Grand Committee

Government report: Communication of the European Commission on the EU economic governance review

For the Government of Finland

INTRODUCTION

Pendency

The Government has submitted a report on the Communication of the European Commission on the EU economic governance review (EJ 12/2021 vp – E 14/2020 vp) to the Parliament.

Statements

The following statements were submitted:
- Commerce Committee TaVL 12/2022 vp
- Finance Committee VaVL 1/2022 vp

Experts

The Committee has heard the following experts:
- Leena Mörttinen, Permanent Under-Secretary, Ministry of Finance
- Jarkko Kivistö, Senior Economist, Bank of Finland
- Anne Marttinen, Chief Economist, SOSTE Finnish Federation for Social Affairs and Health

The Committee has received a written statement from:
- Professor of Practice Martti Hetemäki, Helsinki Graduate School of Economics

The Working Section of the Grand Committee has heard the following experts:
- Tuomas Saarenheimo, President of the Eurogroup Working Group, Chairman of the Economic and Financial Committee
- Antti Ronkainen, doctoral student, University of Helsinki
- Professor Niku Määttänen, Helsinki Graduate School of Economics
- Jussi Ahokas, Economist, BIOS research unit
- Peter Nyberg, Doctor of Social Science
- Professor of Practice Vesa Vihriälä
- Professor Emeritus Matti Virén

The Working Section of the Grand Committee has received a written statement from:
- Professor Päivi Leino-Sandberg, University of Helsinki

GOVERNMENT FOLLOW-UP EUROPE COMMUNICATION

Proposal

On 5 February 2020, the Commission adopted a Communication on launching the public debate on the review of the EU's economic governance framework. However, the debate was suspended in the spring of 2020 due to the coronavirus crisis. The Commission relaunched the public debate with a Communication published on 19 October 2021 that took stock of the economic impact of the coronavirus crisis, the lessons learnt from the crisis, and its impact on the EU's economic governance. In the Communication, the Commission invited all the Member States to engage in the debate, with the aim of reaching a consensus on the content of the future governance framework. In particular, this was discussed by the Eurogroup and the Working Groups under it in the spring of 2022. In addition, in late 2021, the Commission organised a public consultation, and the questions proposed in connection with it were discussed in the Communication.

In early March 2022, the Commission adopted a Communication on fiscal policy guidance for 2023. It contained initial observations on key elements for which a consensus in the review of the EU framework could be achieved based on the discussions between the Member States so far. The key elements were:

- Ensuring debt sustainability and promoting sustainable growth through investment and reforms;

- Paying more attention to the medium term in the EU fiscal surveillance;

- Further discussing what insights can be drawn from the design, governance and operation of the Recovery and Resilience Facility;

- Simplification, stronger national ownership and better enforcement.

The discussions between the Member States are expected to continue in the spring of 2022, and the possible legislative amendments could be discussed in the autumn of 2022.

Communication from the Commission

The Commission states that the main conclusions of the 2020 Communication are now more relevant than ever, because the pandemic changed the EU's economic conditions, and it is now vital that the green and digital transitions are accelerated. The main conclusions are:

1) Public debt ratios of the Member States have increased further;

2) Public investment must be sustained at high levels in the near future;

3) The counter-cyclical discretionary fiscal policy and the temporary EU support tools have proved highly effective in cushioning the negative impact of the crisis;

4) The policy response has highlighted the importance of policy coordination and developing synergies between EU-level and national measures;

5) The rapid change of economic conditions during the crisis illustrated that using indicators that are not observable for fiscal rules is challenging, because some of the rules will always be unsuitable for the changed conditions;

6) Several of the macroeconomic imbalances that existed even before the crisis have become more severe, while new ones have emerged; Reacting in a timely way is now more important than ever.

Future of EU fiscal rules

The Commission states that the most significant challenge for EU fiscal rules will be to reduce the high public debt ratios of (some) Member States sustainably and in a growth-friendly manner. The Member States should resume a path of economic growth and debt ratio reduction, and sustained economic recovery is essential for this. Public investment is key and will be temporarily supported from the Recovery and Resilience Facility (RRF).

The Commission also states that the stabilising effect of policy coordination has been vital in cushioning the shock in the EU area. The activation of the general escape clause enabled a coordinated fiscal policy response to the crisis. The Commission notes that the ability to provide fiscal stimulus in bad times requires fiscal buffers to be built in good times.

In the Commission's view, simplifying the framework especially requires stronger ownership by the Member States and better enforcement.

Future of the Macroeconomic Imbalance Procedure

The Commission states that preventing and correcting macroeconomic imbalances would improve the Member States' ability to respond to economic shocks and support economic convergence. Responding to these imbalances would help in recovering from the crisis and strengthen long-term growth.

Although the Macroeconomic Imbalance Procedure (MIP) has increased awareness of macroeconomic imbalances, it has not led to any reforms in the Member States with persistent imbalances. Multilateral dialogue enhances the national ownership of policy actions needed to address the identified vulnerabilities. The Excessive Imbalance Procedure has never been activated for any Member State, so in the Commission's view, some of the components of the MIP have never been used.

