GREENTERVENTION

Contribution of Greentervention
to the consultation on the reform of the European economic governance
(Informal translation of the original in French)

Main points

The reform of economic governance is on the agenda. This governance is based on three pillars: the rule for enforcing the prohibition that public deficits exceed 3% of GDP and the debt 60% of GDP; the rule imposing on the States to aim for a budget balance close to balance on average over the cycle; a procedure targeting other macroeconomic imbalances that are to be corrected by measures in different areas of economic policy.

The reform we are proposing aims to ensure strong and lasting legitimacy for a governance that involves the interference of the European level in political choices at the heart of national democratic debate.

This legitimacy will be based on national programmes adapted to the particularities of each country, the pursuit of specific and shared objectives of common European interest, the financing of the expenditure necessary for the transition, procedures that are as simple as possible, robust methods and incentives for the efficiency of public expenditure and policies

We propose to replace the current governance based on uniform rules and recommendations "from the centre to the states" with a contractual approach "from the states with the centre". In addition, the artificial separation between fiscal policies and policy and reform programmes will be overcome.

Each State will present annual five-year national transition and budgetary programmes (NTPB) with a focus on the contribution to the stability of the European economy and to the objectives of common interest, without going into detail on what are national policy choices.

The NTPB will replace the two programmes currently required, the budget programme (stability/convergence) and the reform programme. This replacement will force greater coherence between budget and regulatory, administrative and fiscal measures.

The general and unmeasurable objective of strengthening "potential growth", an unobservable variable, will be replaced by specific, measurable objectives that can be linked to actual progress in the transformation of European economies.

The national programmes will be validated by the Council on a Commission's proposal and an opinion of the European Parliament. In order to allow for a trade-off between debt and expenditure with proven effectiveness, they will be analysed in two dimensions.

a) The sustainability of the debt according to a method developed from that currently used by the Commission. This method will have to take into account the risks of under-investment in climate policy as well as the interactions between fiscal, macro-prudential

and monetary policies. An increase in the ratio of public debt to GDP will not be taboo if it goes hand in hand with expenditure and policies with a proven impact on the transition;

b) The contribution of expenditure and policies to the achievement of objectives of European interest, in particular climate change objectives, on the basis of physical and social outcome and performance indicators supported by impact assessments.

In the same spirit of simplification and coherence between fiscal policies and transition policies, the Excessive Deficit Procedure (EDP) and the Macroeconomic Imbalance Procedure (MIP) will be replaced by a single procedure.

Fiscal policies are decisive in correcting macroeconomic imbalances. There is no rationale for not dealing with them in the context of a procedure explicitly dedicated to such imbalances.

This single procedure, "economic, social and environmental sustainability", will be based, like the MDP, on indicators alerting to the risks of under-utilisation of productive capacity, to excessive pressures on it or to unsustainable developments; the alert would trigger an in-depth dialogue between the parties on the appropriateness of corrective measures.

This procedure will also establish the list of relevant factors to be taken into account when deciding on the opening of an excessive deficit procedure under Article 126 TFEU.

States will be encouraged to strengthen automatic stabilisers and to improve methods of programming, implementing and monitoring public expenditure.

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Question 1

How can the framework be improved to ensure sustainable public finances in all Member States and to help eliminate existing macroeconomic imbalances and avoid new ones arising?

Response:

Coordination of national fiscal and economic policies is necessary in the Union. However, the policies to be coordinated are at the heart of national democratic choices. This coordination will only remain politically legitimate, and therefore acceptable and effective, if it is transparent, does not involve excessive interference with national policy choices and is consistent with the social and environmental objectives agreed at European level.

The new governance will have to open up spaces for trade-offs between stabilisation, debt and financing of climate policies.

A preliminary remark: even improved coordination will remain perfectible without a substantial European budgetary capacity and without putting an end to tax evasion and avoidance.

