European fiscal rules:

The proposal of the European Commission tested for 2024 !

The quality of a recipe is measured by the smell and taste of the dish on the table. No agreement has yet been reached on a new recipe for European fiscal rules. Negotiations in the European Parliament and the Council on a proposal by the European Commission have only just begun.

But the recommendations for the 2024 fiscal policies that the European Council is being asked to adopt at the end of June provide a foretaste. And it is a bitter one.

In the outdated tradition of the Stability Pact, the main course of these recommendations is a constraint on net public spending.

In line with the rules still in force, but also in line with the reform under discussion, the recommendations amount to a demand for a reduction in the deficit in 14 countries (Annex 1). These 14 countries, which have budget deficits in excess of 3% of GDP, account for almost 70% of European GDP. The deficit adjustment requested would generally be 0.5% of GDP, or even 0.7% of GDP for four countries (France, Italy, Spain and Belgium).

For 8 other countries, the effort required is in general 0.3% of GDP. One reason for this recommendation is that their "structural deficit", an unobservable variable whose calculation depends on numerous assumptions, would be too far from a level close to equilibrium. Or another is that they need to reduce a public debt ratio above 60% of GDP. Under the old rules, a close-to-balance level is supposed to ensure that the observed deficit is kept below 3% of GDP at any time. This requirement would not disappear with the new rules. At the very most, but this remains to be agreed, the pace of adjustment could be slowed. This year, only five countries out of 27 escape a numerical recommendation to reduce their deficit: their "structural" deficit is calculated as being close to zero.

Has any assessment been made of the cumulative and spillover effects from one country to another, in addition to those of the current tightening of policy? How are we supposed to finance the expenditure needed to speed up the transition without jeopardising social cohesion and by imposing such a reduction in budgetary expenditure net of tax increases?

To accompany the main course, the heads of state and government are preparing to recommend that all countries reduce their dependence on fossil fuels. That's all well and good. But the accompaniment is "light". The recommendation is not quantified. It is therefore in no way operational.

So let's remind ourselves of a few truths. Meeting the climate targets will require a substantial shift in policies and an approximate 3-fold increase in the rate of reduction in greenhouse gas emissions. Depending on the assumptions made about the development of economic activities and energy efficiency, this will require a reduction of 15 to 35 percentage points in our dependence on fossil fuels. Between 1990 and 2021, the share of fossil fuels in the available energy mix (Annex 2) fell by only 12 percentage points on average in the European

Union (from 82% to 70%). And much of the reduction in greenhouse gas emissions has been achieved by replacing coal with gas.

In reality, the finance ministers remain locked into a paradigm that ignores the impact of economic activities on the climate and the literal and figurative incendiary backlash that can be expected. Yet these activities depend on the policies for which they are responsible. The discussion at the ECOFIN Council on Friday 16 June bears witness to this blindness, if proof were needed. One finance minister summed up perfectly the only point of division that he felt needed to be overcome: should we impose a numerical rule on the deficit and debt that is identical for all countries, the German position, or should we leave a little flexibility to encourage growth and respect the national parliaments that make the final decisions?

But even if we look only at financial stability and the sustainability of sovereign debts, finance ministers should be concerned about the speed and efficiency of the energy transition. The ECB's annual report on financial stability, published in May 2023, reiterates this point: climate change is a source of risk for public budgets, but well-calibrated adaptation policies and a rapid and coherent energy transition would reduce these risks. It is also likely that sovereign debt rating agencies will be required to take climate risks and action increasingly into account.

The logical conclusion is that the new recipe for financial and economic stability must allow a trade-off between additional debt on the one hand and spending to accelerate the energy transition on the other. A recipe is only as good as the balance between bitter and sweet. What ingredients are missing from the current proposal to ensure this balance?

