The Commission proposals for the reform of fiscal governance: some considerations

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The Commission proposals for reform of EU fiscal governance: high-level principles and practical implementation

Proposed reform revolving around two high-level principles:

- Fiscal sustainability: economic rationale for having fiscal framework at EU level
- National ownership: political condition for EU fiscal framework to work.

Departures from high-level in the passage from initial orientations (Commission 2022) to legislative proposals (Commission 2022b, c)

Important to reaffirm high-level principles, especially fiscal sustainability rationale, not least to have a chance to secure national ownership of the EU framework.

The Commission proposals for reform of EU fiscal rules: stylised process

- Commission makes public a 'technical trajectory' for adjustment (for a subset of Member States with certain risk features)
- Member Statecarries out techncial dialogue with Commission and subsequenlty submits its fiscal-srtrucural plan
- Commision provides assessment of the plan according to clealry specified criteria for endorsement by the Council
- Member State implements the plan as endorsed by Council - Commission and Council monitor compliance

Interpreting the sustainability criterion for fiscal-structural plans: an open question

Qualitative formulation of sustainability criterion for fiscal-structural plans:

> whether the national medium-term fiscal-structural plan ensures that *public debt* is put or kept *on a plausibly downward path* by the end of the adjustment period at the latest, *or stays at prudent levels*
>
> …
>
> whether the government deficit is maintained below the 3% of GDP reference value in the absence of further budgetary measures over a period of 10 years.

Operational meaning of "downward path" *or* "prudent level" open to question

Commission risk assessment methodology offering consistent approach to interpreting the sustainaibility criterion based on joint consideration of level of and trajectory of debt

Interpreting the sustainability criterion for fiscal-structural plans: apossibel interpretation

Projected debt level (10 years from end of adjustment period)	**Projected debt trajectory (over 10 years from end of adjustment period)**	**Stress test on baseline projection (deterministic and stochastic)**	**Compliance with sustainability criterion**
Above 90% of GDP (high risk)	Continuously decreasing (low risk)	No high-risk deterministic or stochastic test	*Compliance*
		Any other case	Non-compliance
	Any other case (medium or high risk)	Any	Non-compliance
Between 60% and 90% of GDP (medium risk)	Continuously decreasing (low risk)	Any	*Compliance*
	Peak within 2 years from end of adjustment period (medium risk)	No high-risk deterministic or stochastic test	*Compliance*
		Any other case	Non-compliance
	Any other case (high risk)	Any	Non-compliance
Below 60% of GDP (low risk)	Any	Any	*Compliance*

Adding criteria for fiscal structural plans

Sustainability criterion - by the end of the adjustment period:

- \- The government debt ratio is and remains on a plausibly downward path, or stays at prudent levels at unchanged policies ;
- \- The government deficit is brought and maintained below the 3% of GDP reference value at unchanged policies .

No backloading *criterion – during the extra years of the adjustment period:*

- *- the adjustment should be (no more than) proportional to relative size of the extension*

Benchmark adjustment *criterion – during the adjustment period:*

- *- The adjustment should be of the order of 0.5% of GDP (in structural terms) as long as the deficit exceeds 3% of GDP reference value.*

End-of-adjustment debt level *criterion – at the end of the adjustment period:*

- *- The government debt ratio is below the level at the beginning of the period*

The criteria are meant to be verified *ex ante* in terms of plans, not outcomes
Commission to issue illustrative 'technical trajectories'
to guide Member States with debt ratio > 60 *or* deficit ratio > 3

Limited value added and potential for confusion from additional criteria

- **No backloading** criterion adding **valuable specification** to sustainability criterion (not placing the burden of adjustment on the next government).

- **Benchmark adjustment** criterion having **no *effet utile*** if taken in conjunction with **already existing EDP specifications** (if debt > 60, in case of breach of 3% deficit EDP ‘automatic’; if debt < 60, in case of breach of 3% deficit, Commission and Council *should* have discretion)

- **End-adjustment debt level** criterion economically indefensible for countries already at low risk (e.g., Estonia) and **essentially arbitrary and with little value added** (given no backloading criterion) even for countries in need to put debt on downward trajectory.

Limited value added and potential for confusion from additional criteria

- **Loss of economic readability** of Commission proposals for reform in the passage **from initial orientations to legislative proposals.**
- **Streamlining** of additional criteria or **contextual reinterpretation** in the light of sustainability criterion **desirable.**
- Demand for additional criteria reflecting **mistrust of Commission and Council determination to exclude abuse of sustainability criterion.**
- Possible abuse of sustainability criterion to be addressed via **institutional solutions** (role for national fiscal councils, EFB at EU level) **not via additional arbitrary numerical rules**
- Insistence on ‘safeguard’ ex ante in strange contrast with **apparent indifference to effective implementation and enforcement.**
- **Greater focus needed on implementation and enforcement**: new European Council Resolution on the SGP?

Overcoming the Fiscal Compact?

From the **proposal for amending the Council directive on budgetary frameworks** (COM(2023) 242 final):

> The reformed economic governance framework, thus, retains the fundamental objectives of budgetary discipline and growth promotion of the SGP and its founding provisions in the Treaty on the Functioning of the European Union (TFEU).
> At the same time, by aiming at sound and sustainable public finances as well as the promotion of sustainable and inclusive growth, the reformed framework also meets the main objectives of the Fiscal Compact which forms Title III of the TSCG …
> *Considering these commonalities, the proposed reformed economic governance framework can be considered as incorporating the substance of the fiscal provisions of the TSCG into the legal framework of the EU, as per Article 16 of the TSCG*.

Adoption of the economic governance reform package offering opportunity **to overcome balanced budget principle** established by Art. 81 of the Constitution (as amended by constitutional law No 1 of l 20 April 2012) and reinforced law 243/2012 or to **re-interpret it consistent with the new medium-term objective**.