle - the preventive arm of the SGP (see Box A1 on how to read the table)**

	Spring 2021			Autumn 2021	2022	Spring 2023		
		Fiscal recommendation for 2022				Final Commission assessment		
	Distance to MTO in 2021 % of GDP	Requirement	Flexibility clauses (granted ex ante)	Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2022 Spring Package)	Observed fiscal performance in 2022 (% of GDP)		Conclusion
						ΔSB	NEG*	
BE	-5.8	Use the RRF to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Preserve nationally financed investment.	Severe economic downturn clause	Belgium planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Belgium planned to preserve nationally financed investment.	Belgium planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Belgium planned to preserve nationally financed investment.	0.6 **No assessment of compliance**	-2.0	Belgium continued to support the recovery with investments financed by the Recovery and Resilience Facility. Belgium preserved nationally financed investment. Belgium did not sufficiently limit the growth in nationally financed current expenditure (not part of the recommendation).
BG	-1.6	Pursue a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. Keep the growth of nationally financed current expenditure under control.	idem	-	The fiscal stance was projected to be supportive. Bulgaria planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Bulgaria planned to preserve nationally financed investment. Bulgaria did not plan to sufficiently keep under control the growth of nationally financed current expenditure.	0.7 **No assessment of compliance**	-1.2	The fiscal stance was supportive. Bulgaria continued to support the recovery with investments to be financed by the Recovery and Resilience Facility and other EU funds. Bulgaria preserved nationally financed investment. Bulgaria sufficiently kept under control the growth in nationally financed current expenditure.
CZ	-6.7	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	idem	-	The fiscal stance was projected to be broadly neutral. Czechia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Czechia did not plan to preserve nationally financed investment.	1.3 **No assessment of compliance**	-0.1	The fiscal stance was broadly neutral. Czechia continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Czechia preserved nationally financed investment. Czechia sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).

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Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
		Fiscal recommendation for 2022				Final Commission assessment		
	Distance to MTO in 2021 % of GDP	Requirement	Flexibility clauses (granted ex ante)	Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2022 Spring Package)	Observed fiscal performance in 2022 (% of GDP)		Conclusion
						ΔSB	NEG*	
DK	0.6	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	Severe economic downturn clause	-	The fiscal stance was projected to be supportive. Denmark planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Denmark planned to preserve nationally financed investment.	**-1.3** **No assessment of compliance**	**0.6**	The fiscal stance was contractionary, which was appropriate in a context of high inflation. Denmark continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Denmark did not preserve nationally financed investment, which was not in line with the Council recommendation. Denmark sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
DE	-5.7	idem	idem	The Commission projected the fiscal stance to be supportive. Germany planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Germany planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. Germany planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Germany planned to preserve nationally financed investment.	**0.6** **No assessment of compliance**	**-2.7**	The fiscal stance was supportive. Germany continued to support the recovery with investments financed by the Recovery and Resilience Facility. Germany preserved nationally financed investment. Germany did not sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
EE	-3.7	idem	idem	idem	idem	**4.1** **No assessment of compliance**	**1.3**	The fiscal stance was contractionary, which was appropriate in a context of high inflation. Estonia continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Estonia did not preserve nationally financed investment, which was not in line with the Council recommendation. Estonia sufficiently limited the growth in nationally financed current expenditure (not part of the recommendation).

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Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
		Fiscal recommendation for 2022				Final Commission assessment		
	Distance to MTO in 2021 % of GDP	**Requirement**	**Flexibility clauses (granted ex ante)**	**Commission assessment of draft budgetary plan (DBP)**	**In-year assessment (Commission 2022 Spring Package)**	**Observed fiscal performance in 2022 (% of GDP)**		**Conclusion**
						ΔSB	**NEG***	
IE	-4.2	Pursue a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	Severe economic downturn clause	The Commission projected the fiscal stance to be supportive. Ireland planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Ireland planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. Ireland planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Ireland planned to preserve nationally financed investment.	**0.9**	**-0.2**	The fiscal stance was broadly neutral, which was appropriate in a context of high inflation. Ireland continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Ireland preserved nationally financed investment. Ireland sufficiently limited the growth in nationally financed current expenditure (not part of the recommendation).
						No assessment of compliance		
EL	-6.9	Use the Recovery and Resilience Facility to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Preserve nationally financed investment.	idem	Greece planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Greece planned to preserve nationally financed investment.	Greece planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Greece planned to preserve nationally financed investment.	**2.5**	**-1.0**	Greece continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Greece preserved nationally financed investment. Greece sufficiently limited the growth in nationally financed current expenditure (not part of the recommendation).
						No assessment of compliance		
ES	-4.9	idem	idem	idem	idem	**-0.4**	**-2.5**	Spain continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Spain preserved nationally financed investment. Spain did not sufficiently limit the growth in nationally financed current expenditure (not part of the recommendation).
						No assessment of compliance		

(Continued on the next page)

Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
		Fiscal recommendation for 2022				Final Commission assessment		
	Distance to MTO in 2021 % of GDP	**Requirement**	**Flexibility clauses (granted ex ante)**	**Commission assessment of draft budgetary plan (DBP)**	**In-year assessment (Commission 2022 Spring Package)**	**Observed fiscal performance in 2022 (% of GDP)**		**Conclusion**
						ΔSB	**NEG***	
FR	-6.3	Use the Recovery and Resilience Facility to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Preserve nationally financed investment.	Severe economic downturn clause	France planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. France planned to preserve nationally financed investment.	France planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. France planned to preserve nationally financed investment.	**0.9** **No assessment of compliance**	**-2.0**	France continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. France preserved nationally financed investment. France did not sufficiently limit the growth in nationally financed current expenditure (not part of the recommendation).
HR	-2.2	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. Keep the growth of nationally financed current expenditure under control.	idem	-	The fiscal stance was projected to be supportive. Croatia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Croatia planned to preserve nationally financed investment. Croatia did not plan to sufficiently keep under control the growth of nationally financed current expenditure.	**1.9** **No assessment of compliance**	**0.2**	The fiscal stance was broadly neutral, which was appropriate in a context of high inflation. Croatia continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Croatia did not preserve nationally financed investment, which was not in line with the Council recommendation. Croatia sufficiently kept under control the growth in nationally financed current expenditure.
IT	-9.8	Use the Recovery and Resilience Facility to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Preserve nationally financed investment. Limit the growth of nationally financed current expenditure	idem	Italy planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Italy planned to preserve nationally financed investment. Italy did not plan to sufficiently limit the growth of nationally financed current expenditure.	Italy planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Italy planned to preserve nationally financed investment. Italy did not plan to sufficiently limit the growth of nationally financed current expenditure.	**-0.2** **No assessment of compliance**	**-3.2**	Italy continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Italy preserved nationally financed investment. Italy sufficiently kept under control the growth in nationally financed current expenditure.

