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BUDGET, TREASURY AND PLANNING
COMMITTEE

FINAL DOCUMENT, PUBLISHED PURSUANT TO RULE OF PROCEDURE NO 127, RELATING TO:

The Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions – Communication on orientations for a reform of the EU economic governance framework" (COM(2022)583 *final*)

Approved 8 March 2023

APPROVED FINAL DOCUMENT

The Budget, Treasury and Planning Committee of Italy's Chamber of Deputies,

Having examined, pursuant to Rule 127.1 of the Chamber's Rules of Procedure, the Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions – "Communication on orientations for a reform of the EU economic governance framework" (COM(2022)583 final).

Whereas:

- The changed circumstances of European economies in the wake of the pandemic have laid bare the problems inherent in the current European economic governance framework, whose capacity to guarantee sustainable public finances and prevent macroeconomic imbalances is open to question, whose rules are excessively complex, and whose ownership is insufficiently national. Not only, the changed circumstances have also led to the emergence of other problems relating to, in particular, the issuance of additional public debt to deal with the consequences of the pandemic crisis;

- National and European economic policymakers responded robustly and promptly to the crisis as early as March 2020 by invoking the "general escape clause," which effectively suspended the rules of the Stability and Growth Pact. Originally intended to remain in effect until 2022, the general escape clause was later extended until the end of this year. The EU also responded to the crisis with extraordinary temporary instruments, such as Next Generation EU;

- It is against this backdrop that the Commission, following a public debate, proposed a path to reform that does not entail changes to the Treaties, but does require amendments to secondary legislation and regulatory enforcement actions;

- While this path rules out making any changes to the deficit and debt limits or assigning a more active role to the ECB, it is still the most realistic course to follow in as much as it requires no change to the Treaties;

- Accordingly, no change has been made to the Treaty reference values of 3% of GDP budget deficit and 60% debt-to-GDP ratio. Meanwhile, in an acknowledgement that the current debt reduction benchmark (the so-called 1/20th rule) implies a too demanding fiscal adjustment that is also pro-cyclical, the benchmark has been revised to facilitate country-specific adjustment paths "to reduce high public debt ratios in a realistic, gradual and sustained manner;"

- National medium-term fiscal-structural plans are the cornerstone of the new Stability and Growth Pact. In them, Member States set out their fiscal, reform and investment commitments within a common EU framework;

- In particular, the Commission envisages a revised governance framework divided into four steps that differentiates between the sustainability risk of the public finances of each Member State. On the basis of a risk assessment carried out by the Commission, a category of “high,” “medium” or “low” risk would be assigned to each Member State;

- As a first step, the Commission would propose benchmarks and adjustment paths for Member States. For those with a “substantial” public debt challenge, the adjustment path would cover a period of at least four years, but a Member State may ask for a longer period of up to seven years in exchange for promising reforms and investments. The adjustment path would also be structured so that, starting at least from the end of the planning horizon, the 10-year debt trajectory at unchanged policies would follow a plausibly and continuously declining path, while the deficit would be credibly maintained at below the 3% of GDP limit;

- Meanwhile, countries with a “moderate” debt challenge would need to make sure that their debt started to decline within three years of the plan horizon;

- For Member States with a “low” public debt challenge, the deficit should be maintained below three per cent of GDP over a 10-year period at most 3 years after the horizon of the plan;

- The second step is for each country, following a technical dialogue with the Commission, to submit its medium-term fiscal-structural plan to the Commission, which must assess whether the reforms and investments that the country intends to include in the plan will ensure growth and improve the sustainability of the public finances, whether they are consistent with European priorities, and whether or not they are having the unwanted effect of crowding out earlier programmes;

- The plans should set out a medium-term fiscal path whose viability can be determined from measurements of net primary expenditure, i.e. expenditure net of discretionary revenue measures and excluding interest expenditure, as well as cyclical unemployment expenditure. The medium-term fiscal path should ensure that debt is put or kept on a downward path or kept at prudent levels, while keeping the deficit below 3% of GDP and ensuring sustainable growth;

- Net primary expenditure would therefore function as a baseline against which to define the fiscal adjustment path; it would also constitute a single reference benchmark for the purposes of the annual surveillance carried out by the Commission and the Council within the framework of the European Semester;

