European Green Deal and reform of the Stability Pact

Bringing the economic governance in line with the Green Pact for Europe and a just transition: an imperative

The European Commission has initiated a reform of the economic governance of the Union and the Stability Pact and will make legislative proposals during the first half of 2023. Will this reform mark a turning point that will enable us to respect the objectives that Europe 2030 has set itself and accelerate the march towards the zero-carbon objective in 2050?

Failure to meet the 2030 targets would have an immense cost for the Union and in each Member state: environmental because each ton of CO_2 emitted is a ton too much; for internal political reasons because it would further despair the younger generations; for external political reasons because the EU, a leader of international cooperation on the climate, would fail in its own commitments; economic because uncertainties about the credibility of economic policy would hamper private investment in the transition; financial because the cost of fossil disengagement increases with each delay.

Let's measure the extent of the shift needed to turn the corner! In 2021, the European Union's greenhouse gas (GHG) emissions are still 78% of their 2005 level, the European Green Deal has set a target of reducing GHG emissions by 55% up to 2030 compared to the 2005 level. To meet this target, GHG emissions will have to fall 2.5 to 3 times faster than the annual average of the last 10 to 15 years. And this without “exporting” European emissions to third countries.

Such a shift is possible. The response to the health and energy crisis with which the Union is still struggling should inspire how to do so. Since 2020 the budgetary rules of the Stability Pact have been suspended. Fiscal policies have not been freed from all norms. But the order of priorities has been revisited so as to be able to respond to health and now energy emergencies and to their economic and social consequences. This has made it possible to preserve employment and the productive apparatus.

The priority now is to implement policies, including fiscal policies that accelerate the decarbonisation of the economy by transforming production methods and by encouraging and helping households to restructure their consumption. And this without contributing to global GHG emissions through our imports. There are many mature or nearly mature technologies available now. However, in addition to carbon taxation and the reduction of fossil fuel subsidies, accelerating their adoption requires targeted public policies and budgetary means to invest in infrastructure, support professional retraining and help private actors overcome the initial capital cost. Areas of intervention with rapid energy and environmental benefits include the insulation of buildings and the production of low-carbon heat (geothermal and solar), the massive development of renewable energies for the production of electricity, the transfer of individual transport and freight to rail, and the transformation of agricultural methods.

New challenges for economic governance

The climate and social emergency require both public and private actors to consider a greater differentiation of objectives. This puts the European coordination of national economic and social policies at the crossroads of four processes:

- the rules of the stability pact;
- the climate energy governance;
- the social agenda;
- and the European prudential rules which should encourage banks and the financial sector to divest in orderly fashion from fossil dependent activities. This point is important because it conditions the ability of decision-makers to manage transition risks without jeopardizing financial stability. Prudential rules are being overhauled by the European legislator. One of the major issue is indeed how far the rules will take climate risks into account.

In addition, there is a pressing need for Member States to improve their methods of ex ante and ex post environmental impact assessment, as pointed out by the European Commission. Weaknesses in this area should not, however, be used as an excuse to delay policies. The precautionary principle and the urgency of the situation mean that we have to learn as we go along.

For programmes with the right hierarchy of priorities

The principles recently proposed by the Commission for reforming the economic governance open up prospects. Admittedly, they remain trapped in the public deficit and debt standards that have been anchored in the Treaty for thirty years. But a trade-off between speed of adjustment to these standards and investment would be possible. This trade-off would be translated into a budgetary and reform program covering four to seven years. The objective should be "to enhance growth, support the sustainability of public finances and address the various priorities of the Union". This program would be the pillar of the new governance.

If the European legislator follows the Commission's proposal, there would be margins to calibrate policies that respect the Union's climate promises and social commitments while ensuring a high employment rate. However, it would be essential to ensure that future legislation does not lock the dialogue into too narrow a technical framework. This would be the case if reference were made to a rigid concept of investment in public infrastructure alone, whereas interventions of a differentiated nature are needed to accelerate the transition. This would also be the case if unobservable variables such as potential GDP were still used to calibrate the amount of expenditure “authorized” under the budgetary programme. Potential GDP is a central variable in the current rules and experience has shown that it is unreliable. In any case, no one can predict the effect of transition policies on the growth of activities measured by GDP. Orienting fiscal policies towards this indicator in the hope that "green" growth will be achieved could only produce perverse effects.

Monitoring and responding to environmental and social imbalances

The second part of the Commission's proposal also opens the discussion on an interesting option. The terms of it need, nonetheless, to be clarified. The starting point is that the economic, environmental and social impact of a budgetary and reform program over 4 or 7 years is uncertain. Implementation may either fail to produce the expected effects or produce unexpected and damaging collateral effects. The order of priorities to be assigned to the various possibly contradictory objectives may change over time. A feedback loop is therefore needed to make corrections to the original plan along the way. The Commission is making a proposal to this effect, building on an existing surveillance procedure that currently only targets financial imbalances (the Macroeconomic Imbalance Procedure). But the Commission is vague on how to change the substance of the procedure to consider the new environmental and social challenges.

