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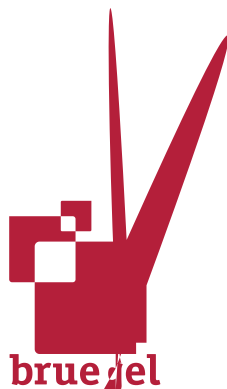
Zsolt Darvas (zsolt.darvas@bruegel.org) is a Senior Fellow at Bruegel and a Senior Research Fellow at Corvinus University of Budapest

ACHIEVING THE EUROPEAN Union's climate goals and decoupling from Russian energy will require a massive increase in green public spending, which will be di cult when EU scal rules requiring scal consolidation are reinstated.

THE TWO MAJOR proposals to address the con icting goals of scal consolidation and increased green public investment needs are a possible new European climate investment fund and a green golden rule. e latter would exclude any increase in net green public investment from the scal indicators used to measure compliance with scal rules, for countries with sound public nances.

AN EU CLIMATE fund and a well-designed green golden rule would be equivalent in terms of project selection, implementation and control procedures.

IF THE CLIMATE fund does not involve redistribution across member states, then the treatment of related spending and consequent borrowing in national scal indicators and in the EU's scal framework would be the same. New regulations would be needed to set ux/T1_264 (uld indic) the siibbe1ibbe1ib



1 Introduction

e European Union aims to reduce greenhouse gas emissions by 55 percent by 2030 relative to 1990 with its 'Fit for 55' package, and then achieve carbon neutrality by 2050 with the European Green Deal. Achieving these targets will require substantial additional investment and major regulatory and tax measures. Available estimates suggest the additional green investment to meet the goals will amount to 2 percent of GDP[1]. Meanwhile, REPowerEU, the EU's energy policy response to Russia's invasion of Ukraine, foresees either additional or frontloaded measures to foster the green transition[2]. ese investments will have to be funded.

A substantial portion of the funding for green investment will have to be provided by the public sector either directly in the form of public investment, or indirectly in the form of subsidies or guarantees to encourage private investment. By analysing the funding composition of national climate and energy plans, Darvas and Wol (2022) concluded that the public share could be around 30 percent of total green investment needs. Private sector investment could be fostered by appropriate government regulation, taxation policy and, in particular, a higher carbon price, which should make green investment more pro table for the private sector (Kempa and Moslener, 2017). However, each of these instruments has limitations. For example, a signi cant increase in gas and electricity prices related to the Ukrainian war should be welcomed from the perspective of the green transition, because it creates strong incentives for the private sector to move away from fossil-fuel consumption. But governments throughout the EU have rushed to dampen the impact of higher energy prices[3]. ere are political limitations to energy price increases, and the same applies to tighter regulations and subsidy elimination.

is implies that the green transition will require a substantial increase in public funding for green investment. But when the EU scal rules, suspended in the context of COVID-19, are re-introduced (most likely in 2024), all EU countries except Denmark, Luxembourg and Sweden will have to implement scal consolidation[4]. Past scal consolidation episodes resulted in cuts to public investment. is time, investment needs to be increased while consolidating budget de cits, which is unlikely to happen.

Two major proposals have been made to address the con icting goals of scal consolidation and increased green public investment needs. Garicano (2022) proposed a new European climate investment fund akin to the loan component of the EU Recovery and Resilience Facility (RRF)[5]. Darvas and Wol (2022) proposed a green golden rule to exclude any increase in net green public investment from the scal indicators used to measure compliance with scal rules.

In this Policy Contribution, we compare these two proposals in terms of their treatment under the current EU scal rules, and analyse the legal options for their introduction in the EU scal framework. We start with a brief review of the rationale for a green golden rule and then discuss legal options.

1 See IEA (2020), IRENA (2021) and Bloombe g NEF (2021) fo t he o ld, and D'Ap ile (2020) and E opean Commi ion (2020) fo t he EU.

2 See https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1511.

3 See B egel' dt a t on nt ional policie t o hield con me f om i ing ene g p ice : https://www.bruegel.org/publications/datasets/national-policies-to-shield-consumers-from-rising-energy-prices/.

4 Int he ca e of Denma k, L embo g and S eden,t he Ma 2022 E opean Commi ion fo eca t fo t he t t al balance in 2023 e ceededt he medi m-t e m objet i e b a la ge ma gin. e fo eca t t t al balance i ell belo t he objet i e fo all t he EU co nt ie .

5 While Ga icano (2022) init iall poke abo t g ant and loan ,"hi det ailed p opo al cla ifi edt ht *there would be no direct transfers to the bene t of certain member states. Redistribution would only exist through lower borrowing costs – an implicit subsidy from the more creditworthy members to the less creditworthy ones."*

2 The rationale for a green golden rule

system, similar to the governance system of the Recovery and Resilience Facility, would address the de nitional ambiguity and reduce the risk of 'greenwashing' to a minimal level.

