financial affairs

Zsolt Darvas, Maria Demertzis and Stavros Zenios

Inflation in the euro area has declined continuously since its late-2022 peak. It is now forecast by the European Central Bank to be close to its 2 percent target, in both 2024 and 2025. However, inflation differentials persist within the euro area, leading to shifts in competitiveness that may require differentiated economic policy interventions. The scope for ECB interest rate cuts – and thus reductions in private-sector nominal borrowing costs, which were at a 15-year high before the start of the monetary easing phase – remains uncertain. Economic growth remains weak, as your services expect the EU economy to grow only 1 percent in 2024.

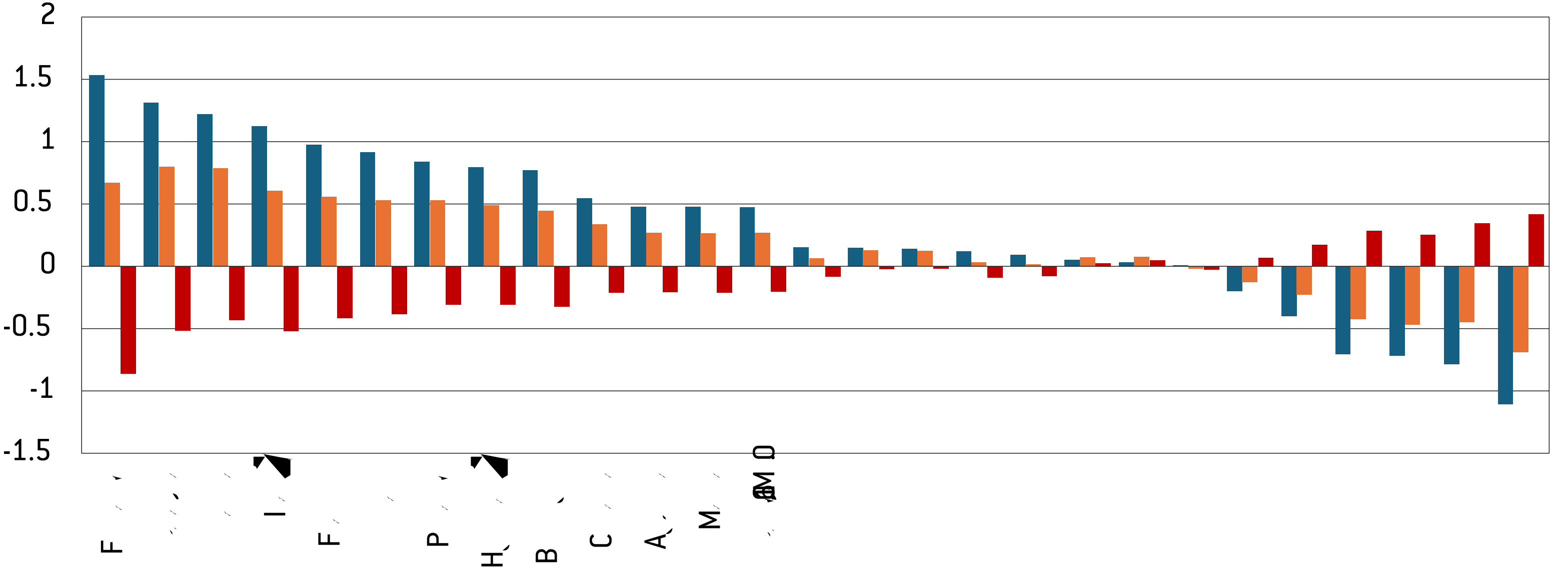
Unprecedeuire d (e)1E”4scal sort providd (e)1Eduring both the pandemic and the energy crisis is nd (0.9 (v)3 (er)-7 (theles)2 (s p)1 (a)10 (

Within the European Semester, the coordination of fiscal policies has entered a new phase with the entry into force in April 2024 of

1: - fi

2: [illegible]

% [illegible]



Source: Bruegel based on June 2024 AMECO dataset for macro variables, June 2024 market expectations for interest rates and inflation rates. Note: the European Commission's methodology was used. A positive number for the four and seven-year adjustments indicates that the country must increase its structural primary balance. Difference = the gap between the four-year and the seven-year average annual adjustment requirements. The six countries on the right side have either debt levels well below 60 percent of GDP (Denmark, Estonia, Ireland, Luxembourg, and Sweden), and/or large primary surpluses (Cyprus and Denmark), implying that these countries could implement fiscal expansions (ie reducing the structural primary balance) under the new fiscal framework.

why the poor CSR implementation record is a challenge for your portfolio: it jeopardises the success of NextGenerationEU. Addressing CSRs was a requirement for the approval of national recovery and resilience plans (NRRPs), but assessments vary of how well NRRPs have incorporated the relevant CSRs, while governance, labour market and taxation reforms have been implemented poorly (Figure 1).

