Background Document

On the assessment of the feasibility and impact of fiscal policy reform proposals

This document accompanies the report on the Feasibility and Impact of Fiscal Reform Proposals.

The feasibility and impact study of fiscal policy reform proposals was finalised **before the relaunch European Commission's review of the economic governance framework** on 19 October 2021 and therefore represents the state of debate before that date.

The assessments of the feasibility and impact of the here presented reform proposals are based on desk research and expert meetings with civil society organisations and European Commission staff that took place between 14 September and 13 October 2021.

For more information about our **assessment methodology**, please have a look into our report here.

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Proposals for reforming the EU fiscal framework

Abolishing/adjusting budgetary targets

The EU fiscal framework sets budgetary targets for all Member States. Depending on whether Member States are in the preventive arm or the corrective arm[1], different budgetary targets apply. Member States in the preventive arm are confronted with medium-term objectives (MTOs) and Member States in the corrective arm are confronted with a debt-reduction benchmark. Both set budgetary targets that Member States are required to achieve. The MTOs set targets for a close-to-balance or in-surplus budget that Member States need to comply with. These targets are country-specific and cyclically adjusted. The debt-reduction benchmark requires Member States with a debt-to-GDP ratio of more than 60% to reduce annually by 1/20 of the total level the value by which their debt-to-GDP ratio exceeds the 60% threshold. This often binds Member States to austerity as they are forced to generate budgetary surpluses. Abolishing or adjusting (e.g. setting less strict targets) the MTOs and the debt-reduction benchmark would therefore generate fiscal flexibility because Member States would only have to respect the deficit and debt rule of the Stability and Growth Pact (SGP).

Addressed in public debate (Score 3):

We assign a score of 3. Finance Watch has presented adjusting both the MTOs and the debt-reduction benchmark as possible reforms[1]. The IMK has addressed a reform of the debt-reduction benchmark[2]. The European Fiscal Board advocated for adopting realistic debt targets specific to the EU's national economies[3], which can also be understood as a critique to the MTOs and the debt-reduction benchmark. The European Parliament called 'for debt targets to properly reflect the new economic reality as well as country-specific challenges'[4]. Klaus Regling, head of the European Stability Mechanism, has criticised the debt-reduction benchmark[5]. However, this proposal has not been in the centre of attention in the debate about reform proposals.

Political support (Score 3):

We assign a score of 3. While there has not been much support outspoken for this proposal, there has similarly been not been much opposition to the proposal. Considering the currently strong momentum for fiscal policy reforms and the strong opposition to proposals that aim to abolish/adjust the deficit and debt rule, abolishing or adjusting the budgetary targets would certainly face more support and less opposition. Furthermore, the conclusions from the upcoming economic governance review are expected to give momentum to this proposal[6].

Extent of consensus needed (Score 2):

We assign a score of 2 because for these reforms to be implemented, changes in the preventive (MTO) and corrective (debt-reduction benchmark) arms of the SGP are required. Changing the MTOs would be achieved through an OLP, requiring a majority in the European Parliament (EP) and a qualified majority in the Council of the EU. Amending the debt-reduction benchmark (as its foundation is laid in

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[1] Member States are in the corrective arm if they have either breached or are at risk of breaching the deficit threshold of 3% of GDP or having a debt level above 60% of GDP.

Article 126 TFEU), however, requires a Special Legislative Procedure and thus unanimity in the Council.

Administrative hurdles (Score 3):

We assign a score of 3 because changing or abolishing the MTOs require significant changes in the SGP to allow for more fiscal flexibility. However, the current governance structure and distribution of competencies remain unchanged. Adjusting the MTOs would require a revision of the country-specific and cyclically adjusted objective to reach a structural deficit of 1.0 % of GDP to a structural surplus which were decided on in the SGP reform in 2005. An adjustment of the debt-reduction benchmark which was introduced as part of the "Six-Pack" in 2011 could be replaced by just a more sustainable value than the 1/20 benchmark. As part of the OLP, the EP and the Council (Ecofin) would have to negotiate new criteria for both rules proposed by the European Commission (EC), if not chosen to be abolished. Depending on the new criteria, this reform might conflict with the Fiscal Compact which applies to most Member States and, for some, with their respective constitutions. The Fiscal Compact is hierarchically below EU legislation and would be subject to changes in the SGP, if not part of the national constitution. Depending on legislation of the respective Member State, a change to national budget rules enshrined in national constitution would require a national referendum[7, 8].

Additional fiscal capacity (Score 2):

We assign a score of 2. Fiscal capacity would be increased for Member States as they would no longer be obliged to comply with MTOs or debt-reduction benchmarks. Especially Member States with a debt-to-GDP ratio of more than 60% would profit from abolishing or adjusting the debt-reduction benchmark as they would not be forced to generate surpluses anymore, which would be crucial for avoiding austerity. However, the generated fiscal capacity is limited because Member States would still need to comply with the deficit and debt rule. Even before the outbreak of the pandemic, many Member States were not able to comply with these rules.

Tied to green/social (Score 1):

We assign a score of 1 because the fiscal flexibility generated by this proposal results would not be tied to green or social purposes.

Tied to investments (Score 1):

We assign a score of 1 because the fiscal flexibility generated by this proposal would not be tied to investments.

Excluding certain expenditures from deficit rule

The deficit rule constrains public expenditures by limiting the annual deficit of the government budget to 3% of GDP. Special treatment could be given to certain expenditures by excluding them from the deficit rule. Expenditures that qualify for an exclusion from the deficit rule would then not be taken into account when calculating the budget deficit. For instance, green investments could be excluded from the calculation of the Member States' budget deficit ("golden rule"). This would generate fiscal flexibility as it enables more investments while still complying with the deficit rule.

