POSITION PAPER

BUSINESSEUROPE

July 25, 2023

EU ECONOMIC GOVERNANCE REVIEW

KEY MESSAGES

- **Agreement on new fiscal rules is urgently needed** ahead of Member States setting their 2024 budgets. Given high debt and deficit levels in some countries, a credible and respected framework is essential to maintain public finance sustainability in the EU.

- We welcome the focus in the Commission's April 2023 legislative proposal on reference values in accordance with the European Treaties. The Commission's legislative package, focussing on Member States' net primary expenditure can potentially **simplify the rules** and help Member States construct medium-term adjustment paths that are less sensitive to cyclical conditions, thus more credible. But the rules must not provide excessive flexibility in their interpretation. It is important that, as the Commission proposes, the reference values of 3% of GDP for government deficits and 60% for government debt continue to be at the basis of the Economic Governance Framework.

- We welcome the proposal to **support Member States undertaking growth enhancing reforms and public investment** through a longer fiscal adjustment path. But proper implementation needs to be ensured with flexibility only granted if Member States present credible reform and investment programs that support sustainable growth and debt sustainability.

- The Commission's simplified proposals, including greater ownership by Member States, can potentially **enhance the enforceability of the rules**. Greater flexibility must go hand in hand with a stronger and more credible enforcement framework, linked to the possible withdrawal of Commission funding.

- **Deepening Economic and Monetary Union** goes hand in hand with strengthening economic governance, including completing the banking and capital markets unions and reinforcing the European Semester's role in increasing growth, competitiveness and convergence. We look forward to further proposals in these areas.

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RECOMMENDATIONS FOR THE REFORM OF THE EU ECONOMIC GOVERNANCE FRAMEWORK

Background

The European Commission released a package of legislative proposals on 26 April 2023, proposing new economic governance rules, in particular regarding the reform of the Stability and Growth Pact. The communication followed two broader discussion papers released by the Commission in 2019 and 2021 and a communication in November 2022. Key points from the proposals include:

- As part of the common EU framework, the Commission would present a reference fiscal adjustment path, covering a period of four years, based on its debt sustainability analysis methodology. This reference adjustment path should ensure that the debt of Member States with substantial or medium debt challenges would be put on a plausible downward path, and that the deficit would remain credibly below the 3% of GDP reference value set out in the Treaty.
- Member States would then submit plans setting out their medium-term fiscal path, and priority reform and public investment commitments. Member States would be able to propose a longer adjustment period, extending the fiscal adjustment path by up to three years provided that the proposed path is underpinned by a set of reform and investment commitments that support debt sustainability and respond to common EU priorities and targets.
- As a third step, the Commission would assess the plans, providing a positive assessment if debt is placed on a downward path or stays at prudent levels, and the budget deficit remains credibly below the 3% of GDP reference value over the medium term. The Council would endorse the plans following a positive assessment from the Commission.
- Finally, the Commission would continuously monitor the implementation of the plans. Member States would submit annual progress reports on the implementation of the plans to facilitate effective monitoring and ensure transparency.

In terms of next steps, the paper notes that Member States and the Commission should reach a consensus on the reform of the economic governance framework ahead of Member States' budgetary processes for 2024 (ie early 2024), now that the Commission has tabled legislative proposals on the basis of the November 2022 Communication.

BusinessEurope Position

BusinessEurope welcomed the Economic Governance Review when it was launched by the Commission in 2019. We have argued that the review provides the opportunity to improve the clarity of the Stability and Growth Pact, in particular to simplify the fiscal rules and reduce their pro-cyclicality, thus helping to ensure they play their full role in helping Member States put their finances on a sustainable footing. We have also made clear that review should also consider how the framework can best support growth-enhancing public investment and structural reforms.

Recent years have reminded us that sound public finances provide governments with more fiscal space to support the economy in times of crisis. More generally, strong public finances can support business confidence and investment through reducing the interest rate at which all parties borrow. The EU's economic governance framework can play an important role in helping Member States strengthen their public finances.

BusinessEurope welcomed the focus in the commission's legislative proposal on numerical benchmarks, including the 3% and 60% Maastricht benchmarks. However, there remains also a risk that the newly proposed framework will not deliver a significant increase in simplicity for the overall framework, and thus risk undermining the ability to ensure clear and credible enforcement. It remains important to achieve the right balance between allowing Member States to develop and take ownership of their own fiscal plans and ensuring that there is a common framework that can deliver stronger public finances in a way that is not procyclical.

Need for Urgency

The suspension of the SGP is a unique opportunity to change the current framework, which is unsuitable to the new economic backdrop. It is essential that Member States take the opportunity provided by the continuing activation of the SGP's general escape clause, to agree new rules ready governments to have guidelines for setting their 2024 budgets. In practice this means new rules agreed by Spring 2024.

As we write in July 2023, there remains some uncertainty regarding how the Council will take forward the Commission's April 2023 proposals.

Need to simplify fiscal rules

There is a need to simplify the fiscal rules and reduce their pro-cyclicality. Excessive complexity increases the risk of noncompliance by allowing for ambiguities in interpretation, therefore making EU Member States budgetary positions less transparent, and undermines confidence in the euro.

The Commission's proposal, with an increased focus on a single indicator, the Member State's net primary expenditure, takes an important step forward towards simplifying the rules. Clarity should be increased by the focus on a well-defined fiscal adjustment path for each Member State. The medium-term horizon of the plans is important in order to

tailor fiscal adjustment to the specific country conditions. It will help to construct adjustment paths that are less sensitive to cyclical conditions, thus more credible.