1. It is widely recognised and experience has shown that it is not possible to judge the appropriateness of fiscal policies and the risks to financial stability on the basis of arbitrary numerical rules for public debt and the fiscal balance. Interactions with other macroeconomic, financial and monetary, social and now climate variables and policies need to be taken into account. The possible risks of unsustainable public debt developments that would justify constraints on a country's public finances must be identified and explained on a case-by-case basis. The arguments must be presented in a transparent and simple manner so as to be accessible to a democratic debate at national level and among European partners.

2. Governance should be permissive of the public funding needed to achieve the energy transition to which the EU is committed. Delays and under-investment in the fight against environmental imbalances increase the medium and long term material and transition risks as well as financial instability with the risk of spill-over from one country to another. They would impose an excessive, even unsustainable, cost on future generations.

3. The objectives assigned to economic policy coordination must be specific and their achievement verifiable. The mere reference to an objective as general and imprecise as "sustainable growth" does not provide lasting legitimacy for interference by the European level in national debates. Retaining as objectives those associated with the decarbonisation of the European economy and the protection of biodiversity through a just transition as well as the realisation of the European social rights floor can. These objectives have been agreed at European level and are or can be associated with specific and measurable quantitative outcome indicators. These indicators can guide and verify the choice of volume and allocation of public funding and accompanying policies. They should be given equal consideration to monetary and financial indicators.

4. The preventive arm of the fiscal rules and the macroeconomic imbalance procedure (MIP) will be replaced by a single procedure, the economic, social and environmental sustainability procedure (ESESP), which puts the analysis of fiscal policies into context. As the MSP already includes the social dimension, this would mean broadening its scope to include the environmental and strengthening the fiscal dimension. Fiscal policies are an essential instrument to redress economic imbalances, including between EU countries. There is no rationality in maintaining two separate procedures dealing with related issues and based on the same Treaty article. The reference values for the WSSE indicators would be, as in the current MDP, thresholds warning of potential instability. Any recommended measures would

have to take into account the specificities of the country and in particular its adjustment capacity and would be symmetrically addressed to both surplus and deficit countries. (MDP Compendium, P. 8).

5. Corrective arm: Unless Art. 126 TFEU is revised, the list of factors relevant for assessing whether breaches of the reference values for deficit (3% of GDP) and debt (60% of GDP) threaten the stability of the Union economy and justify an excessive deficit procedure will be reviewed. The EESP will provide a framework for identifying these factors. Recommendations for an excessive deficit procedure will have to be realistic and also take into account the current levels of debt and deficit as well as the risks that would result from a rapid reduction in expenditure and a delay in the ecological transition.

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Question 2 :

How to ensure responsible and sustainable fiscal policies that safeguard long-term sustainability, while allowing for short-term stabilization?

Response:
The sustainability of each country's fiscal policies and the risks they pose to partners are regularly debated, and rightly so. This debate is useful if it is based on a shared assessment framework that takes into account all available information.

Budgetary programming adapted to the needs of each country

Contrary to what the current texts suggest, there is no single upper limit for a sustainable public deficit path determined by a rule of convergence of ratios to GDP towards a norm. Sustainable debt paths depend on the specificities of each country, including the policy choices that are made with respect to employment, non-recurrent expenditure planning, wage and redistribution policies and taxation.
In a contractual approach (similar to the governance of the Recovery and Resilience Facility - see answer to question 4), each country will present a five-year budgetary programme, which can be revised annually, and which will be validated by the Council on the basis of a proposal by the European Commission.

A common framework for assessing fiscal policies

Debt sustainability analyses, which are probabilistic and based on scenarios around the national budget programme, should largely replace the current indicators centred on unobservable and irrelevant variables. Warning thresholds for indicators such as the level of interest payments on public debt, the difference between nominal GDP growth and the interest rate on public debt, the level of primary surplus needed to stabilise the debt-to-GDP ratio, the average maturity of the debt would be defined. Exceeding them would trigger a procedure that could lead to a revision of the programme.
The evaluation will also take into account the interactions with monetary policy.
This multi-dimensional and country-specific approach is preferable to the spending rule sometimes proposed, anchored on the unobservable variable "potential output".

