Time to get it right: EU fiscal rules reform risks going wrong

In a hurried bid to close a deal on new EU fiscal rules by the end of the year, EU finance ministers are now pushing through an ill-considered agreement. The latest compromise text proposed by the Spanish presidency reintroduces common numerical targets while disregarding the need for sufficient fiscal space for quality public investments. Instead of rushing towards a bad deal, finance ministers should strive towards a deal on fiscal rules that responds to the challenges of the 21st century and encourages qualitative investments and national budgets alignment for a green and just transition.

On 28 November, EU finance ministers may meet again to discuss the reform of the Stability and Growth Pact. Under the auspices of the Spanish presidency, the last ECOFIN Council reviewed a compromise draft, building upon the European Commission's initial proposal. Ministers are aiming for a deal on 8 December. This will form the basis for negotiations with the European Parliament.

All governments want to strike a deal before the end of this year. However, the Stability and Growth Pact is the cornerstone of the EU's economic and fiscal policy coordination. A rushed agreement would lock us in for the next decade without the provisions necessary to address today's challenges.

Regrettably, the compromise proposed by the Spanish presidency seems to disregard a very broad consensus among economists' and the lessons of the 2008 global financial crisis. If they are not significantly improved, these rules would fail to promote long-term debt sustainability and would also prevent most Member States from reaching their climate, employment and social targets, undermining the resilience of European economies and societies.

The signatories are particularly concerned with:

1. **Lack of space for quality investments in EU priorities**. In the absence of debt sustainability risks, investment in common EU objectives should be excluded from deficit, debt and expenditure limits, emphasising their positive impact on the development and resilience of EU economies and their positive assessment by investors. As a minimum, Member States should back the EU parliament's draft proposal to exclude national co-financing of EU programmes from fiscal limits.

2. **Numerical targets contradicting the EU objectives**. Proposed "common safeguards" that require countries to reduce their debt and deficits by a minimum amount contradict the spirit of the Commission's legislative proposal, which brought two important novelties: country-specificity and incentives for member states to grow out of debt via quality reforms and

investments targeted towards achieving national challenges and EU objectives. The current benchmarks under discussion, including a minimum structural primary adjustment and a new deficit target, risk curtailing governments' ability and incentives to leverage public investments for debt reduction, especially green investments with their high fiscal multipliers.[1]

3. Reduced reform and investment ambitions. The compromise also removes the requirement on governments to propose new investments and reforms in their first national-fiscal structural plan, to receive a first extension of the debt reduction adjustment path. Instead, the compromise states that commitments made in National Recovery & Resilience Plans would suffice. This removes a crucial tool to encourage urgently needed additional reforms and investments post-2026 towards agreed EU objectives and in particular the just transition.

4. Prioritising defence spending over other EU objectives. The compromise suggests that defence investments receive an explicit mention as a relevant factor to be considered before triggering an Excessive Deficit Procedure (EDP) against a country, alongside other relevant factors proposed by the Commission (which do not explicitly include climate- and nature-related actions). Investments in all agreed EU priorities listed in the proposal should be considered as relevant factors to be assessed for all member states, regardless of their debt levels, before launching an EDP.

5. Lack of incentives for quality investments. Finally, the rules do not include any additional assessment criteria to ensure the quality of public investments, such as the do no significant harm to climate and environment principle or ending fossil fuel subsidies, and do not mention the role of partners, national parliaments, civil society organisations and other stakeholders in the drafting of national plans.

We are concerned that these proposals could undermine the positive effects of the Recovery and Resilience Facility, pull the brakes on the needed transformation of our economies and societies, and let people down at a moment when they need more than ever to be protected against recurring shocks.

The people of Europe need a deal that reflects lessons learned from the past decade and gives governments the tools to proactively invest towards achieving the EU's agreed climate, social and economic objectives.

[1] Mostly advocated for by Germany, the main numerical benchmarks currently under negotiation are a minimum structural primary adjustment of 0.5 pp.% of GDP/year for countries above 3% deficit, a minimum average debt reduction of X pp.% (left open to discussion) of GDP/year, and a new deficit target below the 3% limit enshrined in the EU Treaties.