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Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

**amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of
budgetary positions and the surveillance and coordination of economic policies**

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

The global economic and financial crisis has exposed and amplified the need for greater co-ordination and enhanced surveillance of economic policies in the economic and monetary union (EMU). Existing instruments and methods of co-ordination and surveillance enabled the EU to weather a storm that no Member State could have withstood on its own. The European institutions and Member States reacted quickly and are continuing to work together to recover from a crisis that has no precedent in our generation.

However, these recent experiences also revealed remaining gaps and weaknesses in the current system of coordination and in the existing surveillance procedures. There is a broad agreement that the framework for EMU should be urgently strengthened in order to anchor macroeconomic stability and the sustainability of public finances, which are preconditions for durable output and employment growth.

The crisis has drastically reversed the favourable economic and financial conditions that prevailed until 2007 and made clear yet again that windfalls accumulated during good times had not been sufficiently used to create room for manoeuvre when times turn bad. Very sizeable consolidation will be necessary in most Member States to bring public debt back onto a downward path. This is all the more urgent as European societies and economies are facing the effects of ageing populations, which will put further pressure on labour supply and public budgets. Reducing debt levels is highly relevant for most countries in view of their negative effects on economic incentives and growth through higher taxes and risk premia.

The key instrument for fiscal policy co-ordination and surveillance is the Stability and Growth Pact (SGP), which implements the Treaty provisions on budgetary discipline. Strengthening the Pact is important for both increasing the credibility of the agreed co-ordinated fiscal exit strategy and avoiding a repetition of past mistakes. The set of proposals now being presented aims to strengthen the Pact by: (i) improving its provisions in the light of experience, not least of the crisis; (ii) equipping it with more effective enforcement instruments; and (iii) complementing it with provisions on national fiscal frameworks. This set of proposals is part of a broader reform of economic governance under the umbrella of the Europe 2020 strategy, which includes proposals for addressing macroeconomic imbalances through stronger surveillance, including alert and sanction mechanisms. The different strands of economic policy coordination, including surveillance of structural reforms, are to be integrated in a new surveillance cycle, the European Semester, which will bring together existing processes under the SGP and the Broad Economic Policy Guidelines, including simultaneous submission of stability and convergence programmes and national reform programmes.

2. RESULTS OF CONSULTATIONS WITH INTERESTED PARTIES

The outlines of the present proposals were announced by the Commission in two communications: Reinforcing economic policy coordination of 12 May 2010 and Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance of 30 June 2010. In opting for a formal communication, the Commission wished to demonstrate its commitment to fostering dialogue with Member States, the European

Parliament and all stakeholders, while at the same time delivering concrete proposals for action.

In June 2010, the European Council agreed on the urgent need to reinforce the coordination of our economic policies. The agreement included first orientations as regards the SGP and budgetary surveillance. In particular, the European Council agreed on: (i) strengthening both the preventive and corrective parts of the SGP, including with sanctions and taking due account of the particular situation of euro-area Member States; (ii) giving, in budgetary surveillance, a much more prominent role to levels and evolutions of debt and overall sustainability; (iii) ensuring that all Member States have national budgetary rules and medium term budgetary frameworks in line with the SGP; (iv) ensuring the quality of statistical data.

The European Council invited the Task Force on economic governance chaired by its President and established in March 2010 and the Commission to rapidly develop further and make operational these orientations. A constructive relationship developed between the Commission and the Task Force. The Commission contributed to the work of the Task Force through the Communications referred to above and through ad hoc contributions.

