Stability and Growth Pact: possible way forward

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Pierre Gramegna

Good evening, ladies and gentlemen. Let me start by thanking Eurofi for putting together this impressive programme with more than 1,100 participants. I am glad to be back at Eurofi for the first time with a new hat as the Managing Director of the ESM.

Let me say on a serious note as an introduction, that we are very fortunate that we had Valdis Dombrovskis presenting in 20 minutes to us today what the Commission has in mind. In a nutshell what struck me in the presentation is that to improve the public debt compared to GDP, you have to act not only on the numerator, which means on the amount of debt, you also have to act on the denominator. In other words, it is not only about reducing debt or stabilising it, which is the numerator; it is also about the denominator, which means enhanced growth. Strengthening public debt sustainability and boosting sustainable and inclusive growth go hand in hand.

The first question out of the two that I will ask my friends the panellists to address is: how do we reduce the high and divergent public debt in the EU countries, as we have high heterogeneity, a different point of departure on the one hand? Do you think that having a realistic growth-friendly, but at the same time case-by-case approach, will be helpful? This is also one of the guidelines that Valdis has indicated to us. I will start by giving the floor to Vincent for that.

Vincent Van Peteghem

Thank you very much Pierre and good evening, everybody, I am very happy to be here in Stockholm and I am already looking forward to the session in Ghent in February next year. I am sure that you can also be a moderator of one of the sessions that will take place there, Pierre.

First, I think that it is a good thing that the Commission put the proposal on the table. We should be honest enough to say that the current rules did not really work, because we have very specific situations and very specific contexts in each and every member state. Every member state has a different debt level, different labour markets, different challenges, and we should take these specific contexts into account. It means that today I am also sure that the idea of having one rule to fit all does not work today.

We should consider the different challenges that each of us have. That is why I also believe that we need to differentiate between the different member states, look at the context of every member state. For example, if I look to my country, we have high debt and we also know that we have an ageing problem, which has an impact on healthcare and on our pensions. This can be completely different for other member states. At the moment that we take into account the debt reduction and then the sustainable debt that we need to have in the medium and the long-term, it is not only necessary to look to that debt evolution but also to the specific context of that member state.

That is the reason why I really believe in the proposal of the Commission. That it is indeed, as Pierre is indicating, not only focusing on the nominator but also focusing on the denominator, look at what kind of reforms and investments can be done, of course, specific for every and each member state, taking into account the goals and challenges that we all have. That does not mean that we also do not need to look to the general challenges that we have as a continent, including the climate goals. We need to be prepared for the future challenges of Europe, but at the same time we need to also look at the specific situations in each member state of Europe, but at the same time we need to also look at the specific situations in each member state.

Pierre Gramegna

Thank you, Vincent. Jacques de Larosière, what is your comment on the disparities and heterogeneity that we have in the Economic and Monetary Union?

Jacques de Larosière

Thank you very much for giving me the floor. I think that we should remind ourselves that a monetary union does not, by itself, create convergence, but it should not exacerbate the existing heterogeneities of our Union. However, since the establishment of the euro in 1999, we have observed that the divergence that existed amongst the member countries has increased. That I think should not be accepted. The existence of a Union should not exacerbate the divergencies. What we have seen in a little more than 23 years is that budgetary discrepancies have increased, structural deficiencies have increased, productivity gains have been distorted, and so the existence of the Union has been concomitant with a very serious aggravation of the heterogeneity.

Fiscal deterioration is something we have to look at very seriously because fiscal deterioration is developing in our Union. If we do not understand that then the discussion that we have this evening makes very little sense. Beyond a certain point, which is the mere point of non-sustainability of public debt, the deterioration of public finance is much more than the deterioration of public finance, because it pushes monetary policy towards the monetisation of the deficits. At one point, it is the fabric of the financial market that is jeopardised and unfortunately, we have reached that point. If we do not understand that the discussion on a stability pact is to no avail.

The Stability and Growth Pact has not worked well, and we have to admit that. It has not worked well, because of a fundamental reason which was a lack of will, a lack of political desire to cooperate and, perhaps more, that lack of will than the details of the pact itself.

The legislative proposal of the Commission, of which we have heard by Mr Dombrovskis presentation, is in my view a very useful set of recommendations, because it does not change the figures in themselves. I have nothing against 60% in terms of the maximum of debt that we have to search for. I am completely in favour of keeping the 3% deficit, which is rather benevolent. The idea of the Commission is good, because instead of putting these objectives, which are very difficult to obtain and which become a pretext for not doing anything, you start with each country's practical situation. Instead of saying, 'You should reach not more than 60% debt in terms of GDP', you say, 'Well, we are going to start with the facts. We are going to start with the present position, and we are going to determine together a trajectory that will make you gradually closer to these objectives'.