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Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
		Fiscal recommendation for 2022				Final Commission assessment		
	Distance to MTO in 2021 % of GDP	Requirement	Flexibility clauses (granted ex ante)	Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2022 Spring Package)	Observed fiscal performance in 2022 (% of GDP)		Conclusion
						ΔSB	NEG*	
CY	-4.7	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	Severe economic downturn clause	The Commission projected the fiscal stance to be supportive. Cyprus planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Cyprus planned to almost preserve nationally financed investment.	The fiscal stance was projected to be contractionary, while the Council recommended a supportive fiscal stance. Cyprus planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Cyprus did not plan to preserve nationally financed investment.	3.2 **No assessment of compliance**	0.0	The fiscal stance was neutral, which was appropriate in a context of high inflation. Cyprus continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Cyprus did not preserve nationally financed investment, which was not in line with the Council recommendation. Cyprus sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
LV	-5.2	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. Keep the growth of nationally financed current expenditure under control.	idem	The Commission projected the fiscal stance to be supportive. Latvia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Latvia planned to preserve nationally financed investment. Latvia did not plan to sufficiently keep under control the growth of nationally financed current expenditure.	The fiscal stance was projected to be supportive. Latvia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Latvia planned to preserve nationally financed investment. Latvia broadly kept under control the growth of nationally financed current expenditure.	2.5 **No assessment of compliance**	0.0	The fiscal stance was neutral, which was appropriate in a context of high inflation. Latvia continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Latvia did not preserve nationally financed investment, which was not in line with the Council recommendation. Latvia kept under control the growth in nationally financed current expenditure.
LT	-6.0	idem	idem	The Commission projected the fiscal stance to be supportive. Lithuania planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Lithuania planned to preserve nationally financed investment. Lithuania did not plan to sufficiently keep under control the growth of nationally financed current expenditure.	The fiscal stance is projected to be supportive. Lithuania planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Lithuania planned to preserve nationally financed investment. Lithuania did not plan to sufficiently keep under control the growth of nationally financed current expenditure.	1.1 **No assessment of compliance**	0.9	The fiscal stance was contractionary, which was appropriate in a context of high inflation. Lithuania continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Lithuania preserved nationally financed investment. Lithuania sufficiently kept under control the growth in nationally financed current expenditure.

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Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
		Fiscal recommendation for 2022				Final Commission assessment		
	Distance to MTO in 2021 % of GDP	Requirement	Flexibility clauses (granted ex ante)	Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2022 Spring Package)	Observed fiscal performance in 2022 (% of GDP)		Conclusion
						ΔSB	NEG*	
LU	0.6	Pursue a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	Severe economic downturn clause	The Commission projected the fiscal stance to be supportive. Luxembourg planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Luxembourg planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. Luxembourg planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Luxembourg planned to preserve nationally financed investment.	**-0.3** **No assessment of compliance**	**-0.9**	The fiscal stance was supportive. Luxembourg continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Luxembourg preserved nationally financed investment. Luxembourg did not sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
HU	-4.7	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	idem	-	The fiscal stance was projected to be broadly neutral. Hungary planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Hungary planned to preserve nationally financed investment.	**0.3** **No assessment of compliance**	**-0.4**	The fiscal stance was supportive. Hungary continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Hungary did not preserve nationally financed investment, which was not in line with the Council recommendation. Hungary sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
MT	-9.7	idem	idem	The Commission projected the fiscal stance to be neutral. Malta planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Malta planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. Malta planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Malta did not plan to preserve nationally financed investment.	**1.6** **No assessment of compliance**	**-0.2**	The fiscal stance was broadly neutral. Malta continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Malta did not preserve nationally financed investment, which was not in line with the Council recommendation. Malta sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).

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Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
	Distance to MTO in 2021 % of GDP	Fiscal recommendation for 2022		Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2022 Spring Package)	Final Commission assessment		
		Requirement	Flexibility clauses (granted ex ante)			Observed fiscal performance in 2022 (% of GDP)		Conclusion
						ΔSB	NEG*	
NL	-2.9	Pursue a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	Severe economic downturn clause	The Commission projected the fiscal stance to be supportive. The Netherlands were assumed to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. The Netherlands planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. The Netherlands planned the positive contribution to economic activity of expenditure financed by grants under the Recovery and Resilience Facility and other Union funds to remain stable compared to 2021. The Netherlands planned to preserve nationally financed investment.	**0.9** **No assessment of compliance**	**-0.5**	The fiscal stance was supportive. The Netherlands continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. The Netherlands did not preserve nationally financed investment, which was not in line with the Council recommendation. The Netherlands sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
AT	-5.3	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	idem	The Commission projected the fiscal stance to be supportive. Austria planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Austria planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. Austria planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Austria planned to preserve nationally financed investment.	**0.6** **No assessment of compliance**	**-2.8**	The fiscal stance was supportive. Austria continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Austria did not preserve nationally financed investment, which was not in line with the Council recommendation. Austria sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
PL	-2.9	Pursue a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	idem	-	idem	**-2.8** **No assessment of compliance**	**-3.0**	The fiscal stance was supportive. Poland continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Poland preserved nationally financed investment. Poland sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).