3. LEGAL ELEMENTS OF THE PROPOSAL

The legal basis for the SGP is laid down in Articles 121 and 126 of the Treaty on the Functioning of the European Union. The SGP consists of: Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (referred to as preventive part); Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (referred to as corrective part); and the Resolution of the European Council of 17 June 1997 on the Stability and Growth Pact. These Regulations were amended in 2005 by Regulations (EC) No 1055/2005 and (EC) No 1056/2005 and complemented by the Council Report of 20 March 2005 on 'Improving the implementation of the Stability and Growth Pact'. The present proposals seek further amendments to Regulations No 1466/97 and (EC) No 1467/97. Additional enforcement instruments are proposed in a new Regulation of the European Parliament and the Council on the effective enforcement of budgetary surveillance in the euro area, based on Article 136 of the Treaty, in combination with Article 121(6). The requirements for the budgetary frameworks of the Member States are the subject of a new Council Directive based on Article 126(14): the Directive aims in particular to specify the obligations of national authorities to comply with the provisions of Article 3 of Protocol No 12 to the Treaties on the excessive deficit procedure.

The preventive part of the SGP is meant to ensure that Member States follow prudent fiscal policies so that there is no need to adopt more stringent forms of coordination to avoid public finance sustainability being put at risk, with potential negative consequences for EMU as a whole. Accordingly, Member States are required to present stability and convergence programmes outlining their plans to achieve medium-term budgetary objectives (MTOs), which are defined as a percentage of GDP in structural terms (i.e. adjusting for the effect of the cycle and excluding one-off and temporary measures) and are differentiated across countries around a close-to-balance position to reflect the level of public debt and liabilities related to ageing. Member States not having reached their MTO are expected to converge towards it at an annual pace of 0.5% of GDP in structural terms.

However, progress towards MTOs has been generally insufficient, leaving public finances badly exposed to the economic downturn. Moreover, the structural balance has in practice proved an insufficient measure of a country's underlying fiscal position, owing to the difficulty of assessing the cyclical position of the economy in real time and to insufficient account being taken of revenue windfalls and shortfalls not directly related to the economic cycle (in particular housing and financial market developments). As a result, in a number of countries, even apparently sound budgetary positions before the crisis masked a strong reliance on windfall revenues to finance expenditure, the reversal of which contributed to soaring budget deficits.

To respond to these shortcomings the reform of the preventive part that is being proposed, while retaining the current MTOs and the 0.5% of GDP annual convergence requirement, makes them operational in terms of a new principle of prudent fiscal policy-making. This principle implies that annual expenditure growth should not exceed – and if the MTO has not been achieved should be clearly below – a prudent medium-term rate of growth of GDP, unless the MTO has been significantly overachieved or the excess of expenditure growth over the prudent medium-term rate is matched by discretionary measures on the revenue side. The essential aim is to ensure that revenue windfalls are not spent but are instead allocated to debt reduction. The new principle will provide the benchmark against which countries' fiscal plans in the stability and convergence programme will be examined. Additionally, failure to respect keep to the agreed rate of growth of expenditure, in conjunction with the stipulated revenue measures, will make the Member State concerned liable to a warning from the Commission and, if persistent and/or particularly serious, a Council recommendation to take corrective action issued under Article 121 of the Treaty. Such a recommendation, while being issued in the context of the preventive part, would be backed, for the first time and for euro-area countries only, by an enforcement mechanism under Article 136 of the Treaty, in the form of an interest-bearing deposit, amounting to 0.2% of GDP. A procedure of 'reverse voting' mechanism is introduced for imposing the interest-bearing deposit: on the issue of a recommendation, the deposit would become due on proposal by the Commission, unless the Council decides to the contrary by qualified majority within ten days. The Council could reduce the amount of the deposit only unanimously or based on a Commission proposal and a reasoned request from the Member State concerned. The deposit will be returned with the accrued interest once the Council is satisfied that the situation giving rise to it has come to an end.

The corrective part of the SGP is meant to avoid gross errors in budgetary policies, which might put at risk the sustainability of public finances and potentially endanger EMU. This translates into the obligation for Member States to avoid excessive government deficits, which are defined against a numerical threshold for deficit (3% of GDP) and debt (60% of GDP or sufficiently declining toward it). The excessive deficit procedure (EDP) that implements the ban on excessive deficits provides for a sequence of steps, which, for euro-area countries, include the eventual imposition of financial sanctions.

