Reforming the EU fiscal framework

The Commission proposals

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European Commission

Current EU fiscal framework

Preventive arm	Corrective arm
• Anchor = Medium-term objective in structural terms • Quasi-uniform adjustment of the structural balance towards the MTO, with spending rule and structural reform and investment clauses • Significant deviation procedure	• Deficit based EDP: 3% ceiling • Debt-based EDP based on debt reduction benchmark (1/20th rule)

<u>Challenges:</u>

- **Complexity**: many indicators and rules (Structural balance, net expenditure growth, …)
- **Unrealistic pace of debt reduction** implied by 1/20th debt rule
- **Pro-cyclical bias** in good and bad times
- **Limited incentives** for reforms and investment
- **Lack of ownership**: Adjustment common across the board, ‘determined by the EU’
- **Low enforcement**: half of the MS never met the MTO. Debt-based EDP never opened.

A suggested new fiscal framework

National ownership embedded in EU framework

0. Commission puts forward reference adjustment paths
1. Member States propose medium-term fiscal structural plans
2. Annual budgets will commit to follow the fiscal trajectory and ensure that debt will start converging to prudent levels within horizon of the plan
3. Member States can request a longer adjustment period underpinned by reforms and investments
4. Council endorsement of the plan
5. Stronger role of national IFIs

Simplification and focus on fiscal risks

1. Net expenditure path anchored on debt and agreed by Council will be the single fiscal indicator
2. Surveillance and enforcement will be risk-based
3. Debt reduction benchmark, benchmark for reduction in structural balance, significant deviation procedure and matrix of requirements no longer exist

Enforcement

1. Deficit-based EDP (3% of GDP threshold) maintained
2. Debt based EDP will be operationalised and strengthened, as a tool to ensure compliance with the agreed net expenditure path
3. Financial sanctions toolbox will be enriched with smarter sanctions
4. Macroeconomic conditionality will be maintained

Medium-term fiscal-structural plans: *simplification and focus on fiscal risks*

- National medium-term fiscal-structural plans would be the cornerstone of the new governance architecture. Plans would cover at least 4 years and include fiscal trajectories as well as reforms and investment objectives.

- Net expenditure path anchored on debt sustainability and agreed by Council would be the single fiscal indicator

- Surveillance and enforcement would be based on challenges to debt sustainability

- The 1/20th debt reduction rule, the benchmark for reduction in structural balance, significant deviation procedure and matrix of requirements would be superseded

Medium-term fiscal-structural plans: *greater national ownership*

- Member States' fiscal-structural plans should demonstrate how their net expenditure path is consistent with public debt converging or staying at prudent levels and budget deficit remaining below 3% of GDP over the medium-term

- The revised common EU framework would set requirements that take into account the degree of public debt challenge faced by the Member States (low, moderate or substantial): the greater the challenge, the more demanding the requirement

- As a technical contribution, the Commission would put forward *reference* net expenditure paths for Member States with a substantial or moderate public debt challenge

- The adjustment period can be extended by up to 3 years to facilitate major investments and reforms put forward by the Member States, subject to clear and transparent EU criteria

- The plans would be endorsed by the Council on the basis of a Commission assessment

Medium-term fiscal-structural plans: *stronger enforcement*

- Annual implementation reports will be the basis for annual surveillance, covering fiscal, reforms and investments.
- Enforcement under the **preventive arm:** recommendations with early warnings before the conditions for opening an EDP are reached.
- Enforcement under the **corrective arm:**
  - ✓ Breaches of 3%: deficit based EDP
  - ✓ **Deviations from net expenditure path** when debt-to-GDP ratio is above 60% → COM assesses relevant factors (Art. 126.3 report)
    - ➢ If Member State has substantial public debt challenge, deviation leads by default to EDP opening
    - ➢ If Member State has moderate public debt challenge, deviation could lead to EDP opening
- Financial sanctions of lower amounts and enhanced reputational impacts
- A new **tool for enforcing reform and investment** underpinning an extension of the adjustment period would empower the EU to correct the adjustment path in the plan and to impose financial sanctions to euro area Member States

Next steps: to be confirmed

- Presentation and debate at the ECOFIN of 6 December
- First discussion at Euro Area Summit of 15 December
- *(Orientation for preparation of SCPs and DBPs 2023)*
- Presentation of legislative proposals in the first quarter (March 2023)
- *(May-June European Semester package)*
- *(Second half of 2023: repeal of general escape clause)*

Main criticisms, in Italy

- With DSA and risk analysis the proposed framework is more complex than the current SGP
  >> *No, DSA enters only at the beginning in identifying the adjustment path*

- In deciding the good investments and reforms, the Commission has a too intrusive role
  >> *No, it's up to MS to select them, within a common framework*

- The focus on debt will put Italy in the category of tightly monitored MS
  >> *Yes, together with France, Spain, Belgium, Portugal, Greece,…*

- Better keep the structural balance instead of focussing on spending
  >> *No, net primary expenditure is more controllable and anti-cyclical*

- Not having changed the 3%/60% imposes a deflationary bias for many years
  >> *No, after 4/7Y, the debt will continue to go down with further restrictions*

For more details: see my letter to La Stampa, 21/11/2022