

CRASH COURSE - WEBINAR

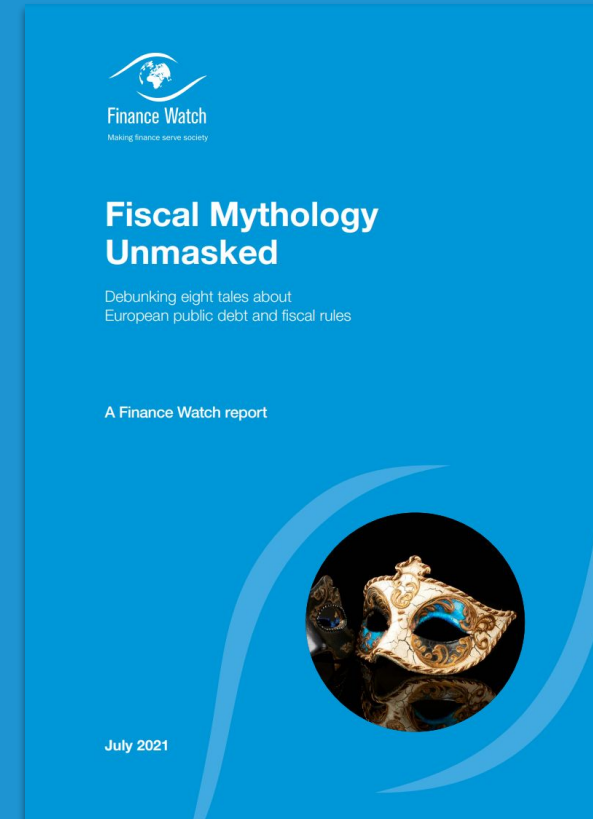
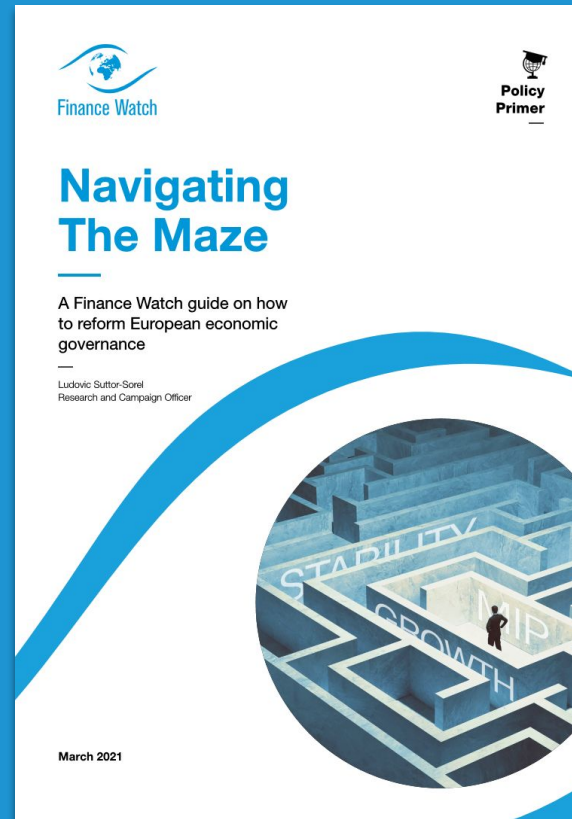
The future of the EU fiscal framework



Ludovic Suttur-Sorel | Finance Watch

7 October 2021

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- 3 | THE NAVIGATION** - How to reform the EU fiscal framework?