The EDP has been regularly applied in line with the relevant provisions, even against the background of the exceptional circumstances of the financial crisis, thereby contributing to anchoring expectations of its orderly resolution. However a number of shortcomings have emerged. While the deficit and the debt criterion are in principle on an equal footing, and persistently high levels of debt arguably represent a more serious threat to public finance sustainability than occasionally high deficits, in practice the '3% of GDP' threshold has been the almost exclusive focus of the EDP, with debt playing a marginal role so far. This owes to the less straightforward nature of the debt threshold compared to the deficit, including the

ambiguity of the notion of sufficiently diminishing pace of reduction and the greater impact on the debt ratio of variables outside the control of the government, notably inflation. The EDP is backed in principle by a strong enforcement mechanism, as financial sanctions can, and should be, imposed in the event of persistent failure to correct an excessive deficit. However, such sanctions arguably come into play too late in the process to represent an effective deterrent against gross fiscal policy errors, not least because the financial situation of the country concerned may have deteriorated so much as to make the threat of a fine less credible at the very time when it should become real. Finally, the recent crisis has highlighted that if the obligation to correct excessive deficits contributes to anchoring the expectation that government solvency will be maintained, the timeline of the correction and the profile of the adjustment may have to reflect EMU-wide considerations.

To respond to these shortcomings the following key proposals for the reform of the corrective part are being put forward.

The debt criterion of the EDP is to be made operational, notably through the adoption of a numerical benchmark to gauge whether the debt ratio is sufficiently diminishing toward the 60% of GDP threshold. Specifically, a debt-to-GDP ratio above 60% is to be considered sufficiently diminishing if its distance with respect to the 60% of GDP reference value has reduced over the previous three years at a rate of the order of one-twentieth per year. Non-compliance with this numerical benchmark is not, however, necessarily expected to result in the country concerned being placed in excessive deficit, as this decision would need to take into account all the factors that are relevant, in particular for the assessment of debt developments, such as whether very low nominal growth is hampering debt reduction, together with risk factors linked to the debt structure, private sector indebtedness and implicit liabilities related to ageing. In line with the greater emphasis on debt, more consideration should be given to relevant factors in the event of non-compliance with the deficit criterion, if a country has a debt below the 60% of GDP threshold.

The more flexible approach put forward with respect to considering the relevant factors in the steps of determining the existence of an excessive deficit could also benefit countries undertaking systemic pension reforms, beyond the currently foreseen five-year transitory period. The special provisions of the SGP for systemic pension reforms with regards the deficit criterion are also extended to the debt criterion; through establishing the same five-year transitory period for considering the net costs of such reforms when assessing the compliance with the debt criterion. Finally, equal consideration shall be given to the partial or total reversal of previously implemented systemic pension reforms, during both the launch and the abrogation of an EDP.

Enforcement is strengthened by introducing a new set of financial sanctions for euro-area Member States, which would apply much earlier in the process according to a graduated approach. Specifically, a non-interest-bearing deposit amounting to 0.2% of GDP would apply upon a decision to place a country in excessive deficit, which would be converted into a fine in the event of non-compliance with the initial recommendation to correct the deficit. The amount is equal to the fixed component of the sanctions already provided for in the final step of the EDP. It also bears a link with the EU budget, which should facilitate the envisaged move to a system of enforcement based on the EU budget as outlined in the above-mentioned Commission Communication of 30 June 2010. Further non-compliance would result in the sanction being stepped up, in line with the already existing provisions in the SGP. To reduce discretion in enforcement, the 'reverse voting' mechanism is envisaged for imposing the new sanctions in connection with the successive steps of the EDP. Specifically, at each step of the

EDP, the Commission will make a proposal for the relevant sanction, and this will be considered adopted, unless the Council decides to the contrary by qualified majority within ten days. The size of the non-interest-bearing deposit or the fine could only be reduced or cancelled by the Council unanimously or based on a specific proposal from the Commission on grounds of exceptional economic circumstances or following a reasoned request by the Member State concerned.

