STUDY

Requested by the ECON committee

European Parliament

The role of reforms and investments in the EU fiscal governance framework

External authors:

Waltraud SCHELKLE

Marcello NATILI

Joan MIRÓ

Economic Governance and EMU scrutiny Unit (EGOV)
Directorate-General for Internal Policies
PE 741.526 - July 2023

EN

The role of reforms and investments in the EU fiscal governance framework

Abstract

This briefing paper assesses Commission proposals to monitor reforms and investments in member states through a revised EU fiscal governance framework. Major innovations, such as a key operational role for an expenditure rule, are discussed in relation to the stated objectives, with a focus on social resilience. These innovations are welcome, but we also see a need for engaging national stakeholders to increase loyalty to the policy process.

This document was provided by the Economic Governance and EMU Scrutiny Unit at the request of the ECON Committee.

This document was requested by the European Parliament's Committee on Economic and Monetary Affairs.

AUTHORS
Waltraud SCHELKLE, European University Institute
Marcello NATILI, Università degli Studi di Milano
Joan MIRÓ, Institut Barcelona d'Estudis Internacionals

ADMINISTRATOR RESPONSIBLE
Samuel DE LEMOS PEIXOTO
Giacomo LOI

EDITORIAL ASSISTANT
Donella BOLDI

LINGUISTIC VERSIONS
Original: EN

ABOUT THE EDITOR
The Economic Governance and EMU Scrutiny Unit provides in-house and external expertise to support EP committees and other parliamentary bodies in shaping legislation and exercising democratic scrutiny over EU internal policies.

To contact the Economic Governance and EMU Scrutiny Unit or to subscribe to its newsletter please write to:
Economic Governance and EMU Scrutiny Unit
European Parliament
B-1047 Brussels
E-mail: egov@ep.europa.eu

Manuscript completed in May 2023

This document and other supporting analyses are available on the internet at:
http://www.europarl.europa.eu/supporting-analyses

CONTENTS

LIST OF ABBREVIATIONS

ALMPs	Active Labour Market Policies
CSRs	Country-Specific Recommendations
DSA	Debt Sustainability Analysis
ECB	European Central Bank
EMU	Economic and Monetary Union
NGEU	Next Generation European Union
NMFPs	National Medium-term Fiscal-structural Plans
NRRPs	National Recovery and Resilience Plans
MTO	Medium-term budgetary objective
PES	Public Employment Services
RRF	Recovery and Resilience Facility
SGP	Stability and Growth Pact

LIST OF BOXES

LIST OF FIGURES

LIST OF TABLES

EXECUTIVE SUMMARY

Background

EU fiscal governance has been a construction site ever since its inception. The list of reforms shows that there was an overall trend that made the rules more contextual in terms of a country's situation, growth-sensitive and medium-term in its time horizon. The Communication by the Commission from November 2022 and the following legislative proposals in April 2023 are the latest in this list of (suggested) revisions and follow this trend.

Aim

The aim of our briefing paper is, first of all, to understand why EU fiscal governance has not become a more settled institution, conducive to promote sustainable public finance, reforms and investments in public goods. Our core argument is that the history of polity-formation in the footsteps of Stein Rokkan and Charles Tilly can teach us that fiscal governance requires the EU to be mindful of the reciprocity between supranational authority and member state loyalty (Ferrera, Kriesi and Schelkle 2023). Three elements define a polity: 1) its boundaries, which can be territorial but also functional, for instance its regulations extending beyond its borders; 2) its binding authority, which can be centralised and hierarchical or devolved and shared; 3) its political system of bonding, primarily through participation rights and public welfare provision. From this, we derive that elected representatives must be able to make the case for compliance with the EU fiscal governance framework because it provides tangible advantages over national self-determination. Onerous reporting and the threat of sanctions without any EU funding for reforms and investments will not make that case. On the contrary, it runs the risk of escalating pertinent conflicts over policies into foundational conflicts over membership in the EU polity.

Secondly, we discuss the governance aspects of the proposed framework. Central to the communication and the legislative proposals is a new balance between EU-level enforceability and country-specific flexibility traditionally seen as a trade-off. The operational role of the net primary expenditure rule has clear advantages over the calculation of structural budget balances. The move towards a risk-based approach is a welcome deviation from the one-size-fits-all norm of the original Stability and Growth Pact (SGP). The problem of strengthening enforceability without undermining loyalty has not been solved, however. The envisaged close monitoring of national reforms and investments through fiscal governance without additional EU funding will encounter the same implementation problems that have been observed in the European Semester. Our framework suggests that strengthening the fiscal framework requires more national engagement with the budgetary plans of reforms and investments, such as a greater agenda-setting role for national governments, greater transparency of the planning process for national legislatures, and shared authority to enforce it.

National parliaments should be given a formal stake in the process. Social partners and sub-national authorities are also crucial to ensure pressures for delivery. The Commission proposal contains a basket of innovations that would introduce more deliberation in the application of the framework than the existing framework. However, the legislative proposal has watered down these innovations in two crucial respects (reputational sanctions and the role of independent fiscal councils).

Thirdly, we revisit the experience of two crucial cases, Italy and Spain, regarding the reform and investment record before and after the introduction of the Recovery and Resilience Facility (RRF). This experience illustrates the difference that weaker or stronger reciprocity of authority and loyalty makes. The European Semester pre-2021 rested on a weak form of reciprocity: the obligation to implement the Country-specific Recommendations did not come with any tangible support for delivering on these obligations. The same reforms were then included in the National Recovery and Resilience Plans (NRRPs) after 2021. The commitment to deliver was unsurprisingly much higher under the NRRPs, even if actual implementation is still ongoing. This raises now the question how the EU monitoring of reforms and investments can create the same commitment to the policy process when it is not tied to extraordinary funding for recovery.

Conclusions

To sum up, we argue that, although the Communication of 2022 was more promising, the legislative package to reform the fiscal framework has a number of constructive proposals that can improve fiscal governance. We highlight the operational role of the net primary expenditure rule and a rethink of the sanctions regime. These changes acknowledge that the return to sustainable public debt levels must be paced so as to leave fiscal space that addresses the enormous ecological -- and, we would add, social -- challenges ahead.

But we also think that the new governance framework tries to impose more central authority on member states' budgets while it does not spell out any ways of increasing loyalty. Without additional EU funding, the EU cannot hope to achieve the same commitment as the policy process around recovery funding. Therefore, the governance framework has to adapt its ambitions and rely on shared authority with the ultimate authorities over national budgets, that is member state parliaments. They must be able to use the EU's fiscal framework as a political resource by which they can influence a government's reform and investment policies. This could be achieved by encouraging member states to institutionalise dedicated committees that have strong rights of scrutiny, for instance to ask questions about the consultations between Commission and government and have the underlying data revisited. The stipulations in the legislative proposal point in that direction but should be strengthened: the framework that sets important parameters for national budgets does not foresee any mandatory political scrutiny by elected representatives. This would also require simplified procedures and indicators, so that the interested public can engage with the policy process.

1. FISCAL GOVERNANCE IN THE EU'S EVOLVING POLITICAL SYSTEM

1.1. Introduction

The EU fiscal governance framework is a permanent construction site. It is important to understand, in political-economic terms, why that is. The diagnosis will shape any evaluation of the latest attempt at revising this framework as published by the European Commission in its *Communication on orientations for a reform of the EU economic governance framework* from 9th November 2022 (European Commission 2022). This Communication was followed by three legislative proposals to implement a comprehensive reform of the EU's economic governance rules on 26th April, 2023 (European Commission 2023a, 2023b, 2023c). We note the main differences between the Communication and the legislative proposals in the first Annex.

Through fiscal governance, the Commission proposes to monitor reforms and investments in member states. The key metric supposed to provide the link between fiscal governance, on the one hand, and reform and investment plans, on the other, is *net primary expenditure* planned over a decade and broken down into annual spending ceilings. While the rule itself is not new, its key operational role is a noticeable addition to the existing Maastricht indicators of 3% deficit-to-GDP ratio and a 60% public debt-to-GDP ratio. This expenditure rule is supposed to be more directly controllable by fiscal authorities, especially in times of very volatile GDP growth and inflation. It is designed to temper a sole focus on returning to lower public debt levels with a regard for growth, the ecological transition to net-zero and digitalisation.

In this section, our analysis first outlines how we see fiscal governance in the evolving political system of the EU and specifically the promotion of public investments and reforms through an expenditure rule. EU fiscal governance has a legitimate role in an interdependent system of political decision-making in that budgetary policies of member states are a matter of common concern. But the history of polity-formation[1] in the footsteps of Stein Rokkan and Charles Tilly can also tell us that fiscal governance requires the EU to be mindful of the reciprocity between supranational authority and member state loyalty (Ferrera, Kriesi and Schelkle 2023). Elected representatives must be able to make the case for compliance with the EU fiscal governance framework because it provides tangible advantages over national autonomy. Onerous reporting and the threat of sanctions without funding for reforms and investments will not make that case. If not accompanied by additional administrative and pecuniary resources, it comes across as burdensome intrusion (Bressanelli 2022: 32). In hard times, this runs the risk of escalating pertinent conflicts over policies into foundational conflicts over membership in the EU polity (Ferrera et al 2023: 13-14).

In light of our approach that sees the EU as an evolving political system, the second section discusses the governance aspects (i.e., the patterns of task allocation, vertical power sharing and structuring of the decision-making process) that the new fiscal framework envisages. Central to the proposals is a new balance between EU-level enforceability and country-specific flexibility traditionally seen as a trade-off. Our theoretical framework suggests that strengthening the fiscal framework requires more national engagement with the budgetary plans of reforms and investments. This can be achieved by greater transparency in the planning process for national legislatures, and shared authority to enforce it. These are the conditions for getting national stakeholders, in particular member of parliaments, interested. While the Commission legislative proposals are less ambitious than the Communication,

[1] See the second Annex for further details on this approach.

bothcontain a basket of innovations that potentially make these principles more complementary than they are in the current framework.

