POSITION PAPER

May 21 2021

EU ECONOMIC GOVERNANCE REVIEW

KEY MESSAGES

- Whilst the immediate concern is for policy-makers to avoid any premature unwinding of measures to support business and workers, in the medium term Member States must return to fiscally sustainable positions.

- Proper enforcement of the Stability and Growth Pact, revised following the conclusion of the ongoing review, preferably with simplified rules and reduced pro-cyclicality and reflecting the post-pandemic context, will be essential to help Member States put their public finances on a sustainable footing and strengthening investment confidence.

- The current low-interest rate environment provides some flexibility regarding the pace at debt levels need to be reduced, provided this is employed wisely by focusing on productive investment and reforms that create fiscal space for future crises.

- Rapid implementation of the EU's Next Generation EU Recovery instrument is essential. The funds must support investment and reforms that can help transform EU growth, productivity and competitiveness.

- More attention needs to be directed at the quality of investments, with a greater focus on the proportion of Member States' expenditure towards growth-enhancing expenditures, particularly public investment.

- Deepening Economic and Monetary Union goes hand in hand with strengthening economic governance, including completing the banking and capital markets union and reinforcing the European Semester's role in increasing growth, competitiveness and convergence.

BUSINESSEUROPE a.i.s.b.l.
AVENUE DE CORTENBERGH 168 – BE 1000 BRUSSELS – BELGIUM
TEL +32 (0)2 237 65 11 – FAX +32 (0)2 231 14 45 – E-MAIL main@businesseurope.eu
WWW.BUSINESSEUROPE.EU – Follow us on Twitter @BUSINESSEUROPE
EU Transparency register 3978240953-79

21 May 2021

Recommendations for the EU Economic Governance Review

Background

On February 5 2020 the European Commission officially launched an Economic Governance Review, observing that "The start of a new political cycle in the Union is an opportune and appropriate moment to assess the effectiveness of the current framework for economic and fiscal surveillance, especially the six-pack and two-pack reforms, for which the Commission is required to report on their application". The review was first intended to be completed by end-2020, but has been postponed due to COVID-19.

We welcome the initiative. The Economic Governance Review provides the opportunity to improve the clarity of the Stability and Growth Pact, in particular to simplify the fiscal rules and reduce their pro-cyclicality, thus helping to ensure they play their full role in helping Member States put their finances on a sustainable footing. The review should also consider how the framework can best support growth-enhancing public investment.

The economic governance framework has evolved over time. The six-pack and two-pack legislation were introduced to address the vulnerabilities exposed by the economic and financial crisis. The economic context has changed materially since then. The European economy has experienced seven years of consecutive growth, but is now faced with one of the steepest GDP drops in modern history. Moreover, even before the onset of the COVID-19 pandemic many Member States experienced low growth and had high levels of public debt levels. The reform momentum seems to have faded and progress has become uneven across countries and policy areas. At the same time, in the face of a pandemic that has caused unprecedented economic damage and a rapidly changing global landscape where competition in many business sectors is intensifying, it has never been more essential that we ensure the fiscal rules are well-designed to support long-term growth and competitiveness in Europe.

No premature unwinding of present measures, but the revised government framework needs to be in place for the upturn

The normal fiscal rules governing deficits have been temporarily suspended through the activation of the general emergency clause in March 2020. Given the resurgence of the virus, policy-makers must avoid any premature unwinding of measures to support business and workers, such as wage subsidies and tax holidays, which would risk a new recession and greater long-term economic scarring.

In the short run, reactivating the normal deficit rules prematurely will hinder these efforts and therefore be detrimental to Europe's recovery. On the other hand, countries do need to return to sustainable budgetary positions, so in the medium term, Members States will need to ensure their total debt levels are sustainable, reflecting the situation in the aftermath of the COVID-19 pandemic, and ensuring there is no "debt explosions" leading to negative financial market reactions. The ongoing EU economic governance review needs to be concluded in a timely manner that supports these efforts.

BusinessEurope therefore recommends:

- Given the resurgence of the virus, policy-makers must avoid any premature unwinding of measures to support business and workers, including a premature deactivation of the general emergency clause

- In the medium term, Member States must ensure fiscally sustainable positions, supported by a reactivation of a revised economic governance framework.

Fiscal rules must be both enforceable and enforced

Proper enforcement of the Stability and Growth Pact (revised following the conclusion of the ongoing review) will be essential to help Member States put their public finances on a sustainable footing, and in particular bring down debt levels, which in many Member States, even before the onset of the pandemic remained well above the 60%/GDP threshold. Fiscal sustainability, including where appropriate fiscal consolidation, is key in order to strengthen investors' trust in the European economy and support longer-term prospects for driving economic growth.