Our proposed governance system would also be rather similar to the governance system

Because the first option appears somewhat odd, existing proposals focus on the second option. As with RRF loans, EU countries jointly guarantee the repayment of EU debt so the EU can borrow at a lower interest rate than more than half of its member states. Since the EU lends to its members at its actual borrowing cost, some countries could cut interest payments by borrowing from the EU instead of borrowing from the market. By underwriting EU borrowing, more creditworthy EU countries implicitly subsidise those countries that borrow from the EU, by running the risk that they default on their liability to the EU. This risk is probably not high, not least because no EU country has ever defaulted on an EU liability, and the share of EU climate fund-related debt would be small compared with the total national debt. But there is a risk.

Both options for a no-direct-redistribution fund would result in the same treatment of the resulting climate spending in deficit and debt indicators and for the purposes of the fiscal rules.

In line with the European System of Accounts (European Union, 2013) and a Council legal option, Eurostat (2021) concluded that national spending financed by RRF grants will not be included in national deficit and debt indicators, but spending financed by RRF loans will.

The justification for excluding RRF grants is that EU borrowing to finance these grants should not be counted as member-state debt because “ ” and “ ” (paragraph 38 of the Eurostat guidance). Thus, since there is redistribution (“ ”) and it is impossible to calculate the expected value of the national liability to the repayment of EU debt in 2028-2058 (“ ”)[8], EU debt used to finance the grants constitutes only “ ”, but not a national debt (paragraph 42). The national budget deficit is defined as the net borrowing of the government and thus spending from RRF grants does not matter for deficits: countries record a revenue item (payment received from RRF) and an expenditure item (national expenditure financed by the RRF), which is called “ ” in the statistical jargon (paragraph 28 of Eurostat, 2021).

Thus, by blurring the liability that EU countries have for repaying the EU debt, the financing of RRF grants does not appear in national debt and deficit statistics and is thus exempt from EU fiscal rules.

This is different for spending financed by RRF loans: Eurostat concluded that these loans should be recorded as national debt and thus expenditure financed by that debt increases national budget deficits (paragraphs 43-45 of the Eurostat guidance). So, spending financed by RRF loans is not exempt from fiscal rules.

An EU climate fund would be recorded in the same way as the RRF.

8 See Darvas (2021) on the nonsense of Next Generation EU net balance calculations.

4 The 2015 treatment of the European Fund for Strategic Investments in statistical indicators

An important question is whether the statistical treatment of the 2015 European Fund for Strategic Investments (EFSI)[9], often called 'The Juncker plan'[10], would be a precedent for the statistical treatment of a possible new EU climate fund. EFSI involved two types of contributions from EU countries: an initial capital transfer to EFSI and regular national co-financing of projects also co-financed by EFSI. The initial national contributions to EFSI were excluded from the structural deficit calculation. Based on this precedent, Garicano (2022) suggested that a Commission decision would be sufficient to exclude spending financed by a possible new EU climate fund from the deficit and debt calculation without changing the fiscal rules. Unfortunately, this is not the case, for the following reasons.

European Commission (2015) noted that “

5 An new EU climate fund with direct redistribution

national budget de cits are going to be larger, all else being equal. e only exceptions are resources countries cannot levy, like the proposed carbon border adjustment, but it's unlikely that such a source would provide a sizeable contribution to an EU climate fund.

7 The scope for promoting green public investment in the current EU fiscal framework

In the current EU scal framework, there are only limited options for promoting green public investment (either in the form of a green golden rule or a new EU climate fund without redistribution), and these exist only in the preventive arm of the Stability and Growth Pact (SGP) but not in the corrective arm. is requires revisions to:

- e existing 'investment clause'[12] to alter the adjustment path in the next years, and
- e medium-term objective (MTO) to change the long-run anchor for the structural balance.

A Council decision would be su cient for these changes.

7.1 The 'investment clause'

Since 2015, the EU scal framework has included a limited golden rule, called the 'investment clause'. e conditions and the scope of the investment clause are not speci ed in any EU legislation, but are based on a Council decision, informed by a Commission proposal (European Commission, 2015), a Council legal service option and an Economic and Financial Committee[13] compromise agreement (Council of the European Union, 2015).

