REFORMING THE STABILITY AND GROWTH PACT

VINCENT VAN PETEGHEM
Deputy Prime Minister and Minister of Finance, Belgium

Reform of the EU budget rules: towards a new generational deal

The European budgetary rules are still out of order. Due to the severe energy and purchasing power crises, the General Escape Clause has put the rules temporarily on hold. But starting in 2024, we again fall under this framework. As those budgetary rules are clearly outdated, we are currently discussing a much-needed reform.

Of course, 2024 is getting there rapidly. Therefore we need to reach a swift agreement on this reform. We need to create predictability. Especially at a moment when economic forecasts are surrounded by uncertainties, we as politicians should provide clarity and prepare the long term. Our citizens and companies, but also the financial markets need a long-term perspective on where we are heading to.

When it comes to the political discussions, the main division lines are clear now: we need to find an agreement that combines a more country-specific based approach with which certain minimum quantitative benchmarks.

According to me, it will be a matter of political courage to reach a compromise. This is not about pitting countries against each other, but about creating a new deal with our future generations. There can be no taboos, no red lines, for no single actor involved. We need to find an agreement with all 27 Member States, and with the European Parliament. Therefore, each of us will need to jump over its own hurdles.

Finding a new balance, a new deal with our future generations, is of utmost importance because the existing European budgetary rules did not work in the past and would not do so in the future. These rules do not take into account the different foundations on which our economies are built. They do not recognize the heterogeneity of economic performance between euro area countries. One-size clearly does not fits all, when it comes to debt reduction trajectories. Moreover, the budgetary rules are not adapted to the current macro-economic environment. The European fiscal framework sets the pace (1/20th rule) at which Member States must reduce their debt levels to the 60% benchmark (the average when the rules were created in 1992). For many Member States, that pace is far too high, making compliance unachievable. In order for the rules to be applied, they should at least be realistic.

Therefore, more than ever, a thorough reform is needed. Of course, the starting point of the European fiscal rules remains unchanged: we need sustainable debt ratios in the medium and long term. Nonetheless, the current focus has shown to be too one-sided. In addition to a healthy budget, we also need a strong economy. Productivity and future economic growth - through investments and reforms - must also have their place. Because those too have a positive effect on future debt levels.

Over the past years, I have been highlighting the importance of structural reforms, the need to structurally tackle the deficiencies of our labour markets, of our pension systems, and tax systems. A reform of our budgetary rules should not solely focus on reducing debt, but should encourage Member States to improve the supply side of their economy in order to achieve higher sustainable growth.

In order to incorporate reforms and investments into the European fiscal framework, I have been pleading for a more commitment-based approach. Member States should set up a package of investments and reforms according to their country-specific needs, allowing them to extend their debt reduction trajectory. This could create more ex-ante flexibility. But ex-post, this mechanism will also enhance compliance and an effective commitment of a member state to its fiscal path, due to strict control of this package.

Of course, the eligible investments allowing for a prolonged debt trajectory need to be growth-enhancing. This requires a clear labelling of investment, and those 'labelled' investments would need approval by the Member States. This more country-specific approach will not only create more ownership for Members States, it will also encourage Member States to see debt reduction, investments, and reforms as one package for increasing the resilience of their economies.

Therefore our future budgetary framework should shift away from the one-sided focus on debt reduction, towards a tripartite European budgetary framework with a focus on and debt reduction and investments and reforms. Only this way, we will be able to align debt reduction with strengthening our future economy, towards a new intergenerational deal.

GINTARĖ SKAISTĖ
Minister of Finance of the Republic of Lithuania

The new fiscal rules must be realistic and account for fundamental challenges

In recent years, the EU has grappled with a series of significant shocks, ranging from the global pandemic to russia's war against Ukraine and the energy price shock. While the EU has demonstrated remarkable agility and resilience in the face of these unprecedented challenges, it has come at the cost of elevated public deficits and mounting debt levels across member states.

The deterioration of public finance came at the time of significant shifts in the macroeconomic environment. With the inflation rate surging to levels unseen in decades, central banks were prompted to raise interest rates in an expeditious manner. Consequently, the era of low interest rates has gone to the past, and debt accumulation is becoming increasingly costly. Though the rise in public debt does not pose immediate debt sustainability risks, vulnerabilities in fiscal positions may grow as member states will have to refinance debt at much higher interest rates in the future.

Against this backdrop, the reform of the EU fiscal rules takes on paramount importance, particularly as the general escape clause will be deactivated next year. We are faced with a looming risk that a return to the old rules, which require annual debt cuts by 1/20 in excess of 60% of GDP, may impose overly burdensome consolidation paths on high-debt countries, leading to economic hardship that could weaken these member states and the entire euro area.

The EU economic governance review presents a significant opportunity to enhance the fiscal framework and address the shortcomings of the current rules. There is a broad consensus that a one-size-fits-all approach has not yielded satisfactory results over the last decade, especially considering that public debt levels in the EU have increased. We have substantial heterogeneity among member states in terms of economic performance and the state of public finance and the revised fiscal rules must duly take the existing reality into account.

The Commission's proposal rightly aims to introduce a forward-looking and differentiated approach that would reflect country-specific circumstances. The new approach should lead to realistic and achievable fiscal objectives tailored to ensure sustainable reduction of debt in high debt countries and it should be effective in preventing excessive debt accumulation in countries with currently low debt levels. Granting member states with enough room for political manoeuvre in shaping their reforms and investment policies within the agreed fiscal adjustment path will be vital to foster the sense of national ownership.

The introduction of a forward-looking perspective and differentiated fiscal targets should go hand in hand with strengthening the multilateral nature of the fiscal framework and ensuring equal treatment of all member states. The credibility of the framework should be supported by maximum transparency at every stage of the fiscal cycle as well as a strengthened role of the EFB and IFIs. All together this should provide a robust accountability mechanism to ensure member states adhere to the agreed-upon rules and targets.

Security challenges caused by russia's war against Ukraine require adequate attention in the review. A sensible treatment of the defence spending should be upheld, though not in the form of a "golden rule", but rather smart and targeted flexibility that would allow bolstering expenditure aimed at preserving the territorial integrity of the EU and security of the member states, especially for countries with an external EU border and ample fiscal room. For instance, such spending could be regarded as a relevant factor when assessing breaches of the 3% deficit limit.

Security challenges require a sensible treatment of the defense spending.

The renewed fiscal framework must aptly account for the challenges and opportunities presented by the green and digital transformation era. The proposed flexibility to extend the adjustment period for countries committed to growth-enhancing reforms and investments is a welcomed feature, but it must be complemented by a rigorous ex-ante and ex-post assessment of the quality and efficacy of intended reforms and investments.

Sufficient safeguards must also be put in place to prevent backloading of fiscal adjustment and ensure a sustainable decline in debt levels, which remains the overarching objective of the economic governance review.

In conclusion, the ongoing review of the fiscal framework holds immense significance for the future economic trajectory of the continent. Drawing on the lessons of the past and taking into account the broader economic, technological, and geopolitical context, the EU can strengthen its economic governance foundation to ensure prosperity and resilience for member states and the Union.