Take into account the risks associated with the climate emergency by favouring expenditure with proven effectiveness

In addition to macroeconomic factors, the material and transitional risks associated with climate change must be taken into account. These risks can jeopardise the environmental sustainability of economic activities and thus financial stability.

As the urgency of climate change requires accelerated investment in the transition, controlled increases in debt ratios should not be taboo if they go hand in hand with expenditure whose effectiveness is documented.

This effectiveness depends in particular on policies related to the fight against climate change which are essentially sectoral policies. They will require the mobilisation in the medium and long term of significant public funding in the form of investment, aid to households and businesses to achieve the energy transition, and professional training. Correctly measuring the impact of these policies through result indicators is essential to assess the relevance of the trade-off between investment in the transition and debt (e.g. number of homes whose insulation has been completed, number of employees of a carbon industry who have found a job).

Strengthen automatic stabilisers

Fiscal policies can contribute to the stabilisation of the economy and at least avoid destabilising it by

- Stabilising the expectations of private actors by announcing and continuously deploying a programme of economic and fiscal policies in support of the transformations required to achieve the objectives of the European Green Pact, in particular the 55% reduction in greenhouse gas emissions;
- Strengthening automatic income and employment stabilisers;
- Strengthening prevention and collective security mechanisms, in particular to deal with new environmental risks for which insurance does not exist or is not accessible to all
- Anticipating the risk that insufficient support in times of economic downturn may have lasting effects on productive capacity (hysteresis)

T**he fiscal framework would provide sufficient flexibility** to support or constrain demand based on a judgement of a range of macroeconomic indicators reflecting pressures on productive capacity in different sectors of the economy: unemployment, inflationary pressures on prices and wages, external accounts and an analysis of the specific source of instability. The use of unobservable variables, such as the output gap, to estimate the cyclical position should be abandoned because of the methodological weaknesses of these concepts.

Question 3 :

What is the appropriate role for the EU surveillance framework in incentivising Member States to undertake key reforms and investments needed to help tackle today and tomorrow's economic, social, and environmental challenges while preserving safeguards against risks to debt sustainability?

Response:

Whatever the agreement on the rules to ensure the sustainability of national public debts, it should include the possibility to trade-off debt and expenditure in support of specific objectives of priority European interest, such as energy transition, biodiversity protection or the realisation of the core set of fundamental social rights.

In the context of budgetary programming, States should be able to trade off debt against expenditure, provided that the effectiveness of the latter is documented. The approach will encourage them to put in place budgetary programming modalities that are results and performance oriented and based on social and environmental impact assessments.

The current flexibility clauses that favour certain spending linked to structural reforms or investments that can "enhance growth potential" are quantitatively insufficient and qualitatively insufficiently specific.

Depending on the solution for the fiscal rule, the reform could be a simple revision of the flexibility clauses applicable on a case-by-case basis such as the existing ones ("structural reform" and "investment"), the introduction of a "green golden rule" systematically excluding certain expenditure from the calculation of the relevant deficit, or any other form adapted to the new modalities of debt and deficit assessment.

In any case, the quantitative limits placed on the current flexibility clauses are not adapted to the needs of the climate emergency. They should be reviewed in the framework of the revision of the sustainability analysis (see answer to question 2).

The fundamental question, which is identical in all cases, is the identification ex ante of the expenditure to be prioritised and whose effectiveness should be monitored ex post. However, in the case of national budgets, the method chosen should not involve excessive intrusion by the European level into the details of expenditure.

The use of a taxonomy focused solely on the characteristics of the expenditure, such as the European "green taxonomy" currently being finalised or the taxonomy used in the framework of the Recovery and Resilience Facility, is not appropriate. As this is a public expenditure, its impact depends on the behaviour of many actors and the regulatory, administrative and fiscal measures that accompany it. It is the assessment of this impact that must be decisive.

Public investment expenditure and aid to households, businesses and employees, pursuing a specific objective of the European Green Pact, will benefit from a flexibility clause when they are part of a documented public policy. Performance and result indicators allowing the monitoring of effectiveness are associated with them. These will generally be material

performance indicators (e.g. number of houses renovated) or social indicators (e.g. number of former employees of the car industry who have kept or found a job).