For certain EU-funded projects, the investment clause allows for temporary deviations from the MTO, or from the adjustment path towards it, amounting to at most 0.5percent of GDP[14], for a period of maximum of three years, under the following (rather strict) conditions[15]:

- GDP growth is forecast to be negative or to remain well below its potential (resulting in negative output gap greater than 1.5 percent of potential GDP);
- e member state remains in the preventive arm at the time of the assessment of the application for use of the clause;
- An appropriate safety margin with respect to the 3 percent of GDP de cit reference value is preserved;
- Only national co- nancing of projects co-funded by the EU under the Structural and Investment Funds, Trans-European-Network, Connecting Europe Facility and the European Fund for Strategic Investments (EFSI) are allowed;
- e projects nanced must have positive, direct and veri able long-term budgetary e ects;
- Co- nanced expenditure should not substitute for nationally- nanced investments, so that total public investment does not decrease;

12 See: https://www.consilium.europa.eu/en/policies/stability-growth-pact- exibility/.

13 A polic coo dinat ion committ ee; ee https://europa.eu/efc/index_en.

14 In ca et he membe t at e al o benefit f omt he o-called ' t ct al efo m cla e', t hent het ot al c m lat i e t empo a de iat ion allo ed nde t het o cla e cannot e ceed 0.75 pe cent of GDP.

15 Seet he det ailed pecifi cat ion on page 22-25 oft he *Vade Mecum* (E opean Commi ion, 2019).

- The maximum initial distance of the structural balance from the MTO is 1.5 percent of GDP, so that in the benchmark case of an annual adjustment of 0.5 percent of GDP, the member state can achieve its MTO within the four years;
- In the period of adjustment towards the MTO, the clause can be applied only once.

As a result of these restrictive conditions, only two countries, Italy[16] and Finland[17], have so far applied for the investment clause. Anderson and Darvas (2021) concluded that the extra room for manoeuvre offered by the investment clause was minuscule for the two countries that applied for it, which, along with the very strict criteria for application, brings into question the usefulness of this clause.

The current investment clause would not provide a good legal basis for excluding spending financed by an EU climate fund or a green golden rule from fiscal rule indicators, because the allowed maximum initial 0.5 percent of GDP temporary deviation, which should be corrected in three years, would be too tiny and for a too-limited period to make a difference. Moreover, the European Commission's May 2022 forecast suggested that only two countries, Denmark and Lithuania, would meet its very strict conditions in 2023[18].

The investment clause could theoretically be revised by a Council agreement following a Commission Communication, yet the Commission already struggled to find a legal basis for this narrow investment clause in 2015: the Stability and Growth Pact does not allow exceptions for investments, but allows for structural reforms. Article 5(1) of Regulation (EC) No 1466/77 was used to justify the investment clause:

This article does not mention public investment. Thus, when using this legal provision for a temporary deviation from the structural balance targets in case of investments, the member state has to demonstrate that the particular investments are economically equivalent to structural reforms, because they have a direct, positive and verifiable effect on fiscal sustainability. The member state's request for such a temporary deviation is subject to a plausibility assessment by the Commission and the Council.

Nevertheless, possible revisions of the investment clause could include changing the scope from specific EU-financed investments to any green public investment, the removal of the GDP condition, the removal of (or an increase in) the maximum 1.5 percent of GDP initial structural balance distance condition, increasing the allowed 0.5 percent maximum temporary devia-

16 It al e e t ed a 0.3 pe cent of GDP de iat ion in 2015 fo t he 2016 b dget , of hich 0.25 pe cent a g ant ed nde condit ion , b t t hi e ibilit fo 2016 a et oact i el ed ced t o 0.21 pe cent of GDP in 2017, in light of t he in e t ment act all made in 2016, hich e e lo e t han planned.

17 Finland e e t ed a 0.1 pe cent of GDP de iat ion in 2016 fo t he 2017 b dget , hich a g ant ed, b t it a et oact i el it hd a n in 2018 beca e o tt n dat a fo 2017 ho ed a decline in p blic in e t ment in 2017 compa ed t o t he p e io ea , hile in e t ment linked t o Union f nd e e e t imat ed t o ha e emained t able. e 0.1 pe cent of GDP de iat ion fo Finland and t he 0.21 pe cent of GDP de iat ion fo It al e e d a fed b t he e i ion of t he 2017 t ct al balance e t imat e .

18 Amongt he t h ee co nt ie fo hich t he E opean Commi ion fo eca t a negat i e o t p t gap g eat e t han 1.5 pe cent of pot ent ial GDP in 2023 (Lit h ania -2.1 pe cent , Denma k -1.9 pe cent , Romania -2.7 pe cent), Romania i e pect ed t o ha e a 6.3 pe cent of GDP b dget deficit .

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European Commission (2019) *: 2019*, available at https://data.europa.eu/doi/10.2765/724849

European Commission (2020) 'Impact assessment accompanying the document "Stepping up Europe's 2030 climate ambition. Investing in a climate-neutral future for the bene t of our people"', SWD/2020/176 nal, available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020SC0176

European Union (2013) *f* , *A 2010*, Luxembourg: Publications O ce of the European Union, available at https://ec.europa.eu/eurostat/documents/3859598/5925693/KS-02-13-269-EN.PDF

Eurostat (2021) 'Guidance note on the statistical recording of the Recovery and Resilience Facility', available at https://ec.europa.eu/eurostat/documents/10186/10693286/GFS-guidance-note-statistical-recording-recovery-resilience-facility.pdf

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