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School of European Political Economy

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Carlo Bastasin

Policy Brief 6/2023

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April 28, 2023

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The regulation proposal[1] presented on April 26, 2023 by the European Commission marks an important step, but by no means conclusive, in the process of reforming the rules of European economic governance. The proposal (and the related documents[2] reforming the existing legislation[3]) is likely to be followed by a heated confrontation between the governments within the European Council and a debate in the European Parliament. On April 26, the Commission proved that it intends to maintain its former orientations, but it is possible that the clash within the EU Council will continue for months and that the expected deadline, the end of 2023 or at the latest May 2024, will only be reached at the cost of compromises. These compromises, however, are still hard to determine. The reform of the Stability Pact is a hot issue in the public discourse of several countries, starting with Germany, which has already responded rudely to the Commission's proposal. But the reform is of existential significance also for Italy.

In February 2020, a second review of the 'Six Pack' and 'Two Pack' rules, which was called for in the legislation, revealed the possible areas for improvement in the Stability and Growth Pact.[4] Based on the review, the Commission launched a public consultation on ways to improve the framework for EU macroeconomic surveillance. The consultation was put on hold at the onset of the COVID-19 pandemic, but it was then relaunched in October 2021.

In November 2022, the Commission presented its reform proposals[5] focused on the dialogue between Brussels and individual countries and on debt reduction commitments linked to individual economic reform plans agreed among the parties. According to the Commission, "The central objective of these proposals is to strengthen public debt sustainability while promoting sustainable and inclusive growth in all Member States through reforms and investment. The proposals address shortcomings in the current framework." The aims of the proposals are described as follows:

> **Stronger national ownership:** National medium-term fiscal-structural plans are the cornerstone of the Commission's proposals. Member States will design and present plans setting out their fiscal targets, measures to address macroeconomic imbalances and priority reforms and investments over a period of at least four years. These plans will then be assessed by the Commission and endorsed by the Council based on common EU criteria.

[1] https://economy-finance.ec.europa.eu/system/files/2023-04/COM_2023_240_1_EN.pdf
[2] https://economy-finance.ec.europa.eu/system/files/2023-04/COM_2023_241_1_EN.pdf
[3] https://economy-finance.ec.europa.eu/system/files/2023-04/COM_2023_242_1_EN.pdf
[4] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:l25021
[5] https://economy-finance.ec.europa.eu/system/files/2022-11/com_2022_583_1_en.pdf

Simpler rules taking account of different fiscal challenges: Fiscal situations, challenges and economic prospects vary greatly across the EU's 27 Member States. Hence, a one-size-fits-all approach does not work. The proposals seek to move to a more risk-based surveillance framework that puts public debt sustainability at its core, while promoting sustainable and inclusive growth. This approach will adhere to a transparent common EU framework.

Facilitating reforms and investment for EU priorities: The proposals therefore aim to facilitate and encourage Member States implementing important reform and investment measures. Member States will benefit from a more gradual fiscal adjustment path if they commit in their plans to a set of reforms and investment that comply with specific and transparent criteria.

Providing for effective enforcement: Rules require enforcement. While the proposals provide Member States with more control over the design of their medium-term plans, they also put in place a more stringent enforcement regime to ensure Member States deliver on the commitments they undertake in their medium-term fiscal-structural plans.

Last March, the European Council acknowledged the "orientations"[6] of the Commission after considering the final results[7] of the public consultation. Since then, however, divisions among the governments have started to surface. Germany has publicly criticized[8] the Commission's plan as weak and discretionary. Prevailing over the proposals[9] of the minister for economic affairs, the Greens' Robert Habeck, German Finance Minister Christian Lindner circulated an informal proposal (a non-paper[10]) based on common rules for all countries with the request for a mandatory (not overly stringent) adjustment. Furthermore, Berlin made no mystery of considering the European Commission too inclined to compromise and not credible in imposing discipline. This attitude adopted by the European Commission was still the subject of division between the French government and the more intransigent German one. Lindner reiterated his criticisms even after the new proposal from Brussels incorporated some of his requests. With a sober sense of proportion, some German newspapers declared the Stability Pact dead and defunct.

Perhaps the ideal solution could have been different: a "Grand Bargain" made up of strict fiscal rules, large European investment funds on the model of the Recovery Funds, and a capital markets union. The latter was the subject of intense discussions, at the highest institutional level, during the European Council meeting last March. However, it became clear that there was no political availability either for rigorous fiscal rules (by the indebted countries) or for replicating the Recovery Funds (by the "frugal" countries). The Commission therefore had to work within the existing Stability Pact, merging fiscal rules and recovery funds into one possible compromise.

From the perspective of the disagreeing governments, the bone of contention is principally the quantity of fiscal "rigor" intrinsic to the new rules. In fact, it would be a mistake to read the Commission's proposals only in terms of harshness-versus-compliance or austere-versus-undisciplined. The proposal contains technical aspects that the more and the less austere both find inconvenient. The novelty of the compromise is the search

[6] https://www.consilium.europa.eu/en/press/press-releases/2023/03/14/economic-governance-framework-council-agrees-its-orientations-for-a-reform/
[7] https://economy-finance.ec.europa.eu/system/files/2022-03/swd_2022_104_2_en.pdf
[8] https://www.ft.com/content/8ec1d936-aabb-4f8a-b8db-ed45430888ab
[9] https://www.bmwk.de/Redaktion/EN/Downloads/P/proposed-principles-to-guide-the-german-government-in-deliberations-on-the-reform-of-eu-fiscal-rules.html
[10] https://www.sven-giegold.de/wp-content/uploads/2017/10/17-10-10-Non-Paper-BMF-on-Reforming-ESM-09-10-2017.pdf

for an ad hoc result for each country through bilateral discussions between the national governments and the Commission rather than through the judicial application of the complex numerical rules engraved in the Stability Pact.

The reason for this change of strategy seems clear. In the ten years before the pandemic, the old rules had worked rather well, bringing the average debt of the euro area from around 90% of the euro-area GDP to around 80%, albeit in a very different way from country to country. This resulted in continuous fiscal divergence within the euro area, as reflected in an unchanged standard deviation in the distribution of national debt-to-GDP ratios. However, the relatively good performance of the old rules must be interpreted in the context of a decade when interest rates were close to zero. Over the next few years interest rates are expected to stabilize at "normal" (that is, much higher) levels. The financial risk for indebted countries will thus become relevant again. Already today, day after day, there are smoke signals on the sustainability of the Italian debt. Financial investors react in particular when the dialectic between the country and the rules is antagonistic, considering that a country that diverges from the rules may not be able to repay its debt. Moreover, it is highly probable that the European Central Bank is juridically incapacitated to defend a "non-compliant" member state. In such a case, financial instability can easily tear apart the political consensus in Europe by strengthening the rhetoric about dissipating versus considerate peoples, isolating the indebted countries from the frugal public opinions.

With the Commission's new proposal, every single country is asked to agree to be accompanied by the Commission in combining (a bit of) fiscal discipline, reforms, and investments. In this configuration, the financial markets will no longer isolate a country even in the event of a recession or other difficulties, knowing that if the Commission has supported its action plan (although based on a questionable debt-sustainability analysis), and as long as the country does not dissociate from the commitments made, the European Central Bank will be able to intervene and defend it from a financial crisis.