

Reforming EU economic governance

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Key elements of the COM proposal

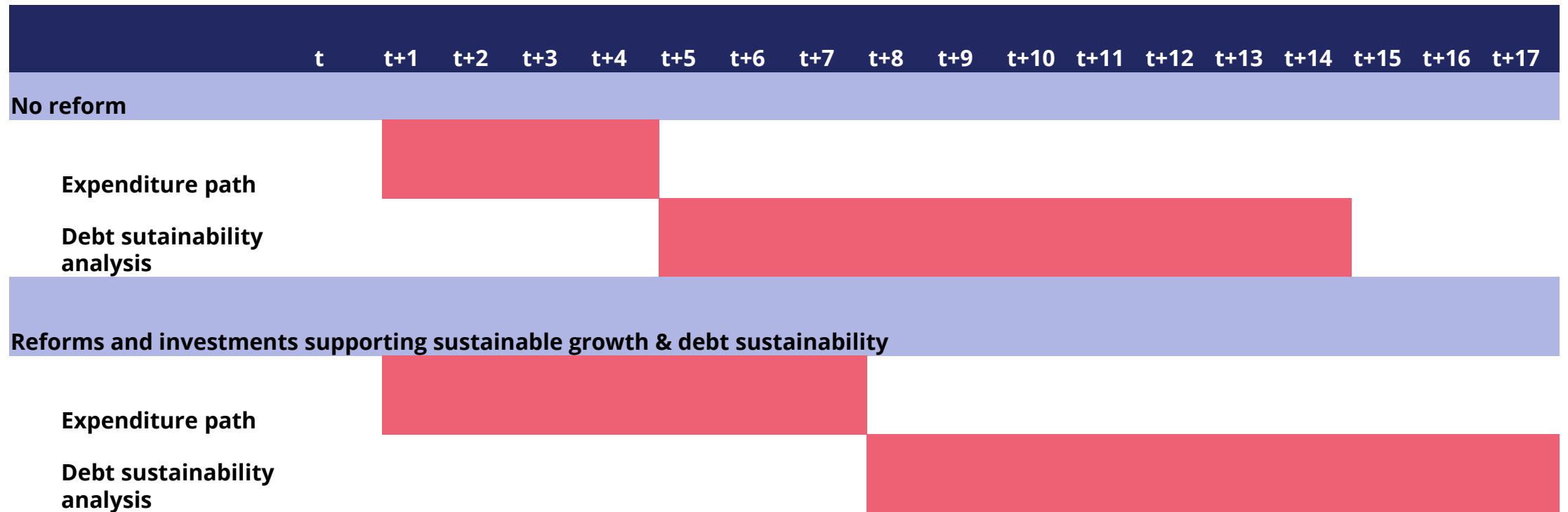
Goal: Limited debt stock

Analytical means: Debt sustainability analysis

Operational indicator: Net expenditure path over four years

Net expenditure = net of discretionary revenue measures & excluding interest expenditure and cyclical unemployment expenditure;