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Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
		Fiscal recommendation for 2022				Final Commission assessment		
	Distance to MTO in 2021 % of GDP	**Requirement**	**Flexibility clauses (granted ex ante)**	**Commission assessment of draft budgetary plan (DBP)**	**In-year assessment (Commission 2022 Spring Package)**	**Observed fiscal performance in 2022 (% of GDP)**		**Conclusion**
						ΔSB	**NEG***	
PT	-3.2	Use the Recovery and Resilience Facility to finance additional investment in support of the recovery while pursuing a prudent fiscal policy. Preserve nationally financed investment. Limit the growth of nationally financed current expenditure.	Severe economic downturn clause	Portugal submitted a new draft budgetary plan on 14 April 2022 and its assessment was in line with the in-year assessment.	Portugal planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Portugal planned to preserve nationally financed investment. Portugal planned to broadly limit the growth of nationally financed current expenditure.	**0.4** **No assessment of compliance**	**-1.5**	Portugal continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Portugal did not preserve nationally financed investment which was not in line with the Council recommendation. Portugal sufficiently limited the growth in nationally financed current expenditure.
SI	-7.5	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	idem	The Commission projected the fiscal stance to be supportive. Slovenia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Slovenia planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. Slovenia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Slovenia planned to preserve nationally financed investment.	**0.5** **No assessment of compliance**	**-1.2**	The fiscal stance was supportive. Slovenia continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Slovenia preserved nationally financed investment. Slovenia sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
SK	-5.0	idem	idem	The Commission projected the fiscal stance to be contractionary in a context of high output growth and emerging capacity constraints in 2022, broadly as recommended by the Council. Slovakia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Slovakia planned to almost preserve nationally financed investment.	The fiscal stance was projected to be contractionary, while the Council recommended a supportive fiscal stance. Slovakia planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Slovakia planned to preserve nationally financed investment.	**3.5** **No assessment of compliance**	**1.3**	The fiscal stance was contractionary, which was appropriate in a context of high inflation. Slovakia continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Slovakia preserved nationally financed investment. Slovakia sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).

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Table (continued)

	Spring 2021			Autumn 2021	2022	Spring 2023		
	Distance to MTO in 2021 % of GDP	Fiscal recommendation for 2022		Commission assessment of draft budgetary plan (DBP)	In-year assessment (Commission 2022 Spring Package)	Final Commission assessment		
		Requirement	Flexibility clauses (granted ex ante)			Observed fiscal performance in 2022 (% of GDP)		Conclusion
						ΔSB	NEG*	
FI	-2.8	Maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment.	Severe economic downturn clause	The Commission projected the fiscal stance to be supportive. Finland planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Finland planned to preserve nationally financed investment.	The fiscal stance was projected to be supportive. Finland planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Finland planned to preserve nationally financed investment.	**1.7**	**-0.1**	The fiscal stance was broadly neutral. Finland continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Finland preserved nationally financed investment. Finland sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
						No assessment of compliance		
SE	-0.9	idem	idem	-	The fiscal stance is projected to be supportive. Sweden planned to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. Sweden planned to preserve nationally financed investment.	**0.3**	**0.4**	The fiscal stance was contractionary, which was appropriate in a context of high inflation. Sweden continued to support the recovery with investments to be financed by the Recovery and Resilience Facility. Sweden preserved nationally financed investment. Sweden sufficiently kept under control the growth in nationally financed current expenditure (not part of the recommendation).
						No assessment of compliance		

* Net expenditure growth compared to the medium-term rate of nominal potential GDP (NEG) does not follow the methodology of the expenditure benchmark as defined in Regulation (EC) 1466/97, but an adapted version used in the fiscal recommendations for 2022. The adapted indicator does not smooth investment expenditure over the past four years, includes expenditure financed by transfers from the EU budget and excludes the impact of the Covid-19 pandemic-related temporary emergency measures. Moreover, the medium-term nominal potential growth uses estimates of the Commission 2023 spring forecast, as opposed to freezing the reference point at the beginning of the surveillance cycle (Commission 2021 spring forecast).
Source: European Commission

Table A2: **Application of EU fiscal rules in the 2022 surveillance cycle - the corrective arm of the SGP; countries not in EDP (see Box A1 on how to read the table)**

	Spring 2021		2022	Spring 2023		
				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	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Belgium's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was partly in line with the fiscal guidance contained in the Council recommendation and invited Belgium to take the necessary measures to ensure consistency with the recommendations.	Non-compliant	Compliant	**24.5.2023 –** The Commission confirmed that Belgium 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
BG	Compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
CZ	Non-compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
DE	Non-compliant	Non-compliant	**23.5.2022 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Germany 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Germany's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was partly in line with the fiscal guidance contained in the Council recommendation and invited Germany to take the necessary measures to ensure consistency with the recommendations.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.

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Table (continued)

EE	Non-compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Estonia's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was partly in line with the fiscal guidance contained in the Council recommendation and invited Estonia to take the necessary measures to ensure consistency with the recommendations.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
EL	Non-compliant	Non-compliant	**23.5.2022 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Greece 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Greece's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.	-	-	**24.5.2023** – Greece had the general government gross debt above 60% of GDP at the end of 2022, but respected the deficit criterion and the debt reduction benchmark; therefore Greece was not considered in the Commission's report.
ES	Non-compliant	Non-compliant	**23.5.2022 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Spain 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Spain's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.	Non-compliant	Compliant	**24.5.2023 –** The Commission 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
FR	Non-compliant	Non-compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on France's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.	Non-compliant	Non-compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.

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Table (continued)

IT	Non-compliant	Non-compliant	**23.5.2022 –** 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 ibecause of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **14.12.2022** – The Commission published its opinion on updated Italy's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.	Non-compliant	Non-compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
LV	Non-compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **24.2.2023** – The Commission published its opinion on updated Latvia's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
LT	Non-compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Lithuania's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was partly in line with the fiscal guidance contained in the Council recommendation and invited Lithuania to take the necessary measures to ensure consistency with the recommendations.	-	-	**24.5.2023** – Lithuania respected the deficit and the debt criteria; and was not considered in the Commission's report.
HU	Non-compliant	Non-compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy.	Non-compliant	Compliant	**24.5.2023 –** The Commission confirmed that Hungary 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
MT	Non-compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Malta's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.

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Table (continued)

AT	Non-compliant	Non-compliant	**23.5.2022 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Austria 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Austria's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was partly in line with the fiscal guidance contained in the Council recommendation and invited Austria to take the necessary measures to ensure consistency with the recommendations.	Compliant	Compliant	**24.5.2023 –** The Commission's report assessed that Austria fulfilled the deficit and debt criteria.
PL	Non-compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy.	Non-Compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
SI	Non-compliant	Non-compliant	**23.5.2022 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Slovenia 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Slovenia's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was partly in line with the fiscal guidance contained in the Council recommendation and invited Slovenia to take the necessary measures to ensure consistency with the recommendations.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
SK	Non-compliant	Compliant	**23.5.2022 –** 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Slovakia's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was partly in line with the fiscal guidance contained in the Council recommendation and invited Slovakia to take the necessary measures to ensure consistency with the recommendations.	Non-compliant	Compliant	**24.5.2023 –** 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 until spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.
FI	Non-compliant	Non-compliant	**23.5.2022 –** Further to Art. 126 (3) TFEU, the Commission prepared an Omnibus report confirming that Finland did not fulfil the debt 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 because of the exceptional uncertainty, including for designing a detailed path for fiscal policy. **22.11.2022** – The Commission published its opinion on Finland's DBP. The Opinion did not include an assessment of compliance with fiscal rules. It stated that the DBP was in line with the fiscal guidance contained in the Council recommendation of 12 July 2022.	Compliant	Non-compliant	**24.5.2023 –** 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 until Spring 2024 because of the uncertainty, including for designing a detailed path for fiscal policy.

