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.
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> **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.

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[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.

Quotes

European Anti-Poverty Network (EAPN): "We advocate for a fiscal framework that addresses the root causes of poverty and fosters a sustainable future for all. The ongoing reform of the Stability and Growth Pact marks a critical juncture for shaping a fair and inclusive economic framework that truly serves the well-being of all European citizens. Our unwavering commitment to eradicating poverty and promoting social justice underscores the importance of getting these reforms right. We strongly urge EU finance ministers to seize this opportunity and ensure that the reformed rules prioritise investment in social protection, tackle income inequality, climate crisis, and safeguard the most vulnerable. It's time to get it right for a fair and prosperous Europe", said Juliana Wahlgren, EAPN Director.

New Economics Foundation: "Not all debt is equal, debt incurred to finance the green transition pays for itself. It can transform our economies, attracting new green manufacturing, creating good quality jobs and reducing the cost of living through more efficient homes, more accessible public transport and better public services. Those that want to unnecessarily restrict public investments stand in the way of a speedier and more equitable transition", said Sebastian Mang, Senior Policy and Advocacy officer at the New Economics Foundation (NEF).

Finance Watch: "Europe stands at a crossroads. To build a resilient, sustainable future, we must prioritise qualitative public investment over arbitrary debt limits. Contrary to prevailing misconceptions, it's not the size of the debt but the strength and resilience of a country's economy and institutions that truly matters to financial markets. By focusing on future-oriented fiscal rules, we not only secure Europe's prosperity but also earn the trust of investors and creditors, ensuring that future generations inherit opportunity, not just obligations", said Ludovic Suttor-Sorel, Senior Research and Advocacy Officer at Finance Watch.

Social Platform: "The last wave of austerity left deep social scars and plunged many people across Europe into poverty. To avoid a return to damaging cuts to social protection, education and services, the new EU fiscal rules must move away from pushing arbitrary debt and deficit reduction levels. We need to enable investment in people, allowing them to thrive, rather than just survive in the transition to climate neutrality. Without prioritising wellbeing for all, the transition will fail", said Laura de Bonfils, Secretary-General of Social Platform.

ETUC: "The current fiscal rules were flawed from the start, and the proposed changes won't fare any better in the future; they must evolve. Recent evidence underscores that supporting the economy for a socio-ecological transformation is the path towards resilient economies and sustainable finances. Austerity, after the global financial crisis, inflicted lasting economic and social scars, as well as delaying vital investments for a just transition. Let's learn from the past, discard ideology, and shape fiscal rules that lead to resilient economies. Collective action is essential for a purposeful economic governance, ensuring prosperity and well-being for all, not just a privileged few. The time to act is now", said Ludovic Voet, ETUC Confederal Secretary

European Youth Forum: "The coming decade is pivotal. My generation has been through austerity, Covid, and now we are facing the impact of the climate crisis. The EU Council of Finance Ministers is withholding from us the tools that we need to secure our future. Without urgent public investment in the next years, we will not be able to build ourselves a life that is at least as good as that of our parents", said María Rodríguez Alcázar, President of the European Youth Forum.

European Environmental Bureau: "The proposed fiscal rules are a short-sighted gamble with our future. They prioritise deficit reduction over long-term sustainability, preventing member states from investing in the green transition we need to transform our economies and avert climate catastrophe", said Patrizia Heidegger, Deputy Director at the European Environmental Bureau (EEB).

Greentervention: "The social and economic future of the Europeans citizens, old and young, primarily depends on investments in adaptation to climate change, on Europe being world leader in protecting the climate and biodiversity and in a speedy and just transformation of the energy sector away from fossil. Not on an obsessive focus on percentage points of debt to GDP ratios. Finance ministers should rethink and design an economic governance leaving space for lucid and future oriented fiscal policies", said Michael Vincent, President of Greentervention.