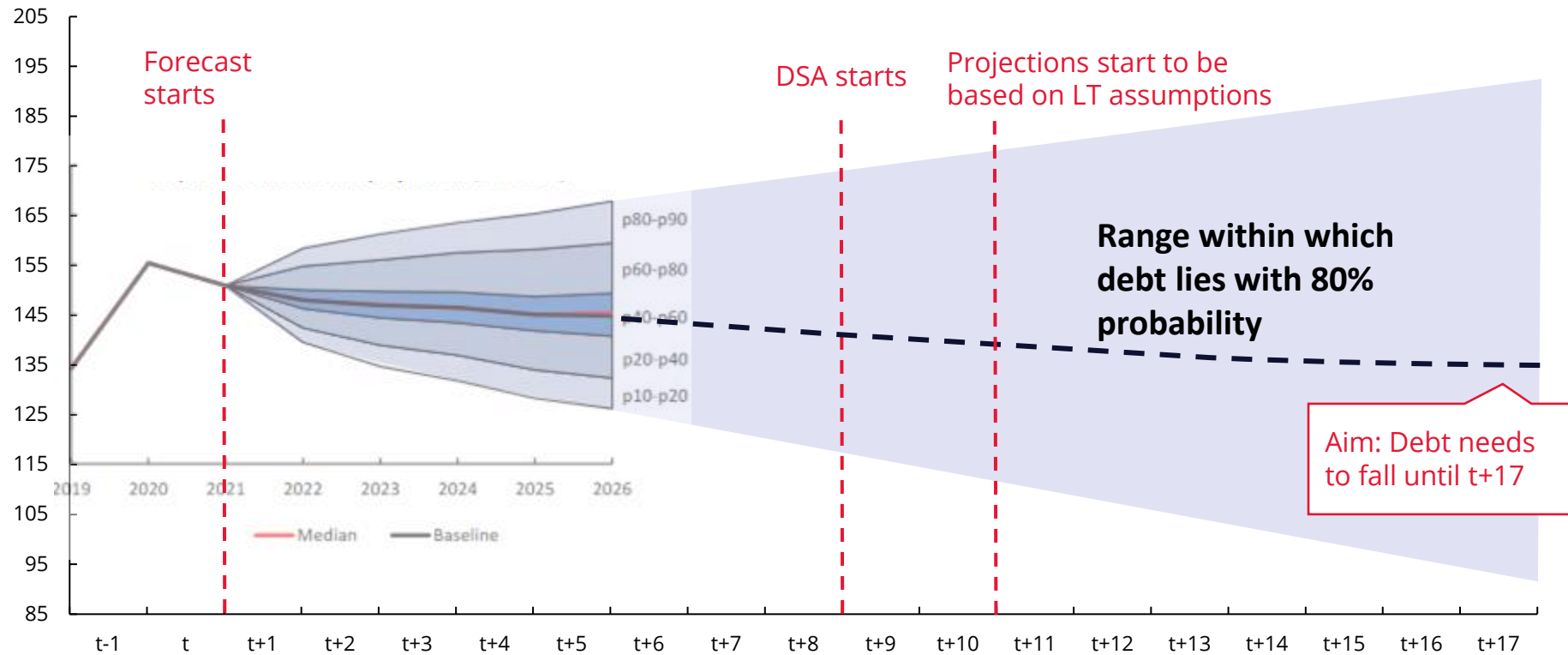
Process for countries with a substantial debt challenge



How much do we know about the future?

Stochastic DSA Italy

Vintage 2021, updated 2022



One-sided perception of risks?

Requirements to pass the DSA test

- Plausibly and continuously falling debt
- Debt to fall in all shock scenarios
 1. Structural primary balance -0.5pp
 2. Interest growth rate differential increases by 1pp
 3. Interest rate increase by at least 1pp., calibrated based on fundamentals (Schuster, forthcoming: ECB collateral framework matters)
- Debt to fall with 70% probability

