New fiscal rules for the EU:
The European Commission proposals

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1. Main features of the EGR orientations

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2. A risk-based medium-term surveillance framework anchored on debt sustainability
3. The single operational indicator
4. Surveillance and enforcement

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1. Main features of the EGR orientations
Recap – Overview

1. **National medium-term fiscal structural plans,** integrating fiscal, reform and investment objectives. They are binding on annual budgets.

2. A country specific **medium-term net expenditure path** will be the single operational fiscal indicator.

3. **Debt sustainability risk** as the main anchor for the adjustment path.

4. **Reforms and investments** promoting sustainable growth and other EU priorities.

5. **Enhanced enforcement** based on excessive deficit procedure and underlying thresholds.

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1. Main features of the EGR orientations

Overview of process – ownership in common EU framework

Common Framework

Commission makes public a *reference* multiannual expenditure path anchored on debt sustainability

Design of the Plan

Member State presents its policies, discusses with Commission and subsequently submits it fiscal-structural plan

Adoption

Commission provides an assessment of the plan to be endorsed by the Council

Implementation

Member State implements the plan and Commission and Council monitors compliance with the endorsed fiscal-structural plan

2. A risk-based medium-term surveillance framework anchored on debt sustainability

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2. A risk-based medium-term surveillance framework

2.1. Requirements are differentiated based on Member States public debt challenge (classification based on Commission DSA)

- The fiscal adjustment path should be consistent with **debt converging to prudent levels.** Requirements differentiated according to the debt level and dynamic (DSA)

Criteria for country classification

- **Deterministic projections:**
  - **Debt level at the end of the projections (based on standard no-policy change)**
  - **Debt path**
  - **Fiscal consolidation space**
- **Stochastic projections:**
  - **Probability that debt will not stabilise**
  - **Degree of uncertainty**

Intuitive reading of DSA criteria

- **Substantial public debt challenge:** if debt is high, likely to increase over the next few years and/or there is little room for corrective action
- **Moderate public debt challenge** if debt is high but continuously and realistically declining, or it is at least stabilising below 90% of GDP
- **Low public debt challenge** if debt is below 60% of GDP or declining towards that level over the medium term

2. A risk-based medium-term surveillance framework

2.2. Overview of ‘reference path’ requirements dependent on debt challenge

<table>
<tr><th></th><th>Substantial debt challenges</th><th>Moderate debt challenges</th><th>Low debt challenges</th></tr>
<tr><td>Default adjustment period</td><td>4 years
Can be extended to 7 years together with reforms and investments</td><td colspan="2">7 years
Can be extended to 10 years together with reforms and investments</td></tr>
<tr><td>Debt criterion</td><td>After (at most) 4 years, 10-year debt trajectory at unchanged policies on a plausibly and continuously declining path*</td><td>After (at most) 7 years, debt trajectory at unchanged policies on a plausibly and continuously declining path*</td><td></td></tr>
<tr><td>Deficit criterion</td><td colspan="2">After (at most) 4 years, deficit maintained below 3% of GDP over 10-year period at unchanged policies</td><td>After (at most) 7 years, deficit maintained below 3% of GDP over 10-year period at unchanged policies</td></tr>
<tr><td>Reference adjustment path provided?</td><td colspan="2">Yes</td><td>No</td></tr>
</table>

*The DSA tool is used to assess the plausibility of the declining debt path

2. A risk-based medium-term surveillance framework

2.3. Extension of the fiscal adjustment period for reforms and investments

- The **adjustment period (of 4 years)** can be **extended by up to 3 years** to facilitate a set of major investments and reforms that should:
  - be growth enhancing and support fiscal sustainability.
  - address common EU priorities and CSRs, including under the MIP.
  - be sufficiently detailed, frontloaded, timebound and verifiable.
  - ensure that investment priorities can be addressed without investment cuts elsewhere.
- If **the set of reforms and investments**, which have been the condition for the extension of the adjustment period, **are not implemented**, the EU will be empowered :
  - to correct the adjustment path in the plan in a more restrictive sense and
  - to impose financial sanctions to euro area Member States

2. A risk-based medium-term surveillance framework

2.4. Member States with low debt challenges

- **Only Member States with substantial or moderate debt challenges** are required to put their debt on a plausibly declining path
- **Member States are generally considered as having low debt challenges** if, *under unchanged policies*:
  - debt is projected to remain below 60% of GDP
  - Or, debt is projected to decline over the medium term
- Member States with low debt challenges should nevertheless ensure that their policies do not put them at risk of facing a moderate or substantial debt challenges

