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WRITTEN BY
MATILDE CASTOLDI

EDITED BY
ALEX MARCHAN

SUPERVISED BY
CANSU MACIT KARADUMAN

Amid a paradigm shift in EU economic governance, a draft compromise seen by Euractiv reveals that, under the new Economic Governance Review (EGR), defence spending might be granted special status within European Union (EU) fiscal rules (Pugnet &Allenbach-Ammann, 2023). According to Euractiv, this document, tabled by the Spanish presidency of the EU Council on 3 November 2023, seeks to stimulate member state investment in defence. It is also part of a grand effort to overhaul current EU debt and deficit reduction rules, which were suspended for four years in order to allow increased spending and will be returning in full force in 2024 (Leali & Smith-Meyer, 2023).

"We need fiscal rules that are fit for the challenges of this decade" (European Commission, 2023): so said President of the European Commission Ursula von der Leyen on 26 April 2023, following the presentation of the most substantial reform proposals to the Stability Pact since the 2008 economic and financial crisis' aftermath (European Commission, 2023). The April and November proposals are both part of a comprehensive effort to reform the EU's economic governance rules, which is set to come to a head on 8 December 2023, when the European Council "will seek a general approach on the proposed reform of the economic governance framework [and ministers] will adopt implementing decisions approving modified recovery and resilience plans, submitted by some member states" (European Council, 2023).

The Stability and Growth Pact (SGP) which EU policymakers are looking to reform is a set of rules which aims to facilitate the coordination of EU Member States' fiscal policies; its legal basis is found in Articles 121, 126, and Protocol 12 of the Treaty on the Functioning of the European Union (TFEU). Art 121 addresses the question of multilateral surveillance, Art 126 outlines the Excessive Deficit Procedure (EDP), and Protocol 12 explains the EDP in more detail. Art 126(2) TFEU and Art 1 Protocol 12 TFEU state that where a Member State has a government deficit above 3% of its gross domestic product (GDP) or public debt above 60% of its GDP, the EDP will be triggered.

The objective of the legislative proposals presented on 26 April 2023 is twofold: to enhance public debt sustainability and to foster growth through targeted reforms and investments (European Commission, 2023). Key points of the proposals include the introduction of national medium-term fiscal-structural plans, a more risk-based surveillance framework, and multi-year expenditure targets (European Commission, 2023). The April proposal is just one piece in the puzzle of "the European Commission's proposed far-reaching changes" (Rahman, 2023). Given the extent to which EU fiscal rules will be changed, "[d]oom and gloom have surrounded the prospect of a deal on this matter for some time" (Rahman, 2023). Germany is especially worried, remaining unsure about whether the proposed approach will ensure sufficient debt reduction in the four-year period envisioned for countries to reduce their debt-to-GDP ratios, or a seven-year period if they also undertake reforms and investments that promote the EU's strategic priorities (Rahman, 2023).

Although the legislative changes proposed in April were certainly extensive, the November 2023 draft paper seen by Euractiv envisions an "increase of government investment in defence compared to the average over the four years before the plan, where applicable, to be explicitly recognised as a specific relevant factor when triggering an Excessive Deficit Procedure (EDP), alongside other relevant factors" (Pugnet & Allenbach-Ammann, 2023).

In fact, the draft suggests that member states which increase defence spending should be treated with more leniency if they exceed the EU's deficit rule of 3% of their GDP—which would usually trigger the Excessive Deficit Procedure (EDP) (Pugnet & Allenbach-Ammann, 2023). This marks a significant addition to the European Commission's legislative proposals presented in the spring, where defence spending was not explicitly considered.

The November defence spending proposal aims to balance debt sustainability with strategic investments. While the European Commission initially focused on four common EU priorities (green and digital transitions, social rights, and defence) for extensions on fiscal adjustment periods, the Spanish Presidency's 'landing zone' paper explicitly mentions defence as a priority for leniency in the face of an EDP (Pugnet & Allenbach-Ammann, 2023). This represents a reflection of an evolving geopolitical landscape—particularly in the aftermath of Russia's 2022 invasion of Ukraine—where member state investment in defence has become increasingly important (Pugnet & Allenbach-Ammann, 2023).

The proposed special status for defence spending is not, as pointed out to Euractiv by a source in the defence industry, a blanket exemption but a nuanced approach aimed at encouraging member states to spend more on defence (Pugnet & Allenbach-Ammann, 2023). Were this draft paper to be adopted, as an EU diplomat noted, "defence spending would benefit from a 'good money' label as opposed to a 'bad money' one to incentivise investments" (Pugnet & Allenbach-Ammann, 2023) in a sector which would benefit from, at this point in time, high levels of financial commitment. While the proposed move may be small in scale, it carries a certain political significance as it incentivises member states', and the defence industry at large's, production capacities for the longer term (Pugnet & Allenbach-Ammann, 2023). The potential for enhanced loan access from banks and private funds further underscores the strategic implications of this proposal.

With the 8 December 2023 deadline looming large, challenges remain (Rahman, 2023). Divergent national positions make reaching a consensus complicated—Germany in particular insists on stricter debt and deficit reduction numerical benchmarks, while France and other EU states wish for increased investment flexibility (Pugnet & Allenbach-Ammann, 2023). The state of negotiations is representative of current Franco-German relations, but a no-deal outcome is hoped to be avoided, given the EU economy's need for "more sensible deficit and debt reduction, higher public investment, and also reform" (Rahman, 2023). Without a deal, member states would have to negotiate their fiscal policies with Brussels on an annual basis, and both the process and possible outcomes would be uncertain (Rahman, 2023). An added layer of complexity is added by the lack of leeway envisioned for green and digital investments, even though they, too, are claimed to be priorities (Pugnet & Allenbach-Ammann, 2023). In fact, the absence of a rule for environmentally friendly and climate change mitigation-related investments similar to that for defence raises concerns about the alignment of the proposed changes with the EU's sustainability goals.

The special status proposed for defence spending within EU fiscal rules represents a marked response to evolving geopolitical realities and a desire to strike a delicate balance between debt sustainability and strategic investments. The proposals for reform stand as a testament to the intricate challenges inherent in steering the economic course of the European Union toward resilience and sustainability, but also to the EU policymakers' dedication and will for a more transparent and resilient European Union.

References

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