As noted in its August 2019 assessment of EU fiscal rules by the European Fiscal Board, "starting in 2003 (..) Member States' commitment to the SGP [has begun] to weaken", whilst "the SGP was only loosely enforced (..) and Member States failed to take advantage of the good economic times before the crisis to build up sufficient fiscal buffers". The review must explore ways to ensure better enforcement and less procyclical rules so that Member States in future commit more fully to building up sufficient fiscal space in normal times.

The current low-interest rate environment provides additional flexibility in terms of the pace at which an economy moves back towards the debt levels foreseen in the Stability and Growth Pact. Moreover, with a number of Member States facing very high debt levels in the aftermath of the COVID-19 pandemic, the economic ramifications of the strictest possible application of the rules risk being counterproductive and thus jeopardize the recovery. To illustrate, it is a concern that some Member States, having seen their debt/GDP soar during the COVID-19 outbreak, could be required under the current rules to reduce their debt by what could amount to some 5% of GDP in repayments annually, which may well prove economically unsustainable. At the same time, while low interest rate levels offer some respite in the current situation, economic policy must be designed bearing in mind they cannot be taken for granted in the medium-run, making it imperative that we ensure sustainable debt levels compliant with common fiscal deficit rules. The European Semester should play a larger role to better help guide and ensure appropriate national growth- and productivity-enhancing reform programmes after the pandemic.

BusinessEurope therefore recommends:

- Fiscal sustainability is key in order to strengthen investors' trust in the European economy. Proper enforcement of the Stability and Growth Pact is essential to help Member States put their public finances on a sustainable footing in the longer run.

- The current low-interest rate environment provides some flexibility regarding the pace at which debt levels need to be reduced, provided borrowing is focussed on productive investment. Adjustment paths foreseen in the Stability and Growth Pact must be consistent with levels that can maintain economic growth.

Need to simplify fiscal rules

There is a need to simplify the fiscal rules and reduce their pro-cyclicality, thus helping to ensure they play their full role in helping Member States put their finances on a sustainable footing and provide sufficient buffer for future crises.

We agree that a less complex and wide-spanning rulebook is helpful, since excessive complexity increases the risk of noncompliance by allowing for ambiguities in interpretation, makes EU Member States budgetary positions less transparent. However, we note that the complexity often springs from the desire to pursue several policy objectives and to better take specific circumstances into account, making it difficult to fundamentally simplify the rulebook.

The discussion has recently centered around the use and measurement of output gaps. In particular, the Member States Medium-Term Objectives are defined in terms of structural GDP. Several points have been made that the review should assess. As such, an assessment of the Commonly Agreed Methodology (CAM) should be an integral component of the ongoing economic governance review. However, the underlying idea that current economic circumstances must be evaluated in relation to underlying structural factors remains valid and well-founded on economic theory.

BusinessEurope therefore recommends the following:

- There is a need to simplify the fiscal rules and reduce their pro-cyclicality, thus helping to ensure they play their full role in helping Member States put their finances on a sustainable footing.

- The European Commission must thoroughly assess and consider whether its current methodology is adequate and appropriate, taking into account the uncertainty relating to measures of unobservable factors, whilst remembering that evaluating economies in terms of structural properties is well-founded on economic theory.

BUSINESSEUROPE

Improving the quality of public spending to support investment

The EU's Next Generation EU Recovery instrument must be implemented without delays. Member States' Recovery and Resilience plans must support investment and reforms that can help transform EU growth, productivity and competitiveness.

Governments have increased spending considerably in response to the pandemic, with additional money about to flow from the Recovery and Resilience Facility into investments. In this context it is important that more attention is directed at the *quality* of the spending and what long-term economic advantages investments and reforms will unlock. Provided investments are sound the current low-interest rate environment is highly supportive of investment spending to support our beleaguered economies. In economic terms that would suggest greater flexibility in terms of how fast fiscal positions would need to revert back to what the rules prescribe.

More broadly, it is essential that the Stability and Growth Pact gives the fullest support possible to Member States that wish to orientate their budgets towards investments and growth-supporting expenditure. The Commission's Economic Governance Review provides the opportunity to improve the clarity of the Stability and Growth Pact, in particular to simplify the fiscal rules and reduce their pro-cyclicality, thus helping to ensure they play their full role in helping Member States put their finances on a sustainable footing.

Debt sustainability cannot only be about public expenditures, but must also rely on driving growth forward through appropriate reforms and investments, including through improving competitiveness and productivity, unlocking new growth potentials in the longer run. We therefore stress that governments should as a matter of urgency focus on, as appropriate in each Member State, reforms in areas such a labour and product markets, public sector, including through increased digitalization, education and research, pension systems, infrastructure for transportation and energy, business regulation, whilst generally supporting private investments. Ambitious reform agendas, rather than simply establishing income support schemes, both through the Next Generation EU Recovery Instrument and through other national reform programmes, will help create more fiscal space for Member States and are imperative to bringing our economies on sustainable footing for the long term.