3. The single operational indicator

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3. The single operational indicator
3.1. Nationally financed net expenditure

- A single operational indicator anchored on debt sustainability: **Nationally-financed net primary expenditure**
- Broadly similar definition as for the expenditure benchmark. Corrected for:
  - interest payment
  - cyclical part of unemployment benefit expenditure
  - *net of discretionary revenue measures*

⇒ - Simple and transparent (one indicator)
- Compliance under government control
- Allows for the operation of automatic stabilisers

4. Surveillance and enforcement

1. Recap – Main features of the EGR orientations
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4. **Surveillance and enforcement**

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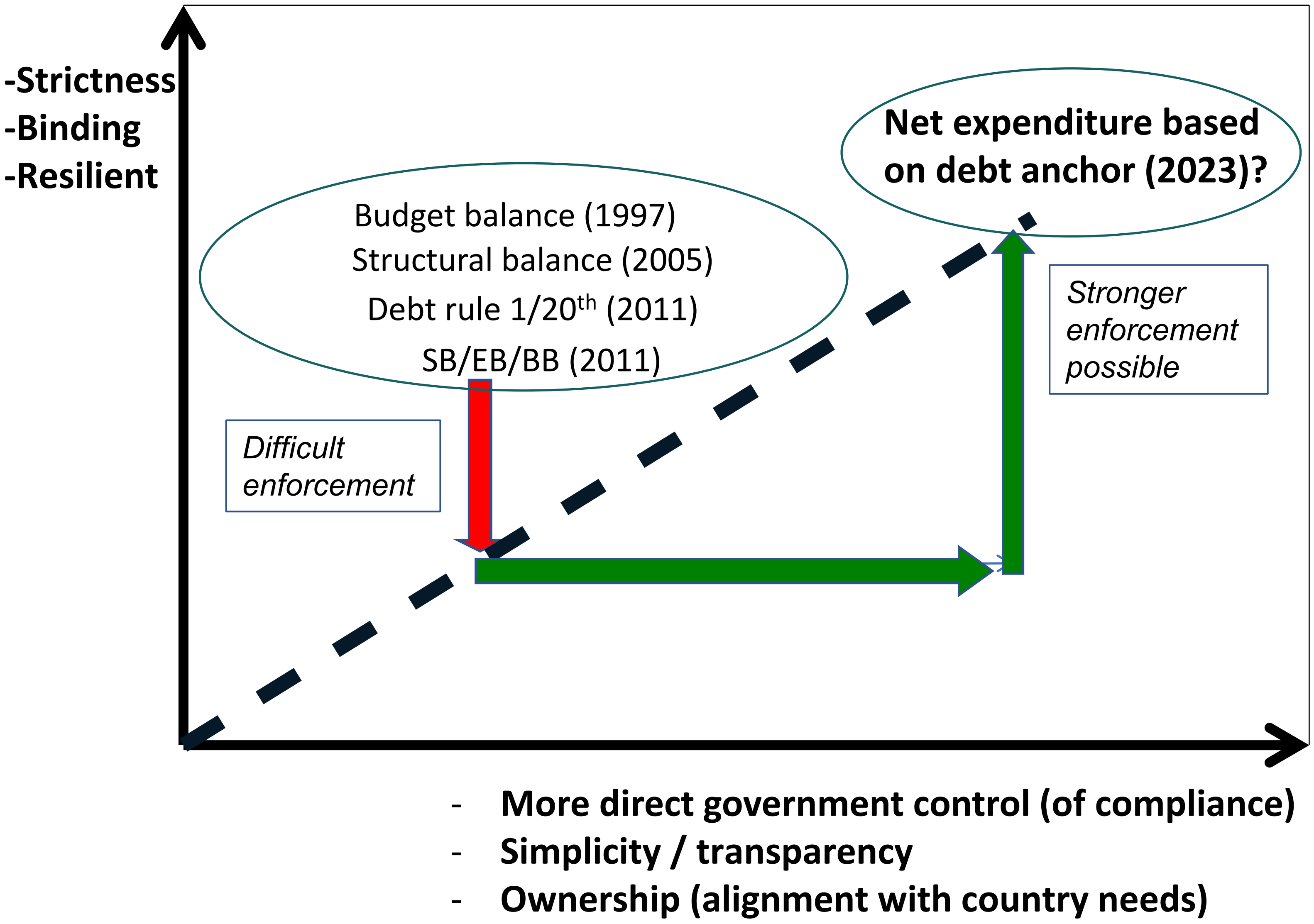
4. Surveillance and enforcement