Moreover, the criteria for assessing compliance with the recommendations at each step, including the possibility of allowing an extension of the deadlines for the correcting the excessive deficit, are clarified by placing explicit emphasis on the fiscal variables that can be assumed to be under the direct control of the government, in particular expenditure, by analogy with the approach proposed for the preventive part. Beyond these country-specific circumstances, the possibility is introduced of extending the deadlines also in the event of a general economic crisis.

Effective enforcement of the EMU budgetary coordination framework cannot be expected to derive only from provisions laid down at EU level. The particular decentralised nature of fiscal policy-making in the EU and the general need for national ownership of EU rules make it essential that the objectives of the EMU budgetary coordination framework are reflected in the national budgetary frameworks. A national budgetary framework is the set of elements that form the basis of national fiscal governance, i.e. the country-specific institutional policy setting that shapes fiscal policy-making at national level. This includes public accounting systems, statistics, forecasting practices, numerical fiscal rules, budgetary procedures governing all stages of the budget process and medium term budgetary frameworks in particular, and fiscal relations across government sub-sectors. While Member States' specific needs and preferences must be respected, a number of features stand out as being needed in terms of ensuring minimum quality and consistency with the EMU budgetary framework. These are the subject of the Directive on national budgetary frameworks that is being proposed to complement the reform of the SGP. Such features firstly require that the most primary elements of national budgetary frameworks, namely accounting and statistical issues and forecasting practices, work in line with minimum European standards to facilitate transparency and the monitoring of fiscal developments. Domestic budgetary frameworks need also to adopt a multi-annual fiscal planning perspective so as to ensure the achievement of the medium-term objectives set at EU level. Additionally, Member States must have in place numerical fiscal rules conducive to compliance with the deficit and debt thresholds. Member States must ensure that these features apply to all general government sub-sectors. National authorities must also guarantee the transparency of the budget process by providing detailed information on existing extra-budgetary funds, tax expenditures and contingent liabilities.

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(6) thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national Parliament,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) The coordination of the economic policies of the Member States within the Union, as provided by the Treaty, should entail compliance with the guiding principles of stable prices, sound public finances and monetary conditions and a sustainable balance of payments.
- (2) The Stability and Growth Pact initially consisted of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure² and the Resolution of the European Council of 17 June 1997 on the Stability and Growth Pact³. Regulations (EC) No 1466/97 and (EC) No 1467/97 were amended in 2005 by Regulations (EC) No 1055/2005 and (EC) No 1056/2005 respectively. In addition Council Report of 20 March 2005 on 'Improving the implementation of the Stability and Growth Pact' was adopted.
- (3) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth underpinned by financial stability and conducive to employment creation.
- (4) The preventive part of the Stability and Growth Pact requires that Member States should achieve and maintain a medium-term budgetary objective and submit stability and convergence programme to that effect.

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 209, 2.8.1997, p. 6.

³ OJ C 236, 2.8.1997, p. 1.

- (5) The content of the stability and convergence programmes as well as the criteria for their examination should further be adapted in the light of the experience gained with the implementation of the Stability and Growth Pact.
- (6) Adherence to the medium-term budgetary objective of budgetary positions should allow Member States to have a safety margin with respect to the 3% of GDP reference value in order to ensure rapid progress towards sustainability and to have room for budgetary manoeuvre, in particular taking into account the needs of public investment.
- (7) The obligation to achieve and maintain the medium-term budgetary objective needs to be put into operation, through the specification of principles of prudent fiscal policy-making.
- (8) The obligation to achieve and maintain the medium-term-objective should equally apply to participating Member States and Member States with a derogation.
- (9) Prudent fiscal policy-making implies that the growth rate of government expenditure does normally not exceed a prudent medium-term growth rate of GDP, increases in excess of that norm are matched by discretionary increases in government revenues and discretionary revenue reductions are compensated by reductions in expenditure.
- (10) A temporary departure from prudent fiscal policy-making should be allowed in case of severe economic downturn of a general nature in order to facilitate economic recovery.
- (11) In the event of a significant deviation from prudent fiscal-policy a warning should be addressed to the Member State concerned and in case the significant deviation persists or is particularly serious, a recommendation should be addressed to the Member State concerned to take the necessary corrective measures.
- (12) In order to ensure compliance with the fiscal surveillance framework of the Union for participating Member States, a specific enforcement mechanism should be established on the basis of Article 136 of the Treaty for cases where a persistent and significant deviation from prudent fiscal policy making prevails.
- (13) References contained in Regulation (EC) No 1466/97 should take account of the new Article numbering of the Treaty on the Functioning of the European Union.
- (14) Regulation (EC) No 1466/97 should therefore be amended accordingly,