Addressed in public debate (Score 4):

We assign a score of 4 because the massive investment needs for the green transition have triggered an intense debate about how to finance these investments. Thereby, especially the 'golden rule' has received a lot of attention. This proposal allows to stick to the current fiscal rules and at the same time

enables large-scale investments by excluding these investments from the fiscal rules. The 'golden rule' is heavily supported by the two German research institutes, the Institut der deutschen Wirtschaft (IW) and Institut für Makroökonomie und Konjunkturforschung (IMK)[9], which is remarkable because the former is considered to be representing employees and the latter is associated with German trade unions. Further prominent calls for a 'golden rule' stem from Bruegel[10], the European Economic and Social Committee (EESC)[11], the European Fiscal Board (EFB)[12], the European Trade Union Institute (ETUI)[13] and economist Peter Bofinger, formerly a member of the German council of economic experts[14].

Political support (Score 4):

We assign a score of 4. Opposition from certain countries must be expected because the exclusion of large amounts of expenditure depicts a departure from conservative fiscal policies. However, proposals like the golden rule have received meaningful support by the French Finance Minister Bruno Le Maire[15], the German green party[16], EU Commissioner for Economy Paolo Gentiloni[17] and even fiscally conservative countries are expected to not boycott exempting green investments[18]. Additionally, the European Commission is working on how to change the application of the SGP, especially to exempt investments, environmental ones in particular[19]. Furthermore, the conclusions from the upcoming economic governance review are expected to give momentum to this proposal[20].

Extent of consensus needed (Score 2):

We assign a score of 2. This proposal would require changes to the SGP. Depending on the concrete design of the proposal, amending elements of the SGP requires an Ordinary Legislative Procedure (OLP) or a Special Legislative Procedure (SLP). The exact changes required depend on the concrete design of the proposal. Most likely, the preventive arm of the SGP, particularly the MTOs and the adjustment path in case of non-compliance, would need to be changed so that they allow for the exclusion of net public investments from the structural deficits, if those are financed through additional government debt (OLP required). Such changes would then also affect the corrective arm of the SGP, as an *Excessive Deficit Procedure* oblige Member States to reduce their structural deficits[21]. Furthermore, the debt-reduction benchmark in the corrective arm of the SGP would have to be modified as well to allow for debt-financed net-public investment while reducing debt-to-GDP ratio (SLP required). To clarify the definition of investment, an 'investment protocol' could be enshrined in primary law. This would require unanimous agreement among Member States as part of a Simplified Revision Process of Article 48(2) of the TFEU.

Administrative hurdles (Score 3):

We assign a score of 3 for this proposal. The implementation of a golden rule, besides legislative changes, would require a comprehensive definition of investment. To avoid the need to change every rule that concerns structural deficits or the 3% deficit rule in the SGP, an "investment protocol" could be established[22]. This would clarify the definition and be enshrined in treaties so that it then applies to all fiscal rules in primary and secondary law[23,24] .

Additional fiscal capacity (Score 4):

We assign a score of 4 because this proposal would allow for large-scale investments because they would not count towards the deficit (and debt) rule.

Tied to green/social (Score 4):

We assign score of 4 because the fiscal flexibility generated by this proposal results from excluding expenditures from the deficit rule which would most likely be tied to green or social purposes. However, this would only include investments in fixed assets and financial assets, and would exclude certain investments in education, research and other crucial areas[25].

Tied to investments (Score 5):

We assign a score of 5 because in all prominent proposals of this type, only investments are excluded from the deficit rule and the generated fiscal flexibility is therefore entirely tied to investments.

Fiscal Union

In recent years, various proposals for a fiscal union have been discussed. Proponents argue that a fiscal union in one form or another would be the next level in advancing the integration of the European Monetary Union (EMU), to which 19 of the 27 member states belong. In a fiscal union, the EU Member States would share a common budget consisting of contributions from each Member States. The current fiscal rules that Member States need to comply with would be redundant because a centralised fiscal authority would coordinate spending and taxation. Debt financing would also be handled through common bonds and not individually by Member States.

Addressed in public debate (Score 4):

We assign a score of 4 because advancing a fiscal union is a proposal that has been in the public debate for many years now[26] and is also discussed as a potential way for the current recovery process. A recent paper by Shahin Vallée from the German Council on Foreign Relations (DGAP) has sketched this way towards a fiscal federation together with the detailed interim steps required[27]. Further support for the idea of a fiscal union in the EU stems from the EFB[28] and the International Monetary Fund (IMF)[29].

Political support (Score 2):

We assign a score of 2. While influential politicians like Christine Lagarde[30], Olaf Scholz[31] and Emmanuel Macron[32] have indicated their support for a fiscal union, many Member States are strongly opposed to the idea[33]. In Germany's election debate, the conservative party clearly rejects this proposal[34] while the green party and the SPD support it[35].

Extent of consensus needed (Score 1):

We assign a score of 1. A deeper integration of the EMU towards a centralised fiscal authority that coordinates spending, taxation and debt financing would overhaul national and EU fiscal rules and would require significant changes to institutional competences. Although the extent of consensus needed to implement such a reform depends on level of integration and format of the fiscal union, it is also set out in the treaties that Member States remain fully competent with regards to their fiscal decisions. Hence, the realisation of a complete fiscal union requires a treaty change.

In addition, national constitutions limit the shift of competences in fiscal matters to supranational level. This is particularly the case for Germany, where the German constitutional court sets quite strict limits to the transfer of competences to EU level. For example, according to the court, the German Bundestag is prevented from ceding its budgetary competences to the supranational level. The

Bundestag is also supposed to make all fundamental and central decisions in fiscal matters[2]. It therefore stands to reason that a transfer of competences in fiscal policy matters to the Union level would be in conflict with the German constitutional order.