- **Annual implementation reports** will be the basis for annual surveillance.
- Deviations from the MS net expenditure path (as endorsed by the Council) are basis for enforcement.
- Enforcement under the **preventive arm:** early warnings.
- Enforcement under the **corrective arm:**
  - ✓ Breaches of 3%: deficit based EDP
  - ✓ Deviations from net expenditure path when debt-to-GDP ratio is above 60% → 126.3 report
    - ➢ If MS has substantial public debt challenge, by default EDP
    - ➢ If MS has moderate public debt challenge, could lead to EDP
- **Notional control account** to track cumulative deviations
- Financial **sanctions of lower amounts** and enhanced **reputational impacts**

Surveillance and enforcement

Stronger enforcement as counterpart for flexibility in the path



- Stronger ex-post **enforcement at the EU level as a counterpart for more flexibility** in setting the path.
- Stronger enforcement feasible due to framework characteristics

Thank you

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RECAP

MIXED COMPLIANCE WITH THE EU FRAMEWORK

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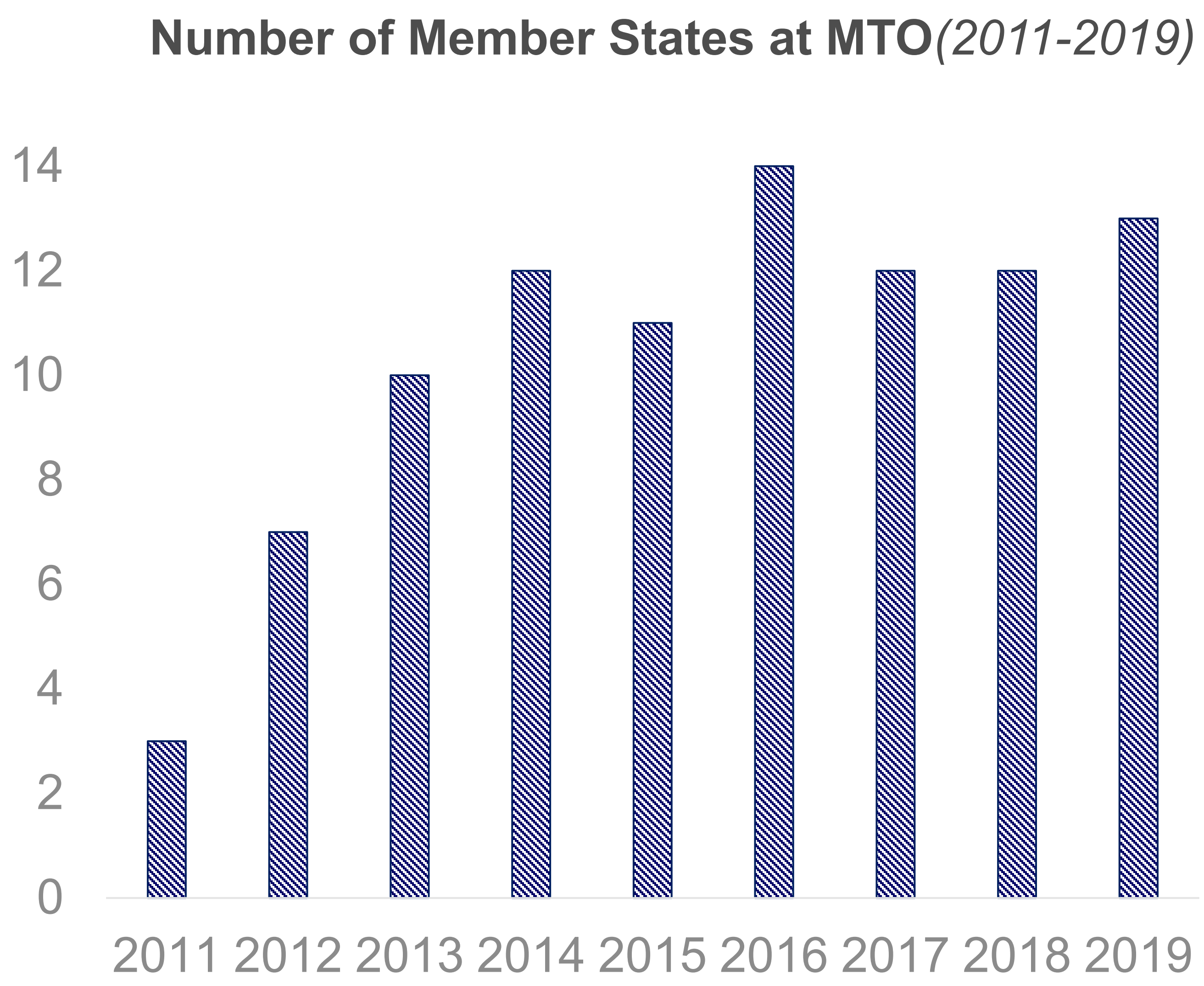
To what extent have Member States complied with EU fiscal rules (medium-term) framework?