The dialogue with the European level will focus on the programming method, the coherence of the plan, the volume of expenditure and the performance indicators. Where appropriate, compliance with national plans aiming at objectives of common European interest, such as the National Energy and Climate Plans or the Climate Change Adaptation Plans, will have to be ensured.

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Question 4 :

How can one simplify the EU framework and improve the transparency of its implementation?

Response:

Simplification of the framework will improve its legitimacy and effectiveness.
The desirability of replacing the procedures for the prevention of excessive deficits and macroeconomic imbalances with a single procedure was set out in response to question 1.

Two other simplification projects should be considered:

Merging into a single National Transition and Budgetary Programme (NTBP) the two programmes that Member States are required to present, the budgetary stability or convergence programme on the one hand and the reform programme on the other.

Focusing the NTBP on its contribution to the European objectives.

This merger is not only desirable because of its significant contribution to the simplification and transparency of the coordination process. The fact that Member States are required to submit two separate documents, a "national reform programme" and a "budgetary stability and/or convergence programme", is an obstacle to the development of a coherent vision of the macroeconomic framework and the underlying economic and budgetary policies.

The NTPB would be submitted in April of each year, replacing the two national "reform" and "stability/convergence" programmes. It will be validated by the Council, after receiving the opinion of the European Parliament and consulting the social partners and civil society, on a proposal from the Commission. It should above all highlight the contribution of national policies to the achievement of the specific objectives of the European Green Pact as well as the social objectives agreed at European level, and to the stabilisation of the European economy, without going into detail on what are essentially national policy choices.

The programme presented by the Member States will include risk indicators associated with alert thresholds adapted to the specificities of the country. Exceeding these thresholds would indicate deviations from the programme that could lead to a potentially unsustainable economic imbalance, e.g. the level of the interest burden on public debt, the rate of public borrowing, the rate of unemployment or inflation, delays in the energy transition. It will trigger a European procedure to assess whether the reason is an exogenous cause and whether corrective action is needed.

Ensuring transparency and robustness of methods

The current rule based on the respect of two indicators, the level of government deficit and debt, has only the appearance of simplicity. In reality, its application has required the development of increasingly complex codification and calculations that are accessible only to a handful of specialists. It has also led to increasing recourse to flexibility clauses and discretionary judgement.

However, the complexity of economic phenomena and the uncertainties that plague them do not allow us to hope for a simple rule whose application would be adapted to each country at all times and would guarantee stability. The assessment of a budgetary stance must use a multivariate evaluation framework and cannot evacuate a judgement on the risks, which is a political matter and therefore requires a consensus at European level.

It is all the more important to guarantee the transparency and reliability of the methods, such as the abandonment of all unobservable variables, including the "production potential". The use of this non-observable variable, which is supposed to be a standard for defining GDP growth in the medium/long term and for defining a "normal" level of economic activity in the short term, has shown all its empirical and theoretical weaknesses and is politically questionable and contested. The weaknesses of this indicator will be aggravated insofar as the energy transition will involve upheavals in production and consumption patterns in their scope and nature that are unprecedented and largely unpredictable on the basis of past projections.

When projections are needed to guide budgetary policies, they should be expressed in the form of intervals or scenarios, marking the degree of uncertainty or their normative character. This is particularly true for the projection of GDP growth, a key variable in budgetary projections, which is subject to many uncertainties in the short, medium and long term, and which depends on many policy choices, including employment.

In a context of growing uncertainties and the possibility of extreme events, intellectual honesty and the quality of democratic debate require a clear distinction between what is known and what is not known, including the difficulties to date in integrating energy and economic-environmental feedback loops into macroeconomic models.

Question 5 :

How can surveillance focus on the Member States with more pressing policy challenges and ensure quality dialogue and engagement

Response:

Focusing the monitoring on the most urgent challenges is a welcome objective. This will reduce the degree of interference from the European level in national policy choices and increase the legitimacy of the procedure.

