DSA in the new EU fiscal surveillance framework

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ESM conference "Assessing Debt Sustainability: modelling challenges and the way forward", Luxembourg, 30 November 2023
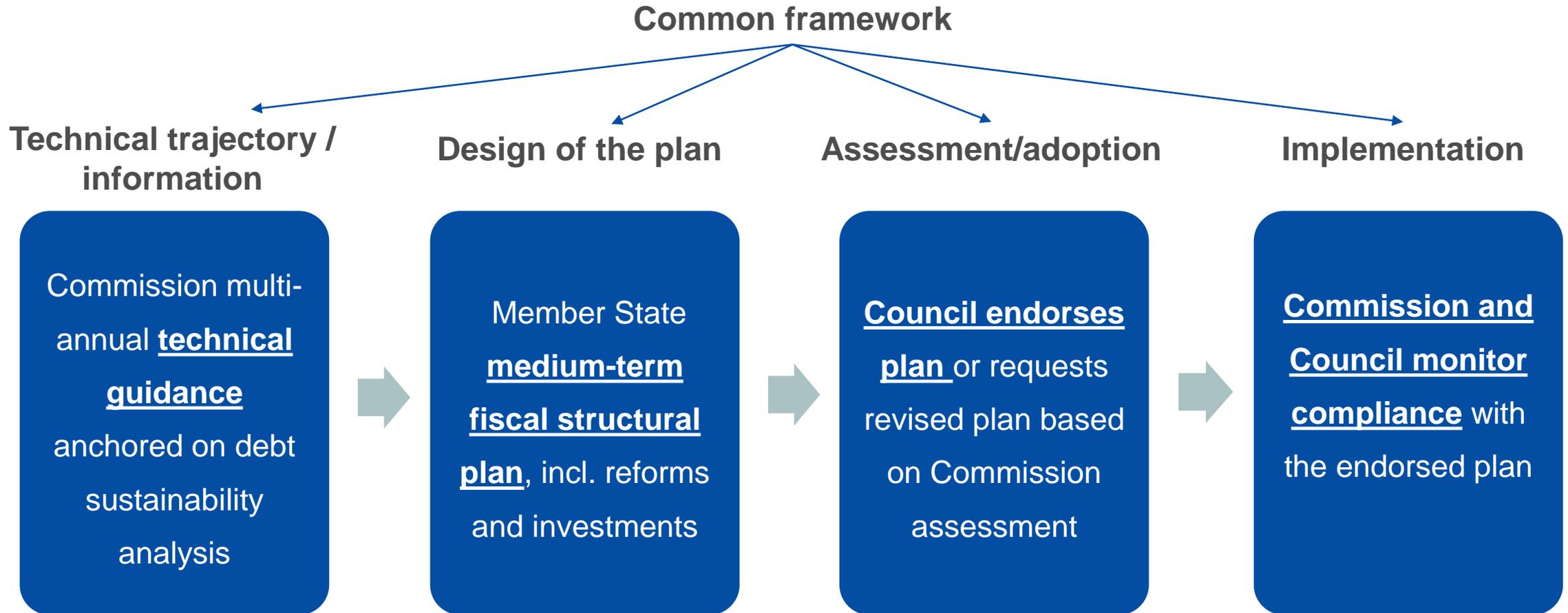
The DSA: a technical tool to be used for planning purpose

Key objectives and innovations of the reform

Key objective of the reform: strengthen **debt sustainability** and promote **sustainable and inclusive growth**

Key innovations	How?
Risk-based approach	Differentiated fiscal path reflecting public debt challenges (i.e. fiscal and macroeconomic fundamentals)
Medium-term perspective	Medium-term fiscal-structural plans at the cornerstone of the new system (political commitments on fiscal path, investment and reforms)
Increased role of the DSA	DSA used for the preparation / assessment of the plans (including technical guidance)

Revised process for coordination of economic and multilateral surveillance

Common framework

Technical trajectory / information

Design of the plan

Assessment/adoption

Implementation

Commission multi-annual **technical guidance** anchored on debt sustainability analysis

Member State **medium-term fiscal structural plan**, incl. reforms and investments

Council endorses plan or requests revised plan based on Commission assessment

Commission and Council monitor compliance with the endorsed plan

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The DSA as an operational tool to set the fiscal path

DSA mainly used ex-ante to set the country-specific fiscal path

- **Technical trajectory provided by the Commission to countries facing highest risks**