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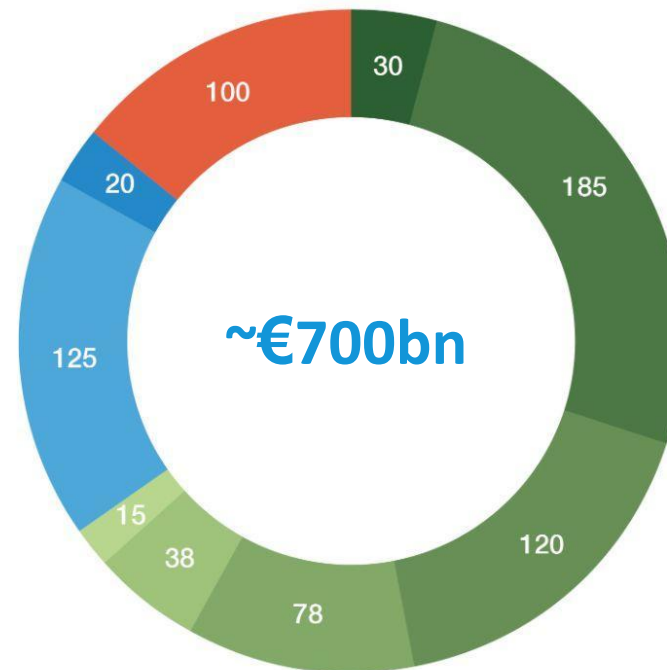
3 | THE NAVIGATION - How to reform the EU fiscal framework?

1. PERSISTENCE OF IMPORTANT FUNDING GAPS

Estimated annual EU funding gap

(billion)

(Source: European Commission, 2020)



Green funding gap =
~ €450 bn/year (until 2030)



Public investment gap =
~ €100 bn/year

Private finance alone will not bridge the EU annual funding gap

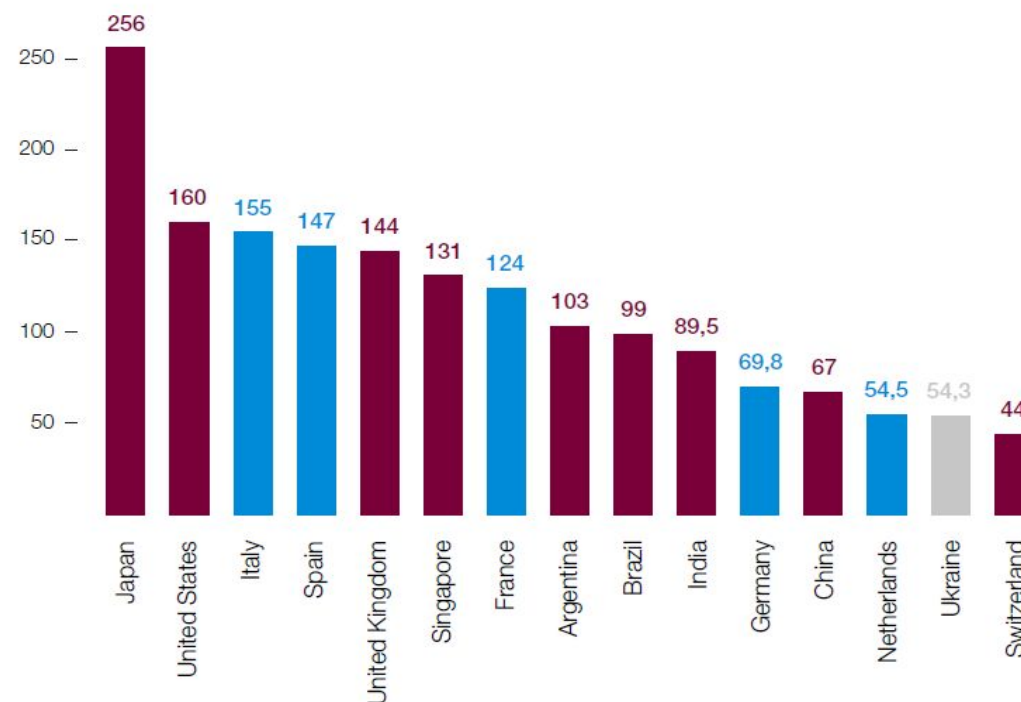
Public finance will also have to be unlocked

2. PUBLIC DEBT STOCK INCREASED

Government debt-to-GDP, 2020

(%)

(Source: OECD, Eurostat, Statista)