BusinessEurope therefore recommends:

- Rapid implementation of the EU's Next Generation EU Recovery instrument is essential. The funds must support investment and reforms that can help transform EU growth, productivity and competitiveness.

- More attention needs to be directed at the quality of investments, with a greater focus on the proportion of Member States' expenditure towards growth-enhancing expenditures, particularly public investment.

- Fiscal space should be created by carrying out ambitious reforms to unlock growth potentials, boost productivity and increase competitiveness. Monitoring and benchmarking of implementation on the ground will be important to ensure the maximum impact. As social partners we stand ready of course at national and EU level to offer guidance and our expertise to advice on what reforms and use of the Recovery and Resilience Facility will bring most added value.

It is crucial that the EU's fiscal rules do not pose undue constraints on the efforts necessary to success in the transition towards a carbon-free economy. The review should consider how the framework can best support growth-enhancing public investment. We recognize that massive investments are needed in order for the EU Member States to obtain their ambitious climate objectives. This will require financing both through national budgets and by drawing on EU funding through the Recovery and Resilience Facility. Ensuring that this is possible and money is well spent on high-impact projects must be a priority.

It is essential the governance framework encourage public investment that can support necessary long-term structural changes in our economy including the green transition. The existing investment clause already provides some scope for additional investments beyond the Stability and Growth Pact budget deficit ceilings.

BusinessEurope therefore recommends:

- It is important that the governance framework encourages public investment that can support the green transition, although we note an investment clause already exists to provide for additional investments beyond the Stability and Growth Pact debt ceilings.

Deepening Economic and Monetary Union goes hand in hand with strengthening economic governance

Increasing convergence between EU Member States, and ensuring cross-EU economic and financial linkages can play a role in dissipating the impact of an adverse shock affecting any single Member State across the EU, will reduce pressures on Member States' public finances, and thus in turn enhance adherence to, and hence the credibility of, the Economic Governance framework.

At the same time, it is clear the EU-wide political support for deepening Economic and Monetary Union requires strong compliance by Member States with the framework, and in particular the rules of the Stability and Growth Pact. In this sense the deepening of Economic and Monetary Union goes hand in hand with the strengthening of EU economic governance.

Investment requires a safe and predictable environment, which is why completing Economic and Monetary Union and strengthening trust in the Euro is a priority for business. There should be urgent and renewed efforts to agree to, and fully implement, longstanding initiatives such as the Banking Union and Capital Markets Unions. The EU economy is vulnerable to shocks and disruptions as long as these remain incomplete.

Following the crisis, the EU has developed a number of important temporary tools to spread the economic risks associated with the COVID-19 crisis between Member States. We have supported both the SURE scheme, given its temporary nature, and the Next Generation recovery instrument, in particular the Recovery and Resilience Facility.

In the long-term we support a strengthening of the Economic and Monetary Union's ability to handle asymmetric shocks to one or more of its economies through access to a Euro Area stabilisation fund, fully conditional on Members States implementing structural reforms and there being no increase in the overall tax burden. To ensure an effective stabilisation function support should be rapid and temporary, the Commission should reflect on how this can be achieved, focusing on both increasing productive investment and growth enhancing reform, drawing on the work on national recovery and resilience plans through the Recovery and Resilience Facility, whilst at the same time increasing the EU's ability to respond to asymmetric shocks.

The Economic and Monetary Union must also deliver convergence towards strong growth rates in all Member States. We must reinforce the European Semester's role in increasing growth, competitiveness and convergence through ensuring all Member States, supported by national parliaments and social partners, implement agreed growth and employment enhancing structural reforms. This includes strengthened implementation of the Macroeconomic Imbalance Procedure in both deficit and surplus countries. Completion and enforcement of the single market is an equally important convergence driver, with less new, but better and properly implemented legislation being key to supporting integration and avoiding fragmentation. Relevant benchmarking and scoreboarding are valuable tools that can help drive convergence and contribute to high quality of economic policy.

BusinessEurope therefore recommends:

- Completing the Economic and Monetary Union by finalizing work on the Banking Union and pressing ahead with Capital Markets Union must be a priority.

- Reinforcing the European Semester's role in increasing growth, competitiveness and convergence.

- Consider how a permanent instrument can be developed to reduce the impact of asymmetric shocks on Member States, drawing on the focus on investment and growth enhancing reform in the national recovery and resilience plans.