The right approach would have two dimensions:

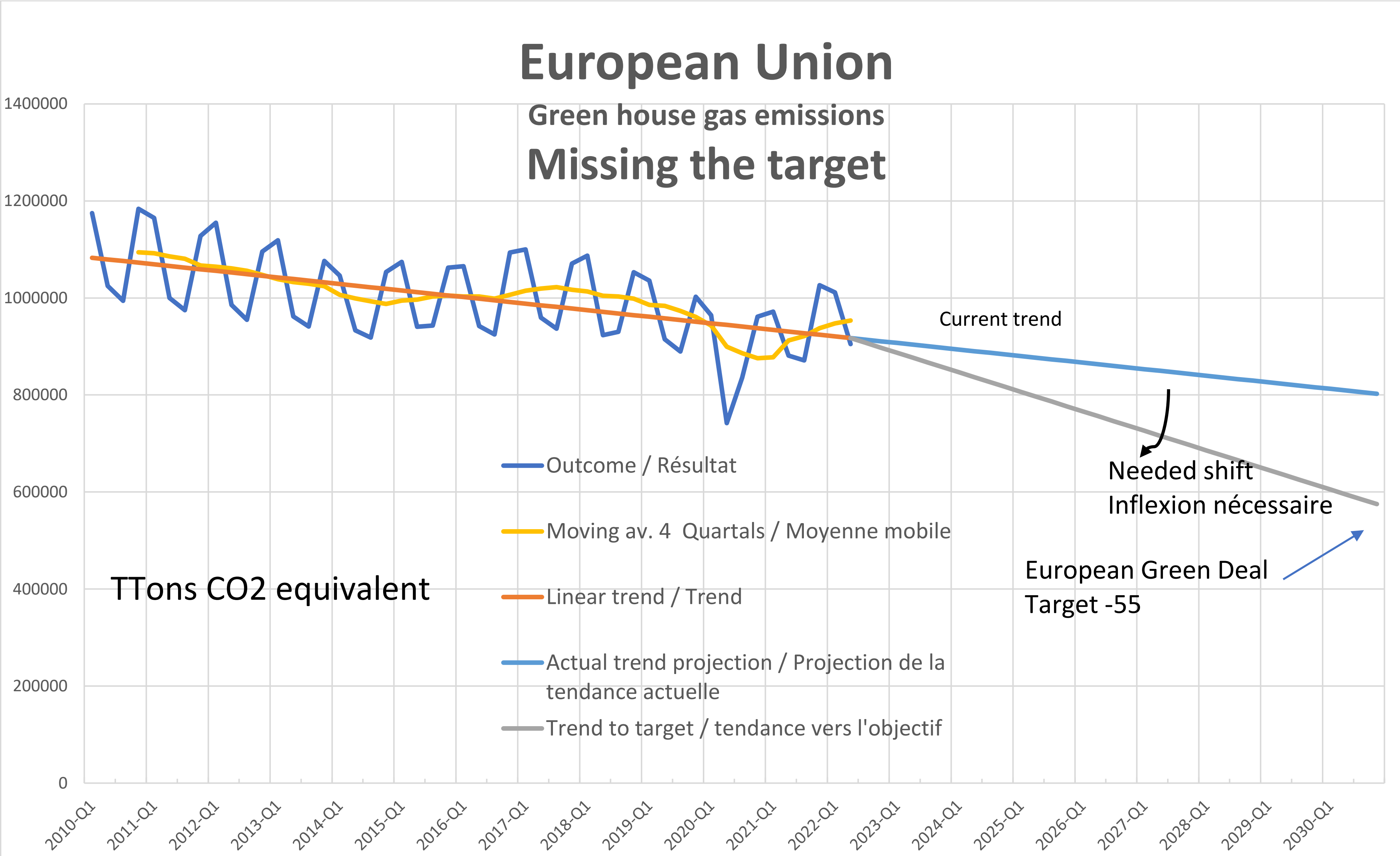
- First, within the framework of the MIP, monitor the specific risks associated with the transition, in particular the exposure of the financial and banking sector to fossil fuels, inequalities and employment, or the changes in material risks to economic infrastructure.

- Secondly, recognise that delays in meeting climate and environmental or social targets are on their own a major macroeconomic risk. Such delays should trigger the procedure with the ultimate objective of correcting the budgetary, investment and reform program.

The indicators included in the procedure guiding scoreboard should be adapted accordingly. The way would be for example to include with the same statute as the financial imbalance indicators a greenhouse gas emissions indicator (that is now available promptly and quarterly) as well as an inequality indicator and indicators of progress made in adaptation to climate change and of residual material risks.

The Commission does not deny the interactions between economic and budgetary policies, energy transition and social objectives. However, it considers that these interactions can be dealt with in a general way within the framework of the European Semester, the various monitoring mechanisms complementing each other (Annual Sustainable Growth Survey, 2023, P.16). There is no doubt that each monitoring mechanism has its own value and that taken together they should be presented in a coherent form. But, for the reasons given above, this approach would remain insufficient. It does not focus on the economic risks and imbalances resulting from failures in the results of environmental and social policies. Above all, it does not create a sufficiently robust loop between such failures and the corrections to be made to budgetary programmes and national reform and investment plans. Only the explicit consideration of economic, financial, environmental and social interactions in a formal integrated procedure could do so in a coherent way.

And the inevitable reminder for the monetary Union: whatever the quality of future budgetary rules, the burden put on the coordination of national economic and fiscal policies will be excessive as long tax policy cannot be more easily coordinated by lifting the unanimity rule; and as long there is no permanent successor to the Recovery and Resilience Facility that has been set up to help states in the COVID crisis and is now adapted to the energy crisis new needs.


European Union
Green house gas emissions
Missing the target
1400000
1200000
1000000
800000
600000
400000
200000
0
TTons CO2 equivalent
Current trend
Needed shift
Inflexion nécessaire
European Green Deal
Target -55
Outcome / Résultat
Moving av. 4 Quartals / Moyenne mobile
Linear trend / Trend
Actual trend projection / Projection de la tendance actuelle
Trend to target / tendance vers l'objectif
2010-Q1
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2012-Q1
2013-Q1
2014-Q1
2015-Q1
2016-Q1
2017-Q1
2018-Q1
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