Questions and answers: Commission Communication on fiscal policy guidance for 2023

Brussels, 2 March 2022

Why is the Commission issuing this Communication?

The Communication provides Member States with guidance on the conduct of fiscal policy in 2023. Based on the Commission's Winter 2022 Economic Forecast, and being mindful of the exceptionally high uncertainty surrounding economic developments, including Russia's unprovoked and unjustified invasion of Ukraine, the Communication sets out main principles regarding the conduct and coordination of fiscal policy in 2023 and beyond. The latest development underscores the need for strong coordination of economic and fiscal policies and for fiscal policies to stand ready to react to rapidly changing circumstances. The guidance will be adjusted to economic developments as needed. Lastly, the Communication also provides an overview for the state of play on the economic governance review.

The Communication takes into account the positive experience with the similar guidance provided by the Commission in March 2021, which contributed to the continuous discussion in the Council, the Eurogroup and with other EU and international stakeholders on the appropriate fiscal policy response to the coronavirus crisis and its adaptation to the evolving situation.

The guidance set out in the Communication should guide Member States' forthcoming stability and convergence programmes. Further guidance will be provided in the Commission's European Semester spring package in May 2022, which will include a fiscal policy recommendation to each Member State.

How has the Russian invasion of Ukraine affected the economic outlook?

The Winter 2022 Economic Forecast did not factor in the invasion of Ukraine and the ensuing geopolitical tensions. This impacts negatively the growth outlook and tilts the risks further to the downside. For example, inflation may turn out higher than expected as a result of cost pressures stemming from supply-side bottlenecks. Higher energy prices being passed on from producer to consumer prices to a larger extent, may weigh on aggregate demand. Global supply bottlenecks are likely to persist well into 2022. In addition, higher than expected second-round effects from potentially above-productivity wage increases may keep inflation high over a longer period. Fiscal policies should stand ready to react to rapidly changing circumstances. The Commission will closely monitor the situation and adjust its guidance as needed.

What are the main issues discussed in the Communication?

The Communication sets out five key principles that will guide the Commission's assessment of Member States' stability and convergence programmes and draws implications, based on the Commission 2022 winter economic forecast, for its fiscal recommendations to be proposed to Member States in May 2022 for their budgetary plans for 2023. Exceptional uncertainty and risks call for strong coordination of economic and fiscal policies to transition out of the COVID-19 crisis. The Commission will closely monitor the situation and adjust its policy guidance as needed.

The Communication also summarises the state of play on the economic governance review.

What are the five principles set out in the Communication?

The Communication sets out five key principles that will guide the Commission's assessment of Member States' stability and convergence programmes and its fiscal recommendations to be proposed to Member States in May 2022 for their budgetary plans for 2023. These five principles are:

1. **Ensure policy coordination and a consistent policy mix**. Fiscal policy coordination remains key. A continued strong coordination of fiscal policies is needed to ensure a smooth transition towards a new and sustainable growth path and fiscal sustainability. The appropriate fiscal stance for the euro area should result from a proper balance between sustainability and stabilisation considerations. It is essential to achieve such articulation at the country level and

taking into consideration the euro area/EU dimension.

2. **Ensure debt sustainability through a gradual and high-quality fiscal adjustment and economic growth**. Multi-year fiscal adjustment combined with investment and reforms to sustain growth potential is needed to curb debt dynamics. Ensuring sustainable public finances through a gradual reduction of high public debt is important.
3. **Foster investment and promote sustainable growth**. All Member States should protect overall investment and, where justified, expand nationally financed investment, including for the green and digital transition. Emphasis should be put on a high quality of investment, in line with investment financed from the RRF.
4. **Promote fiscal strategies consistent with a medium-term approach to fiscal adjustment, taking account of the RRF**. Fiscal adjustment in high-debt Member States should be gradual, not lead to an overly restrictive fiscal stance, and be underpinned by investment and reforms that relaunch growth potential, facilitating the attainment of credible downward debt trajectories. The path of fiscal policy adjustment should account for the effects of the RRF support on economic activity.
5. **Differentiate fiscal strategies and take into account the euro area dimension**. Fiscal recommendations should continue to be differentiated across Member States and take into account possible cross-country spillovers.

Does this Communication provide formal fiscal guidance to Member States? How does this differ from the annual European Semester package?

The Communication does not constitute formal guidance to Member States under the European Semester nor under the Stability and Growth Pact. It seeks to provide more clarity to Member States as they prepare their stability and convergence programmes.

The guidance contained in the Communication today will provide an input to the upcoming ECOFIN and Eurogroup discussions. Based on those discussions and taking into account the evolving economic situation, the Commission will propose specific fiscal policy guidance to each Member State as part of the European Semester Spring Package in late May 2022.

How will the fiscal guidance for 2023 interact with the Recovery and Resilience Facility?

