Green Deal – European Semester : Green Golden Rule as a necessary link

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Inter Group « Green Deal »

(European Parliament)

Strasbourg

GREENTERVENTION

European Semester – Green Deal The links

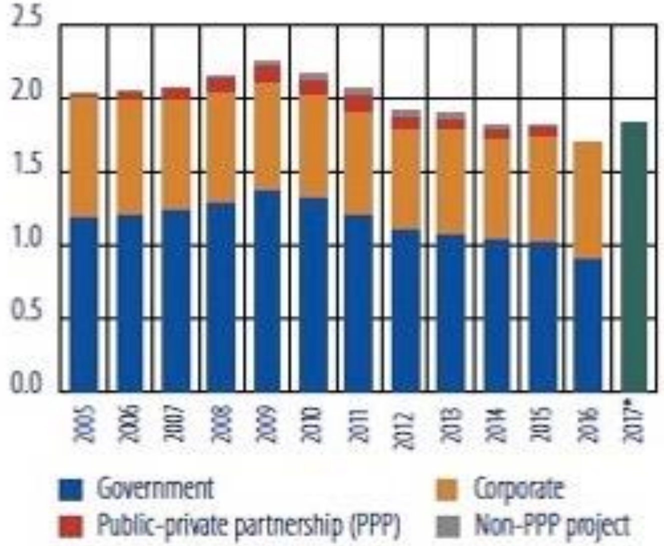
- Funding link: Funding mobilised at national level is needed to fill the gap between the Green New Deal, 100 billion per year, and the estimated needs of 260-300 billions (1,9% - 2,1% du PIB) only for the energy transition.
- Governance - Subsidiarity link : From where ever the funding will come, spending – public or private, European or national, loans or grants - will be driven by regulatory, tax, subsidization, investment policy decisions mainly taken at national or sub-national level
- Information link: The two governance pillars the medium/long term oriented « Energy Union – Climate Action governance » and the European Semester shall inform each other (including through recommendations under Stability and Growth Pact coherent with budgetary programming under the medium term « National Energy and Climate Plans »)

Government and infrastructure matter

(Source EIB)