The integration of the MIP and the Stability and Growth Pact (SGP) has not always been leveraged in the surveillance framework. In the Commission's view, it could be possible to strengthen the interaction between the measures when addressing macroeconomic imbalances, potential growth challenges and risks related to public debt. In addition, the Commission states that the MIP in its current state does not address new economic challenges related to climate change and environmental pressures.

Lessons from the RRF

The Commission emphasises that lessons learned from the successful fiscal policy coordination and especially the RRF framework may be useful for the review of the fiscal governance framework. The aim of the EU-level initiative was to create an extensive framework that allowed the Member States to plan national reforms and investments.

The Commission states that such a framework would enable the Member States to strengthen their ownership of the reforms and investments, which may promote implementation. The Commission also highlights the importance of a transparent assessment and monitoring framework and the resulting enhanced mutual trust in the implementation of the RRF. The RRF can be used to simultaneously pursue extensive results in certain areas such as the green transition and digitalisation at the EU level and to respond to the national challenges of the Member States.

Supporting the green transition and digital transformation

The Communication includes an estimate stating that the amount of the public and private investments required to deliver the twin transition (green and digital) is EUR 650 billion per year until 2030. The majority of the additional investments, around 80 per cent, or some EUR 520 billion, would need to be targeted at the green transition.

According to the Commission's estimate, the share of climate energy policy of the total would be 60 per cent, or around EUR 390 billion. This would be aimed primarily at decarbonisation, but it also reflects the energy and transport needs of an expanding economy. The Commission estimates the share of investments required for the other areas of environmental policy to be 130 billion per year. The estimate includes the investment needs of biodiversity, resource management and the circular economy.

For the digital transformation, the Commission estimates the need for additional investments to be EUR 125 billion per year. This figure includes investment gaps in communications networks, digital skills development and key digital technologies but does not cover the digitalisation of public services.

The Government's view

According to the report, Finland is open to exploring different questions and options in accordance with the views expressed in the EU policy report. In its follow-up Europe communications in the spring of 2022, Finland will form a more detailed opinion on the EU economic governance review and the reform of fiscal rules based on consultations and the discussions had in connection with them.

Finland's views on the matter have been outlined in the Government's EU policy report as follows:

Economic and fiscal policy

In the Economic and Monetary Union (EMU), it is vital that the economic policy competences remain the responsibility of the Member States in line with the EU Treaties. Ensuring this requires the Member States to have genuine room for manoeuvre in economic policy. The Member States must be able to create buffers for themselves during good times to shield them in bad times. It is important to investigate the potential for simplifying the overly complex regulatory framework of fiscal policy without having to propose amendments to the EU Treaties. In particular, more emphasis should be given to the Member States' debt sustainability and possible imbalances in current accounts. Harmony between monetary policies and fiscal policies is more important than ever. The conditions for the controlled implementation of debt restructuring should be improved in the euro area. The economic policy framework must enable fiscal policies that are proportionate to the cyclical conditions; this must be considered when the Fiscal Compact and its role are reviewed.

The rules of the SGP were created to control the risk of the Member States becoming over-indebted and thus prevent the deterioration of monetary policy independence.

The European Semester and green growth

The European Semester is a central framework in the coordination of the Member States' economic policy. The European Semester is the primary instrument used to reduce the differences between the Member States, promote employment and social cohesion, and sustain the stability of the euro area. Finland supports including the promotion of the UN Sustainable Development Goals (Agenda 2030) in the European Semester and aims to actively contribute to the balanced development of the Semester's activities to ensure that the development primarily focuses on the coordination of economic policy but continues to take the interaction of economic, social, employment, and energy measures and policies into account better than previously and promotes ecological recovery. As part of the preparations for the European Semester, intense dialogue will be engaged in with different parties such as social partners and NGOs. However, it must be ensured that the overall process is not overloaded.

Finland aims for a socially, economically and ecologically sustainable European Union. The EU has ratified the Paris Agreement and is committed to implementing the UN Sustainable Development Goals (Agenda 2030). The Covid-19 crisis further highlighted their importance. We seek a Union that forms the world's most competitive and socially cohesive climate-neutral economy. The European Commission's aim of using the European Green Deal to transform the EU into a fair, prosperous and climate-neutral society is in line with Finland's goals.

Funding supporting economic recovery will help accelerate the transition to a new stage in which the development of the EU economy and competitiveness 2(12) will be anchored to green growth and the digital economy. The transition must be realised in a socially fair manner and by leveraging the EU's key resource, which is strong human capital. The starting point of Finland's EU policy is that the Union supports the development of a welfare society and increasing the wellbeing of EU citizens.

The European Recovery Instrument and other crisis measures

Finland highlights that the Recovery Instrument, designed as a response to the economic impact of the Covid-19 crisis, is a temporary and extraordinary crisis measure with a clearly defined duration and purpose. The legal basis of the Recovery Instrument is responding to the crisis. The Recovery Instrument is implemented within the framework of EU Treaties, legislation and EU institutions without disturbing the balance between different institutions. Finland accepted the Recovery Instrument under these constraints. The EU's activities will primarily be funded from the Multiannual Financial Framework (MFF) in the future as well.