- As a third step, the national plans would be endorsed by the Commission on the basis of a common assessment framework, and subsequently approved by the Council. Except in objectively exceptional circumstances, plans that have been thus approved could not be revised for the next four years. In the event of no agreement, the reference plan drawn up by the Commission would be applied;

- The fourth step is annual monitoring. Member States would submit annual progress reports on the implementation of the plans and on their reforms and investments. The surveillance work would entail examinations both of the nominal fiscal balance and of the curve of net primary expenditure;

- The deficit-based excessive deficit procedure (EDP) would be maintained, while the debt-based EDP would be reinforced so that departures from the agreed path by Member States with a substantial public debt challenge would by default lead to the opening of an EDP. For Member States with a moderate public debt challenge, deviations from the path, if assessed as giving rise to gross errors, could lead to the opening of an EDP;

- An EDP should be associated with three types of sanctions: financial sanctions, which should become easier to impose as they would be based on smaller amounts than those currently contemplated; reputational sanctions, which would include an obligation to explain what measures a Member State had taken in response to European recommendations; and sanctions in the form of macroeconomic conditionality, which would include the possible suspension of EU funding if a country fails to comply with its obligation to remedy excessive deficits;

- Finally, the procedure for macroeconomic imbalances would be revised to become better integrated with the fiscal framework. The revision would mean including reforms and investments in the medium-term fiscal-structural plans drawn up to correct macroeconomic imbalances, and simplifying the post-programme surveillance framework;

Being of the opinion that:

- The Commission's proposal is a step forward because, rather than concerning itself with the annual calibration of fiscal policy, it focuses on fiscal sustainability, on simplifying the regulatory framework, on increasing national ownership, and on striking a better balance between prudence and realism in the adjustment paths of each country;

- While the risk of different countries receiving different and unequal treatment must be kept at a minimum, this proposal recognises that, in a complex highly interdependent context such as the EU, it is impossible to lay down fiscal rules that apply to all possible circumstances, nor should fiscal rules be based exclusively on the indiscriminate application of the same numerical criteria to all EU countries. Instead, a sufficient degree of regulatory flexibility is indispensable for the effective application of the rules;

- Greater regulatory flexibility implies greater discretionary powers on the part of the European institutions (the Commission and the Council) in charge of their enforcement, which is a prospect that needs to be very carefully assessed;

- Of particular and primary concern is the as yet unspecified nature of the initial communication by which the Commission would invite Member States to pursue a net primary expenditure path based on expanding aggregate expenditure, with the objective of gradually lowering the debt-to-GDP ratio;

- At this early stage, it might be opportune for the Commission to limit itself to indicating a reference adjustment path rather than setting specific objectives, also because there can be no wish to interfere in the institutional arrangements between government and parliament for producing the national economic and financial planning in the manner prescribed in the Economic and Financial Document and in the relevant Update to the same;

- Another matter that merits attention is the role that the debt sustainability analysis (DSA) will play, particularly as DSA is used to determine a country's risk category. As DSA is highly susceptible to underlying assumptions, care needs to be taken when communicating the results of an analysis;

- The Communication makes no provisions for discriminating between different types of investment spending in a manner that would be conducive to fulfilling the priorities and growth needs of the European economy, with particular regard to the green and digital transition, nor for discriminating between spending on financial assistance and spending on the establishment of a common European defence;

- Further, a closer look needs to be taken at the exclusion of some forms of social spending from the reference aggregate so as not to aggravate the differences between individual States;

- A rethinking of the rules should also lead to consideration being given to the introduction of an effective supranational fiscal capacity, which would serve both a macroeconomic stabilising function against shocks and a financing function for the provisioning of European public goods;

- Also worth exploring are the mechanisms that might be used in a system of incentives and rewards to accompany the system of sanctions;

- The full scope of the measures referring to reputational sanctions and macroeconomic conditionality will have to be carefully evaluated with an eye to the potential of the former to impact the financial markets and the potential of the latter to handicap efforts to reach investment and public finance objectives;

- In spite of the evident multiple connections between macroeconomic imbalances and fiscal discipline, not enough details are given about the relevant surveillance;

Taking note of the fact that:

- The Economic and Financial Affairs Council (ECOFIN), at its meeting on 14 March 2023, could adopt conclusions on orientations for a reform of the European Union's economic governance framework that would then be submitted for approval to the European Council of 23 and 24 March;