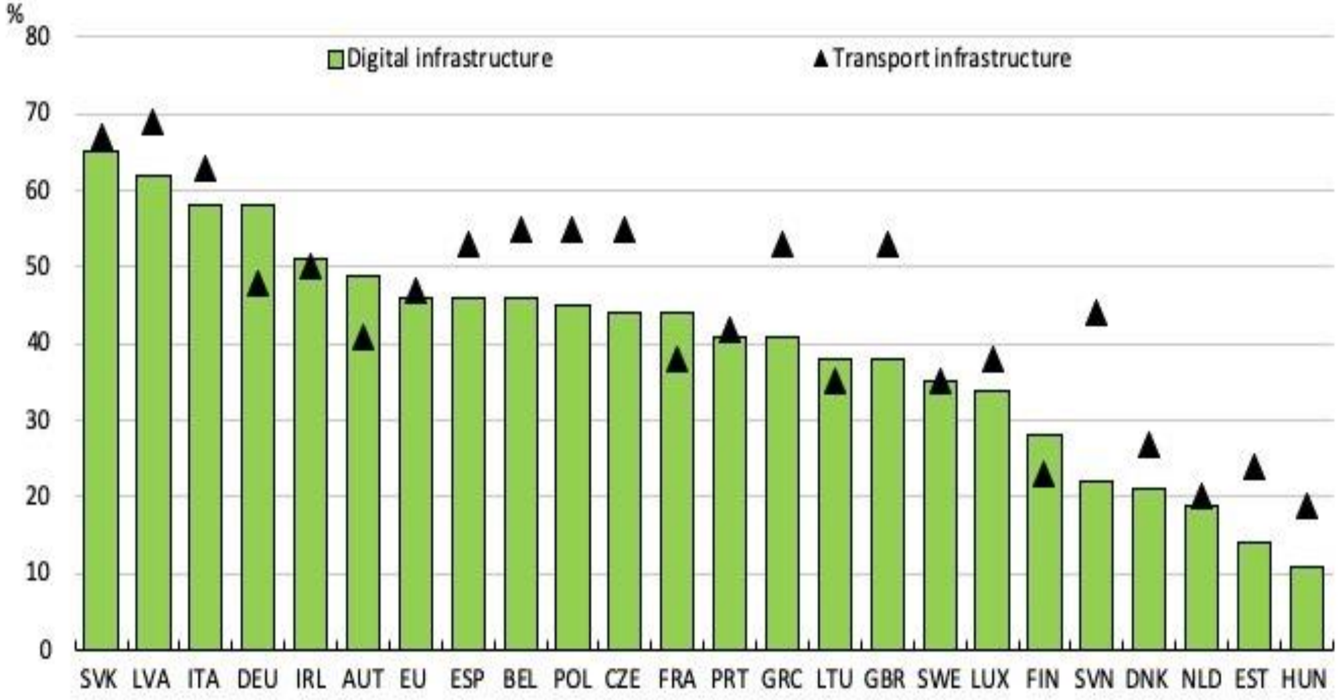
Figure 8

EU infrastructure investment by institutional sector (% of GDP)



Note: *Based on Eurostat, Projectware, EPEC data. Data for 2017 are provisional. Data are missing for Belgium, Croatia, Lithuania, Poland, Romania and the United Kingdom. Source: EIB Infrastructure Database.*

Figure 4 Firms reporting that infrastructure is an obstacle to their investments (%)



Source: European Investment Bank Investment Survey, 2018.

The necessary reform of the fiscal rule

TO BETTER FILL THEIR ORIGINAL TASK, PROVIDING A STABLE AND LEGITIMATE FRAME FOR SUSTAINABLE ECONOMIC ACTIVITIES

TO BE COHERENT WITH THE GREEN DEAL

A ROBUST GREEN GOLDEN RULE SHOULD BE PART OF THE REFORM

On fiscal rules

Fiscal rules in an open economic Union with fragmented fiscal power are a necessity (absolute necessity in a monetary Union). To provide clarity over the medium term orientation of fiscal policies; to deliver policy coherence; to mitigate fears among partners of negative spill over from diverging fiscal policies.

Fiscal rules shall contribute to align national fiscal policies with European short and long term priorities.

Treaty provides for two numbers and for room for interpretation via secondary legislation or implementation rules. Since 1997 and the Stability and Growth Pact fiscal rules have been regularly adapted to lessons learnt, circumstances and emerging priorities.

Climate emergency put both dimensions of the Stability and Growth Pact at risk.

After the black swans, the arrival of green Swans

Events out of regular expectation, with huge potential damage

The thing we know:

The nature is fighting back

and

“The overall damages caused by unmitigated climate change will be high and **the probability of catastrophic events non-negligible”**. (IMF - 2019)

Lessons learnt : Treaty objectives

(Quotes: European Commission, Communication (2020) 55, Economic governance review)

3%

- « All Member States respected the 3% of GDP deficit criterion in 2018. 16 Member States have also reached, or are close to, their medium-term budgetary objectives.. »

60%

- « Public debt levels are now (again) below 60% of GDP in around half of the Member States, but remain around or (well) above 100% of GDP in some others, accounting for a large share of euro area GDP. »

Lessons learnt : Political and economic objectives

(Quotes: European Commission, Communication (2020) 55, Economic governance review)

Legitimacy	• "the higher degree of sophistication of the SGP has increased its complexity and reduced its transparency…,"
Stabilisation	• "Member States' fiscal policies have remained largely pro-cyclical". This means they amplified fluctuations.
Medium term orientation	" the focus **on medium-term budgetary planning** has weakened"