  - Adjustment path set to ensure a 'plausible' decline of debt (or that it remains at safe levels) and that the deficit is brought and maintained below 3% of GDP

  - Over the medium-term and under a range of adverse scenarios

- **Technical information provided by the Commission to countries facing less risks**

  - Plan should be compatible with a fiscal position that allows keeping the deficit below 3% of GDP over the medium-term

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Stylised results for a high-debt country, 4-year adjustment period
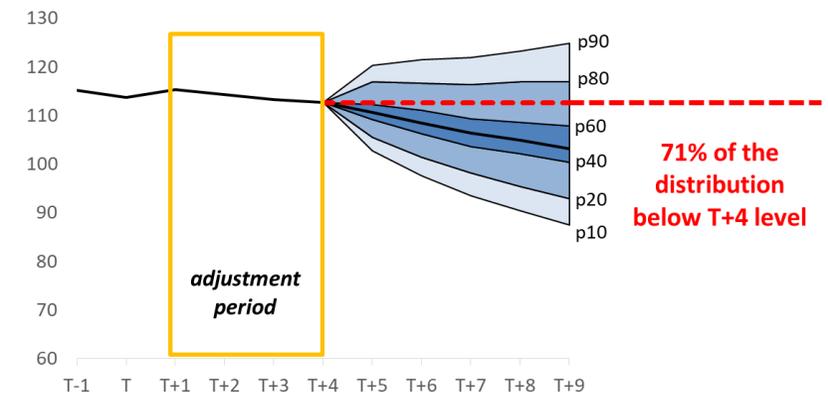
Under technical trajectory (0.65 pp of GDP per year)
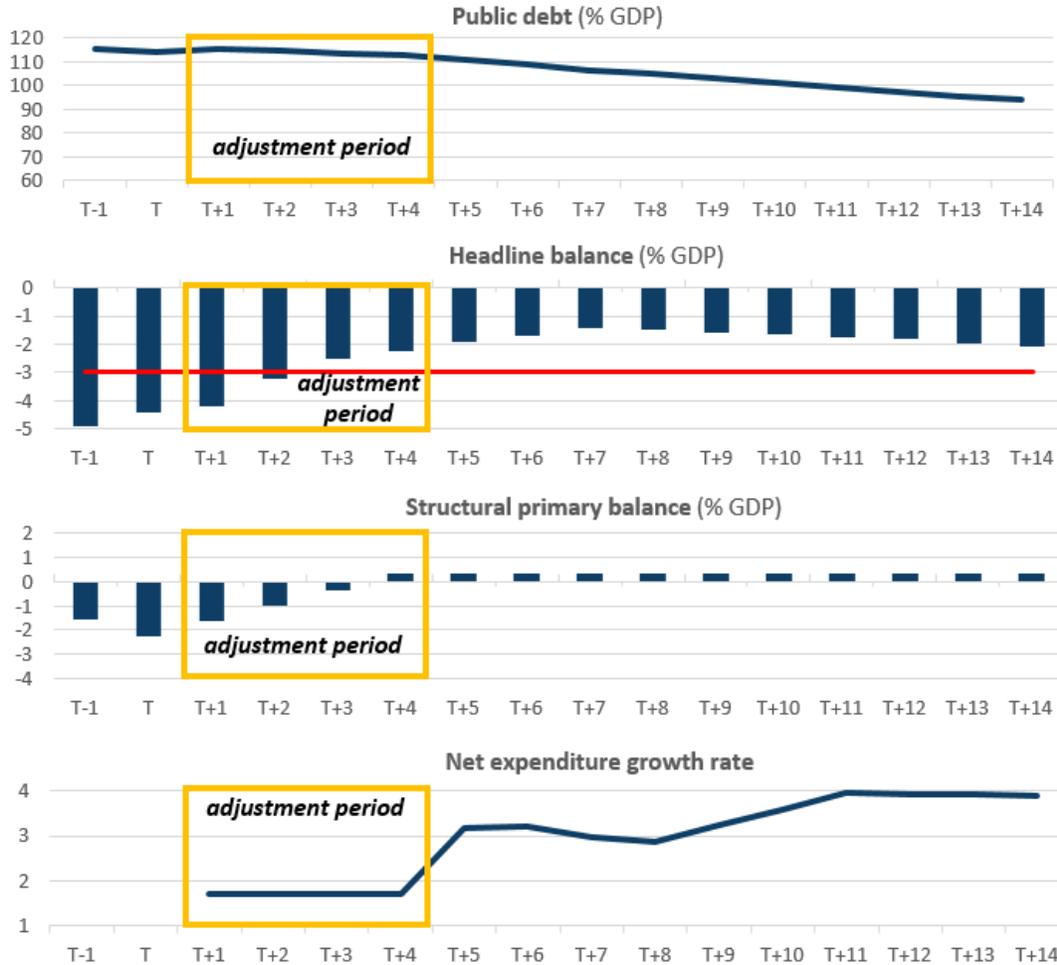
Debt: technical trajectory and deterministic stress tests
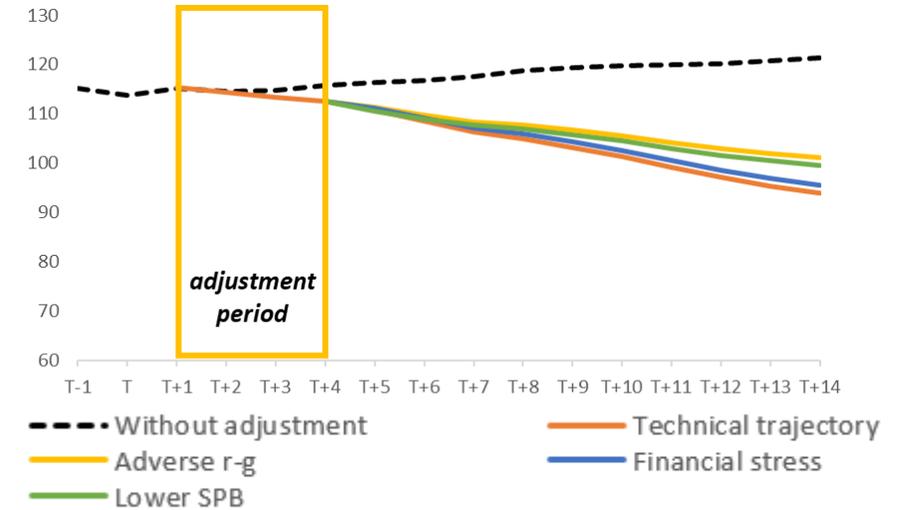
Debt: stochastic projections around technical trajectory

