4. THE IMPLEMENTATION OF THE REVAMPED EUROPEAN FISCAL RULES: ANOTHER MISSED OPPORTUNITY FOR ADDRESSING THE DEBT PROBLEM?

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ABSTRACT

Fiscal policy in Europe faces extraordinary challenges. The need to reduce high public debt and restore fiscal buffers to ensure effective macroeconomic stabilisation is increasingly constrained by mounting pressures linked to ageing populations, climate and digital transitions, and growing demands for security, defence, and competitiveness. In this context, well-designed national fiscal frameworks and the recent reform of EU fiscal rules are essential to support medium-term planning and safeguard debt sustainability. While the new framework represents a conceptual improvement—introducing greater flexibility, country specificity, country ownership and a debt-based anchor—its effectiveness will depend on implementation. Weak enforcement mechanisms, limited involvement of national parliaments and independent institutions, and the absence of a genuine common fiscal capacity to finance common public goods may ultimately constrain its ability to deliver lasting results in terms of improving debt sustainability.

1. INTRODUCTION

The fiscal architecture of the European Union has undergone a profound transformation with the adoption of a new economic governance framework in April 2024. This reform comes at a critical juncture. Following successive crises —the global financial crisis, the sovereign debt crisis, the COVID-19 pandemic, and the war in Ukraine— European fiscal policy finds itself under renewed pressure. On one hand, high levels of public debt and the erosion of fiscal space call for credible consolidation strategies. On the other hand, Europe faces unprecedented investment needs arising from structural megatrends such as demographic ageing, climate change, digital transformation, and geopolitical instability, including the need to boost defence spending and industrial competitiveness.

In this demanding environment, striking a balance between fiscal sustainability and economic resilience is more important than ever. The reform of the EU fiscal rules aims to provide a more realistic, transparent, and country-specific framework to guide fiscal policy over the medium term. By shifting the focus from annual deficit targets to multi-year expenditure paths anchored in debt sustainability analysis (DSA), the new rules seek to reconcile fiscal discipline with flexibility and national ownership.

However, while the reform addresses some of the key shortcomings of the previous framework —including excessive complexity and weak compliance— important challenges remain. Questions of implementation, transparency, and coordination across levels of government persist. In particular, the absence of a common fiscal capacity at the EU level and the limited role assigned to Independent Fiscal Institutions (IFIs) risk undermining the credibility and consistency of the new rules. This paper assesses the scope and limitations of the new fiscal framework and reflects on the institutional and political conditions necessary to ensure its effectiveness.

2. INNOVATIONS IN THE NEW FISCAL FRAMEWORK

In February 2024, the institutions and governments of the European Union reached an agreement on the reform of the fiscal governance framework, which is structured around the Stability and Growth Pact (SGP). The new framework introduces significant changes in the approach to fiscal surveillance at the European level. However, before outlining the main features and challenges of the new framework, It is useful to briefly analyse the sources of past errors and to review the root causes of the complexity that came to define the previous system, in order to avoid the risk of repeating the same shortcomings under the new governance model (Carnot, Deroose, Mourre and Pench (2018)).

When Romano Prodi described the Stability and Growth Pact (SGP) in 2002 as "stupid" and "rigid," he could scarcely have anticipated that, in time, the fiscal rules would evolve to become so "intelligent" and "flexible" that their complexity would ultimately render them virtually unenforceable. Over the years, successive reforms and reinterpretations of the European Union's fiscal governance framework have accumulated, resulting in a structure that was excessively complex and increasingly unpredictable.

The previous fiscal architecture was built on the premise of a "complete contract," a highly ambitious approach that sought to reflect and anticipate all economic contingencies and adjust the Stability and Growth Pact (SGP) accordingly. Some of the reforms adopted —such as the Six-Pack, the Two-Pack, and the Fiscal Compact—were designed as responses to crises, while others were ad hoc changes introduced to address specific situations, such as the low growth, low inflation environment that prevailed in many EU countries in the years after the financial and sovereign crises. Over time, interpretative adjustments introduced short-term flexibility in the form of deviations from fiscal targets to accommodate public investment and structural reforms (European Commission, 2015)

The belief that every possible detail and special circumstance could be codified led to an accumulation of overlapping rules—on headline balances, structural balances, public expenditure, and debt—each associated with its own compliance indicators.

Implementation procedures, including both ex ante and ex post evaluations, were equally intricate. A key source of this complexity was the central role assigned to non-observable indicators, particularly the structural balance. Though theoretically appealing as a tool for promoting countercyclical policy, its estimation has been shown by numerous authors to be highly error-prone. This significantly increased the unpredictability of the framework and made it easier to justify non-compliance with fiscal, as policy decisions were based on provisional figures subject to considerable revision. As will be seen later, the goal of reducing reliance on non-observable variables has not been fully achieved.

While the system was initially intended to rest on transparent fiscal rules and multilateral pressure through the European Council, in practice, the growing number of exceptions allowed for bilateral negotiations between Member States and the European Commission. This trend progressively weakened fiscal requirements (Beetsma et al., 2018). For example, Zettelmeyer (2022) criticizes these bilateral arrangements as an unacceptable way to balance fiscal consolidation, macroeconomic stabilization, and investment priorities.