Source: European Commission

Table A3: **Application of the EU fiscal rules in the 2022 surveillance cycle - the corrective arm of the SGP; countries in EDP (see Box A1 on how to read the table)**

	2021				2022	2023		
	EDP status (deadline)	Revised targets/requirements for 2022 % of GDP		Procedural steps before the reference period	Procedural steps during the reference period	Final assessment % of GDP		Procedural steps after the reference period
		Headline budget balance	Structural adjustment			Headline budget balance	Change in the structural budget balance	
RO	In abeyance (2024)	-6.2	-1.8	**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. **14.10.2020** – The Romanian authorities sent a report on effective action. **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.	**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.	-6.2	-0.4	**24.5.2023** – The Commission issued an assessment of Romania's compliance with its EDP targets in the recitals of the country-specific recommendations. Based on data validated by Eurostat, the Commission assessed that Romania complied with its nominal deficit target while the required structural adjustment in 2022 was well below the target. The latter called for careful analysis based on the expenditure benchmark which showed that net primary expenditure growth was 14.1%, well above recommended 1.3%. Since Romania complied with its headline budget balance target, the Commission has kept the procedure in abeyance.

Source: European Commission

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 2022 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 A1. Application of EU fiscal rules in the 2022 surveillance cycle: preventive arm

The application of the severe economic downturn clause for 2022 and its broad interpretations changed the standard fiscal surveillance methods under the preventive arm of the SGP in particular. Explanations for Table A1 describe surveillance practice for 2022 and the standard practice in normal years (before the activation of the severe economic downturn clause).

Distance to the medium-term budgetary objective (MTO): The difference between the country-specific medium-term budgetary objective and the 2021 structural balance, based on the Commission's 2021 spring forecast.

In normal years, this measure is used for establishing fiscal requirements underpinning the country-specific recommendations.

Requirement: For 2022, fiscal guidance was of a qualitative nature defining country-specific fiscal impulses ('fiscal stance' in Commission language) and some of its components (impulse provided by the Recovery and Resilience Facility; impulse of nationally-financed investment; or nationally-financed primary current expenditure). The non-binding notes to the fiscal recommendations (recitals) quantified a reference rate of 10-year average nominal potential growth. The fiscal impulse was measured by comparing this medium-term nominal potential growth rate with the annual rate of change in primary expenditure, net of discretionary revenue measures and Covid-related temporary measures, including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds.

In normal years, the annual adjustment requirement is expressed in terms of the two quantitative indicators of the SGP's preventive arm: (i) the expenditure benchmark and (ii) the change in the structural budget balance (ΔSB). The expenditure benchmark 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. 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 2022, the severe economic downturn clause was applied.

Commission overall assessment of the 2022 draft budgetary plan (DBP): In 2022, the assessment for euro-area Member States was qualitative, based on the Commission's assessment of the fiscal impulse.

In normal years, all euro-area countries submit their DBPs by 15 October, unless there is a macroeconomic adjustment programme (in line with Regulation (EU) 473/2013). 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 (2019).

In-year assessment: The Commission's assessment presented in the 2022 spring package.

Observed fiscal performance in 2022: Presents fiscal developments on the basis of two indicators: (i) the change in the structural budget balance (ΔSB); and (ii) net expenditure growth compared to the medium-term nominal potential

([1]) The *required structural adjustment based on matrix* is based on the matrix for specifying the annual adjustment required to achieve the medium-term budgetary objective under the preventive arm of the SGP, as presented in the Commonly agreed position on flexibility in the Stability and Growth Pact endorsed by the ECOFIN Council of 12 February 2016.

([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)

GDP growth (i.e. NEG). Both indicators are expressed as a percentage of GDP and were presented in the 2023 spring package.

In normal years, the observed deviation from (i) the ΔSB and (ii) the EB are monitored for the given year and over two consecutive years. The assessment of both indicators informs the overall conclusion on compliance, broad compliance or non-compliance.

Conclusion: Presents the Commission's final assessment for 2022 in the 2023 spring package. The Commission did not provide the usual compliance assessment for 2022, but provided a qualitative assessment compared to the qualitative fiscal guidance. The Commission did not take any procedural steps for the assessed deviations from the guidance.

In normal years, the Commission concludes on the overall assessment and follows up with procedural steps after the reference period in case of assessed non-compliance with the requirements.

Table A2. Application of EU fiscal rules in the 2022 surveillance cycle – the corrective arm: countries not subject to the excessive deficit procedure (EDP)

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

Debt rule (DR)/transitional arrangement – Minimum Linear Structural Adjustment (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; see Sections 2.2.1.2 and 2.2.1.3 of the Vade Mecum (2019).

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 2022, this column presents a single report written pursuant to Article 126(3) Treaty on the Functioning of the European Union, the first step in the EDP–and analyses compliance with the Treaty's deficit and debt criteria for 18 Member States; and assessments of the draft budgetary plans of euro-area 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. For 2022, this column presents the Commission's report under Article 126(3) TFEU, analysing compliance with the Treaty's deficit and debt criteria of 16 Member States.

Table A3. Application of EU fiscal rules in the 2022 surveillance cycle – the corrective arm: countries subject to the excessive deficit procedure (EDP)

EDP status (deadline): Presents a country's status in the EDP procedure; in brackets, the deadline set by the Council for correcting the excessive deficit.

Procedural steps before the reference period: This column presents all steps taken in 2021 and a Member State's status in the EDP procedure.

- **Headline budget balance:** The Council recommends that Member States subject to the EDP meet annual headline deficit targets to ensure the excessive deficit is corrected by a set deadline. This column presents the required headline budget balance for 2022 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 taken during the reference period: Covers all steps taken under the corrective arm of the SGP in 2022.

(Continued on the next page)

Box (continued)

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 2022 or information attesting to the correction of the excessive deficit.

- **Structural adjustment**: The estimated structural adjustment made in 2022, 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 (2019).

