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Fiscal Policy for a Thriving Europe

A Feasibility and Impact Analysis of Fiscal Policy Reform Proposals

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Content

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Feasibility and Impact Analysis of Fiscal Policy Reform Proposals

Executive summary

The current EU fiscal framework is not fit for purpose to cope with today's challenges: unprecedented levels of investments are needed to achieve environmental, societal, and economic goals and for a sustainable recovery after the COVID pandemic. Public funding plays an important role to navigate through this transition and build resilient societies. However, the fiscal flexibility of Member States is constrained by the EU governance framework, which requires EU governments to adhere to strict fiscal rules.

After the 2008 financial crisis, austerity policies in the EU led to a double-dip recession, the EU economy recovered much slower than others, unemployment rose massively in many parts of Europe and triggered the euro crisis. Austerity measures have contributed to anti-EU sentiment and enabled populist sentiments and movements to rise. The risk of instability and divergence of Member States through austerity must now be avoided.

The political momentum for reforming the EU fiscal framework is larger than ever. In this lively and critical debate, many reform proposals have been put forward, however, reform proposals tend not to be responsive to the political sensitivities and the technical feasibility at the same time.

This report fills a gap as it provides a structured overview of the reform proposals for the EU fiscal framework and a comprehensive assessment of their feasibility and impact. It assesses the political feasibility of the reform proposals, identifies what changes in EU legislation would be required to implement the proposals and highlights the administrative hurdles that implementation could entail. In addition, the proposals are also assessed in terms of the potential additional fiscal flexibility they would generate and whether the proposals are tied to green and social objectives as well as investment.

By comparing the different goals of the proposals and identifying the different parts of the existing regulations targeted by the proposals, the report shows which reform proposals can complement each other and which are mutually exclusive. It thus provides a solid basis for decision-makers to facilitate comparison and discussion of the existing reform proposals.

1. Introduction

»And the lessons from the financial crisis should serve as a cautionary tale. At that time, Europe declared victory too soon and we paid the price for that. And we will not repeat the same mistake.«

Ursula von der Leyen, President of the European Commission, September 2021[1]

The European Union (EU) is currently facing unprecedented challenges: The average global temperature is steadily rising[2] and the loss of biodiversity has accelerated in recent years[3]. Habitat destruction, overexploitation, pollution, and climate change are putting pressure on our ecosystems, with devastating consequences for freshwater, air quality, and crops[4]. At the same time, almost all societies in the EU have become more polarised since 2000[5], which also threatens the stability and health of European democracies. In addition to polarisation, Europe is facing demographic challenges caused by an ageing population and falling birth rates, which could threaten the sustainability of social protection systems in the EU[6].

Against this backdrop, the consequences of the COVID-19 crisis still remain centre-stage in the EU. The economic effects of the pandemic have exacerbated pre-existing socio-economic differences between the Member States and could lead to lasting divergences in the future[7]. The pandemic has also highlighted how underfunding of public health systems[8] has led to inadequate preparedness and has revealed gaps in the resilience of our societies and economies.

Public funding[1] has an essential role to play in addressing these challenges and building resilient economies and societies. Europe is now at a crucial juncture in history to bridge massive funding gaps to achieve social, environmental, and economic goals. However, Member States' ability to close those gaps is currently constrained by the EU's economic governance framework. The EU economic governance framework consists of strict fiscal rules that oblige EU governments to limit their debt levels and maintain balanced budgets. With the activation of the general escape clause in the outbreak of the pandemic, these rules were temporarily suspended. When the EU moves back to its normal fiscal framework with the deactivation of the clause[9] in 2023, fiscal consolidation in many EU Member States could be triggered. This poses a risk for the stability of the EU, as fiscal consolidation and austerity are drivers of the

1 Public funding comprises public spending and public investments. Public spending refers to the acquisition of goods and provision of services for current use while public investment acquires goods and services for future use.

success of anti-EU populist movements. In the United Kingdom it even provided the foundation for Brexit, as Thiemo Fetzer puts it: *"The EU referendum could have resulted in a Remain victory had it not been for austerity"*[10]. Hence, it is now the moment to review these rules, not least because *"the risk [of divergence] is stronger if you don't open the debate on the rules"*, as stated by Commissioner Paolo Gentiloni in June 2021[11].

The outbreak of the COVID pandemic, the resulting surge in public debt and the activation of the general escape clause provided strong political momentum for reforms to create fiscal flexibility that now seems greater than ever before. The president of the European Commission, Ursula von der Leyen, recently called for a consensus on potential reforms to the EU fiscal framework: *"The Commission will relaunch the discussion on the Economic Governance Review [...]. The aim is to build a consensus on the way forward well in time for 2023"*[12]. In a recent Centre for Macroeconomics (CFM) survey, more than 95 % of experts on the European economy have advocated for a revision of the existing fiscal rules. Further support stems from important players like the French, Italian and Spanish government, and the green party in Germany[13], the president of the European Central Bank, Christine Lagarde[14], her predecessor and Italian Prime Minister Mario Draghi[15], EU Commissioner for Economy Paolo Gentiloni[16], the European Fiscal Board[17] and the IMF[18].

The lively debate about the current EU fiscal framework has put forward many reform proposals for increasing fiscal flexibility in the EU, which has further intensified the discussion. However, the proposals are all very different in terms of their goals and tackle very different parts of the existing rules. Some proposals are complementary, and others are alternatives to one another. What is missing in this debate so far is a clear structuring of all the proposals as well as a comprehensive analysis of whether they are politically and legally feasible or not. To fill this gap, this report provides a structured analysis of the feasibility of the main fiscal policy reform proposals. To offer a solid basis for comparison of the proposals, the expected impact of all proposals is assessed as well. The analysis is intended to provide a basis analysis for decision-makers to facilitate a comparison and discussion of the advantages and disadvantages of the existing reform proposals.

In addition to existing EU fiscal rules, EU governments are of course also subject to national budgetary rules, some of which vary considerably in their strictness. This report focuses on the EU fiscal framework, and reforms at the national level are not considered in this study, nor are efforts to create fiscal flexibility through possible national tax increases.

This report is structured as followed: In the following pages, we will first present the current fiscal framework, including an explanation of legislative procedures required to amend the different fiscal rules. Second, we will highlight the need for reform of the current fiscal governance framework at EU level. Next, we will set out the methodological framework for the assessment of the feasibility and impact of fiscal policy reform proposals and presents the results of our analysis. In a fourth step, the report discusses the reform proposals and the way forward. The conclusion wraps up the discussion and provides an outlook.

2. Current fiscal framework

The existing fiscal framework consists of fiscal rules at the EU and national level. At the EU level, the fiscal policy architecture sets a narrow scope for fiscal flexibility for Member States: Member States have committed to a set of common fiscal rules and minimum requirements for national fiscal governance[19], as well as to the coordination of their national budgetary policies[20]. This chapter provides an overview of the main elements of the EU fiscal framework as well as the rules enshrined in primary and secondary legislation and the legal procedures required for amending them. The EU fiscal architecture consists of a number of different EU legislations, some of which are enshrined in the EU Treaties. Regulations and the interpretive guidance on the rules and procedures have been revised several times, resulting in a complex structure of the EU governance framework. In the diagram below, **Figure 1**, an overview of this architecture is visualised and then core rules are outlined in **Table 1**.