In addition to the growing body of EU-level rules, efforts were made to reinforce fiscal discipline by introducing national fiscal rules, ideally enshrined in national laws or constitutions. In particular, the Fiscal Compact decentralized discipline by requiring Member States to adopt national balanced budget rules, limiting the cyclically adjusted deficit to no more than 0.5% of GDP (Medium Term Objective (MTO)). Over time, the evolution of the EU rules was not mirrored by parallel developments in national frameworks. This mismatch generated new inconsistencies and sources of complexity. In some cases, Member States took advantage of the misalignment between national and EU rules, engaging in regulatory arbitrage between both, further complicating enforcement and undermining the credibility of the entire system.

Dissatisfaction with the former governance model was widespread, and the need for reform broadly recognized (Darvas, Martin and Ragot (2018)). A common critique emphasized the intricate nature of the framework and its failure to secure consistent compliance from member states. In 2020, the European Commission itself acknowledged that "the fiscal rules have become less transparent, hampering predictability, communication, and political buy-in" (European Commission, 2020).

More critically, the former framework failed to foster the sound design of fiscal policy in several key areas. Specifically, it has not ensured the sustainability of public finances; it has not enabled the adoption of countercyclical fiscal strategies; and it has certainly not facilitated the effective coordination of fiscal policies across the Economic and Monetary Union (EMU) as a whole.

THE ADVANTAGES OF THE NEW FRAMEWORK

The shortcomings outlined above underscored the need for a comprehensive and coherent reform process to enhance both the functionality and legitimacy of the EU's fiscal governance framework.

Conceptually, the reform has been shaped by a shared recognition among European economies of a prevailing macroeconomic environment that differs significantly from the one in place when the original Pact was conceived. This new context is marked by lower growth prospects, a greater frequency of economic shocks, and substantial public spending and investment needs to address both a complex geopolitical landscape and structural competitiveness gaps—challenges highlighted in the Draghi (2024) and Letta (2024) reports- compounded by broader megatrends already identified in previous analyses, including climate change, population ageing, and digitalisation. In this sense, the EU's new economic governance framework builds on the premise that fiscal sustainability, reforms and investments are mutually reinforcing and should be fostered as part of an integrated approach.

The reform has also been shaped by a shift in the prevailing paradigm concerning the role and effectiveness of fiscal policy that has taken place during recent years of economic turbulence (Alberola, 2024). The original fiscal rules were conceived with a predominantly prohibitive logic: aimed at preventing fiscal policies that could result in "excessive" deficits or debt, to avoid negative spillovers in a monetary union. By contrast, the revised framework reflects a growing consensus around the enhanced effectiveness of fiscal policy—not only as a tool for macroeconomic stabilization but also as a means to address structural spending needs. Consequently, the new approach seeks to reconcile fiscal consolidation with growth-oriented strategies, promoting reforms and investment through a more gradual, credible, and country-tailored path of fiscal adjustment.

In terms of design, the reform seeks to address several weaknesses of the previous framework, including excessive complexity, the reliance on unobservable indicators for fiscal surveillance, weak enforcement mechanisms, and insufficient national ownership.

A particularly welcome development is the effort to move away from the short-termism associated with annual deficit targets, which often induce a procyclical fiscal stance. Instead, the new framework shifts the focus towards medium- and long-term public debt sustainability. Placing sustainability at the core of the framework in a more transparent and straightforward manner represents a significant step forward, in line with proposals by authors such as Blanchard et al. (2021).

In particular, the new framework is anchored in a country-specific assessment of debt sustainability risks. This risk-based surveillance approach relies on the Debt Sustainability Analysis (DSA) of the European Commission to determine the fiscal adjustment paths needed to ensure that public debt is placed on a plausibly declining trajectory by the end of the adjustment period (set at four years by default, extendable up to seven years under specific conditions). In addition, the budget deficit must be brought below the 3 percent of GDP threshold —if currently exceeded— and subsequently maintained below that level. The framework also includes compliance with a series of safeguards for minimum required reductions in deficits and debt levels, largely introduced at the insistence of Germany.

This risk-based surveillance approach implies more differentiated fiscal adjustment requirements across countries. In contrast to the rigid and uniform targets of the previous framework, the reformed approach aims to introduce greater gradualism and feasibility (Darvas et al (2024)). These commitments are not determined solely by initial conditions —i.e. past fiscal trajectories— but also by forward-looking pressures, particularly those associated with population ageing, which currently represent the most reliably quantifiable source of long-term fiscal stress. However, the spirit of the reform also includes provisions encouraging countries to progressively deepen their analysis of additional long-term risks to public finances, most notably those arising from climate change.