ANNEX B: STATISTICAL ANNEX

Table B1: **Gross domestic product at constant prices (annual percentage change, 2005-2024)**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
BE	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	2.3	-5.4	6.3	3.2	1.2	1.4
BG	7.1	6.8	6.7	6.1	-3.3	1.5	2.1	0.8	-0.6	1.0	3.4	3.0	2.8	2.7	4.0	-4.0	7.6	3.4	1.5	2.4
CZ	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	-5.5	3.6	2.5	0.2	2.6
DK	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	1.5	-2.0	4.9	3.8	0.3	1.5
DE	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	1.0	1.1	-3.7	2.6	1.8	0.2	1.4
EE	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	3.8	3.7	-0.6	8.0	-1.3	-0.4	3.1
IE	5.7	5.0	5.3	-4.5	-5.1	1.7	0.8	0.0	1.1	8.6	24.4	2.0	9.0	8.5	5.4	6.2	13.6	12.0	5.5	5.0
EL	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	1.9	-9.0	8.4	5.9	2.4	1.9
ES	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	2.0	-11.3	5.5	5.5	1.9	2.0
FR	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	-7.8	6.8	2.6	0.7	1.4
HR	4.3	4.9	5.0	2.0	-7.2	-1.2	-0.1	-2.3	-0.4	-0.4	2.5	3.6	3.4	2.8	3.4	-8.5	13.1	6.2	1.6	2.3
IT	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	7.0	3.7	1.2	1.1
CY	4.9	4.7	5.1	3.6	-2.0	2.3	0.4	-3.4	-6.6	-1.8	3.4	6.6	5.7	5.6	5.5	-4.4	6.6	5.6	2.3	2.7
LV	10.7	12.0	9.9	-3.2	-14.3	-4.5	2.6	7.0	2.0	1.9	3.9	2.4	3.3	4.0	2.6	-2.3	4.3	2.8	1.4	2.8
LT	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	0.0	6.0	1.9	0.5	2.7
LU	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	1.2	2.3	-0.8	5.1	1.5	1.6	2.4
HU	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	4.9	-4.5	7.2	4.6	0.5	2.8
MT	3.4	2.5	4.8	3.8	-1.1	5.5	0.5	4.1	5.5	7.6	9.6	3.4	10.9	6.2	7.0	-8.6	11.8	6.9	3.9	4.1
NL	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	-3.9	4.9	4.5	1.8	1.2
AT	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	2.4	1.5	-6.5	4.6	5.0	0.4	1.6
PL	3.5	6.1	7.1	4.2	2.8	2.9	5.0	1.5	0.9	3.8	4.4	3.0	5.1	5.9	4.5	-2.0	6.9	5.1	0.7	2.7
PT	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	-8.3	5.5	6.7	2.4	1.8
RO	4.7	8.0	7.2	9.3	-5.5	-3.9	4.5	1.9	0.3	4.1	3.2	2.9	8.2	6.0	3.9	-3.7	5.8	4.7	3.2	3.5
SI	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	4.5	3.5	-4.3	8.2	5.4	1.2	2.2
SK	6.6	8.5	10.8	5.6	-5.5	6.7	2.7	1.3	0.6	2.7	5.2	1.9	2.9	4.0	2.5	-3.3	4.9	1.7	1.7	2.1
FI	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	-2.4	3.0	2.1	0.2	1.4
SE	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	-2.2	5.4	2.6	-0.5	1.1
EA-20	1.7	3.2	3.0	0.4	-4.5	2.1	1.6	-0.9	-0.2	1.4	2.0	1.9	2.6	1.8	1.6	-6.1	5.4	3.5	1.1	1.6
EU-27	1.9	3.5	3.1	0.6	-4.3	2.2	1.8	-0.7	-0.1	1.6	2.3	2.0	2.8	2.1	1.8	-5.6	5.4	3.5	1.0	1.7

Note: EA and EU aggregated figures are weighted in common currency.
Source: European Commission 2023 spring forecast

Table B2: **Harmonised index of consumer prices (percentage change on preceding year, 2005-2024)**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
BE	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	10.3	3.4	3.5
BG	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	13.0	9.4	4.2
CZ	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	14.8	11.9	3.4
DK	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	8.5	4.3	2.5
DE	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	8.7	6.8	2.7
EE	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	19.4	9.2	2.8
IE	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	8.1	4.6	2.6
EL	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	9.3	4.2	2.4
ES	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	8.3	4.0	2.7
FR	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	5.9	5.5	2.5
HR	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	10.7	6.9	2.2
IT	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	8.7	6.1	2.9
CY	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	8.1	3.8	2.5
LV	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	17.2	9.3	1.7
LT	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	18.9	9.2	2.2
LU	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	8.2	3.2	2.6
HU	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	15.3	16.4	4.0
MT	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	6.1	5.4	2.8
NL	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	11.6	4.9	3.3
AT	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	8.6	7.1	3.8
PL	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	13.2	11.7	6.0
PT	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	8.1	5.1	2.7
RO	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	12.0	9.7	4.6
SI	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	9.3	7.0	3.8
SK	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	12.1	10.9	5.7
FI	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	7.2	4.8	2.1
SE	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	8.1	6.0	1.9
EA-20	2.2	2.2	2.2	3.4	0.3	1.6	2.7	2.5	1.4	0.4	0.2	0.2	1.5	1.8	1.2	0.3	2.6	8.4	5.8	2.8
EU-27	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	9.2	6.7	3.1

Note: National index if not available.
Source: European Commission 2023 spring forecast

