European Fiscal Board

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Some challenges facing EMDEs (and other economies)

- Raising potential growth
  - Importance of investment in infrastructure and energy transition
- Climate adaptation
- Reducing inequality and poverty
- Rich economies: population ageing
- All this must be done
  - while keeping public finances sustainable
  - makes the quality of spending even more important, for example large needs to invest in infrastructures (digital, energy transition)

Ensuring fiscal sustainability

- Political myopia is a common phenomenon, although its importance depends on the political landscape (likely less important with a tradition of coalition governments)
- Budgetary rules needed to protect finances against the consequences of such myopia
- “Good” rules induce governments to save in good times to give them fiscal space for bad times

Ensuring fiscal sustainability

- Good *design* of rules is not enough to guarantee low debt and low deficits – learn from EU experience
- Combine with well-designed medium-term budgetary framework, budgetary procedures, strong Minister of Finance, strong IFIs
- Need credible enforcement, which requires
  - sufficient ownership of the rules
  - strong IFIs to enhance fiscal transparency and provide unbiased projections

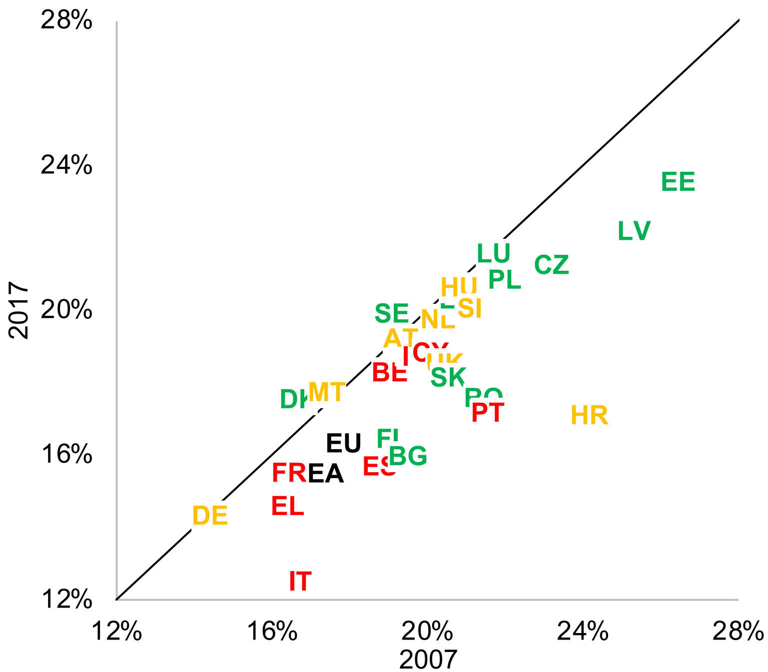
Revision of the EU's fiscal rulebook

- Simplification, differentiation and national ownership
  - Simplification: single indicator in form of net primary expenditure path
    - Simplification watered down at later stages
  - Differentiation: across initial debt positions
  - National ownership:
    - Countries propose own plans
    - Expanded role IFI's: largely undone by Council
- Where does the quality of spending come in?

Have EU fiscal rules improved the quality of public finances?

- **Productive public expenditure has borne the brunt of fiscal consolidation** especially in very high-debt countries and countries subject to EDPs

Productive public expenditure as share of total public expenditure, 2017 versus 2007