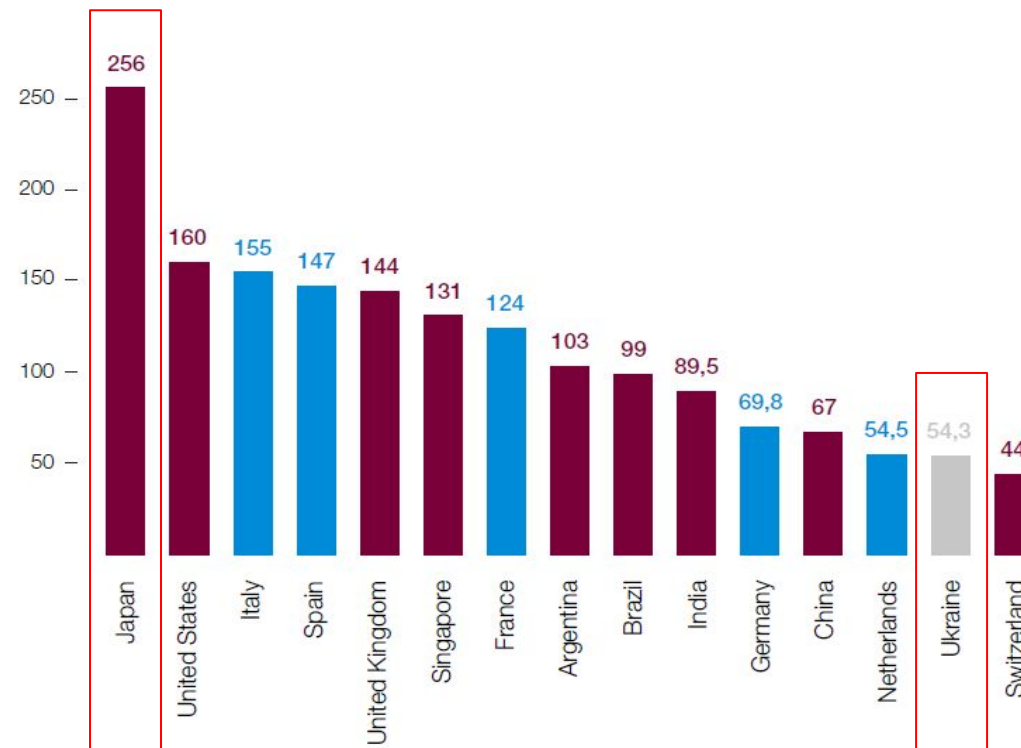


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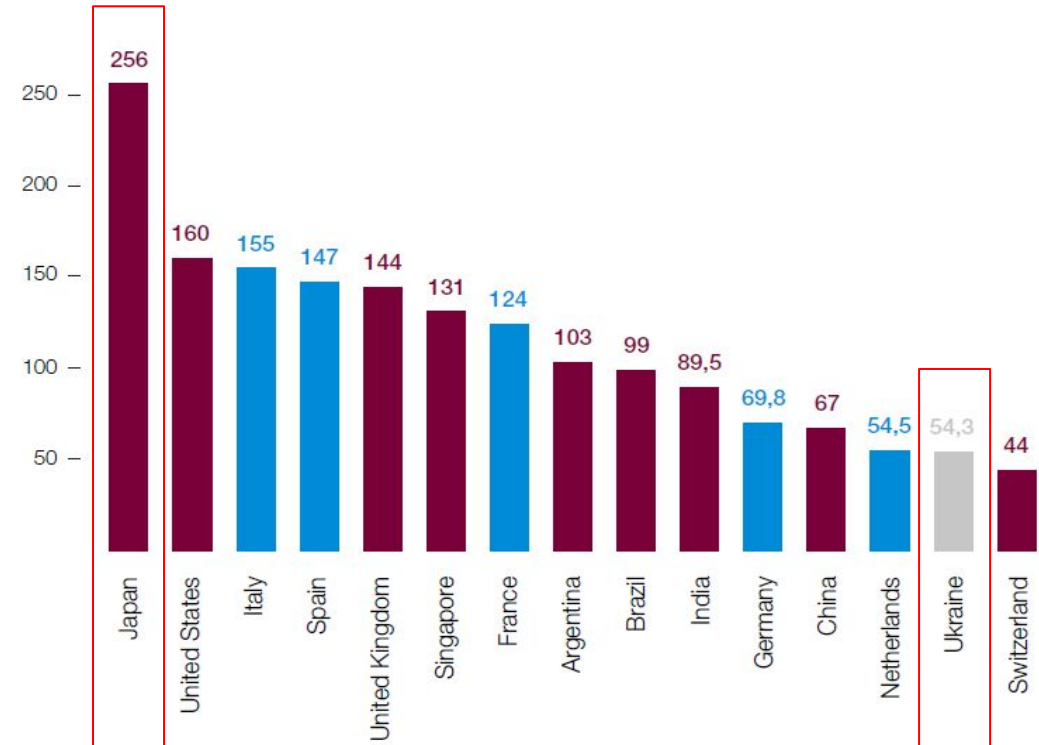


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If not the stock of debt, **which factors** determine **Debt sustainability** ?