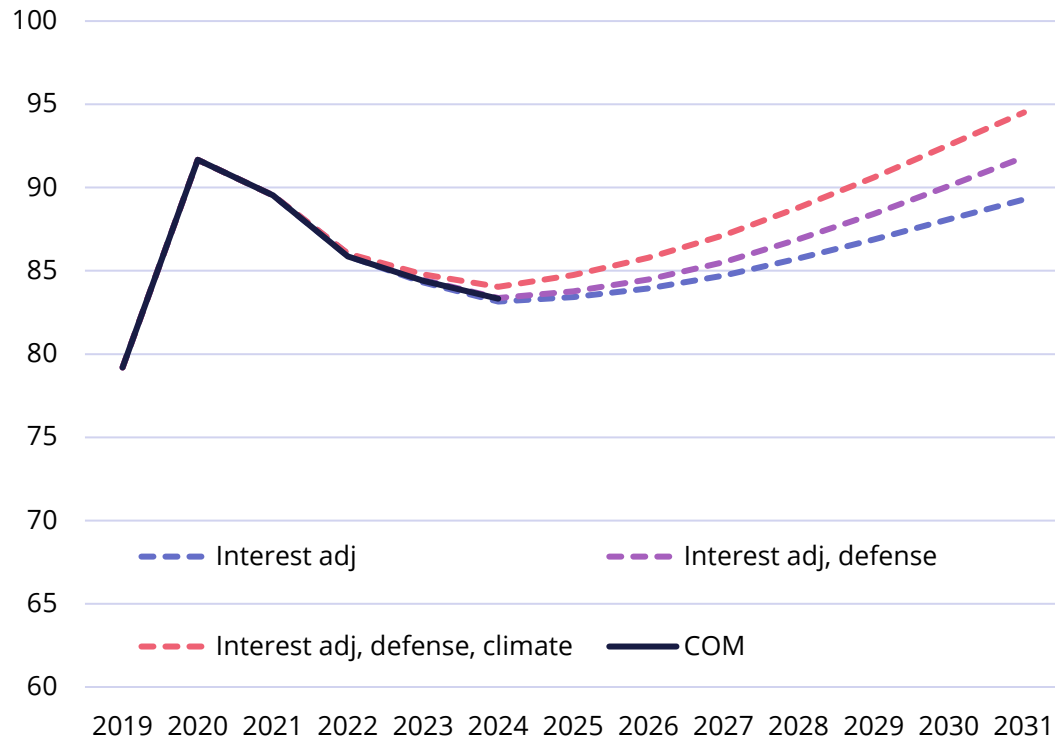


There is no safety in high surpluses, only a walk on a tight rope balancing growth and fiscal consolidation

Incompatibility of goals?

EU debt

% of GDP



- Multiple cost pressures
 - Higher financing costs
 - Higher defense spending reaching 2% p.a. in 2031
 - Spending needs for decarbonisation at 1% of GDP p.a.
- Competition from the USA with the Inflation Reduction Act

What follows from this?

Three suggestions

- Countries that meet a common fiscal parameter are not required to undergo full process
 - **Primary balance** calibrated based on current growth/interest environment
 - Growth and fiscal risks weighted equally
 - Focus on gross errors
- If you keep unobservables reform them
 - Instead of defining potential output/growth in a backward looking way, estimate them based on reforms and investment
- Retain sovereignty of national legislatures
 - Approve fiscal paths and DSA assumptions every year with the budget & before sent to the EU-COM (where applicable)
 - Publish underlying calculations to make assumptions and process transparent

Open questions

- How to meet all spending needs
- Interaction with the ECB

Kontakt

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What are the assumptions?