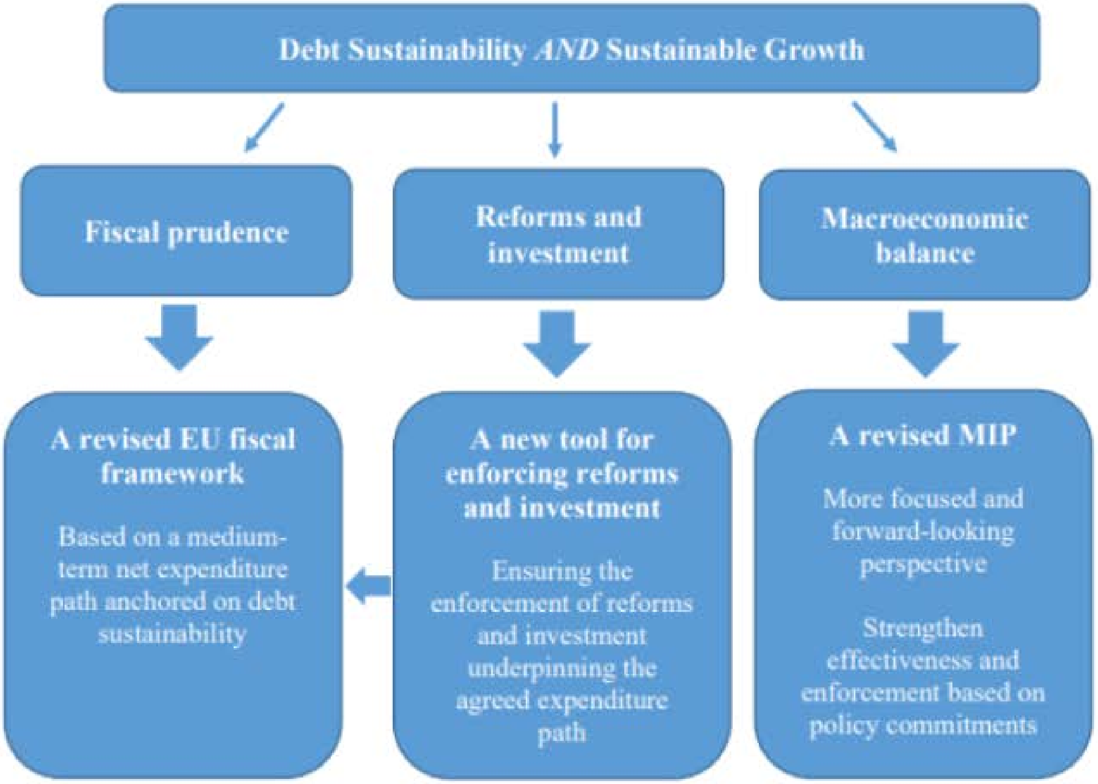
Note: Productive public expenditure includes expenditure on R&D, education and transport (COFOG classification).

- **2015: investment clause** meant to shield investment in bad times, **structural reform clause** to incentivise reforms
- **Only few countries qualified for the flexibility clauses**, even fewer have benefitted from them
- **Weak progress** with country-specific recommendations CSRs on the quality of public finances

➔ **Need to better protect growth-enhancing public expenditure that reinforces sustainability of public finances**

Original Commission orientations

- European Commission puts debt sustainability and sustainable growth in the centre of their proposal, but deficit and debt thresholds remain



Original Commission orientations

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

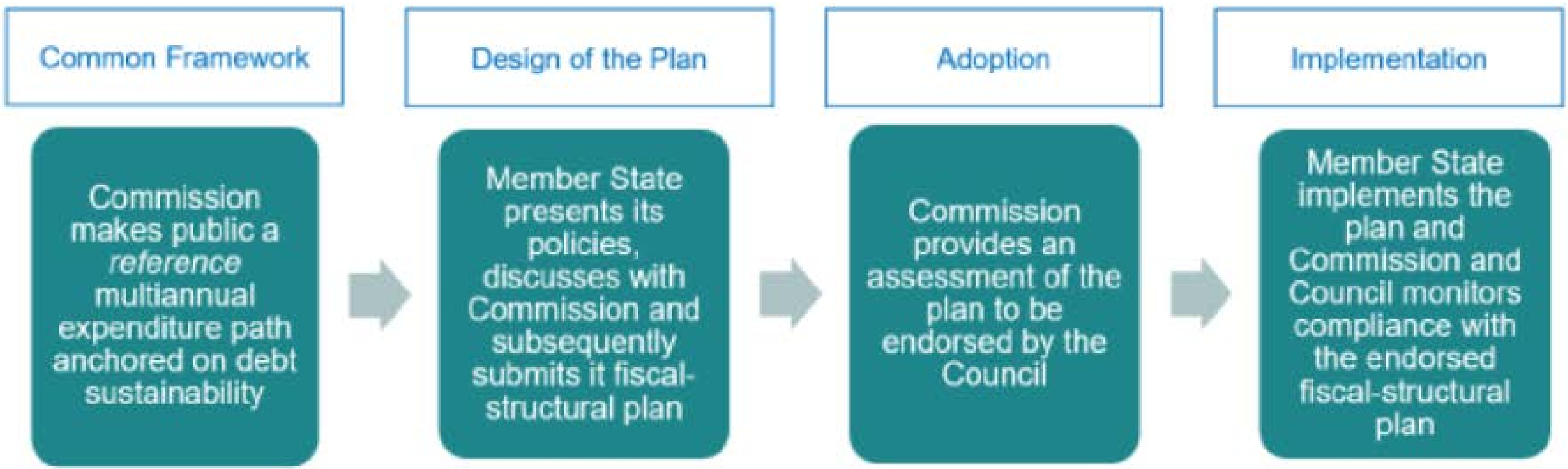
1. Net expenditure path anchored on debt and agreed by Council will be the single fiscal indicator
2. Surveillance and enforcement will be risk-based
3. Debt reduction benchmark, benchmark for reduction in structural balance, significant deviation procedure and matrix of requirements no longer exist