Table B3: **Net lending (+) or net borrowing (-), general government (as a percentage of GDP, 2005-2024)**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
BE	-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	-3.9	-5.0	-4.7
BG	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	-3.8	-3.9	-2.8	-4.8	-4.8
CZ	-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	-5.1	-3.6	-3.6	-3.0
DK	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	3.6	3.3	2.3	1.3
DE	-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	-2.6	-2.3	-1.2
EE	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	-5.5	-2.4	-0.9	-3.1	-2.7
IE	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	-5.0	-1.6	1.6	1.7	2.2
EL	-6.2	-5.9	-6.7	-10.2	-15.2	-11.4	-10.5	-9.1	-13.4	-3.7	-5.9	0.2	0.6	0.9	0.9	-9.7	-7.1	-2.3	-1.3	-0.6
ES	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	-10.1	-6.9	-4.8	-4.1	-3.3
FR	-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	-9.0	-6.5	-4.7	-4.7	-4.3
HR	-3.0	-1.9	-2.1	-2.3	-7.0	-6.7	-7.6	-5.5	-5.5	-5.2	-3.5	-1.0	0.6	-0.1	0.2	-7.3	-2.5	0.4	-0.5	-1.3
IT	-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	-9.7	-9.0	-8.0	-4.5	-3.7
CY	-2.2	-1.0	3.2	0.9	-5.4	-4.7	-5.7	-5.7	-5.6	-8.8	-0.9	0.3	1.9	-3.6	1.3	-5.8	-2.0	2.1	1.8	2.1
LV	-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	-4.4	-7.1	-4.4	-3.8	-2.7
LT	-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	-6.5	-1.2	-0.6	-1.7	-1.4
LU	-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	2.2	-3.4	0.7	0.2	-1.7	-1.5
HU	-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	-2.0	-7.5	-7.1	-6.2	-4.0	-4.4
MT	-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	2.0	0.5	-9.7	-7.8	-5.8	-5.1	-4.5
NL	-0.5	0.0	-0.2	0.1	-5.2	-5.3	-4.4	-3.9	-3.0	-2.3	-1.9	0.1	1.4	1.5	1.8	-3.7	-2.4	0.0	-2.1	-1.7
AT	-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	-5.8	-3.2	-2.4	-1.3
PL	-3.9	-3.5	-1.9	-3.6	-7.3	-7.5	-5.0	-3.8	-4.3	-3.7	-2.6	-2.4	-1.5	-0.2	-0.7	-6.9	-1.8	-3.7	-5.0	-3.7
PT	-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	-2.9	-0.4	-0.1	-0.1
RO	-0.8	-2.1	-2.8	-5.4	-9.5	-7.1	-5.6	-3.8	-2.3	-1.2	-0.5	-2.5	-2.5	-2.8	-4.3	-9.2	-7.1	-6.2	-4.7	-4.4
SI	-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	0.7	-7.7	-4.6	-3.0	-3.7	-2.9
SK	-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	-1.2	-5.4	-5.4	-2.0	-6.1	-4.8
FI	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	-5.6	-2.8	-0.9	-2.6	-2.6
SE	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	-2.8	0.0	0.7	-0.9	-0.5
EA-20	-2.6	-1.5	-0.7	-2.2	-6.2	-6.3	-4.3	-3.8	-3.1	-2.5	-2.0	-1.5	-0.9	-0.4	-0.6	-7.1	-5.3	-3.6	-3.2	-2.4
EU-27	-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	-0.5	-6.7	-4.8	-3.4	-3.1	-2.4

Source: European Commission 2023 spring forecast

Table B4: **Interest expenditure, general government (as a percentage of GDP, 2005-2024)**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
BE	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	2.0	1.7	1.5	1.7	2.0
BG	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	0.6
CZ	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	0.8	1.2	1.3	1.3
DK	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	0.6	0.6	0.7	0.6	0.5
DE	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	0.7	0.8	0.9
EE	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	0.1	0.4	0.6
IE	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	0.7	0.6	0.6
EL	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	3.2	3.2
ES	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	2.4	2.5	2.4
FR	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	1.9	2.0	2.0
HR	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	1.5	1.4	1.2	1.2
IT	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	3.6	4.4	4.0	4.1
CY	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	1.5	1.3	1.3
LV	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	0.6	0.5	0.5	0.6	0.8
LT	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	0.4	0.5	0.6
LU	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	0.2	0.3	0.3
HU	4.1	3.8	4.0	4.1	4.5	4.1	4.1	4.6	4.5	4.0	3.4	3.1	2.6	2.3	2.2	2.3	2.3	2.8	3.9	4.3
MT	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	1.1	1.0	1.2	1.5
NL	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	0.5	0.7	0.7
AT	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	0.9	1.1	1.3
PL	2.5	2.4	2.2	2.1	2.5	2.5	2.6	2.7	2.6	2.0	1.8	1.7	1.6	1.4	1.4	1.3	1.1	1.6	2.0	2.1
PT	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	2.0	2.2	2.7
RO	1.2	0.8	0.7	0.8	2.0	1.9	2.0	2.2	2.1	1.8	1.6	1.4	1.1	1.0	1.0	1.2	1.1	1.2	1.8	1.7
SI	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	1.2	1.1	1.2	1.3
SK	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	1.3	1.2	1.2	1.1	1.0	1.1	1.2
FI	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	0.9	0.7	0.5	0.5	0.8	1.2
SE	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	0.5	0.7	0.6
EA-20	2.9	2.8	2.9	2.9	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	1.7	1.7	1.8
EU-27	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	1.6	1.7	1.8

Source: European Commission 2023 spring forecast

Table B5: **Structural budget balance, general government (as a percentage of GDP, 2013-2024)**

