Ministry of Finance

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Mr Valdis Dombrovskis
Executive Vice-President
European Commission
Brussels
BELGIUM

Date	29 oktober 2022
Subject	Economic governance review: increasing compliance and oversight

Dear Mr. Dombrovskis,

I am writing you regarding the review of the economic governance framework. I welcome a swift continuation of this debate, including the Stability and Growth Pact (SGP). In April this year, a Spanish Dutch paper on the way forward aimed to give impetus to the discussions. The Dutch approach to this debate centers on three elements: upward economic convergence, debt sustainability and effective oversight. In this letter I would like to share with you my thoughts specifically on compliance and oversight. Compliance with and oversight of the rules of the SGP has been insufficient in the past. Improving this is necessary to safeguard the sustainability of public finances in the European Union and subsequently equip Member States with sufficient fiscal space to meet current and future challenges. Several improvements to the fiscal rules and the oversight could be made to ensure this.

Firstly, compliance could be improved by making the rules simpler and numerical targets more consistent. Simplicity and transparency will be crucial in order to strengthen compliance of the rules, to be able to explain the rules to the public and ensure equal treatment among member states. Only applying an expenditure rule could contribute to this, which can strengthen the accountability of member states.

Secondly, enforcement mechanisms and oversight of the rules can be made more credible. This can also help to prevent the backloading of budgetary efforts. Clear safeguards should be in place to ensure that steps are taken by the Commission and the Council when Member States fail to comply with the rules, including the implementation of excessive deficit procedures. This is especially important for countries with high debt sustainability risks. In general, we need to take a different view on excessive deficit procedures: they should not be seen as punishment but as predefined steps to help correct budgetary imbalances. Also, the rules currently leave a lot of room for discretionary judgement by the Commission and the Council, which causes rules to be applied in a nontransparent and sometimes inconsistent manner. This should be addressed in the upcoming review.

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There are several avenues that can be explored to improve enforcement. Firstly, flexibility clauses, including the general escape clause, should be supplemented with clear rules on how and when to apply them. Secondly, the use of relevant factors by the Commission when drawing up an 126(3) reports could be clarified. For each relevant factor, it could be specified how that factor could be applied and whether the factor constitutes a mitigating or aggravating factor. Thirdly, a control account could be set up to keep track of small deviations, which have to be compensated by Member States in later years to make sure they don't add up to large deviations. These options can increase the transparency, predictability and consistency of the implementation of the rules.

Thirdly, to improve the governance and checks and balances of the framework, it could be explored whether the European Fiscal Board (EFB) could be given a stronger mandate to audit the implementation of the fiscal rules by the Commission and the Council without amending the Treaty. The assessments of this body could be taken into account better and could serve as a second opinion, which can increase the quality of decision making. Furthermore, national fiscal frameworks could be strengthened to increase national ownership and compliance. To improve national ownership, strengthened Independent Fiscal Institutions can be given a bigger role in the SGP.

Lastly, compliance with the European fiscal rules can also be strengthened by increasing market incentives to stimulate sound budgetary policies. Market incentives could be strengthen by a stronger role of the debt sustainability analysis or through risk-weighted government bonds on bank balance sheets. In doing so, risks for self-fulfilling market dynamics should of course be minimized.

All in all, enhancing the compliance and oversight of the rules is an important precondition for a successful review. Changes to the economic governance framework that focus only on upward economic convergence and debt sustainability will fall short of the ambitions that we should have. I trust you will take my ideas on improved oversight into account and look forward to your communication on the economic governance framework and the discussions that will follow.

Yours sincerely,

S.A.M. Kaag

Minister of Finance of the Netherlands