1. Future government revenues
2. Cost and maturity of debt
3. Difference between interest rates and growth rates (*i.e. r/g*)
4. Fiscal risks (*e.g. public guarantee, climate-related*)
5. Investor beliefs/perceptions (*i.e. determines risk premium*)
6. Types of debt holders (*cf. domestic vs foreign investors*)

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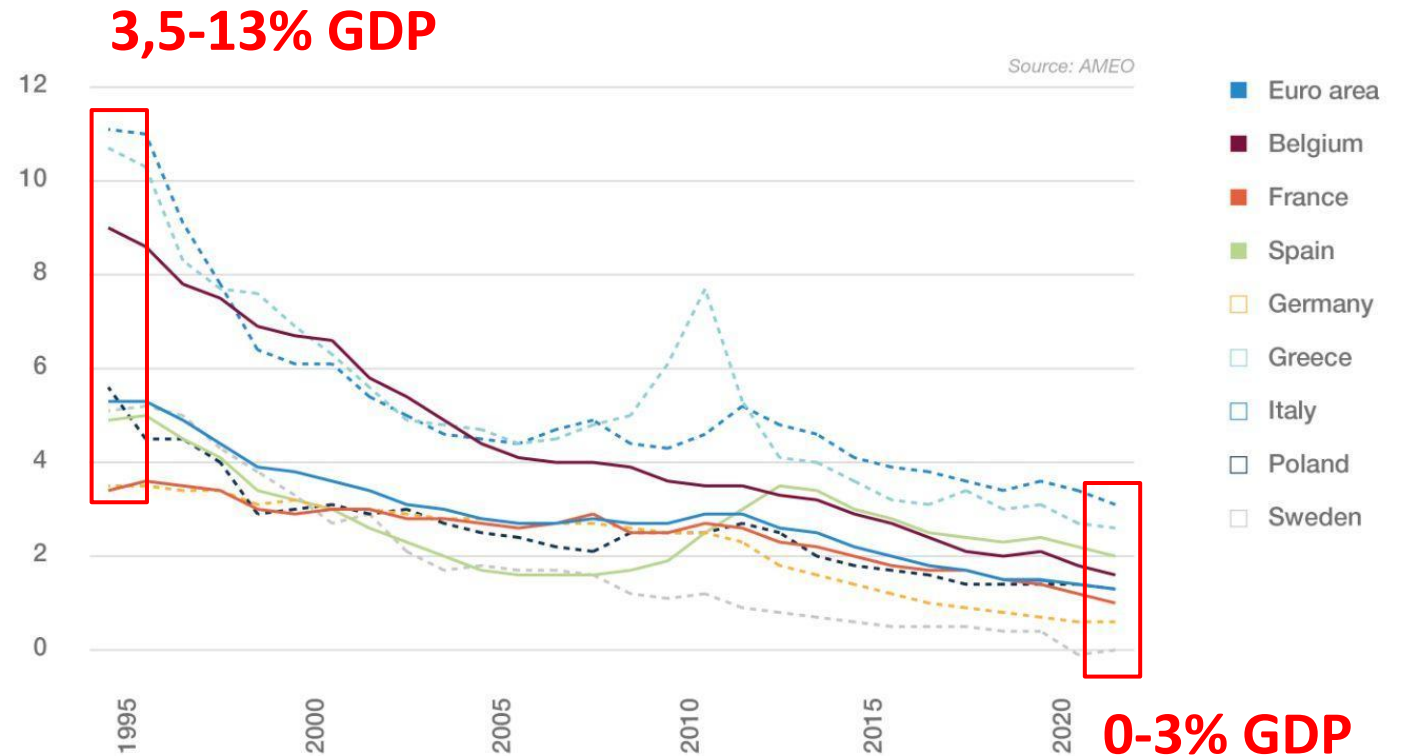
→ DSA is a **probabilistic exercise** & subject to **uncertainty**