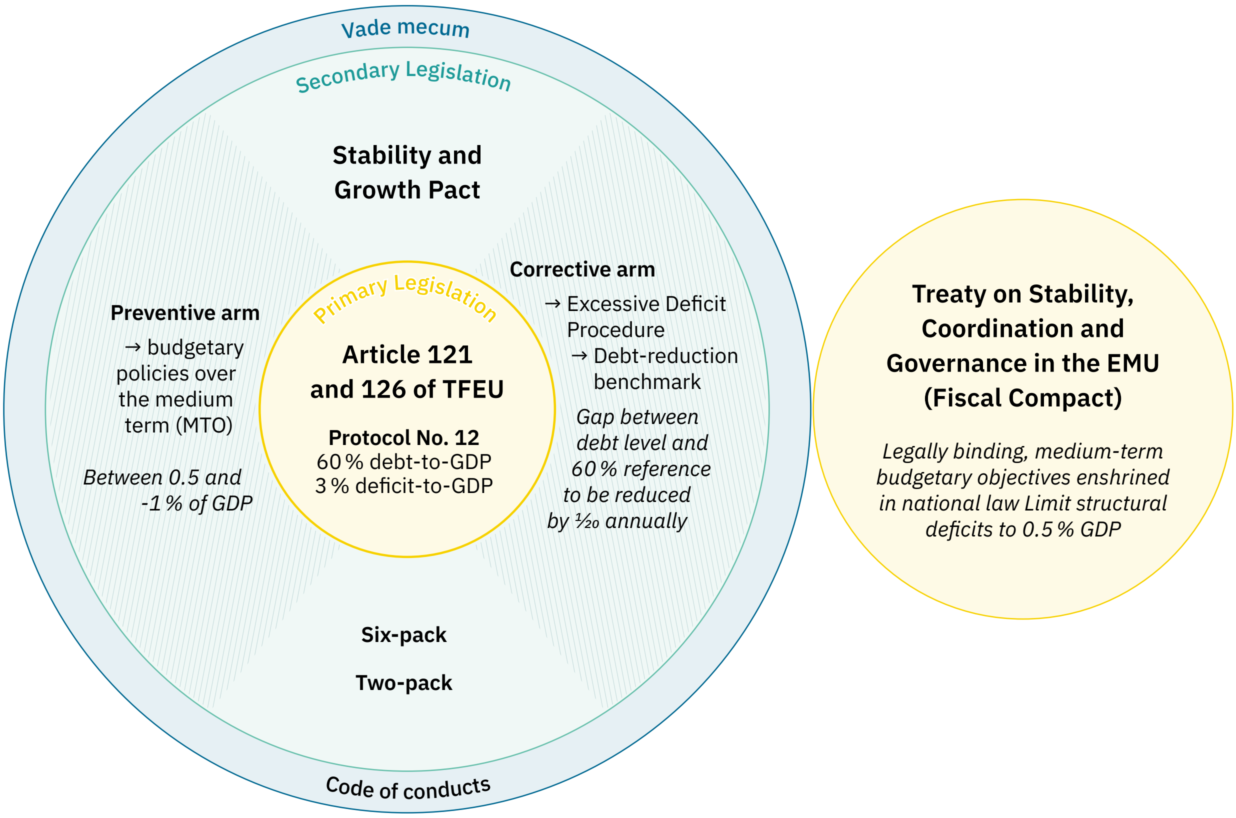

Figure 1: *Structure of the European fiscal framework*

The table below outlines five core aspects of the fiscal framework, which are each elaborated in the following subsections.

Rule		Rule enshrined in ...	Can be amended by ...
Debt rule	*National debt cannot be more than 60% of the Gross Domestic Product (GDP)*	Treaty on the Functioning of the European Union (TFEU)	Changing Protocol No. 12, annexed to the TFEU (see **Box 1**)
Deficit rule	*A state's budget deficit cannot exceed 3 % of the GDP*	TFEU	Changing Protocol No. 12, annexed to the TFEU (see **Box 1**)
Structural deficit rule	*Structural deficit cannot be more than 0,5–1 % of the GDP*	Fiscal Compact (National fiscal rules)	National legislative or constitutional amendment processes
Structural budget balance must be higher than the country-specific medium-term objective (MTOs)	*MTO must be chosen at or above −0.5 % of GDP or −1 % of GDP for countries with a debt-to-GDP ratio below 60 %;* *If the structural balance is lower than the MTO, it must increase by 0.5 % of GDP per year as a baseline*	Stability and Growth Pact (SGP) preventative arm	Ordinary Legislative Procedure (see **Box 3**)
Debt reduction rule in case of debt levels above 60% of GDP	*The gap between a country's debt level and the 60 % reference value needs to be reduced by 1/20 th yearly*	SGP corrective arm	Ordinary Legislative Procedure (see **Box 3**)

Table 1: *Overview of the main fiscal rules*

2.1 The Maastricht Treaty on debt and deficit rules

Articles 121[21], 126[22] and 148[23] TFEU lay out the foundation for the EU's economic governance framework. The basic rule of EU fiscal policy enshrined in the TFEU is that the Member States shall avoid excessive government deficits[24]. The reference values that specify excessive deficits are set out in Protocol No 12[25], annexed to the treaties, which are 3 % for government deficit and 60 % for gross debt in relation to GDP.

2.2 Two arms of the Stability and Growth Pact (SGP)

The Stability and Growth Pact in secondary EU law sets out in more detail how the rules of the treaty shall be implemented:

The **preventative arm** defines the procedures for multilateral budgetary surveillance. It lays down the obligation for the Member States to adhere to the medium-term objectives (MTOs)[30] for their budgetary positions of "close to balance or in surplus". The MTO are country-specific and cyclically adjusted and range from –1 % of GDP to a structural surplus. If Member States have not achieved their MTO, their structural balance shall be reduced by 0.5 % of GDP per year.

The **corrective arm** lays down the conditions under which to apply the excessive deficit procedure[31]. It includes an early warning system and provides recommendations and sanctions when a county has either breached or being at risk of breaching the deficit threshold of 3 % of GDP or having a debt level above 60 % of GDP. In this case, the gap between a country's debt level and the 60 % reference value needs to be reduced by 1/20th annually on average over three years.

The first Economic Governance Package ("Six Pack") of 2011 reformed and amended rules of the SGP. It

Box 1: **Change of Protocol No 12 of the TFEU**

Changing Protocol No. 12 of the TFEU is governed by Article 126 (14)[26]: "The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the European Central Bank, adopt the appropriate provisions which shall then replace the said Protocol". Hence, a Special Legislative Procedure (SLP) is required, specified in Article 289 of the TFEU[27].

Box 2: **Treaty reform**

Treaty revision is governed by Article 48 of the TFEU[28]. There are two main revision procedures:

1. **Ordinary revision:** this relates to key changes in relation to the competencies of the EU and requires the convening of an intergovernmental conference to adopt proposals for amendments by consensus ("Convention").

2. **Simplified revision procedure** allows amendments by unanimous decision of the European Council without making a Convention. A simplified revision procedure can only be applied if the proposal is limited to Part III of TFEU and if the amendment does not increase the EU's competencies.

Both procedures need a unanimous agreement among the Heads of governments of the EU Member States followed by national ratification according to their own constitutional procedures. In both cases, the initiative to change the Treaties may come from Commission, European Parliament (EP), or a Member State[29].

enforced budgetary discipline and put a greater emphasis on prevention. A reduction path for excessive debt levels was laid down, the sanction system was tightened and minimum standards for national budget rules were set. In addition, the macroeconomic imbalance procedure was introduced to correct imbalances and enhance fiscal coordination.

The 2011–2012 reforms of economic governance and the fiscal policy framework ("Two Pack") includes two regulations to enhance the monitoring of budgetary policies and strengthen the surveillance of Member States in the euro area.

The Stability and Growth Pact contains **flexibility clauses** that allow for general exemptions from the fiscal rules in case of economic recessions or exceptional events ("general escape clause" and "exceptional events clause"). Similarly, flexibility clauses are intended to encourage structural reforms ("structural reform clause") and investment ("investment clause"). On 23 March 2020, the Council of Economic and Finance Ministers (Ecofin) activated the 'general escape clause' to allow Member States to respond more effectively to the economic consequences of the COVID-19 pandemic. The clause is expected to be deactivated again as of 2023[32]. However, the room for manoeuvre is very small due to tight conditions for the application of the clauses. The elements of the SGP can be amended by an Ordinary Legislative Procedure, as governed by Article 121 (6)[33] and Article 136 of the TFEU[34].

Box 3: **Ordinary Legislative Procedure (OLP)**

The OLP is the standard decision-making procedure for passing legislation at the EU level unless the treaties state otherwise. The procedure puts the EP and the Council of the European Union on equal footing. The initiative comes from the European Commission with a legislative proposal (usually for a regulation, directive or decision). The co-legislators must agree to the original proposal or amendments made by the EP or Council. The EP votes by simple majority at first and second readings, and by absolute majority at third reading. In an OLP, the Council usually takes its decisions by qualified majority. However, some decisions also require unanimity, for example when amending the Own Resources Decision.

Box 4: **The Council of the European Union**

The Council of the EU is a single legal entity, but it meets in 10 different "configurations", depending on the subject being discussed. The most relevant Council meetings for fiscal policy are the Economic and Financial Affairs Council (Ecofin) meetings. The Ecofin Council is composed of the Ministers of Economy and Finance or Secretaries of State of all Member States.

2.3 Fiscal Compact

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union[35] (Fiscal Compact) complements and tightens these decisions of the 2011-2012 SGP reforms. Notably, it introduced national debt brakes, tightened the deficit procedure, and provided further agreements to improve economic policy coordination. The fiscal compact limits the Member State's structural deficit to 0.5 % of GDP. For countries with a debt-to-GDP ratio significantly below 60 %, the structural deficit can run up to 1 % of GDP. The Fiscal Treaty is thus stricter than the SGP for the Member States with high debt ratios or risks to the sustainability of their public finances.

This intergovernmental treaty, which is not part of EU law, is signed by 26 countries has been enshrined in constitutional law in several EU countries. In general, EU law takes precedence and changes in EU secondary law automatically apply to the fiscal compact. However, national legislative amendment processes or constitutional amendment processes are needed to lift national debt brakes.

2.4 Interpretive guidance on the SGP

The Code of Conduct of the SGP[36] contains specifications on the implementations of the SGP, among which the specifications on flexibility clarifying the investment clause and structural reform clause and cyclical adjustments.

The Vade Mecum[37] is a manual prepared by the European Commission (Directorate-General for Economic and Financial Affairs that sets out procedures and methodologies for the implementation of the SGP. In 2019, the fifth edition was published. Changing interpretive guidance is in the legal scope of the European Commission.