As you enter the second half of the lifetime of the RRF programme, your challenge will be to assess NRRP implementation objectively and nudge member states towards a successful close. The evidence so far points to delays, which will require an acceleration of implementation. A further problem is that exceptionally high inflation in the first two years after Russia's full-scale invasion of Ukraine has meant that costs associated with the implementation of projects have increased compared to initial plans. Under current provisions, national budgets bear the

Among existing EU tools, you should ensure that the projects supported in the remaining lifetime of the InvestEU programme (which uses €26.2 billion in EU budget guarantees to mobilise €372 billion in private investment from 2021 to 2027) have EU value-added and are in line with EU strategic priorities. You should also support EU countries in completing all planned investments in their national recovery and resilience plans by 2026, the RRF expiry date.

As part of the Macroeconomic Imbalances Procedure, you monitor current account developments yearly and aim to identify the reasons for such high inconsistencies between savings and investments in the EU. It will be crucial for the CSRs, the tool at your disposal, to focus on actionable policies that can make a material difference for the countries concerned.

You should work with other commissioners to detect the factors that drive investments outside Europe and remedy those deficiencies

Deficiencies in the functioning of the EU single market also likely inhibit the within-EU utilisation of European savings. Your colleague responsible for financial services will be working towards creating better conditions that will enable wider and deeper capital markets in the EU. Other parts of the Commission will attempt to improve the functioning of the single market by removing regulatory or other obstacles. You should work with these and other commissioners to detect the factors that drive investments outside Europe and remedy those deficiencies.

You must rethink whether financial institutions, including the EIB and the ESM, can also do more to attract private capital. While the EIB has increased its gearing ratio to expand its activities, the question is whether they can be reformed or possibly repurposed in this regard. This raises the issue of participation in more risky projects as a way of helping companies enter areas they would otherwise not pursue. It also raises the question of whether and how should the EIB increase its leverage ratio.

Similarly, the role of the ESM as an institution can also be rethought. There have been many discussions on ESM reform and there are ideas on how to use its firepower during calm times to help with, for example, finishing the banking union by providing a deposit guarantee (Tordoir, 2022). This would help increase the EU's resilience. On the other hand, one could go further and ask whether there is more that can be done to repurpose the ESM's €400 billion firepower, in the context of closing the investment gap when there is no EU country in distress.

The next EU budgetary cycle will start in 2028 and there will be considerable pressure for more EU funding than the MFF has provided until now. You should contribute to the discussions on financing EU projects within and beyond the MMF, in two ways:

- **Climate fund**
  Climate is a global, and also an European, public good. There is a rationale for closing some of the climate investment gap via the EU budget. Since increased climate spending will be needed for decades, the best option would be to increase the size of the MFF to create a new dedicated climate fund within it. Failing that, you should foster an agreement on a temporary (eg five-year), debt-financed new EU climate fund outside the MFF. The fund could provide grants and concessional loans directly to applicant companies (ie not pre-allocated to countries). Such grants and loans could be provided on a competitive basis. If the cross-country allocation is not directly related to national contributions to the fund, as was the case with RRF grants, then these allocations would not be counted as national debt and thus would not be constrained by the EU fiscal rules (Darvas, 2022). At the same time, you should progress with the new own resources debate as a way of securing means to finance the interest and repayment of such borrowing.
- **European Strategic Investment fund**
  A follow-up instrument for InvestEU should be created at a

objectives consistently. The EU must pursue a structural approach to defining and financing its long-term strategic objectives. Currently, there is a lack of continuity in how the EU pursues investments. Programmes are finite and sporadic, with different funding sources and overlapping objectives. A new European strategic investments (ESIs) fund could come initially from a partly repurposed EU budget. Projects should be evaluated on how well they provide added value to the EU and contribute to its strategic objectives.

You will also have the scope to steer adjustment requirements for the eight excessive deficit countries. There is some ambiguity in the EDP regulation (Council Regulation (EU) 2024/1264), which creates a risk that the EDP will become a shelter for lower fiscal adjustment than what is required when the country is not subject to an EDP (Pench, 2024). You should make sure that debt sustainability, the primary objective of the new fiscal framework, is also required from EDP countries. Otherwise, the new fiscal framework will lose its traction right from the start.

Darvas, Z. (2022) 'A European climate fund or a green golden rule: not as different as they seem', , 3 February

Darvas, Z., L. Welslau and J. Zettelmeyer (2024) 'Incorporating the impact of social investments and reforms in the EU's new fiscal framework', 07/2024, Bruegel

Pench, Lucio (2024) 'Three risks that must be addressed for new European Union fiscal rules to succeed', 08/2024, Bruegel

Tordoir, S. (2022) 'The European Stability Mechaism is not Ready for the Next Crisis', , 29 November, Centre for European Reform