European Commission

A Golden Investment Rule for Europe: some sceptical comments

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Monday, 2 March 2015

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A QUICK REFRESHER ON THE GOLDEN RULE

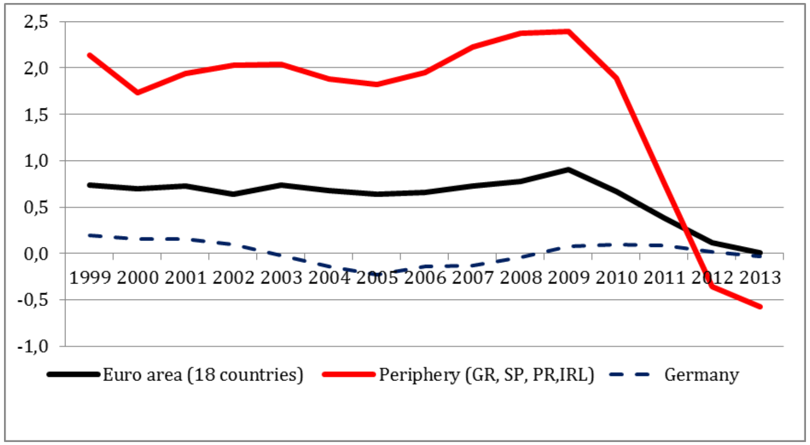
The Golden Rule, or the ***ethic of reciprocity*** is a maxim, ethical code or morality stating that one should treat others as one would like others to treat oneself.

The Golden Rule of ***capital accumulation***: How much to save (=invest) in Solovia so that consumption per capita is maximised on a sustainable basis.
"do unto future generations as we hope previous generations did unto us."

The Golden Rule, as it pertains to ***government spending***, stipulates that a government will borrow to invest, not to finance existing spending. In other words, the government should borrow money only to fund investments that will benefit future generations, and current spending must be covered by existing taxes.

Introducing a "quasi"-golden rule in the SGP?
Exclude (net) public investment from the debt and deficit figures

Net fixed capital formation, general government sector
in % of GDP



IMPLICIT ASSUMPTIONS:

- **LESS SHORT-RUN "AUSTERITY"**
- **MORE "GOOD" PUBLIC INVESTMENT**

BOTH ASSUMPTIONS ARE QUESTIONABLE:

- **FISCAL CONSOLIDATION NEEDS (AND PACE) IN THE PERIPHERY WERE NOT DRIVEN BY THE SGP-RULES**
- **EMPHASIS ON GROWTH-FRIENDLY CONSOLIDATION**
- **"GOOD" AND "BAD" PUBLIC INVESTMENTS (CLASSIFICATION: "NONSENSE VS. MORAL HAZARD")**
- **EXISTING FLEXIBILITY WITHIN THE SGP-RULES**

MAKING THE BEST USE OF THE FLEXIBILITY WITHIN THE EXISTING RULES OF THE STABILITY AND GROWTH PACT

The Communication provides **additional guidance**, *without changing or replacing the existing rules of the Pact.*

The guidance focuses **on three specific dimensions**:

- **investments**, in particular in relation to the setting up of the new European Fund for Strategic Investments (EFSI)

- **structural reforms**

- **cyclical conditions**.

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THE INVESTMENT CLAUSE

1. *Trigger*: national expenditures on **projects co-funded** by the EU under the **Structural and Cohesion** policy, **Trans-European Networks, Connecting Europe Facility** or projects co-funded by the **EFSI**

2. *Conditions*:

   - At MS level: GDP growth is negative or (negative) output gap is greater than minus 1.5% of GDP

   - deviation does not lead to breach of 3% deficit and "safety margin" is preserved

   - total public investment is not decreasing

   - budgetary position to return to MTO within 4 years

3. *Consequence*: temporary deviation allowed from MTO or adjustment path towards it. Amount of deviation linked to incremental investment costs.