The framework presented thus shows that at the EU level a number of intertwined rules form the fiscal framework. However, it also becomes clear that the EU Treaties themselves offer leeway for changes to the framework. Clarity on this is an essential background for assessing the legal feasibility of the reform proposals.

3. The need for reforms

The EU fiscal framework, outlined above, needs reform as it is not designed for, nor responsive to, the current circumstances and challenges. When the cornerstones of the current framework, the Maastricht treaty and the SGP were designed in the 1990s today's challenges like climate change and the COVID-19 pandemic had not been foreseen. We now know that in its current form it hinders Member States to react properly to economic crises, limits the ability of the EU to deal with the climate and wider ecological crisis, lacks the flexibility to react to changing interest rates and ultimately threatens the stability of the EU in its current form.

3.1 Inability to deal with economic crises properly

We know today that the fiscal rules of the EU limited the abilities of Member States to bounce back from the 2008 crisis. The procyclical nature of the rules allows the Member States to invest in upswings but prescribes consolidation in downswings and crises[38]. Not taking into account the positive effects of public funding through the multiplier effect[2] and taking away the opportunity to sufficiently invest after the 2008 crisis had severe consequences. Compared to the US, which recovered from the crisis quickly by considerably investing in the economy after the financial crisis, the EU didn't recover as well. Instead of bouncing back fast, it saw a double-dip recession caused by the lack of investment (see **Figure 2**).

After the 2008 crisis, unemployment soared as a consequence of austerity as many jobs were cut back[39]. Since this was particularly striking in the southern Member States like Greece and Spain, a dramatic divergence among the EU member states occurred. For the timeframe from 2005 to 2020, **Figure 3** presents the monthly unemployment rates in some EU Member States as well as the EU average. This graph shows that these EU countries had similar unemployment rates before the financial crisis in 2008. As a result of the austerity that followed the financial crisis and the euro crisis, unemployment rates have diverged dramatically, with Spain's and Greece's unemployment rate temporarily exceeding 25 %[40].

Austerity measures have not only exacerbated socioeconomic inequalities in Europe but also contributed to the underfunding of healthcare systems[41], leading to a large number of deaths that could have been prevented[42]. The consequences of this have been felt throughout the pandemic not only because we were not adequately prepared for such an event, but also our systems were not resilient enough to deal with it. Much of the suffering and tragedy of the pandemic could have been prevented if public funds had addressed these gaps in advance.

2 The fiscal multiplier describes the effect of government spending on national economic output. While government spending initially decreases the budget balance, a resulting increase in economic output can increase the budget balance, e.g. through higher tax revenues.

GDP USA vs EU (Trillions, constant 2010 US $)

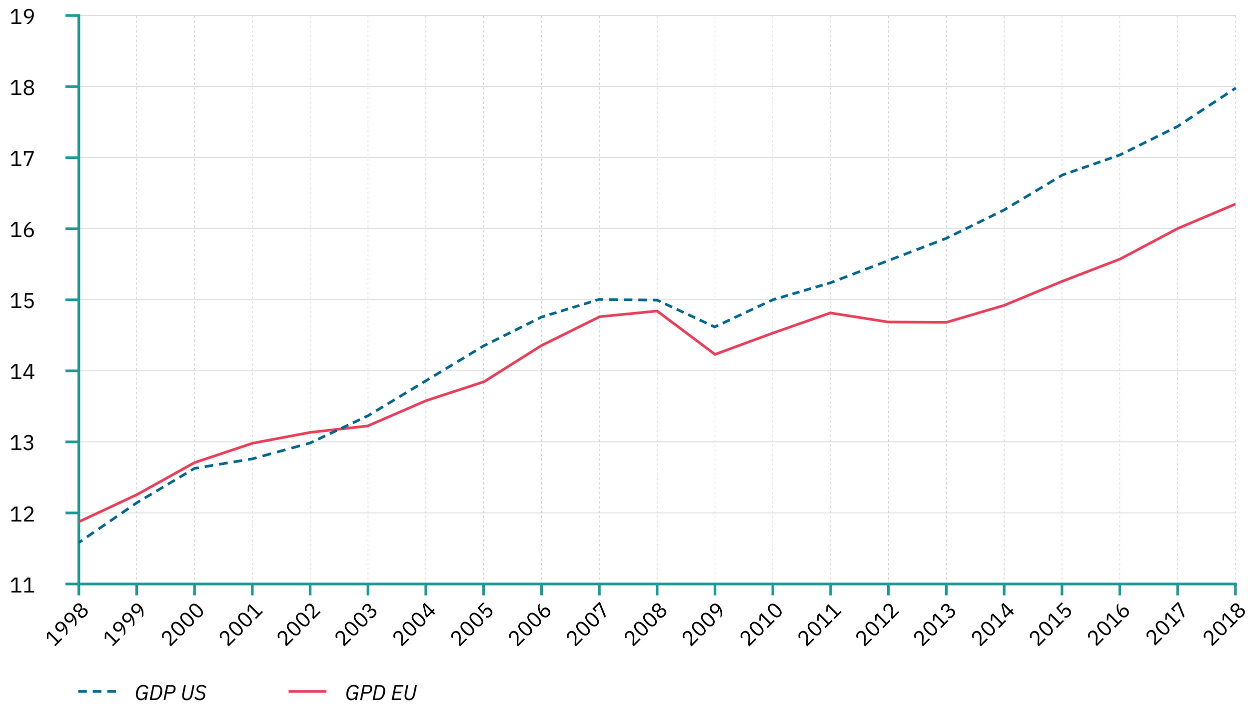

Figure 2: *GDP of the US and the EU compared. Source: World Bank Open Data*

Unemployment Rate EU (%)

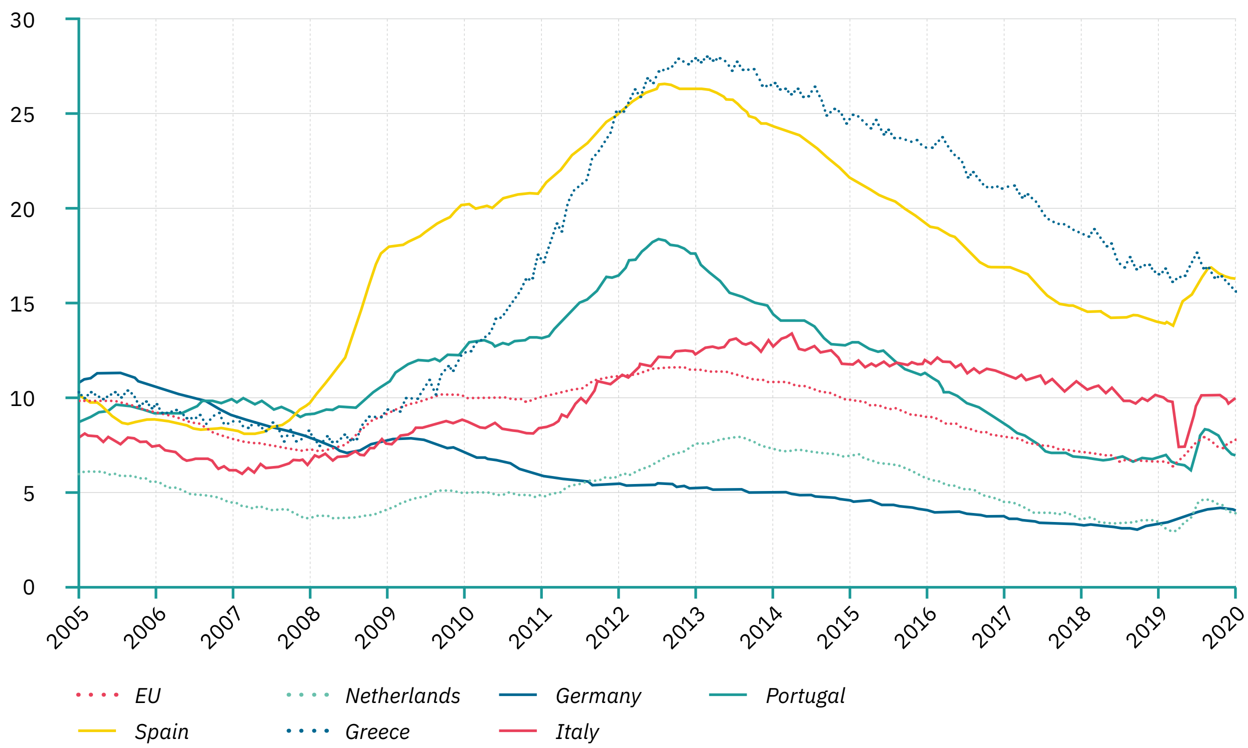

Figure 3: *Unemployment Rate in the EU and several Member States. Source: EUROSTAT*

Social polarisation as a consequence of high unemployment rates[43] is not just a challenge in its own right, it is also a threat to citizen support and connection to the EU. Many anti-EU populist narratives and movements have been built up and strengthened as a reaction to the social challenges caused by austerity[44].

