

## REFORMING EU ECONOMIC GOVERNANCE: THE START OF A MARATHON

The European Commission has relaunched a comprehensive review of the economic governance framework of the European Union. This initiative is necessary considering the impact of the Covid-19 pandemic on public finances as well as the investment needs in the context of the green and digital transformation. The review process comes with several challenges: an agenda which is particularly broad, the inclusive nature of the debate, involving many stakeholders and, as far as fiscal governance is concerned, the necessity for EU member states to strike a balance between committing to policy discipline whilst keeping national fiscal policy leeway. Given the state of public finances in most EU countries, sensible fiscal rules are necessary to gradually create the much-needed fiscal room for manoeuvre.

The Stability and Growth Pact (SGP) – the budgetary pillar of the Economic and Monetary Union but with application for the whole EU without exception –, has been adopted in 1997. Since then, it has been amended on a number of occasions. Although it consists of a complex set of rules, the focus in the public debate on the SGP tends to be on the Maastricht criteria of a budget deficit of 3% of GDP and public debt of 60% of GDP.

Judging by the annual performance of EU member states on these two dimensions, it is clear that very often the objectives have not been met (see chart). Quite understandably, this is particularly the case at the current juncture. The Covid-19 pandemic necessitated major fiscal efforts, which led to the activation in March 2020 of the general escape clause. This allowed countries to deviate from the budgetary paths that had been defined pre-Covid-19. The SGP is scheduled to be restored in 2023<sup>1</sup>, which calls for an assessment and possibly a revision of the fiscal rules.

This will be part of a comprehensive review of the economic governance framework of the European Union that was recently relaunched by the European Commission. This initiative faces multiple challenges. One, finding a balance between meeting public investment needs – which will remain high for years to come in the context of the green and digital transition – and the necessity to reduce budget deficits to create fiscal space in order to have sufficient leeway for a counter-cyclical discretionary fiscal policy when the next recession hits. Two, the agenda is particularly broad, covering a large number of topics, grouped in 11 open questions<sup>2</sup>. Three, the review process will be based on an inclusive debate with many stakeholders<sup>3</sup>. This should be welcomed

1. EU to keep its borrowing limits suspended in 2022, restore them in 2023, Reuters, 2 June 2021.

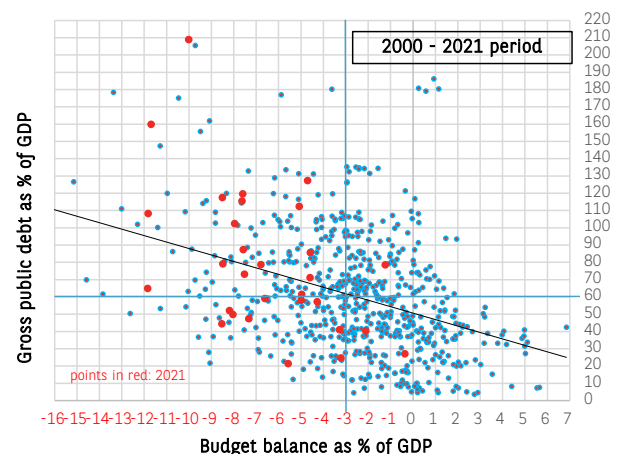
2. The list of topics is huge and the questions cover: ensuring sustainable public finances, help eliminate existing macroeconomic imbalances and avoid new ones arising, how to ensure responsible fiscal policies that safeguard long-term sustainability, while allowing for short-term macroeconomic stabilisation, how to incentivise Member States to undertake the key reforms and investments needed to deliver on the Green Deal and help tackle today's and tomorrow's economic, social, and environmental challenges while preserving safeguards against risks to debt sustainability, how to simplify the EU framework and improve its transparency, how to focus surveillance focus on Member States with more pressing policy challenges, how can the design, governance and operation of the RRF provide useful insights in terms of economic governance, is there scope to strengthen national fiscal frameworks and improve their interaction with the EU fiscal framework, how can the framework ensure effective enforcement and what should be the role of financial sanctions, reputational costs and positive incentives, how can the framework best ensure an adequate and coordinated policy response at the EU and national levels, how should it take into consideration the euro area dimension and the agenda towards deepening Economic and Monetary Union, are there any other challenges that the economic governance framework should factor in beyond those identified so far? (Source: Questions and answers: Commission relaunches the review of EU economic governance, Brussels, 19 October 2021).

3. "The Commission looks forward to an inclusive debate with the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions, the European Central Bank, national central banks, national governments and parliaments

but it may reduce the time available to reach a political agreement. Inviting citizens and organisations to submit their contributions to the debate is reminiscent of the 'ECB listens' events that were organised by the ECB in the preparation of its strategy review. However, the debate on economic governance and fiscal governance is far more complex than the one on monetary policy strategy, with the former having an important distributional dimension – levels of taxation, income transfers, expenditures – as well as an intertemporal angle (the conditions for debt sustainability). Finally, as far as fiscal governance is concerned, EU member states will need to strike a balance between committing to policy discipline whilst keeping national fiscal policy leeway. In its list of 11 questions, the European Commission raises the question about the possible role of financial sanctions, reputational costs and positive incentives. It is probably the most difficult question to tackle and agree upon. Yet, given the state of public finances in most EU countries, sensible fiscal rules are very much necessary to gradually create the much-needed fiscal room for manoeuvre.

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### PUBLIC ACCOUNTS OF EU27 AND UK (AGGREGATE + COUNTRIES)



SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

as well as a wide range of stakeholders, including social partners, academia, independent fiscal institutions and national productivity boards. The debate will take place through various fora, including dedicated meetings, workshops and an online survey. The online survey has been relaunched today and citizens, organisations and public authorities are invited to submit their contributions by 31 December 2021." (Source: see footnote 2)