A way around this could be to move forward with only a limited number of Member States, where the constitution allows for a deeper fiscal integration. In this case, "Enhanced cooperation" could be an option[36]. The procedure of "enhanced cooperation" allows a minimum of nine EU Member States to set up advanced integration. Member States who wish to participate in an enhanced cooperation would have to submit a proposal to the Commission. The Commission can approve or reject the request. In case of approval, the Commission must then submit a request for a proposal for enhanced cooperation to the Council of the European Union and the EP. The Council takes a decision by unanimity on the request. Should the Council approve the request, the EP also has to approve it by simple majority voting. "The procedure is designed to overcome stalemate where a particular proposal is blocked by one or more Member States who do not want to take part. It does not, however, allow for an extension of powers outside those permitted by the EU Treaties"[37]. Thus, changes to institutional competences might still require treaty changes. The treaties can be changed in an ordinary or simplified revision procedure. However, unanimity is required in both cases.

Administrative hurdles (Score 1):

We assign a score of 1. Major tasks of a complete fiscal policy are the provision of public goods, redistribution, and the stabilisation of aggregate demand at the potential of the national economy to prevent macroeconomic imbalances. To set up such structures at EU level, significant changes in the current structure of the Union are needed. Even for a rather incomplete version of a fiscal union, changes in the institutional framework are indispensable. For example, a system of financial risk sharing at EU level would need to be established. Such a harmonisation would require reinforcing the integration of the capital markets towards a Capital Market Union and a completion of the Banking Union[38]. Likewise, a fiscal union would need the establishment of a supranational authority that coordinates spending and taxation.

Additional fiscal capacity (Score 5):

We assign a score of 5 because a fiscal union would gather all the EU's fiscal capacity centrally. New fiscal rules could be negotiated that allow for ample fiscal flexibility and new revenue sources could be agreed upon to collect a large number of resources available for fiscal policy.

Tied to green/social (Score 1):

We assign a score of 1 because the fiscal flexibility generated by a fiscal union is not necessarily tied to any green or social purpose unless there is clear guidance for the fiscal policy of the union.

Tied to investments (Score 1):

We assign a score of 1 because the fiscal flexibility generated by a fiscal union is not only tied to investments but will also give way to a big amount of public spending.

Reforming escape clauses

The EU fiscal framework includes escape clauses that allow for deviations from the SGP's preventive or corrective arms in exceptional circumstances (Excessive Deficits Procedures included)[39]. This can

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[2] The Bundesverfassungsgericht established already in its Lisbon-judgment that 'particularly sensitive areas, such as 'fundamental fiscal decisions on public revenues and public expenditure' had to remain under the control of the German parliament, cf. 2 BvE 2/08 - Lisbon-judgment BVerfG, paras. 167, 250, 252.

be done either through the *unusual events clause* or through the *general escape clause*. Since the outbreak of the COVID-19 pandemic, the *general escape clause* is activated. It can be activated when the euro area or the Union as a whole faces a severe economic downturn. The *unusual events clause* can be activated when an unusual event outside the control of one or more Member States has a major impact on the financial position of the general government. The *general escape clause* allows for more far-reaching flexibility than the *unusual events clause*. However, both can only be applied "provided that this does not endanger fiscal sustainability in the medium-term"[3]. Hence, by relaxing the conditionality for activating the clauses, both clauses could be reformed to enable more fiscal capacity for Member States in exceptional circumstances. There is also a need to clarify the procedures of the escape clauses, for instance by making it more clear for Member States and all other stakeholders about the steps, processes and responsibilities in the case of the activation and deactivation of one of the two escape clauses.

Addressed in public debate (Score 1):

We assign a score of 1. Finance Watch has called for clarifying the escape clauses' procedure[40] and Paolo Gentiloni, EU Commissioner for the Economy, has advocated making it easier to suspend fiscal rules in a downturn[41]. However, media coverage or intense debates around this proposal are hard to find.

Political support (Score 2):

We assign a score of 2. While Paolo Gentiloni has advocated for making it easier to suspend fiscal rules in a downturn[42], there has been no strong campaigning for this proposal by any Member States.

Extent of consensus needed (Score 2):

We assign a score of 2 for this proposal. The EC could, through tweaking the Code of Conduct of the SGP, affect the implementation of the *general escape clause* and the *unusual event clause* (e.g. for how long they can be activated). While this could generate some flexibility, major changes or specifications to the conditions of the clauses and their application need to be decided by unanimity in the Ecofin Council. A SLP is required as amendments in the preventive as well as the corrective arm of the SGP are needed.

Administrative hurdles (Score 4):

We assign a score of 4 because it only requires changes in the definition of the conditions when the clauses apply. No significant changes in governance structure would be needed since the framework regarding implementation and surveillance is already in place[43].

Additional fiscal capacity (Score 2):

We assign a score of 2. While a reformed escape clause would certainly create huge fiscal capacities when activated, this would only apply in exceptional circumstances. In usual circumstances, a reformed escape clause does not generate additional fiscal capacity.

Tied to green/social (Score 2):

We assign a score of 2 because the generated fiscal flexibility when activating the potentially reformed escape clause would not necessarily be tied to green or social purposes. However, it is possible that a reform of both clauses would establish such a conditionality.

[3] Article 6(3) of Regulation (EC) 1466/97: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:01997R1466-20111213&from=EN

Tied to investments (Score 2):
We assign a score of 2 because the generated fiscal flexibility when activating the potentially reformed escape clause would not necessarily be tied to investments. However, it is possible that a reform of both clauses would establish such a conditionality.