3.2 Threat to the stability of the EU

The inability of the current EU fiscal framework to deal with economic crises had devastating consequences that were felt by EU citizens in their everyday lives. It is therefore not surprising that anti-EU sentiments and support for populist parties have increased as a consequence of austerity[45]. Austerity measures induced political crises, for example in Greece[46]. The scenario looms that another wave of austerity could destabilise the EU. There is evidence, for example, that austerity policies were the breeding ground for Brexit, which might not have happened without austerity[47]. Thus, if the rules are not reformed and the current fiscal framework is not strengthened again after the suspension of the general escape clause in 2023, there is a significant risk of divergence between the Member States as austerity policies pose a serious threat to EU cohesion.

3.3 Inadequacy to tackle the climate and ecological crisis

By imposing austerity, tight fiscal rules have not only led to devastating consequences and worrying anti-EU sentiments in the past, but they are also not suitable to cope with future challenges. The transformation of the EU economy to a climate-neutral economy, the green and just transition and digitalisation require large-scale investments. The additional investments required to achieve the current climate and environmental policy goals of the EU for 2030 amount to € 470 bn per year[48]. And this only refers to investment needs for climate and environmental goals. The number of additional investment requirements is even higher when considering the multiple other challenges that the EU is currently facing. While a large share of this will have to be covered by the private sector, the share covered by the public sector is estimated to be around 20–25 % according to Bruegel[49] and 28 % according to the European Investment Bank (EIB)[50].

The role of the public sector is especially important where the market does not provide sufficient investments. Many necessary investments for the green transition lack a business case, for example because renewable energy is not cheap enough yet. A McKinsey report has estimated that until 2030, 60 % of necessary investments do not have a business case with the share decreasing to 36 % in the timeframe from 2030 to 2040[51]. However, since these investments are nonetheless indispensable for the green transition, the public sector will need to step in and provide the investments that the market fails to generate. With its strict fiscal rules, the current EU fiscal framework prevents the public sector from fulfilling this crucial role.

3.4 Lack of flexibility to react to interest rate changes

Another aspect where the fiscal framework of the EU is no longer fit for the current circumstances is the neglect of the level of interest rates. Refinancing costs depict a crucial element of fiscal sustainability which is why a well-designed fiscal framework should take into account the level of interest rates. To stabilise the overall refinancing costs over time, fiscal flexibility for the Member States should be higher in a low-interest environment than in a high-interest environment.

To sum up, the current EU fiscal framework fails to react properly to economic crises, limits the ability of the EU to deal with the climate and wider ecological crisis, lacks the flexibility to react to changing interest rates and ultimately threatens the stability of the EU in its current form. A reform of the current fiscal framework of the EU is therefore urgently needed. The next chapter summarises and structures the currently discussed reform proposals and assesses them in terms of feasibility and impact.

4. Feasibility & Impact Analysis

Against the backdrop of massive investment needs and the EU's outdated fiscal framework, many reform proposals have been put forward[3]. We investigated 29 reform proposals that either suggest changes to the current fiscal framework or ways for circumvention. We were able to synthesise the examined proposals into a set of twelve reform proposals that reflect the full spectrum of the current debate and which we discuss in this report. We classified the proposals into three categories: **a)** Proposals that intend to reform the current EU fiscal framework, **b)** proposals that intend to circumvent the current EU fiscal framework by generating fiscal flexibility without changing fiscal rules, and **c)** technical amendments to the current framework that allow for more fiscal flexibility. To assess their feasibility and impact, we have developed a corresponding methodology, which is presented in this chapter.

Proposals that circumvent the fiscal framework do not offer solutions to reform the fiscal rules. Due to their popularity in the current debate on the reform of the EU governance framework, we also take them up in our analysis and assess them according to the same method. This is mainly to consider these proposals as complementary measures to reforms.

4.1 Methodology

The proposals are evaluated against a total of seven criteria, with each criterion being ranked on a scale of 1-5. The higher the score, the greater the feasibility or impact of the reform proposal. To reflect their respective importance, we have weighted the criteria differently. The feasibility criteria and the impact criteria both add up to 1. The respective weighting is discussed below in the explanation of each criterion.

The assessments are based on secondary research and expert meetings with civil society organisations and European Commission staff. The background document on feasibility and impact scores provides details on how each assessment was arrived at.

Assessment of the feasibility of reform proposals

To assess the feasibility of the reform proposals, we consider two dimensions: The popularity of the reform proposal on a **political level** as well as the feasibility on a **technical level**, including an evaluation of the decision-making process and administrative changes required for the implementation of the proposal. In the weighting both dimensions, the political and the technical, are considered equally important with 0.5 points each, and thus add up to 1.

The political dimension consists of two criteria: **1)** the uptake of the reform proposal in the **public debate** and **2)** its **political support**. The first criterion considers the coverage of the proposals in the political debate and media. The higher the coverage, the higher the political feasibility. Here, both EU level and national level debates are considered, with EU level debates inducing a higher score than national level debates. A high ranking on the 1–5 scale indicates that the proposal is frequently picked up by media and extensively discussed in the public debate. However, it is important to note that low political debate, and hence a low politicization of the proposals, could also mean less political resistance to implement the reform proposals. For this reason, we weight this criterion only weakly, with 0.1 out of 0.5. Nevertheless, especially for more fundamental changes of the fiscal rules public support is needed which is why media coverage is important.

The second criterion within the political dimension assesses the support for or the opposition to the reform proposal of key decision-makers at the national as well as EU level. The higher the support and the lower the political opposition, the higher the political feasibility. Not only support but also the assessment of resistance is particularly important, as una-

3 There are possibilities at national level to increase fiscal flexibility, especially for environmental concerns, notably by levying environmental taxes or abolishing fossil fuel subsidies. However, as discussed at the outset, this analysis focuses only on reforms of the EU fiscal framework, including ways to circumvent them.

nimity is required for many proposals (as explained in the criterion "degree of consensus required" below). Since political will or lack of resistance for some reform proposals is a decisive factor to move forward with a reform proposal, this criterion is weighted with 0.4 out of 0.5.

The evaluation of the **technical feasibility** of the reform proposals aims on the one hand to map out the degree of unanimous decision-making for the implementation of the reforms and on the other hand to discuss the complexity of changes in governance structures and administrative hurdles for their implementation.

We assess the **degree of consensus needed** to implement each reform proposal. If a treaty reform is needed, we use a rank of 1 due to the necessity of consensus at the EU level, the organization of an intergovernmental conference as well as national ratification processes (see **Box 1**). If a change in the protocol of the treaty is required, a rank of 2 is assigned (see **Box 2**). A rank of 3 means that changes to current framework can be implemented in a co-decision between the European Parliament and the Council of the European Union (see **Box 3**). A rank of 4 is used for proposals where minor changes like adjusting the Code of Conduct are required (see chapter 2.4). We weight this criterion with 0.4 out of 0.5, as the degree of consensus needed is a 'make-or-break' factor for policymakers to further pursue reform proposals.

We further evaluate the technical feasibility by **administrative hurdles** and necessary changes in governance structures for the implementation of the proposal. The highest rank, 5, suggests that the necessary structures for the implementation of the reform proposal are already in place. The lowest rank indicates a drastic shift in competencies from national to EU level, as for the establishment of a fiscal union. This criterion is weighted with 0.1 out of 0.5 because administrative hurdles, while making reforms significantly more difficult, do not necessarily hinder the political will to advance a proposal.

Assessment of the impact of reform proposals

To measure the **impact** of the reform proposals, we assess both the **quantitative impact** and the **qualitative impact** of the proposals. The amount of fiscal flexibility generated directly determines the amount of funding for green or social purposes, but without certain criteria in place, there is a risk that public funds could be used for activities that potentially harm to social and environmental goals. For this reason, we assign equal weights (0.5 each) to the quantitative and the qualitative impact. The three criteria that are used to measure the impact of the reform proposals add up to 1.

The **quantitative impact** is measured by the **additional fiscal capacit**y that could be generated through the reform. Again, we use a scale from 1–5 to determine if it has a very high monetary impact (5) or if the fiscal capacity that could be generated from reform is rather low (1).

The **qualitative impact** is assessed by the criteria whether the reform proposal ties **public funding to a green and / or social purpose** (1 = No, 2 = rarely, 3 = partially, 4 = mainly, 5 = Yes) and whether the generated fiscal flexibility is **tied to investment** (1 = No, 2 = rarely, 3 = partially, 4 = mainly, 5 = Yes). We give more weight to the former criterion (0.4 out of 0.5) than to the latter (0.1 out of 0.5) because we perceive investments that are not tied to green / social purposes to be potentially more harmful than green / social expenditures that are not tied to investments.

4.2 Reform Proposals

The following chapter provides an overview of the feasibility and impact of the most relevant fiscal policy reform proposals. Here, we also indicate at which level of the EU fiscal framework a change needs to be made to enforce the proposal. However, this chapter does not discuss the required changes at the national level to implement the proposals. Necessary changes in the fiscal compact are therefore not considered. A detailed discussion of the feasibility and impact scores and a justification of each score is annexed to this report, including a consideration of required changes to the fiscal compact for the reform proposals.