The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) established during the Covid-19 crisis is a temporary one-off crisis measure used to respond to the acute crisis. The need for new instruments and the associated benefits and risks should be investigated to prepare for the possibility that debate on new permanent instruments happens at the EU level. Permanent changes to the EU's economic policy structures should not be made in response to an acute crisis. Collaboration to improve control of counter-cyclical policies in fiscal policy should be increased with mutual and parallel actions agreed separately by the Member States.

In the public debate about the Communication and as part of preventative work and in addition to the Government Report, Finland highlights the following perspectives:

The EU's fiscal rules were created to control the risk of the Member States becoming over-indebted. In the future, the potential to increase the role of more extensive debt sustainability analyses in the Commission's reviews of the state of the Member States' public finances and in procedures related to public finances could be investigated. A variety of methodologies exists for debt sustainability analysis; their suitability must also be assessed in future debate.

In the Economic and Monetary Union (EMU), it is vital that the economic policy competences remain the responsibility of the Member States in line with the EU Treaties. Each Member State is responsible for establishing sustainable fiscal policies, and commitment to rules that enhance the long-term sustainability of the economy should be strengthened. This should be supported by joint surveillance of public finances, because it would help avoid mistakes that could endanger the stability of an individual Member State or the entire EU or euro area.

The EU's economic governance framework and the fiscal rules in particular have become a complex entity. It is important to investigate the potential to simplify the framework without having to propose amendments to the EU Treaties. The investigation should be initiated by examining the flexibility of the current legislative framework. The role of financial sanctions, market reactions and positive incentives in effective implementation should be assessed in future debate, and the lessons learned from them should be carefully analysed.

The economic policy regulatory framework must enable fiscal policies that are proportionate to the cyclical conditions. The indicators used in the framework and their application should be discussed. In addition, ways to increase collaboration to improve control of counter-cyclical policy in fiscal policy with mutual and parallel actions agreed separately by the Member States should be examined.

The EU's climate goals require large investments. In the Government's view, the options for achieving the goals at the EU-level should be carefully assessed. Among other things, the current rules enable public investments to be considered when assessing the deficit and debt criteria included in the Treaties, and the preventive arm of the SGP includes an investment clause that enables deviating from the path towards the Medium-Term Objective.

In the Government's view, the European Semester is the primary instrument in preventing and correcting macroeconomic imbalances and in the general coordination of the economic policies of the Member States. Macroeconomic development, progress on the country-specific recommendations, and the state of macroeconomic imbalances are monitored during the Semester. Macroeconomic imbalances (e.g. unemployment, private sector indebtedness, and financial sector liabilities) affect the sustainability of public finances. Close monitoring of macroeconomic imbalances and multilateral surveillance must also be ensured in the future. In addition to the Member States' debt sustainability, more emphasis should be placed on possible imbalances in current accounts. However, the Semester as a process must not be overloaded.

Finland highlights that the Recovery Instrument, designed as a response to the economic impact of the Covid-19 crisis, is a temporary and extraordinary crisis measure with a clearly defined duration and purpose. The key part of the temporary Recovery Instrument, the RRF, encourages the Member States to implement the structural reforms and investments identified during the European Semester. As the implementation of the RRF is still in its early stages, there is no information on the impact its incentives have had on the implementation of the reforms and investments. In future debate, open discussion can be engaged in on the practices, functionality and effectiveness of the RRF from different perspectives. The need for new instruments and the associated benefits and risks should be investigated to prepare for the

possibility that debate on new permanent instruments happens at the EU level. Permanent changes to the EU's economic policy structures should not be made in response to an acute crisis.

THE COMMITTEE'S RATIONALE

The Grand Committee deems the review of the regulatory framework of economic policies a necessary and important initiative. The aim should be to create a framework that is functional also in the long term. The framework should be renewed to better steer the Member States towards debt sustainability. Simultaneously, it should be ensured that the Member States can make the investments required to deliver the green transition. The framework should better enable the Member States to act in proportion to different cyclical conditions.

According to the expert statements received by the Grand Committee, Russia's invasion of Ukraine does not affect the direction into which the economic policy framework should be developed. However, it does have a negative effect on the economic growth of and inflation in the EU and the euro area, which are currently still recovering from the effects of the pandemic. In the Grand Committee's view, the effects of the current situation should in all cases be carefully assessed as part of the process of the EU economic governance review. In the future, we should also strive to respond to crises more effectively as an economic area.

Russia's invasion and the pandemic that preceded it highlight the need to ensure the sustainability of public finances and the creation of sufficient buffers during good times; this would enable us to better react to unpredictable events. In extraordinary circumstances, the rules should also allow flexibility, but in a predefined manner and in accordance with uniform criteria (SuVM 1/2021 vp, VaVL 1/2022 vp).

The green transition and abandoning fossil fuels have become more important and urgent due to the need to reduce Europe's dependence on Russian energy. The fact that the war has created pressure on the Member States to increase public investment must also be considered. This applies especially to defence investment. In preparing the review, the security of supply and the need to strengthen Europe's strategic autonomy must also be covered.

Like the Government, the Grand Committee considers it a key principle that economic policy decisions remain the responsibility of the Member States. The rules must steer the Member States towards responsible fiscal policies. The rules must more effectively push the Member States towards debt sustainability and a staggered long-term adjustment of public debt. The Grand Committee also agrees with the Government's statement that the role of more extensive debt sustainability analyses in the reviews of the state of the Member States' public finances should be increased in the future (VaVL 1/2022 vp).