- Grant the same status to indicators for reducing the economy's dependence on fossil fuels and greenhouse gas emissions have the same status as deficit and debt indicators, so that the necessary trade-offs can be made in full knowledge of the facts. Quantifying targets by country .
- Guarantee the sincerity of the evaluation of the medium-term financing needs to achieve the 2023 National Energy and Climate Plans (currently being updated). The public policies in the various sectors - transport, energy, buildings, industry and agriculture - required to meet the objectives of the Green Pact for Europe will have a budgetary cost. This cost must be evaluated precisely, country by country, without prior censorship. For this assessment, the climate rationale must prevail over the budget rationale, just as the health rationale prevailed during the COVID crisis.
- Abandon the requirement for a sufficiently low deficit on an ongoing basis and the implicit or explicit use of unobservable variables, in particular the structural deficit.
- Abandon the use of common numerical targets for deficit and debt, which rigidify the conduct of fiscal policies.
- Quantify an obligation to reduce fossil fuel subsidies.
- Reverse timeframe: what needs to be accelerated is investment in transition, not deficit reduction. At the very least, it should be possible to strike the right balance between the two, year after year.
- Exclude the expenditure necessary for the energy transition from the "constrained" deficit (Green Golden Rule). It is paradoxical in the current proposal that exceptional expenditure resulting from climatic disasters can be removed from the deficit, whereas expenditure on prevention and mitigation cannot.

- As a corollary, the quantitative imperatives for the deficit and spending will be expressed in the form of a corridor, not a single path. The corridor will only be used for spending that accelerates the transition.

The climate is a common good and the Union is collectively committed to non-negotiable targets for reducing greenhouse gases. The proposed method will, where necessary, highlight inconsistencies between national public financing needs for a just transition and the constraints that would be imposed to national debt.

Highlighting these inconsistencies will create a solid basis for further discussion of the necessary complementary European policies, which are the responsibility of the finance ministers:

- Coordinated increases in direct taxation.
- Increased European funding from the Community budget and/or on the model of the Recovery and Resilience Facility.
- Accelerated "greening" of monetary policy instruments in coordination with the ECB
- Adaptation of financial regulations to accelerate the withdrawal of financial institutions from fossil fuels and redirect private financing towards renewable energies.

Further reading

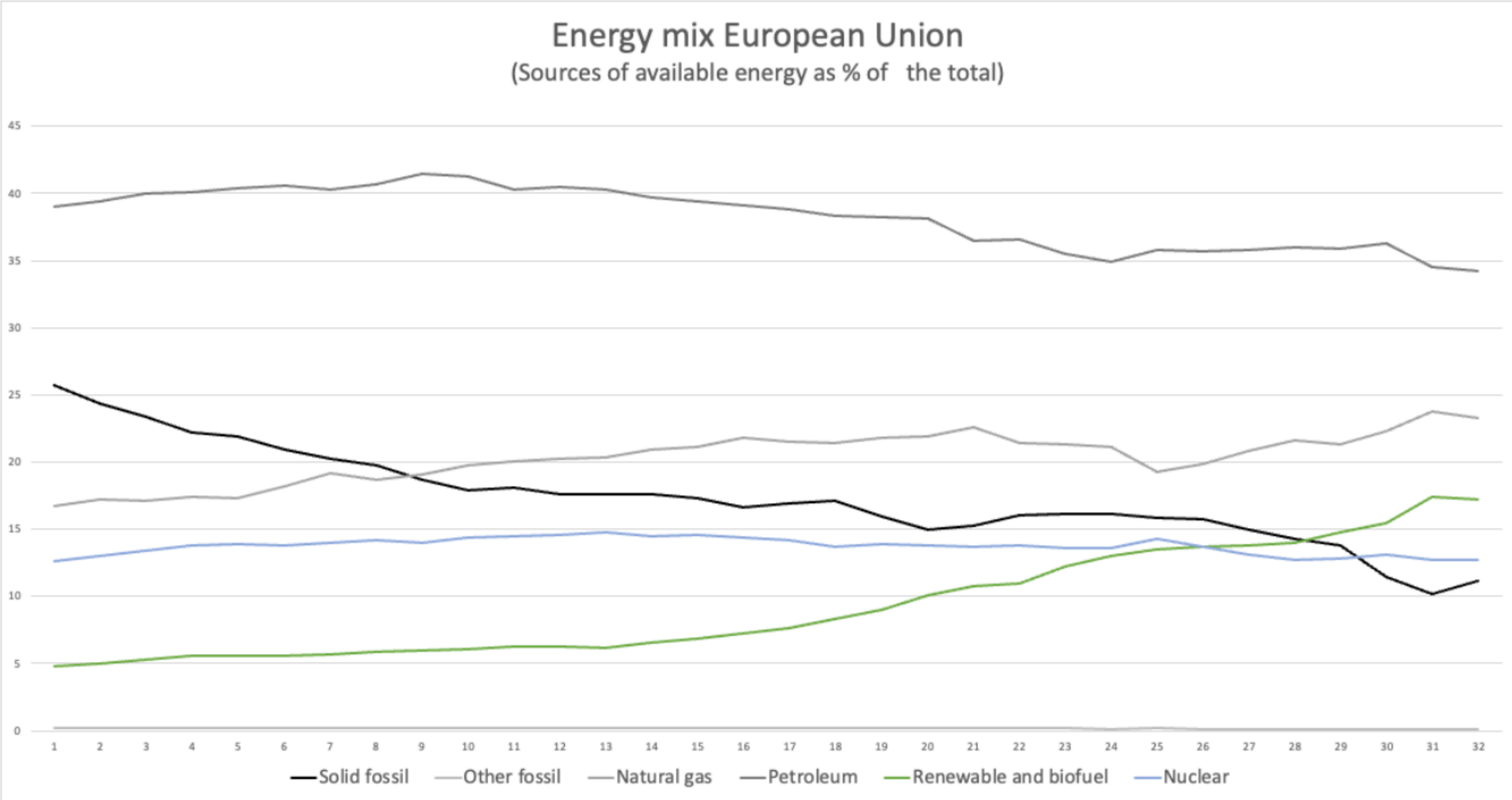
- Opinion column by Alain Grandjean / Ollivier Bodin: "European fiscal rules leave no flexibility for adapting to climate change"
- Drought, climate change and growth
- The house is on fire and the Ecofin Council is looking the other way
- The responsibilities of finance ministers
- Weather reports and fiscal rules
- Identifying green spending and promoting transition
- European economic governance
- European economic governance (video)
- Structural balances and potential GDP
- Output gap nonsense and Why structural balances should be scrapped from EU fiscal rules

