A new European fiscal framework for 2024... will it be possible?

The upturn in debt yields on a global scale has put the fiscal situation back in the spotlight. The case of Europe is of particular interest, since in 2024 the fiscal rules will be reinstated after having been suspended since 2019 due to the pandemic and the outbreak of the war in Ukraine. The purpose of this «pause» was to develop a new fiscal framework and in April 2023 the European Commission presented a draft of its proposal, which serves as the basis for drawing up the final document which should be adopted before the end of the year, before being implemented in 2024. The ECB is also urging an agreement to be reached on time, aware of the challenge posed by the current situation (economic slowdown and high levels of debt).

What the new fiscal framework proposes

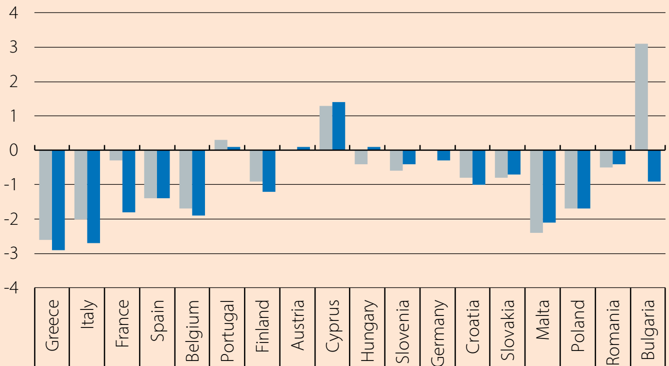
The European Commission's proposal reinforces the key role of national governments, which will have to draw up a four-year fiscal plan (extendible to seven years if they present reform and investment plans that promote growth) in order to reduce excessive structural deficits and ensure the sustainability of their debt in accordance with the European Commission's analyses. This reduction path will be tailored for each country, negotiated between the Commission and each Member State and approved by the Council.[1]

These multi-year plans are subject to two major restrictions or safeguards. On the one hand, the benchmarks of 3.0% of GDP for the government deficit and of 60% for public debt are maintained as medium-term targets. On the other hand, the reduction path incorporates a primary net expenditure rule[2] as a control variable and requires an annual reduction in the deficit of at least 0.5% of GDP. The European Commission has limited itself to setting «a minimum fiscal reduction of 0.5% of GDP per year», but various sources[3] interpret that in order for this measure to contribute to fiscal consolidation it must refer to the structural deficit. Therefore, the main developments appear to be that the fiscal adjustment path will be made more flexible by adapting to each country's particular situation; a primary expenditure rule is applied as a control variable (rather than the structural deficit); the 1/20th debt reduction rule (which states that debt should be reduced by the equivalent of 1/20th of the difference between its value as a percentage of GDP and the 60% target) is abolished, and a deficit-based reduction rule is introduced in its place.

Is the proposed plan more or less strict than the current one?

Bruegel[4] has evaluated the Commission's proposal by calculating the implications of the fiscal adjustment for all EU countries with debt exceeding 60% of GDP or a deficit exceeding 3%. In its conclusions, it acknowledges that the proposed framework remains ambitious, given that on average Member States will be required to reduce their structural deficit by around 2% of GDP between 2025 and 2028 in the four-year plans (slightly less if the plans last seven years). In addition, both frameworks agree on which countries will face the most aggressive adjustments and which ones the least aggressive, but they differ on the magnitude of the adjustment. In fact, for almost half of the cases where both the deficit and the debt level exceed the required thresholds, the structural deficit reduction proposed under the new framework would be lower, by almost 1.0% of GDP on average, than the current one establishes (in both four and

Difference in the structural deficit reduction required in the multi-year plans under the new framework vs. the current framework
(pps of GDP)



	Greece	Italy	France	Spain	Belgium	Portugal	Finland	Austria	Cyprus	Hungary	Slovenia	Germany	Croatia	Slovakia	Malta	Poland	Romania	Bulgaria
*	154	140	110	109	107	103	76	73	72	71	67	64	62	59	56	53	46	28
**	-0.6	-3.7	-4.3	-3.3	-4.7	-0.1	-2.6	-1.3	2.1	-4.4	-2.9	-1.2	-1.3	-4.8	-4.5	-3.7	-4.4	-4.8

