Improving economic policy

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Five slides with all you need to know about the EU's ongoing fiscal governance reform*

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**Warning: may be outdated by Wednesday*.

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The original idea
(November 2022 EC communication)

1. Risk-based, country-specific fiscal adjustment requirements, based on Commission DSA and 3% benchmark.
2. Standard 4-year adjustment period, extendible by 3 if countries credibly reform/invest (with a "no backloading" condition to prevent leaving adjustment to last 3-years).

Logic/pros

i. Subsidiarity/efficiency: do not require more fiscal adjustment than is necessary from a sustainability and Treaty perspective.
ii. National ownership: Linked to i. Countries more likely to comply if rules less stupid.
iii. Incentives for reform. Sustainability via denominator or D/Y, not just numerator.
iv. 7-year adjustment period makes adjustments from large deficit positions feasible

The main worry (and a proposed remedy: “safeguards”)

Worry: gives Commission too much discretion/room for political games (via EC DSA).

Proposed remedy: additional “safeguards”: rules guaranteeing minimum adjustment. Latest:

1. *Debt safeguard*. Minimum average speed of debt decline of 1% of GDP per year for countries with debt>90% (or 0.5% for countries 90%>debt>60%) over 4 years *starting in 2025 or after country exits from the excessive deficit procedure*;

2. *Deficit resilience safeguard*. Countries with deficits between 1.5% and 3% of GDP must continue adjusting in steps of at least 0.3% of GDP per year until deficit is less than 1.5%.

Our take:

- The worry is valid. But the proposed remedy (more rules) could undermine purpose of reform. Better approach: make DSA a common methodology, and fully transparent.
- Question: would proposed safeguards be “binding”?

Implications of the new framework, based on the EC’s DSA and the latest Council ”safeguards”

The good news

- ”Safeguards” mostly not binding for initial 4-7 adjustment period. Framework remains mostly DSA-driven.

The bad news

- Commission DSA tougher than (many) expected: requires large adjustments for most high debt countries.
- “Deficit resilience safeguard” requires extremely high structural primary balances for some countries *after* the 4-7 adjustment period.
- Framework is not very friendly to (green) public investment, in the sense that creates barriers to an investment push even if this is ok from a DSA perspective.

Fiscal adjustment implications of the emerging Council position

Fiscal adjustment requirements (% of GDP)

Fiscal adjustment requirements under proposed EU fiscal framework

(in percent of GDP; preliminary)

	European Commission forecasts for 2024			SPB* required by end of adj. period ... ... by DSA + 3% reference only		SPB* required by end of adj. period ... ... by DSA + 3% + "safeguards"		Average annual adjustment need during adj. period		SPB required to reach 1.5% deficit resilience target	
	Debt	Fiscal balance	SPB	4-year period	7-year period	4-year period	7-year period	4-year period	7-year period	4-year period	7-year period
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8) = {6)-(3)}/4	(9) = {(7)-(3)}/7	(10)	(11)
Greece	152	-0.9	2.0	1.8	1.9	2.5	3.5	0.13	0.21	3.3	3.7
Italy	141	-4.4	-0.9	3.7	3.3	3.7	3.3	1.15	0.61	4.3	5.1
France	109	-4.4	-2.4	1.0	0.7	1.0	0.7	0.86	0.45	2.2	2.6
Spain	106	-3.2	-1.0	2.1	2.4	2.5	2.5	0.88	0.50	2.4	2.8
Belgium	106	-4.9	-2.4	2.4	2.6	2.4	2.6	1.19	0.71	2.7	2.9
Portugal	100	0.1	2.1	2.7	2.6	2.7	2.6	0.15	0.07	2.8	2.6
Finland	77	-3.2	-1.0	0.5	0.4	2.2	1.3	0.79	0.33	1.1	1.1
Austria	76	-2.4	-0.7	1.1	1.2	1.1	1.2	0.44	0.27	1.1	1.2
Hungary	72	-4.3	1.0	2.6	3.2	2.6	3.2	0.41	0.32	2.6	3.2
Cyprus	71	2.1	3.4	0.0	-0.3	0.0	1.2	-0.86	-0.32	0.0	1.2
Slovenia	68	-3.3	-1.1	1.9	2.1	1.9	2.1	0.74	0.45	1.9	2.1
Germany	64	-1.6	-0.2	0.8	0.7	0.8	0.7	0.25	0.13	0.8	0.7

determined by deficit resilience safeguard

determined by debt safeguard

SPB consistent with 1.5% deficit > SPB*

Debt and deficit consequences of temporary rise in investment during the 7-year adjustment period

Scenario:

- 0.5% of GDP additional green public investment over 6 years from 2025 to 2030;
- 2031 SPB* adjusted to ensure that DSA requirements, 3% reference, and deficit resilience safeguard is met.

Main insight: very little delay in debt decline. Yet, the scenario shown would be:

- Inconsistent with no-backloading condition
- Inconsistent with minimum adjustment requirement under excessive deficit procedure and in some cases with debt safeguard