HAVE ADOPTED THIS REGULATION:

Article 1

Regulation (EC) No 1466/97 is amended as follows:

1. Article 2 is replaced by the following:

'Article 2

For the purpose of this Regulation 'participating Member States' shall mean those Member States whose currency is the euro and 'Member States with a derogation' shall mean Member States other than those whose currency is the euro.'

2. Article 3 is amended as follows:

- (a) paragraph 1 is replaced by the following:

'1. Each participating Member State shall submit to the Council and Commission information necessary for the purpose of multilateral surveillance at regular intervals under Article 121 of the Treaty in the form of a stability programme, which provides an essential basis for price stability and for strong sustainable growth conducive to employment creation.'

- (b) paragraph 2 is amended as follows:

- (i) point (a) is replaced by the following:

'(a) the medium-term budgetary objective and the adjustment path towards this objective for the general government balance as a percentage of GDP, the expected path of the general government debt ratio, the planned growth path of government expenditure, the planned growth path of government revenue at unchanged policy and a quantification of the planned discretionary revenue measures;'

- (ii) point (c) is replaced by the following:

'(c) a quantitative assessment of the budgetary and other economic policy measures being taken or proposed to achieve the objectives of the programme, comprising a cost-benefit analysis of major structural reforms which have direct long-term cost-saving effects, including by raising potential growth;'

- (c) paragraph 3 is replaced by the following:

'3. The information about the paths for the general government balance and debt ratio, the growth of government expenditure, the planned growth path of government revenue at unchanged policy, the planned discretionary revenue measures and the main economic assumptions referred to in paragraph 2(a) and (b) shall be on an annual basis and shall cover, the preceding year, the current year and at least the following three years.'

3. Article 4 is replaced by the following:

'Article 4

1. Stability programmes shall be submitted annually between 1 and 30 April. A Member State adopting the euro shall submit a stability programme within six months of the Council Decision on its participation in the euro.

2. Member States shall make public their stability programmes.'

4. Article 5 is replaced by the following:

'Article 5

1. Based on assessments by the Commission and the Economic and Financial Committee, the Council shall, within the framework of multilateral surveillance under Article 121 of the Treaty, examine the medium-term budgetary objectives presented by the Member States concerned, assess whether the economic assumptions on which the programme is based are plausible, whether the adjustment path towards the medium-term budgetary objective is appropriate and whether the measures being taken or proposed to respect that adjustment path are sufficient to achieve the medium-term budgetary objective over the cycle.

The Council, when assessing the adjustment path toward the medium-term budgetary objective, shall examine if the Member State concerned pursues an appropriate annual improvement of its cyclically-adjusted budget balance, net of one-off and other temporary measures, required to meet its medium-term budgetary objective, with 0.5% of GDP as a benchmark. For Member States with a high level of debt or excessive macroeconomic imbalances or both, the Council shall examine whether the annual improvement of the cyclically-adjusted budget balance, net of one-off and other temporary measures is higher than 0.5% of GDP. The Council shall take into account whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times.

With a view to ensuring that the medium-term budgetary objective is effectively achieved and maintained, the Council shall verify that the growth path of government expenditure, taken in conjunction with the effect of measures being taken or planned on the revenue side, is consistent with prudent fiscal policy-making.

