European Commission consultation on the reform of European economic governance: a contribution from the Italian banking, insurance, and finance community

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Introduction

Among EU countries, the pandemic and the financial crises of the previous decade have led to an average increase in the Eurozone's public debt/GDP ratio of about 100%. In particular, the pandemic caused an unprecedented economic decline in 2020, with the EU's real GDP falling by 6.1%, resulting in an even greater loss of economic wealth than that suffered during the global financial crisis of 2007.

By introducing the common debt and adopting a solidarity approach that was completely absent during the financial crises of 2008-09 and 2010-12, Europe's NextGenEU programme has significantly altered the role of the European budget. Consequently, the EU's response to the crisis was swift, decisive, and well-coordinated.

However, from the Member States' perspective, the social and industrial policy measures have led to the suspension of the fiscal rules introduced with the common monetary policy, and namely with the Stability and Growth Pact (SGP). In fact, the freezing of the national public finance constraints until 2023 has allowed Member States to take far-reaching measures in favour of companies and families with ultra-expansive fiscal policies, which would have otherwise been at odds with the rigid deficit and debt/GDP ratio reduction parameters.

The public measures introduced to deal with the consequences of the pandemic have led to the question (and the Commission has done well to summon the stakeholders for consultation) of whether it is necessary to return to an integral "status quo ante", or whether it would be better to change that mechanism, especially in light of the fact that the parameters were never entirely functional, even during the long period in which they were in force, generating widespread discontent and loss of trust between countries, and proving to be ineffective, never fully applied, and pro-cyclical.

And a return to the quo-ante situation is all the more unthinkable now, with the much anticipated, albeit tiring, exit from the pandemic, the challenging yet indispensable prospect of enormous investments in the transition, which the NextGenEU and the national plans render concrete, and with the huge expenditures in strategic sectors, and in European security and defence. While disciplinary rules for public finance are necessary, also to restore trust between Member States and within individual communities, they will need to be updated with respect to those in place at the end of the last millennium.

The response of the European Union and the individual Member States to the crisis has worked for the combination of fiscal policies, as well as monetary policies. Thanks to the innovations made to the national frameworks, it has been shown that the debt objectives introduced in Maastricht can be achieved through "positive incentives", and not only through compliance with rigid and abstract numerical rules.

A new Pact will be necessary, but it will have to take into account concrete and shared lessons learned from the crisis. These include:

1. the fact that budgetary rules are necessary, but will need to be updated to take into account long-term structural policies promoting the digital and sustainable transition, and the supply of European public goods, such as energy, security, and corporate capitalisation;
2. the budgetary policies must be adapted to the national situations, and cannot merely consist of fixed parameters for all;
3. forms of common debt, such as those introduced by the NextGenEU programme, are appropriate and effective, especially if conditioned by credible and accountable national reform plans. These forms of indebtedness should lead to a real common budget with greater internal resources;
4. political negotiations between Governments can be more effective than rigid and automatic mechanisms;
5. more flexible fiscal rules with respect to productive public investments go hand-in-hand with the completion of the banking and capital markets union, and more in the direction of a "financial constitution" even with existing treaties;

Answers to several specific questions raised by the European Commission Consultation concerning the economic governance review

QUESTION no. 3 - "What is the appropriate role for the EU surveillance framework in incentivising Member States to undertake key reforms and investments needed to help tackle today and tomorrow's economic, social, and environmental challenges while preserving safeguards against risks to debt sustainability?"

A growth-friendly composition of public finances should promote investment and support sustained, sustainable and inclusive growth. Reflection is needed on the appropriate role of the economic governance framework to incentivise national investment and reforms. Promoting green, digital and resilience-enhancing public investment deserves special attention, given the long-term challenges facing our economy. We therefore hope that **the EU budgetary policies will be better aligned with the need for greater ESG and digital investments ("twin transition")**: Europe's SGP rules will have to be simplified through the introduction of clear and understandable target objectives, perhaps even differentiated among member states, inviting governments to promptly introduce countercyclical policies when the macro-economic frameworks require it. That is to say that it will be necessary to further reduce spending during times of growth, so that it can be increased in times of crisis. The new SGP will therefore have to guarantee a greater degree of countercyclical flexibility. This can be achieved by placing a greater focus on spending for sustainable investments (of a social and environmental nature, but also relating to digital inclusion), which, in turn, allow for the deployment of private sector resources, conveyed through the European and national financial systems.