Adjustment commitments are now expressed through a single operational variable: net primary expenditure (defined as primary spending net of discretionary revenue measures, cyclical unemployment-related costs, expenditure fully financed by EU funds, and national co-financing of programmes funded by the EU). The logic aligns with key contributions in the literature (e.g., Darvas, Martin, and Ragot, 2018), which broadly advocate replacing the existing multitude of complex rules with, in principle, a simpler one: nominal spending should not grow faster than long-term nominal GDP to ensure debt sustainability and should grow more slowly in countries with excessive levels of debt.

This shift is expected to yield several benefits in terms of simplicity, transparency, and enforceability. Unlike the structural balance —previously the core indicator of the framework— net primary expenditure is more predictable, observable, and directly manageable by national authorities. It is also less prone to large ex post revisions, making it a more reliable anchor for fiscal surveillance. The use of limits on net primary expenditure helps create fiscal space during economic upturns or in the presence of windfall revenues —such as those linked to the real estate boom prior to the global financial crisis. At the same time, the exclusion of cyclical unemployment-related spending ensures room for the operation of automatic stabilisers. The simplicity of the measure also facilitates communication with the public, increasing the reputational cost of non-compliance. Eliminating reliance on structural measures may further encourage national administrations to internalise the rules, thereby enhancing compliance.

Another important innovation is the introduction of "memory" into the system. A control account will track cumulative deviations from the agreed expenditure paths. If these deviations exceed specified numerical thresholds, they may trigger a debt-based Excessive Deficit Procedure (EDP), under the corrective arm of the Stability and Growth Pact.

The new framework introduces the option to extend the fiscal adjustment period from four to seven years, in exchange for credible commitments to implement structural reforms and public investment. This element provides room for fiscal manoeuvre and introduces a pragmatic balance between consolidation and growth, allowing for more tailored and sustainable fiscal strategies.

Furthermore, the reformed framework incorporates two escape clauses—one at the EU level and another at the national level— to ensure that fiscal policy can play a stabilising role in the face of exceptional circumstances. The general escape clause allows for temporary deviations from the targets set, in response to a severe economic downturn affecting the EU as a whole. The national escape clause, on the other hand, permits country-specific deviations in the event of extraordinary circumstances beyond the government's control. Academic literature has long emphasised that credible, viable, and durable fiscal rules must include mechanisms that allow flexibility in response to shocks and events beyond the control of national governments. Replacing the previous complex system of waivers and ad hoc flexibility arrangements with more clearly defined escape clauses could enhance both the transparency and the predictability of the framework.

Finally, the reform aims to improve compliance with the fiscal framework by strengthening each country's commitment to its own adjustment path—what is commonly referred to as national ownership—and by developing credible mechanisms for the effective enforcement of the rules.

3. FROM THEORY TO PRACTICE: IMPLEMENTATION CHALLENGES

3.1. IMPLEMENTATION CHALLENGES EMERGING FROM THE LACK OF AMBITION OF THE REFORM AGAINST A BACKGROUND OF MASSIVE INVESTMENT NEEDS.

The new EU economic governance framework, while analytically sound, faces significant implementation challenges. At the forefront of these challenges is the lack of ambition in its design, which risks exposing the framework to an existential test even before it becomes fully operational.

Recent experience shows that the need for European fiscal coordination cannot be justified solely by the risk of negative spillovers from undisciplined national fiscal policies. This rationale led in the past to strict limitations on discretionary action by Member States and to hard-to-enforce clauses such as the "no bail-out" rule. Today, a broader vision is required —one that values the European project itself and aims to strengthen its legitimacy through better outcomes in growth and prosperity.

Public investment needs are raising immense and fundamental questions about the efficiency and legitimacy of the current allocation of spending responsibilities between the EU and its Member States. Based on estimates from the European Commission and NATO, Dorrucci et al. (2024) calculate a public funding gap for the green transformation, the digitalisation of the economy and the strengthening of its military defence amounting to €900 billion across the EU for the 2025–2031 period —representing roughly 0.6 to 1 percentage point of GDP annually. This is consistent with projections in the Draghi Report (2024). Although the revised fiscal framework improves the capacity to address such needs, particularly through extended adjustment periods, the scale of the challenge far exceeds the current flexibility.

The discussion is no longer limited to the need for a fiscal capacity to stabilise asymmetric shocks. The EU's response to the COVID-19 pandemic, the war in Ukraine and the new geopolitical context have contribute to reopen the debate on how European public goods are defined, funded, and distributed (Bakker et al, 2024). The development of "own resources" at the EU level could play a critical role in achieving strategic autonomy in areas like industrial policy, defence, and technological competitiveness.

The first significant test arose when the United States announced its intention to scale back its defence commitments in Europe, prompting the need to activate the national escape clause to allow for increased defence spending at the national level. The EU has launched a process aimed at enhancing its strategic autonomy in defence by 2030. The European Commission's REARM plan proposes €800 billion in investment, with €650 billion expected from national budgets. To accommodate this without significantly affecting other government spending plans, the Commission proposed a partial suspension of fiscal rules via the country-specific escape clause introduced in the new framework, which allows deviations from medium-term fiscal plans in exceptional circumstances. Specifically, under the Commission's proposal countries would be able to exceed their approved net expenditure paths by up to 1.5 percentage points of GDP annually during the period 2025–2028 for defence-and security related spending, provided they formally request activation of the clause. This additional fiscal space is calculated based on 2021 defence expenditure levels irrespective of any subsequent increases between 2021 and 2024, which are considered as part of the baseline current expenditure. For reporting purposes, defence expenditure is classified under COFOG (Classification of the Functions of Government). Sixteen Member States have expressed intent to use this mechanism, and twelve have submitted formal requests by the (flexible) deadline of April 30. Spain has yet to decide.