Reforming investment clause

The investment clause in the SGP allows for temporary deviations from the medium-term budgetary objective or from the fiscal adjustment path towards it for those member states whose investments can be considered equivalent to major structural reforms under these conditions[44,45]:

- their GDP growth is negative, or their GDP is below its potential
- the deviation from the MTOs or path towards it does not lead to a government deficit greater than 3% of GDP and an appropriate safety margin is preserved to prevent such a breach
- investment levels are increased as a result of the deviation granted
- the deviation is linked to the fact that a member state co-finances projects that are also funded by the EU programmes and by the EFSI
- the Member State compensates for temporary deviations within the timeframe established in the Member State's programme (stability programme for the euro area Member States and convergence programme for non-euro area Member States)

These strict conditions prevent a regular application of the investment clause. It could be reformed by relaxing the conditionality, and by being turned into a 'sustainable investment clause', i.e. favouring necessary sustainable public investment[46]. One proposal that is currently discussed aims to relax the conditionality by mirroring the Recovery and Resilience Facility (RRF) process. This would include 5-year national investment plans proposed by the member states and an assessment and approval by the Commission and the Council. All the investment and spending related to the approved national plan would then have special treatment in the fiscal rules.

Addressed in public debate (Score 2):
We assign a score of 2 because this proposal has not been mentioned frequently in the public debate. A reform of the investment clause has been mentioned by Bruegel[47] and Finance Watch[48]. However, the debate on this proposal has always been overshadowed by the much livelier debate around the 'golden rule' proposal which is similar in the sense that it also targets the exclusion of investments from the fiscal rules but goes beyond the investment clause proposal because it includes this as a permanent feature and not just as a clause for exceptional circumstances. The debate around excluding investments from the fiscal rules has therefore been much more centred around the 'golden rule' than around the investment clause.

Political support (Score 4):
We assign a score of 4. The support from the French Finance Minister Bruno Le Maire[49], the German green party[50] and EU Commissioner for Economy Paolo Gentiloni[51] for excluding certain expenditure from the deficit rule can also be seen as support for reforming the investment clause. If excluding certain expenditure from the deficit rule should not be feasible, reforming the investment clause for only temporary exclusions of investments from the fiscal rule would be an obvious second-best solution[52]. The fact that even fiscally conservative countries are expected to not boycott exempting green investments[53] can also be relevant for this proposal. Additionally, the Commission itself has

acknowledged that the current design of the investment clause does not give Member States the required flexibility[54]. Furthermore, the conclusions from the upcoming economic governance review are expected to give momentum to this proposal[55].

Extent of consensus needed (Score 3):

We assign a score of 3. As with the reform of the escape clauses, any change or specification of the conditions for the application of the investment clause requires an amendment of the corrective arm of the SGP which the investment clause is a part of. Therefore, this reform requires an OLP, which requires a simple majority in the EP and a qualified majority in the Ecofin Council.

Administrative hurdles (Score 4):

We assign a score of 4. Besides the legislative process, the investment clause is already put into place and does not necessarily require any additional changes in governance structures in terms of implementation or surveillance. On the contrary, as part of relaxing its conditionality, Member States would be able to circumvent the necessity of just being able to invest in projects that are part of an EU programme or the EFSI which would allow for more flexibility as well.

As for a “sustainable investment clause”, the changes to be made would be the same but require broad definition of necessary sustainable investment and may require some safeguards to prevent abuse of such an investment clause which could be included into the European Semester[56,57].

Additional fiscal capacity (Score 3):

We assign a score of 3. On the one hand, the investment clause could be reformed in a way that it allows for many large-scale investments. On the other hand, it would still be a clause that would have to be activated and would not mean a permanent exclusion of investments from the fiscal rules.

Tied to green/social (Score 4):

We assign a score of 4. While it is heavily dependent on how the investment clause would be reformed, we expect green and social purposes to be central to a reform.

Tied to investments (Score 5):

We assign a score of 5 because it is inherent in this proposal that fiscal flexibility is only generated for investments.

Replacing debt rule with national medium-term debt targets

Only the MTOs of the current EU fiscal framework are country-specific fiscal rules. The deficit and the debt rule are not country-specific and therefore fail to adopt to country-specific circumstances. The debt rule could therefore be replaced by national medium-term debt targets. There are many different proposals for designing these national medium-term debt targets, for instance the setting of national debt targets by each government and an assessment of the compatibility of these targets with EU sustainability standards by Independent Fiscal Institutions (IFI) under consultation of the Commission and the Council[58].

Addressed in public debate (Score 2):

We assign a score of 2. The EFB has been the most prominent voice calling for adopting realistic debt targets specific to the EU’s national economies[59]. Besides that, there has been no intense debate.

Political support (Score 2):

We assign a score of 2. While Valdis Dombrovskis, the Executive Vice President of the European Commission, has stated his support for "a debt reduction path that is realistic for all Member States"[60]. While Member States with high debt levels will most likely support this reform, fiscally conservative governments are likely to block it, as it would require abolishing the debt (and deficit) rule.

Extent of consensus needed (Score 2):

We assign a score of 2 because this proposal would require amending the uniform numerical threshold for the debt (60% of GDP) and the deficit (3% of GDP) rule, which are set out in Protocol 12 annexed to the TFEU. However, the authors of the reform proposals note that "the reforms we propose are substantial but compatible with the essential provisions of the European Treaties".

In addition, the value for public debt which is mentioned in Article 126 would need to be interpreted as country-specific rather than uniform. Ultimately, this would require amending Protocol 12. Amending protocol 12, annexed to the TFEU, requires unanimous agreement in the Council of the EU as part of a SLP.