Lessons learnt : Political and economic objectives

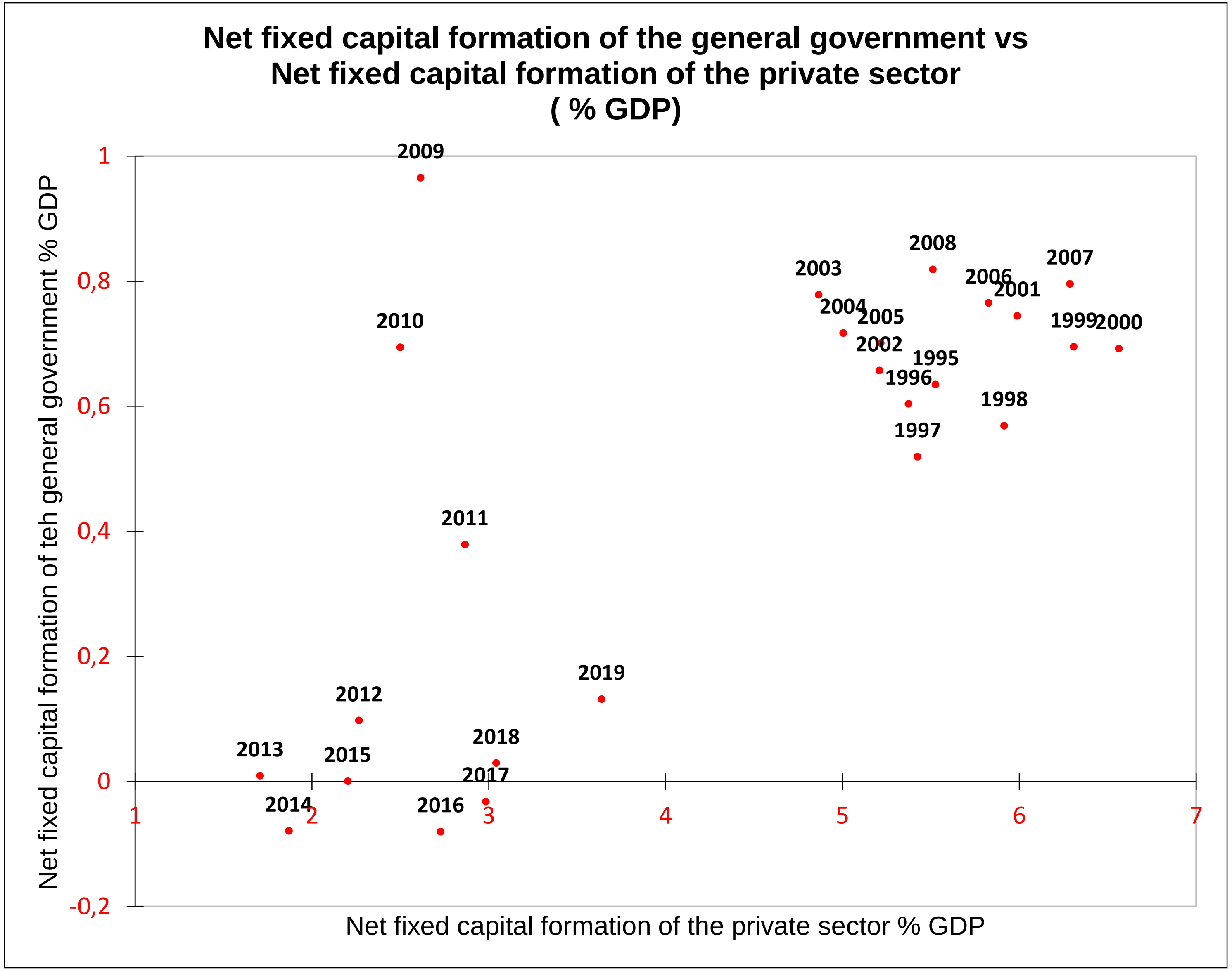
(Quotes: European Commission, Communication (2020) 55, Economic governance review)

Symmetric treatment of Member States

- While the SGP has established procedures for the correction of high public deficits in terms of nominal thresholds, it cannot *compel* fiscal policies in support of economic activity »
- **=> No room for pro-active fiscal policy of the Eurozone as a whole**

Priority to investment

- “Overall, however, the current fiscal framework did not prevent a decline in the level of public investment during periods of fiscal consolidation”


Net fixed capital formation of the general government vs
Net fixed capital formation of the private sector
(% GDP)
Net fixed capital formation of teh general government % GDP
Net fixed capital formation of the private sector % GDP
1
0,8
0,6
0,4
0,2
0
-0,2
1
2
3
4
5
6
7
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
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2000
1995
1996
1997
1998

Changed macroeconomic context

Interest rates historically low (near to zero or negative)

Despite this, low private and public investment and high saving

Lasting depressed economy unable to meet future challenges

Public budget and climate emergency (examples)
The cost of inaction or The tragedy of horizons

LOW NET SPENDING TODAY → **MUCH HIGHER SUFFERED HUMAN COST AND FINANCIAL DAMAGES TOMMOROW**

- Public investment in climate-proofing infrastructure, water management
- Subsidies in support of agricultural transition, coastal relocation
- Just transition: social and regional cohesion
- Carbon taxes with declining impact on long term revenues (if successfull) at an uncertain speed
- Emissions Trading System revenues (idem)
- Subsidies for clean energy transition (building, transport, energy production/distribution)