- Depending on what the conclusions say, the European Council could invite the European Commission to fast-track legislative initiatives with a view to having the new rules ready by the end of the current year and, therefore, ready before the deactivation of the general escape clause of the Stability and Growth Pact,

Mindful that the present final document needs to be promptly forwarded to the European Commission as part of the political dialogue, as well as to the European Parliament and the Council,

commits the Government to continuing negotiations at the European level and to highlighting the following points:

a*)* More detailed information needs to be given about the nature and content of the communication in which the Commission first lays out a reference plan instructing Member States to follow a net primary expenditure path based on the growth of aggregate expenditure and gradually lower the debt-to-GDP ratio, also because there can be no wish to interfere in the institutional arrangements between government and parliament for producing the national economic planning as provided for in the Economic and Financial Document and in the relevant Update to the same;

b) With a view to strengthening national ownership of the new rules, even at the *ex ante* stage of planning, Member States must be fully involved in mapping out their own paths toward nominal aggregate expenditure growth.

c) While nations with a high debt/GDP ratio need to follow an adjustment path (provided that it is compatible with their growth objectives) that is more challenging than that of less indebted nations, continuity in the fiscal policies applied across the euro area still needs to be maintained, which requires proper coordination;

d) Given that debt sustainability analyses are highly susceptible to the assumptions that are made about GDP growth, interest rates, inflation and public finance projections, it is of the utmost importance that the benchmarks on which the assumptions are based be very carefully selected and agreed upon by the European Commission and individual Member States using clear, transparent and empirical evidence and technical arguments that also take account of the effects on potential growth of structural reforms;

e) The scope of the expenditure aggregate used as a reference needs to be clarified so that it takes into account unexpected turns of events that are beyond the control of individual States and have repercussions on expenditure. Consideration should be given to the possibility of discriminating in favour of certain forms of expenditure, such as investment spending that aligns with the priorities and development needs of the European economy, with particular regard to expenditure on the green and digital transition, expenditure on financial assistance, and expenditure on the establishment of a common European defence. Further, a closer look needs to be taken at the exclusion of some forms of social spending from the single reference aggregate so as not to aggravate differences between individual states;

f) An extension of the scope of the unusual events clause is to be recommended so that it may be invoked by individual countries not only in response to a natural disaster, but also when unforeseen events beyond the control of individual states cause macroeconomic variables with a fiscal impact to deviate significantly from expectations;

g) To make sure national policies are managed with the necessary flexibility and to increase democratic legitimacy, it would be opportune to allow for changes of government when planning the multi-year adjustment path, and to contemplate the possibility that a newly seated Parliament might be allowed to revise its nation's adjustment path;

h) To avoid prejudicing the achievement of investment and public finance objectives, a careful assessment needs to be made both of the scope of reputational sanctions and of the imposition of macroeconomic conditionality leading to the suspension of EU funding;

i) The procedure for the surveillance of macroeconomic imbalances is in need of suitable improvement. Specifically, any interactions between macroeconomic and fiscal surveillance should be enhanced, while economic policies that address macroeconomic imbalances need to be better coordinated;

l) An appraisal should be made of the willingness of other Member States to develop a common tool that, by drawing on European rather than national resources, will enable the EU to deal efficiently with any further systemic shocks and provide adequate and equitable support to European companies, regardless of the different debt margins of individual countries;

m) Negotiations on the revision of the economic governance framework must proceed with reference to the ongoing discussions on: the Green Deal Industrial Plan and, especially, the Temporary Crisis and Transition Framework, which reforms the rules of State aid; the need for the more flexible deployment of current EU funding; and the establishment, as envisaged by the Commission, of a European Sovereignty Fund to support investments in strategic sectors. The aim must be to adopt a single comprehensive decision that increases the effectiveness of European action by strengthening the Union's industrial competitiveness while avoiding the risk of fragmenting the internal market or increasing socio-economic divergences among Member States;

n) The negotiations on the reform of economic governance should be accompanied by parallel discussions about what sort of undertakings individual states can make to encourage investment spending in areas such as the green and digital transition, with particular reference to the effects of investment spending on national debts. A case needs to be made for the possible adoption of mechanisms to support these undertakings using European resources.