The [Recovery and Resilience Facility (RRF)] contributes to supporting public investments and reforms in Member States, to be achieved by 2026. These investments and reforms will help build resilience and achieve the EU's green and digital goals. The expenditure financed by the RRF with non-repayable support will (i) make it possible to fund high-quality investment projects and (ii) cover costs of productivity-enhancing reforms, without giving rise to higher deficits and debt.

Therefore, the RRF financing will boost the economic recovery, foster higher potential growth and support a gradual improvement of fiscal positions, including in Member States with the highest public debt ratios.

To maximise the positive effects of RRF funded support:

- Public investment financed by the Member States should be promoted and protected in medium-term national fiscal plans.
- Member States' fiscal policies should be reoriented to support the twin green and digital transitions, in order to achieve sustained and sustainable growth.
- Successful debt reduction strategies should focus on fiscal consolidation, on the quality and composition of public finances, and on promoting growth.

How should Member States design their medium-term fiscal strategies?

The Communication indicates that stability and convergence programmes should demonstrate how Member States' medium-term fiscal plans ensure (i) a gradual reduction of public debt to prudent levels and (ii) sustainable growth through gradual consolidation, investments and reforms.

Furthermore, the medium-term plans need to be consistent with Member States' debt sustainability analysis. They should be underpinned with concrete and detailed references to their planned investments and reforms, and should account for the expected timeline of disbursement of EU funds (including RRF grants).

Finally, for the period beyond 2023, these plans should focus on pursuing fiscal consolidation to achieve medium-term prudent fiscal positions in a gradual, sustained and growth-friendly manner.

What is the status of the "general escape clause"?

The "general escape clause" of the Stability and Growth Pact (SGP) was activated by the Commission and Council in 2020 to allow Member States to undertake measures to deal adequately with the COVID-19 crisis, while departing from the budgetary requirements that would normally apply under the European fiscal framework.

While the "general escape clause" will continue to apply in 2022, it is expected to be deactivated as of 2023 on the basis of the Commission's Winter 2022 Economic Forecast. This will be reassessed on the basis of the Commission's Spring 2022 Economic Forecast in view of the high uncertainty.

What are the implications of this Communication for the opening of excessive deficit procedures (EDPs) in the course of 2022?

The Commission will not propose to open new excessive deficit procedures (EDPs) in spring 2022. The coronavirus pandemic continues to have an extraordinary macroeconomic and fiscal impact, creating exceptional uncertainty, including for designing a detailed path for fiscal policy. On these grounds, the Commission considers that a decision on whether to place Member States under the EDP should not be taken in spring 2022.

The Commission will re-assess the relevance of proposing to open EDPs in autumn 2022.

What is the state of play of the economic governance review?

The coronavirus crisis has highlighted the relevance and importance of many of the challenges that the Commission sought to discuss and address in the public debate on the economic governance framework. Following President von der Leyen's commitment in the State of the Union address to build a consensus on the future of the EU's economic governance framework, in October 2021 the Commission relaunched the public debate on the review of the EU's economic governance framework, inviting other EU institutions and all key stakeholders to engage. The debate is ongoing, drawing on both the Commission's view of the effectiveness of the economic surveillance framework presented in February 2020 and the lessons learnt from the coronavirus crisis.

The public debate about the EU fiscal framework focuses in particular on the challenge of a gradual, sustained and growth-friendly reduction to prudent debt levels; the need to sustain public investment at high levels for years to come, including those for the twin transition and to enhance resilience; the importance of a good composition and quality of public finances, the need for counter-cyclical fiscal policy and for creating fiscal room for stabilisation; the importance of strong policy coordination between different policy tools and between the EU and national levels; and the need to simplify the EU framework and to ensure effective enforcement of the EU fiscal framework.

The debate is taking place through various fora, including dedicated meetings, workshops and an online survey, which closed on 31 December 2021. The Commission is currently analysing the submissions it has received and will come forward with a summary report in March 2022.

The ongoing debate is also providing Member States with an opportunity to reflect on the key objectives of the governance framework, its functioning and new challenges ahead. Discussions are taking place mainly in the Economic and Financial Committee and the Economic Policy Committee, but also at ministerial level in the Council (ECOFIN) and - for specific euro area aspects - among euro area members in the Eurogroup.

Based on the ongoing public debate and the discussions with Member States, the Commission will provide orientations on possible changes to the economic governance framework with the objective of achieving a broad-based consensus on the way forward ahead of 2023.

What is the Commission's current thinking on the economic governance review?

In the view of the Commission, the current state of play of the discussions points to a number of key issues, where further and more concrete work could pave the way for an emerging consensus for the future EU fiscal framework:

- Ensuring debt sustainability and promoting sustainable growth through investment and reforms are key to the success of the EU fiscal framework;
- More attention to the medium-term in the EU fiscal surveillance appears as a promising avenue;
- It should be further discussed what insights can be drawn from the design, governance and operation of the RRF; and
- Simplification, stronger national ownership and better enforcement are key objectives.

For More Information

Press release: European Commission presents fiscal policy guidance for 2023

Communication on fiscal policy guidance for 2023

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