I think it is a better method than just setting the objectives, because you start from reality, and you forge a trajectory that hopefully would make sense.

Pierre Gramegna

Thank you, Jacques. Let me also ask Harald Waiglein how he sees the thrust of the proposal, but also in the sense of the question that I asked: on the one hand heterogeneity case-by-case. You could also phrase it reinforcement versus flexibility. How do you see that?

Harald Waiglein

Let me start with what I heard and probably what you heard, Pierre, in Washington two weeks ago. The message from the IMF was pretty clear: debt is back in focus and consultation is a must. Whatever rules we choose to adopt, I think we have to look at the results. If they achieve the results, then they are good rules. If they do not achieve the results, then they are obviously not so good. Against that background there are many good elements in the proposal by the Commission, there are some clever ones and there are some where there is at least a question mark, from our point of view, on whether they will achieve the goals in practice.

That is not because there is an inherent mistake in the rules themselves, but precisely because of what Jacques said: the old rules did not work because they were designed badly, but because there was not a will to apply them. That is the same for this proposal. If there is no will apply it in a way that actually reduces debt then the new rules will also not work. Just to go back to the question because I love these very European questions: how do we reduce the high and divergent debt in a sustainable and growth friendly, realistic manner? I love this language. I am so used to it. It is: how do I jump into a swimming pool without getting wet? Of course, if you want to consolidate at some point there has to be pain otherwise there is no consolidation. The only way to reduce debt and actually enhance growth happens in a situation where you are already in big trouble because your interest rates are so high that they themselves are an obstacle for growth.

I hope we do not get into that situation, but we have to accept that austerity, coming back from high debt levels, will be painful. There is no way this cannot be painful, and this is also one of the messages that came from the IMF and that is the benchmark against which we have to assess part of the proposals. It is a good idea to include investment in there and focus on the role of investments, but, then again, we have to be very careful about what these investments actually achieve, whether they actually reduce debt and increase growth. I have been in many discussions in the past where we had the investment questions and I am not going to say who, but one country said, 'An increase in pensions is an investment in social stability'. If that is the benchmark we are obviously not going to get very far. I will leave some more space for thoughts from Jacques.

Pierre Gramegna

Thank you, Harald, for showing that you can prepare a panel as much as you want, but if you have the Vice President of the Commission presenting the new plan just before it is difficult to stick to the agenda. I congratulate you for that, not only you, but all of us here, because the theme is well-known to the public here. What is more interesting is for this debate to get to the heart of the matter of what the four of you here think is key, so the public can understand the challenges that ministers face trying to find a compromise on this. Additionally, the challenges between what would be the most advisable economic solution and what is politically feasable. Let us give you the chance, Mindaugas, to give an initial view on this from your side.

Mindaugas Liutvinskas

This is indeed a very timely discussion having the fresh Commission proposal on the table. I am so glad to be here. Overall, I tend to see what has been proposed as a broadly balanced proposal. It could be a potential landing-zone going forward. A great deal of discussions at the Council went into what has been proposed.

Let me focus on one specific element at the heart of the proposal, which has to do with domestic ownership. I come from a country with relatively low debt levels, so we do not seem to have big problems with domestic ownership when it comes to fiscal discipline, but it is a big issue when it comes to the EU as a whole. I would say that the whole idea of having a risk-based framework with a country-specific approach, is the key pillar for enhancing domestic ownership. Individual plans that the member state negotiates with the Commission, and which is later approved with the Council, should ideally increase domestic buy-in. That is the whole idea, especially when we talk about the possibility of having a longer adjustment path. This creates space for investments, which is often quoted as an element for domestic ownership, investments that could enhance the growth potential. This should also be in favour of domestic ownership.

However, at the same time it might come at a cost to the multilateral nature of the framework. This is an important trade-off that we have been discussing and the answer that I came to myself in having this debate is that the only way forward to deal with this trade-off is to ensure maximum transparency. Maximum transparency in the criteria, in the way the member state deals with the Commission, otherwise we risk having a very bilateralised framework which then loses a key element of its character in terms of the multilateral element.

Going forward, on the domestic ownership element, it is important that whatever we construct has some inherent flexibilities. What I mean by this is that if a country agrees with the Commission on a fiscal adjustment path, the country itself, the authorities, should have a certain degree of flexibility in terms of proposing and implementing the specific design and instruments on both the revenue and expenditure side when it comes to fiscal as long as the agreed fiscal path is respected. Otherwise, we risk creating some rigidity that might harm domestic ownership. That is also an important element to keep in mind.