While the need to strengthen strategic autonomy in defence is not in question, some authors argue that the partial activation of the escape clause —limited exclusively to defence spending— represents an interpretation of the rules that closely resembles the discretionary and ad hoc approaches of the past which, in turn, could undermine its credibility. Rather than subjecting the new framework to such reinterpretations, it would have been more desirable to establish a common fiscal capacity at the European level. Overcoming the resistance by some Member states to pool certain resources could generate significant synergies. True, this would involve a strategic reassessment of spending priorities, notably in politically sensitive areas such as defence, which is beyond the scope of this paper. However, without such strategic reassessment, more critical consequences may arise from the fiscal side, as the new framework risks perpetuating a cycle of debt accumulation without sufficient consideration of long-term fiscal constraints.

The creation of the euro remains an incomplete project —a fair-weather currency unprepared to withstand the sequence of crises that we are now experiencing: the global financial and sovereign crises, the pandemic, the war in Ukraine, and the erosion of the United States as a reliable geopolitical partner. The contrast between Europe's fragmented response to the global financial crisis and its more coordinated actions following the pandemic and the war in Ukraine is significant—but insufficient. The opportunity to link the recent reform of fiscal rules to the introduction of a common fiscal capacity was quickly abandoned. Yet, today it is clear that creating fiscal space at the EU level is essential to finance European public goods—ranging from defence and energy security to climate action and technological competitiveness.

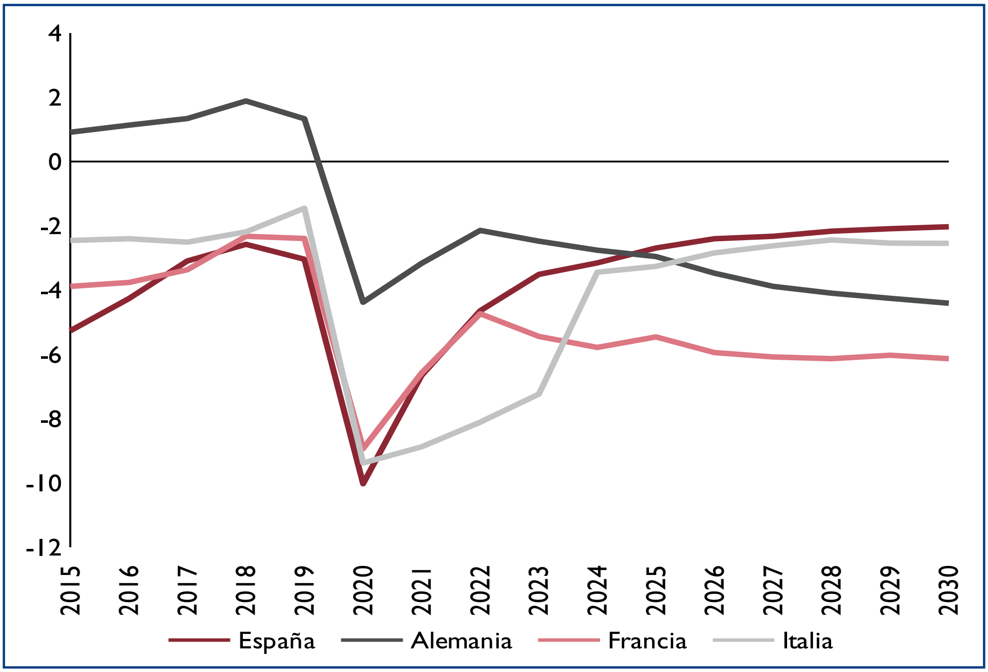
Public spending pressures in certain Member States, combined with political difficulties to adop significant offsetting measures, could represent another critical test for the functioning of the European fiscal framework. In particular, the fiscal situation and prospects for France and Germany raise concerns that history may repeat itself. The situation recalls the political crisis of 2005, when the Stability and Growth Pact was reformed after France and Germany breached the 3% deficit limit, exposing how political considerations could override rules-based discipline.

Nowadays, Germany —traditionally a champion of fiscal orthodoxy— has taken the historic step of reforming its constitutional "debt brake" to exempt defence spending from borrowing limits, marking a significant departure from its previous fiscal stance. The new defence golden rule excludes defence and security expenditures above 1% of GDP from the 0.35% structural deficit ceiling and establishes a €500 billion off-budget fund for infrastructure investment during a 12-year period. According to the coalition agreement, the federal government plans to invest €150 billion of this fund by 2029 —equivalent to approximately 0.9% of GDP annually. In addition, the reform allows German states (Länder) to run structural deficits of up to 0.35% of GDP— whereas they were previously required to maintain balanced budgets —thus expanding borrowing capacity also at the subnational level. Germany was among the first Member States to request activation of the national escape clause for defence spending, even if doing so results in an increase in public debt.

