EU Fiscal Rules Reform: Social Platform's analysis of institutional positions

How do the positions of the EU Council and the European Parliament measure up and how do we think they need to change during trilogues? Read our analysis below.

The Council's position: added safeguards will significantly restrict fiscal space for investments

Rules for fiscal adjustment

The Council keeps the Commission's problematic approach to deficit reduction, forcing Member States to bring and maintain their deficit-to-GDP ratios below the 3% threshold over the course of the adjustment period of 4 or 7 years (in case of an extension). With 12 Member States reporting deficit ratios above 3% in 2022, this risks being a very steep adjustment for several Member States with high deficit ratios.

The Council maintains Commission's improved proposal for the debt trajectory, obliging Member States to put, by the end of the adjustment period, their debt ratio on a downward path or keeping at prudent levels below 60%. However, importantly, it adds a safeguard for "debt sustainability" that forces Member States with a debt-to-GDP ratio above 90% to decrease it by a minimum annual average amount of 1 percentage point of GDP, while those with a ratio between 60% and 90% need to do so by a minimum annual average amount of 0,5 percentage points of GDP.

The Council also adds a second problematic safeguard for "deficit resilience" that obliges Member States to continue fiscal adjustments until they reach a deficit level that provides a margin of 1,5% of GDP relative to the 3% deficit ratio set in the EU treaties. Even worse, it prescribes an annual improvement of 0,4% of GDP (0,25% of GDP in case of an extension of the adjustment period).

These new safeguards would mean a return to the one-size-fits-none approach to debt and deficit reduction that has not worked in the past. They are procyclical and risk being too steep for several Member States, which would have to implement significant budget cuts that could mean austerity for some and see their fiscal space for crucial reforms and investments severely restricted.

The Council text also maintains a shortsighted "no backloading clause" that forces a fiscal adjustment effort that is linear over the period of the fiscal structural plan that Member States need to submit and that is at least proportional to the total adjustment effort. Investments are needed now to finance just green and digital transitions and prevent the worst effects of climate change. This clause risks harming these efforts and increasing budgetary impacts of climate-change even more in the long run.

As highlighted by various stakeholders, these rules risk being too demanding for several countries and will significantly restrict fiscal space for important investments. Some already predict that they will likely prove to be unworkable. This already shows by a temporary concession, made in the Council text, which includes transitory period (2025-2027) during which the Commission can adjust the corrective path for the first medium-term national fiscal-structural plan ("national plan) downwards. However, this only postpones problems and the more stringent adjustment requirements will hit Member States after RRF funds run out. At this point, investment gaps to achieve a just green transition will be far from bridged, but fiscal space to fill investment needs will be severely restricted, especially if the EU does not agree to a central fiscal capacity or RRF successor fund for just transitions.

Provisions for quality reforms & investments as well as stakeholder consultation

As foreseen by the Commission proposal, Member States will need to put forward national plans that contain reforms & investments that support four common EU priorities: 1) achieving a fair green and digital transition, 2) ensuring energy security, 3) strengthening social and economic resilience and, where necessary, 4) the build-up of defence capabilities.

It is positive that social objectives are a part of these common priorities. However, the European Pillar of Social Rights (as well as other EU strategies to achieve these priorities, such as the European Green Deal) is only explicitly mentioned in a recital, not in the core of the text. It also neither refers to the EPSR headline targets nor the new social convergence framework.

The text includes several references that aim to strengthen reforms and investments: it states that the level of nationally financed public investment must be higher than in the medium term before the plan and must take into account the scope and scale of country-specific challenges. However, in practice, this risks not meaning much if safeguards or DSA force levels of debt and deficit reduction that prevent the necessary fiscal space for these investments.