TREATMENT OF CONTRIBUTIONS TO THE EFSI

Member States can financially contribute:

- directly at the level of the EFSI
  - Cash contributions to the Fund should not have an impact on the deficit, but will have an impact on debt if financed through govt. borrowing → will be dealt through the consideration of **relevant factors within the EDP** framework (as it has been the case for financial contributions to the ESM)
- to specific projects co-funded by the EFSI
  - Equity and loans should not have an impact on the deficit, but may have an impact on debt if financed through govt. borrowing → will be dealt through the consideration of **relevant factors within the EDP** framework
  - Grants will have a direct impact on deficit → will be dealt through the **investement clause up to the 3% threshold + close and temporary principle above the 3% threshold ,** and indirect one on the debt → will be dealt through the consideration of **relevant factors within the EDP** framework

THE STRUCTURAL REFORM CLAUSE – PREVENTIVE ARM

1. *Trigger*: "major structural reforms" with "long-term positive budgetary effects, **including by raising potential sustainable growth**" and "verifiable impact on the long-term sustainability of the public finances"

2. *Conditions*:

   - only implemented reforms

   - deviation does not lead to breach of 3% deficit and "safety margin" is preserved

   - budgetary position to return to MTO within 4 years

3. *Consequence*: "temporary deviation" allowed from MTO or adjustment path towards it. Amount of deviation cannot exceed 0.5% of GDP.

DO WE NEED A GOLDEN INVESTMENT-RULE?

For short-run "cyclical" stabilisation purposes?

NOT REALLY

To safeguard public investment in the long-run?

NOT REALLY

Could it be even counterproductive?

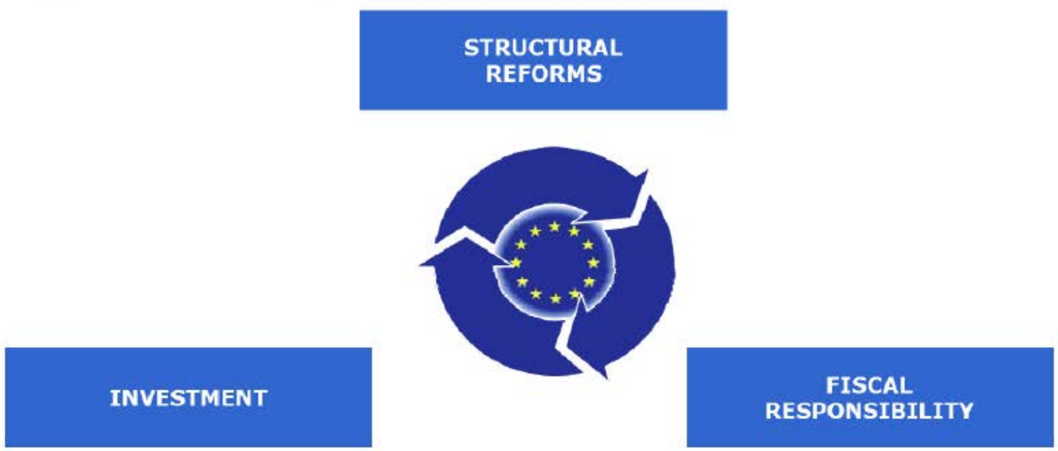
PERHAPS

AND WE WOULD NEED A TREATY CHANGE

Getting out of stagnation:

A new boost to jobs, growth and investment in the EU

Economic policy priorities: Three pillars



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Thank you very much for your attention