Although this shift does not pose immediate risks to Germany's fiscal sustainability, it raises serious concerns regarding fiscal coordination at the EU level. As Zettelmeyer (2025) argues, full utilisation of the additional borrowing space created by Germany's reformed debt brake would fundamentally conflict with EU fiscal rules, as it could result in public debt increasing from 63% of GDP in 2024 to around 100% by the late 2030s. Such a trajectory would clearly undermine the requirement to ensure a sustained and plausible decline in the debt ratio. Moreover, this shift raises doubts about Germany's future willingness to finance common European public goods.

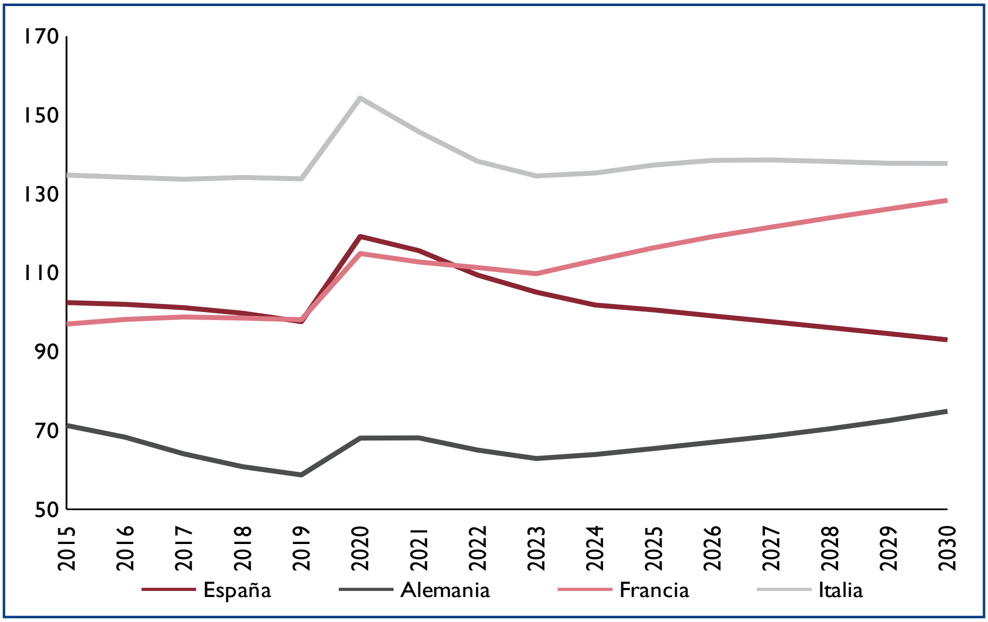
France also presents significant fiscal risks and thus, also threatens the intended functioning of the fiscal framework. Independent and international institutions, including the IMF, have raised serious doubts about the credibility of its objective to reduce the deficit below 3% of GDP by 2027. According to the IMF's projections, the deficit will remain at 5.3% in 2024 and decline only marginally to 4.5% by 2027 —well above the official target of 2.9% (see chart 1). This discrepancy stems from fiscal adjustment measures that are either not yet specified or face substantial political resistance. Public debt stood at 112% of GDP in 2024 and is projected to rise to 120% by 2027 in the absence of corrective action. The Cour des Comptes has warned that the current deficit-reduction path is unrealistic, especially in light of fiscal pressures related to climate change and the energy transition that are not adequately accounted for in current projections.

BUDGET BALANCE (% OF GDP)



Fuente: AMECO.

PUBLIC DEBT (% OF GDP)



Fuente: AMECO.

This situation is fuelling renewed calls for yet another reform of the EU fiscal rules—not solely to accommodate Germany, but to benefit all Member States currently facing constraints on public investment (Boivin and Darvas, 2025). Among the proposals under discussion are the exclusion of EU-approved infrastructure spending from the initial application of fiscal rules, and a revision of the Treaty's debt reference value from 60% to 90% of GDP. Some also advocate for the elimination of the *deficit resilience safeguard* —a provision paradoxically introduced at Germany's insistence during the 2024 reform— which requires a minimum annual reduction of 0.25 percentage points in the structural primary deficit when the debt-to-GDP ratio exceeds 60% and the structural primary deficit is greater than 1.5% of GDP.

The history of the SGP shows that fiscal rules are too often reformed as a reaction to external shocks, to increase flexibility. With massive investment needs, unless the European Union establishes a common fiscal capacity —equipped with the ability to issue joint debt—, the fiscal framework could face the same cycle of patchwork fixes and erosion of credibility and effectiveness.

3.2. MEDIUM-TERM PLANS (MTPS): STRENGTHS, GAPS, AND EXECUTION RISKS

Beyond these existential challenges, the reform completed in April 2024 left several key aspects of implementation unaddressed or at least open to very different potential outcomes.

