

Non-paper on incentives for public investment

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Introduction

During the second trilogue on the review of the economic governance framework, on 30 January 2024, the Commission was requested to explore possible incentives for public investment in the economic governance framework, building on the proposals already put forward by the co-legislators.

Overall, the proposed reform of the economic governance framework will provide Member States with more fiscal space for public investment compared to the current framework, thanks to a more gradual debt and deficit reduction and country-specific fiscal adjustment paths, including through the possibility of extending the fiscal adjustment period for Member States that commit to specific investments and reforms in their fiscal-structural plan meeting a set of criteria. The possibility to extend the adjustment period has been preserved in the Council's and the Parliament's mandates as the main incentive for investment, with some modifications (see below). Furthermore, the risk-based approach of the proposed reform is consistent with deficit levels that remain substantially above the balanced budget requirement of the current rules, creating additional fiscal space for reforms and investments. This remains the case in the Parliament and Council mandates.

The Council's and the Parliament's mandates include some additional proposals in this area.

- The **Council** proposes to:
 - consider an increase in defence expenditure as a relevant factor when considering opening of an excessive deficit procedure.
 - as a transitional provision, to take into account commitments included in the RRP for an extension of the adjustment period.
 - as a further transitional provision, to take into account projects related to RRF loans and national co-financing of EU funds in 2025 and 2026 whenever a Member State requests an exception to the no-backloading safeguard.
- The **Parliament** proposes to:
 - increase the discretion of the Commission and Council when deciding on an extension of the adjustment period.
 - exclude national co-financing of EU programmes (up to a cap of 0.25% of GDP) and borrowing related to RRF loans from the net expenditure indicator.
 - include an exception for the compliance threshold of the control account (for a maximum period of five years) if a Member State undertakes strategic investment in line with common Union priorities, and that the threshold would only apply in years of positive GDP growth.
 - include in the medium-term fiscal-structural plans an assessment of investment gaps and how they will be addressed, with consistency of investment and reforms between the plans, the RRP and Partnership Agreements in the MFF.

- add, in the corrective arm, to the relevant factors “*the delivery and commitment by the Member State on the implementation of the investments and reforms to address the common priorities of the Union..., of the Recovery and Resilience Facility, Cohesion Funds and future EU investments instruments that serve the same purpose*”.

Considerations on the additional incentives for investment in the Parliament and Council mandates

This section presents some considerations to support the co-legislators in seeking possible compromises, taking into account their respective mandates.

1. Criteria for the extension of the adjustment period

In the Parliament’s mandate, the criteria for the set of reforms and investments underpinning an extension (Article 13) would only need to be fulfilled “*as a general rule*”. The criteria would also be broadened relative to the Commission’s proposal, by the addition of “*resilience-enhancing*” (on top of “*growth-enhancing*”). The condition that the level of investment should be higher than before the plan is removed in the Parliament’s mandate. In the Council’s mandate, additional provisions are added to ensure that significant progress in the implementation of investment commitments is achieved at the latest by the end of the adjustment period, and to include indicators to allow the assessment of their implementation and monitoring. The Council proposes to delete the requirement that the set of reform and investment commitments shall be commensurate to the degree of public debt challenges and challenges to medium-term growth.

The amendments proposed by the Parliament would make it easier for Member States to benefit from an extended fiscal adjustment period. Without the quantitative criterion that the level of investment should be higher than before the plan, the appropriateness of the set of reforms and investments would still be assessed *vis-à-vis* the four principal criteria. The criteria as formulated in the current texts apply to the set of reform and investment commitments, and not to each individual measure, implying a global assessment. The addition of “*as a general rule*” would give more discretion to the Commission and the Council when allowing an extension, with a risk of reducing predictability for Member States. The proposal by the Council to include associated indicators and to require significant progress in the achievement of investments by the end of the adjustment period could help to reinforce effective implementation. The deletion of the requirement relating to the degree of public debt challenges and challenges to medium-term growth would ensure an equal incentive for all Member States with greater challenges in these respects. Finally, relative to the Commission proposal, softening the requirements for Member States to be able to benefit from an extension may not *per se* be conducive to strengthening incentives for reforms and investments.

