German technical non-paper following up on selected issues identified by the ECOFIN conclusions

I. Implementing a common methodology, common quantitative benchmarks and common safeguards into the fiscal framework

With its Conclusions of 14 March 2023, the ECOFIN Council has shown its commitment and ownership for a reform of the EU economic governance framework and provided important orientations for the further work, outlining both areas of convergence as well as issues where further clarifications and discussions are needed.

This non-paper follows up on specific elements identified by the ECOFIN Council for further discussion. In particular, it outlines proposals for common quantitative benchmarks and safeguards which are essential for a reformed fiscal framework to provide for a multilateral approach and equal treatment of member states as well as to ensure that it can meet the objective of a realistic, timely and sufficient step-by-step reduction of debt- and deficit ratios as well as safeguarding growth and fostering investment in particular in the green transition.

Specifically, regarding the issues of a common methodology, common quantitative benchmarks and common safeguards in the fiscal framework, the ECOFIN Council has referred to:

- **"The Commission trajectory should be based on a common methodology to be agreed that is replicable, predictable and transparent, and should include an analysis of public debt and economic challenges"** (para 5c)
- **"[…] appropriateness and design of common quantitative benchmarks to support the reformed framework" (para 7)**
- **"[...] common safeguard provisions to ensure sufficient debt reduction and prevent back-loading of fiscal efforts should be explored**." (para 5c)

To transpose these parts of the Council Conclusions into the fiscal framework, a simple and transparent expenditure rule as well as a specific safeguard of a sufficient debt ratio reduction and a review clause should be included. Debt Sustainability Analyses alone are not an appropriate instrument especially due to their strong sensitivity to changes in the underlying assumptions and their complexity.

This non-paper outlines possible approaches to specify these elements. Evidently, their specific role and mutual relationship will eventually also be influenced by other aspects of the overall setup of the fiscal framework which are not addressed here.

1. Proposal for an expenditure rule as a "common quantitative benchmark"

"appropriateness and design of common quantitative benchmarks to support the reformed framework" and *"The Commission trajectory should be based on a common methodology to be agreed that is replicable, predictable and transparent, and should include an analysis of public debt and economic challenges":*

These parts of the Conclusions should be implemented by a simple and transparent expenditure rule with quantitative targets as a minimum requirement to ensure sufficiently declining deficits or to maintain deficits at prudent levels. To reduce deficits, the basic requirement is that spending has to increase more slowly than potential growth. The difference between potential growth and net primary expenditure growth is defined as the convergence margin. The margin could be operationalized as an increasing and possibly continuous function of the debt-to-GDP ratio, i.e. the higher the debt ratio (above 60%), the larger the convergence margin. Alternatively, the convergence margin could also be defined and differentiated in relation to the public debt challenge (low/medium/high), i.e. the higher the challenge, the larger the convergence margin. For MS with high debt ratios/high debt challenges, the minimum convergence margin could be 1 percentage point.

In addition, a limit must be set until which the convergence margin is applicable. One suitable option would be the structural balance within the range of -0.5 % or max. -1 % of GDP (-1%: actual minimum requirement of the preventive arm for Euro-MS). The debt sustainability analysis as main instrument to define deficit ceilings or expenditure paths is not the appropriate tool. Since expenditure rules alone cannot always guarantee sufficient debt reduction, common safeguards are needed in addition to common quantitative benchmarks.

2. Proposal for a "common safeguard"

"common safeguard provisions to ensure sufficient debt reduction and prevent back-loading of fiscal efforts should be explored".

The current ideas of the Commission should be amended in a way that the medium-term fiscal plans lead to a (sufficient) decline in high debt ratios in each year from the start of the reformed fiscal framework on. Therefore, in addition to the expenditure rule described above, it should also be ensured that an actual reduction in debt ratios on an annual basis is achieved. For this purpose, a safeguard provision should be introduced. Irrespective of the outcome of the negotiations on the fiscal plans, this provision should fix a binding lower limit for a necessary decline in the debt ratio of an appreciable magnitude in each year. As a floor, it could for example be foreseen that the debt-to-GDP ratio must decline by at least 1 percentage point per year for MS with high debt challenge /debt ratios and by at least 0.5 percentage points per year for MS with medium debt challenge /debt ratios above 60%.

As a supplement to this annual requirement, an ex-post safeguard should ensure the effectiveness of the reformed framework. To this end, there should be a specific revision clause which is anchored in the actual reduction in debt ratios. If the reformed framework

does not achieve a reduction in the debt ratios, it must be revised after a maximum period of four years.

II. Strengthening incentives for future-oriented investment in a reformed fiscal framework

As also described in the Council Conclusions, the EU economy faces multiple short- and long-term economic and social challenges, many of which require ambitious reforms and substantial investments. This is particularly true for the green and digital transition. In order to meet the challenges of the future, the quality of finances has to be improved. To that end, a limited investment clause that takes into account additional EU programmes compared to the current investment clause which have a substantial positive impact on potential growth and debt sustainability should be considered. In any case the debt reduction safeguard has to be respected.

III. Further requirements for a reformed fiscal framework

To underline long-standing positions that are also reflected in the Council Conclusions and that has to be included in the legislative proposals: It is necessary to maintain the multilateral character of our fiscal rules, to strengthen compliance and enforcement of the rules by restricting discretionary leeway and limiting exceptions and to maintain an unchanged deficit procedure in case of a breach of the deficit criterium. This entails in accordance with the existing rules that for MS with a debt-to-GDP ratio above 60%, relevant factors shall only be taken into account, if the deficit remains close to the reference value and the excess over the reference value is only temporary. Also, compliance with the reference path cannot be a relevant factor when this double condition is not met. The duration of the adjustment period should be limited to a regular electoral cycle to allow the democratic process in Member States to shape their economic policies.