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Carlo Bastasin

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In the next two meetings, on November 9 and December 8, Ecofin (The council of the finance ministers of the EU countries) is expected to make substantial progress in the finalization of the announced reform of the EU fiscal rules. Originally, a decision on the new fiscal framework was expected to be reached before the end of 2023. The commitment to that deadline, however, is now becoming less compelling. A deal would necessitate not only the agreement on a legal text in the Council, but also the start of a dialogue with the European Parliament that might protract the process. Although the eventuality of a swift agreement, strongly advocated by the European Central Bank, cannot be dismissed, it is possible that the final decision will only take place in the first quarter of 2024. Consequently, the revised fiscal rules are unlikely to apply next year and could start being applied in 2025.

The delay in the application of the new rules would lead to the prominence, next year, of deficit controls through the traditional Excessive Deficit Procedure (EDP) that the Commission intends to reintroduce. EDPs, the "old bottle" affecting countries like Italy whose deficit exceed the 3% threshold, may play a central role in bridging the gaps on the negotiation table and pave the way for the "new wine": a compromise on the revised fiscal rules that will be applied only after the country exits the EDP.

Distances have been shortened between France and Germany during a round of bilateral meetings on October 8-9 that brought together French President Emmanuel Macron and German Chancellor Olaf Scholz. The bilateral meetings had a positive impact also on the successive Ecofin meeting on October 17. Ministers came out of that meeting with the impression that an agreement was in reach.[1] Scholz and Macron seem to have ironed out most of the problems concerning the original proposal by the European Commission: a commitment to ensure that the debt-to-GDP ratio at the end of the forecast horizon (up to 7 years) is lower than at the start. This commitment was not considered sufficient by German Finance Minister Christian Lindner, who promised to block the whole reform, after making no secret of his contrariety to the Commission's proposal.[2]

Two successive proposals have introduced different options for the reduction of the debt. A Spanish proposal (Madrid is holding the rotating Presidency of the EU Council) accommodated Lindner's call for stricter commitments through the enforcement of an annual reduction of 1% of the debt-to-GDP ratio for ten years after the initial four/seven years. This proposal was mainly criticized for not allowing for cyclical adjustments, resulting in a pro-cyclical fiscal policy since a yearly reduction would have had to

[1] https://www.consilium.europa.eu/en/meetings/ecofin/2023/10/17/
[2] https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Press_Room/Namensartikel/2023-06-15-reform-of-europes-fiscal-rules.html

take place even during a recession. A Danish compromise proposal has bridged much of the gap, suggesting that debt reductions of around 10% should be averaged over a period of several years. As other analysts have already noted, the exact rates, how to enforce them, allowance for investment spending and how to assess deficits separately from debt are still all contested. However, Berlin signaled that it could live with a compromise of that kind, if public deficits are also kept under control.

Lindner demands that a country's public expenditure growth remain at 1% below its growth potential until member states achieve a fiscal deficit of 1% of GDP. This would imply that a member state would be compelled to implement a structural adjustment of 0.5% of GDP per year until a fiscal deficit of 1% is reached, de facto reintroducing the level of correction required under the "medium-term-objective", the fundamental parameter on which the old rules were based. Lindner's position is still strongly opposed by those who privilege the notion of debt sustainability over that of the lowest possible debt. A "blind" reduction of public expenditure would not discriminate low-multiplier expenses versus high-multiplier investments in a historical period that requires states to invest – possibly in a coordinated manner – in "public goods-related" sectors like defense or the digital and environmental agendas. Another argument concerns the need for fiscal space to accommodate structural reforms. The German position represents a hard blow to the Commission's proposal, which, instead, took into account either the quality of public expenditure or the reforms implemented by each country. By doing so, the Commission would exploit the margins of discretionary valuation that had some eyebrows raised in Berlin.

Lindner is expected to defend his position in the upcoming Eurogroup and Ecofin meetings by pointing to the fiscal slippages, and to the hard-to-measure impact of the announced reforms, allegedly contained in the Draft Budgetary Law presented by Italy in mid-October. Incidentally, Lindner's position will put pressure on the European Commission when it will acknowledge the conformity of Italy's proposed fiscal plan. Berlin's skepticism over the efficacy of Italy's current reforms is also affecting the debate on an eventual replication of the Recovery and Resilience Plan expected to expire in 2026.

Concerning investments, Scholz and Macron seem to have reached an agreement on the desirability that investments in the defense sector could be counted as "relevant factors" and, as such, not included in the calculation of the deficit or the debt. There is less understanding regarding the Italian idea that investments funded by the Recovery Fund loans should be excluded from deficit calculations. For the Italian government, however, this is particularly relevant given the tax credit scheme for housing renovation (the so-called Superbonus) that is creating holes in its budget.

The fact that the new rules will not apply in 2024 does not exonerate governments from fiscal discipline. The Commission has already announced that it will open Excessive Deficit Procedures (EDP) in Spring 2024 for countries with deficits above 3% of GDP next year. The EDP had been suspended since 2020 because of the need for government spending in the wake of the COVID-19 pandemic. Some observers think that the triggering of the procedure next year might be postponed to after the European elections in June 2024 in order to spare the rules from the suspicion of being wielded as a political weapon against some governments.

The reintroduction of the excessive deficit procedure might, instead, serve as a bridge between the old rules and the new: for those countries under a deficit based-EDP, the Stability Pact's corrective arm—which is not subject to the reform—will apply. Fiscal adjustment requirements under the EDP would not exceed 0.5% of GDP per year. They might be considered acceptable for Italy and France and, at the same time, come very close to the German proposal. Only when a member state exits the EDP would the new fiscal rules kick in. Extending the rate of fiscal adjustment, as requested by Berlin, might come as an obvious consequence of the EDP application in the first years.