3. DEBT SUSTAINABILITY ALSO INCREASED...

Debt servicing cost
(interest payment/yr)

(in % GDP)

(Source: European Commission - AMECO)



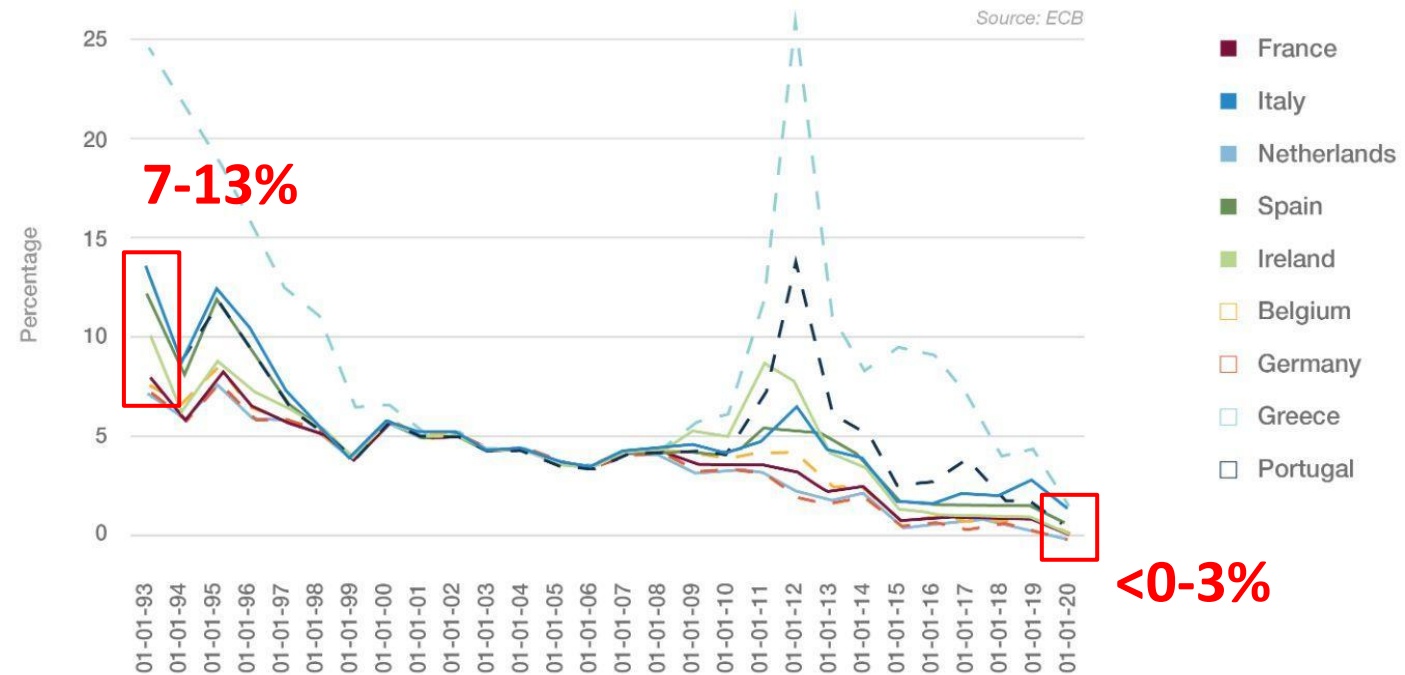
= Servicing public debt has rarely cost so little
(even with higher debt stock)

4. ... AS (LT) INTEREST RATES LOWERED

Evolution of long-term sovereign interest rate

(10yr; in %)

(Source: European Central Bank database)



= **Historically low interest rate**

Why?

1. Global savings glut hypothesis *(i.e. demographic change; inequality; supply)*
2. Accomodative monetary policy *(e.g. low key ECB interest rates; APP)*
3. EU financial assistance capacity *(i.e. European Stability Mechanism)*
4. Low (core) inflation
5. Unmet demand for safe assets
6. Sovereign bonds as risk-free assets *(in prudential regulation and ECB MO)*
7. Etc.