In the Grand Committee's view, the commitment of the Member States to respecting fiscal rules should be enhanced. This would require rules that are credible and realistic. Several of the experts heard by the Grand Committee stated that the existing 60 per cent debt-to-GDP rule and the rule to decrease excess debt by five per cent annually (the '1/20 rule') are unrealistic in the current circumstances. The experts also noted that if the public debt general escape clause is lifted at the end of 2022 as planned, it may be necessary to activate the Excessive Deficit Procedure for as many as 14 Member States. The Finance Committee and the Commerce Committee have stated (VaVL 1/2022 vp, TaVL 12/ 2022 vp) that increasing the limit from 60 per cent could be considered in the continued preparations. At the same time, instruments steering the Member States towards sustainable economic policies could be created and made more robust (TaVL 12/2022 vp).

The Grand Committee also deems it important to assess the effectiveness of sanctions. The option to impose sanctions on the Member States breaching the rules aims to enforce the rules' implementation, but the threshold to impose any genuinely effective sanctions is very high. The threat of sanctions has been ineffective, and the repeated breaches of the rules have reduced their credibility. Considering granting positive incentives for the Member States that abide by the rules as an option for the sanctions is justified (VaVL 1/2022 vp).

The Grand Committee agrees with the Government's view that the regulatory framework must be simplified. The rules are widely deemed to be complex and open to interpretation. Their simplification would also increase transparency. The Grand Committee agrees with the Government's view that the economic policy regulatory framework must enable fiscal policies that are proportionate to the cyclical conditions. As the Grand Committee has previously stated, the regulatory framework must encourage the creation of buffers during economic upswings but also allow sufficient fiscal space in downturns (SuVM 1/2021 vp). According to the experts heard by the Grand Committee, one issue with the current rules has been that they are pro-cyclical, i.e. they exacerbate cyclical trends. Among other things, the experts noted that monitoring structural deficits has often led to pro-cyclical policies instead of counter-cyclical ones. This is especially due to the fact that structural deficit estimates must often be changed retroactively.

According to the statements of the Finance Committee and the Commerce Committee, one option for simplifying the rules and making them more counter-cyclical could be to give more weight to the expenditure rule for increasing public expenditure. An expenditure rule would support scaling fiscal policies which is difficult to do in real time, especially during cyclical turns (VaVL 1/2022 vp). According to the Commerce Committee, an expenditure rule could be used to link the maximum allowed increase in public expenditure to the predicted increase in nominal GDP. However, the expenditure target would not prevent an increase of expenditure financed by increased taxes (TaVL 12/2022 vp).

Like the Finance Committee, the Grand Committee stresses that the European Semester is important for coordinating the economic policies of the Member States. Close monitoring of macroeconomic imbalances and multilateral surveillance must also be ensured in the future. It is also justified to place more emphasis on possible imbalances in current accounts, as the Government has stated (VaVL 1/2020 vp).

In addition to improving the sustainability of public finances, the EU economic governance review aims to secure sufficient investments for the green transition and the digital transformation. In its Communication, the Commission estimates that the amount of public and private investment required to deliver the twin transition is EUR 650 billion per year until 2030. According to the Commission, around 80 per cent of this should be aimed at the green transition.

The Grand Committee considers the green and digital transitions to be central EU goals, the delivery of which also requires public investment (VaVL 1/2022 vp). Investments are central to the EU's growth and its competitive edge, and the current geopolitical situation further highlights the need to respond to the strategic competition with sufficient investment in the fields of climate and energy policies as well as digitalisation (TaVL 1/2022 vp). The economic policy regulatory framework must allow the Member States to make the necessary investments. The current efforts to accelerate the green transition in all EU countries simultaneously may make the necessary investments more expensive.

The idea that deviating from the fiscal rules would be allowed for investments related to the green transition (the 'golden rule') has been brought up in public debate. Like the Government, the Grand Committee believes the best option for enabling the necessary investment must be carefully considered. Special green transition rules could prove problematic from the perspective of controlling indebtedness. As the Finance Committee has stated, if a significant share of the investment expenditure fell outside the SGP reference values for deficit and public debt, the special rule would work against the SGP's central goal of controlling the over-indebtedness of the Member States. The special rule could also make drawing lines more difficult, which could increase the complexity of the framework (TaVL 12/2022 vp and VaVL 1/2022 vp). According to the Commerce Committee, at a minimum, special rules would require that expenditure could be expected – based on credible research information – to improve the balance of public finances and thus provide an economic payback within a reasonable timeframe (TaVL 12/2022 vp).

The Grand Committee highlights that the Government's report stated that the current regulatory framework already included components that enabled public investment to be considered, and in addition, the EU's RRF supports the green and digital transitions (VaVL 1/2022 vp). Some 40 per cent of the RRF's assets are directed at the green transition. The experts heard stated that it could be assessed whether the measures proposed in the national action plans could be redirected to accelerate the delivery of the transition and reduce energy dependence.