Fiscal policy-making shall be considered prudent and thereby conducive to the achievement of the medium-term budgetary objective and its maintenance over time if the following conditions are satisfied:

- (a) for Member States that have achieved the medium-term budgetary objective, annual expenditure growth does not exceed a prudent medium-term rate of GDP growth, unless the excess is matched by discretionary revenue measures;
- (b) for Member States that have not yet reached their medium-term budgetary objective, annual expenditure growth does not exceed a rate below a prudent medium-term rate of GDP growth, unless the excess is matched by discretionary revenue measures. The size of the shortfall of the growth rate of government expenditure compared to a prudent medium-term rate of GDP

growth is set in such a way as to ensure an appropriate adjustment towards the medium-term budgetary objective;

- (c) discretionary reductions of government revenue items are matched either by expenditure reductions or by discretionary increases in other government revenue items or both.

The prudent medium-term of growth should be assessed on the basis of projections over a ten-year horizon updated at regular intervals.

When defining the adjustment path to the medium-term budgetary objective for Member States that have not yet reached this objective and in allowing a temporary deviation from this objective for Member States that have already reached it, under the condition that an appropriate safety margin with respect to the deficit reference value is preserved and that the budgetary position is expected to return to the medium-term budgetary objective within the programme period, the Council shall take into account the implementation of major structural reforms which have direct long-term cost-saving effects, including by raising potential growth, and therefore a verifiable impact on the long-term sustainability of public finances.

Special attention shall be paid to pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar. Member States implementing such reforms shall be allowed to deviate from the adjustment path to their medium-term budgetary objective or from the objective itself, with the deviation reflecting the net cost of the reform to the publicly managed pillar, under the condition that the deviation remains temporary and that an appropriate safety margin with respect to the deficit reference value is preserved.

The Council shall furthermore examine whether the contents of the stability programme facilitate the achievement of sustained convergence within the euro area, closer coordination of economic policies and whether the economic policies of the Member State concerned are consistent with the broad guidelines of economic policies of the Member States and of the Union.

In periods of severe economic downturn of a general nature Member States may be allowed to temporarily depart from the adjustment path implied by prudent fiscal-policy making referred to in the fourth subparagraph.

2. The Council shall carry out the examination of the stability programme within at most three months of the submission of the programme. The Council, on a recommendation from the Commission and after consulting the Economic and Financial Committee, shall, if necessary, deliver an opinion on the programme. Where the Council, in accordance with Article 121 of the Treaty, considers that the objectives and the content of the programme should be strengthened with particular reference to prudent fiscal policy-making, the Council shall, in its opinion, invite the Member State concerned to adjust its programme.'

5. Article 6 is replaced by the following:

'Article 6

1. As part of multilateral surveillance in accordance with Article 121(3) of the Treaty, the Council shall monitor the implementation of stability programmes, on the basis of information provided by participating Member States and of assessments by the Commission and the Economic and Financial Committee, in particular with a view to identifying actual or expected significant divergences of the budgetary position from the medium-term budgetary objective, or from the appropriate adjustment path towards it ensuing from deviations from prudent fiscal-policy making.

2. In the event of a significant deviation from prudent fiscal-policy making referred in the fourth subparagraph of Article 5(1) of this regulation, and in order to prevent the occurrence of an excessive deficit, the Commission, in accordance with Article 121(4) of the Treaty may address a warning to the Member State concerned.

A deviation from prudent fiscal policy making shall be considered significant if the following conditions occur: an excess over the expenditure growth consistent with prudent fiscal policy-making, not offset by discretionary revenue-increasing measures; or discretionary revenue-decreasing measures not offset by reductions in expenditure; and the deviation has a total impact on the government balance of at least 0.5 % of GDP in one single year or of at least 0.25 % of GDP on average per year in two consecutive years.

The deviation shall not be considered if the Member State concerned has significantly overachieved the medium-term budgetary objective, taking into account the presence of excessive macroeconomic imbalances, and the budgetary plans laid out in the stability programme do not jeopardise this objective over the programme period.

The deviation may be equally not considered in case of severe economic downturn of a general nature.