5. EMERGENCE OF NEW (FISCAL) RISKS

Estimation of UK's climate-related fiscal risks by 2050

(in % of UK's GDP)

(Source: OBR, Fiscal Risks report 2021)



+ 20 %
debt-to-GDP
by 2050

+ 45 %
debt-to-GDP
by 2050

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1. PERSISTENCE OF IMPORTANT FUNDING GAPS

2. PUBLIC DEBT STOCK INCREASED

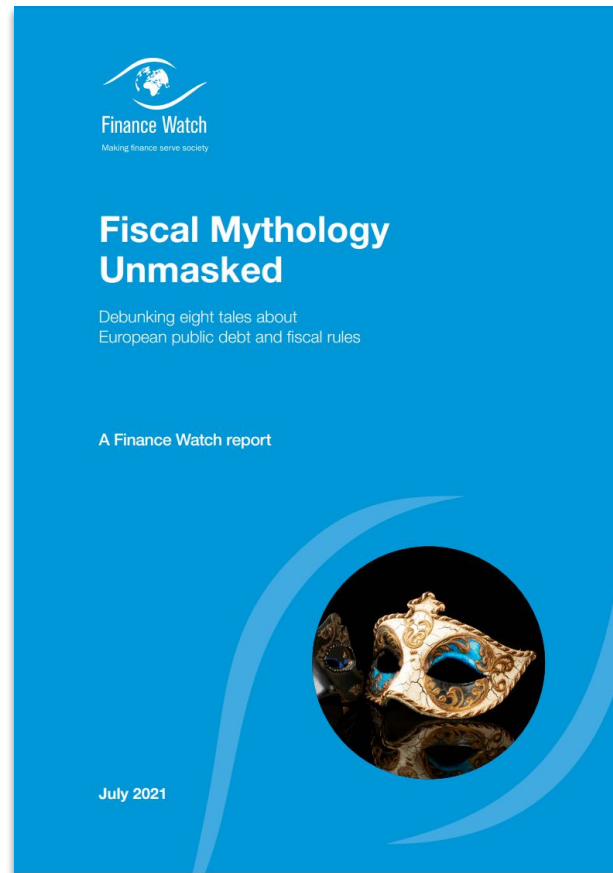
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1 | THE MAZE - What is the EU fiscal framework?

- **What ?** Set of rules constraining EU Member States' **fiscal policy**
- **Why ?** Reduce contagion risks *(cf. incomplete EMU; lack of monetary backstop, central fiscal capacity)*
- (Main) **numerical fiscal rules:**

Debt rule	< 60% of the GDP
Debt reduction benchmark	- 1/20th of the gap/yr.
Deficit rule	< 3% of the GDP
Structural deficit rule	< 0,5-1% of the GDP
(Expenditure benchmark rule)	(Exp. G. = Pot. output G.)

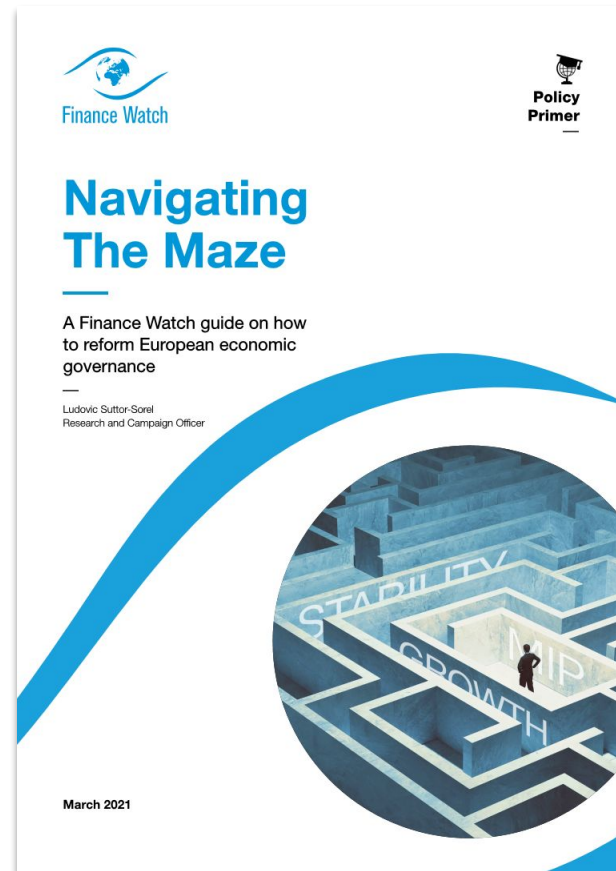
- Intertwined with **the “European Semester”** *(cf. 3 pillars of EU Econ. governance)*

1 | THE MAZE - What is the EU fiscal framework?