The experts heard by the Grand Committee also raised the question of whether more public goods should be produced at the EU level when the aim is to respond to cross-border challenges such as climate change or reducing energy dependence. This would probably require the EU's financial framework to be extended.

The Commerce Committee has also stated that among other challenges, those related to climate change or digitalisation are fundamentally cross-border and global questions, which means that the investments of any individual country cannot be seen as the most effective solution. It should also be noted that increased flexibility at the EU level could correspondingly reduce investment opportunities at the national level. It is therefore important to determine the public goods whose production at the EU level would result in more added value in the EU’s competitiveness compared with measures at the national level (TaVL 12/2022 vp).

In the Grand Committee’s view, reintroducing market discipline in stages is important for the implementation of the SGP (VaVL 1/2022 vp, TaVL 12/2022 vp). In practice, the ECB’s securities purchases in euro-area countries have worked as debt relief that has maintained favourable financing conditions despite the increase in public debt. The experts heard stated that when viewed as a monetary union, the sustainability of the fiscal policies of the states of the United States is largely based on market discipline.

The Committee calls for the completion of the banking union and the establishment of the capital markets union and emphasises the importance of reducing banks’ sovereign risk for the sustainability of the economy. Like the Government, the Committee considers it important to improve the conditions for controlled debt restructuring (TaVL 12/2012 vp).

The Grand Committee also recalls the importance of just, effective and sustainable taxation. As the Grand Committee stated in its report on the Government Report on EU Policy, Finland must promote solutions that secure and strengthen the tax base of Finland and the EU as a whole in a globally sustainable manner and promote fair competition between companies by tackling harmful tax evasion (SuVM 1/2021 vp).

The Grand Committee considers it important that the Government continue to exert its influence in relation to the EU economic governance review, and actively seeks and proposes in the negotiations the best options that simultaneously ensure debt sustainability as well as enable sustainable growth and the investments required for the operational capacity of the Member States.

GRAND COMMITTEE’S STATEMENT

The Grand Committee proposes *that the Government considers*

what is stated herein.

Helsinki, 6 May 2022

The following members participated in the decisive committee reading:

1st Vice-Chair Jani Mäkelä, Finns Party
Member Eva Biaudet, Swedish People’s Party
Member Sari Essayah, Christian Democrats
Member Maria Guzenina, Social Democratic
Party
Member Olli Immonen, Finns Party
Member Eeva Kalli, Centre Party
Member Anne Kalmari, Centre Party
Member Pia Kauma, National Coalition Party
Member Ville Kaunisto, National Coalition
Party
Member Johannes Koskinen, Social
Democratic Party
Member Jouni Ovaska, Centre Party
Member Jussi Saramo, Left Alliance
Member Jenna Simula, Finns Party
Member Saara-Sofia Sirén, National Coalition
Party
Member Iiris Suomela, Green League
Member Sinuhe Wallinheimo, National

Coalition Party
Alternate Member Sanna Antikainen, Finns Party
Alternate Member Heikki Autto, National Coalition Party
Alternate Member Inka Hopsu, Green League
Alternate Member Jari Leppä, Centre Party
Alternate Member Matias Marttinen, National Coalition Party
Alternate Member Matias Mäkynen, Social Democratic Party
Alternate Member Anders Norrback, Swedish People's Party
Alternate Member Hussein al-Taee, Social Democratic Party
Alternate Member Peter Östman, Christian Democrats

The secretary of the Committee was Counsel

Kaisa Männistö

Grand Committee's statement SuVL 6/2022 vp
Dissenting opinion 1

Dissenting opinion 1

Rationale

The Finns Party deems the comprehensive review of the regulatory framework of economic policy justified, because the framework is complex, and interpreting the rules has proved increasingly difficult. In addition, the rules have not prevented the over-indebtedness of the Member States, and even before the coronavirus crisis, many Member States did not meet the reference values on public debt and deficit set in the Stability and Growth Pact (SGP). The weaknesses of the SGP have been exposed. This is seen in the single currency area in particular, because it has not itself accounted for the fact that the free movement of capital leads to an accumulation of capital, which in turn results in macroeconomic imbalances.

Activating the escape clause deactivated the reference values on debt and deficit for the 2020–2022 period. The Covid-19 pandemic made it clear that the Member States would have to accrue significant debt to recover from the economic losses caused by the coronavirus shutdowns, and that these losses were distributed unevenly. The largest losses were seen by the Mediterranean countries, whose debt was already high and for whose economies tourism is significant. In the Finns Party's view, the escape clause must be deactivated as soon as possible. Due to the green transition, the energy crisis, the war in Ukraine and the generally weaker economic outlook, the temptation to continue to counter debt with central-bank-driven stimulus is high.

The Finns Party recalls that the terms and conditions of the SGP have not been complied with, and not once have these violations resulted in sanctions more severe than a warning, even though the rules allow the imposition of financial penalties. It cannot be expected that a system based on following the rules works without market discipline or sanction mechanisms that are not under political discretion. We therefore propose the reintroduction of market discipline and the creation of sanction or incentive mechanisms.