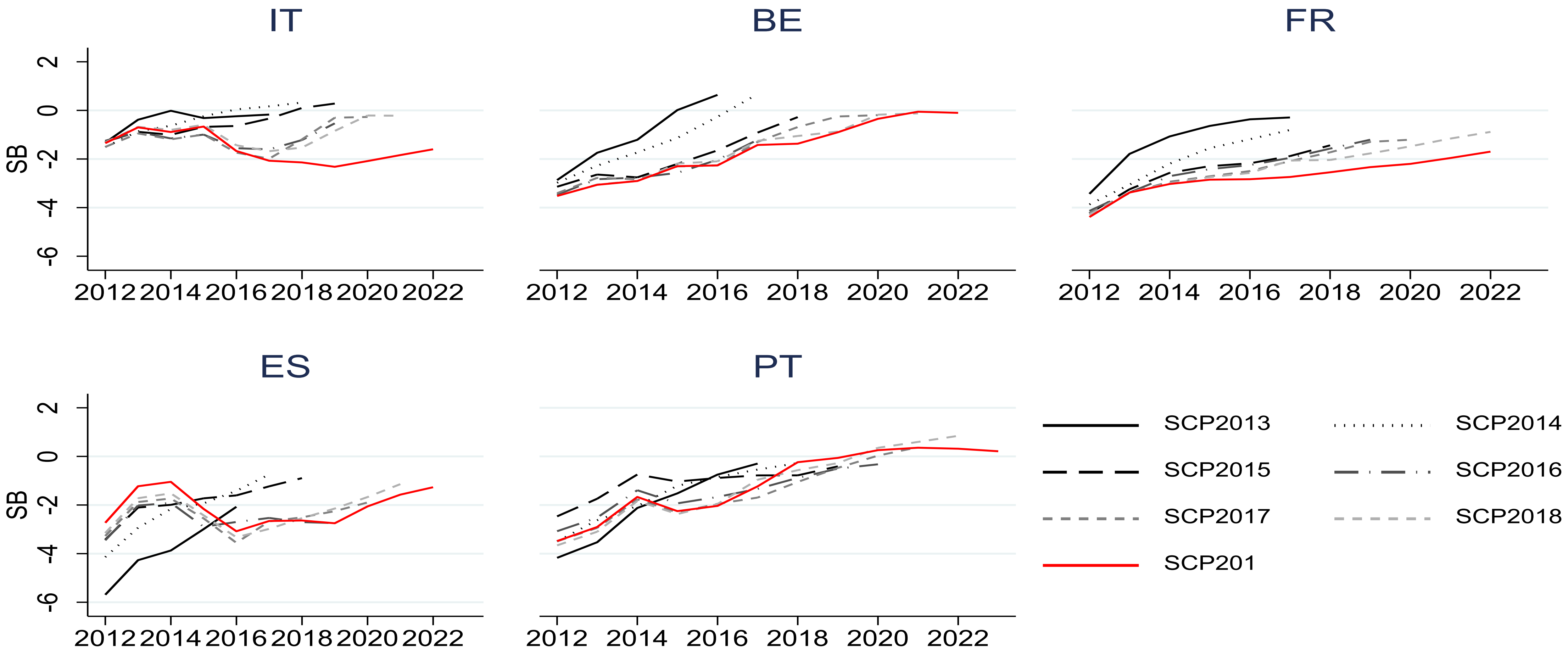


Preventive arm

- Large heterogeneity
- Around half of Member States reached MTO by 2016.
- Others never reached MTO or moved away from it.