4.2.1 Proposals for reforming the EU fiscal framework

requires changes in the SGP

Abolishing / adjusting budgetary targets

The EU fiscal framework sets budgetary targets for all its Member States. Depending on whether the Member States are in the preventive arm or the corrective arm[4], different budgetary targets apply. Member States in the preventive arm are confronted with medium-term budgetary objectives and the Member States in the corrective arm are confronted with a debt-reduction benchmark. Both set budgetary targets that the Member States are required to achieve. The MTOs set targets for a close-to-balance or in-surplus budget that the Member States need to comply with. These targets are country-specific and cyclically adjusted. The debt-reduction benchmark requires the Member States with a debt-to-GDP ratio of more than 60 % to reduce annually by $\frac{1}{20}$ of the total level the value by which their debt-to-GDP ratio exceeds the 60 % threshold. This often binds the 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 SGP.

Political Feasibility	Addressed in public debate	1	2	**3**	4	5	Mentioned frequently but not in the centre of the reform debate
	Political Support	1	2	**3**	4	5	Little support but also little opposition
Technical Feasibility	Extent of consensus needed	1	2	**3**	4	5	OLP
	Administrative hurdles	1	2	**3**	4	5	Requires agreement on new criteria, including changing the objective for Member States to reach a structural deficit of 1.0 % of GDP to a structural surplus and the value of the debt-reduction benchmark
Quantitative Impact	Additional fiscal capacity	1	**2**	3	4	5	Limited because the Member States still have to comply with the deficit and debt rule
Qualitative Impact	Tied to green / social	**1**	2	3	4	5	No
	Tied to investment	**1**	2	3	4	5	No

4 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 debt level above 60 % of GDP.

Requires changes in the SGP and eventually creation of an "Investment Protocol"

Excluding certain expenditures from deficit rule

The deficit rule constrains public funding 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 for financing urgent needs, such as climate action, as it enables more investments while still complying with the deficit rule.

Political Feasibility	Addressed in public debate	1	2	3	**4**	5	Frequently as it addresses the issue of high investment needs
	Political Support	1	2	3	**4**	5	High-level political support from France and the EU Commission, unclear whether frugals agree
Technical Feasibility	Extent of consensus needed	1	**2**	3	4	5	OLP, investment protocol needs unanimous agreement
	Administrative hurdles	1	2	**3**	4	5	Need for a firm interpretation of the rule through an "Investment Protocol" which ensures that certain expenditures don't fall under the deficit- and debt rule, as well as the deficit rules of the SGP
Quantitative Impact	Additional fiscal capacity	1	2	3	**4**	5	Would allow for large-scale investments
Qualitative Impact	Tied to green / social	1	2	3	**4**	5	Yes, but some dimensions cannot be covered
	Tied to investment	1	2	3	4	**5**	Entirely tied to investments

Requires treaty change with a shift of compe-tences from national to EU level

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 the Member States need to comply with would be redundant because a centralised fiscal authority would coordinate funding and taxation. Debt financing would also be handled through common bonds and not individually by the Member States.

Political Feasibility	Addressed in public debate	1	2	3	**4**	5	Debated as a long-term solution for many years now, but not really discussed as a short-term solution
	Political Support	1	**2**	3	4	5	Scattered high-level support but strongly opposed by many Member States
Technical Feasibility	Extent of consensus needed	**1**	2	3	4	5	Depending on the format, treaty change could be required (unanimity)
	Administrative hurdles	**1**	2	3	4	5	Overhaul of fiscal rules, shift in competencies and a centralised fiscal authority to oversee public funding taxation and debt required
Quantitative Impact	Additional fiscal capacity	1	2	3	4	**5**	Very high (central fiscal capacity with tax-raising and debt-issuing power)
Qualitative Impact	Tied to green / social	1	2	3	4	5	No
	Tied to investment	1	2	3	4	5	No

Requires changes in the SGP

Reforming escape clauses

The EU fiscal framework includes escape clauses that allow for deviations from the Stability and Growth Pact's preventive or corrective arms in exceptional circumstances (Excessive Deficits Procedures included)[52]. This can be done either through the “unusual events clause” or through the “general escape clause”. In the current pandemic, the “general escape clause” is activated. It can be activated when the euro area or the Union as a whole face 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”[53]. Hence, by relaxing the conditionality for activating the clauses, both clauses could be reformed to enable more fiscal capacity for the Member States in exceptional circumstances.

Political Feasibility	Addressed in public debate	**1**	2	3	4	5	Barely (only in expert debate)
	Political Support	1	**2**	3	4	5	High-level support from EU Commission but no further support
Technical Feasibility	Extent of consensus needed	1	2	**3**	4	5	OLP
	Administrative hurdles	1	2	3	**4**	5	Only requires changes in the definition of the conditionalities of the escape clause
Quantitative Impact	Additional fiscal capacity	1	**2**	3	4	5	Very high but only when activated
Qualitative Impact	Tied to green / social	1	**2**	3	4	5	Not necessarily (depending on reform)
	Tied to investment	1	**2**	3	4	5	Not necessarily (depending on reform)

Requires changes in the SGP

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[54][55]:

- their GDP growth is negative, or their GDP is below its potential
- the deviation from the Medium-Term Objectives 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 European fund for strategic investment (EFSI)
- the member state compensates for temporary deviations within the time-frame 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[56]. 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.

Political Feasibility	Addressed in public debate	1	**2**	3	4	5	Overshadowed by the "golden rule" debate
	Political Support	1	2	3	**4**	5	High-level political support from France and the EU Commission, unclear whether frugals agree
Technical Feasibility	Extent of consensus needed	1	2	**3**	4	5	OLP
	Administrative hurdles	1	2	3	**4**	5	Already in place, only adjustments to the conditions of the current clause needed
Quantitative Impact	Additional fiscal capacity	1	2	**3**	4	5	Very high but non-permanent (only when activated)
Qualitative Impact	Tied to green / social	1	2	3	**4**	5	Depending on design but very likely
	Tied to investment	1	2	3	4	**5**	Yes

Amending Protocol 12 of the TFEU

Replacing debt rule with national medium-term debt targets

Only the medium-term budgetary objectives 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 country-specific circumstances. These rules 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 of the EU[57].

Political Feasibility	Addressed in public debate	1	**2**	3	4	5	Only addressed in expert debate
	Political Support	1	**2**	3	4	5	Likely to be blocked by frugal countries as it requires abolishing the debt rule
Technical Feasibility	Extent of consensus needed	1	**2**	3	4	5	SLP (unanimity)
	Administrative hurdles	1	**2**	3	4	5	Requires a redefinition of responsibilities of IFIs, the EFB and the EC regarding audit, implementation and monitoring of debt targets
Quantitative Impact	Additional fiscal capacity	1	2	3	**4**	5	Depending on the strictness of new targets but potentially large
Qualitative Impact	Tied to green / social	**1**	2	3	4	5	No
	Tied to investment	**1**	2	3	4	5	No

Requires Treaty change

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 public funding 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)[58].

Political Feasibility	Addressed in public debate	1	2	3	**4**	5	Many different proposals have been brought up
	Political Support	**1**	2	3	4	5	Low support, ruled out by the president of Eurogroup
Technical Feasibility	Extent of consensus needed	**1**	2	3	4	5	Requires revision of the treaties (unanimity)
	Administrative hurdles	1	2	**3**	4	5	Establishment of a qualitative framework, the standards are based on, is required and additional capacities for fiscal surveillance are needed that assess compliance with the fiscal standards
Quantitative Impact	Additional fiscal capacity	1	2	3	**4**	5	Depending on the strictness of new targets but potentially large
Qualitative Impact	Tied to green / social	1	2	3	**4**	5	Very likely due to the qualitative assessment of budgetary policy
	Tied to investment	1	2	3	**4**	5	Very likely due to the qualitative assessment of budgetary policy

Requires changes and in the SGP and / or Protocol 12

Replacing deficit rule with expenditure rule

The deficit rule of the SGP could be replaced by an expenditure rule that only limits government expenditure instead of the budget deficit as the difference between government expenditure and government revenue. 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[59]. 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 as a replacement for the deficit 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[60]. 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.