Primary legislation <i>(EU treaties)</i>	Art 126 TFEU	1992: Excessive Deficit Procedure (EDP)	<ul style="list-style-type: none"> • Member States shall avoid excessive deficit (crossing reference values) • The EC examines MS's compliance • If non-compliance = EC prepares a report & makes reco. to the Council
	Protocol n°12	1992: Reference values	<ul style="list-style-type: none"> • Reference values (3% deficit-to-GDP, 60% debt-to-GDP)
Secondary legislation <i>(Regulation, directive)</i>	Reg. (EC) No 1466/97	1997: SGP (preventive arm)	<ul style="list-style-type: none"> • MTO (balanced or in-surplus budget) • Stability or Convergence Programme (MTO, adjustment path, etc.)
	Reg. (EC) No 1467/97	1997: SGP (corrective arm)	<ul style="list-style-type: none"> • EDP timeline • Clarify sanctions in case of ED • Unusual event clause
	Reg. (EC) No 1055-56/2005	2005: SGP reform (amending 2 arms)	<ul style="list-style-type: none"> • Structural deficit rule • Minimum adjustment path (>0,5% GDP) • Structural reform clause
	2-Pack, 6-Pack, etc.	2011, 2013	<ul style="list-style-type: none"> • Debt reduction benchmark; General escape clause • Etc.
Intergov. treaty	TSCG	2012: TSCG: "Title III. Fiscal compact"	<ul style="list-style-type: none"> • A tightened structural deficit rule (0.5-1.0%) • An (automatic) correction mechanism (in case of significant deviation)
Extra-legislative, interpretative guidel.	Code of Cond. SGP; CAM; etc.		<ul style="list-style-type: none"> • Details on flexibility (e.g. inv. clause); Guidelines on the content of DBP; CAM (OG)

1 | THE MAZE - What is the EU fiscal framework?

More details in →



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3. **Blind to environmental and social concerns** *(i.e. monitoring; secondary; no procedures)*
4. **Asymmetric** *(i.e. constraints deficits; not equipped to force spending)*
5. **Overly complex** *(i.e. the Maze; tension between simplicity, adaptability & enforceability)*

2 | THE PROBLEMS - What's wrong with the EU fiscal framework?

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3 | THE NAVIGATION - How to reform the EU fiscal framework?



1st - Keep EU fiscal rules frozen (until 2023)

2nd - Restart the European Economic governance review consultation (19 Oct.)

3rd - Reform fiscal rules:

Option 1 - Tweaking SGP interpretative guidance & (non-legislative) documents

Option 2 - Reforming the Stability and Growth Pact (short-term action)

Option 3 - Reforming the European Treaties (long-run)

Option 1 - Tweaking SGP interpretative guidance & (non-legislative) documents

- **The investment clause** (2011) → ~~Ease unnecessarily restrictive conditions~~
- **The escape clauses** (1997, 2011) → Clarify procedures
- **Structural Deficit Rule** (2005) → Change how output gaps are calculated (cf. CAM)

→ **Not enough to fix problems !**

3 | THE NAVIGATION - How to reform the EU fiscal framework?

Option 2 - Reforming the Stability and Growth Pact (short-term action)

- **The debt-reduction benchmark** (2011) → **country-specific debt pathways** *(based on DSA)*
- **The investment clause** (2011) → **relax the conditionality** + **green golden rule**
- **The stab. & conv. prog.** (1997, 2005, 2011) → **tracking public spending quality**
(transparency, comparability, accountability)
- **The European Semester** (2011) → **prioritise SDGs-related inv. and reforms**
- **The expenditure benchmark** (2011) → **central role** *in MTO assessment*

3 | THE NAVIGATION - How to reform the EU fiscal framework?