The third section draws on the experience of two crucial cases, Italy and Spain. Their reform and investment record before and after the introduction of the Recovery and Resilience Facility (RRF) illustrates the difference that weaker or stronger reciprocity of authority and loyalty makes. The European Semester (ES) pre-2021 rested on a weak form of reciprocity: the obligation to implement the Country-specific Recommendations (CSRs) did not come with any tangible support for delivering on these obligations. The same reforms were then included in the National Recovery and Resilience Plans (NRRPs) after 2021. The commitment to deliver was unsurprisingly much higher under the NRRPs; actual implementation is still ongoing, however, and only time can tell whether this continues.

In the concluding section, we draw lessons from our analysis. The Communication and proposals for a reformed framework have a number of constructive ideas that can improve fiscal governance. They acknowledge that the return to sustainable public debt levels must be paced so as to leave fiscal space that addresses the looming ecological -- and, we would add, social -- crises ahead. But a governance framework without EU funding cannot simply hope that the policy process around NRRPs, with its detailed setting of goals, can be replicated without such funding. EU fiscal governance has to share authority with the ultimate authorities over national budgets, that is member state parliaments.

1.2. The central role of fiscal governance

Our remit is to assess the role that the EC Communication and the legislative proposals foresee for member states' multi-annual budgeting of reforms and investments as an integral part of fiscal governance. This requires, first, to understand why fiscal governance needs yet another revised framework, and, second, whether extending fiscal governance to member states' reforms and investments via multiannual spending plans is advisable.

The scholarly literature has analysed fiscal governance in the EU extensively. Originally built on the understanding that "rules rather than discretion"[2] should prevail, successive reforms have shown that the EU has not found a workable institutional solution. Reform after reform conceded that the original idea of the rules did not work. Box 1 lists the major reforms and shows that while there was a back-and-forth on sanctions, an overall trend is also discernible: to make the rules more contextual in terms of a country's situation, growth-sensitive and medium-term in their time horizon. The revisions proposed in the Communication followed this trajectory and made sanctions more political, in the sense of inflicting reputational costs on governments for their political failures. The legislative proposals have, however, not taken up this idea of applying political sanctions in the case of non-compliance with the political obligations of membership.

For outsiders, it is hard to understand why the EU spends so much political energy and administrative resources on a complex substitute for a central budget that could bind the member states into a system of revenue-sharing and coordinated spending. Against the benchmark of fiscal federalism, it is a poor substitute as it has no means to incentivise governments positively to comply, notably via federal budget transfers. And yet, few experts would consider the fiscal system of its closest peer, the United States, to be a role model that the EU should emulate (Rodden 2005). The EU has found its own ways in supporting member states when catastrophic risks materialise that overwhelm the capacities of the nation-state. It has pulled through a series of severe crises in which it managed to create institutions that took the United States several decades (Frieden 2016). In this arduous process, the European union of nation-states with its policy-domain specific integration dynamics has arguably become a unique

Box 1: Reforms of the EU fiscal framework

In 2005, after a Court case that pitched the Commission against the Council, the **Stability and Growth Pact (SGP)** of 1997 was considerably reformed. It introduced country-specific *Medium-Term Objectives* for cyclically-adjusted deficits and allowed exemptions for major reforms, such as introducing a pre-funded public pension scheme.

In 2011, the **Six-Pack reforms** introduced an expenditure cap on annual spending growth, a *Macroeconomic Imbalances Procedure* with many more indicators and an operational measure for correcting a deficit deemed excessive: annually 0.5% or 1/20th of the deficit ratio above 60% debt-to-GDP. Sanctions were made semi-automatic and gradual, reaching up to 0.5% of GDP. The *European Semester* provides the framework for the surveillance cycle.

In 2012, the **Fiscal Compact** was introduced outside the legal framework of the Treaty, in which signatory states committed to enshrine fiscal rules and independent fiscal watchdogs into national legislation, preferably into their constitution.

In 2013, a **Two-Pack reform** introduced a two-tier surveillance system, more stringent for euro area members at high risk of bond market turmoil, and all other euro area members. All are requested to introduce independent *Fiscal Councils*.

In 2015, **new guidance** on implementing the SGP goes back to the reform thrust in 2005, i.e. allowing for flexibility if justified by reforms and investment.

In 2016, a **European Fiscal Board** is introduced as the EU-equivalent of independent national Fiscal Councils.

Sources: IMF (2022: Box 1) and European Commission

[2] Kydland and Prescott (1977). For the adoption of this rules-based approach in the euro area, see Schelkle (2006, 2009).

but recognisable political system.[3] It has developed more defined territorial and functional boundaries, a (dispersed) binding authority and second-order bonds of loyalty that create expectations on the side of citizens. Second-order loyalty here means loyalty to the EU compared to the primary allegiance of citizens to the national political system.

In this view, the difficulties that make fiscal governance for good reason contested terrain are two-fold. First, the EU's dispersed authority cannot easily bind member states that do not comply with the obligations of membership. Moreover, the second-order loyalty leaves uncertain how much risk-sharing member states owe each other and can expect from each other. This is particularly relevant wen reforms and investments have to be delivered, of which the outcome is inherently uncertain.

The Maastricht rules defined the obligations of membership very narrowly as observing fiscal constraints; avoiding other macroeconomic imbalances remained outside their purview. This hard-and-fast rule for exercising the authority of fiscal surveillance did not generate loyalty on any side. For those in breach of the rules, they came across as meddling with national affairs, threatening with sanctions that worsened the fiscal situation the rules were meant to remedy. For the rule-abiding members, it was alienating that the rules were not enforced, especially not against Germany as their instigator. Reforms since then have broadened the scope and amended some asymmetries: the macroeconomic imbalances procedure is a case in point. Counter-productive sanctions, which threaten to sanction governments in fiscal difficulties with penalties that add to those difficulties, are officially still in place but cannot be enforced. The Commission therefore had to exercise discretion in the application of the rules which turned the rules into dead letter. This antagonises both sides, those who support and those who resent such rules.

Some judgement in the application of rules has to be allowed for, above all because a budget (im-)balance is an outcome of the state of the economy and the responding tax-transfer system. Paradoxically, some discretion must be allowed for, in order to delimit discretion to a sensible degree and avoid the impression of favour for influential members like France or, on the contrary, leniency towards smaller members. This discretionary application of authority is and has to be shared. It is a valid question, therefore, whether there should be a role for European and national parliaments, in addition to the Commission and the Council.

The Covid reform package, Next Generation EU, was a grand political gesture. It came in the guise of transfers and non-market loans to places where they were needed. We will discuss in section 3 how this tangible gesture of support played out in terms of loyalty and the process of governance. The EU support for national reforms and investments that should help the recovery from a catastrophic pandemic and improve resilience for the future has been appreciated by national administrations, who were eager to invest (Miró, Natili and Schelkle, forthcoming). However, the procedure of unlocking the funds is extremely cumbersome. The norm of "ownership" suggests that authority over planning rests primarily with member states. But the extreme time pressure for delivery makes ownership not necessarily a source of empowerment for national authorities but a target of blame attribution. Responding to these incentives, ministries will try to avoid blame, which is not conducive to unlocking reforms and investments.

[3] See Table A2 in the Appendix for the specific configurations of the EU polity, with further references. Kelemen and McNamara (2022) have recently made the case for mobilising the state-building tradition to understand the evolution of the EU. Predecessors, with a broader understanding of this tradition, are Bartolini (2005), Fabbrini (2007), Ferrera (2005) and Hix (2007).

1.3. An expenditure rule to govern reforms and investments.

In order to see what lessons have been drawn from the permanent revision of the fiscal framework, we briefly discuss what is new in the rule that is supposed to govern member states' reforms and investments: the *net primary expenditure* rule tries to capture the spending on reforms and investments.[4] The definition of this indicator in the Communication and in the legislative proposal on the preventive arm of the SGP is quite complex and scattered across article 2 and Annex II. The recital sums it up this way:

> *"expenditure net of discretionary revenue measures and excluding interest expenditure as well as cyclical unemployment expenditure and expenditure on Union programmes fully matched by revenue from Union funds. This indicator allows for macro-economic stabilisation as it is not affected by the operation of automatic stabilisers, including revenue and expenditure fluctuations outside the direct control of the government."* (European Commission 2023b: 10 (recital 8) and 14 (art. 1)

In other words, this metric relies on 1) a long-term revenue trend which is not bent to fit the spending plans on reforms and investments ("net of discretionary revenue measures"); while 2) it is a *primary* measure that excludes the ongoing drag on spending from inherited public debt ("excluding interest expenditure"), which may fluctuate with bond market conditions; and 3) it also excludes the only relevant automatic stabiliser on the spending side ("excluding [..] cyclical unemployment expenditure"). Compliance with the rule should also not impair the implementation of programmes co-financed by the EU. The reason for this is emphasised in the follow-up sentence.

In effect, the rule is therefore a cyclically-adjusted ("structural") measure of debt-financed spending, controllable by government and not reliant on any outside funds. Notably this would make new EU funding strictly additional from the point of view of fiscal surveillance. The rule would not constrain spending on above-trend unemployment in a recession nor tighten the constraint if bond markets suddenly ask for higher yields on new debt. All of this is sensible from a political economy point of view because it includes only spending for which a government can and should be held accountable.

The Communication formulates the rationale for this rule as a way of getting at the Maastricht measures of a budget deficit and debt.