Political Feasibility	Addressed in public debate	1	2	**3**	4	5	Mentioned frequently but not in the centre of the reform debate
	Political Support	1	**2**	3	4	5	Considerable support but very strong opposition because deficit rule would have to be abolished
Technical Feasibility	Extent of consensus needed	1	**2**	3	4	5	OLP and, depending on the format, amending reference values in Protocol 12
	Administrative hurdles	1	2	**3**	4	5	Provision of common methodology that defines nominal government expenditures and institutional competencies for monitoring / fiscal surveillance required
Quantitative Impact	Additional fiscal capacity	1	2	3	**4**	5	High because only spending would be constrained, investments would be excluded
Qualitative Impact	Tied to green / social	1	2	3	4	5	No
	Tied to investment	1	2	3	**4**	5	Some leeway for spending but the majority would be set free for investments

4.2.2 Proposals for circumventing the EU fiscal framework

generates fiscal flexibility without amending EU fiscal rules

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 that can be called from the 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 the fiscal flexibility of Member States, either by borrowing more on financial markets and giving it to the Member States or by paying out more from the budget to the 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[61 62]:

- 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

Political Feasibility	Addressed in public debate	1	**2**	3	4	5	Some debates but not motivated by the aim of generating fiscal flexibility
	Political Support	1	2	**3**	4	5	Dependent on Member States' position on strengthening EU competencies
Technical Feasibility	Extent of consensus needed	1	**2**	3	4	5	SLP (unanimity)
	Administrative hurdles	1	2	**3**	4	5	Each legislation would require an elaborate process for creation and approval, but some processes already started
Quantitative Impact	Additional fiscal capacity	1	2	**3**	4	5	Dependent on the lifting of EU Own Resources Ceiling
Qualitative Impact	Tied to green / social	1	2	**3**	4	5	No, but steering effect of taxes
	Tied to investment	**1**	2	3	4	5	No

generates fiscal flexibility without amending EU fiscal rules

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[63], the primary income of the special purpose vehicle has to come from the market.

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 the 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.

Political Feasibility	Addressed in public debate	1	2	**3**	4	5	Frequently in German debate but less frequently in other Member States
	Political Support	1	2	3	**4**	5	Strong momentum in Germany, potentially accepted even by frugals
Technical Feasibility	Extent of consensus needed	1	2	3	**4**	5	In scope of Member States
	Administrative hurdles	1	2	**3**	4	5	Could be arranged within existing framework but circumventing fiscal rules requires a highly complex process
Quantitative Impact	Additional fiscal capacity	1	2	3	**4**	5	Very high but only through loans
Qualitative Impact	Tied to green / social	1	**2**	3	4	5	Very likely but cannot finance subsidies
	Tied to investment	1	2	3	4	**5**	Entirely tied to investment

generates fiscal flexibility without amending EU fiscal rules

Making Next Generation EU (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 the Member States with financial resources and thereby increase their fiscal flexibility. The NGEU's Recovery and Resilience Facility (RRF) could form the basis for 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[64]).

Political Feasibility	Addressed in public debate	1	2	3	**4**	5	Frequently discussed, especially in EU-wide debates
	Political Support	1	2	**3**	4	5	Opposed by frugals, supported by the French Government
Technical Feasibility	Extent of consensus needed	1	**2**	3	4	5	Unanimity
	Administrative hurdles	1	2	3	4	**5**	NGEU already established
Quantitative Impact	Additional fiscal capacity	1	2	3	**4**	5	High (especially through grants)
Qualitative Impact	Tied to green / social	1	2	3	**4**	5	Mainly
	Tied to investment	1	2	3	**4**	5	Mainly

4.2.3 Technical amendments

Requires changes in the OGWG's methodology

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 the 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[65]. 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[66].

Political Feasibility	Addressed in public debate	1	**2**	3	4	5	Frequently, but rather in expert debate and focused on Germany
	Political Support	1	2	**3**	4	5	In general, low opposition, but could be opposed if it creates much fiscal flexibility for Member States with high unemployment
Technical Feasibility	Extent of consensus needed	1	2	3	**4**	5	Approval by the Ecofin Council
	Administrative hurdles	1	2	3	**4**	5	Revision of calculation methodology
Quantitative Impact	Additional fiscal capacity	1	2	**3**	4	5	Dependent on national circumstances
Qualitative Impact	Tied to green / social	1	2	3	4	5	No
	Tied to investment	1	2	3	4	5	No

4.3 Results

4.3.1 Feasilbility & Impact Analysis of Fiscal Policy Reform Proposals

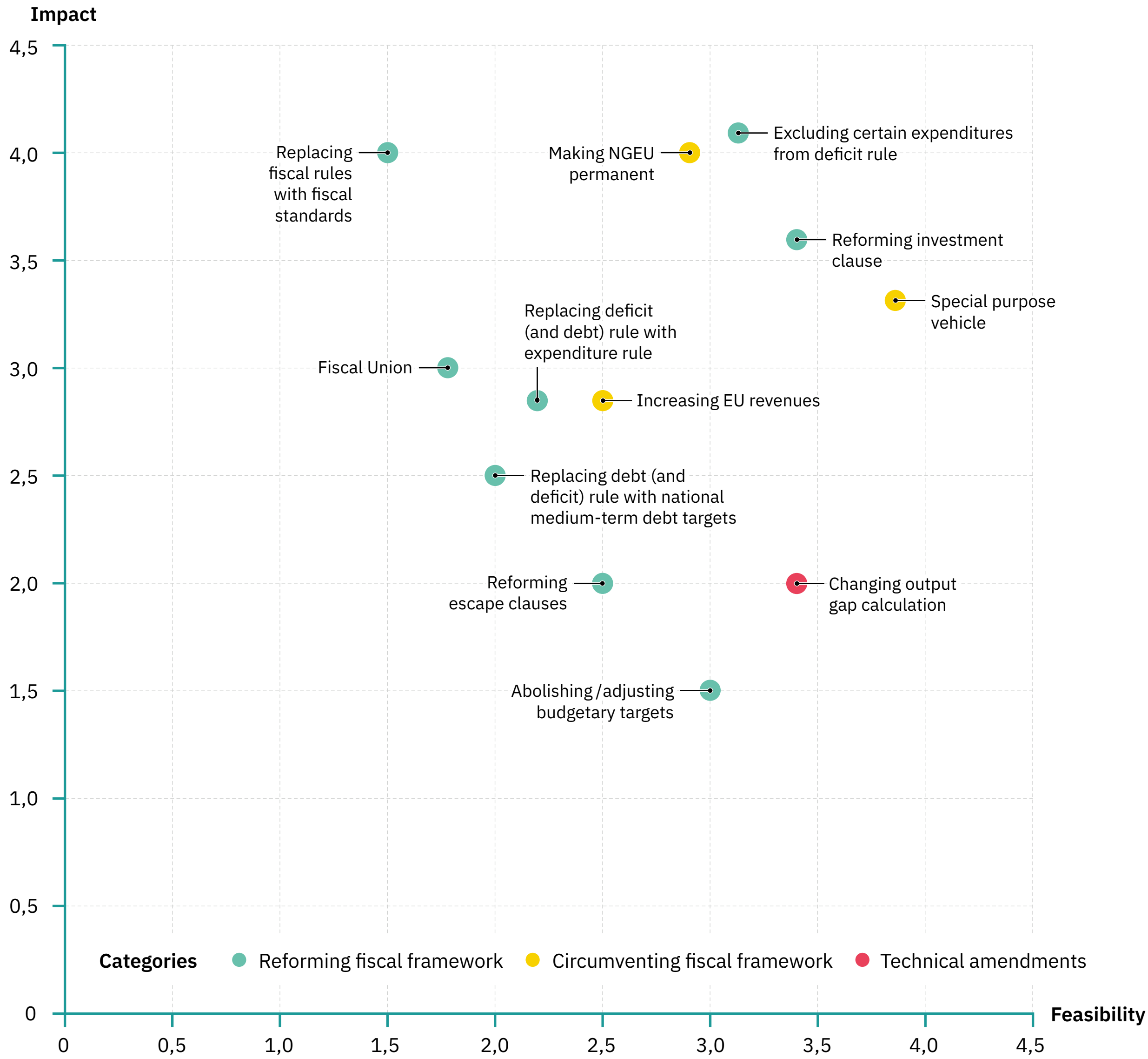

Figure 4: *Overall feasibility and overall impact of the reform proposals*

Figure 4 presents the feasibility and impact scores of all analysed proposals. The weighted average score of the feasibility dimension on the x-axis and the weighted average score of the impact dimension on the y-axis are plotted in this diagram. The diversity of the reform proposals analysed points to a trade-off: many proposals that have a relatively high impact have relatively low feasibility and vice versa. This is not surprising, as ambitious proposals often have a large impact but lower feasibility than moderate proposals, which in turn often have a lower impact. However, some proposals break this pattern and perform considerable in terms of both feasibility and impact. These proposals form a cluster in the upper-right corner and embrace making the NGEU permanent, excluding certain expenditures from the deficit rule, reforming the investment clause and special purpose vehicles. Other proposals stand out by a combination of high feasibility but low impact (changing output gap calculation, abolishing/adjusting budgetary targets) or high impact but low feasibility (replacing fiscal rules with fiscal standards).