Example debt sustainability analysis

Netherlands

1. General Government Debt and financing needs projections under baseline and alternative scenarios and stress tests

NL - Debt projections baseline scenario	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Gross debt ratio	48,5	54,3	57,5	56,8	56,1	56,0	56,0	56,2	56,8	57,6	58,6	59,8	61,3	62,8
Changes in the ratio (-1+2+3) of which	-3,9	5,8	3,2	-0,7	-0,8	-0,1	-0,1	0,2	0,6	0,8	1,0	1,2	1,4	1,5
(1) Primary balance (1.1+1.2+1.3)	2,5	-3,5	-4,8	-1,7	-0,7	-0,9	-1,1	-1,4	-1,7	-1,9	-2,1	-2,3	-2,6	-2,8
(1.1) Structural primary balance (1.1.1-1.1.2+1.1.3)	1,5	-1,2	-3,9	-2,0	-1,2	-1,3	-1,4	-1,5	-1,7	-1,9	-2,1	-2,3	-2,6	-2,8
(1.1.1) Structural primary balance (bef. CoA)	1,5	-1,2	-3,9	-2,0	-1,2	-1,2	-1,2	-1,2	-1,2	-1,2	-1,2	-1,2	-1,2	-1,2
(1.1.2) Cost of ageing						0,1	0,2	0,4	0,7	0,9	1,0	1,1	1,1	1,1
(1.1.3) Others (taxes and property incomes)						0,0	0,0	0,0	0,1	0,1	0,1	0,1	0,1	0,1
(1.2) Cyclical component	0,8	-2,3	-0,8	0,4	0,5	0,3	0,3	0,2	0,0	0,0	0,0	0,0	0,0	0,0
(1.3) One-off and other temporary measures	0,2	0,0	-0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
(2) Snowball effect (2.1+2.2+2.3+2.4)	-1,8	1,5	-2,9	-2,4	-1,4	-1,0	-1,1	-1,1	-1,1	-1,1	-1,1	-1,1	-1,1	-1,1
(2.1) Interest expenditure	0,8	0,7	0,5	0,4	0,3	0,3	0,3	0,2	0,2	0,2	0,2	0,2	0,2	0,3
(2.2) Growth effect	-1,0	1,9	-2,0	-1,8	-0,9	-0,4	-0,5	-0,4	-0,4	-0,3	-0,2	-0,2	-0,2	-0,3
(2.3) Inflation effect	-1,5	-1,1	-1,3	-1,0	-0,9	-0,9	-0,9	-0,9	-1,0	-1,0	-1,1	-1,1	-1,1	-1,2
(2.4) Exchange rate effect linked to the interest rate	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
(3) Stock-flow adjustments	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3
(3.1) Base	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3
(3.2) Adjustment due to the exchange rate effect	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Pro memoria														
Structural balance	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7
Gross financing needs	8,1	14,5	10,2	12,1	11,1	11,4	11,6	11,9	12,4	12,8	13,3	13,8	14,4	14,9

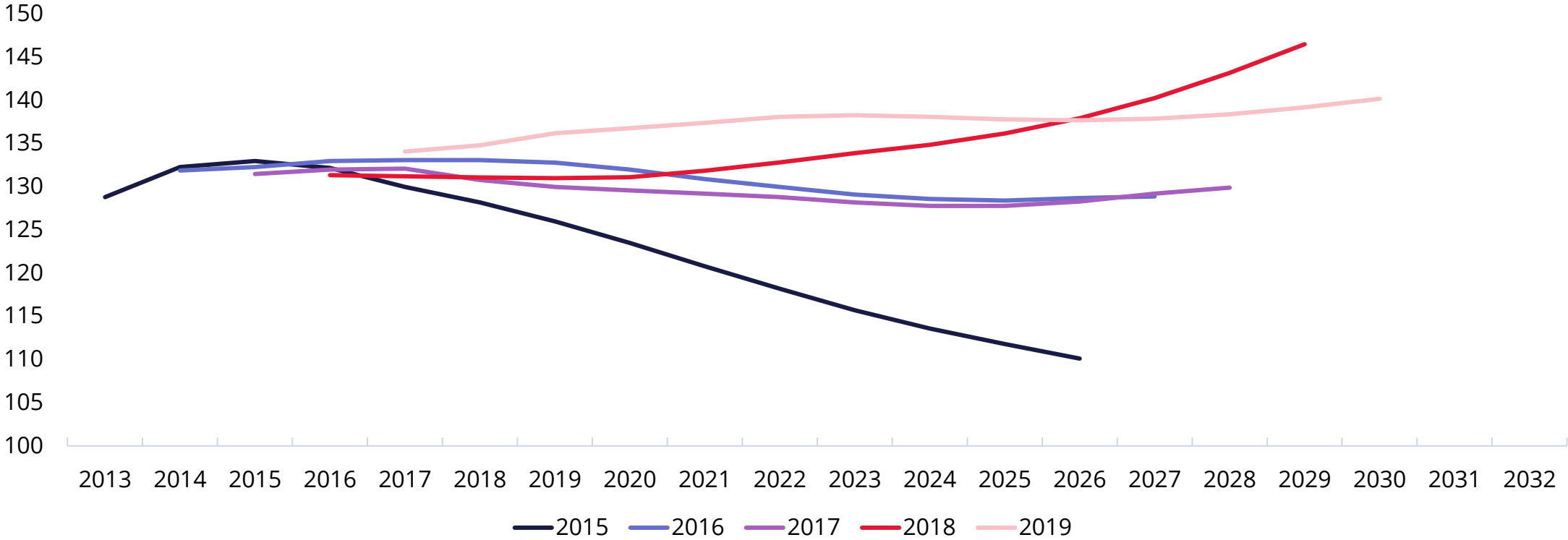
Key assumption I:
Interest rate =
ECB rate + risk premium