The academic definition of debt sustainability states that economic growth must be equal to or higher than the rate of interest of debt. This means that a good economic outlook and growth improve debt sustainability. In addition, during times of zero interest, any amount of debt is sustainable, but when the rate of interest increases, the situation changes. A debt ratio ceiling is therefore required; if the ceiling is exceeded, budgetary policies must be cautious. The actual level is less important than the direction. If investors assess that a country's economy is trending downwards, their assessment often becomes self-fulfilling. The maximum allowed budget deficit should therefore be linked to the economic outlook. A prudent level of debt and active adjustment efforts that are deemed sufficient are the best ways to combat debt crises. However, efforts to adjust expenditure that weaken the economic outlook should be implemented with caution.

The debt-to-GDP ratio reference value in the SGP is 60 percentage points. Only a few euro-area countries have managed to keep their debt under this. As the experts stated, determining the level of debt-to-GDP ratio is slightly arbitrary, and country-specific differences affect it. Setting the same debt-to-GDP reference value for all countries is not the optimal solution. However, political

realities must be kept in mind. If country-specific debt-to-GDP ratios are allowed, a country with more political influence could demand more favourable conditions. However, if the debt-to-GDP ratio is increased to 80 per cent, for example, it could be interpreted as meaning that the ratio is not especially important. This could further increase the lack of commitment, which is already a significant issue.

The countries with a debt-to-GDP ratio clearly exceeding the reference value will in all cases need measures tailored to their situation, and assessing the economic policies of these countries is not really the road to the SGP; instead, it is the road to debt adjustment and even to withdrawal from European Monetary Union (EMU). We therefore expect the sub-optimal 60 per cent debt-to-GDP ratio to be maintained, but we propose changing its nature from a binding maximum limit to a target level that the Member States would be obliged to strive for by decreasing the budget deficit and increasing economic growth. Current EU Treaties forbid monetary financing, although something resembling that is currently being implemented. However, there is no desire to propose amendments to the Treaties, and if the Central Bank simply printed the money requested by the Member States regardless of the rules, it would lead to an unrestricted increase of expenditure, borrowing and the debt burden. Monetisation therefore cannot be recommended, and practices for reducing sovereign debt should therefore be established as quickly as possible.

Commitment to the SGP has been low. Even when the euro area was established, only France met the Maastricht criteria. No sanctions have been imposed on any Member State for breaches. Due to the breaches, supporting agreements with market discipline or even using it instead of agreements should be seriously considered. The full introduction of market discipline is considered impossible in practice, because too many Member States depend on external support. We therefore propose a model of partial market discipline. In this model, when issuing new debt securities, states would be obliged to issue junior debt securities (no-bailout debt) corresponding to five to ten per cent of the nominal value of the issued debt, with the following conditions: (a) purchases of these could not be added to the balance sheet of a central bank or other government body in any circumstances; (b) creditors would not be bailed out in any circumstances; and (c) if debt cuts must be made, these securities would be the first target. The interest rate of these securities would probably settle at a level significantly higher than that of regular securities. The interest rate spread could be used to directly and instantly infer the general opinion of the markets on a country's economic policies and economic outlook. Economic policy could aim to reduce the spread. The model we propose would be humane, because the share of this 'no-bailout debt' would initially be only a small percentage of the total stock of debt, and even after a longer period, it would only be up to a minimum value (5–10%).

Finland has had mostly positive experiences with expenditure frameworks. With slight changes, the framework introduced in 2003 could be quickly introduced in other Member States as well. This would also solve the issue many of the experts discussed, i.e. that in practice, debt sustainability would be best maintained by preventing government expenditure from increasing too intensely.

The debt criteria only focus on sovereign debt, and this approach was proved wrong during the debt crisis. For example, in Finland, large sovereign guarantees and municipal debt affect debt

sustainability. Excessive private sector debt is also a threat to the debt sustainability of public finances. Unfortunately, debt statistics are difficult to monitor; in practice, it would be easier to monitor the development of current accounts, because these indicate the level of private and public debt to other countries.

In connection with monitoring current accounts and instead of only monitoring deficit, attention should also be paid to the surplus. As we know, the deficit of one country is the surplus of another. For example, in banking supervision, it has been deemed easier to supervise banks and set capital and reporting requirements for them instead of supervising debtors. The macroeconomic stability agreements already include the surplus as a sign of instability that should oblige remedial action, but nothing has been done thus far. Controlling the surplus would prevent the emergence of investment booms in other euro-area countries targeting a single euro-area country, which is considered to have been a major contributor to the debt crisis. In addition, if countries with a deficit are steered to reduce their deficit early, the liabilities of these countries cannot increase to a level where debt reduction measures would be impossible. In the debt crisis, the considerable debt receivables of France and Germany from Mediterranean banks and countries proved to be the issue, and the result was that these receivables were made the joint and several liability of all the Member States, which has been seen as unfair. This cannot be repeated, and smaller countries must be protected from bearing the consequences of the adventurous investments of larger countries. The Finns Party proposes that both current accounts and cumulative current accounts be monitored.

