Economic governance – the new fiscal rules – a return to austerity

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Background

In response to the need for emergency public spending and investment measures to deal with the pandemic, the European Commission activated an “escape clause” in the Stability and Growth Pact which meant that member states had temporary relief from trying to attain or stick to the key thresholds for debt (60% of gross domestic product – GDP) and deficits (3% of GDP).

EPSU and the ETUC welcomed the suspension of the fiscal rules and called on the Commission not to deactivate the escape clause until it has established a new approach to economic governance.

The Commission relaunched the review of economic governance in October 2021 and its report on the consultation revealed substantial input from trade unions with the Commission noting that: “many respondents are of the view that that fiscal policy should become more growth-friendly, mindful of social issues, and support the policy priorities for the twin green and digital transition.”

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Commission proposals …
Council and Parliament debates

In November 2022, the European Commission published its Communication on its orientations for economic governance reform in November 2022. It claimed that the aim was "to ensure that the framework is simpler, more transparent and effective, with greater national ownership and better enforcement, while allowing for reform and investment and reducing high public debt ratios in a realistic, gradual and sustained manner."

Many of these elements appear in the revised legislation but the question is how the protections for public investment, expenditure on climate change and commitment to take account of the European Pillar of Social Rights and provisions on social convergence will play out in relation to the concrete, numerical benchmarks.

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Debt and deficit "safeguards"

The new rules set two "safeguards" and a four- or seven-year timescale for countries to reduce their debt and deficits.

The **debt sustainability safeguard** requires that the projected general government debt-to-GDP ratio decreases by a minimum annual average amount of: 1% of GDP as long as the general government debt-to-GDP ratio exceeds 90%; or 0.5% of GDP as long as the general government debt-to-GDP ratio remains between 60% and 90%.

The **deficit resilience safeguard** requires that fiscal adjustment continues, where needed, until the Member State reaches a deficit level that provides a common resilience margin in structural terms of 1.5% of GDP relative to the 3% of GDP deficit Treaty reference value.

Stricter implementation?

According to the ETUC: “These new debt rules have a much stricter enforcement mechanism. The mandatory debt and deficit reduction requirements will become hard rules which must be complied with, and spending cuts or tax increases would be needed, and reforms would be required.”

The ETUC analysis indicates that the old rules would have meant that, on current levels of debt and deficit, seven countries (Croatia, Netherlands, Czech Republic, Lithuania, Luxembourg, Bulgaria, Estonia) would **not** be required to make any fiscal adjustment but will have to now because of the new “*deficit resilience safeguard*” of 1.5% of GDP.

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Timescale

Countries will have to draft fiscal structural plans that set out their plans and they will have to meet targets over four or five years although this might be extended to seven years if they commit to specific investments and reforms that meet criteria set by the Commission.

As the ETUC warns, the nature of the reforms are critical and hark back to the days of austerity when the Commission advocated labour market reforms such as decentralisation of collective bargaining.

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Social and other key objectives

The new rules are supposed to be applied in a framework that addresses important areas of spending, namely:

- achieving a fair digital and green transition, including the Climate Law, ensuring energy security
- supporting open strategic autonomy
- addressing demographic change,
- strengthening social and economic resilience and sustained convergence, and
- implementing the strategic compass for security and defence

…all of which requires reforms and sustained high levels of investment in the years to come..

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Public investments

Along with the range of social, digital, environmental and security questions, the new rules do include provisions on public investment and Member States will have to:

"ensure that the planned overall level of nationally financed public investment over the lifetime of the national medium-term fiscal-structural plan is no lower than the medium-term level before the period of that plan taking into account the scope and scale of the country-specific challenges."

Debt sustainability analysis

The first fiscal structural plans are due to be submitted by 20 September and a key element of the European Commission's assessment will be the debt sustainability analysis (DSA).

This will be crucial in determining how deep and rapid any fiscal consolidation might have to be implemented. The legislation at least commits the Commission to be transparent and consult over the DSA methodology which may avoid earlier criticism of the assessment as relying on unobservable economic data.

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Can you have “growth-friendly fiscal consolidation?”

EPSU’s main criticism of the rules as applied up to 2020 were that the focus was on fiscal consolidation with the European Commission persisting with the idea that “growth-friendly fiscal consolidation” was possible despite all the evidence to the contrary. That phrase remains in the amended legislation.

A key element in this debate was the notion of the fiscal multiplier with the Commission and other international financial institutions claiming that the multiplier was less than 1 and so a euro cut in public spending would lead to less than a euro cut in general economic activity.

Research suggests, however, that the multiplier overall is more than one and that, indeed, certain categories of public spending, particularly health expenditure, have multipliers much higher than one. So in a positive sense more health spending is a real boost to the economy and cuts in health expenditure would mean austerity.

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Further privatisation?

Under the new regulations, member states will maintain their current investment levels (Slide 9). This implies that there will be no increase in current investments, despite the recognition that existing levels are insufficient to address all public sector needs and facilitate the green transition. Consequently, there exists a gap between the required public investment and the constraints imposed by the new regulations.

The Commission and the Council propose that this gap be bridged by private capital. This entails providing direct state support to companies in key sectors, along with European support and guarantees to facilitate bank loans. However, this approach creates room for further privatization of public services. As a result of insufficient investments, public services are likely to deteriorate, paving the way for increased private investment in sectors such as healthcare and social care for example.

Consultation

The revised legislation is clear about the need for Member States to consult when drafting their fiscal structural plans and this process should include social partners, civil society, other stakeholders and national parliaments. It remains to be seen how this will work in practice and whether trade unions will really have the opportunity to influence the outcomes.