Key assumption II:
growth, converging to
potential growth

Variability of projections?

Debt to GDP projections Italy

DSA vintages

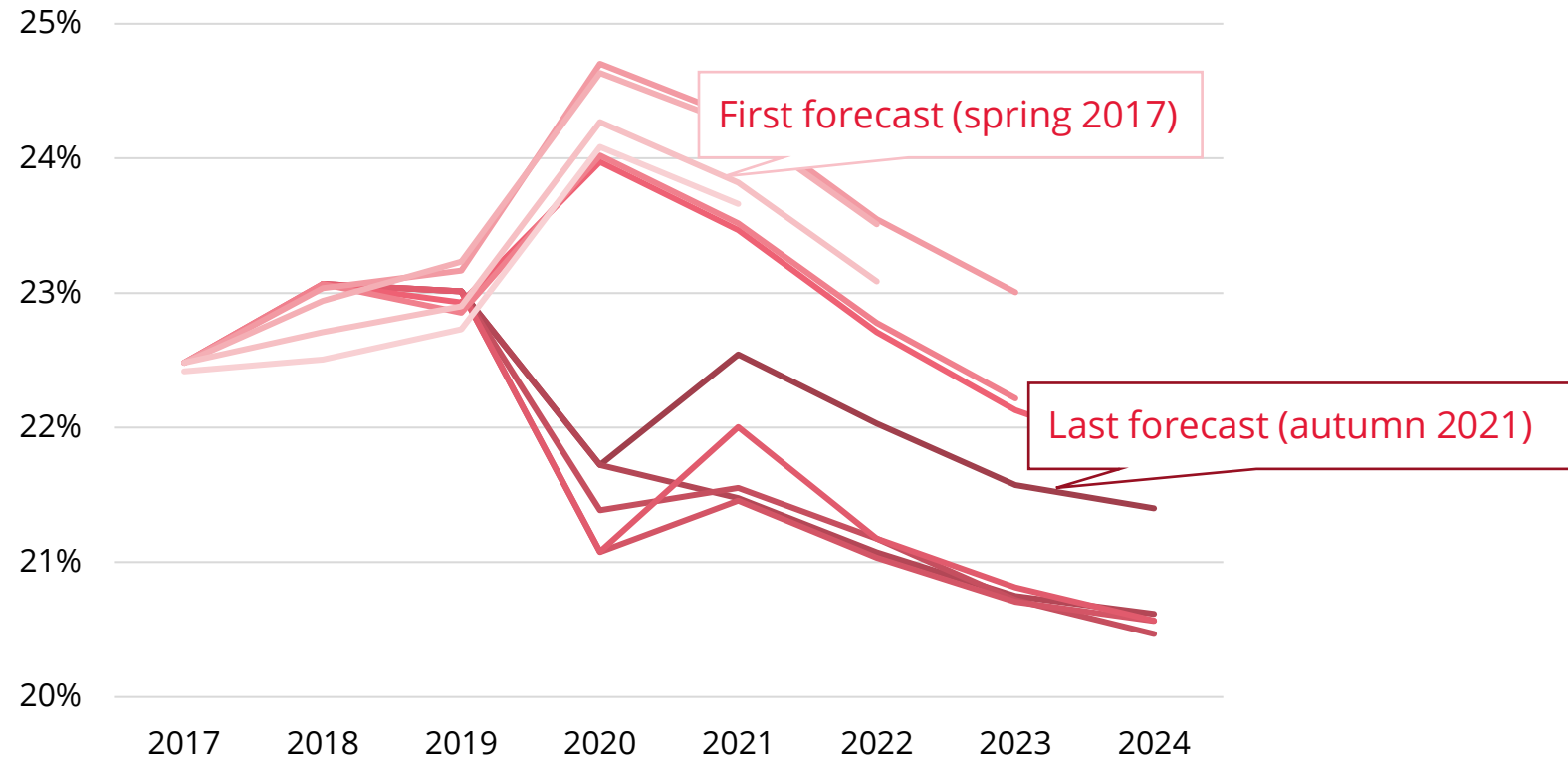


Sources: EU-Commission

How to project (non-discretionary) tax revenue?

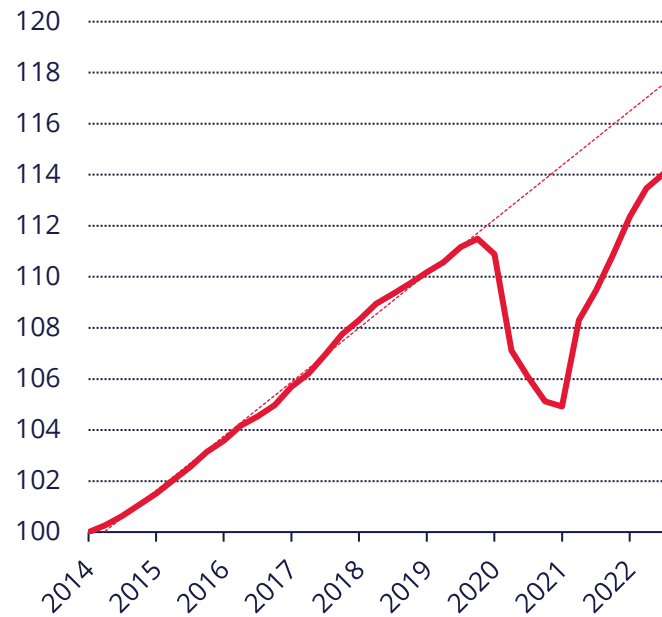