However, it is also important that the rules do not provide excessive flexibility to any single institution (in this case the Commission) in their interpretation. In particular, content codified in Annex II – VII should be included in the core part of the regulation and not be subject to unilateral changes through delegated acts by the Commission, in order to safeguard the "non-essential elements"-principle in accordance with Art. 290 TFEU. This concerns above all the information to be provided by Member States in the medium-term fiscal-structural plans and the annual progress reports; and the assessment framework for the set of reform and investment commitments underpinning an extension of the fiscal adjustment period.

It would be useful to increase the role of National Fiscal Councils regarding the technical evaluation of the plans. In this context, it is important that, as the Commission proposes, the 3% of GDP reference value for government deficits and 60% reference value for government debt, continue to be a basis for the Economic Governance Framework, given that they are well known benchmarks in the treaties of the Functioning of the European Union.

We also believe that discussion in the Council could benefit from the Commission providing a staff working paper illustrating how the proposed framework would work in practice by demonstrating how the rules would have been applied to Member States in previous years.

Fiscal rules must be both enforceable and enforced

Given high debt and deficit levels in some countries, a credible and respected framework is essential to maintain public finance sustainability in the EU. In recent years, the lack of proper enforcement of both the Stability and Growth Pact and the Macroeconomic Imbalances Procedure has undermined the effectiveness of the governance framework, reducing at the same time, the market's faith in the euro, and penalising countries with less sound public finances. In its August 2019 assessment of EU fiscal rules, the European Fiscal Board noted that, "starting in 2003 (..) Member States' commitment to the SGP began to weaken", whilst "the SGP was only loosely enforced (..) and Member States failed to take advantage of the good economic times before the crisis to build up sufficient fiscal buffers".

The Commission's simplified proposals can potentially enhance the enforceability of the rules. A mechanism should be envisaged for defining a European fiscal stance consistent with the economic conditions of the entire European Union, in order to reduce procyclicality of the rules.

We also welcome the renewed focus on the role of Member States using the flexibility within the rules to develop their own fiscal policies, and tailor them to national circumstances, therefore increasing ownership of the process within Member States. But this also need to be accompanied by an acknowledgement that divergences from agreed rules, notably from the agreed net primary expenditure path, cannot be accepted. Greater flexibility on fiscal adjustment must be accompanied by significant sanctions for non-compliance to maintain credibility. Withdrawing Commission funding, as seen in recent months, can potentially be an important and credible sanction to increase enforcement.

Improving the quality of public spending to support investment and reform

Given, on the one hand, the increased challenges to public finances following recent crises and, on the other hand, the need for public expenditure arising from the green and digital transitions as well as population ageing, it is important that more attention is directed towards increasing the *quality* of spending and ensuring that public expenditure is efficient and supports growth.

We welcome the Commission's proposals to allow Member States to be granted an extension of the fiscal adjustment period (by a maximum of 3 years), provided the fiscal path is underpinned by a set of reforms and investments that supports growth and debt sustainability. Nevertheless, as public debt to GDP ratio in several Member Countries is significantly higher than the 60% reference value, it is crucial to demonstrate a credible and consistent downward trajectory of debt levels with the support of a ten year forecast of the public debt to GDP ratio after the end of the plan, as already envisage by the Debt Sustainability Analysis elaborated by the Commission.

In this context it will be important that the agreed framework allows the Commission to draw on the experience of the Recovery and Resilience Facility to ensure that reforms and investments are fully implemented according to detailed and agreed milestones. Reforms plans should also be supported by independent analysis showing they will support long-term growth before qualifying for an extended adjustment period. Utilising the European Semester as a primary tool for developing and monitoring national debt reduction plans – also beyond the RRF timeframe – establishing a collaborative framework for social partner involvement is crucial. This will enable Member States to make targeted investments and enhance the national ownership approach pursued by the Commission.
Improving the quality of public finances also means a greater focus on public investment, and in particular, ensuring that investment that is genuinely growth-enhancing is not the first to be cut when economies enter downturns. Nevertheless, in order to maintain fiscal discipline, and ensure Governments are not able to take advantage of scope to reclassify expenditure, we welcome the fact that the Commission has avoided proposing a 'golden rule' which might exempt public investment, including green or digital investment, from the provisions of the fiscal framework.

Deepening the Economic and Monetary Union goes hand in hand with improving economic governance

At the same time, pressure on Member States' public finances can be reduced by increasing convergence between EU Member States and ensuring cross-EU economic and financial linkages can play a role in dissipating the impact of an adverse shock affecting any single Member State across the EU. In turn, this would enhance adherence to and the credibility of the Economic Governance framework.

Whilst we recognise that the Commission has focused on the Economic Governance Framework in its November 22 Communication, it is important that it maintains its efforts to deepen and strengthen the EMU, including through the following actions:

- finalising work on the Banking Union and pressing ahead with the Capital Markets Union;

- reinforcing the European Semester's role in increasing growth, competitiveness and convergence; and

- considering how a permanent instrument can be developed to reduce the impact of asymmetric shocks on Member States. Although we welcome the focus on investment and growth enhancing reforms in the national recovery and resilience plans, an extension of the Next Generation Recovery and Resilience facility should not be the overall model for such an instrument, given the RRF's role as a one-off response to a largely symmetric shock.