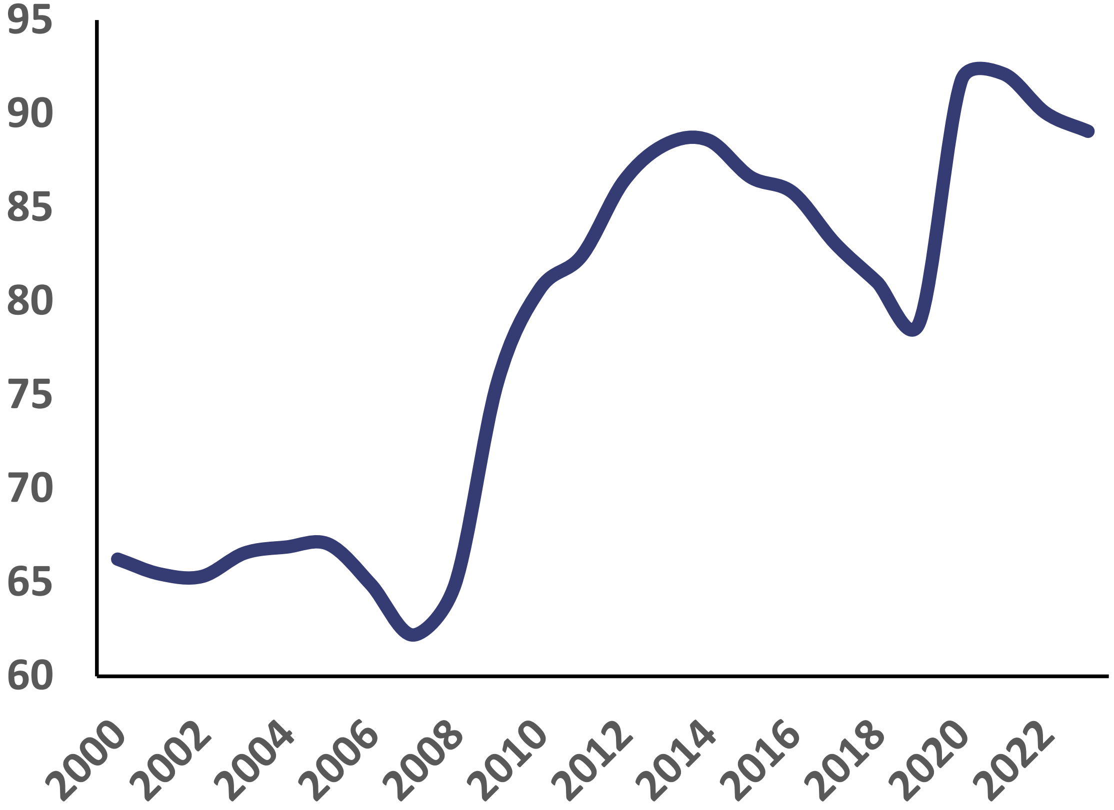
Past experience shows systematic delays in fiscal adjustments

Member States medium term' plans in consecutive Stability Programmes
(structural balance, % of potential GDP)