Germany tax revenue projections

In % of GDP, vintages from 2017 to 2021

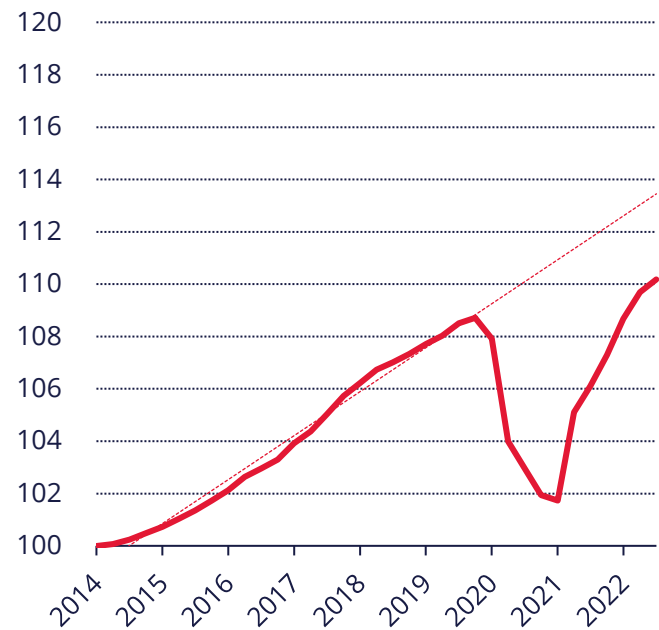


Where does the recovery stand?

European Union
Real GDP per capita



Euro Area
Real GDP per capita



United States
Real GDP per capita