3. In the event that the significant deviation from prudent fiscal-policy making persists or is particularly serious, the Council, on a recommendation from the Commission, shall address a recommendation to the Member State concerned to take the necessary adjustment measures. The Council, on a proposal from the Commission, shall make the recommendation public.'

6. Article 7 is hereby amended as follows:

- (a) paragraph 1 is replaced by the following:

'1. Each Member State with a derogation shall submit to the Council and the Commission information necessary for the purpose of multilateral surveillance of regular intervals under Article 121 of the Treaty in the form of a convergence programme, which provides an essential basis for price stability and for strong sustainable growth conducive to employment creation.'

- (b) paragraph 2 is amended as follows:

(i) point (a) is replaced by the following:

'(a) the medium-term budgetary objective and the adjustment path towards this objective for the general government balance as a percentage of GDP, the expected path of the general government debt ratio, the planned growth path of government expenditure, the planned growth path of government revenue at unchanged policy and a quantification of the planned discretionary revenue measures, the medium-term monetary policy objectives, the relationship of those objectives to price and exchange rate stability and to the achievement of sustained convergence;'

(ii) point (c) is replaced by the following:

'(c) a quantitative assessment of the budgetary and other economic policy measures being taken or proposed to achieve the objectives of the programme, comprising a cost-benefit analysis of major structural reforms, which have direct long-term cost-saving effects, including by raising potential growth;'

(c) paragraph 3 is replaced by the following:

'3. The information about the paths for the general government balance and debt ratio, the growth of government expenditure, the planned growth path of government revenue at unchanged policy, the planned discretionary revenue measures and the main economic assumptions referred to in paragraph 2(a) and (b) shall be on an annual basis and shall cover the preceding year, the current year and at least the following three years.'

7. Article 8 is replaced by the following:

Article 8

1. Convergence programmes shall be submitted annually between 1 and 30 April.
2. Member States shall make public their convergence programmes.'

8. Article 9 is replaced by the following:

Article 9

1. Based on assessments by the Commission and the Economic and Financial Committee, the Council shall, within the framework of multilateral surveillance under Article 121 of the Treaty, examine the medium-term budgetary objectives presented by the Member States concerned, assess whether the economic assumptions on which the programme is based are plausible, whether the adjustment path towards the medium-term budgetary objective is appropriate and whether the measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the medium-term budgetary objective over the cycle and to achieve sustained convergence.

The Council, when assessing the adjustment path toward the medium-term budgetary objective, shall take into account whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad

times. For Member States with a high level of debt or excessive macroeconomic imbalances or both, the Council shall examine whether the annual improvement of the cyclically-adjusted budget balance, net of one-off and other temporary measures is higher than 0.5% of GDP. For ERM2 Member States, the Council shall examine if the Member State concerned pursues an appropriate annual improvement of its cyclically adjusted balance, net of one-off and other temporary measures, required to meet its medium-term budgetary objective, with 0.5% of GDP as a benchmark.

With a view to ensuring that the medium-term budgetary objective is effectively achieved and maintained, the Council shall verify that the growth path of government expenditure, taken in conjunction with the effect of the measures being taken or proposed on the revenue side, is consistent with prudent fiscal-policy making.

Fiscal-policy making shall be considered prudent and thereby conducive to the achievement of the medium-term budgetary objective and its maintenance over time if the following conditions are satisfied:

(a) for Member States that have achieved the medium-term budgetary objective, annual expenditure growth does not exceed a prudent medium-term rate of GDP growth, unless the excess is matched by discretionary revenue measures;

(b) for Member States that have not yet reached their medium-term budgetary objective, annual expenditure growth does not exceed a rate below a prudent medium-term rate of GDP growth, unless the excess is matched by discretionary revenue measures. The size of the shortfall of the growth rate of government expenditure compared to a prudent medium-term rate of GDP growth is set in such a way as to ensure an appropriate adjustment towards the medium-term budgetary objective;

(c) discretionary reductions of government revenue items are matched either by expenditure cuts or by discretionary increases in other government revenue items or both.

