EUROPEAN CENTRAL BANK

EUROSYSTEM

Banca d'Italia workshop on EU Fiscal Governance

Panel "A little less conversation / a little more action, please"

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The views expressed do not necessarily reflect those of the ECB.

Question 1: How important would be a reform of the EU fiscal framework for the future of Europe?

…Important *if* :

1. **It addresses 3 core priorities - see Eurosystem (2021):**
   - ***Sustainability***
   - ***Stabilisation***
   - ***Investment***

2. **It is flexible *and* credible enough to adjust to ever changing shocks. → Two phases:**
   - ***Phase 1: Reform of the Fiscal Framework***
   - ***Phase 2: Development of a Central Fiscal Capacity***

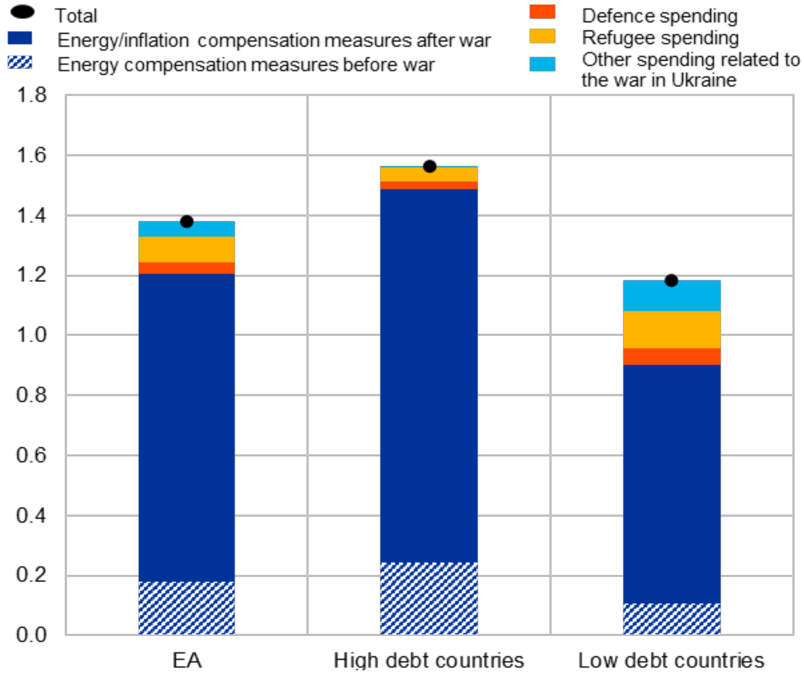
Why SGP reform soon?

War-related fiscal support in the euro area with budgetary impact in 2022

(measures taken until end-August 2022; percent of GDP)

REASON 1

The war-related crisis raises a risk of uncoordinated fiscal response which, in some cases, might pose some risks to the sustainability of public finances



Source: ECB staff calculations.

Notes: Euro area high debt countries are those with debt-to-GDP ratio above 90% in 2019: BE, GR, ES, FR, IT, CY, PT. Cut-off date: end-August 2022. Further stimuli have been approved since then (notably in DE).

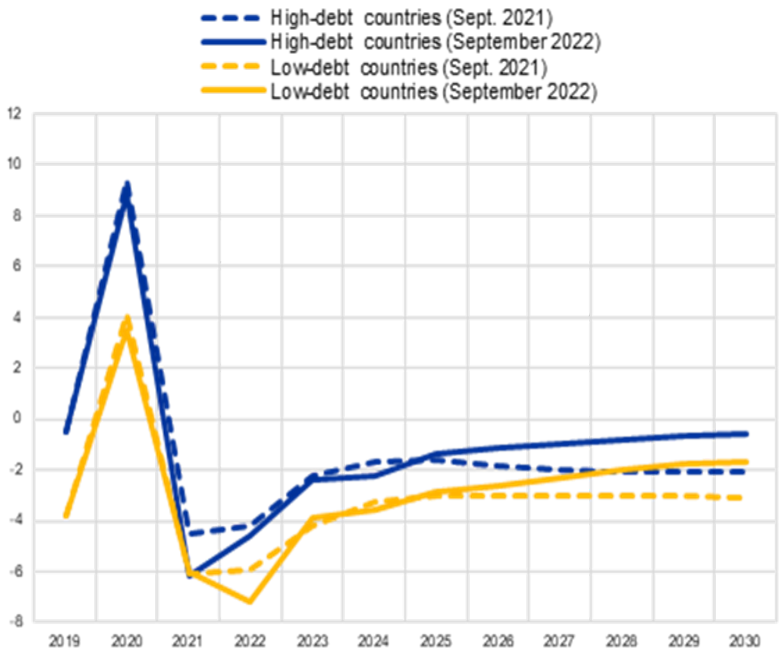
Why SGP reform soon?

