Pierre Gramegna

Minister of Finance, Luxembourg

How to reconcile economic growth and debt sustainability in the EU over time?

Thank you, Didier. You have made my day this morning by starting the introduction in Luxembourgish. This is quite rare and really a treat. Congratulations, because it was perfect in terms of grammar and pronunciation, so I think you can easily become an honorary citizen of Luxembourg. I know you come often and with pleasure to our country. I hope that you, I and all our listeners, who are normally participants in the Eurofi meetings, can all soon meet again for real.

Today is 16 April 2021. It was one year and one week ago, on 9 April 2020, that the Eurogroup and Ecofin Ministers decided the emergency measures to cope with the consequences of the pandemic. I remember what happened on that night very well. There were long negotiations and there was the three-pronged response to the pandemic, which triggered a symmetric economic shock that sent waves through all the countries in Europe and the world. We were able to show solidarity, take measures together and even seized the opportunity to have a Hamiltonian moment, as it has been described, by giving the Commission the possibility to take up debt on behalf of the European Union. Luxembourg was the signatory of a letter by nine Prime Ministers, saying that we should act in such a direction. We were the only triple-A country to do and I am glad we did so. Europe has, thanks to that, been able to give a credible response to the challenges ahead.

If I look at the three measures we took, there was the European Stability Mechanism (ESM) facility, which just by its existence has reassured markets and has allowed all countries to find on the capital markets the necessary bond facilities that they needed. The European Investment Bank programme with guarantees for companies is running, and the Support to mitigate Unemployment Risks in an Emergency (SURE) programme has been a total success in financing labour systems in many countries.

As the longest serving Finance Minister in the Eurogroup, I am very pleased about what happened. We can also be a little proud of what we achieved, but nevertheless let us be realistic: we still have a lot of challenges in front of us. What I have just described is what we did, in a nutshell, in a couple of weeks, just at the moment where the first wave happened. The theme of today is how to combine higher debt with good growth. Maybe because I have been in the Eurogroup for nine years, in order to understand how to deal with it, the best thing to do is to distinguish between the short, medium and long term. What did we do in the short term? Part of this has already passed behind us, in 2020 and the beginning of 2021. The short term, for me, continues in the months to come, probably for the whole of 2021 and part of 2022. The medium terms is five years from now, and then it is the long term.

What can I say about the short term? What we did in the aftermath of the immediate lockdown and the three emergency measures that I described was that we had an attitude that we should do whatever it takes to support the economy and save jobs and livelihoods. Obviously such a 'whatever it takes' approach costs a lot of money. Over the months we have learnt to live with the pandemic, waiting for the vaccines. Now the vaccines are here and we realise that we still need to support the economy, but I think that we have shifted from a 'whatever it takes' approach to a more targeted support of the economy. What do I mean by 'targeted'? I mean that we have to support those sectors that are still suffering from a partial lockdown, on the one hand; secondly, we must help those who have lost their job or are about to lose their job, through upskilling or reskilling so that they can find a new job. The second phase of more targeted support is obviously slightly less expensive but it is still very costly.

In the short-term, in which I count 2020, 2021 and 2022, we have realised that all countries have increased their debt considerably. If I take my country, we have gone from a debt-to-GDP ratio of 21% or 22% up to 28%. In my country, this is considered an enormous jump. If I compare that with other countries, our increase is still less, even in percentage terms, than other countries. In some member countries, the jump is a double-digit figure; sometimes it is as large as a 20% increase of debt compared to GDP. For that reason, and also because the national deficits have grown considerably and are far beyond the 3% limit, the European Commission and the member states decided to use the escape clause that is foreseen in the treaty, and so, for 2020 and 2021, the escape clause has allowed us to increase spending, which in consequence led to higher debt and deficits. For 2022, the decision has not formally been taken, but as the pandemic is lasting for longer than anticipated, despite the vaccine, it is close to inevitable that we will need the escape clause in 2022. In my opinion, that should be the last time we will use it, but it is inevitable that we will use it in 2022. That is for the short term.

