in short
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Better not to reform than to reform wrongly?

Evaluating the draft legislation on the reform of the Stability and Growth Pact

Tim Peter

The Stability and Growth Pact (SGP) is at the heart of European debt rules. The European Commission has currently presented a draft legislation for a reform of these rules. Indeed, a reform *would be necessary*: (1) *necessary* because enforcement of the SGP rules is poor and the current reduction paths are unrealistic. In particular, some member states have significantly exceeded the Maastricht debt ceiling of 60 per cent of gross domestic product (GDP). For example, according to Eurostat data of 2022, Greece reached a debt-to-GDP ratio of about 171 per cent, Italy of about 144 per cent, Spain of about 113 per cent and France of about 112 per cent – debt levels that would be difficult to reduce within 20 years, as required by the rules. (2) *Would be* because a reform should offer a better and more effectively enforceable set of rules than the existing EU debt rules. Why the current bill is not an improvement on the previous rules will be outlined below.

Too much room for negotiation

The draft reform envisages that the Maastricht criteria on the debt-to-GDP ratio of a maximum of 60 per cent and the government budget deficit of a maximum of 3 per cent of GDP are to be maintained. Moreover, countries are to reduce their spending by 0.5 per cent of GDP if they have surpassed the 3 per cent criterion, and primary net expenditure growth is to be below their medium-term output. However, these criteria are likely to have little impact on the debt practices of member states because at the heart of the draft legislation are individual reduction paths that leave too much room for interpretation to ensure a rule-based reduction in debt ratios.

Too many exceptions

In particular, the period of the envisaged four-year reduction path can be extended to seven years if reforms are implemented and certain investments are made. This approach is problematic because the exceptions for investments with areas such as digitalisation, climate protection, defence and demographic challenges, among others, contain too many reasons to deviate from the four-year path. However, a seven-year reduction path would extend beyond a government's legislative term and thus reduce its binding nature.

Furthermore, a debt sustainability analysis is to underlie the debt reduction paths, taking into account other factors such as the interest rate level, inflation and potential economic growth. On the other hand, these framework factors may lead to even greater discretionary decision-making scope for the Commission and the member states as opposed to uniform rules.

Reform of the one-twentieth rule

The EU Commission's current draft legislation only marks the beginning of a debate – not the long-awaited end. Meanwhile, time is pressing, as the SGP's general escape clause, which has been activated since 2020 and originally suspended the application of debt rules due to the Covid-19 pandemic, is set to expire at the end of the year. This would reinstate the so-called one-twentieth rule, which requires the debt ratio to be brought back to the Maastricht criterion of 60 per cent of GDP in one-twentieth increments of the difference between the Maastricht criterion and the actual

debt ratio. A country would thus have to reach the 60 per cent mark within 20 years. Applying the one-twentieth rule would entail very harsh austerity measures for countries such as Greece or Italy, which would likely trigger a recession. Therefore, the one-twentieth rule would have to be replaced – but in contrast to the draft legislation with uniform and binding rules.

Effective enforcement

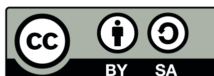
Finally, it must be emphasised that the current debt rules have so far failed not because of themselves, but because of their deficient enforcement. An individual, qualitative assessment of the fiscal policy of the member states by the Commission according to the proposed design is therefore a step in precisely this direction: if the Commission has so far only insufficiently ensured the enforcement of the EU debt rules, why should it now succeed with even more room for interpretation instead of uniform rules? Rather, what is needed is more automation in the application of EU debt rules and an independent, non-political supervision body. One possibility would be to upgrade the independent European Fiscal Board.

Against this background, the current draft legislation must be understood merely as a reform proposal. On the one hand, there is a need to reform the one-twentieth rule. On the other hand, this need cannot justify an extensive softening of the EU debt rules as envisaged in the bill.

Konrad-Adenauer-Stiftung e. V.

Tim Peter
Competitiveness of Europe
Analysis and Consulting

tim.peter@kas.de



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