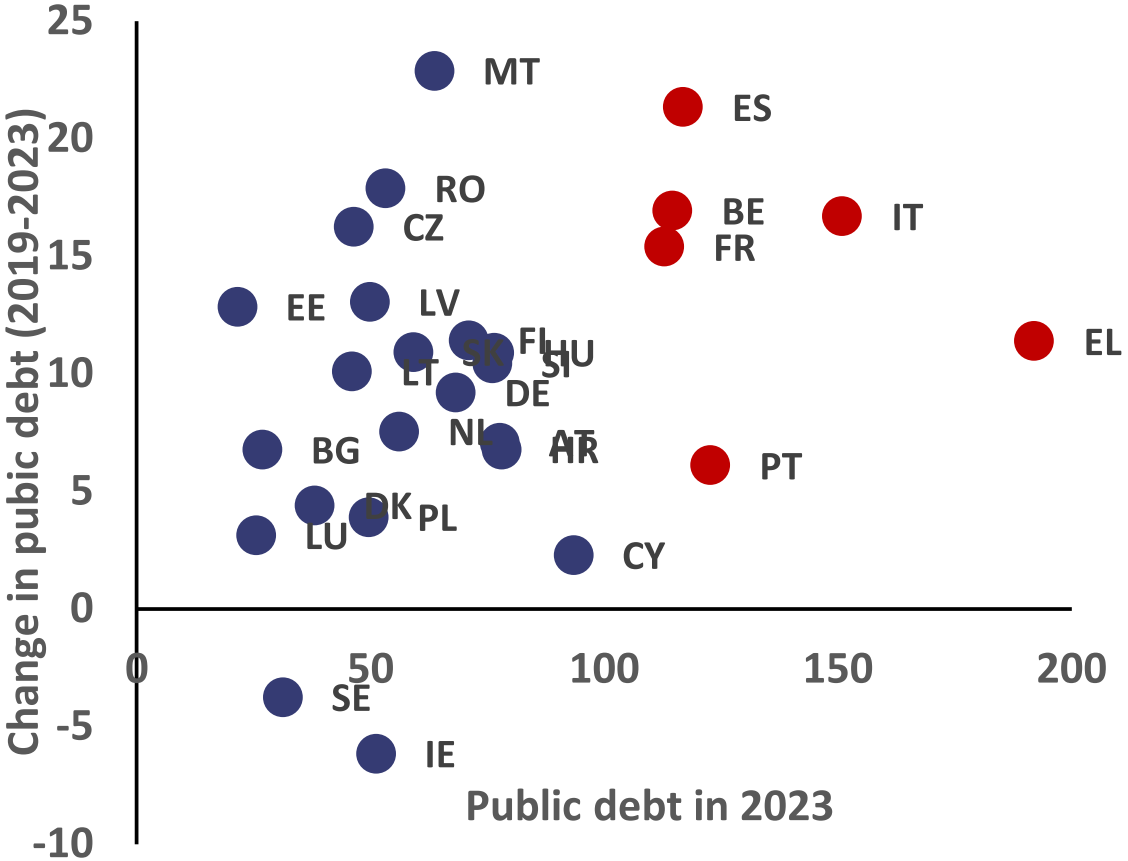


EGR – Strong (heterogenous) debt increases

Aggregate public debt in the EU
(2000-2023, % of GDP)

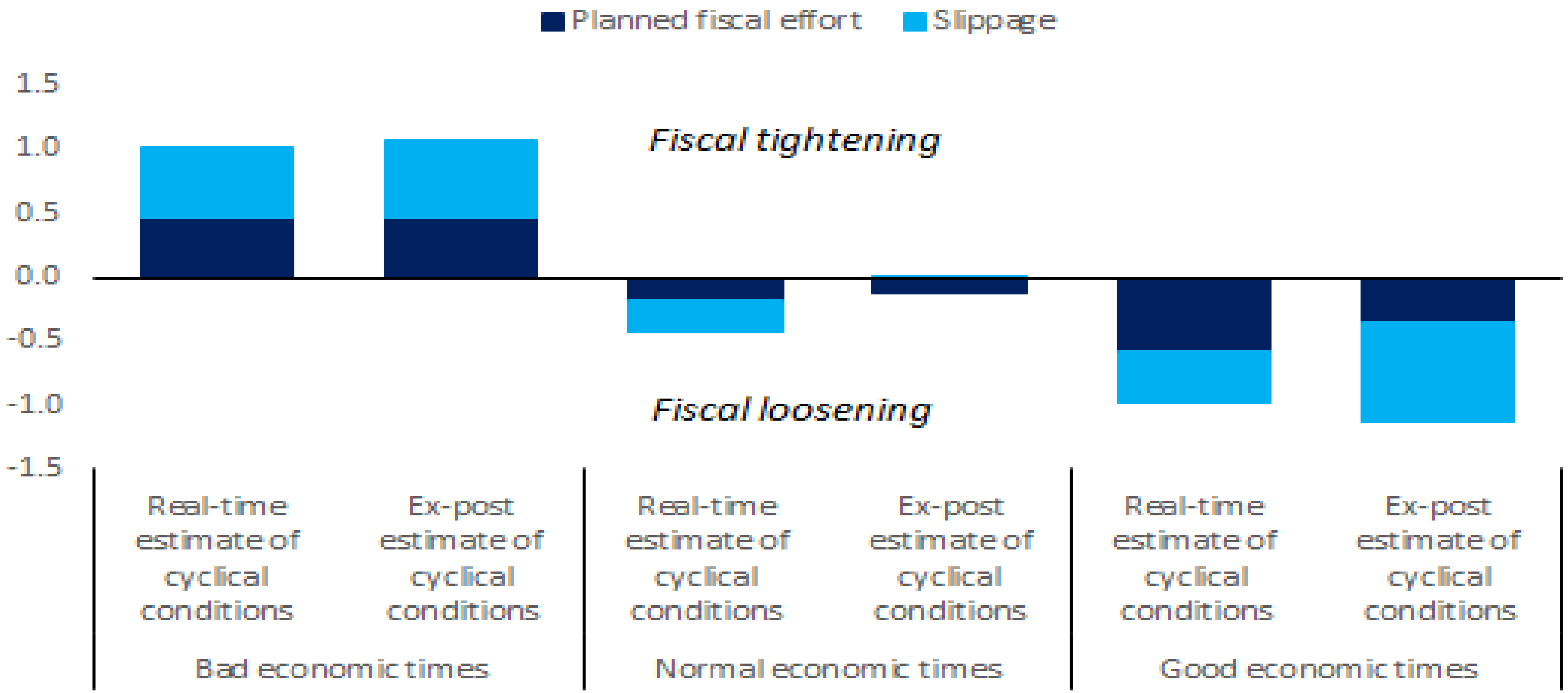


Change in public debt in the EU
(2019-2023, % of GDP)