It is also necessary to **promote the progressive reduction of the EU Member States' public debt ratios (which are too high and too divergent), but in a sustainable and growth-friendly manner.** This will be the greatest challenge that we face in the post-pandemic world. When economic conditions allow, resuming a path of reduction in public debt/GDP ratios will be essential for maintaining sound public finances, avoiding persistent fiscal divergence between Member States. At the same time, an excessively large early reduction in the debt ratio would entail high social and economic costs, and would ultimately be counter-productive to economic growth.

Finally, since it has been shown that **robust national fiscal frameworks can contribute to a more effective economic governance framework**, it is worth considering the possibility of bolstering the institutional

mechanisms and aligning them with the best practices in Member States. Thanks to the innovations made to the national frameworks, the debt objectives introduced in Maastricht can be achieved through "positive incentives", and not only through compliance with rigid and abstract numerical rules. Such a system would also help mitigate the crisis of confidence among Member States. Confidence must be restored in order to reach an agreement not only on the fiscal rules, but also on the creation of a permanent fiscal capacity, which the Euro area badly needs. This common spending capacity would allow for shared investments to be made and for future economic crises to be overcome more quickly and efficiently, avoiding the mistakes made in 2010 (during the Greek sovereign debt crisis), and building upon the much anticipated successes of the NextGenEU programme.

QUESTION no. 10 - "How should the framework take into consideration the Euro area dimension and the agenda towards deepening the Economic and Monetary Union?"

The governance of the Economic and Monetary Union (EMU), the Stability and Growth Pact (SGP), the Treaty on the European Stability Mechanism (ESM) and the Banking and Capital Markets Union are largely interdependent. Together they form the institutional cornerstone of Europe's economic governance, and are aimed at maintaining the Euro area's financial stability. However, due in considerable part to recent events, several shortcomings and gaps have emerged that could undermine this stability, and could even lead to the Euro playing a less prominent role on a global scale. The financial crisis of 2008-09 and the subsequent Euro area debt crisis showed that a common monetary policy in various countries can lead to the accumulation of unsustainable financial imbalances in the private sector, which, in turn, can jeopardise the sustainability of public finances following a financial shock. The reasonable answer would be to **establish more flexible tax rules in relation to productive public investments on the one hand, and to encourage a new impetus for the completion of the banking union on the other.** Despite important progress, the banking union remains incomplete, without its cross-border deposit insurance pillar supported by a credible fiscal backstop.

We believe that the time has come to accelerate the integration processes, thus reassuring financial investors that the Euro will not once again be brought to the brink. In this sense, the governance framework must simultaneously guarantee 1) the sustainability of public finances, 2) the strength and resilience of the Member States' economies, and 3) effective coordination of policies at the European and national levels. At the same time, further EMU reforms, **such as the introduction of an adequately sized stabilisation capacity, together with the banking backstop**, would allow the fiscal policy to make a greater contribution to macroeconomic stabilisation at the overall Euro area level. In addition, **greater impetus must be given to the Capital Markets Union (CMU) in order to facilitate the sharing of market risks, and to simplify and render the supervisory and budgetary surveillance framework more effective.**

QUESTION no. 11 - "Considering how the COVID-19 crisis has reshaped our economies, are there any other challenges that the economic governance framework should factor in beyond those identified so far?"

The stabilisation role of coordinated discretionary fiscal policy has proven to be crucial in the pandemic: in fact, the crisis has highlighted the positive role that counter-cyclical discretionary fiscal policy and European coordination can play in responding to large economic shocks and containing their social fallout. However, the ability to provide fiscal stimulus in bad times requires building fiscal buffers in good times. Reinforcing counter-cyclicality in the EU fiscal framework could strengthen the medium-term dimension of fiscal policy, and thus the ability of national fiscal policy to respond to economic fluctuations. Furthermore, **the general objectives of the simplification and increased national possession of reform and resilience strategies** must be pursued. This calls for simpler fiscal rules that use observable indicators for measuring compliance. A simpler framework would contribute to increased ownership, better communication, and lower costs (even politically) for enforcement and compliance. In this sense, increased involvement in the public debate on the

part of the Parliamentary Budget Office (PBO), as is the case for example with the Dutch “Central Planbureau”, could prove to be beneficial for getting citizens more involved and increasing their awareness of the effects that policy choices have on public finance. This would lead to a more knowledgeable public opinion, and would improve the productive use of public resources.