> "*The agreed multiannual net primary expenditure path should ensure that debt is put or kept on a downward path at the latest by the end of the adjustment period or stays at prudent levels, while ensuring that the budget deficit is maintained below 3% of GDP over the medium term.*" (European Commission 2022: 8)

This downward path can be achieved by projecting that revenue will grow with expected GDP growth, for instance by 2% over the planning horizon of 10 years, and then allow for a growth rate of net public expenditure that is below this rate of 2%. So if one wanted to achieve a debt reduction of 1/20th or 0.5%, net primary expenditure could increase by only 1.5%.[5] The legislative proposal spells this out in more detail, in particular that "national net expenditure growth remains below medium-term output growth, on average, as a rule over the horizon of the plan" (European Commission 2023c: Article 6).

[4] See van den Noord (2023) for a more extensive discussion of the fiscal rule proposed.

[5] On 5 April 2023, the German government has reportedly sent a paper to the Commission in which it requested such an implied deficit adjustment: 'Germany also asks for a "common quantitative benchmark" to ensure spending doesn't outpace growth, whereby the difference between a country's potential growth and net primary expenditure could be 1 percent.' (Hanke Vela 2023) In the example we give above, this would mean that net primary expenditure could rise by 1% only given projected GDP and revenue growth of 2%.

The proposed rule of net expenditure is therefore implicitly a "Golden Rule" in the sense that debt-finance must be justified by reforms and investments from which future generations of taxpayers presumably benefit. It has technical advantages over the measurement of structural deficits that is likely to lead to fewer errors.[6] Golden rules privilege expenditure on public capital like hospital equipment and school buildings over current expenditure for salaries of nurses and teachers. This may or may not be justified in light of the state of public investment but it is a bias of which decision-makers should be aware. Public investment is indeed very low and/or has been falling in the big member states (cf. section 3). But understaffing is also a problem.

Moreover, how does this rule perform in terms of considerations that EU citizens and their political representatives can understand and do care about? The exercise of authority must not come across as heavy-handed and provide opportunities that reward loyalty to the obligations of membership in the polity. The rewards could include administrative support by the EU in fulfilling the data requirements for budgetary planning and co-financing the up-front costs of ambitious reforms. The modicum of discretion that the expenditure rule implies is helpful in that reforms and investments for which a government can make the case will be constrained only within limits that are determined by its growth and debt situation.

Finally, the distinction between member states' fiscal position that the framework introduces is an important signal: rules do not apply uniformly but address the agreed problem of historically high public debt levels with potential spillovers to others, mindful that the crises since 2008 have left a legacy of social deprivation and stagnating living standards. The legislative proposal on the preventive arm is quite explicit about this:

> "*The economic governance framework of the Union should put debt sustainability and sustainable and inclusive growth at its core and therefore differentiate between Member States by taking into account their public debt challenges and allowing country-specific fiscal trajectories.*" (European Commission 2023c: 12 (recital 6) and 17(Art. 1))

This is a major deviation from the one-size-fits-all norm of the original Stability and Growth Pact (SGP) and moves towards the "risk-based approach" advocated by the IMF (2022: 1): the higher the risks to financial sustainability as codified by the Maastricht criteria of permissible deficit and debt ratios, the greater must be "the speed and ambition of fiscal consolidation". The expenditure rule, which was already a "benchmark" in the previous framework, is now meant to play a pivotal role: "the Commission should base its assessment [of the medium-term fiscal-structural plan] only on nationally financed net primary expenditure developments" even though member states are allowed to use the structural (cyclically adjusted) balance of the SGP in their national planning (European Commission 2023c: 14 (recital 19)). This is obviously a way for the EU to avoid disputes about the accuracy of its data on structural balances, which – when proven wrong -- undermined its authority in the past.

2. GOVERNING REFORMS AND INVESTMENT

The revised EU fiscal framework intends to achieve several macroeconomic objectives, such as the dual transition to net-zero carbon emission and digitalisation. Implicitly, these objectives are also meant to

[6] The structural deficit rule of 3% has been criticised by senior staff at Bruegel, notably Zsolt Darvas, for some time and for good reasons (see Claeys et al. 2016); hence a blog on the Communication (2022) endorses the new rule (Blanchard et al. 2022). In 2016, the ECOFIN Council allowed the Commission already – under specific and limited circumstances – to depart from the output gap estimates of the commonly agreed methodology in its assessment of the member states' cyclical positions when conducting fiscal monitoring (European Commission 2018a: 57). In practice, this provided the Commission with constrained discretion to identify the plausible level of the output gap, necessary for structural measurement.

meet a number of political conditions. Fiscal governance should follow three main principles: (1) flexibility to adapt to changing economic conditions and uncertainty, (2) predictability and transparency to effectively detect, prevent and correct unsustainable policies, as well as to ensure an equal treatment of Member States, and (3) enforceability to effectively impinge on national executives' behaviour, preventing so-called "gross errors" in the conduct of fiscal policy. Senior Commission officials have come to admit that these three objectives may be in conflict with one another (Pench et al. 2018). Flexibility requires some discretion, which can undermine their credibility and enforceability as governments will find reason to circumvent rules whenever they become binding.[7] The added complexity that comes with regulating flexibility poses challenges to predictability and transparency: multiple target variables and escape clauses allow for tactics of cherry picking, while failing to provide interpretable signals to both public and private actors (Miró 2021). The "risk-based approach" is also susceptible to accusations of unequal treatment: high-risk countries may feel treated as second-class members; the same risks may be treated differently, depending on which member state shows signs of them.

To avoid these trade-offs, task allocation in the fiscal framework must be mindful of the reciprocity between supranational authority and member state loyalty. Given the complex vertical overlap between European and national levels of government in the EMU, mechanisms that enable joint authority to be exercised by the different actors are essential to ensure the political sustainability of the framework. Drawing on the scholarship on the flaws of federalism (Rodden 2005), we argue that EU-level authority must be robust enough to offer effective guidance but limited enough to preserve a sense of national responsibility and agency.

2.1. Changing the rationale of the framework

The Commission's reform proposals aim to establish a framework in which flexibility, predictability and enforceability reinforce, instead of undermine, each other. Essentially, Member States' flexibility in determining their reform pathways would be increased, while the enforcement mechanisms of EU surveillance would be strengthened simultaneously.

Enhanced flexibility is meant to come from more country-specific debt-reduction paths and the underpinning Debt Sustainability Analysis (DSA). The existing SGP requires all Member States to make similar adjustment efforts on the basis of the 1/20th (0.5% of GDP) debt reduction benchmark. The revised framework, while maintaining the original SGP debt and deficit indicators, removes this rule and proposes to draw on DSA, an established analytical toolkit for assessing debt sustainability risks. The DSA serves the Commission to propose the "technical trajectory" for debt reduction, i.e., country specific pathways towards attaining the 3% deficit and 60% debt targets of the SGP. This adds flexibility but also complexity.

According to the latest Commission proposal on the preventive arm of the SGP (European Commission 2023c), the policy process is sequenced as follows. The Commission would kick-off the process by proposing, for member states with public deficit to GDP ratios higher than the 3% target of the SGP, a multiannual adjustment path in terms of primary expenditure over four years, depending on the fiscal risks. Member States would follow up by drafting "National Medium-term Fiscal-Structural Plans" (NMFPs) outlining reform and investments necessary to meet these reference debt paths. The contents of the NMFPs would be negotiated between the national executive and the Commission in a confidential technical dialogue before being presented to the Council for endorsement. The plans

[7] Hagelstam et al. (2019: 11) quote ECB President Draghi for this message.

would be translated into annual national budgets and expenditure ceilings. Overall, the NMFPs become the centrepiece of the new governance architecture, replacing the Stability or Convergence Programmes and the National Reform Programmes of the previous framework.

Some additional flexibility is built in to ensure fiscal adjustment. The new rules would allow to extend the plans' adjustment period by three years if the request for extension is underpinned with reforms and investment commitments that are growth-enhancing, support fiscal sustainability, address the Union's common priorities, address relevant CSRs, and guarantee that the overall level of nationally financed public investment over the lifetime of the NMFP is higher than the medium-term level before the period of that plan (European Commission 2023c: 22 (Art. 123)).

The medium-term plans can be revised in the case of "objective circumstances" preventing the implementation of the original NMFPs. Similarly, when a new government is sworn in, it can request to submit a new NMFP (European Commission 2023c: 22 (Art.14)). However, the new adjustment trajectory should not reduce or backload of the previously planned fiscal adjustment. In terms of democratic policymaking, the Commission's legislative proposal improves slightly on the previous reform Communication (European Commission 2022). The latter allowed for revisions only four years after the adoption of the plan, which would have been binding legislatures over the election cycle. But the constraints on permissible revisions are quite stringent: a new government can only change how it complies, presumably by restructuring expenditure (cuts), but not how much and how fast.

Originally, in the Communication of the Commission, enforcement could make use of three types of sanctions (European Commission 2022: 17). First, the already existing macroeconomic conditionality for structural funds (and for the RRF) could facilitate the suspension of EU financing. Second, reputational sanctions could be introduced, such as Ministers of Member States in EDP being required to defend the reforms that supposedly comply with EDP-linked paths in the European Parliament. Third, the use of financial sanctions in the EDP would become less of a nuclear option by lowering their amounts, de facto converting them also into reputational sanctions (Blanchard et al. 2022), possibly making them more usable at the same time. Reputational sanctions provided an interesting mechanism to strengthen authority while nurturing loyalty. Opportunities for 'blaming and shaming' could generate deliberation among peers and public debate, raising the political costs of non-compliance while potentially strengthening the hand of national domestic reformers who can provide the government with a case for its preferred course of action. But the legislative proposal only marginally amends provisions on sanctions, not changing their nature (European Commission 2023b: articles 12-14). The proposals do not seem to strengthen reputational sanctions. Instead, they retain the possibility of a "dialogue" with Member States "in the event of a significant risk of deviation from the net expenditure path, the European Parliament may offer the opportunity to that Member State, to participate in an exchange of views." (European Commission 2023c: 27 (Art. 28) While this sounds like an invitation to more deliberative governance, it is an offer that could be refused. It is not a sanction and therefore leaves the old, unenforceable sanctions regime in place.