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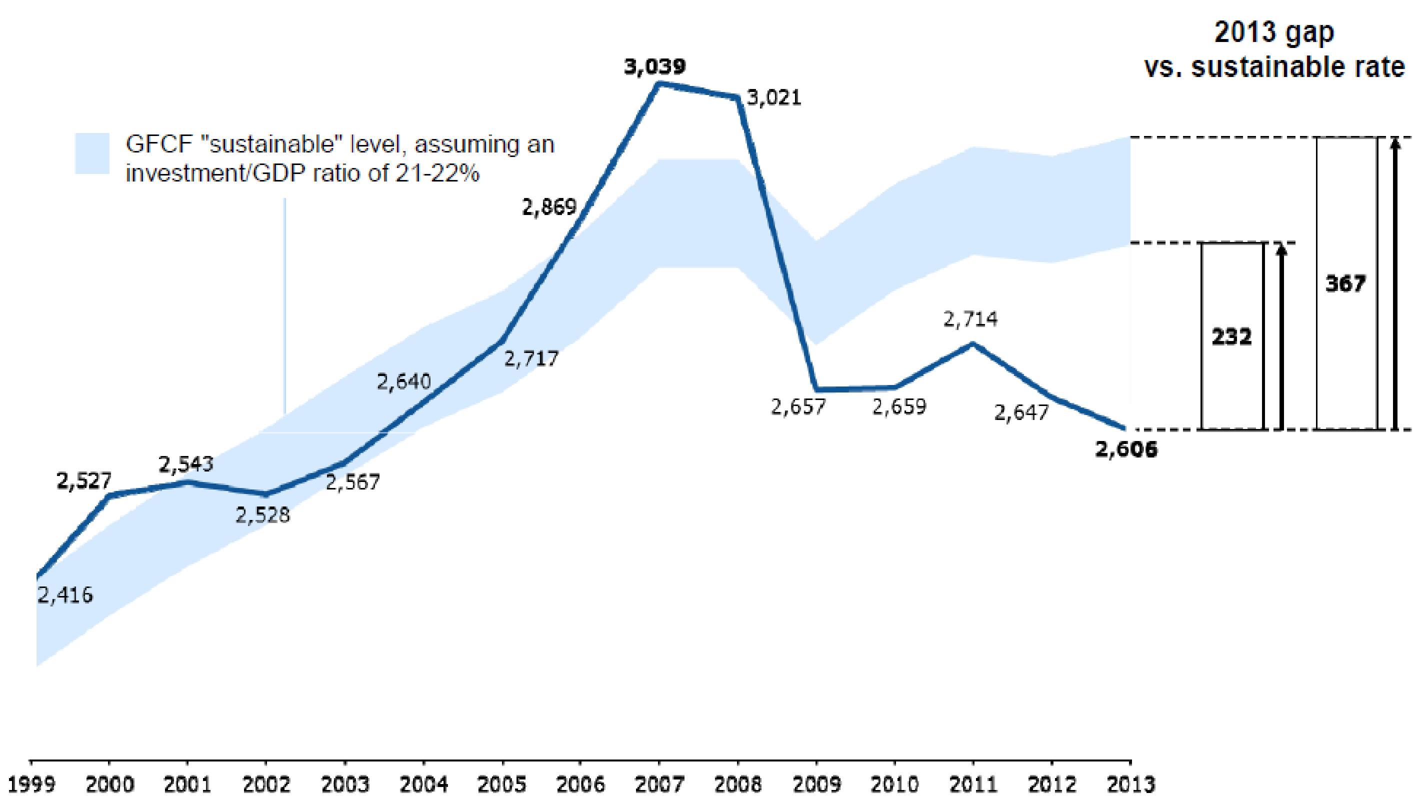
Real gross fixed capital formation – Observed trend vs. "sustainable" level
EU-28, in 2013 prices, € bn



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An Investment Plan for Europe: Three Strands

MOBILISING FINANCE FOR INVESTMENT

- Strong boost to strategic investments
- Better access to investment finance for SMEs and mid-cap companies
- Strategic use of EU budget
- Flexibility in the Stability and Growth Pact for Member States contributing to the new European Fund for Strategic Investments
- Better use of the European Structural and Investment Funds