Option 3 - Reforming the European Treaties (long-run → unanimity)

- The 3% and 60% reference values (1992) → scrapped or relaxed
- The foundation of fiscal & socio-eco pillars → better integrate sustainability imperative

(Articles 121, 126 and 148 TFEU)

4 | THE NAVIGATION - How to reform the EU fiscal framework?

Reforming fiscal rules:

easy

Option 1 - Tweaking SGP interpretative guidance & non-legislative documents

→ Technical formality

feasible

Option 2 - Reforming the Stability and Growth Pact *(short-term action)*

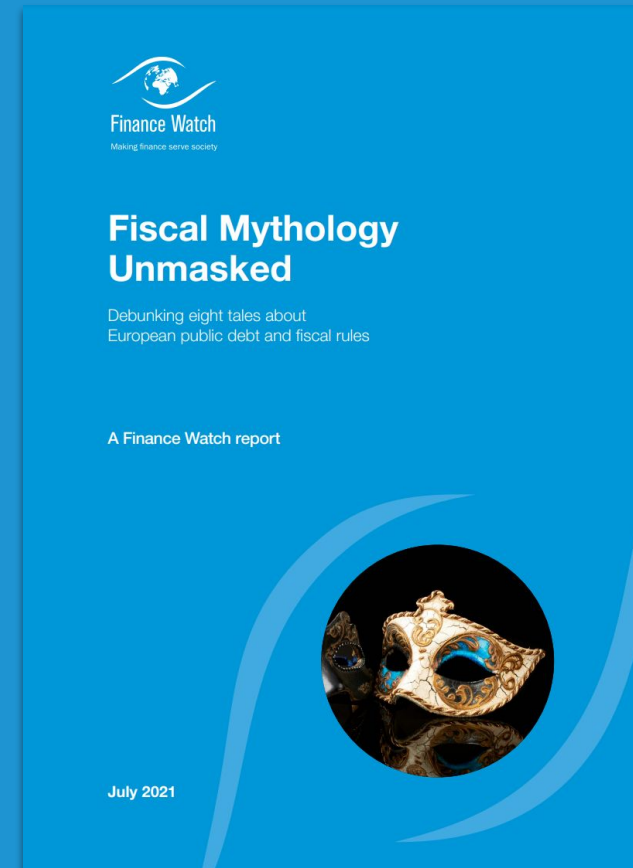
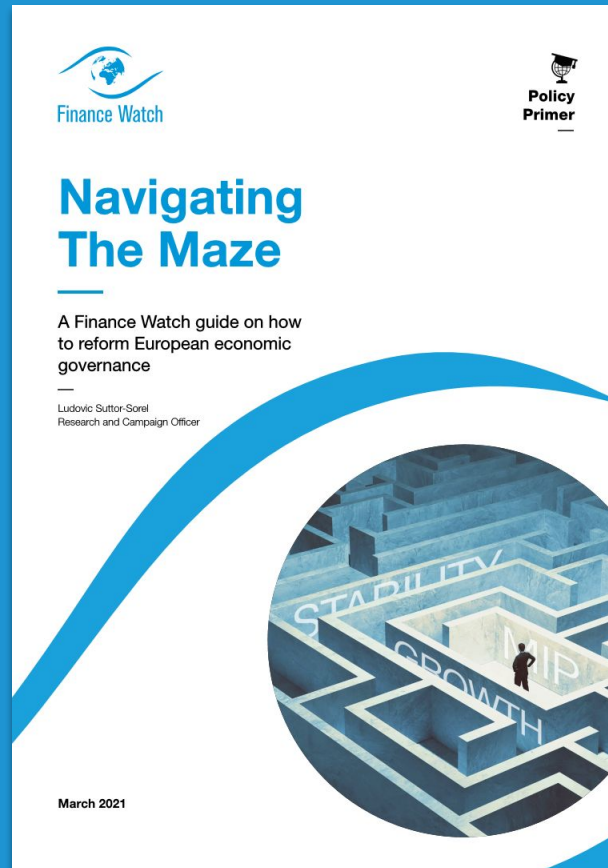
→ Ordinary legislative procedure *(Art 194 TFEU)*

hard

Option 3 - Reforming the European Treaties *(long-run)*

→ Ordinary and simplified revision procedure (unanimity) *(Art 48 TEU)*

Based on Finance Watch's reports



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