2.2. Striking a compromise between equally valid objectives

In political terms, the Communication, and to a lesser extent the legislative proposals, offer a sensible approach to reforming the fiscal framework. Increasing the scope for country-specific flexibility and allowing for more gradual adjustment paths should improve political support for reforms in high-debt countries. The lack of national ownership has been pointed out to be a key factor undermining implementation by national governments (Manasse and Katsikas 2018), particularly in those Member States where reform is needed most. In the existing framework, this has politicised the enforcement of the framework (Baerg and Hallerberg 2016, 2022), undermining the Commission's willingness to ask strenuously for the implementation of controversial reforms (Sacher 2021). *De jure* strong enforcement has been replaced by more tailored Commission advice *de facto*, negotiating the minimum requirements of debt reduction bilaterally (Eisl 2022, Schmidt 2016).

Therefore, the reform would regularise an already tried and tested practice towards more deliberation in the application of the framework, which began in 2015 with the Commission's Communication *Making the Best Use of Flexibility within the Existing Rules of the Stability and Growth Pact* (Miró 2021). In this Communication, the Commission (2015) introduced three clauses in the fiscal codebook that justified the temporary deviation from medium-term budgetary objectives (MTOs): the "cyclical conditions clause", the "investment clause", and the "structural reform clause". All three clauses provided a "margin of interpretation" (European Commission 2015: 4) for the Commission in applying the preventive arm of the SGP. In the 2018 annual cycle of surveillance, the Commission introduced the so-called "margin of discretion" (EFB 2019: 17, 20). Hence, the 2018 CSRs issued to Italy and Slovenia lowered the fiscal adjustment requirements for these countries with the aim of "striking the right balance between the Member State's stabilization and sustainability needs" (Commission 2018: 207). The most recent Commission proposal has to be compared not with the formally hierarchical enforcement structure, but the practice of more realistic consolidation requirements negotiated in bilateral discussions between the Commission and concerned member states (Schmidt 2016). However, these existing practices are opaque and highly discretionary.

In the revised framework, stronger ex-post enforcement would be the counterpart to enhanced flexibility. The rationale is similar to the one informing the RRF planning and implementation process: more leeway to Member States to define their adjustment paths comes with stronger monitoring capacities for the Commission (and the Council) to control the correct implementation of the commitments (Miró, Natili and Schelkle forthcoming). In a diverse union, this is likely to enhance public support for shared fiscal governance in fiscally more conservative member states. In hard-pressed, fiscally less hawkish countries, the response may be more mixed, especially if increased flexibility comes without additional tangible resources to meet agreed adjustment requirements. While more flexibility may still be welcome, it is not a free lunch: drawing up NMFPs is demanding in terms of administrative resources and may be controversial in domestic politics.

2.3. Assessment of the proposed reforms

The Communication of 2022 is more far-reaching than the legislative proposal of 2023. We assess what applies to both and note when Communication and legislative proposal diverge (for an overview, see Table A2 in the Annex).

The scholarly and political reactions to the Communication suggest a broad consensus that the main weakness of the proposed framework is the "oversized role" of the Commission (Blanchard et al. 2022; see also Ellina 2023 and Lorenzoni et al. 2023). Several member states, such as Germany and the Netherlands, have expressed reluctance towards the enhanced leeway that the proposal would give to the Commission (Liboreiro and Chadwick 2023). The Dutch executive, for instance, advocates a "common numerical benchmark" of debt-reduction to ensure transparency and prevent each country's situation becoming "so idiosyncratic that you lose the political oversight over the tableau" (Liboreiro and Chadwick 2023). Like the German finance ministry, the Netherlands proposes constraints on the discretion for the Commission to define national debt-reduction pathways.

This is evidence that the European Commission is seen as "going native", a critique that IMF country desks have received over many years, in similar hierarchical setting with intergovernmental oversight. The perception is that the Commission has not always issued "unbiased recommendations to the

Council" (Claeys et al. 2016: 15). By constantly interacting with national officials in the context of the ES, Commission officials may in fact internalise the political constraints emphasised by national authorities, resulting in potential collusion between the Commission and national officials struggling to meet the pressures of surveillance (Eyraud and Wu 2015: 28).

We have indicated above that the Commission plays a central role in the proposed framework: the DSA, the reference multiannual adjustment path covering at least 4 years, and the corresponding level of structural primary balance at the end of the 4-year adjustment period are adjudicated by the Commission. It is also judge and jury on plans that the Council rejects. In fact, the Council assessment of the NMFPs shall be based on a recommendation by the Commission. It seems likely that no side is satisfied with this top-down approach, neither the member state concerned nor the Council majority; and the Commission is put in a difficult position. It can easily be accused of being too lenient by some and too hardline by others, losing political capital with both sides. Since the technical dialogue is confidential, there is no third party that can adjudicate. Too much strength of the centre can be a weakness in devolved fiscal governance (Rodden 2005).

To address this shortcoming, leading economists proposed to upgrade and strengthen the role of independent fiscal councils (IFCs) – public bodies providing external assessments of budgets (e.g., Arnold et al. 2022; Davoodi et al. 2022; Blanchard et al. 2022; Heinemann 2018). IFCs had to be introduced in all euro area Member States since the 2011 'Six-Pack'. Some reactions to the Communication go further. The IMF argues that national IFCs' should have their independence guaranteed by an EU Directive, and their role in fiscal forecasting and medium-term planning be expanded (Arnold et al. 2022). Blanchard et al. (2022; cf. Martin et al. 2021) advocate that "the initial adjustment path should be proposed by the national Independent Fiscal Institutions", on the base of which the national government would then submit medium-term fiscal structural plans. In these proposals, IFCs would be connected via a fully independent European Fiscal Board (EFB). Either the IFCs or the EFB would also assume responsibility for assessing whether the conditions for involving escape clauses are present.

This has now been endorsed, to a certain extent by the legislative package, in contrast to the Communication. Article 22 of the proposal on the preventive arm and Article 8 of the proposal on national budgetary frameworks codify some minimum standards for IFCs and extend their role in assessing compliance to national fiscal frameworks, further embedding them in the European governance framework. Their remit is, rightly, focused on assessing the fiscal plans and whether they comply with the stipulations over the planning horizon. In this role, they may participate in regular hearings and debates in the national parliament. All this is supposed to improve "national ownership" (European Commission 2023c: 8).

This role of national IFCs would make sense if the sole issue were to get a member state back on a sustainable debt trajectory that would allow it to access bond markets again. But this is not the situation that the proposed reform envisaged. It tried to find room within fiscal governance for medium-term reforms and investments, even if debt reduction has to happen as well. As long as reforms and investments are financed by national revenue and debt, it is the prerogative of parliaments to scrutinise the budget plans. Political representatives from the ruling and the opposition parties can be greatly helped in their work by the information they receive from an IFC. But the search for such a strong role for a depoliticised and impartial referee is misguided in a European Union of democracies. Apart from raising serious questions about authoritarian "emergency rule" that the EU has so far tried and succeeded to avoid (Truchlewski et al 2021)[8], it is also futile. Even if the role of IFCs in conjunction with the European Fiscal Board is meant primarily to prevent the Commission "to go native", such top-down verdicts by pertinently technocratic agents is unlikely to impress elected political representatives.[9] And even if it did, a stronger role of IFCs favours instrumentalising reforms and investments for fiscal consolidation, which is not the sole and overriding concern of national stakeholders. The European and the national political process therefore takes place in different universes while they need to be connected.

The political process in democracies revolves around the budget, engaging political representatives in debates about 'who gets what, when and how'. Dynamics of politicisation can also engulf the Commission and the ECB (Spielberger 2023; Susana et al. 2016 on the Portuguese IFC). The risk is that the politicisation of the policy recommendations, which overly strong independent bodies make, leads to politicisation of the EU surveillance process as such, questioning its political system (Ferrera et al 2023: 13). And this should not come as a surprise: the proposal asks governments to come up with plans for reforms and investments, that have to be operationalised in annual expenditure ceilings, which are then entirely monitored by unelected (non-majoritarian) bodies. This strengthens the hierarchical role of the EU framework and fiscal considerations without strengthening national loyalty to the process. Even if one endorses this empowerment for the sake of fiscal sustainability, past experience suggests it will not succeed. Only if national stakeholders with an interest in reforms and investments can be engaged and come to see it as a political resource – at the disposal of the ruling party and the opposition – does the new framework stand a chance to succeed. In the conclusions we suggest that dedicated parliamentary committees with strong information rights, at both the European and the national level, could make the process such a political resource.

The Commission's enhanced space for negotiation and judgement is in our view not necessarily a problem. The Commission's intermediary role in the surveillance process and its familiarity with what happens in different local conditions constitute strengths in comparison to the exclusively national viewpoints of IFCs.[10] Even if the Council can only act based on a legal proposal by the Commission, the ultimate locus of shared authority remains the Council, particularly in the event of disagreements. In case a NMFPs is rejected, the Council must take responsibility for launching an EDP – as well as to eventually decide on sanctions – if the member state concerned refuses to adjust its plan. Trying, yet again, to legislate a framework that projects mistrust in representative and democratic institutions of (some) member states, is bound to fail.

To sum up, what undermines compliance in the existing framework is arguably not the lack of a technically competent referee proposing hard targets, nor the absence of *de jure* strong enforcement mechanisms. It is the weak domestic engagement with the policy planning process. Multi-level governance in the EU fiscal governance has so far meant to separate the EU from the national level and

---

[8] The literature on 'emergency politics' claims the EU has embraced crisis politics as an opportunity to further its agenda of fiscal prudence and open markets without much consultation of national stakeholders, but in cooperation with national technocratic reformers. Truchlewski et al. (2021) scrutinises these claims with respect to the dual – economic and public health – crisis of Covid-19 and does not find much evidence for it. However, such overreach is always a possibility.