A key innovation of the new framework is the requirement to submit national medium term fiscal structural plans (MTPs or Plans) covering four or five years depending on the length of the national electoral cycle. In these plans, each EU Member State commits to a multi-year public net expenditure path and explains how it will deliver investments and reforms that respond to the main challenges identified in the context of the European Semester. The plans must be submitted for endorsement to the European Commission and, ultimately, to the Council of the EU.

The submission and endorsement of the first set of national medium-term fiscal-structural plans (MTPs) was the first milestone in the implementation of the reformed economic governance framework. In October 2024 most EU Member States prepared the first set of Plans under the reformed economic governance framework. Germany, Lithuania and Austria have not yet submitted their plans at time of writing, with the delay attributed to elections and the subsequent formation of new governments in these countries, thus hindering the preparation process. Spain has submitted its Plan, but its Parliament has not been able to pass the draft budget for 2025. The ECOFIN Council endorsed the MTPs of most Member States on 21 January 2025 on the basis that the fiscal paths in the plans are credible and increased public investment is foreseen even amid fiscal consolidation.

However, according to EU Independent Fiscal Institutions (IFIs, 2025), most MTPs submitted by Member States include the mandatory information requested by the European Commission, but the completeness of the data is often insufficient to assess the realism of the proposed multiannual fiscal trajectories. In many cases, governments have failed to provide macroeconomic forecasts beyond 2025 or 2026, as well as on key assumptions regarding the composition of growth, essential to project public spending needs. In this respect, the macroeconomic scenario presented in some MTPs constitutes a step backwards compared to previous instruments such as Stability Programmes or public finance programming laws.

The details concerning the reforms and investments that Member States are expected to implement in order to qualify for an extension of the adjustment period from four to seven years are also insufficient. Most of the reforms are so far only public commitments – important parameters concerning the design and implementation of the reforms are still to be decided. Therefore, the overall impact on potential output growth is hard to quantify.

Even more concerning is the lack of information on public finances: several plans do not include forward-looking revenue projections or estimates of discretionary revenue measures, making it impossible to evaluate the plausibility of fiscal paths beyond 2024.

All of these projections are essential components of any credible medium-term fiscal strategy. In a context marked by intense and growing expenditure pressures, the public deserves to be informed about the strategy their governments intend to pursue in order to address these challenges. Transparency and completeness in fiscal planning are not only technical requirements, but also democratic imperatives.

An area that warrants particular attention in the Plans is the projected behaviour of public investment, as one of the central goals of the revised fiscal framework is to incentivise this spending. Experience suggest that public investment is often the first casualty of budgetary adjustment, although there is limited empirical evidence that EU fiscal rules systematically lead to cuts in public investment (Delgado et al., 2020); Indeed, recent research points to the so-called *social dominance hypothesis:* regardless of fiscal constraints, policymakers tend to prioritise current expenditure over investment (Larch and von Varder Wielen, 2024). In this context, the overall increase in public investment ratios across the EU remains modest —below 0.2% of GDP— based on national plans. According to the MTPs, more than one-third of EU Member States plan to reduce nationally financed public investment over the next four years. This is yet another indication that more innovative mechanisms, such as the creation of a new EU-level fund, could be essential to unlock the required scale of investment.

3.3. INSTITUTIONAL GAPS AND OWNERSHIP DEFICITS IN THE PREPARATION OF MTPS

A guiding principle of the reform was the reinforcement of national ownership —that is, the alignment of national institutions and procedures with the revised EU fiscal framework. In this context, strong political commitment from the central government is a necessary condition for the effectiveness of fiscal adjustment paths. However, political commitment alone does not constitute genuine national ownership. The latter requires the active involvement of a broader set of national institutions and stakeholders, including national parliaments, independent fiscal institutions (IFIs), and subnational governments. This is particularly crucial in decentralised countries, where broad consensus across institutional levels enhances both the legitimacy and the viability of the agreed fiscal path.

Although strengthening national ownership was a key objective of the governance reform, the changes introduced in the institutional architecture of the Economic Governance framework remain limited —particularly with respect to the role and capacity of national IFIs. Moreover, most Member States have failed to engage national stakeholders, including parliaments and IFIs, in the preparation of their Medium-Term Fiscal-Structural Plans. This omission risks undermining both the quality of the plans and the credibility of their implementation.

In particular, engagement with national parliaments was limited and largely confined to informal exchanges rather than being part of the formal approval processes. Only nine Member States officially submitted their Plans to their national parliament, and just three of them obtained formal parliamentary approval prior to submission to the European Commission. Furthermore, only ten Member States involved civil society and social partners in the consultation process, and in most of these cases, the consultations took place only after the government had already approved the plan (EU IFIs, 2025).