Notes: ** Public debt (% of GDP). ** Fiscal balance (% of GDP). Both forecasts for 2024 by the European Commission.*
Source: *CaixaBank Research, based on data published by Bruegel.*

1. In addition, after the reduction period has ended, each country must generate fiscal margin in order to be able to cope with the costs associated with the ageing of the population.
2. Refers to public expenditure excluding interest charges, the cyclical component of unemployment spending and one-off measures, and net of revenues arising from any new tax measures.
3. e.g. Bruegel.
4. See Z. Darvas, L. Welslau and J. Zettelmeyer (2023). «A quantitative evaluation of the European Commission's fiscal governance proposal». Working Paper 16/2023. Bruegel.

seven-year plans), and this would benefit Greece, Italy, Belgium and Spain in particular. In the case of Austria, France, Germany and Portugal, the intensity of the reduction would be similar under both frameworks, especially for the four-year plans.

Still no agreement with less than two months to go before the year end

To «untangle» the negotiations, Germany and France have initiated a bilateral dialogue in order to facilitate an agreement before the end of the year. There seems to be widespread consensus on the adoption of tailored fiscal consolidation plans. Beyond that, the French bloc is calling for greater flexibility in order to avoid stifling economic growth, while the German bloc, which has already managed to convince the European Commission to include in the draft the requirement for all Member States to reduce their deficit by a minimum of 0.5% of annual GDP, also wants to include a mandatory annual debt reduction of 1.0% of GDP in all cases where debt exceeds 60% of GDP. Italy, for its part, continues to call for a «golden rule» in order to remove strategic spending from the deficit computation (which each country then deciding whether such spending should correspond to green, digital or defence investments). Meanwhile, Spain's proposal stresses that the plans must include adequate safeguards that do not jeopardise the investments needed to boost growth, while still guaranteeing the reduction of the debt and the deficit.

The political authorities point out that there is already agreement on 70% of the plan, but consensus on the most conflictive aspects is yet to be reached and it will be difficult for everything to be approved before the end of the year: it will need to be approved by all national parliaments and then be backed by a qualified majority in the European Council in order to finally be put before the European Parliament. In addition, with the upcoming European elections on 6 June 2024 and with all parties busy campaigning, we cannot rule out the possibility that the approval of the new fiscal framework could be delayed until the second half of next year. As a result, all the indicators suggest that 2024 may be a transitional year in terms of fiscal governance.

Budgets presented

In this context, the budgets presented by the major economies show their commitment to a return to fiscal orthodoxy, but also confirm the difficulties in meeting the demands, whether under the current framework or what is expected for the new one. Italy, for example, has presented a less ambitious budget plan than the one presented in April and now anticipates that the fiscal deficit, having stood at around 5.3% of GDP in 2023, will reach 4.3% in 2024 and will not fall to –3.0% until 2026. In addition, the reduction of the structural deficit would be rather sharp in 2024 (–1.1 pps of GDP), but it would be somewhat unambitious in 2025 and 2026, which explains the persistence of the levels of public debt (139.6% of GDP in 2026 vs. 140.2% in 2023).

There is a similar pattern in the case of France, which, after estimating a fiscal deficit of around 4.9% for 2023, is postponing when it expects to meet the –3.0% target until 2027 (making it one of the last to achieve it); with a structural deficit that would be cut by just 0.4 pps in 2024 (in subsequent years the reduction could be even smaller), this would mean that public debt would remain above 109% of GDP until 2026 and would barely fall from current levels (109.7% in 2023). At the opposite end of the spectrum we have Germany, the champion of fiscal austerity, which has already announced that it will reinstate the constitutional «debt brake» rule (which limits borrowing to no more than 0.35% of GDP per year), despite the slowdown of its economy. In short, the budgets have been drawn up with the intention of returning the fiscal metrics to more sustainable levels, but without forgetting that Europe is going through a delicate phase (a short and moderate recession cannot even be ruled out), which will condition the speed and intensity of the much-needed fiscal adjustment. In any case, in a context as complex as the current one, it will be the financial markets that will ultimately pass sentence on the suitability of the adjustment in each case.

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