[9] This seems to be contradicted by Beetsma (2023: 16-20) who lists a number of examples that seem to show a positive effect of IFCs on fiscal performance. But it is a list of best practices from almost every member state and cannot, as the author himself is careful to point out, give systematic evidence for long-term effects. Similarly, Franchino (2023) finds strong effects of the EU's oversight on fiscal discipline. But he cannot find any difference between the original framework and subsequent reforms, which raises the question whether it is a general trend that is independent from the fiscal framework. We would see this as supporting our argument that fiscal discipline is not undermined if it is not made the sole focus of fiscal governance.

[10] In Miró, Natili and Schelkle (forthcoming), we cite interviewees from national administrations who were impressed with the knowledge that Commission staff had about the functioning of their welfare systems.

to give stern guidance for domestic policy-making. The legislative proposal continues this trajectory, in contrast to the Communication. More in the spirit of the latter, we suggest three ways of how this can be achieved in section 4.

3. COUNTRY EXPERIENCES WITH REFORMS AND INVESTMENTS

In line with the Communication, the legislative package on a revised fiscal framework has obviously taken inspiration from the National Recovery and Resilience Plans (NRRPs) under the RRF. Member states would have to plan and commit more formally to reforms and investments over the medium-term, after intense bilateral negotiations with the Commission, and would have to be adopted by the Council. The role of targets (quantitative indicators) and milestones (qualitative indicators) is replaced in the NMFPs by the net primary expenditure rule projected and broken down to annual spending ceilings.

In this section, we draw on the experience of the European Semester (ES) to steer reforms and investments in member states, and of the RRF in meeting the investment needs and reform imperatives of Italy and Spain in active labour market policies (ALMP). This is to give some idea how engagement with the process can lead to conflicts but also how they were resolved. EU funding and an extremely compressed timeframe were crucial for conflict resolution. Neither are envisaged for the revised framework. This limits the incentives for engagement with the process and weakens the EU's authority compared with the drafting of NRRPs. While the compressed timeframe could not be sustained anyhow as it takes a heavy toll on national administrations, the absence of any additional funding in return for compliance requires to scale back the ambition of technocratically orchestrated governance.

3.1. The ability of European governance to steer reforms and promote investments.

The experience with the ES is not encouraging regarding the EU's success in applying a variety of governance instruments, notably the reformed SGP and the Macroeconomic Imbalance Procedure (MIP) (Guardiancich et al. 2022; Zeitlin and Vanhercke 2018). The key instrument were and remain CSRs, which are explicit and formal, and have a coercive character, underpinned by the threat of sanctions under the SGP and the MIP (Dawson, 2015). Their translation into domestic policy is, however, ultimately in the hands of national governments. Comparative studies tend to show that compliance with the CSRs has been modest, although with significant variation across countries.[11]

A report published by the European Parliament (2020) reveals that the implementation rates of the CSRs are relatively low and declining over time.

- On a scale from 0 (no progress) to 1 (full adoption), the average scores for CSR implementation in EU-28 countries during the period 2013–2019 was 0.38, ranging from 0.28 in Luxembourg to 0.47 in the UK (European Parliament 2020).
- Since 2011, the EU-28 member states have received a grand total of 1,097 CSRs: only 49 were fully addressed or recorded substantial progress, while as many as 415 CSRs have achieved no or limited progress (Domorenok and Guardiancich 2022).

What were key factors that influenced member state compliance? Governments seem to respond to financial pressure from the markets rather than to the CSRs, unless the latter are addressed under the

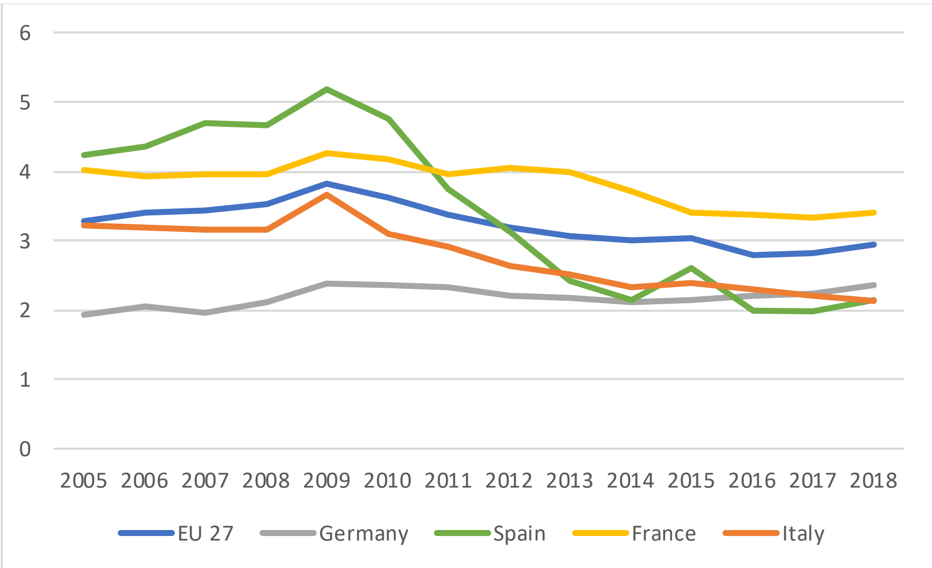
[11] We draw on Di Mascio et al. (2020); Eihmanis (2018); Guardiancich and Guidi (2020); Mariotto and Franchino (2020); Haas et al. (2020); Hagelstam et al. (2019). For country experiences see Al-Kadi and Clauwaert (2019) and Bokhorst (2022).

corrective arm of the SGP through the Excessive Deficit Procedure (Guardiancich and Guidi 2022). Similarly, in 2013–18, implementation rates have worsened at a time when the economic environment has improved and market pressure on sovereigns subsided (Efstathiou and Wolff 2019). As regards political determinants, the quality of governance and the fragmentation of government coalitions increased the adoption of recommended measures (Franchino and Mariotto 2020). Encouragingly, if unsurprisingly, member states implement recommendations better when EU recommendations and governments' reform preferences are largely congruent (Ma 2022). So market pressure and favourable political constellations do help but the overall verdict on the European Semester process is not favourable.

3.2. The need for public investment after a long decade of crisis

With the revised framework, the EU wants to ensure public investments 'for a fair twin transition (green and digital), the need to ensure energy security, open strategic autonomy, as well as social and economic resilience" (European Commission 2023b: 3). This is partly a counter-point to the emphasis on fiscal retrenchment and macroeconomic rebalancing in the ES which did not encourage public investment (Figure 1). According to the High-Level Task Force on Investing in Social Infrastructure in Europe, infrastructure investments in 2016 were 20% below the level experienced in 2007.

Figure 1: Evolution of gross public investment as share of GDP, selected countries, 2005-2018

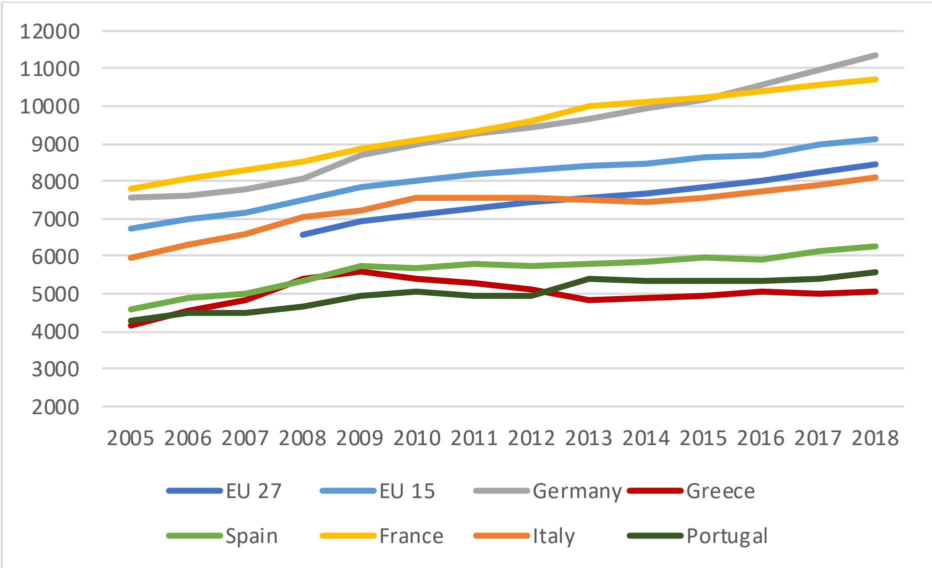


Source: Eurostat

As laudable as these goals are and do include social resilience, some observers note that the EU's economic governance side-lines social goals and concerns about the quality of services (Crespy and Szabo 2018; Crespy and Vanheuverzwijn 2019; De la Porte and Heins 2015). Net investment in long-term physical assets in specific social sectors (education and lifelong learning, health and long-term care, housing) have significantly declined in the EU-28 during the 2008-2018 crisis decade (Fransen et al. 2018). Gross investment rates in education decreased in most EU countries (Germany and Austria included), and were halved in Italy and Spain, and even more in Portugal, where spending decreased to a sixth of its pre-2010 level (Corti et al. 2022). Similar trends can be observed with regard to investment in health care assets.

Indeed, social policy expenditure in Southern Europe diverged from other EU countries (Figure 2).[12] Even though each country was exposed to different pressures in terms of surveillance and underlying challenges, the four Southern European countries took similar direction. Despite recession and slow economic growth between 2008 and 2015, per capita social policy expenditure in Purchasing Power Standards (PPS) decreased by 7.5% in Greece, and increased by 7.5% in Italy, 11,7% in Spain and 14.3% in Portugal (Figure 2), compared to an increase by 19,8% in the EU-27. During a severe crisis, even stagnating social spending means pro-cyclical containment and cuts (Pavolini et al. 2015).