Annex 1

Extract from the country specific recommendation Spring 23

	Debt/GDP % 2023	Headline Balance 2023	Debt/GDP>60% 2023	Headline deficit >3% 2023	Both	Required adjustment in % GDP 2023 to 2024	Structural balance 2023 As calculated
Belgium	107,9	-5,0	1	1	1	0,7	-4,9
Spain	112,5	-4,1	1	1	1	0,7	-3,7
France	110,8	-4,7	1	1	1	0,7	-4,4
Italy	143,6	-4,5	1	1	1	0,7	-5,3
Hungary	75,2	-4,0	1	1	1	0,5	-3,2
Slovenia	69,6	-3,7	1	1	1	0,5	-4,9
Bulgaria	23,6	-4,8	0	1	0	0,5	-5
Czechia	44,2	-3,6	0	1	0	0,5	-2,7
Estonia	19,3	-3,1	0	1	0	0,3	-1,2
Latvia	44,0	-3,8	0	1	0	0,5	-3,5
Malta	59,9	-5,1	0	1	0	0,5	-4,6
Poland	52,9	-5,0	0	1	0	0,5	-4,5
Romania	47,3	-4,7	0	1	0	0,6	-4,3
Slovakia	57,4	-6,1	0	1	0	0,7	-5,8
Germany	66,3	-2,3	1	0	0	0,3	-2
Greece	161,9	-1,3	1	0	0	0,3	-1,5
Croatia	67,2	-0,5	1	0	0	0,3	-1,3
Cyprus	84,0	1,8	1	0	0	#N/A	0,9
Austria	76,6	-2,4	1	0	0	0,3	-2,5
Portugal	109,1	-0,1	1	0	0	0,3	-0,8
Finland	72,0	-2,6	1	0	0	0,3	-1,8
Denmark	32,8	2,3	0	0	0	#N/A	3,5
Ireland	41,2	1,7	0	0	0	#N/A	-0,1
Lithuania	41,0	-1,7	0	0	0	#N/A	-0,6
Luxembourg	26,0	-1,7	0	0	0	0,3	-1,1
Netherlands	52,4	-2,1	0	0	0	0,3	-2,5
Sweden	29,4	-0,9	0	0	0	#N/A	-0,1

Annex 2



Source : Eurostat