Box J: The latest developments towards EU fiscal rules reform

In April 2023, the Commission (2023b) tabled legislative proposals to reform the EU fiscal rules. These build on the Commission's initial set of ideas from November last year (European Commission, 2022). They reflect discussions since then among EU Member States. We have previously discussed the outline of the new reforms in detail.[56] Here, we take a look at the latest state of play.

Agreement progressing but hangs on "safeguards"

At the time of writing, Member States have yet to reach an agreement on the Commission's proposed reforms. Most of the discussions have centred on what are labelled "numerical safeguards". Some Member States are seeking minimum requirements for debt and deficit adjustments that would apply regardless of a country's debt risks. They argue that medium-term country-specific fiscal plans could lack sufficient ambition and give countries too much fiscal leeway. However, other Member States regard the addition of these numerical requirements on top of the risk-based assessment as being too onerous. They argue these requirements would undermine a key tenet of the reforms, which is to tailor a country's fiscal adjustment path to its debt risks.

Member States are continuing to explore a potential compromise. It is hoped that an agreement will be reached by both the European Council and the European Parliament by year-end 2023, given parliamentary elections will take place in June 2024. Such an agreement would allow the new rules to come into effect in early 2024.

In the meantime, the rules will apply a mix of old and new elements

Pending an agreement on the reforms, the current rules still apply. The general escape clause will be deactivated at the end of 2023. As a result, the Commission has set country-specific recommendations for fiscal policies as part of its guidance for 2024.

The Commission's current guidance includes elements of both the new and old fiscal frameworks. For example, the structural balance rule remains in place for now. It sets a minimum annual requirement for the structural balance — the budget balance adjusted for the cycle and one-offs. Such a rule would be eliminated under the new proposals.

However, some parts of the latest proposals are incorporated in the guidance for 2024. The guidance focuses on a maximum growth rate for nationally financed net primary expenditure.[57] This spending limit is broadly consistent with the relevant Member State achieving its required improvement in the structural balance in 2024. In addition, these spending ceilings take account of a country's medium-term debt sustainability challenges.

Ireland will face little scrutiny under the EU fiscal rules in 2024

Some Member States, such as Ireland, are expected to achieve their medium-term objective in 2023.[58] Therefore, there is no guidance on a fiscal adjustment, although the Commission will continue to note the growth in nationally financed net primary expenditure.

All other Member States are expected to ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024. This would cap net spending increases at a slower rate than might otherwise be considered sustainable.[59]

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[56] Box F of the *June 2023 Fiscal Assessment Report* explored these proposals in greater detail.

[57] Nationally financed net primary expenditure is defined as general government expenditure excluding interest, one-offs, EU-funded spending, and temporary spending on unemployment related to the cycle. It adjusts for the net impact of tax measures; tax-raising measures would allow for larger spending increases, whereas tax cuts would reduce the scope for spending increases. Unlike the Expenditure Benchmark it replaces under the current guidance, it does not smooth out investment costs over a four-year period.

[58] In its assessment of *SPU 2023*, the Commission forecast Ireland's structural deficit to be -0.1% of GDP in 2023 (European Commission, 2023c). Ireland's medium-term objective is set as a structural deficit of no more than -0.5% of GDP for 2023. Consequently, Ireland is expected to comply with the structural balance rule in 2023, given its structural balance is expected to be greater than the medium-term objective.

[59] In this instance, sustainable means in line with usual — or "potential" — economic growth, and, by extension, revenue growth.