It is positive that the text keeps the requirement for reforms and investments to be submitted in exchange for an extension of the adjustment path: they must be detailed, front-loaded, time bound and verifiable, implemented within the planning horizon of national plans, with significant progress made by end of the adjustment period. Member States must also include indicators to assess implementation. However, it is very regrettable that no concrete new reforms and investments are needed in addition to those already included in national recovery and resilience plans (NRRPs) to qualify for an extension, if Commission considers them ambitious enough.

With regards to stakeholder involvement, the Council position does not set any requirements for stakeholder consultations, neither in the European Semester process nor the development, implementation, monitoring and evaluation of national fiscal-structural plans. It only refers briefly to the importance of stakeholder involvement in the Semester in a recital and obliges Member States to add information on consultations of national parliament and other relevant stakeholders in their plans. This would allow Member States to undertake tick the box type consultation exercises without structured quality involvement of CSOs and social partners, similarly to the experience of national stakeholders during the development of NRRPs.

European Parliament's position - some improvements, but deficit reduction approach & safeguards risk limiting their impact

Overall, the European Parliament suggests several welcome improvements compared to the Council position, both regarding the fiscal adjustment requirements as well as reforms, investments & stakeholder involvement. However, it maintains some problematic rules for fiscal adjustment.

Rules for fiscal adjustment

Indeed, the report maintains Commission's approach to deficit reduction. It also includes Council's debt sustainability safeguard (even though under a longer time frame, a projection period that adds 10 years to the 4 or 7 years of the adjustment period).

MEPs also add a new safeguard, stating that a Member State is not compliant with its net expenditure path when the balance of its control account - which monitors deviations from the agreed net expenditure path – during the adjustment period is higher than 1% of GDP in the years of positive GDP growth. While logically, it should not apply in periods of negative GDP growth – a recession -, it adds another safeguard, not included by the Commission or by the Council, which is problematic.

Additionally, Parliament keeps the no-backloading clause on debt & deficit reduction that risks postponing urgently needed social & green investments.

It is positive that the Parliament report does not include Council's deficit resilience safeguard. It must be a key objective of rapporteurs in trilogue to make sure it does not enter the final text.

Provisions for quality reforms & investments as well as stakeholder consultation

MEPs make several additions to the Council report to aim to strengthen reforms & investments as well as stakeholder involvement.

When defining net expenditure, the Parliament includes costs related to the borrowing of funds for the loans under the Recovery & Resilience Facility (RRF) as well as national expenditure on co-financing of programmes funded by the Union capped at a limit of 0,25% of GDP. It is a small exemption, but nevertheless positive.

The Parliament also adds the possibility to exceed the limit of cumulated balance of the control account during the adjustment period for maximum 5 years for certain strategic investments addressing the common EU priorities. This is exemption could create a bit more fiscal space, but instead of exemptions to unfit rules, rules fit for purpose should be created in the first place.

It requires that reform and investment commitments in exchange for an extension must be growth and resilience-enhancing, which is welcome (Council only demands that they are growth enhancing). Common EU priorities are defined in the text and, contrary to Council, refer to the concrete EU instruments that serve to achieve them, such as the European Pillar of Social Rights. In addition, the rules are linked to the Social Convergence Framework through the European Semester process.

MEPs also add an obligation for Member States to assess national investment gaps re achieving common EU priorities in their national plans. This is very welcome, as it helps make evidence-based policies and would hopefully inform and guide the Commission in its assessment of national plans.

With regards to stakeholder consultation, the Parliament report obliges Member States to establish a structured cooperation mechanism to receive contributions in the development stage of the national plan from civil society, social partners, regional authorities and other relevant stakeholders. The recommendations and suggestions submitted in the framework of the structured cooperation mechanism must be included as an annex to the national plans. Member States must also discuss annual progress reports on the implementation of their national plan with social partners, civil society organisations and national parliaments, which is positive.

The Parliament states clearly that if a plan is revised by a new government, the levels of ambition of the reform and of investments cannot not be lower than the levels of the original plan. It also includes a medium-term fiscal-structural plans scoreboard to monitor progress of the implementation of the national plans, especially with regards to reforms & investments