Illustrative simulations: adjustment requirements appear on average similar to the current fiscal rules, but better differentiated by sustainability risks

Illustrative fiscal adjustment requirements

(average across Commission DSA risk category)
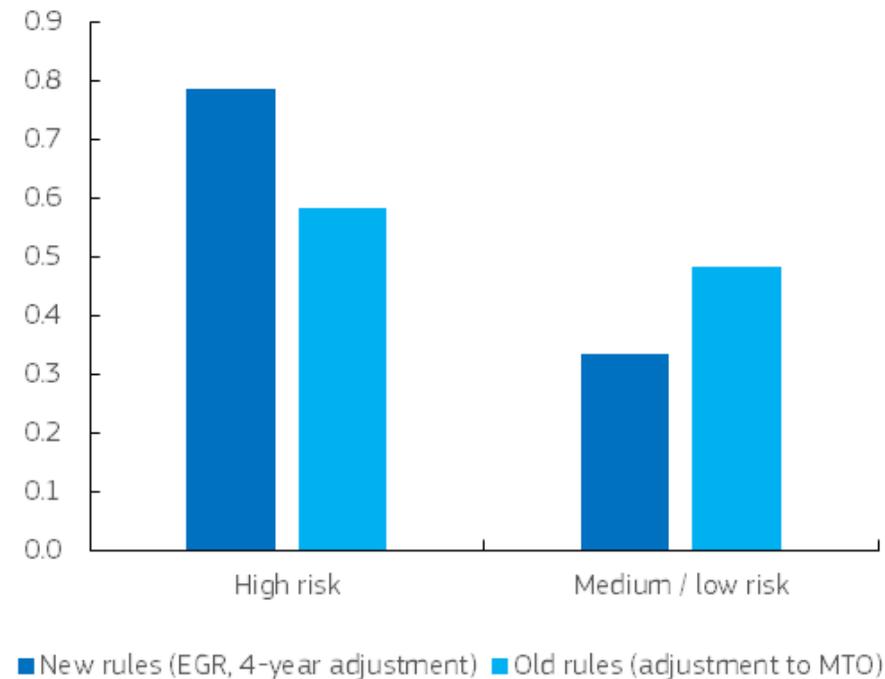
*Source: Commission services based on COM SF 2023*