Figure 2: Social Expenditure per capita in PPS, selected countries, 2005 – 2018



Source: Eurostat

The overall outcome is that the gap in per capita social expenditure between the average EU-15 figure and the four Southern European countries has widened after 30 years of convergence. Portugal and Greece spent in 2015 only around 65% of the EU-27 average per capita. In Italy, per capita social expenditure fell almost 12% below the EU-15 average (Guillén et al. 2022). Hence, Italy, the 'big spender' among Mediterranean countries, devoted 28% less resources in real terms to its welfare system than Germany in 2018, a gap that has almost tripled in less than a decade (Natili and Jessoula 2022).

The RRF has therefore provided a welcome opportunity for capacity-building, dispensing additional financial resources up-front, conditional on the implementation of the CSRs. Instead of more evidence from a bird's eye view, we delve deeper into one example of social investment reforms in the 2012 – 2022 decade in Italy and Spain. They are crucial cases (Eckstein 1975: 119) to assess the extent to which greater fiscal capacity at the centre changes the relationship between authority and loyalty across the multiple governance levels in the EU.

[12] See also Guillén et al. 2022; Natili and Jessoula 2022.

3.3. Reforms and investments in active labour market policies in Italy and Spain

Italy and Spain are among the countries in the EU where the trend towards public underinvestment is most visible, in particular in the social domain, as figure 1 and 2 indicated. These two Mediterranean countries also share challenges with regards to the management of EU funding and policy prescriptions. Previous studies have shown that both countries have an extremely bad record in absorbing cohesion funds (Darvas 2020; Terracciano and Graziano 2016), although recently they perform better when it comes to implementing CSRs (Al-Kadi and Clauwaert 2019; D'Erman et al. 2022: 7). So, reform and investment are a live issue for both.

Italy and Spain are, in absolute terms, the largest beneficiaries of RRF funding: Italy has asked for €191.5 billion in grants and loans, or 11.6% of Italy's 2020 GDP; Spain for €69.5 billion in grants or 6.2% of its 2020 GDP (Freier et al 2022).[13] Despite these similarities, we will show that there are differences between them that justify a flexible, country-specific approach to fiscal governance of reforms and investments.

Active labour market policies (ALMP) are particularly suited to illustrate issue related to the multi-level relationship between EU and member states, especially how more authority cannot be imposed but must be met by loyalty. First, employment services and professional training are among the typical examples of social investment policies, which the EU has been keen in promoting.[14] Second, this is a (social) policy domain in which the EU demanded governments in Italy and Spain constantly to do more (see Table 1), asking for greater investment and improvement in the coordination among different institutional levels and actors. Third, and relatedly, these policy domains severely underdeveloped in Southern European welfare states and their characteristic cash transfer biases (Bonoli 2013; Burroni et al. 2021; Ferrera 2010). In particular, Italy and Spain show lower levels of ALMP expenditure when weighted for the unemployment rate compared to the other EU countries (Kriesi et al. 2019; Giuliani 2022). Yet, there is also interesting variation. Despite similar starting points, Italy and Spain had a very different reform track record between mid-1990s and 2008 with Spain being more pro-active than Italy in promoting social investment (Léon and Pavolini 2014; Natili and Jessoula 2019). However, Table 1 shows that in later years Spain was increasingly reminded of the need to do more social investment, especially in three areas (minimum income, family benefits, labour market segmentation).

[13] In December 2022, the Spanish government also requested loan support under the RRF worth 84 billion euros, thus further increasing the size of EU funding.

[14] De la Porte and Natali (2018); Ferrera (2016); Hemerijck (2017); Ronchi (2018).

Table 1: Country Specific Recommendations in the social domain in Italy and Spain, 2013-2020

Country Specific Recommendations in the social domain	Italy	Spain
Strengthen ALMPs and Public Employment Services	2013, 2014, 2015, 2016, 2017, 2018, 2019	2013, 2014, 2015, 2016, 2017, 2019
Improve the provision of long-term care	2013, 2019	2016
Improve the provision of services for children	2013, 2014, 2018, 2019	2015, 2016, 2017
Improve social assistance minimum income schemes	2013, 2014, 2015, 2016	2014, 2015, 2016, 2017, 2018, 2019, 2020
Improve family benefits	2014, 2018	2013, 2015, 2016, 2017, 2018, 2019, 2020
Improve unemployment benefits	2014, 2020	2020
Reduce labour market segmentation		2014, 2018, 2019
Decentralize collective bargaining	2015, 2017	2015

Source: Authors' elaboration based on EU Commission official documents

Table 2 shows that when weighted for the unemployment rate, both Italy and Spain have low levels of ALMP expenditure compared to the two other large EU countries (see also Burroni et al. 2020; Giuliani 2022; Kriesi et al. 2019). Moreover, the bulk of spending on active policies has traditionally been focused on employment incentives while spending on public employment service (PES) and training is well below levels observed in France and Germany, which are close to the European average.

Table 2: Investment in labour market services and active labour market policies as a % of the GDP

	France	Germany	Italy	Spain
Total expenditure in labour market services				
Average 1997-2007	0.2	0.2	0.03	0.03
Average 2008-2016	0.3	0.4	0.09	0.1
Total ALMPs				
Average 1997-2007	0.8	0.9	0.6	0.5
Average 2008-2016	0.7	0.6	0.3	0.6
Training				
Average 1997-2007	0.3	0.5	0.2	0.1
Average 2008-2016	0.3	0.2	0.2	0.1
Employment incentives				
Average 1997-2007	0.1	0.08	0.2	0.3
Average 2008-2016	0.05	0.05	0.2	0.2

Source: Burroni et al. (2021: 38)

Despite similar starting points, since the early 2000s the turn towards activation was stronger in Spain (Giuliani 2022; Moreno and Amparo Serrano 2011), promoting upskilling, employment support and job subsidies. The onset of the sovereign debt crisis interrupted this development (Natili and Jessoula 2019). Despite important legislative innovations, expenditure for enhancing human capital and workers' competencies through training was extremely poor (Burroni et al. 2020: 38). In Italy, a comprehensive reform of the Italian ALMP system was envisaged only in the 2015 'Jobs Act'. The reform, designed under the auspices of EU institutions (Sacchi and Roh 2016), was poorly implemented, however, above all because it was never adequately financed (Tassinari 2022: 443). An 'Extraordinary Plan for the Strengthening of Public Employment Services (PES)' was then introduced in 2019, following the introduction of the Citizenship Income[15]. Despite almost doubling resources, the plan did not help solving the marginality and limited development of this policy field.

Significant investment in ALMPs could be undertaken only once RRF funding became available. This is not to say that it was motivated by the funds since elements played already a role in the 2018 elections. While the Commission urged the two governments to do more in this policy field, both countries were able to shape the agenda-setting process according to their specific needs (Miró et al. forthcoming). Italy dedicated a total of EUR 6.66 billion to its labour market policies, almost entirely for activation and strengthening PES. In details, the 'National Programme for the Guarantee of Workers' Employability' was adopted, investing €4.4 billion for the three-year period 2021-2023, aiming at integration into the ALMP system all individuals either unemployed or at risk of unemployment. A 'National Plan for New Skills' has also been approved, through the establishment of common training standards for unemployed people registered with employment centres, and the strengthening of the vocational training system, promoting a territorial network of education, training, and work services through public-private partnerships (Corti et al. 2023). The Public Employment Service Strengthening Plan 2021-2023 builds on the existing 2019 measure mentioned above but guarantees an adequate envelope of EUR 0.6 billion for its implementation. The measure includes infrastructure investments, the development of regional labour market observatories and interoperability between regional and national information systems, and training activities for centre operators.

In Spain, active labour market policies are less central, focusing instead on labour market de-segmentation (Guillén et al. 2022; Miró et al. forthcoming). Nonetheless, the plan foresees an investment of around EUR 4.61 billion for a total of seven projects. The key reforms contained in the plan include the modernisation of the ALMP, the review of subsidies and bonuses for labour hiring, and the modernisation and improved efficiency of the PES, in particular investing in digitalisation (Corti et al. 2023). Particularly relevant are investments to upskill and reskill workers (€2.1 billion) and to modernise vocational training. The NRRP also promises to reform the system of hiring incentives –one of the weaker points of the labour market, as stressed in earlier CSRs –by developing individual pathways for counselling and promoting adult learning.

A problem is that RRF funds can be used for initial training of a workforce but not for permanent salaries of training staff, since reforms must not create future current liabilities, "unless in duly justified cases" (EU 2021: Article 5(1)). This 'Golden rule' restriction on the NRRPs hampers progress on activation and improved employment services, which in both countries are characterised by chronic understaffing. A way out would be to use the temporary funds at least in part for current expenditure that the government can later decide to keep financing. The current constraint limits the ability to meet the objective of economic and social resilience. The net primary expenditure rule has the same drawback of introducing a Golden Rule in disguise.

In both countries, the possibility to tailor spending on their needs was vital for a process that was not frictionless but ultimately borne by the will to make it work (Miró et al., forthcoming). Given very tight deadlines, decision-making in Italy and Spain became extremely centralised and exclusive: the Parliament, social partners and sub-national actors were sidelined during the drafting process. The availability of additional funding helped acquiesce social partners and sub-national actors although the need to strengthen ALMPs had been agreed in previous reforms in both countries. But the acquiescence of relevant stakeholders cannot be taken for granted and exclusion does not build loyalty. Implementation problems in both countries, which are evident also in the area of childcare

[15] Although the name suggests a universal unconditional basic income, the Italian Citizenship Income (Law n. 4 of April 2019) is a minimum income scheme: a monetary benefit targeted on poor households conditional on participation to job-search activities. For further details, see Jessoula and Natili (2020).

(Corti et al. 2023), are already revealing the drawbacks of not providing adequate voice to relevant institutional actors.