The proposal to exclude green investments from debt calculations, i.e. the golden rule, has many issues. Excluding investments determined to be 'green' from the scope of the debt criteria would steer countries towards over-indebtedness. In addition, the proposal would considerably shift economic political power to the European Commission that would apparently be the body drafting the required classification rules. Other deviating approaches to using loans for investments are also problematic. With a broad interpretation, anything from education to healthcare could be seen as an investment. In this case too, market discipline would be a better judge than the Commission. The Finns Party does not support the introduction of the golden rule. Shared fiscal capacity, i.e. a common budget, or current transfer mechanisms such as the Recovery Fund now used should not be created for the euro area either. It is true that to function, the euro area requires a larger than current common budget, current transfers, and joint and several debt. The Finns Party's conclusion about this dilemma is that the membership composition of the euro area is sub-optimal. If we want to solve the issues of the euro area, we must address the root causes – the single monetary policy and the ECB enabling joint and several liability, the ECB's purchase programmes and various support mechanisms.

We should remain cautious about the ability of euro-area countries to improve their price competitiveness and capacity to adjust their budgetary expenditure. In practice, the only viable option for many countries is to devalue their national currency, which would adjust the external value of budgetary expenditure in addition to the external cost of labour.

The euro area's problem is the single currency, and the largest issue with the Commission's Communication is therefore that is does not discuss the possibility of withdrawing from the EMU.

The withdrawal would not need to be permanent, as the experts heard also stated. The benefits of withdrawing from the EMU are easy to see. Withdrawal could be used to avoid the transfer of politically contested capital from one Member State to another, because capital should be allowed to move freely within the euro area. In addition, it could be used to mitigate economic difficulties with improved competitiveness. A withdrawal mechanism should be created that would allow the issues associated with foreign currency loans without protection against exchange risk to be avoided. In addition, it should be kept in mind that from the perspective of the Member States, the euro can be seen as a foreign currency, because the Member States largely cannot influence the related monetary policies.

Opinion

In the light of the above, we propose

> that in its statement, the Grand Committee state that in the future public debate, Finland must actively promote the perspectives presented in the rationale above.

Helsinki, 6 May 2022

Olli Immonen, Finns Party
Jenna Simula, Finns Party
Jani Mäkelä, Finns Party

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Rationale

The Communication from the Commission concerns the development of the guidance and coordination framework of fiscal policies. Finland should stress the responsibility of each Member State for its own economy. Unfortunately, the opposite has been done. For example, the EU Recovery Instrument adopted by the Government distances the Member States from sound economic management and market discipline and moves them further away from a policy that respects the EU Treaties. Ensuring sustainable economic policy must not be outsourced to the EU, but the Member States should take national measures to ensure this and that there is room for manoeuvre in years of crisis.

Stability and Growth Pact

The EU's budgetary rules were abandoned during the Covid-19 crisis, and now the Union has launched a debate on how to reform the rules. The Christian Democrats believe that the EU must be developed within the current Treaty framework. The three per cent budgetary deficit limit and the 60 per cent limit for the level of indebtedness of the Stability and Growth Pact (SGP) are good in principle; the issue is that the Member States have diverged from them too much.

The aim of the six-pack and two-pack governance packages was to enhance commitment to the SGP, but some of the provisions included in them are unrealistic, such as the requirement to reduce the debt ratio by 1/20 annually of the difference between the debt-to-GDP ratio and the 60 per cent threshold. For example, Italy would need to exceed the 1/20 growth requirement for several years. A debt ceiling should also be considered when rates are low in relation to the growth of the national economy.

The pension payments of the Member States and the differences between their systems is an issue that was not directly discussed in the consultations; however, it will have a significant impact on the economies in the EU area in the future. In several countries, it will be challenging to cover pension payments in the future, because they do not have a funded pension scheme like Finland's. The pay-as-you-go system will set pension payments at such a high level in the future that many countries will not be able to adjust. We must therefore examine the sustainability of the finances of the Member States with at least a 20-year timeframe, and targets must be country-specific and allow sustainability challenges to be overcome. For many countries, this means that social security cannot be increased, the pension scheme must be reformed, and budgets must be cut.

Supporting the green and digital transitions

In connection with the review of the SGP, the introduction of a 'golden rule' has been proposed, i.e. excluding certain net investments from the application of the deficit rule. However, this is unreasonable. Classifying expenses as 'green investments' in accounting does not make the investment neutral or positive in terms of debt sustainability and vice versa. Many public

investments have no payback at all, whereas many public expenses such as education do. However, it would be reasonable to enable investment or other investment-like expenses without them being restricted by the rules if it can be proved that they are justifiable from the perspective of debt sustainability. This means such deviations must be granted case by case, and they must be based on a credible assessment of the return of the investment. ***European Semester***

The Christian Democrats draw attention to the fact that the Semester has not been able to coordinate and steer the economic policies of the Member States as hoped. The Member States can pick the recommendations they like best, and reforms that are high on the list of priorities are not implemented. In addition to the fact that the European Commission should pay attention to the number of recommendations and prioritise them, it should be ensured that there is no asymmetry in guidance between the Member States. Mechanisms and intervention to prevent EU funds from being misused have proved weak.

Economic and Monetary Union

A well-functioning Economic and Monetary Union (EMU) requires that common rules are respected, economic development is based on the efforts of each region and market discipline works. It is essential to restore the importance of market discipline in the development of the EMU. The European Stability Mechanism must be maintained as an arrangement between the Member States, and its central decision-making must continue to be based on unanimity among the Member States. We are also critical of the various sovereign debt restructuring mechanisms that are based on cutting the receivables of other countries.