MAKING FINANCE REACH THE REAL ECONOMY

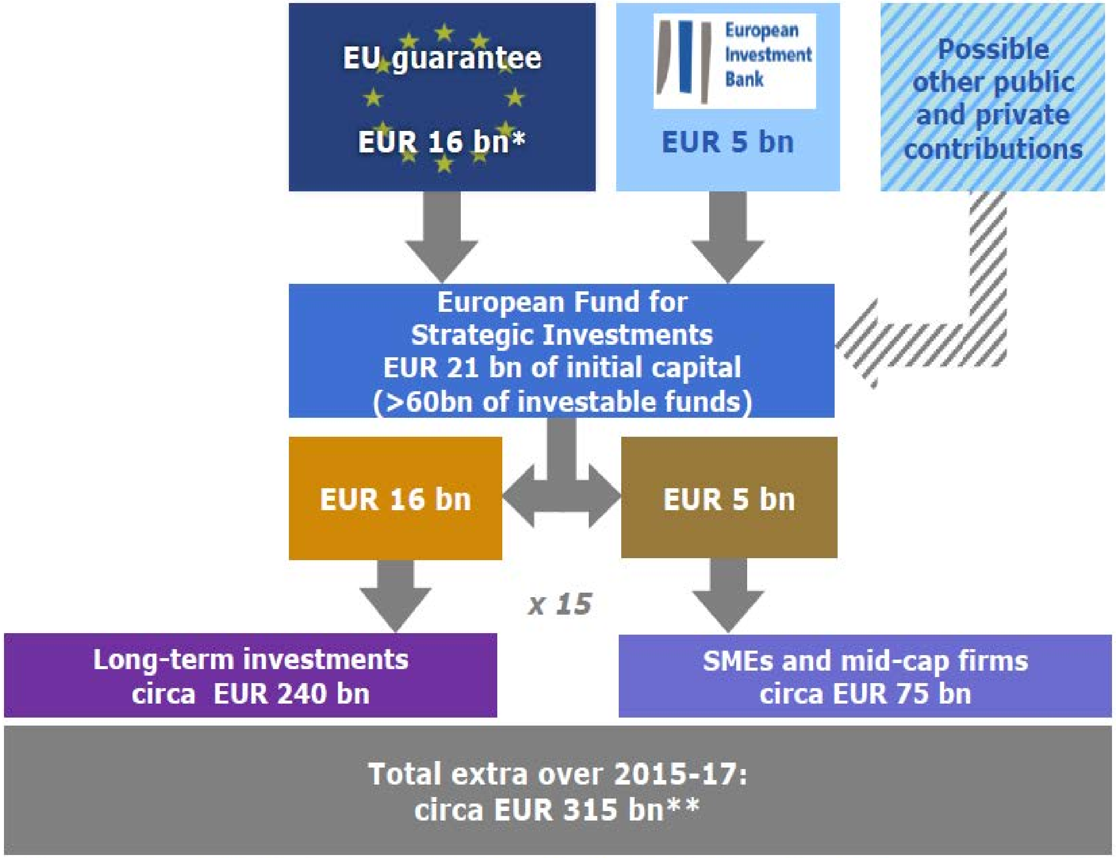
- Project pipeline preparation and selection
- Technical assistance at all levels
- Strong cooperation between National Promotional Banks and the EIB
- Follow-up at global, EU, national and regional level, including outreach activities

IMPROVED INVESTMENT ENVIRONMENT

- Predictability and quality of regulation
- Quality of national expenditure, tax systems and public administration
- New sources of long-term financing for the economy
- Removing non-financial, regulatory barriers
  in key sectors within our single market

Source: Commission services 2014.

The new European Fund for Strategic Investments (EFSI)



* 50% guarantee = EUR 8 bn from Connecting Europe Facility (3.3), Horizon 2020 (2.7) and budget margin (2)

** Net of the initial EU contributions used as guarantee: EUR 307 bn

Source: Commission services 2014.

ACTIVATION OF THE STRUCTURAL REFORM CLAUSE

- Member States will be expected to present a **comprehensive and detailed national action plan of structural reforms** (e.g. NRPs and S/CPs), providing verifiable and time-bound information + budgetary and potential growth impact. The implementation of the reforms, both content- and time-wise, will be monitored through the European Semester.
- In the specific case that a **Member State is in the Excessive Imbalances Procedure** (EIP), the implementation of the reforms will be monitored through the EIP, on the basis of the submitted **Corrective Action Plan**.

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THE STRUCTURAL REFORM CLAUSE – CORRECTIVE ARM

1. *Trigger*: "major structural reforms" with "long-term positive budgetary effects, **including by raising potential sustainable growth**" and "verifiable impact on the long-term sustainability of the public finances"

2. *Conditions*:

   - only implemented reforms / reforms detailed in dedicated plans

3. *Consequence (reforms as relevant factors)*:

   - non-opening EDP

   - longer EDP deadline or longer extension

Non-implementation will constitute an aggravating relevant factor in EDP steps (e.g. when deciding whether opening an EDP, extending EDP deadlines)

MODULATION OF FISCAL EFFORT OVER THE ECONOMIC CYCLE UNDER THE PREVENTIVE ARM

		Required annual fiscal adjustment*	
	Condition	Debt below 60 % and no sustainability risk	Debt above 60 % or sustainability risk
Exceptionally bad times	Real growth <0 or output gap <-4	No adjustment needed	
Very bad times	$-4 \leq$ output gap <-3	0	0.25
Bad times	$-3 \leq$ output gap < -1.5	0 if growth below potential, 0.25 if growth above potential	0.25 if growth below potential, 0.5 if growth above potential
Normal times	$-1.5 \leq$ output gap < 1.5	0.5	> 0.5
Good times	output gap ≥ 1.5 %	> 0.5 if growth below potential, ≥ 0.75 if growth above potential	≥ 0.75 if growth below potential, ≥ 1 if growth above potential