The third point, we have to reflect on the changed geopolitical realities surrounding us. This calls for some smart and flexible treatment of green and defence spending in the framework. I am not saying golden rules, I am saying some smart treatment within the rules, especially for countries that have the fiscal space and need to invest in the build-up of defence capacities. My final point is also on the external environment. When we think about domestic ownership, incentives to comply, we should not forget that the reality when it comes to monetary policy and the market situation is changing. The era of low interest rates seems to be behind us, which means that the market discipline is back. This is an element that could definitely increase compliance rate and domestic ownership to whatever you sign on as a government. I will stop here.

Pierre Gramegna

Thanks, Mindaugas for making explicit what ownership means. All of you touched upon it. It is a very important factor and what we can keep in mind is that ownership means that as a country you want also to have a dialogue on revenue and the expenditure side. On the denominator side you want a dialogue on the type of investments such as for the dual transition or defence expenditures. In a country like Lithuania, which neighbours Russia, this has even more prominence than in other countries. How would you rebound on that Vincent? How do you focus on the different data and variables that you can act on?

Vincent Van Peteghem

Again, it has already been mentioned by others, it will be important that we are responsible for what we put on the table and the goal of what we want to achieve, which for all of us is sustainable debt in the medium-term and long-term. The way that we are going to do that is based on a solid risk-based analysis, and that we know what our goal will be. It will be important that we look at the rules that we are going to have. Today we know that the rules are actually not as they should be. They are unachievable. For example, the 1/20 rule is not achievable.

It is clear that if we want to have new rules and we want to increase the ownership, as was mentioned before, it is important that we focus on a commitment-based approach (with more ex-ante flexibility, but also more ex-post enforcement). For me, it is important that we have that medium-term perspective, that we know what we want to achieve, that we know where we are heading to and that we take into account not only the debt reduction level that we want to obtain, but also look at how we are going to increase our investments and the reforms that are necessary.

Pierre Gramegna

Thank you, Vincent. Harald, maybe you could tell us how you see the dynamics between expenditures, on the one hand, revenues on the other hand, and the major change of focusing more on investment. How can that interplay be helpful? What pitfalls are there?

Harald Waiglein

Vincent made a very good point that it has to be based on some sort of risk analysis, which is part of the proposal. Quality of expenditure is a decisive factor, again, that is easier said than done, because I am sure that we disagree on what high quality expenditure is in different cases. I know for Mindaugas being in his place with the Russian border he has a different view of priorities in the budget than we might have, and that is perfectly understandable.

The expenditure benchmark as the anchor is a good idea because it simplifies things and that has to do both with expenditure and revenue, in a way. Having said that, a debt sustainability analysis is normally a risk management tool. If you want to assess the debt sustainability of a country and you want to be sure, you make very conservative assumptions. It is not normally a tool that you use to determine a potential budgetary path more than 10 years in the future, because there is a risk of retrofitting.

Even though these tools can be useful, we need a multilateral approach. Mindaugas has said it, when we started with the Stability and Growth Pact (SGP) the approach was bilateral and the experience with that was not very good, because countries were treated differently. That was not wanted at the time, so the multilateral character has to be there. It is not possible to reproduce all aspects of the Debt Sustainability Analysis (DSA), but part of that approach is a minimum common benchmark to maintain the multilateral character and ensure there is a minimum consolidation effort. That is why the rule is a good idea and the Commission is a fair basis for this discussion.

Pierre Gramegna

Mindaugas, maybe you can rebound what was said. I will pick up two things that maybe you, Jacques and Vincent would like to pick up too. I like your sentence: debt sustainability is a risk management tool, on the one hand, and the second point that we need minimum common benchmarks. How would you see that Mindaugas? For me, these two issues are at the heart. The importance of a debt sustainability assessment goes to the heart of the ESM's mandate of safeguarding financial stability and assessing the risks. We also want to ensure that the beneficiary countries will be able to pay back the funds that we lend to them. It is just common sense. That is why we need some benchmarks.

Mindaugas Liutvinskas

I will try to build on what Harald said. I see this issue as a broader trade-off between, on the one side the need to maintain or enhance the soundness of public finances, and on the other side all the investment needs that we have. There is defence, green, digital, Union-level goals, and that is the inherent tension on the table and on the DSA element. It is a complex theoretical exercise that is very sensitive to assumptions. Basing the whole new framework on this as a starting point raises questions of clarity, transparency, replicability. I fully agree with you here.