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
5. A new tool to ensure delivery of reforms and investments underpinning gradual adjustment path

Original Commission orientations

- **The proposed fiscal framework comprises four main phases:**



Incentivising investments and reforms

- MTFSPs must show how they ensure delivery of investments and reforms (main challenges = CSRs)
- Explain how they address listed common EU priorities
  - Fair and green digital transition
  - Social and economic resilience
  - Ensuring energy security
  - Where necessary, build-up of defence capabilities
- Extension based on requirements: growth potential & resilience, fiscal sustainability, EU priorities, CSRs, investment level

Revision of the EU's fiscal rulebook

- Medium-term orientation and single intermediate indicator are improvements

- Explicit role for reform and investment is welcome
  - However, should not come at cost of monitoring and enforcement of fiscal side

- Question: how to simultaneously stimulate fiscal discipline and investments that benefit EU at large?

Incentivising public investments

- Careful with (green) golden rules
  - may lead to "disguise" other expenditure as (green) investment
  - preclude integral trade-off

- Proposal Bakker & Beetsma (2023, VoxEU) and follow-ups by Bakker, Beetsma and Buti (2024 in Project Syndicate and Intereconomics)

Proposal Bakker – Beetsma - Buti

- EU Fund dedicated to investments with cross-border benefits (e.g., electricity infra, hydrogen infra, high-speed trains)
- Countries have an envelope within fund
- Conditional on adherence to fiscal rules, they can draw (joint with other “virtuous” countries) resources from fund for investments that benefit multiple countries
- Failure to come up with good plans or to adhere to the fiscal rules will lead the remainder in envelope to be redistributed over the other envelopes
- Two benefits: incentive for fiscal discipline and encouraging investments with public good character

Legal foundation

- Follow closely NextGenEU, which relies on Article 122 TFEU: Council, upon a proposal by the Commission, “may decide, in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy.”

Legal foundation

- Conditionality regime:
  - Conditionality Regulation was introduced January 2021 in context of NGEU initiative
  - Protect the financial interests of the European Union
  - Suspension of payments to member states that do not respect the principles of the rule of law
- Redefine regime to link access to Fund to fiscal discipline at home: EU resources, as expression of solidarity, are to be used in compliance with the obligations under the EU Treaty, including the new economic governance framework
- Conditionality would cover respect of fiscal targets, and reform and investment commitments in case of extended plans

Public and private investments needed:

- Public investment alone is not sufficient
- Estimates for EU: about 25 – 50% needs to come from public (co-) financing (typically infrastructures, such as hydrogen, electricity, high-speed railways, which can be used by multiple parties), remainder needs to come from private financiers.
- However, governments need to take first step and commit to long-term involvement and financing; also need to coordinate parties involved.
- Capital markets union needed to mobilise savings.

Thank you for your attention

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