* all figures are in percentage points of GDP

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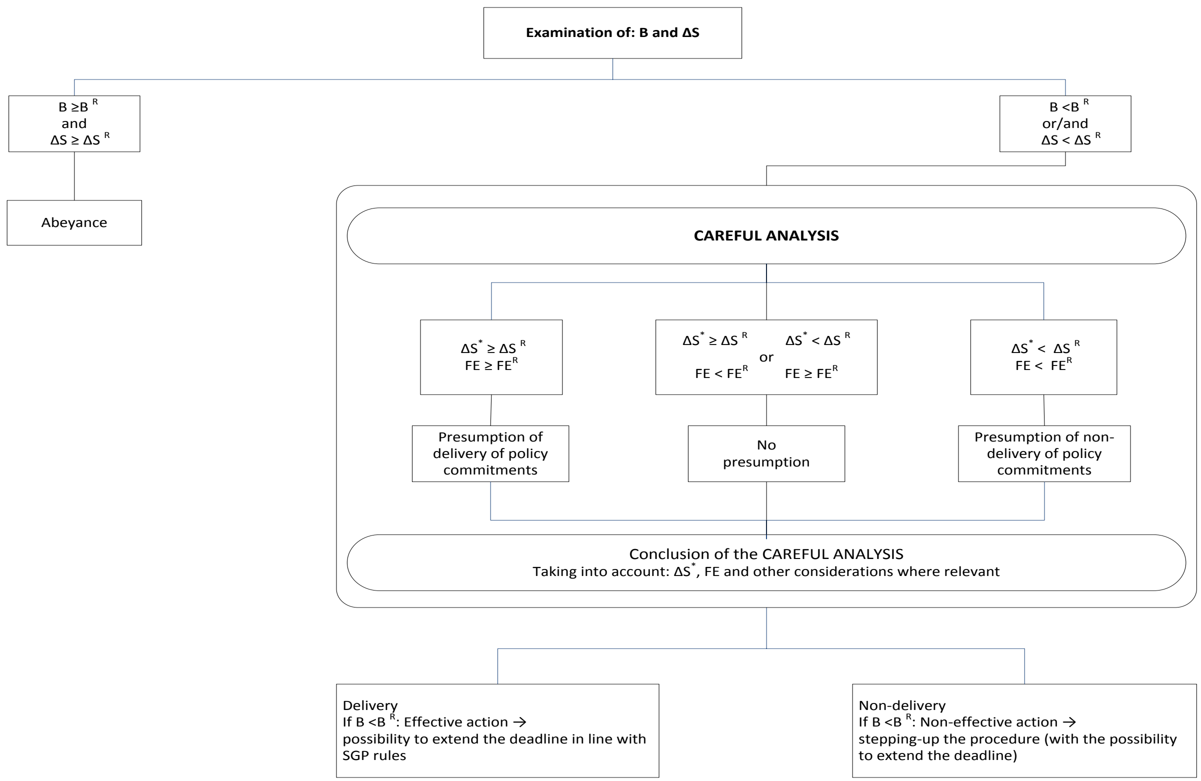
MODULATION OF FISCAL EFFORT OVER THE ECONOMIC CYCLE UNDER THE CORRECTIVE ARM

The Commission will continue to assess the effective action on the basis of a measurement of the fiscal effort, which takes into account unexpected changes of the economic situation

- *The methodology/decision tree – agreed with Member States – to assess effective action is applied*

CORRECTIVE ARM: EFFECTIVE ACTION



Definitions
Observed Budget balance (deficit) = B
Recommended Budget balance (deficit)= B^R
<u>Top-down approach:</u>
Required change in the structural budget balance = ΔS^R
Observed change in the structural budget balance= ΔS
Corrected observed change in the structural budget balance = ΔS^*
<u>Bottom-up approach:</u>
Required new fiscal measures = FE^R
Observed budget impact of the new measures implemented = FE

Severe economic downturn in the euro area or in the Union as a whole

1. *Trigger*: severe economic downturn in the EU or the euro area

2. *Condition*: medium-term fiscal sustainability

3. *Consequence*: adapt the pace of consolidation:

   - Corrective arm: redefine fiscal effort and the EDP deadline

   - Preventive arm: redefine fiscal effort and the MTO deadline