2b. EGR : Pervasive pro-cyclical bias

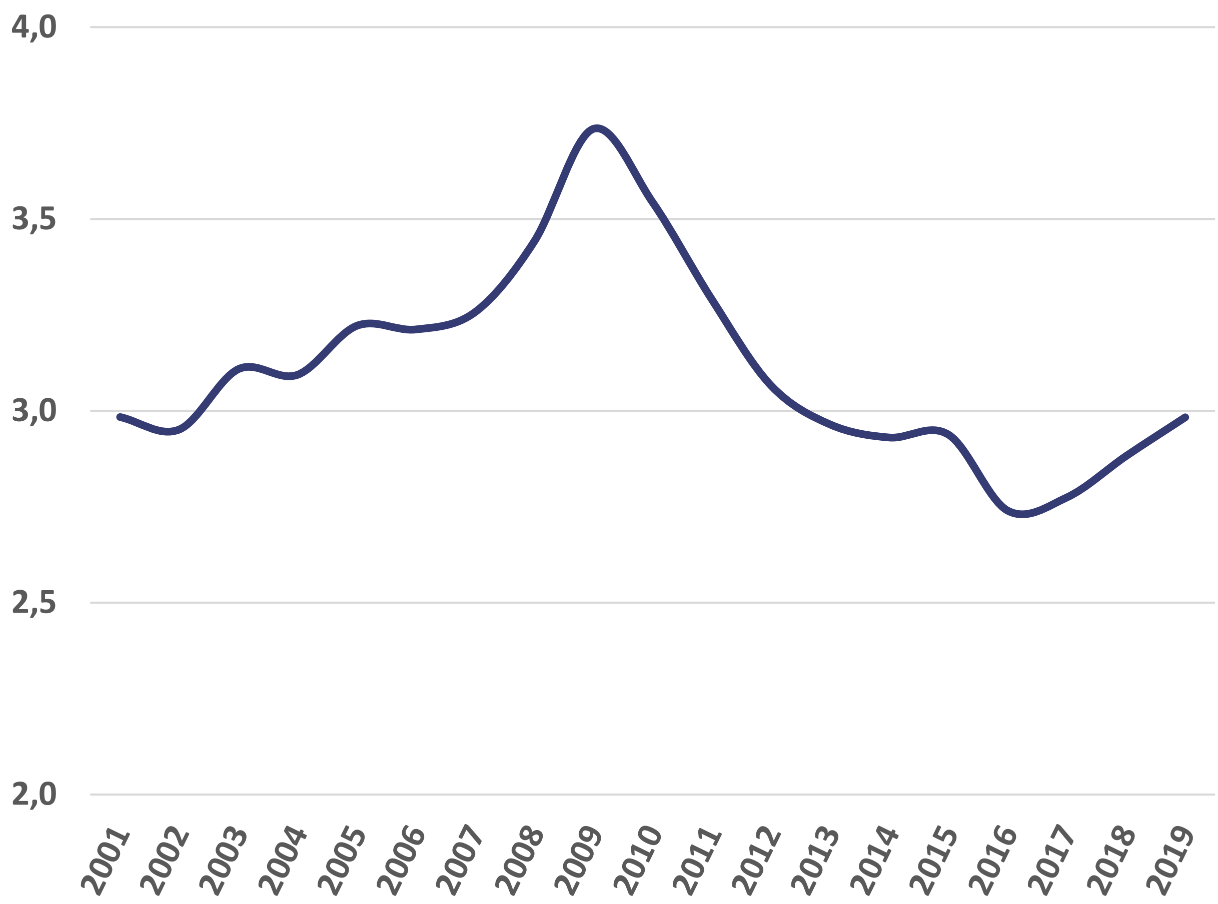
Fiscal effort under different cyclical conditions, 2001-2019