4.3.2 Impact Analysis

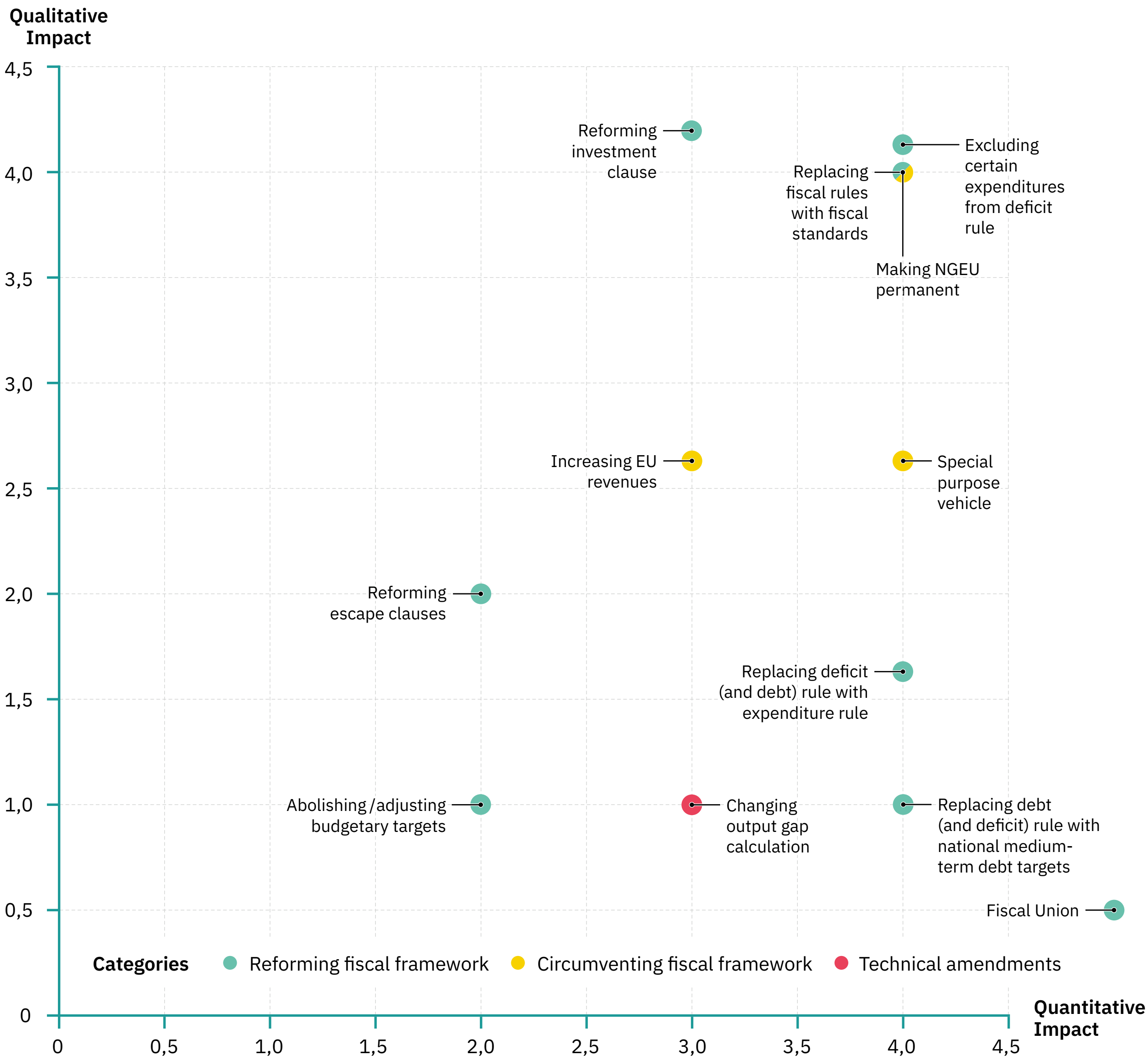

Figure 5: *Qualitative and quantitative impact of the reform proposals*

Figures 5 and 6 break down the feasibility and impact dimensions and present the scores of the reform proposals in terms of the sub-dimensions of feasibility and impact so that they can be viewed independently. With the quantitative impact on the x-axis and the weighted average score of the qualitative impact on the y-axis, figure 5 plots the scores of the reform proposals in terms of quantitative and qualitative impact. Similarly, figure 6 plots the scores in terms of political and technical feasibility with the political feasibility on the x-axis and the technical feasibility on the y-axis.

The impact analysis plot highlights three proposals as having both a high quantitative and a high qualitative impact. The proposal for a fiscal union comes with a high quantitative impact but rather low qualitative impact.

4.3.3 Feasilbility Analysis

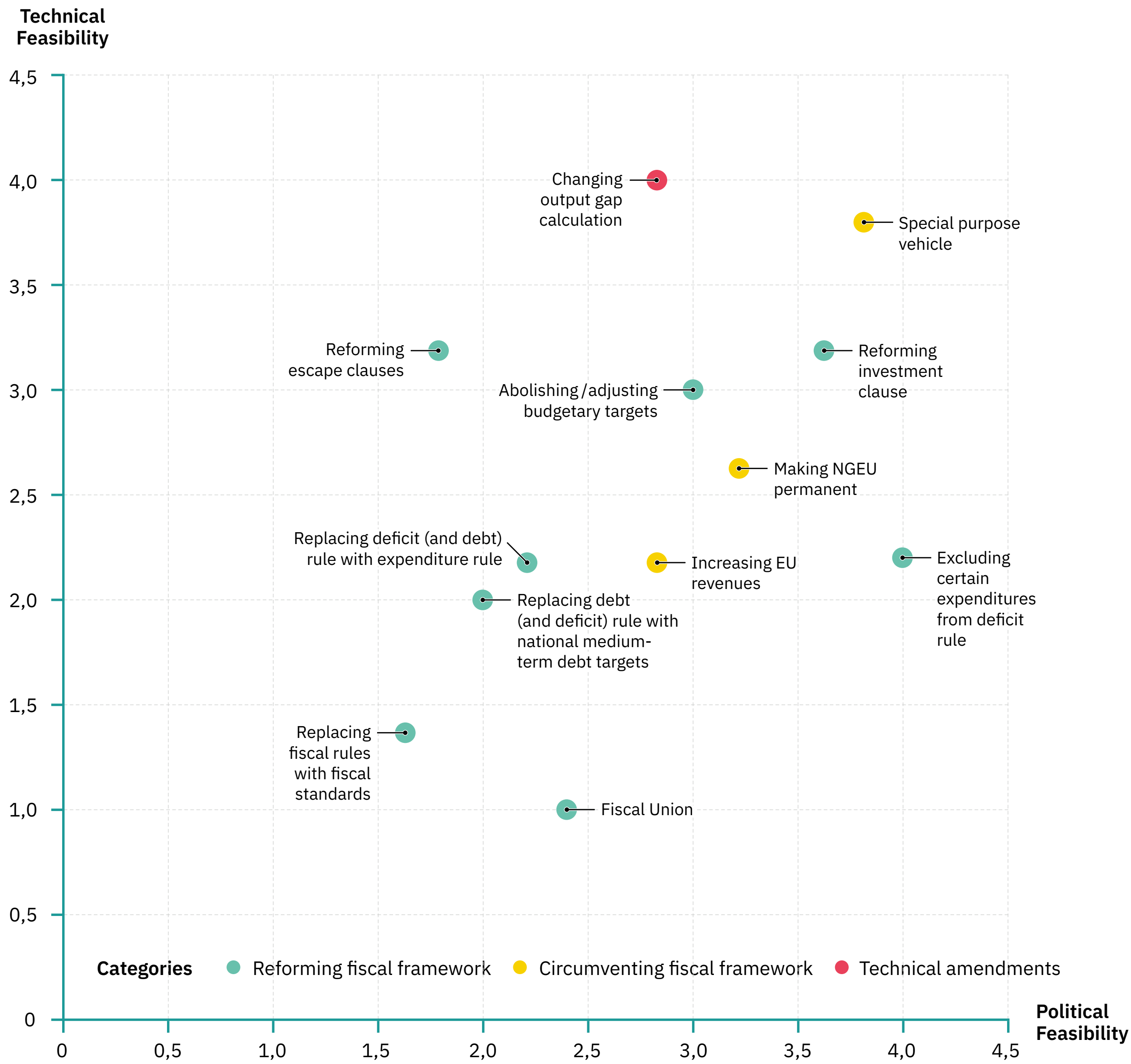

Figure 6: *Technical and political feasibility of the reform proposals*

The feasibility analysis plot shows that there seems to be a positive correlation between political and technical feasibility as most proposals that have high political feasibility also have high technical feasibility while politically less feasible proposals tend to have lower technical feasibility. The plot shows a cluster of four proposals with both a high political and high technical feasibility. With a notable exception, the proposal for implementing fiscal standards shows low feasibility, both in political and technical terms.

This analysis shows how feasible the reform proposals are and evaluates their quantitative and qualitative impact. The discussion in the following section complements this analysis with a critical review of the reforms, their mutual compatibility and an assessment of their suitability given the current challenges facing EU governments.

