Completing a genuine economic and monetary union by Iain Begg

A discussion

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* The views expressed are those of the author and do not necessarily reflect those of the ECB.

This report and my discussion

This report: Genuine EMU - are we there yet?

- Review of the reforms since the crises of the early 2010s.
- Survey of 111 leading experts.
- Conclusions: much has been achieved, but flaws and challenges remain. Road ahead: importance of fiscal reform; legitimacy and leadership.

My discussion: some reflections on fiscal reform needs

- EU fiscal rules are back in the spotlight: need to return to fiscal rules, but old rules no longer adequate. Commission has tabled a proposal.
- Central fiscal capacity: should be in the spotlight.

The current fiscal framework

What worked?

- Evidence fiscal rules have worked to some extent (3% rule)
- Draft budgetary plans a useful process
- Independent fiscal institutions helpful

What didn't work?

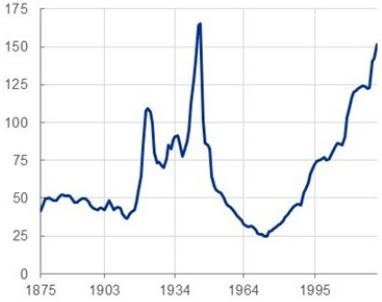
- Has not evolved with the changing economic reality
- Insufficient countercyclical; insufficient focus on euro area aggregate stance
- Wrong composition of public finance (eg investment)
- Sanctions do not work (discliplining effect?)
- Insufficient ownership
- Too complex

Changing economic reality

Interest-growth differential across advanced economies (percent; 5-year moving average)

Sources: Global Financial data and Haver Analytics
Notes: The countries included in the sample shown here are Australia, Austria, Germany, Denmark, Finland, France, Spain, Canada, UK, Ireland, Italy, Japan, the Netherlands, Norway, New Zealand, Portugal, Sweden and the US. Projections for 2021-2022 from AMECO. Last observation: 2022 (annual data)

G7 debt ratio



Sources: Global Financial data and Haver Analytics
Note: Series are unweighted average of G7 countries. Last observation: 2022

Changing economic reality: low r-g; high debt; large investment needs

- r*<g likely here to stay even with policy rates moving away from the ZLB
- This makes high debt levels less concerning and in this environment 1/20th rule combined with 60% debt "target" does not make sense.
- In addition: climate transition and strive for open strategic autonomy may require more public investment (public goods)
- But need for some discipline: debt divergence; very high debt levels increase risk of sudden changes in r-g; during the pandemic, perception came about that the government smoothens out any shock.

Implications for the EU fiscal framework

Question #1: Do we need new rules? My view: YES!

- Old rules no longer adequate. This has been further reinforced by recent developments.

Question #2: Is the COM proposal the right way forward

- Yes and no... Yes: conceptually the new rules make a lot of sense. but... implementation difficult.

Council Conclusions: CONCURS that further clarifications and discussions are needed, including when it comes to the:

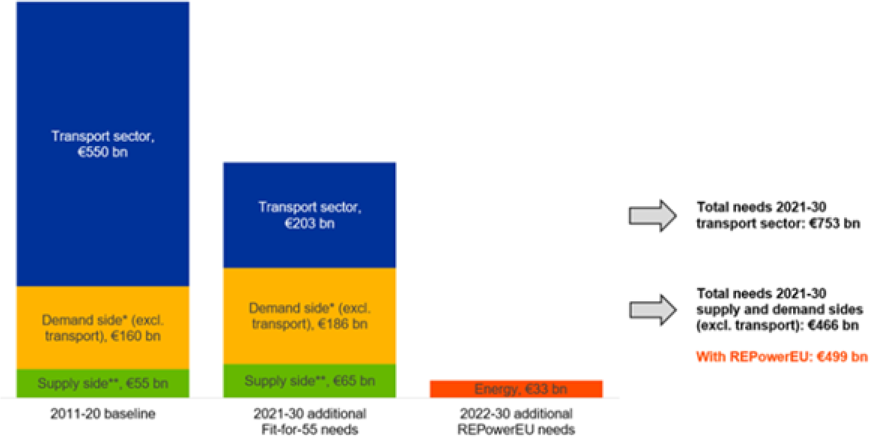
- Definition of the Commission trajectory
- Appropriateness and design of common quantitative benchmarks to support the reformed framework
- Principles for an extension of the fiscal path
- Enforcement national plans; incentives for reforms & investment

The "no" part: is the leap forward going far enough?

The case for a central fiscal capacity

- Are the new rules really able to deal with the large upcoming investment needs?
- Climate transition and war are prime cases for a central fiscal capacity: **a climate and energy security fund**
  - Design of the climate and energy security fund: article 122 (NGEU)... may limit the fund's design; in case of climate also article 192 (environmental policy): "actions to be taken to achieve the Union's environmental objective (see Abraham et al. (2023)).
  - In such a set-up for non public goods, the fiscal rules apply (no golden rules, no exceptions)
- **Central fiscal capacity the basis for other key elements of a genuine EMU**: safe assets (hence CMU), EDIS, avoid divergence.

Climate and energy security



Data shows average annual needs over 2021-2030, public and private, EUR billions in 2022 prices. Sources: ECB staff calculations based on Commission estimates of Fit-for-55 and RePowerEU investment needs. see: https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp221111 9dfd501542.en.html.