2. Exclusion of additional expenditure items from the net expenditure indicator

The Parliament proposes to exclude two additional items from the net expenditure indicator: national co-financing of Union programmes (with a cap of 0.25% of GDP) and costs related to the borrowing of funds for RRF loans. Excluding these expenditure items from the fiscal indicator would not change the *ex-ante* average adjustment needed under the preventive arm but that adjustment would need to be delivered on the basis of other expenditure items (or with additional revenue measures). This would shield the net

expenditure indicator from unexpected changes in the co-financing of Union programmes and costs related to RRF borrowing.

Furthermore, the effect of the exclusion of national co-financing of Union programmes has a symmetric effect. If national co-financing is higher than foreseen, for example because of faster absorption of Union funds, other expenditure items do not have to be cut to meet fiscal requirements. By contrast, budget overruns on other expenditure items cannot be compensated by reducing national co-financing of Union programmes (i.e., by lowering the execution rate of Union programmes). As a result, Member States will have stronger incentives to ensure rapid implementation of Union programmes and lower incentives to cut back on investment expenditure in an economic downturn, which is positive, as changes in this expenditure item will not affect compliance with the net expenditure path.

However, the exclusion of national co-financing of Union programmes from the net expenditure indicator would require addressing data availability issues, given that there are currently no national accounts compatible data on the national co-financing of Union programmes. The exclusion of this item could initially be based on Commission estimates (possibly produced with the involvement of Eurostat), but a statistical framework would need to be developed over time, in collaboration with Eurostat and Member States' statistical offices. It is to be noted that new ESA 2010 reporting requirements, including reporting on transactions between EU and Member States, will enter into force from September 2024. While this will not solve the lack of data on national co-financing, it should improve the availability of data on EU co-financing, which are an input in deriving estimates of the national element of co-financing.

Separately, it should be noted that interest costs for all government borrowing are already excluded from the net expenditure indicator (as in the current expenditure benchmark). Therefore, there is no need to explicitly exclude interest costs related to RRF borrowing.

3. Exception for strategic investment when assessing compliance with the threshold of the control account

The provision proposed by the Parliament to altogether exclude expenditure related to strategic investments addressing the common priorities of the Union from the compliance thresholds of the control accounts would give Member States more leeway to undertake such investments. At the same time, it would constitute a weakening of the fiscal framework as part of government spending would be put outside of the framework, with a similar effect to a golden rule. In addition, it would require a clear identification and measurement of the type of investments which would qualify.

In comparison to the Commission proposal, both the Council and the Parliament mandates include thresholds for the control account, of differing magnitudes. Their calibration has an impact on Member States' scope to increase expenditure, including for investment, over the lifetime of the plan.

The Parliament also proposes to add strategic investment explicitly as a relevant factor when considering the opening of an excessive deficit procedure, following a breach of the 3% of GDP reference value or a deviation from the net expenditure path. The Commission proposal and the Council's text provide that reforms and investment shall be reflected in an Article 126(3) report as appropriate in the context of the relevant factors. A deviation exceeding the annual or cumulated thresholds in the control account would trigger a report under Article 126(3) TFEU. Such a report would assess, among the relevant factors, if the breach was due to a justified unforeseen increase in strategic investment. The relevant factors could also

take account of the national co-financing of Union programmes (if co-financing were included within the net expenditure indicator as per the Commission proposal). This would allow to take into account investments in fiscal surveillance, while keeping clarity on the preparation of an Article 126(3) report following a breach of the thresholds of the control account.

4. Assessment of investment gaps

The Parliament proposes that national public investment gaps would explicitly be addressed by the plans and monitored through the annual progress reports. It further proposes a “scoreboard”, established through a delegated act and updated by the Commission twice annually to monitor the implementation of the plans, including in particular the reform and investment commitments set out in the plans.

These proposals would add an extra degree of scrutiny on Member States’ investment needs and the delivery of their investment commitments, providing positive incentives. At the same time, they would not *per se* create additional fiscal space for public investment and would add to reporting burdens for both Member States and the Commission. It could be further explored how these proposals could be operationalised in a way that minimises complexity and reporting burdens.

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