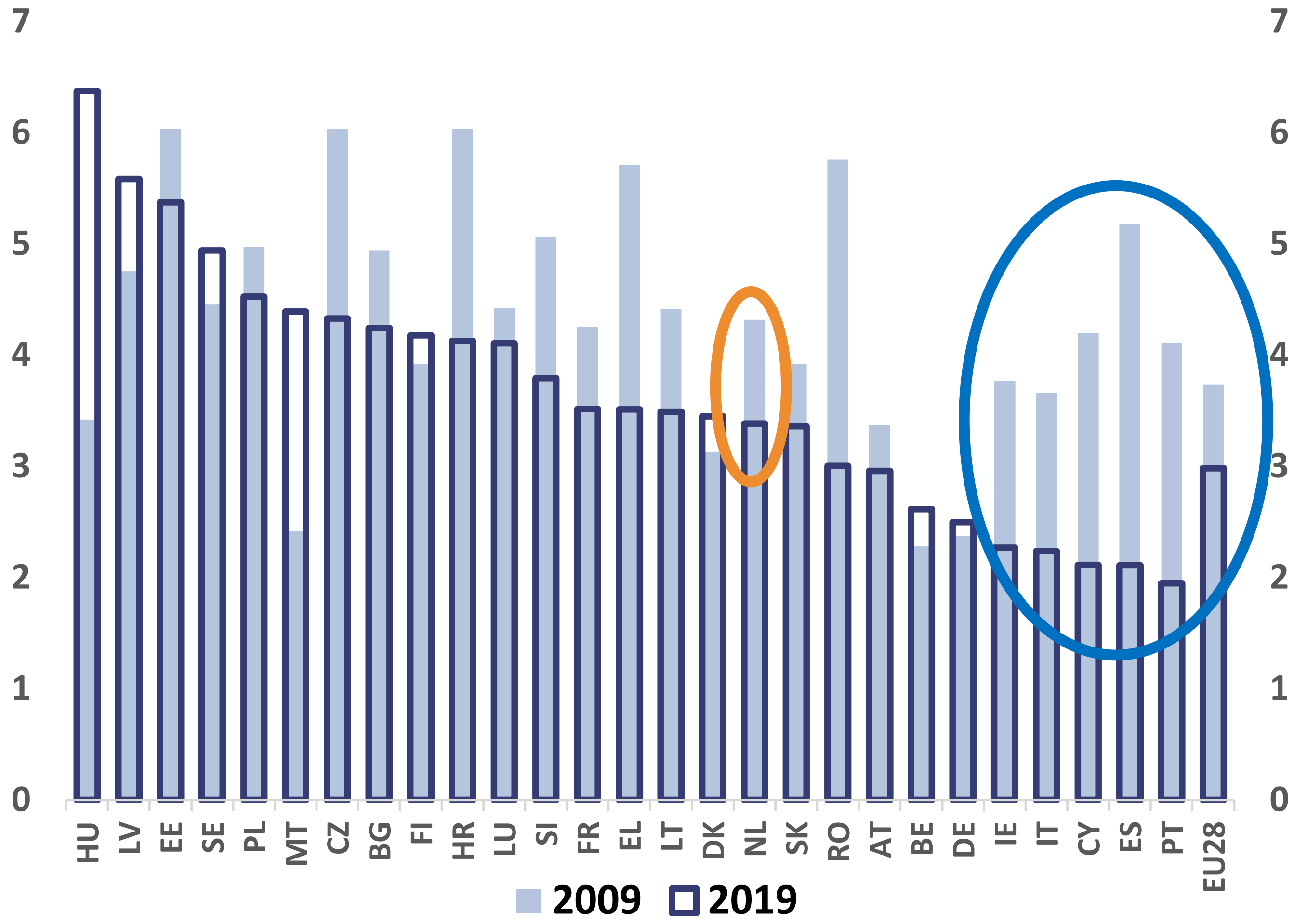
- **Pro-cyclical fiscal policy** both in good and bad times.
- **Budgetary slippages** and **ex-ante fiscal planning** behind pro-cyclicality.

2c: EGR: decline in public investment

Public investment in the EU
(2001-2019, % of GDP)



Public investment by Member States
(2019 vs 2009, % of GDP)



4. Surveillance and enforcement

Escape clauses

- A **general escape clause** for major economic shocks to the euro area or the EU as a whole.
- A **country-specific escape clause** in the case of exceptional circumstances outside the control of the government with a major impact on the public finances.
- Less frequent need for escape clauses?

Good to be tied to the mast when sirens are calling….but escape clauses needed in case of major storm (or other extreme events).