REASON 2

Moving towards less favourable interest-growth differentials

Revisions in (i-g) in the euro area (Sept. 2021 vs Sept. 2022 ECB projections)

(percentage points)



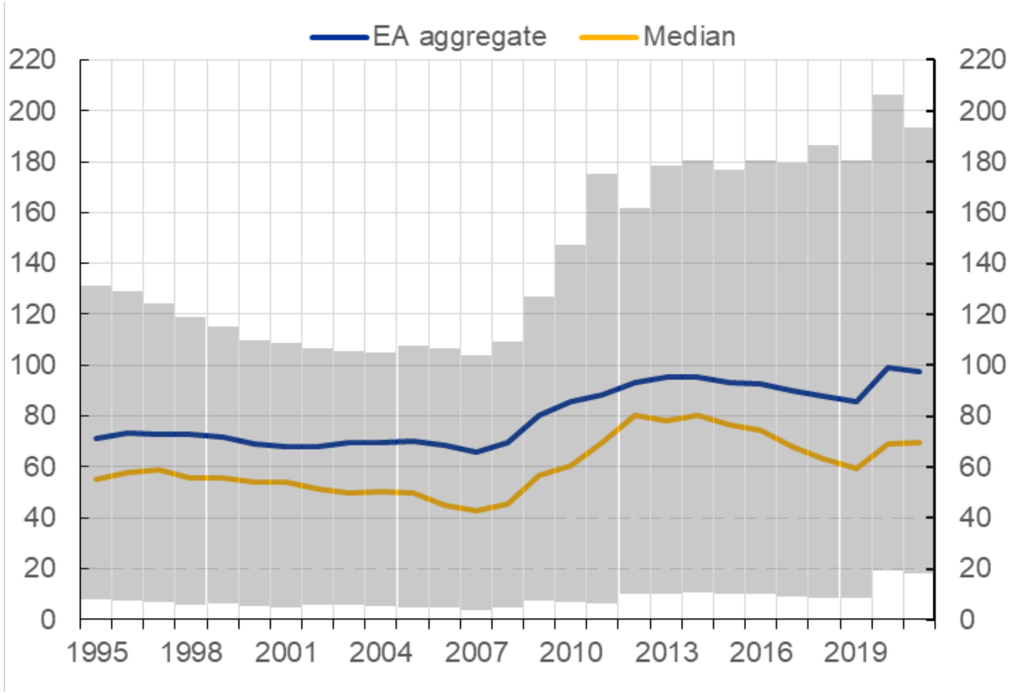
Source: ECB staff calculations based on the ESCB DSA tool (benchmark scenario).
Notes: Interest-growth differentials on government debt. Cut-off date: 23 August 2022. Since then, yields have further increased.

Why SGP reform soon?

REASON 3

Critical environment is compounded by growing cross-country debt heterogeneity

Dispersion in debt-to-GDP ratios in the euro area (1995 - 2022)



Source: ECB staff calculations.
Notes: The grey bars represent the min-max ranges of debt-to-GDP ratios in euro area countries.