EU Recovery Instrument

The Covid-19 crisis has led to major and fundamental changes in the way the EU operates. The EU's Recovery Instrument ties Finnish taxpayers for decades to joint and several debt and higher membership contributions as well as opens the door to EU-level taxation.

In the Europe Communication, the Recovery Fund is deemed a 'one-off' solution, and it is stated that the EU's activities will primarily be funded from the Multiannual Financial Framework (MFF). However, it is also stated in the Europe Communication that 'need for new instruments and the associated benefits and risks should be investigated to prepare for the possibility that debate on new permanent instruments happens at the EU level'.

Opening up the debt facility is likely to lead to a desire to increase the EU's 'one-off' debt and to increase pressure on the EU to find new sources of own resources to repay the joint debt. In addition to the plastics tax to be implemented, the Commission is also planning the next generation of EU own resources.

In its proposal of December 2021, the Commission proposes a targeted increase of the MFF ceilings to introduce automatic adjustments based on the EU own resources that would enable the early repayment of the Recovery Instrument debt and in addition, to accommodate completely new expenditure such as the future Social Climate Fund. The Commission also proposes that the new EU own resources would consist of 25 per cent of the auction revenues from emission

trading, 75 per cent of the revenues from the carbon border adjustment mechanism ('carbon border tax'), and a later proposed share of the residual profit allocated to the market countries of large international corporations.

The proposed new EU own resources would broaden the EU's taxation-like revenue base with entirely new sources of revenue. Although some of the proposed amendments are potentially more favourable to Finland in the current circumstances than a financial contribution based on GDP, the new sources of revenue and the Social Climate Fund proposed by the Commission are permanent steps towards adding more payments resembling taxes, increasing the EU's budget, and bringing social security under the EU's competence. In addition, extending emission trading to road transport and buildings may be premature in the context of the current energy revolution.

Finland's stand on amending and increasing the MFF, the proposals on new EU own resources without extensive impact assessments, and on the Social Climate Fund should be negative.

Finland must draw attention to the fact that a proper impact assessment has not been carried out for the carbon border adjustment mechanism, although in principle, the introduction of the mechanism could prevent carbon leakage. It has been planned to include fertilisers in the carbon border adjustment mechanism, which could be problematic for the security of food supply in the current geopolitical conditions.

Competences over social policies must remain national, and as a net contributor with sparsely populated areas and a cold climate, Finland cannot deem the Social Climate Fund to be fair. Although it is important to implement climate action in a manner that is socially and regionally just, this should be the responsibility of national social policies of the Member States, and the Commission's proposal cannot be deemed fit for purpose.

The extension of the RRF payment schedule linked to the Social Climate Fund is not in Finland's best interest. In addition, not all the Member States are ready to step away from Russian energy, which means using the Social Climate Fund to compensate for energy prices would indirectly fund Russia's invasion.

The Christian Democrats proposed rejecting the Recovery Instrument and instead keeping the financial framework and the Recovery Instrument separate and opening the latter by a separate treaty only to willing contributors and recipients. Finland should not accept a repetition of the arrangement or any other arrangements that weaken the Member States' incentives to rehabilitate their public finances and increase risks to financial and macroeconomic stability in the EU.

In addition, the Europe Communication calls for a determination of how the counter-cyclical policies in the euro area could be better governed with 'mutual and parallel actions agreed separately by the Member States'. This is a better option than increasing joint and several liabilities and current transfers that only decrease commitment and drive states further away from healthy economic policies.

Furthermore, during the Covid-19 crisis, extraordinary economic policy instruments have been created, such as the SURE mechanism to mitigate unemployment risks, which should have been

rejected as a matter falling within national competence. The SURE mechanism aims to promote the establishment of a common unemployment insurance scheme that in the future would function as a fiscal policy stabiliser between the Member States. The Christian Democrats are against this.

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Banking union

In addition to the Recovery Instrument, the Government has promoted other solidarity projects and given the green light for the early adoption of the Single Resolution Mechanism (SRM). The Christian Democrats see a risk that we, the regular bank customers, will end up paying the costs associated with the failing banks of southern Europe. The banking sectors in the banking union the Member States still face varying risks. Many Member States also have inefficiencies and overcapacity in the banking sector, which will lead to more banks being wound up in the coming years. In addition, the Covid-19 crisis and more recently Russia's invasion of Ukraine have created an exceptionally high degree of uncertainty which has not been adequately addressed. There are significant risks in the global economy that could quickly spill over and affect the stability of the banking sector, which means the timing of the promotion of the early adoption of the SRM could not be worse.

A precondition for risk sharing must be adequate risk mitigation. Wind-ups and mergers of unviable banks must be dealt with first. Similarly, before banks can be covered by a common deposit guarantee scheme, they must be brought to the same level in terms of their health. The completion of the banking union must not be forced at any cost.

Opinion

In the light of the above, I propose

> that the views and perspectives presented in the rationale are adopted as the Government's goals in the negotiations.

Helsinki, 6 May 2022

Sari Essayah, Christian Democrats