Administrative hurdles (Score 2):

We assign a score of 2 for this proposal, as it not only requires a change to primary EU legislation but also a redefinition of responsibilities of IFIs and the EFB. Such a decentralization would require strengthened national IFIs that also have audit and surveillance capacities to assess sustainability of public finances. However, a universal definition as well as a common methodology for assessing sustainability would need to come from the EFB.

For effective enforcement, the introduction of an 'adjustment account' is recommended by the authors to keep memory of past spending and contain or permit future spending overruns in each Member States[61].

Additional fiscal capacity (Score 4):

We assign a score of 4. While the actual generated fiscal capacity depends on how strict the national medium-term debt targets would be, the abolishment of the uniform values of the debt (and deficit) rule inherent to this proposal can potentially generate large fiscal flexibility.

Tied to green/social (Score 1):

We assign a score of 1 because the fiscal flexibility generated by this proposal results from the abolishing of previous rules but would not be tied to green or social purposes.

Tied to investments (Score 1):

We assign a score of 1 because the fiscal flexibility generated by this proposal results from the abolishing of previous rules but would not be tied to investments.

Replacing fiscal rules with fiscal standards

The current EU fiscal framework relies on numerical targets for both the government deficit and the government debt. This focus on a quantitative assessment of fiscal policy neglects a qualitative assessment. This could be overcome by abolishing certain numerical targets and replacing them with fiscal standards. Several proposals have been made that can be classified in this category, for instance integrating the quality of spending into stability and convergence programme and draft budgetary

plans, taking the social dimension of fiscal policy into account and a renewed Macroeconomic Imbalances Procedure (MIP)[62].

Addressed in public debate (Score 4):

We assign a score of 4 because many proposals have been made that can be classified under this category. Especially the proposal for standard-based fiscal policy by Blanchard, Leandro and Zettelmayer[63] has attracted a lot of attention in the public debate and has been addressed critically by Dezernat Zukunft[64] and Shahin Vallée[65]. Fiscal standards have also been discussed by Finance Watch[66,67].

Political support (Score 1):

We assign a score of 1 because this proposal is not considerably supported by meaningful political players and will be opposed by many fiscally conservative Member States that reject abolishing the deficit and debt rule. Moreover, Pascal Donohoe, president of the Eurogroup has ruled out fiscal standards[68].

Extent of consensus needed (Score 1):

We assign a score of 1 for this proposal. Replacing fiscal rules with fiscal standards would most likely require amendments in EU primary legislation and thereby unanimity among Member States as part of an Ordinary Revision Procedure. Although Article 126(1) TFEU only obliges Member States to avoid "excessive deficits" and does not contain a precise definition of these deficits, reference is made to (numerical) values. Article 126(2) specifies that, under certain conditions, a Member States shall examine compliance with budgetary discipline if its debt- or deficit-level exceed a certain reference value. This part of the treaty contradicts with the proposed budgetary framework of fiscal standards. In addition, to determine whether fiscal standards are met or not, criteria and procedures need to be enshrined in EU primary or secondary legislation, as well as national changes in national laws to be consistent with EU legislation.

Changing the indicators within the Macroeconomic Imbalance Procedure (MIP) would require an OLP. The MIP is part of the SGP and was implemented as part of the Sixpack reform in 2011. The proposal for reform would have to come from the Commission, followed by co-decision between the EP and the Ecofin Council.

Administrative hurdles (Score 3):

We assign a score of 3. Shifting towards a qualitative framework entails major changes in governmental structures and calculation methods, which could, however, build up on existing methods and processes. For fiscal standards, there is the need to determine debt sustainability via Debt Sustainability Analysis (DSA) which is already widely practised by, among others, the EC, the ESM and the IMF. DSAs are currently produced by the EC for Member States requesting ESM financial assistance, which also lead the EC to produce an extensive annual Debt Sustainability Monitor[69]. However, an adjudicator would play an important role in a standard-based fiscal policy that is based on a qualitative framework. The authors of this proposals argue that national independent fiscal institutions, the European Commission or the EFB could be primarily responsible for fiscal surveillance. Hence, they would initially determine the compliance with the fiscal standards. In a second stance, it could either be the Council of the European Union or the European Court of Justice that is responsible for final adjudication[70]. In any case, there might be the risk of a legitimacy problem when expert bodies decide whether standards are met. This might also be fuelled by the discretion that these bodies can exercise.

Proponents of the proposal to amend the MIP point to the need to adjust the indicators used. This would require the development of a different framework for indicators that factor in the progress towards climate neutrality and should reflect the interaction with monetary policy. A different format to enforce compliance with broader macroeconomic and macro-financial standards should be established. These changes need to be enshrined in secondary legislation. Therefore, an OLP is required.

Additional fiscal capacity (Score 4):

We assign a score of 4 because the abolishment of the deficit and debt rule would generate a lot of fiscal flexibility, only some of which would be constrained by the new fiscal standards.

Tied to green/social (Score 4):

We assign a score of 4 because the reasoning behind fiscal standards is exactly to not just look at the numbers of fiscal performance but also the purpose behind it. This makes it very likely that the generated fiscal flexibility within a fiscal standards framework would be tied to green or social purposes.

Tied to investments (Score 4):

We assign a score of 4 because the reasoning behind qualitative fiscal standards is exactly to not just look at the numbers of fiscal performance but also the purpose behind it. This makes it very likely that the generated fiscal flexibility within a fiscal standards framework would be tied to investments.

Expenditure rule

The expenditure rule would serve as a main operational target which leads to an appropriate medium-term public debt level target. This rule would not prohibit but constrain new government priorities on spending and revenues. As such, nominal expenditures should not grow faster than medium-term nominal output. They should grow slower in countries with excessive debt levels[71]. The main benefit of an expenditure rule is that it can be designed countercyclical, allowing for deficits in recessions, and limiting expenditures to below revenues in booms. An expenditure rule could limit the increase in non-cyclical non-investment (nominal) government expenditure according to the growth rate of potential GDP and debt ratio or debt reduction targets[72]. This would generate more fiscal flexibility for public investments. However, depending on the design of the expenditure rule, public spending (acquisition of goods and provision of services) could also be given more space.