It is too early for a comprehensive assessment of the implementation of the plans. But in both countries, coordination problems between the centre and the periphery (in particular regarding the organisation and participation of municipalities to tenders) are emerging, as well as significant regional differences in the implementation of the plans. This was predictable and could have been partly avoided if the later providers of services, local government, had been involved in the formulation of the plans. It is an advantage of the new NMFPs that they reduce the extreme time pressure and allow for revisiting of the ten year plan.

4. CONCLUSIONS AND RECOMMENDATIONS

Our briefing paper endorses major revisions that the Commission proposes in its November 2022 Communication and the April 2023 legislative proposals. Two clear weaknesses of the existing framework could thus be amended. The operational role of the net primary expenditure rule has clear advantages over the calculation of structural budget balances. Politically more important is that the revisions tackle the sanctions regime. In contrast to the financial penalties in the original SGP, which have never been charged, withholding funds is now proposed as a regular alternative and they have already been withheld for Italy, Hungary, and Poland. Reputational sanctions involving the European Parliament would have signalled that fiscal governance, reforms and investments are matters of common concern; however, the legal proposal does not propose new or different, overtly political sanctions. We think this is a missed opportunity.

The problem of strengthening enforceability without undermining loyalty has not been solved, however. The envisaged close monitoring of national reforms and investments through fiscal governance without additional EU funding will encounter the same implementation problems that have been observed in the European Semester. The entire process could then have a chilling effect on reforms and investments on which, in principle if not in every detail, all sides can agree.

The problem as we see it is that the reform of fiscal governance still seeks to strengthen hierarchical power without rewarding engagement with the process. The sequencing of the reform process, the operational role of a fiscal metric (the expenditure rule), a confidential technical dialogue with member states gives a dominant role to the Commission. IFCs' powers are proposed to be strengthened with a view to guaranteeing "national ownership" (European Commission 2023c: 8). But the framework is owned primarily by those actors in the national context who, *ex officio*, already buy into a focus on fiscal consolidation and budget planning across the electoral cycle. This is not shared by all stakeholders, in particular not by national parliaments. Presumably, social partners also have different priorities. Involvement of national parliaments in the scrutiny of plans drawn up as part of the EU fiscal framework is limited and uneven (Hagelstam et al 2023: 6-7). Without having them on board, no democratically elected national government can afford to take the EU fiscal governance framework as seriously as the proposal requires. The term "national ownership" obfuscates that fiscal governance is a collective EU task and not primarily a member state responsibility. It does not only include bringing down debt levels but also reforms and (social and environmental) investments that are not subordinated but equally valid.

Our framework suggests that strengthening the fiscal framework requires more national engagement with the plans of reforms and investments, such as greater transparency of the planning process for national legislatures and sub-national authorities, and shared authority to enforce it. Without additional EU funding, say for the up-front costs of major reforms, this is going to be difficult. Funding is a fiscal resource but also a political signal that strengthens the loyalty to the EU's political system. But even fiscal governance that is not tied to extraordinary recovery funding can help member states with their different administrative capacities to improve their procedures and thus meet the formidable reporting requirements. The European Fiscal Board in cooperation with Eurostat visiting member states could take the lead on this and prepare reporting templates, statistical packages, a helpline and training courses that facilitate these tasks. Public services in many member states are understaffed, underskilled and underpaid for performing even routine tasks, so the necessary resources for even more elaborate reporting are not readily available. The enormous information requirements that the legislative proposal foresees can therefore lead to fatigue and indicator chasing. This administrative support is a minimum, if the framework wants to stand a chance of governments spending energy on drawing up the NMFPs.

The second conclusion is that if there is no extra fiscal funding forthcoming, then the complementarity between EU authority and loyalty to the EU polity requires devolution of fiscal governance. The formal sequencing of the decision-making process can support or hinder this. In the revised framework proposed by the Commission, the Member States are responsible for the initial drafting of the NMFPs, but with the parameters set by the reference adjustment path as defined by the Commission. By contrast, the NRRPs had to address the European Semester's CSRs but a prominent agenda-setting role for national executives was ensured by allowing them to be the first movers in terms of defining the reforms and drafting the plans. The process of drafting multiannual fiscal structural plans could take its lead from there. While governments accepted intense negotiations in the drafting of the NRRPs, this is less likely in the case of the NMFPs. It is therefore all the more important that simplified procedures and indicators apply. They can feed into the domestic debate and be picked up by the opposition or, indeed, the ruling party: being (no longer) a high-risk country that pays a good share of its budget to creditors, achieving (or not) reforms and investments that increase the living standards of their constituencies – these are all claims that can be informed by the policy process. This holds all the more if the annual reporting proceeds under less time pressure than the NRRP drafting.

Closely related is our third conclusion that the agenda-setting role of governments must be spurred by national stakeholders of reforms and investments if the positive (and negative) incentives of (withheld) funding are not available or diminished. Social partners and sub-national authorities are crucial to ensure pressures for delivery. Not only should they be heard, but given a formal stake in the process. This clearly has costs but political deliberation requires time and effort; without incurring that cost, compliance problems are entirely predictable.

National parliaments above all must be included and consulted. Their competences are not directly addressed in the Commission's Communication nor in the legislative package, although the ultimate decision power in budgetary affairs remains their competence. To increase the role of national parliaments, national executives should be asked to commit to get the NMFPs approved in the national parliaments. The Fiscal Compact, referred to in the legal proposal, had obliged member states to put fiscal commitments into hard law and gave IFCs a role in the national budget process; following this example (intergovernmental treaty), it could be possible to commit member states analogously to ensure the reciprocal right of national legislators to be involved. Supranational fiscal surveillance interferes with national parliaments' fundamental right to endorse or reject budgets; extending this now to plans over the electoral cycle puts the onus on the EU level, Commission, Council and European Parliament, to find continuous support for the framework. The Commission should commit to accept or actively solicit invitations from national parliaments to explain its decisions, given the prominent role it will play in guiding fiscal policy. The Economic Dialogues in the European Parliament could be looked at for inspiration and they themselves could continue the role they play for the RRF. [16]

Fourth, revisions of the multiannual plans must be possible when a new government is sworn in. This is an improvement of the legislative proposal compared to the 2022 Communication. A change of government and policies is the point of democratic elections. This implies that a new government that has taken over from a previous government without a new electoral mandate does not have automatically a right to reopen the fiscal plan their predecessor signed. But a new electoral mandate must be a reason for why a government can ask for revisiting reform and investment plans, especially since the political economy literature can tell us that the predecessor may have wanted to tie the political competitors' hands with its budgetary plans. EU fiscal governance must not become complicit in such strategies or risks losing exactly the credibility that the recent proposal wants to restore.

A last conclusion is that social resilience should be a crosscutting concern of the revised framework. We could not document this at length in this briefing paper, but the social scars of the EU's multiple crises are deep. And looking forward, the green and the digital transition have possibly regressive distributive effects: costs of energy consumption will rise and this will hurt households on small budgets more; in the wake of digitalisation, those equipped with less adaptable skills may find their work more immediately downgraded and less remunerated. The sheer insecurity that these processes generate make it imperative that the EU pays attention to and facilitate the social policy content of reforms and investments.

[16] Bressanelli (2022) has several suggestions of how to keep EU fiscal governance accountable to parliaments, in his case more the European Parliament than national legislatures, while from our perspective, the latter is even more important.

REFERENCES

Al-Kadi, R and Clauwaert, S (2019) Socialising the European Semester? Measuring Member States' Implementation of Country-Specific Recommendations in the Social Policy Field. Brussels: European Trade Union Institute. Available at: https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID3402886_code1950811.pdf?abstractid=3402886&mirid=1

Arnold, N., R. Balakrishnan, B. Barkbu, et al. (2022) "Reforming the EU fiscal framework: Strengthening the fiscal rules and institutions", Departmental Paper 2022/014, International Monetary Fund. Available at: https://www.imf.org/-/media/Files/Publications/DP/2022/English/REFFSFRIEA.ashx

Baerg, N.R. and Hallerberg, M. (2016) "Explaining instability in the Stability and Growth Pact: the contribution of member state power and Euroscepticism to the euro crisis", *Comparative Political Studies* 49(7): 968-1009 https://doi.org/10.1177/00104140166332.

Baerg, N.R. and Hallerberg, M. (2022) "Council checks of the Commission under the European Semester: does member state power and Euroscepticism still matter?", *Journal of Common Market Studies* 60(1): 58-80 https://doi.org/10.1111/jcms.13268.

Bartolini, S. (2005) *Restructuring Europe. Centre Formation, System Building and Political Structuring between the Nation-State and the European Union*, Oxford: Oxford University Press.

Blanchard, O., Sapir, A. and Zettelmeyer, J. (2023) "The European Commission's fiscal rules proposal: a bold plan with flaws that can be fixed", Bruegel blog, November 30. Available at: https://www.bruegel.org/blog-post/european-commissions-fiscal-rules-proposal-bold-plan-flaws-can-be-fixed

Beetsma, R. (2023) "Strengths and weaknesses of independent advisory fiscal institutions in the EU economic governance framework", Briefing paper, Economic Governance and EMU Scrutiny Unit, ECON Committee, Brussels.
https://www.europarl.europa.eu/RegData/etudes/IDAN/2023/741515/IPOL_IDA(2023)741515_EN.pdf

Bokhorst, D. (2022) "The Influence of the European Semester: Case Stu.dy Analysis and Lessons for its Post-Pandemic Transformation", *Journal of Common Market Studies* 60: 101– 117 https://doi.org/10.1111/jcms.13266.

Bokhorst D. and Corti, F. (2023) "Governing Europe's Recovery and Resilience Facility: Between Discipline and Discretion", in *Government and Opposition* (forthcoming).

Bonoli, G. (2013) *The Origins of Active Social Policy*. Oxford: Oxford University Press.

Bressanelli, E., (2022) *Democratic control and legitimacy in the evolving economic governance framework*, EPRS: European Parliamentary Research Service. Belgium. Retrieved from https://policycommons.net/artifacts/3136162/democratic-control-and-legitimacy-in-the-evolving-economic-governance-framework/3929413/ on 08 May 2023. CID: 20.500.12592/s2r5hg.