5. Discussion

Plotting the results in a diagram offers a comparison of the proposals concerning these two dimensions. A reform of the fiscal framework could also include a combination of presented proposals. While there are competing proposals (e.g. fiscal standards that build on qualitative targets cannot be implemented simultaneously with proposals that rely on numerical targets), many proposals are complementary to each other. For example, abolishing or adjusting the budgetary targets might be relevant for a golden rule and for reforming the investment clause. The latter two proposals also show some form of complementarity, because a revised investment clause can be considered as a "small-scale golden rule"[67]. In a similar vein, a golden rule is complementary to an expenditure rule as both could be combined in a framework that limits expenditures but excludes green investments from this limit. A sophisticated reform of the EU fiscal framework might indeed require combining several proposals to one feasible and impactful reform.

Such a combination of proposals might help to address the drawbacks that some proposals entail. The special purpose vehicle, one of the high feasibility and high impact proposals in our analysis, comes at the expense of a loss of democratic oversight of public funds. Due to their legally independent nature, national governments cannot exert the same control over their expenditures as within the fiscal framework. This is a serious challenge that should be factored in when discussing the usefulness of this proposal for increasing fiscal flexibility. In addition to that, national special purpose vehicles would decentralise the EU fiscal policy in the sense that all member states would have to set up their own vehicles which would depict a step back from European collaboration and coordination. To tackle the latter issue, the EIB could be equipped with more equity to enable cross-border investments in Europe and therefore act as a single European special purpose vehicle.

However, special purpose vehicles in general, whether national or European, always entail a circumvention of fiscal rules and rather than reforming them. Chapter three of this report has highlighted the need for reform and underpinned the necessity for amending tight EU fiscal rules. Hence, proposals such as excluding certain expenditures from the deficit rule (e.g. "golden rule") and reforming the investment clause perform similarly well in our analysis, as compared to the special purpose vehicles, and do not come at the expense of a loss of democratic oversight.

Most of the proposed reforms focus on creating more fiscal flexibility for member states. While this certainly helps it would not solve all the problems related to the economic divergence of member states. For example, Member States have different credit ratings, which affects the cost of borrowing at the national level, making it cheaper for some countries than others. Common debt issuing, as described in the proposal of making the NGEU permanent, would remedy differences in credibility ratings among the Member States and make loans with favourable conditions accessible to all Member States. Likewise, the proposal for increasing EU revenues demonstrates that increased tax-raising powers would enable centralised revenue collection and allocation as grants to the Member States. Hence, a long-term solution for a reformed fiscal governance framework must take different socio-economic situations of EU countries into account and should prevent the Member States from drifting further apart. Proposals that work towards a centralised fiscal capacity represents such a vision.

Moreover, while our analysis was mainly focussed on generating fiscal flexibility for meeting investment needs, a fiscal union could not just address investment needs but also the complementarily needed public spending. To tackle social inequality, public investment often needs to be complemented by public spending in order to give everyone equal access to public goods and services (e.g. only people that can afford an electric vehicle will be able to access infrastructure for e-mobility). An evaluation of the potential of reform proposals to enable public spending, with particular consideration of the achievement of social objectives, is thus equally important.

To sum up, feasibility and impact represent crucial dimensions for assessing the reform proposals to the EU fiscal framework, but other aspects should not be neglected. A sophisticated reform might have to make use of the complementarity of the proposals in order to design a fiscal framework that addresses all important aspects. While focusing on feasibility is unavoidable for an immediate reform, more ambitious proposals like a fiscal union should also be central to the debate for a well-designed, long-term solution.

6. Conclusion

The EU requires unprecedented levels of public investment to address the multiple and intersecting challenges faced at present. The current rules of the EU fiscal framework are not designed for today's environmental, social and economic challenges and therefore need reform to give Member States more fiscal flexibility and to address investment gaps.

Our report has structured the most relevant reform proposals and assessed them in terms of their feasibility and impact. In doing so, our analysis provides a basis for further discussion of proposals and ultimately, to support a decision on a comprehensive reform of the fiscal framework, which may require a combination of different, complementary proposals.

The decision on the fiscal framework for the future is momentous. Much is at stake in the reform of the EU governance framework: We have seen the negative consequences of austerity policies in Europe, how long the effects of the 2008 financial crisis were felt in Europe as a result and have witnessed the consequences of underfunded public health systems in the outbreak of the pandemic. As von der Leyen points out: We must not repeat the mistakes of the past.

At the same time, the discussion about the urgently needed investments should not ignore the need for a comprehensive reform for the long term of EU fiscal policy. Many of today's challenges, such as biodiversity loss or climate change, are cross-border problems that cannot be solved at a national level, or with a short-term solution. Therefore, joint action and thus also a centralisation of fiscal capacities in a fiscal union with permanent funds is one of the most efficient solutions to address those challenges that affect member states equally. In this sense, the reform of the EU fiscal policy framework should not only allow the Member States to build long-term resilience but should also allow sufficient space for the implementation of a vision of Europe for the future.

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Annex

Annex 1: Methodology Table

	Weighting	Scaling
Addressed in public debate (To what extent is the proposal discussed in the public debate and covered by media)	0.1	1–5 (5 being highest feasibility), not mentioned in public debate = 1, only mentioned in scientific debate = 2, rarely mentioned in public debate = 3, often mentioned in public debate = 4, one of the most discussed proposals in public debate = 5
Political support (How powerful are the players that support/ oppose the proposal?)	0.4	1–5 (5 being highest feasibility), criteria: how powerful are the players that support/oppose this No support/huge opposition = 1, low political support/strong opposition = 2, balanced support and opposition = 3, strong support/low opposition = 4, huge support/no opposition = 5
Extent of consensus needed (Which extent of consensus is needed to implement this proposal?)	0.4	1–5 (5 being highest feasibility), treaty reform = 1, treaty protocol change = 2, ordinary legislative procedure = 3, less than ordinary legislative procedure = 4, no consensus needed = 5
Administrative hurdles (What effort is required to implement this proposal? New Institutions? New monitoring processes?)	0.1	1–5 (5 being highest feasibility) major changes in the institutional framework of the EU and drastic shift in competencies = 1, major changes in EU legislation and additional responsibilities for different institutions = 2, major changes in EU legislation = 3, minor changes in EU legislation and methodologies (e.g. Output Gap Working Group) = 4, required structures already in place (e.g. NGEU) = 5
Additional fiscal capacity (How big is the amount of money set free for the fiscal policy of Member States?)	0.5	1–5 (5 being highest impact) No additional fiscal capacity = 1, minor revisions = 2, major revisions without reforming/circumventing the deficit and/or debt rule = 3, proposals reforming/circumventing the deficit and/or debt rule = 4, proposals reforming/circumventing both the EU and the national rules = 5
Tied to green/social (Is the fiscal capacity generated tied to green and/or social purposes?)	0.4	1–5 1 = No, 2 = rarely, 3 = partially, 4 = mainly, 5 = Yes
Tied to investments (Is the fiscal capacity generated tied to investments?)	0.1	1–5 1 = No, 2 = rarely, 3 = partially, 4 = mainly, 5 = Yes

Annex 2: Overview of scores

Feasibility & Impact Analysis

	Feasibility							Impact				
	Political Feasibility			Technical Feasibility			Overall feasibility	Quantitative impact	Qualitative Impact			Overall impact
	Addressed in public debate	Political Support	Overall political feasibility	Extent of consensus needed	Changes in governance structure needed	Overall technical feasibility		Overall quantitative impact (Additional fiscal capacity)	Tied to green/social?	Tied to investments?	Overall qualitative impact	
Proposal	0,1	0,4	0,5	0,4	0,1	0,5	1	0,5	0,4	0,1	0,5	1
Abolishing/adjusting budgetary targets	3	3	**3**	3	3	**3**	**3**	**2**	1	1	**1**	**1,5**
Excluding certain expenditures from deficit rule	4	4	**4**	2	3	**2,2**	**3,1**	**4**	4	5	**4,2**	**4,1**
Fiscal Union	4	2	**2,4**	1	1	**1**	**1,7**	**5**	1	1	**1**	**3**
Reforming escape clauses	1	2	**1,8**	3	4	**3,2**	**2,5**	**2**	2	2	**2**	**2**
Reforming invest-ment clause	2	4	**3,6**	3	4	**3,2**	**3,4**	**3**	4	5	**4,2**	**3,6**
Replacing debt (and deficit) rule with national medium-term debt targets	2	2	**2**	2	2	**2**	**2**	**4**	1	1	**1**	**2,5**
Replacing fiscal rules with fiscal standards	4	1	**1,6**	1	3	**1,4**	**1,5**	**4**	4	4	**4**	**4**
Replacing deficit (and debt) rule with expenditure rule	3	2	**2,2**	2	3	**2,2**	**2,2**	**4**	1	4	**1,6**	**2,8**
Increasing EU revenues	2	3	**2,8**	2	3	**2,2**	**2,5**	**3**	3	1	**2,6**	**2,8**
Special purpose vehicle	3	4	**3,8**	4	3	**3,8**	**3,8**	**4**	2	5	**2,6**	**3,3**
Making NGEU permanent	4	3	**3,2**	2	5	**2,6**	**2,9**	**4**	4	4	**4**	**4**
Changing output gap calculation	2	3	**2,8**	4	4	**4**	**3,4**	**3**	1	1	**1**	**2**

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