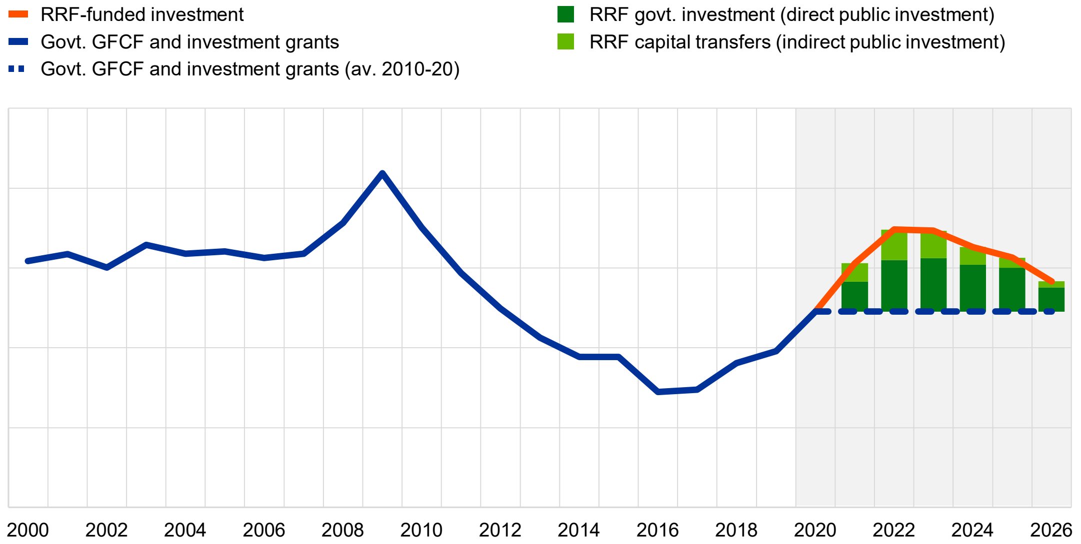
Why SGP reform soon?

REASON 4

Strong case for more productive investment, while NGEU is temporary and will only allow - if well implemented - to return to the euro area public investment levels prevailing before the Great Financial Crisis

Contribution of the Recovery and Resilience Facility to public investment in the euro area

(percentage of GDP)



Sources: Bańkowski, Bouabdallh, Dominguez, Dorrucci, Freier, Jacquinot, Modery, Rodriguez, Valenta and Zorell (2022).
Notes: "RRF-funded investment" includes both government investment (direct public investment, dark green bars) and capital transfers to the private sector (indirect public investment, light green bars). GFCF stands for gross fixed capital formation in national accounts. The public investment-to-GDP ratio (blue line) includes government GFCF and investment grants.

Question 2 – What can help building the reform momentum?

"Risk reduction camp" ⟷	"Risk sharing camp"
➢ Responsibility	➢ Solidarity
➢ Multilateralism ➢ Equal treatment ➢ Rules enforced by the centre	➢ Bilateral contracts COM-country ➢ Country ownership ➢ Country-specific tailoring
➢ Quality/re-composition of public finance at the national level	➢ Promotion of European Public Goods
…	…

… SGP reform will go through once each camp will have sufficiently **internalised** the key arguments and "red flags" from the other camp

Finding the right risk reduction/sharing trade-off is key

Example: Defining a framework for medium-term public debt adjustment based on a net expenditure path

"Risk reduction camp" ⟷	**"Risk sharing camp"**
➢ Enforcement → *Examples:* - *deficit-based EDP unchanged* - *new debt-based EDP ensuring compliance with net expenditure path* ➢ Common boundaries → *Examples:* - *Grouping Member States in country clusters with different ambition of fiscal consolidation linked to fiscal risks identified ex-ante* - *Common minimum pace of debt adjustment*	➢ Country ownership → *Examples:* - *Fiscal/structural plans proposed and owned by the Member States* - *Country-specific fiscal trajectories ensuring that debt levels converge to prudent levels within the horizon of the plan* ➢ Flexibility → *Examples:* - *Requesting longer adjustment periods against reforms and investments* - *Country-specific DSA*