The definition of the "most urgent challenges" should be given particular attention. They may be long or very long term and require permanent attention (debt sustainability, social cohesion, progress towards carbon neutrality, protection of biodiversity) or result from exceptional circumstances affecting all or a limited number of EU countries (health crisis, natural disasters).

Flexibility clauses for exceptional circumstances exist and should be retained.

Some of the proposals in response to the previous questions would allow for a differentiated analysis of the relative urgency of the challenges in order to be able to provide coherent responses adapted to the specificities of each country:

Replace the procedures for preventing excessive deficits and macroeconomic imbalances (MDPs) with a single procedure for economic, social and environmental sustainability (question 1). The indicators would be thresholds alerting to a deviation from the national programme. An alert would trigger a process that should lead to a shared judgement at European level on the need for corrective action. This need would be based on a precise analysis of the risks that the deviation poses to the stability of the European economy and to the achievement of objectives of common interest. (Question 1)

Replace the too vague objectives of "sustainable growth" and "macroeconomic stability" by specific, measurable and relevant objectives agreed at European level because they are of common interest (Question 1); merge the stability/convergence and reform programmes that Member States have to present into a "national transition and fiscal programme" with a focus on such objectives (Question 4)

Adopt realistic budgetary programmes taking into account current levels of public debt (Question 2)

Recognise that delays in energy transition investment have a macroeconomic impact and pose increasing risks to economic and financial sustainability because of the material and transition risks involved (Questions 1, 2, 3)

Revisit the list of relevant factors to be taken into account when applying TFEU 126, in particular the needs related to the fight against climate change while respecting infra- and inter-generational justice, the interactions with monetary and wage policies, the potential contribution of each country to redress external macroeconomic imbalances, and the existence of European solidarity mechanisms (Question 1)

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Question 6

In what respects can the design, governance and operation of the RRF provide useful insights in terms of economic governance through improved ownership, mutual trust, enforcement and interplay between the economic and fiscal dimensions?

Response:

It is obviously too early to draw all the lessons on the results of the FRR and on its capacity to guide the European economies towards the transition objectives assigned to it.

However, a few remarks can be made:

For the reasons given in response to questions 3 and 5, the integration in a single document of budgetary commitments and "structural reforms" practised in the framework of the FRR is an example to follow. The annual stability/convergence and reform programmes would be replaced by a single "National Transition and Budget Programme". This programme would primarily highlight its contribution to European objectives, in particular the energy transition. The focus would be on the long-term policies and budgetary commitments needed to achieve the transitions foreseen in the Green Pact for Europe.

The adoption of the FRR programme and its acceptance by European partners was conditional on additional funding. This seems to have led in some countries, despite the urgency, to substantial debates on the use of the funds and the measures to accompany them. The new economic governance should open up a space for trade-offs between debt and expenditure subject to efficiency. A governance similar to the one chosen for the RRF should be retained for the adoption and validation at European level of the "National Transition and Budgetary Programme" (NTBP). The NTPB prepared by each country would be validated by the Council on a proposal from the Commission. A contractual approach would replace the current one based on recommendations from the European to the national level and would make it possible to clarify responsibilities.

The involvement of the social partners and civil society organisations in drawing up the national plans should be effective, transparent and balanced. A country-by-country assessment of practices in this respect under the RIF is needed.

The modalities for evaluating the effectiveness of the plans cannot be the same as those used in the RRF, which is not, or only marginally, part of an approach to evaluating results and performance. It should be based on the monitoring of specific results indicators and impact assessments, and not on the categorisation of expenditure (see also answer to question 3).

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Question 7

Is there scope to strengthen national fiscal frameworks and improve their interaction with the EU fiscal framework?

Response:

We refer to the definition used by the commission e.g. in the document "Public finance in EMU" of 2010 chapter 3). According to this definition, national fiscal frameworks include (1) numerical fiscal rules, (2) independent fiscal institutions, (3) fiscal procedures governing the preparation, approval and implementation of fiscal plans, and (4) medium-term budgetary frameworks (MTBFs) for multi-annual fiscal planning.