As regards the involvement of Independent Fiscal Institutions (IFIs), most governments did not actively engage them in the endorsement or assessment of their MTPs prior to submission to the European Commission. Out of the twenty-one Member States that submitted a plan, only twelve requested their IFIs to validate the macroeconomic assumptions underpinning the proposed net expenditure paths. Even fewer formally mandated their IFIs to conduct a comprehensive assessment of the full MTPs. Despite this limited formal involvement, a significant number of IFIs undertook assessments of the Plans on their own initiative.

While time constraints and limited experience in some IFIs may have restricted public debate during this first round, the central role of MTPs in the new economic governance framework clearly calls for increasing participation of national stakeholders.

It is important to recognise that the limited involvement of national parliaments and Independent Fiscal Institutions (IFIs) in the first implementation cycle of the new framework reflects, above all, a lack of political will. In the case of IFIs, although the spirit of the reform explicitly endorsed the objective of strengthening their role in fiscal oversight, many institutions performed their functions either because they were already legally mandated to do so at the national level, or out of their own initiative—not because they enjoy strong legal backing under EU law.

In particular, under the new European framework, a Member State may request its Independent Fiscal Institution (IFI) to issue an opinion on the macroeconomic forecast and the underlying assumptions supporting the net expenditure path prior to the submission of its Medium-Term Plan. However, it is only eight years after the entry into force of the regulation that such opinions will become mandatory —and only on the condition that the IFI concerned has developed sufficient technical and institutional capacity. In addition, Member States may ask their IFI to provide an ex post assessment of compliance with the net expenditure path and to analyse the factors contributing to any deviation. Under the corrective arm of the framework, Member States may also invite the IFI to assess the adequacy of the measures taken —or planned— to address an excessive deficit. However, none of these provisions are binding, which raises questions about the consistency and enforceability of national fiscal oversight

As Blanchard et al. (2021) and others have suggested, granting national fiscal councils and the European Fiscal Board a more decisive role in assessing rule compliance could enhance both the credibility and the effectiveness of the framework. Independent Fiscal Institutions (IFIs) can play a pivotal role in bringing transparency to public budgets and enhancing public understanding of fiscal policy. National IFIs are particularly well positioned to deliver independent, technically robust, and country-specific analyses. Compared to the more standardised tools and methodologies applied at the supranational level, they possess a clear comparative advantage in terms of a deep understanding of national idiosyncrasies, such as decentralised governance structures, institutional arrangements, and procedural specificities in the budgetary cycle.

Such granular expertise enables IFIs to assess whether fiscal rules have been respected by Member States and, in doing so, to increase the reputational costs of non-compliance (Beetsma, 2023). In addition, IFIs contribute to strengthening national ownership of the framework by mitigating perceptions of "Brussels-imposed" rules (Kamps and Leiner-Killinger, 2019).

It is therefore surprising that stronger participation by both national parliaments and IFIs was not made mandatory under the new framework. The experience of the EU's fiscal governance to date suggests that political commitment and genuine ownership have remained weak. The Fiscal Rules Compliance Tracker developed by the European Fiscal Board (Larch and Santacroce, 2020) document only moderate compliance with the key provisions of the framework. Moreover, empirical research has shown that non-compliance tends to be more frequent in countries with fragmented governments and during election years, a situation that, regrettably, is all too common across many European economies today (Delgado-Téllez et al., 2017).

Strengthening the role of Independent Fiscal Institutions (IFIs) and the European Fiscal Board (EFB) could also help reduce the opacity of exchanges between the European Commission and Member States (the risk of bilaterality). The French case provides a striking example of this challenge. Following the Commission's evaluation of the French plan, the national budgetary process collapsed, leading to the fall of the government. The newly appointed government subsequently sent a letter to the Commission requesting amendments to the MTP. However, none of the exchanges between the French authorities and the Commission were made public —not even to the Finance Ministers at the ECOFIN Council— prior to the adoption of recommendations on France's net expenditure path on 21 January 2025. The letter in question was only published after the Council had voted.

Supranational institutions such as the EFB are crucial to make sure there is a common level playing field, to ensure that countries in equal circumstances are equally treated, and to detect how the whole framework is performing, looking for example to the policy mix at the euro area level.

3.4. METHODOLOGICAL AND ANALYTICAL CHALLENGES OF THE NEW FRAMEWORK

On more technical grounds, the new governance framework has introduced broader changes in the analytical foundations of fiscal surveillance. Debt Sustainability Analysis (DSA) now takes centre stage as the main anchor for fiscal policy formulation, contrary to the past when DSA mostly served as an ex post analytical tool for surveillance.

However, as emphasised in a series of background papers prepared for the European Parliament (Cotarelli, 2024; Wieland, 2024; Erce, 2025; Jousten, 2025), formally anchoring fiscal policies to Debt Sustainability Analysis (DSA) presents significant methodological and practical challenges. These studies do not question the value of the DSA framework per se, but rather critique specific methodological choices made by the European Commission. Because numerous assumptions and modelling decisions can significantly influence the adjustment path, these authors call for regular, independent assessments of the realism of key assumptions and resulting debt dynamics—ideally carried out by national Independent Fiscal Institutions (IFIs).