For the medium term, the catchphrase here is, 'Quality before quantity'. Let me explain what I mean by that. The 27 countries decided last year to rebuild and restart the economy by setting up a recovery and resilience fund, and there you can already see the road that is being designed for this recovery, and that is that the priorities lie with the double transition: the green and climate transition on the one hand, and the digital transition on the other. 37% of the investments that should be triggered through that fund should be in the field of environment and climate, and 20% should be in the field of digital. That highlights what the key is. The key is to have a qualitative recovery, and we should learn from the crisis of 2008, when we really altogether made a mistake by putting too much emphasis on budgetary discipline without looking in parallel at the need for innovation and investment. We do not want to repeat that mistake and we are in the process of not repeating that mistake.

In other words, we should switch from a stability and growth pact to a growth and stability pact. It is just an inversion of the two initials, but I think the accent should lie on the word 'growth', though stability is necessary at the same time. How does that translate? After 2022 we should revamp our stability and growth pact with one key idea in mind, and that is that qualitative investment needs to be treated differently from current expenditure. We need to encourage countries to do their utmost to innovate and to invest, both at a public level and also by creating a framework in which private investment can thrive. This qualitative investment should obviously partly or to a large extent be in the same direction as the recovery fund. That means helping in the two transitions, the green one and the digital one.

In my own country, we have taken that very seriously. In fact, we have not waited for the recovery fund to put a lot of emphasis on sustainable finance, because, if we want to ensure the green transition, we must make sure, especially as Finance Ministers, that the private sector helps us organise and finance the transition. The European Union has given itself what we call a framework of taxonomy to describe what is sustainable financing of the economy. We have in Luxembourg issued a sustainable bond last year, thanks to a new framework that contains also the taxonomy of the European Union, and it is the first such sustainability bond issued by a European country and it was oversubscribed, showing that the private sector is also expecting governments to go in that direction. Another example is the Luxembourg Green Exchange, where more than half of all the green bonds worldwide are listed. This stock exchange exclusively lists green bonds, but the number of green bonds is still far too limited. They are only 2% to 3% of all the bonds issued worldwide, so we still have a long way to go.

In the medium term, in order to make debt compatible with growth, we need to be sure that we favour investment innovation and do not continue to just spend a great deal on running costs. This is key, because if we do not manage that, not only will the debt level be too high but our economies are not going to be productive and competitive. That is also the upper limit for the debt that we must see at the horizon. What is the magical number of how high or low debt should be? Nobody has that answer. It is clear that in the medium term, if we just let all countries spend as much as they want to support their economy, without insisting on quality, Europe will make itself uncompetitive.

I then come to the very last point, which is about the long term. There is one country in the world that has experienced low interest rates, which we now have. I have not talked about low interest rates yet. I would like to underline that the European Central Bank (ECB) decision to have a very accommodative monetary policy has been key to offsetting the consequences of the pandemic, with this sudden fall of the economy. Secondly, the low interest rate policy has helped all the countries to take up capital on the market at a very low cost. I also suppose that we are going to have that for quite a few years, as the ECB has already said it will do, which gives you a medium-term horizon where you can count on low interest rates, but can we keep that for the long term?

We have only one example in the world where we have seen that for the long term, and that is Japan. I have lived in that country as ambassador for six years, from 1996 until 2002. At that time, Japan already had a decade of low interest rates. Today, as we speak, Japan still has very low interest rates, so it has been there for more than a generation, for 30 years. What do we see? The growth of Japan has been far lower than the rest of the developed world, and obviously far lower than China, but that is true for all the other countries. In the very long term, low interest rates or ultra-low interest rates create other issues like an overvaluation of assets on the one hand, and it also pushes towards a poverty gap in the population in the country. In the long term, we need to take into consideration that you cannot or must not guarantee ultra-low interest rates because you have the risk of making your economy unproductive.

I have tried to answer the question that was asked. It is not an easy one, as you obviously guessed, Didier. I hope I have been as outspoken and clear as possible. In a nutshell, in the short term we have the escape clause and that helps to offset. In the medium term, we need to put the accent on qualitative investment, and in the long term we must strive to reduce again the debt burden. I will conclude by saying we should not forget that it takes one or two years to add 20% of GDP's worth of additional debt; it takes one generation to go back to the previous level, so let us not forget the long term. Thank you.