Addressed in public debate (Score 3):

We assign a score of 3. An expenditure rule has been called for by the EFB[73], EESC[74], the IMK[75] and in an article by staff from the European Commission but has not been in the centre of the public debate.

Political support (Score 3):

We assign a score of 3. The previously mentioned (in the investment clause proposal and the proposal for excluding certain expenditures from the deficit rule) support from the French Finance Minister Brune Le Maire[76], the German green party[77] and EU Commissioner for Economy Paolo Gentiloni[78] for excluding certain expenditure from the deficit rule can also be connected to this proposal. Similarly, the fact that even fiscally conservative countries are expected to not boycott exempting green investments[79] can be relevant for this proposal. And additionally, even fiscal conservatives like Lars Feld have come up with an expenditure-rule-based proposal[80].

Extent of consensus needed (Score 2):

We assign a score of 2 for this proposal. The necessary legal changes depend on the concrete implementation of the expenditure rule. Some proposals would require amending Protocol No. 12 to as they would be inconsistent with the 60% target. Also, the value for public debt which is mentioned in Article 126 would need to be interpreted as country-specific rather than uniform for some reform proposals. Ultimately, this would require a SLP.

However, there are also proposals that are in line with the deficit- and debt-rule of the treaty and that would determine country-specific expenditure paths accordingly. These proposals would only require changes in the preventive and corrective arm of the SGP. In particular, the MTOs and the Excessive Deficit Procedure would both have to be adjusted so they are determined by the country specific expenditure paths instead of the structural deficits of Member States [81]. In this case, it still requires unanimity in the Council since it also affects the corrective arm of the SGP.

Administrative Hurdles (Score 3):

We assign a score of 3 for this proposal. There is the need to provide a common methodology (proposed in IMK paper) and monitoring (as well as the institution responsible for surveillance), definition of non-cyclical non-investment (nominal) government expenditures, exemptions for expenditure rule during severe economic downturns decided by a majority vote in the Eurogroup and the introduction incentives instead of sanctions to abide by the expenditure rules (additionally the introduction of a complementary golden rule for public investments as above)[82].

Additional fiscal capacity (Score 4):

We assign a score of 4 because the expenditure rule would only constrain spending and would generate large fiscal capacity for investments.

Tied to green/social (Score 1):

We assign a score of 1 because an expenditure rule would most likely exclude all types of investments, regardless of its purpose.

Tied to investments (Score 4):

We assign a score of 4 because only investments would be excluded from the rules but the expenditure rule itself might create some fiscal flexibility which is not necessarily tied to investments.

Proposals for circumventing fiscal framework

Increasing EU revenues

Allowing for more deficit and debt is not the only way to generate more fiscal flexibility. Increasing revenues and decreasing harmful expenditures is another way. While doing this on a national level would be a huge lever, analysing specific national circumstances is beyond the scope of this paper. However, revenues can also be increased on an EU level. By collecting more revenues (through increasing the so-called Own Resources Ceiling, the maximum amount of money than can be called

from Member States), the EU could increase either the headroom for borrowing on financial markets or the payments-ceiling under the long-term budget (Multiannual Financial Framework). Both could increase fiscal flexibility of Member States, either by borrowing more on financial markets and giving it to Member States or by paying out more from the budget to Member States. Examples for possible own resources that could be collected additionally to custom duties, VAT-contributions, GNI-contributions and national contributions based on non-recycled plastic packaging waste are[83,84]:

- resources from an extension of the Emissions Trading System
- resources from a carbon border adjustment mechanism
- resources from a digital tax
- resources from operations of companies that draw huge benefits from the EU single market
- resources from a financial transaction tax
- resources from a new common corporate tax base

Addressed in public debate (Score 2):

We assign a score of 2. While there is some debate about the implementation of additional taxes or other forms of additional revenues on an EU level, this is often motivated by possible steering effects of the taxes and not by the aim of generating fiscal flexibility in the EU.

Political support (Score 3):

We assign a score of 3. All political support for a fiscal union should also be valid for increasing EU revenues, as a fiscal union would collect significantly more own resources and would have way higher tax raising powers. Additionally, we expect fewer opposition from Member States to an increase in collected taxes by the EU compared to many other proposals that build on drastic reforms to the EU fiscal framework. However, opposition can be expected from all Member States that oppose a strengthening of competencies of the EU.

Extent of consensus needed (Score 2):

We assign a score of 2. According to Article 311 of TFEU, the Council can introduce new legislative acts for the creation of additional EU revenues and thereby increasing the EU's own resources by a SLP. In this case, the EP has a consulting role. The Council must take a unanimous decision. Additionally, the decision requires ratification by Member States to enter into force.

The EP must vote with an absolute majority on decisions on the EU budget (the Multiannual Financial Framework), which concerns for example the inclusion of additional categories for EU revenue and therefore raising the Own Resource Ceiling.

Administrative hurdles (Score 3):

We assign a score of 3 because each legislation would require an elaborate process for creation and approval. The EC would introduce mechanisms to increase the EU's revenues and have to back them with estimates of the additional generated contributions to the budget. Mechanisms currently in discussion include a carbon border tax, levy on non-recycled plastic packaging waste and a digital tax. As of 1 January 2021, a contribution based on the non-recycled plastic packaging waste was introduced as a new revenue source to the 2021-2027 EU budget. Each of those would require individual legislative acts and additional instances to enforce. All proposals are at some point constrained by the own resource ceiling (currently increased to 2% of GNI due to the Covid recovery) which can be increased by unanimous agreement in the Council, national approval and an absolute majority in the EP when deciding on the MFF [85].