More on the DSA methodology

- **Key principles**

  - Sound methodology

  - Allowing for even-handed treatment, replicability and predictability

  - While catering for country-specific factors and remaining agile

- The Commission's DSA provides a **medium-term multilateral public debt projection framework**

  - Based on common assumptions and methodologies (to a significant extent)

  - Well-established and known by the Member States (introduced in 2011, regular publications and discussions)

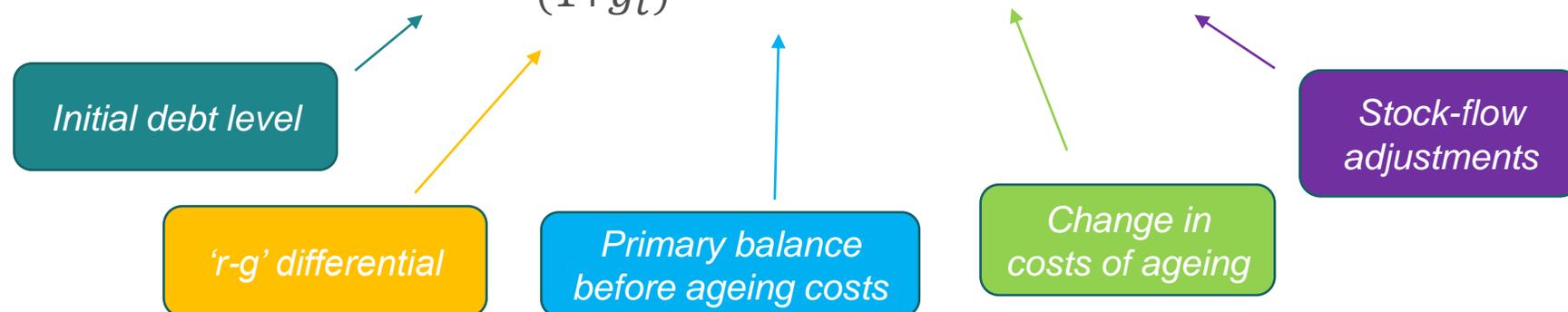 - Already plays a role in EU fiscal surveillance (corrective and preventive arms)
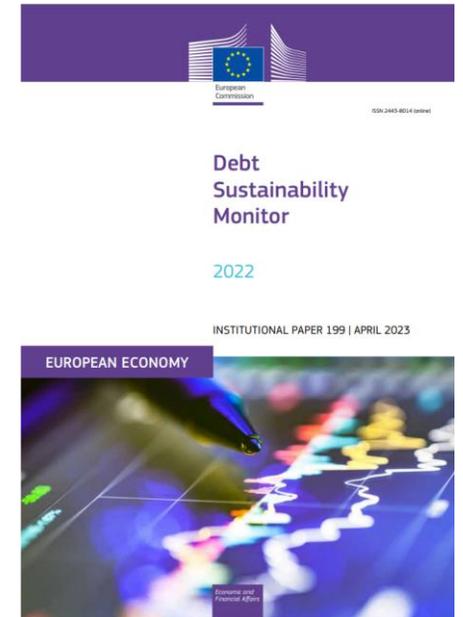
How to best communicate on the DSA?

The DSA is in itself a powerful communication tool, putting the core relevant concept for the fiscal rules at the centre of the discussions

Basic debt dynamic equation

$$\Delta D_t = D_{t-1} \cdot \frac{(r_t - g_t)}{(1 + g_t)} - PB_t + \Delta CoA_t + SFA_t$$

Initial debt level

'r-g' differential

Primary balance before ageing costs

Change in costs of ageing

Stock-flow adjustments

➢The debt dynamic is driven by a few key variables: the *initial debt level*, the current/projected *'r-g' differential*, the current/projected *primary balance* (including costs of ageing) and *stock-flow adjustments*

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Communication challenges and ways forward

- Remove the stigma effect (DSA associated to debt crises and financial assistance)

- Open the black-box ("the DSA is too complex")

- Increase ownership (e.g. providing tools to allow replicability and create a level-playing field)

- Make the best use of most advanced tools (e.g. the stochastic DSA, model-based projections) while remaining intelligible for policy-making

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Thank you

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