The uncertainties and challenges of transition have significantly weakened, if not destroyed, the capacity of numerical fiscal rules to rationally guide fiscal policies.

National fiscal institutions can usefully inform national choices, but their role will necessarily remain limited as it is up to governments to find the political balance between approval at national level and validation at European level.

On the other hand, it is legitimate and indispensable that the European institutions interact strongly with the national authorities to guarantee high minimum standards on the procedures for programming, implementing and monitoring the results as well as medium and long-term programming. Beyond the issue of good budgetary governance and the fight against corruption, this is of common interest because European countries are collectively committed to the fight against climate change, which requires economic and budgetary policies of an unprecedented nature and with a long to very long term horizon.

Furthermore, the involvement of independent institutions at national and European level in charge of giving an opinion on the effectiveness of the policies carried out for the energy transition and the reduction of greenhouse gas emissions and their compliance with European commitments is desirable.

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Question 8 :

How can the framework ensure effective enforcement? What should be the role of pecuniary sanctions, reputational costs and positive incentives?

Response:

First of all, it must be stressed that the rules will be all the better respected if they are intelligent, communicable in the democratic debate and if they guide budgetary policies towards widely shared objectives.

In any case, financial sanctions in the form of fines are not operational between EU Member States. Financial sanctions in the form of suspension of access to the European budget are not desirable either, as they risk interrupting useful programmes at great cost.

Positive incentives in the form of access to medium/long-term oriented facilities or short-term support mechanisms are effective provided the quality of the programmes requested and the conditions attached are met.

It is important to act preventively and therefore to have an instrument that can be easily mobilized to smooth financing of programme in common European interest. Experience has shown that waiting for the crisis to erupt leads to more costly solutions, both financially and politically.

The reputational costs that are often associated with market sanctions are unpredictable in their impact. Depending on the political constellation, they can play a moderating role or, on the contrary, reinforce political conflicts within the country concerned and between countries, and worsen the situation. A cooperative approach, financially and politically balanced, is needed in any case.

Question 9:

In light of the wide-ranging impact of the COVID-19 crisis and the new temporary policy tools that have been launched in response to it, how can the framework – including the Stability and Growth Pact, the Macroeconomic Imbalances Procedure and, more broadly, the European Semester – best ensure an adequate and coordinated policy response at the EU and national levels?

Response:

At the time of writing, there are still significant uncertainties about the evolution of the health crisis and its economic, financial and social consequences. It is unlikely that these uncertainties will be resolved quickly during 2022.

Under these conditions, it is not desirable to reintroduce the budgetary and economic policy coordination rules suspended at the beginning of 2020 before they have been thoroughly reformed in the direction advocated in this contribution.

Essentially, the budgetary and economic policy coordination framework should take into account the specificities of each country, determine realistic deficit and debt paths and fully integrate the urgency of the European Green Pact.

Question 10:

1. Macroeconomic management of the Eurozone, as of any monetary area, must take into account the fiscal policy/monetary policy mix. In the absence of a substantial central budget, this mix is determined by the aggregation of national budgets which must therefore be coordinated among themselves as well as with monetary policy. It will continue to be the task of the European Commission to point out the risks of imbalances between Eurozone countries and a sub-optimal monetary/fiscal policy mix. And it is up to each country to take its responsibility to ensure that policy adjustments, including fiscal ones, are symmetrical.

2. In light of the experience of the last decade characterized by substantial intervention of the ECB on the public bond market, issues related to the effectiveness of monetary policy to steer credit flows to investments supporting the decarbonation of the economy, the prohibition of direct monetary financing should not be longer considered as a taboo.

3. Experience has shown that many countries are reluctant to use central financial instruments whose primary purpose is limited to cushioning macroeconomic imbalances.

4. The legitimacy of a European financial instrument must be grounded in the production of a common good. The fight against climate change is one such good. The sustainability of action programmes in all European countries is necessary for the success of this long-term undertaking. This configuration argues in favour of a permanent financial instrument inspired, subject to an evaluation, by the FRR and intervening to smooth the financing and implementation of these action programmes.