Additional fiscal capacity (Score 3):

We assign a score of 3 because the amount of fiscal capacity generated depends on whether the Own Resources Ceiling would be lifted. While an increase in the EU Own Resources Ceiling would potentially allow the EU to generate large revenues, the collected revenues would remain relatively low if the Own Resources Ceiling won't be increased[86].

Tied to green/social (Score 3):

We assign a score of 3 because on the one hand there is no obligation to direct the collected revenues to green or social purposes but on the other hand for most of the taxes, the tax collection itself will have positive effects on these areas as, for example, greenhouse gas emission reductions are encouraged.

Tied to investments (Score 1):

We assign a score of 1 because there is no obligation to direct the collected revenues to investments.

Special purpose vehicle

The current EU fiscal framework could be circumvented by using special purpose vehicles, which are state-owned entities that borrow funds and use these for public investment. To set up such a fund, the government would have to take on debt to provide the special purpose vehicle with financial capital. The special purpose vehicle could then be commissioned with green and social investments. To avoid being subject to the EU fiscal rules, such special purpose vehicles would have to be legally independent. An injection of financial capital from the government into a legally independent non-public sector entity would be considered a financial transaction and would therefore not be subject to domestic and EU fiscal rules. In order to not be classified as a public sector entity by Eurostat (see European System of National and Regional Accounts), the primary income of the special purpose vehicle has to come from the market. However, since many other factors have to be considered, it is not entirely clear how such a fund would be classified before it is set up. Such a special purpose vehicle can not only be set up on a national level but also on a European level by equipping the EIB with more equity from Member States. As the Bank can lend up to two and a half times its subscribed capital, increased equity would mean that the EIB could finance more investments in the Member States.

Addressed in public debate (Score 3):

We assign a score of 3. In Germany, this proposal is extremely often mentioned as a potential option for circumventing both the EU's and the national fiscal rules in the public debate. It has often been discussed in the German election debate and has been brought up in influential papers by IW and IMK[87] and by Dezernat Zukunft[88]. It is additionally supported by the majority of Germany's most influential economists[89]. However, it attracts much less attention in the debate on EU level.

Political support (Score 4):

We assign a score of 4 because there is a strong momentum for this proposal in Germany which is the most powerful player in the EU. The idea of special purpose vehicles is supported by the German Green Party[90], by the Federation of German Industries (BDI)[91] and CDU/CSU as well as FDP are also expected to be open to this as they want to reduce taxes and increase investment without reforming the fiscal rules[92,93]. And similar to previous proposals, the fact that even frugal countries are expected to not boycott exempting green investments[94] indicates important political support for this proposal.

Extent of consensus needed (Score 4):

We assign a score of 4 because setting up national investment funds is in the scope of Member States. Establishing a legally independent investment fund is a governmental decision.

Administrative Hurdles (Score 3):

We assign a score of 3. On the one hand, a special purpose vehicle could be arranged within the existing framework and would need no adjustment to the fiscal rules. On the other hand, setting up a special purpose vehicle in a way that it is legally independent from the member state is a very complex process. The classification of the vehicle as a public or private entity is done by Eurostat[95]. In order to avoid being classified as a public entity, the special purpose vehicle would, among other conditions, have to generate its primary income from the market.

Additional fiscal capacity (Score 4):

We assign a score of 4. By allowing for large-scale investments that are not counted towards the national and EU fiscal rules, special purpose vehicles would generate large fiscal capacity. The IMK estimated that a national investment fund would allow for €222 billion of additional investments between 2023 and 2030 in Germany if both national and EU fiscal rules are to be circumvented or revised[96]. We do not assign a score of 5 because the fiscal capacity would mainly be generated through loans and not through grants.

Tied to green/social (Score 2):

We assign a score of 2. It is very likely that the special purpose such a vehicle would be designed for, is a green and/or social one. However, two decisive weaknesses justify a rather low score. First, such a vehicle would invest in fixed assets, but a green transition would also require a lot of subsidies, for instance for building renovations or energy prices. Second, the lack of democratic control due to the autonomous nature of such a vehicle carries the risk that the funds will be used for a different purpose.

Tied to investments (Score 5):

We assign a score of 5 because it is inherent in this proposal that fiscal flexibility is only generated for investments.

Making NGEU permanent

Using the already existing recovery fund "Next Generation EU" (NGEU), the EU could set up a permanent fund for increasing the fiscal capacity of the Member States. Such a fund could provide Member States with financial resources and thereby increase their fiscal flexibility. The NGEU's Recovery and Resilience Facility (RRF) could form the basis for a such a long-term fund. This could be enabled by the natural disaster clause, through which the Council "may grant Union financial assistance to the Member States concerned" as a response to "natural disasters or exceptional occurrences beyond the Member States' control" (see TFEU, Article 122).

Addressed in public debate (Score 4):

We assign a score of 4 because this proposal has been addressed frequently in the public debate. Ignazio Visco, governor of the bank of Italy, has called for making the recovery fund a permanent instrument [97]. Similarly, both the EESC[98] and the EFB[99] support making the NGEU permanent. The recent paper on a fiscal union by Shahin Vallée from the German Council on Foreign Relations also touches upon permanent funds[100].

Political support (Score 3):

We assign a score of 3. While many Member States and especially the German CDU/CSU strongly oppose a permanent EU fund[101], German SPD chancellor candidate Olaf Scholz advocated for using the recovery fund as a first step towards a European fiscal union[102], the French government wants to put forward a proposal for a 10-year investment plan when it takes over the EU presidency early in 2022[103] and Christine Lagarde also supports making the NGEU permanent[104].