The prudent medium-term rate of growth should be assessed on the basis of projections over a ten-year horizon updated at regular intervals.

When defining the adjustment path to the medium-term budgetary objective for Member States that have not yet reached this objective and in allowing a temporary deviation from this objective for Member States that have already reached it, under the condition that an appropriate safety margin with respect to the deficit reference value is preserved and that the budgetary position is expected to return to the medium-term budgetary objective within the programme period, the Council shall take into account the implementation of major structural reforms which have direct long-term cost-saving effects, including by raising potential growth, and therefore a verifiable impact on the long-term sustainability of public finances.

Special attention shall be paid to pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar. Member States implementing such reforms shall be allowed to deviate from the adjustment path to their medium-term budgetary objective or from the objective itself, with the deviation reflecting the net cost of the reform to the publicly managed pillar, under the condition that the

deviation remains temporary and that an appropriate safety margin with respect to the deficit reference value is preserved.

The Council shall furthermore examine whether the contents of the convergence programme facilitate the closer coordination of economic policies and whether the economic policies of the Member State concerned are consistent with the broad guidelines of economic policies of the Member States and of the Union. In addition, for ERM2 Member States, the Council shall examine whether the content of the convergence programme ensure a smooth participation in the exchange rate mechanism.

In periods of severe economic downturn of a general nature Member States may be allowed to temporarily depart from the adjustment path implied by prudent fiscal-policy making referred to in the fourth subparagraph.

2. The Council shall carry out the examination of the convergence programme within at most three months of the submission of the programme. The Council, on a recommendation from the Commission and after consulting the Economic and Financial Committee, shall, if necessary, deliver an opinion on the programme. Where the Council, in accordance with Article 121 of the Treaty, considers that the objectives and the content of the programme should be strengthened with particular reference to prudent fiscal-policy making, the Council shall, in its opinion, invite the Member State concerned to adjust its programme.'

9. Article 10 is replaced by the following:

'Article 10

1. As part of multilateral surveillance in accordance with Article 121(3) of the Treaty, the Council shall monitor the implementation of convergence programmes, on the basis of information provided by Member States with a derogation and of assessments by the Commission and the Economic and Financial Committee, in particular with a view to identifying actual or expected significant divergences of the budgetary position from the medium-term budgetary objective, or from the appropriate adjustment path towards it, ensuing from deviations from prudent fiscal-policy making.

In addition, the Council shall monitor the economic policies of Member States with a derogation in the light of convergence programme objectives with a view to ensure that their policies are geared to stability and thus to avoid real exchange rate misalignments and excessive nominal exchange rate fluctuations.

2. In the event of a significant deviation from prudent fiscal-policy making referred to in the fourth subparagraph of Article 9(1) of this Regulation, and in order to prevent the occurrence of an excessive deficit, the Commission, in accordance with Article 121(4) of the Treaty may address a warning to the Member State concerned.

A deviation from prudent fiscal policy making shall be considered significant if the following conditions occur: an excess over the expenditure growth consistent with prudent fiscal policy-making, not offset by discretionary revenue-increasing measures; or discretionary revenue-decreasing measures not offset by reductions in expenditure; and the deviation has a total impact on the government balance of at

least 0.5% of GDP in one single year or of at least 0.25% of GDP on average per year in two consecutive years.

The deviation shall not be considered if the Member State concerned has significantly overachieved the medium-term budgetary objective, taking into account the presence of excessive macroeconomic imbalances, and the budgetary plans laid out in the stability programme do not jeopardise this objective over the programme period.

The deviation may be equally not considered in case of severe economic downturn of a general nature.

3. In the event that the significant deviation from prudent fiscal policy making persists or is particularly serious, the Council, on a recommendation from the Commission, shall address a recommendation to the Member State concerned to take the necessary adjustment measures. The Council, on a proposal from the Commission, shall make the recommendation public.'

10. All references to 'Article 99' shall be replaced throughout the Regulation by references to 'Article 121'.

Article 2

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament
The President

For the Council
The President