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
BE	-3.0	-3.0	-2.6	-2.3	-1.3	-1.8	-3.0	-5.8	-4.7	-4.2	-4.9	-4.5
BG	-0.6	-1.7	-1.4	0.5	1.7	1.8	1.7	-2.4	-4.0	-3.2	-5.0	-5.0
CZ	-0.1	-0.8	-0.7	0.8	0.7	0.0	-0.8	-4.1	-4.5	-3.2	-2.7	-2.4
DK	-0.7	-0.2	-1.3	0.5	2.0	1.0	4.5	2.6	4.4	3.1	3.5	2.1
DE	0.5	1.0	1.2	1.0	0.7	1.5	0.9	-2.7	-2.9	-2.3	-2.0	-1.0
EE	0.9	1.0	0.8	-0.1	-1.3	-1.3	-0.5	-4.1	-4.3	-0.2	-1.2	-1.3
IE	-5.5	-4.8	-3.6	-1.6	-1.0	0.3	2.6	-1.8	-1.7	-0.8	-0.1	1.0
EL	4.6	4.6	4.3	6.4	6.1	5.9	3.0	-3.1	-4.7	-2.2	-1.5	-1.0
ES	-1.3	-0.6	-1.7	-2.6	-2.5	-2.7	-3.8	-3.7	-3.6	-4.0	-3.7	-3.2
FR	-3.0	-2.7	-2.6	-2.8	-2.8	-3.0	-3.5	-4.8	-5.6	-4.7	-4.4	-4.2
HR	-2.1	-3.3	-2.3	-0.8	0.3	-0.9	-0.9	-3.5	-2.9	-1.0	-1.3	-1.9
IT	-0.7	-0.7	-0.4	-1.4	-2.0	-2.4	-1.9	-5.2	-8.4	-8.6	-5.3	-4.5
CY	-0.7	4.5	2.9	1.1	1.4	2.6	-0.1	-4.5	-2.4	0.7	0.9	1.3
LV	-1.0	-1.2	-1.9	-0.7	-1.6	-2.0	-1.4	-3.4	-6.7	-4.2	-3.5	-2.6
LT	-1.8	-1.2	-0.6	-0.3	-0.7	-0.8	-1.1	-6.4	-1.6	-0.4	-0.6	-0.3
LU	1.7	2.1	1.9	1.4	1.4	3.3	2.5	-2.0	0.8	0.5	-1.1	-0.8
HU	-1.3	-2.3	-2.3	-2.1	-3.8	-3.7	-3.7	-5.8	-6.7	-6.4	-3.2	-3.8
MT	-2.0	-2.6	-2.7	1.0	1.5	0.2	-1.3	-5.3	-7.1	-5.5	-4.6	-3.9
NL	-1.7	-0.8	-0.9	0.4	0.6	0.7	0.8	-1.3	-1.6	-0.7	-2.7	-1.9
AT	-1.1	-0.7	0.0	-1.2	-1.1	-0.8	-0.7	-4.9	-4.4	-3.8	-2.5	-1.5
PL	-3.2	-2.6	-2.1	-1.9	-1.7	-1.4	-2.1	-5.7	-2.2	-5.0	-4.5	-2.9
PT	-3.1	-1.7	-2.1	-1.8	-1.4	-0.8	-0.9	-1.6	-1.3	-0.8	-0.8	-0.8
RO	-1.4	-0.9	-0.4	-1.4	-2.7	-3.0	-4.6	-7.4	-6.2	-5.8	-4.3	-4.1
SI	-11.0	-1.3	-0.5	-0.4	-0.1	-0.4	-0.9	-6.1	-5.6	-5.0	-4.9	-3.7
SK	-1.6	-2.4	-2.5	-2.4	-1.1	-1.8	-2.0	-4.3	-5.5	-2.0	-5.8	-4.5
FI	-0.9	-1.1	-0.6	-0.9	-1.0	-1.1	-1.3	-3.9	-2.3	-0.6	-1.8	-1.9
SE	-0.2	-0.6	-0.3	0.7	1.0	0.6	0.4	-0.7	0.3	0.6	0.1	0.7
EA-20	-1.2	-0.7	-0.7	-0.9	-1.0	-0.8	-1.2	-3.7	-4.3	-3.7	-3.2	-2.5
EU-27	-1.2	-0.8	-0.8	-0.8	-0.9	-0.8	-1.1	-3.6	-3.9	-3.5	-3.0	-2.4

Source: European Commission 2023 spring forecast

Table B6: **Gross debt, general government (as a percentage of GDP, 2005-2024)**

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
BE	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	99.9	97.6	112.0	109.1	105.1	106.0	107.3
BG	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	24.5	23.9	22.9	25.0	28.1
CZ	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	30.0	37.7	42.0	44.1	42.9	43.1
DK	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	33.7	42.2	36.7	30.1	30.1	28.8
DE	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	61.3	59.6	68.7	69.3	66.3	65.2	64.1
EE	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	8.5	18.5	17.6	18.4	19.5	21.3
IE	26.1	23.6	23.9	42.5	61.8	86.2	110.5	119.6	120.0	104.3	76.7	74.3	67.6	63.0	57.0	58.4	55.4	44.7	40.4	38.3
EL	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	180.6	206.3	194.6	171.3	160.2	154.4
ES	42.4	39.1	35.8	39.7	53.3	60.5	69.9	90.0	100.5	105.1	103.3	102.7	101.8	100.4	98.2	120.4	118.3	113.2	110.6	109.1
FR	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	111.6	109.6	109.5
HR	40.9	38.4	37.2	39.0	48.2	57.1	63.4	69.2	80.1	83.8	83.2	79.7	76.5	73.2	71.0	87.0	78.4	68.4	63.0	61.8
IT	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	154.9	149.9	144.4	140.4	140.3
CY	63.4	59.3	54.0	45.5	54.3	56.3	65.8	80.1	103.7	108.8	106.8	102.6	92.6	98.1	90.8	113.8	101.2	86.5	80.4	72.5
LV	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	37.0	36.5	42.0	43.7	40.8	39.7	40.5
LT	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	35.8	46.3	43.7	38.4	37.1	36.6
LU	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	20.9	22.4	24.5	24.5	24.6	25.9	27.0
HU	60.5	64.4	65.6	71.8	78.0	80.0	80.3	78.2	77.2	76.5	75.8	74.9	72.1	69.1	65.3	79.3	76.6	73.3	70.7	71.1
MT	69.9	64.3	61.9	61.8	66.3	65.5	70.0	66.6	66.4	62.1	56.2	54.7	47.8	43.7	40.3	52.9	55.1	53.4	54.8	56.1
NL	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	54.7	52.5	51.0	49.3	48.8
AT	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	82.9	82.3	78.4	75.4	72.7
PL	46.6	47.3	44.5	46.7	49.8	54.0	55.1	54.8	57.1	51.4	51.3	54.5	50.8	48.7	45.7	57.2	53.6	49.1	50.5	53.0
PT	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	134.9	125.4	113.9	106.2	103.1
RO	15.9	12.4	11.9	12.3	21.8	29.0	32.3	35.4	37.8	39.2	37.8	37.9	35.3	34.5	35.1	46.9	48.6	47.3	45.6	46.1
SI	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	65.4	79.6	74.5	69.9	69.1	66.6
SK	34.7	31.4	30.3	28.6	36.4	40.6	43.2	51.7	54.7	53.5	51.7	52.3	51.5	49.4	48.0	58.9	61.0	57.8	58.3	58.7
FI	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	64.9	64.9	74.7	72.6	73.0	73.9	76.2
SE	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	39.2	35.5	39.8	36.5	33.0	31.4	30.7
EA-20	70.3	68.3	65.8	69.5	80.1	85.7	88.2	92.8	95.2	95.4	93.4	92.4	89.8	87.9	85.9	99.1	97.2	93.1	90.8	89.9
EU-27	67.1	64.9	62.2	65.0	75.7	80.5	82.3	86.6	88.7	88.9	86.9	86.1	83.4	81.4	79.3	91.7	89.5	85.3	83.4	82.6