- Replacement of damaged building/infrastructure
- Transfers to households affected by extreme natural events
- Explicit contingent liabilities (state guaranted insurance schemes) or implicit (financial institutions in distress)
- Reduction of tax revenues (lasting lower activity or due to extreme climate related event)
- Higher health care spending
- High interest rates due to financial market instability

No magician can guarantee a transition path that is effective and at the same time fiscally balanced

- « *We can / should finance 1 to 1 new green expenditures with a reduction of brown expenditures and higher carbon taxes* » **is misleading during the transition period**
- **Harmful subsidies should be reduced and higher carbon taxes should be introduced following an agenda guaranteeing the political and social acceptance.**
- **This agenda should not constrain what can and should urgently be done in other parts of the economy/society (building insulation, transport, energy production/distribution)**
- **Thinking in terms of balanced net expenditures during the transition is contra productive and uneconomic, especially in view of the extreme low interest rates**

Two overarching objectives? Two rules !

- Renew with regularity and give an halt to « STOP and GO »
- Recognise there are two public goods to be taken care of:
    - Debt sustainability
    - Environmental sustainability and climate emergency

Fiscal discipline

Abandon the current complex rule based on a misleading macroeconomic model for a simple and communicable rule

Adapt adjustment parameters to current depressed situationlow interest rates and lack of investment

Discussion is ongoing among « experts ».

Investment discipline

- Expenditures programmed under the National Energy and Climate Plans shall be ring fenced and deducted from the “Treaty criteria” relevant deficit up to a certain percentage of GDP set for a 7 years period.
- The percentage agreed will depend on two factors: deviation from decarbonisation path and debt level
- The percentage is a minimum (can and must ad minima)

Not alone

Yes:

both rules together may result in higher debt to GDP ratio than present fiscal discipline rules alone would prescribe

"Combating climate change and financing the set of policies with public debt could perhaps be the way out of the existing conundrum for policymakers in advanced economies"

Banque de France, Bank of International Settlement, 2020, The Green Swan

Rating the reform AAA

- Abandon complex and misleading output gap methodology for a simple, readable rule to increase legitimacy, reduce probability of pro-cyclicality and incentivize medium term programming
- Adapt required speed of adjustment of the public deficit and the debt to GDP ratio to the new macroeconomic context (low interest rates, depressed private investments, lower than targeted inflation)
- Adopt a Golden Green Rule to ring fence off budget peer reviewed public expenditures in support of the energy transition (National Energy and Climate Plan)

Towards a robust Green Golden Rule

	Main characteristic	Focus on European CC Commitments to Paris agreement	Depends on the size of EU financing via European funds to the country	Reduces Stop and GO / Stabilises demand over the whole cycle	Favorises long term planning (tragedy of horizon)	Country treatment	Peer Monitoring
Current flexibility clause	Under certain circumstances national co-financing of EU funded projects are deductible from deficit	No.	Yes	No; only temporary deviation from debt path allowed; use possible only at the time of a recession	Not beyond existing incentives for accessing European Funds	Alleviates constraints on "deficit" countries; no impact on surplus countries	Based on eligibility criteria to EU funds + assessment of "strengthening potential output" (?)
Proposal by the European Fiscal Board	Same as above, but allows MS to top up co-financing with expenditures to the same projects	No	largely	No (see above)	To a greater degree than current rule, but remains related to use of European Funds	Alleviates constraints on "deficit" countries; no impact on "surplus" countries	Same as above + assessment of relation to the project (?)
XXX Golden Green Rule to continuously build up natural capital or avoid its erosion; and, to protect the economy against climate hazards **(to be discussed)**	Identification of expenditures in support of CC measures as committed under the Energy and Climate governance (NECP) Ring-fencing these expenditures up to x % of GDP (country specific) disregarding debt rules. Possibly restrict to broad EU priorities with a program (Insulation, Mobility, ..)	Yes	No	Yes;	Yes, within the European Energy and Climate governance National Energy and Climate Plans	Could Constrain equally deficit and surplus countries to pursue CC objectives	Based on input, output and outcome indicators agreed under the European Energy and Climate governance Linked to the biennial review of implementation of the NECP