Extent of consensus needed (Score 2):

We assign a score of 2. It is not clear if a permanent NGEU would require a treaty change because there is no particular law in the treaty that would have to be changed and both article 310 and 323 of the TFEU state, that the EU, through the EC, is empowered to borrow from financial markets under certain circumstances. However, as it was with NGEU, making it permanent would require unanimous agreement among Member States. Additionally, every seven years, it has to be integrated into the EU budget, the multiannual monetary framework (MFF), for which it requires unanimous agreement in the Council as well as an absolute majority in the EP[105].

As for the natural disaster clause, Union financial assistance to a Member States in difficulty (or setting up instruments to do so) has to be granted by the Council.

Administrative hurdles (Score 5):

We assign a score of 5 because the framework for a permanent and common debt financed fund has already been established with the NGEU. Thus, this reform proposal does not require any particularly new mechanism or institutions that have to be elaborated. Because of the common debt instrument, the implementation of a permanent NGEU has to go through a treaty reform. For this, an Ordinary Revision Procedure is need after either the EP, EC or a Member States come forward with a proposal to amend the treaty. Furthermore, the NGEU has to be implemented into future MMFs which also requires raising the own resource ceiling. Regarding debt management and monitoring of national funding plans, there are already existing instances inside the EC (e.g. RECOVER for monitoring) which could be built upon.

As for the natural disaster clause, the EC has to point out 'natural disasters or exceptional occurrences beyond the Member States' control' and define conditions which it proposes to the Council to grant Union fiscal assistance. The justification to activate the clause would be difficult because conditions are so vague and do not specify if severe economic downturn or the immediate and coming consequences of global warming fall under these conditions. Furthermore, "it is not suitable as legal basis for instruments that would address permanent challenges faced by a Member States." [106,107,108,109]

Additional fiscal capacity (Score 4):

We assign a score of 4 because the current NGEU already gives the Member States considerable fiscal capacity and could potentially be extended in its scope in the future.

Tied to green/social (Score 4):

We assign a score of 4 because the NGEU is mainly tied to green or social purposes.

Tied to investments (Score 4):

We assign a score of 4 because the NGEU is mainly tied to investments.

Technical amendments

Changing output gap calculation

Even with the entire EU fiscal framework remaining in place, technical amendments can generate considerable fiscal flexibility. One option would be the amendment of the calculation of the output gap. The output gap is the difference between the estimated potential output and actual output of an economy. The larger the output gap, the bigger the fiscal flexibility allowed for by the current EU fiscal framework. However, since the potential output cannot be observed, it is estimated as the level at which an economy can operate without running above capacity and hence fuelling inflation. The calculation of the output gap has often been criticised for estimating a potential output and hence an output gap that is too low in most cases[110]. Since this heavily constrains fiscal flexibility, the calculation of the output gap could be changed. A proposal by Dezernat Zukunft targets an increase of the potential output to a situation of full utilisation of the labour force. Instead of calculating labour market capacity based on arbitrary historic trends, full employment without long-term unemployment, possible working hours adjusted for involuntary part-time employment and increased gender-based participation rates could be used[111].

Addressed in public debate (Score 2):

We assign a score of 2 because input on this proposal from Dezernat Zukunft[112], Bruegel[113] and Philipp Heimberger[114] has triggered a debate but due to the technical nature of this proposal, it is not broadly covered by the media and has rather remained an expert debate. It is also mostly discussed in Germany.

Political support (Score 3):

We assign a score of 3. While the technical criticism around the output gap has been rejected by Marco Buti, Head of Cabinet of Commissioner Paolo Gentiloni[115], there have been calls for improvements in the output gap estimation by the Italian government[116] and by finance ministers of eight Member States already in 2016[117]. More generally speaking, whether agreeing to technical amendments is a lower hurdle for fiscally conservative countries than for other reform proposals, depends on how much fiscal flexibility the exact amendment would generate.

Extent of consensus needed (Score 4):

We assign a score of 4. There is no formal legislative process needed to introduce a new calculation method. The initiative for an amended methodology can either come from the ECOFIN Council, from the Output Gap Working Group itself or from Member States, like Spain which has asked for a revision in the past (although no revision followed)[118]. An amendment has then to be approved by ECOFIN after it has been agreed on.

Administrative hurdles (Score 4):

We assign a score of 4 because the processes to achieve these reforms are solely internal and won't require a complete overhaul. No real changes in government structures are needed, solely a revision of the methodology for calculating the output gap which would be an internal process inside the Economic Policy Committee (EPC). More specifically, the output gaps are calculated by the Output Gap Working Group (OPWG) of the EPC. These changes could be introduced as part of the ongoing review and fine-tuning process of the methodology by the OPWG. Prior to changing the methodology, the OPWG could also use estimates that are deemed more realistic for their inputs than those used

currently, for which they can build on the already existing methodology (NAWRU, Participation rate, etc…)[119,120,121].

Additional fiscal capacity (Score 3):

We assign a score of 3 because the extent of fiscal flexibility generated depends on national circumstances. The higher the potential output estimated by a revised estimation method, the higher the output gap and the higher the fiscal flexibility. While in countries with high levels of unemployment, the additional fiscal flexibility would be high. In Germany on the other hand, the full utilisation of labour force would increase permitted cyclical deficit by 0.5-0.6 percentage points and effective automatic stabilisers would further increase this by a ratio of 2.4 percentage points[122].

Tied to green/social (Score 1):

We assign a score of 1 because the generated fiscal flexibility by technical amendments is not tied to green or social purposes in any way.

Tied to investments (Score 1):

We assign a score of 1 because the generated fiscal flexibility by technical amendments is not tied to investments in any way.

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