Source: European Commission 2023 spring forecast

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

	Primary balance						Snowball effect (1)						Stock-flow adjustment (2)					
	average 2014-2019	2020	2021	2022	2023	2024	average 2014-2019	2020	2021	2022	2023	2024	average 2014-2019	2020	2021	2022	2023	2024
BE	0.9	-7.0	-3.8	-2.4	-3.3	-2.8	-0.8	6.0	-7.8	-7.8	-3.3	-1.8	0.2	1.4	1.1	1.4	0.9	0.4
BG	0.5	-3.3	-3.4	-2.3	-4.3	-4.2	-0.8	0.5	-2.8	-3.4	-1.9	-0.9	1.8	0.8	-1.2	0.0	-0.2	-0.3
CZ	1.0	-5.0	-4.3	-2.5	-2.3	-1.6	-1.1	1.2	-1.7	-3.1	-3.2	-2.0	-0.2	1.4	1.7	2.7	-0.3	0.5
DK	2.2	0.8	4.2	4.1	2.9	1.8	0.0	0.4	-2.5	-3.1	0.4	-0.5	0.5	8.9	1.1	0.6	2.5	1.0
DE	2.4	-3.7	-3.2	-1.9	-1.5	-0.3	-1.3	1.8	-3.2	-4.1	-3.1	-1.5	0.6	3.6	0.6	-0.8	0.6	0.0
EE	0.0	-5.4	-2.4	-0.8	-2.7	-2.1	-0.6	0.1	-2.3	-2.2	-1.2	-0.7	0.2	4.4	-1.0	2.2	-0.3	0.3
IE	1.3	-4.0	-0.8	2.2	2.3	2.8	-7.2	-1.4	-6.6	-7.8	-3.6	-2.3	-2.1	-1.1	2.7	-0.7	1.6	2.9
EL	2.2	-6.7	-4.7	0.1	1.9	2.5	2.8	22.6	-16.0	-22.2	-8.3	-4.3	-0.2	-3.6	-0.4	-0.9	-0.8	1.0
ES	-1.3	-7.9	-4.7	-2.4	-1.6	-0.9	-0.6	13.5	-6.7	-8.3	-4.4	-2.8	-1.1	0.8	-0.1	0.9	0.1	0.4
FR	-1.4	-7.7	-5.1	-2.8	-2.7	-2.3	-0.4	6.3	-7.1	-4.2	-4.5	-2.3	-0.3	3.2	0.2	0.1	-0.3	0.0
HR	1.4	-5.3	-0.9	1.8	0.7	-0.2	0.2	8.1	-10.0	-9.3	-4.6	-2.1	-0.4	2.5	0.5	1.1	-0.1	0.8
IT	1.6	-6.2	-5.5	-3.6	-0.5	0.5	1.5	14.4	-7.4	-5.2	-5.7	-1.0	0.3	0.2	-3.1	-3.9	1.2	1.4
CY	1.0	-3.7	-0.2	3.6	3.2	3.4	-1.4	7.4	-8.2	-9.7	-4.7	-3.0	0.2	11.8	-4.6	-1.4	1.7	-1.6
LV	0.1	-3.7	-6.7	-3.9	-3.2	-1.9	-0.9	1.1	-3.6	-5.7	-3.3	-1.3	0.4	0.6	-1.2	-1.2	-1.0	0.2
LT	1.3	-5.8	-0.7	-0.3	-1.3	-0.7	-0.9	0.0	-4.8	-6.6	-3.3	-1.4	1.7	4.6	1.5	1.1	0.8	0.2
LU	2.2	-3.2	0.9	0.3	-1.5	-1.1	-0.5	-0.6	-2.4	-1.7	-1.4	-1.1	2.7	-0.5	3.3	2.1	1.2	1.1
HU	0.8	-5.2	-4.9	-3.5	-0.1	-0.1	-2.4	1.3	-7.5	-10.3	-4.9	0.0	1.2	7.4	0.0	3.5	2.2	0.4
MT	2.7	-8.4	-6.7	-4.8	-3.9	-3.1	-3.2	4.4	-5.3	-5.1	-2.9	-2.2	1.5	-0.1	0.8	-1.4	0.4	0.5
NL	1.2	-3.0	-1.8	0.6	-1.4	-1.0	-0.9	1.7	-3.2	-4.2	-3.1	-1.1	-1.0	1.4	-0.8	3.3	0.0	-0.3
AT	1.1	-6.6	-4.7	-2.2	-1.3	-0.1	-0.7	4.3	-4.0	-6.7	-4.4	-2.9	0.0	1.3	-1.3	0.5	0.1	0.1
PL	-0.2	-5.6	-0.7	-2.2	-3.0	-1.7	-1.2	0.3	-5.3	-6.2	-3.5	-1.9	-0.9	5.5	1.0	-0.4	1.9	2.8
PT	1.1	-2.9	-0.5	1.6	2.0	2.6	-0.9	10.9	-6.5	-10.9	-6.6	-1.5	-0.5	4.4	-3.5	1.0	0.9	1.0
RO	-1.0	-8.0	-6.0	-5.0	-2.9	-2.7	-1.7	1.1	-3.6	-6.5	-4.1	-2.3	0.3	2.6	-0.6	0.1	-0.5	0.0
SI	1.1	-6.1	-3.4	-1.9	-2.5	-1.6	-0.9	3.7	-6.7	-7.5	-4.4	-3.0	1.3	4.4	-1.8	1.0	1.1	-1.1
SK	-0.4	-4.2	-4.3	-1.0	-5.0	-3.6	-0.4	1.7	-2.9	-4.2	-5.0	-3.1	-1.0	5.0	0.8	-0.1	0.4	-0.1
FI	-0.5	-4.9	-2.2	-0.3	-1.7	-1.3	-0.6	1.2	-3.2	-3.8	-2.4	-1.5	1.5	3.8	-1.2	3.9	1.5	2.5
SE	0.9	-2.5	0.2	1.2	-0.2	0.1	-1.4	0.4	-2.9	-2.4	-0.9	-0.3	1.5	1.5	-0.2	0.0	-0.8	-0.4
EA-19	0.8	-5.6	-3.9	-1.9	-1.4	-0.6	-0.8	5.4	-5.5	-5.7	-4.2	-1.9	0.0	2.2	-0.3	-0.3	0.5	0.4
EU-27	0.7	-5.3	-3.4	-1.8	-1.4	-0.7	-0.8	4.7	-5.4	-5.6	-4.0	-1.9	0.0	2.3	-0.2	-0.4	0.6	0.5

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: European Commission 2023 spring forecast

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