There is some welcome movement on the issue of whether there should be minimum common safeguards. It is important to ensure that there is a safeguard against the potential backloading of fiscal adjustment, especially in cases where there is an extended period of time, like seven years. Seven years is longer than a political cycle, so it is quite easy to push forward the adjustment and kick the can down the road. That leads to a framework that does not lead to the desired effect of reducing the debt level or keeping it at a sustainable level.

It is also important, when talking about green investment, digital investment or more broadly growth enhancing investment as a basis for extending the adjustment period, is to have ex ante criteria agreed on what is growth-enhancing or fiscal sustainability enhancing reform or a truly green reform for which a country would be given the ability to extend the period of adjustment.

One last point, the whole framework is now based on the risk-focused approach, which makes sense. At the same time, we have a group of lower debt member states. Lithuania is currently part of them, but with a few shocks this could change dramatically. We now have debt to GDP at 38%. If a big shock occurs, we could go closer to 60%. This then changes the whole situation quite dramatically. My asking to the Commission in the debates was always, 'Do not keep us under the radar. Give us something as indicative guidance that would work as an anchor in domestic political debates to help us maintain the fiscal discipline, because this is an important issue. Flexibility is good to some extent, but it should come with norms and limitations.

Pierre Gramegna

Thank you very much Mindaugas. I am now going to come back to Jacques de Larosière. By underlining what you have all said, debt sustainability assessment is important. We need minimum common benchmarks. We heard Valdis Dombrovskis indicate a few safeguards, which I will summarise quickly and then give you the floor. First, the 3% yearly deficit remains a key benchmark. Second the 60% of GDP public debt also remains a key benchmark. Third, a new one, if you are above the 3% annual deficit benchmark, there is a safeguard of 0.5% of GDP fiscal adjustment that you have to apply to your budget.

What one can hear from the presentation – which was said by Mindaugas – it is trying to find the right balance between doing a case-by-case exercise and having ownership. Then you immediately see the risk that it is a la carte and you do what you want. Those are the two extremes. How do you see that Jacques de Larosière.

Jacques de Larosière

Well, I am very much in agreement with what you have said, and I think the observations that the panellists have presented are valid. The amount of scepticism which is going to surround this experience can only be erased if it is matched by an equal amount of seriousness in the analysis. We have been tinkering with this stability pact for too long and people do not take it seriously. You need to have an economic analysis that is impeccable. I agree with my friend Waiglein on this. It is more than just using a few macro-economic figures to say that 'This is the recommendation'. You have to go more in depth. I have some experience on this, because when I was the head of the International Monetary Fund, we did exactly that. It was called the Article 4 examinations. The economists that used to practice this art were remarkable people. Their objectivity was unshakable. It was totally objective.

The amount of knowledge, practice, experience that they had gained in their careers made these examinations very powerful. I do not know one country that pushed aside those reports saying, 'It is of no value'. I never saw that. Often the recommendations were not observed, but they were never dismissed as not serious, not loyal. We have to give this effort a chance, but we also have to understand what the conditions are for success. I am going to tell you how I feel about it.

Firstly, the teams who will write these reports and discuss them with the interested countries have to be really impeccable in terms of their capabilities. It might be a good idea if the Commission were to recruit a few top economists in the IMF or the OECD to buttress the people at the Commission. Secondly, I think it would be a good idea to have a group of either academics or economists of high quality, that would do the 'le suivi 'that we say in France and unfortunately do not do it enough. They would follow the application, the enactment of the reports. If it is not a group of academics it could be the ESM, because the ESM, in my view – and I say that very modestly – has the potential and it has the conjunction of financing capabilities and analytical capabilities.

The ESM should be part of the procedure leading to the report, to follow the report and to check whether it is done and get to the nitty gritty. If a country like France is told not to have more than 60% public debt to GDP then there is not much value because it is too far away. But if they are told they have 60% of GDP in public expenditures with the average in Europe is 50%, and so these 10 points excess of GDP which kills competitiveness. That is going to be the centre of the report. It is going to be the lynchpin of the recommendations to follow them and accompany them on the trajectory that would lead them to a more sensible figure. That makes a lot of sense.

I think if you had a group of people like the ones you could have in your own institution, it would reinforce the Pact. Now, I know that ESM is for the euro zone, but we can solve that. The last point I wanted to say is about national ownership and equal treatment. A sensible minister, in the case for instance of France, could not be hostile to the idea that there is too much public expenditure and that we have to reach a more sensible level. No one would say that is wrong. You have to talk them into the process, and I am perhaps a bit naïve, because I still feel that people are rational and reasonable. I think it is a chance that we must not dismiss, and equal treatment is of the essence, because, for instance, if France gets away with the process it will have absolutely no credibility for the smaller countries.