Several areas for improvement are highlighted:

- **Risk assessment and stress testing:** Most papers stress the need for more robust risk assessments to ensure that debt-to-GDP ratios follow a sustainable downward path even under adverse conditions. In practice, this would require conducting proper stress tests during the adjustment period, not just after it. Although the framework includes a stochastic analysis, it is only applied once the adjustment period (4–7 years) has concluded. During the adjustment phase itself, uncertainty is modelled through deterministic scenarios, which may substantially underestimate fiscal risks.
- **Unobservable indicators and the structural balance:** Core concerns persist regarding the estimation of potential output and the structural primary balance—both unobservable variables that play a key role in the framework. In practice, the Commission continues to base its calculations on the structural primary balance and subsequently converts these into net primary expenditure targets through a technical formula.
- **Uniform fiscal multipliers:** The use of a single fiscal multiplier across all countries fails to account for national differences in economic structures, cyclical positions, and fiscal capacity. This uniformity risks distorting the projected impact of fiscal consolidation measures.
- **Definitional ambiguities in net expenditure:** The determination of net expenditure also raises conceptual challenges. The distinction between discretionary

and non-discretionary revenue measures is far from clear-cut. For instance, the non-indexation of tax brackets illustrates how such measures can blur boundaries in a way that affects fiscal projections.

- **Safeguards and potential procyclicality:** The inclusion of fiscal safeguards reflects a degree of mistrust in the DSA-based approach among some Member States. However, these safeguards may introduce unintended procyclical effects and constrain the capacity to scale up public investment. In particular, in countries where these constraints are binding, any increase in public investment (excluding defence) must be offset one-to-one by cuts elsewhere in spending. This makes it more difficult to implement ambitious investment programmes, even if they are aligned with long-term fiscal sustainability objectives (Darvas et al., 2024).

Despite these technical concerns, only experience will tell whether this new approach delivers better outcomes. Under the previous framework, the required fiscal adjustment was determined ex ante through a mechanical "matrix of requirements" applied uniformly across countries, often disconnected from their actual fiscal positions. By contrast, the new framework calibrates fiscal adjustment on the basis of a country-specific DSA, which is conceptually sounder —even if it involves greater complexity and technical judgment. Ultimately, time will reveal whether the new rules are more effective in ensuring the long-term sustainability of public finances.

4. CONCLUSIONS

The reform of the EU fiscal governance framework marks a conceptual improvement over the previous system. It introduces a more country-specific and risk-based approach to fiscal surveillance, grounded in debt sustainability analysis (DSA), and seeks to provide Member States with greater flexibility to support growth-enhancing policies while ensuring debt sustainability. The move to a single operational indicator —net primary expenditure— and the possibility of extending the adjustment period in exchange for reforms and investment represent significant steps forward. By creating a more reasonable and adaptable framework, the reform also raises expectations of improved compliance.

However, we should remain vigilant about the potential shortcomings of the new framework and avoid falling into complacency . The experience with the previous system suggests that the core problems were not so much a lack of flexibility, but rather unpredictability, legal ambiguity, and increasing complexity. The incentives that governments face have not fundamentally changed. Granting greater control and flexibility does not, by itself, guarantee better compliance, particularly if not accompanied by stronger enforcement and oversight.

While anchoring fiscal policy to DSA is conceptually sound, it introduces new layers of technical complexity. Debt sustainability projections rely on a wide array of assumptions —many of which involve unobservable variables and country-specific parameters.

The effectiveness of the new framework in reducing debt in a sustained and credible manner will thus depend heavily on the robustness of implementation. In this regard, the decision not to significantly strengthen the role of Independent Fiscal Institutions (IFIs) represents a missed opportunity. Their limited role weakens the framework's transparency, replicability, and accountability.

The first test of the new framework —accommodating increased defence spending— has already revealed the limits of a nationally fragmented response to shared challenges. While the proposal for the activation of the national escape clause has enabled some flexibility, it has done so in a manner reminiscent of past ad hoc adjustments, rather than through a collective, forward-looking fiscal strategy.

Moreover, the entry into force of the new framework coincides with a particularly complex geopolitical and macroeconomic environment. The EU faces growing public investment needs in areas such as security and defence, energy transition, ageing, digitalisation, and industrial competitiveness. History shows that EU fiscal rules have often been reformed in response to external shocks. The risk of pushing the current framework to provide maximum flexibility in light of these pressures could ultimately undermine debt sustainability. Germany's constitutional reform and France's fiscal fragilities further underscore the difficulty of enforcing consistent rules across politically and economically diverse Member States.

In such demanding circumstances, a more fundamental rethinking of the EU's fiscal architecture is warranted. The European Union and the euro area would be better equipped to confront future challenges with a genuine common fiscal capacity —financed by increasing own resources and underpinned by the ability to issue common debt— while simultaneously strengthening incentives for compliance with fiscal rules and reinforcing the role of independent fiscal institutions, both at the European and national levels. Until such reforms are enacted, Europe's fiscal governance will remain vulnerable to the same tensions and limitations that have undermined its credibility in the past.

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