The equal treatment is an imperative. I wish you well, Pierre, because you are our hope. I think we agree on most of it. I would agree with Harald on investment. I would be very sceptical to exempt investment from the figures because nothing is easier to baptise investment something that has nothing to do with investment in productive terms. I am a rather conservative guy, but I think that it is a chance, and we should try it.

Pierre Gramegna

Thank you. Coming from you, it is very encouraging. I would like to have your age and be as optimistic as you are. It is difficult to continue, but I would give all of you one more minute and then I would have two minutes to sum up, which is completely impossible. We start with you Vincent.

Vincent Van Peteghem

We were talking about the ownership and I actually think that all countries will agree with that more country-specific approach if the tools that we are going to use, for example the debt sustainability analysis, is clear and transparent and we know on which criteria and parameters that it is based, and do not need thousands of Monte Carlo simulations to come out and know what the plan will be. The same is true for the investments. If you look to the investments, it is already discussed. Pierre, I remember the first time we met we talked about the golden rule about investments. We started with infrastructure, and digital, and sustainable, and we ended with the wages of schoolteachers, because that is also something where you invest in the future. Harald already mentioned the pensions.

It will be important that we are able to label investments at a European level and put a quality stamp on these investments to say, 'Okay, we agree on the facts, based on some criteria, based on the fact that we also do it at a European level, that these kinds of investments are really helping our growth, are productive'. It also needs to be approved by other member states. Again, I believe that if you look to the goals we have with the proposal that is on the table, I am convinced that it can work, that it should work and that everybody can agree as long as it is transparent enough and everybody will also know how the rules and the plans of different member states will be set out.

Pierre Gramegna

Thank you, Vincent. Harald and then Mindaugas.

Harald Waiglein

I will be very brief. I will just highlight my favourite problem I have with the proposal, so that you get the picture. There is a common benchmark in there, but only in the corrective arm, as Mindaugas mentioned. We must not forget the preventative arm of the Pact as it was a lesson learned from the crisis. If it is abandoned there is no benchmark in the proposal for that part. Speaking from an Austrian perspective, if the 3% is the limit and there is no preventive arm and benchmark there, the message that Austrian policymakers will understand is that 3% is the new target, not the limit. The policymakers will think that as long as Austria is under 3% it is fine. That is a worry for Austria, but it might be the incentive structure in other countries as well.

Pierre Gramegna

Thank you for this political wisdom, Harald. Mindaugas?

Mindaugas Liutvinskas

I will repeat what I started from: I think that what has been proposed is a good basis for agreement with some possible tweaks in the future political discussions. There is the possibility and the potential to make the rules more realistic to implement and more effective in practice, and this opportunity should be taken. Together we still need to find the balance between some trade-offs including ownership versus equal treatment, which is a very important element. Secondly increasing fiscal sustainability on the one side and reducing debt levels in high debt countries, versus addressing the very immediate investment needs in many countries, which is also reflected at the Union level.

Pierre Gramegna

Thank you, Mindaugas. I would like to congratulate you all, because we covered a great deal of ground and you all tried to be quite brief and really focus on the essentials. This is not a summary; it is just an impression of the debate: we all agree that the existing system did not work well. This is an understatement but with time it has been learnt that it was not satisfactory and not reachable. For it to be reachable, there has to be change.

What is needed can be formulated in three elements, according to this panel discussion.

The system needs to be transparent; it needs to have reliable and observative data and it needs appropriate criteria. It seems that the expenditure benchmark is quite a good criterion for most, so issues are on the right track in that regard.

The second objective is credibility. This includes ownership that is serious; and enforcement with safeguards. If that is a good balance, we would reach the objective of credibility.

Lastly, everyone mentioned that the system must be even-handed or guarantee equal treatment as far as possible. Transparency, credibility, and equal treatment are success factors.

On a political note, let us not forget that for politicians, especially for the finance ministers, when they come back home, they can be alone against all their other ministers. They need the framework to have something at hand to guarantee sound public finances. I can tell you on a personal note, when I was asked 10 years ago by Xavier Bettel to become the finance minister, and I was not a politician, I said to him, 'I will eventually accept, but in the programme of the coalition we need a benchmark that is serious for Luxembourg, like we want to stay under 30% public debt to GDP. If that is in the coalition programme, I accept. If that is not in the programme you must find something else'. I was wise that day. I don't know which angel was above my head that day, or the Holy Spirit probably was.

Just to finish on this note, saying that you are all representatives of the public finance sector with long experience. They know how difficult it is to fight for sound public finances in council of government in their country. If the framework has a good ownership and fulfils the three criteria, there is hope. Thank you to all of you for being here. Thanks for listening. I look forward to meeting many of you next year.