Burroni, L., Gherardini A. & Scalise, G. (2019) "Policy Failure in the Triangle of Growth: Labour Market, Human Capital, and Innovation in Spain and Italy", *South European Society and Politics* 24:1, 29-52 https://doi.org/10.1080/13608746.2019.1575571.

Claeys, G., Darvas, Z. and Leandro, Á. (2016) *A Proposal to Revive the European Fiscal Framework*, Bruegel Policy Contribution, Available at:
https://www.bruegel.org/sites/default/files/wp_attachments/pc_2016_07.pdf

Corti, F., Liscai, A., Ruiz, T. (2022) "The Recovery and Resilience Facility: boosting investment in social infrastructure in Europe?", *Italian Labour Law e-Journal* 1(15) https://doi.org/10.6092/issn.1561-8048/15706.

Corti, F. and Ruiz, T. (2023) *The RRF's Role in Strengthening Active Labour Market Policies and Public Employment Services*, PE 733.741, European Parliament. Available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2023/733741/IPOL_STU(2023)733741_EN.pdf

Crespy, A. and Szabo, I. (2018) "Healthcare reforms and fiscal discipline in Europe: Responsibility or responsiveness?", *European Policy Analysis* 4: 214–233 https://doi.org/10.1002/epa2.1041.

Crespy, A. and Vanheuverzwijn, P. (2019) "What "Brussels" means by structural reforms: Empty signifier or constructive ambiguity?" *Comparative European Politics* 17: 92-11 https://doi.org/10.1057/s41295-017-0111-0.

Davoodi, H., P. Elger, A. Fotiou, D. Garcia-Marcia, X. Han, A. Lagerborg, W. R. Lam, and P. Medas. (2022) "Fiscal Rules and Fiscal Councils: Recent Trends and Performance During the COVID-19 Pandemic." IMF Working Paper No. 2022/11, International Monetary Fund, Washington, DC. Available at: https://www.imf.org/-/media/Files/Publications/WP/2022/English/wpiea2022011-print-pdf.ashx

Dawson M. (2015) "The legal and political accountability structure of 'post-crisis' EU economic governance", *Journal of Common Market Studies*, 53 (5), 976–993 https://doi.org/10.1111/jcms.12248.

De la Porte, C. and Heins, E. (2015) "Governance of labour market and social policy since the sovereign debt crisis", *Comparative European Politics* 13: 8–28 https://doi.org/10.1057/cep.2014.39.

De la Porte, C. and David Natali (2018) "Agents of institutional change in EU policy: the social investment moment", *Journal of European Public Policy* 25(6): 828-843 https://doi.org/10.1080/13501763.2017.1401110.

Di Mascio, F., Natalini, A., Ongaro, E. and Stolfi, F. (2020) "Influence of the European Semester on national public sector reforms under conditions of fiscal consolidation: The policy of conditionality in Italy 2011–2015", *Public Policy and Administration* 35(2): 201–23. https://doi.org/10.1177/095207671881489

Domorenok E. and Guardiancich, I. (2022) "The Italian National Recovery and Resilience Plan: coordination and conditionality", *Contemporary Italian Politics* 14(2): 191-206 https://doi.org/10.1080/23248823.2022.2046099.

Eckstein, H. (1975) "Case Study and Theory in Political Science", in Greenstein, F. and Polsby, N. (eds) *Handbook of Political Science*, Reading: Addison-Wesley, pp. 79–138.

European Fiscal Board. (2019) *Assessment of EU rules with a focus on the Two-pack and Six-pack legislation*. Brussels. Available at: https://commission.europa.eu/document/download/3746b2cf-963d-4902-9a20-4387d9b288c6_en?filename=2019-09-10-assessment-of-eu-fiscal-rules_en.pdf

Efstathiou, K. and Wolff, G. (2019) 'What Drives National Implementation of EU Policy Recommendations'? Bruegel Working Paper, No. 4. Available at: https://www.bruegel.org/sites/default/files/wp_attachments/WP4-final-2.pdf

Eihmanis, E. (2018) "Cherry-Picking External Constraints: Latvia and EU Economic Governance, 2008–2014", *Journal of European Public Policy* 25(2): 231–49 https://doi.org/10.1080/13501763.2017.1363267.

Eisl, A. (2022) "An overhaul of the European fiscal framework?", Jacques Delors Institute Policy Brief. Available at: https://institutdelors.eu/wp-content/uploads/dlm_uploads/2022/11/PB_221116_COM_Eisl_EN.pdf

Ellina, D. (2023) "Why the EU's new fiscal framework hits the nail near the head", Centre for European Policy Studies, March 7. Available at: https://www.ceps.eu/why-the-eus-new-fiscal-framework-hits-the-nail-near-the-head/

European Commission (2015) *Making the Best Use of Flexibility within the Existing Rules of the Stability and Growth Pact*. COM(2015)12. 13 January.

European Commission (2018) "Vade Mecum on the SGP", Institutional Paper 075, Luxembourg: Publications Office of the European Union.

European Commission (2022) Communication on orientations for a reform of the EU economic governance framework. Brussels, 9 November, COM (2022) 583 final.

European Commission (2023a) Proposal for a Council Directive Amending Directive 2011/85/EU on requirements for budgetary framework of the Member States, Brussels 26 April, COM (2023) 242 final.

European Commission (2023b) Proposal for a Council Regulation Amending Regulation (EC) No 1467/97 on Speeding Up and Clarifying the Implementation of the Excessive Deficit Procedure. Brussels, 26 April, COM (2023) 241 final.

European Commission (2023c) Proposal for a Regulation of the European Parliament and of the Council on the Effective Coordination of Economic Policies and Multilateral Budgetary Surveillance and repealing Council Regulation (EC) No 11446/97. Brussels, 26 April, COM (2023) 240 final.

European Parliament (2020) The Country-Specific Recommendation Database, version: 07/09/2020, V78. Brussels: European Parliament

Eyraud, L. and Wu, T. (2015) *Playing by the Rules: Reforming Fiscal Governance in Europe*, IMF Working Paper WP/15/67. Available at: https://www.imf.org/external/pubs/ft/wp/2015/wp1567.pdf

Fabbrini, S. (2007). Compound democracies: Why the United States and Europe are becoming similar. Oxford University Press

Ferrera, M. (2005) The Boundaries of Welfare: European Integration and the New Spatial Politics of Social Protection. Oxford: Oxford University Press.

Ferrera, M. (2017) "Impatient politics and social investment: the EU as 'policy facilitator'", *Journal of European Public Policy* 24(8): 1233-1251 https://doi.org/10.1080/13501763.2016.1189451.

Ferrera, M., Kriesi, H. and Schelkle, W. (2023) "Maintaining the EU's compound polity during the long crisis decade", *Journal of European Public Policy*. https://doi.org/10.1080/13501763.2023.2165698

Franchino, F. and Mariotto, C. (2020) "Politicisation and economic governance design", *Journal of European Public Policy* 27(3): 460–80 https://doi.org/10.1080/13501763.2020.1712456.

Franchino, F. (2023) "International oversight of fiscal discipline", *European Journal of Political Research*. https://doi.org/10.1111/1475-6765.12600

Fransen, L., del Bufalo, G, and Reviglio, E. (2018) *Boosting Investment in Social Infrastructure in Europe.* Report of the High-Level Task Force on Investing in Social Infrastructure in Europe. Available at: https://economy-finance.ec.europa.eu/document/download/82a1420f-5475-4466-a3de-860a3a8553d3_en?filename=dp074_en.pdf

Frieden, J. (2016) "Lesson for the euro from early US monetary and financial history", Bruegel, May 26. https://www.bruegel.org/sites/default/files/wp_attachments/essay_frieden_may16.pdf

Giuliani, G. A. and Raspanti, D. (2022) "Between the territory and the legacies: The politicization of active labour market policy in southern Europe", *Journal of European Social Policy 32*(5), 548-563 https://doi.org/10.1177/095892872210950.

Guardiancich, I. and Guidi, M. (2022) "The Political Economy of Pension Reforms in Europe under Financial Stress", *Socio-Economic Review* 20(2): 817-840 https://doi.org/10.1093/ser/mwaa012.

Guardiancich, I., Guidi, M., Terlizzi, A. (2022) "Beyond the European Semester: the supranational evaluation cycle for pensions", *Journal of European Social Policy* 32(5): 578-591https://doi.org/10.1177/09589287221101339.

Guillén, A.M., Leon, M. and Pavolini, E. (2022) "Are 'carrots' better than 'sticks'? New EU conditionality and social investment policies in the aftermath of the COVID-19 pandemic in Italy and Spain", *Comparative European Politics* 20: 220–237 https://doi.org/10.1057/s41295-022-00281-w

Haas, J.S., D'Erman, V.J., Schulz, D.F., and Verdun, A. (2020) "Economic and fiscal policy coordination after the crisis: Is the European semester promoting more or less state intervention?", *Journal of Economic Integration* 42(3): 327–344 https://doi.org/10.1080/07036337.2020.1730356.

Hagelstam, K., Dias, C., Angerer, J. and Zoppè, A. (2019) The European Semester for Economic Policy Coordination: A Reflection Paper, Economic Governance Support Unit (EGOV), Directorate-General for Internal Policies, PE 624.440. Available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2019/624440/IPOL_STU(2019)624440_EN.pdf

Hagelstam, K., de Lemos, S. and Loi, G (2023) "Enhanced political ownership and transparency of the EU economic governance framework." EGOV in-depth analysis paper, DG Internal Policies. https://www.europarl.europa.eu/RegData/etudes/IDAN/2023/741517/IPOL_IDA(2023)741517_EN.pdf

Hanke Vela, J. (2023) "Brussels Playbook: He said, she said, Xi said – Fiscal reform scoop – Making big oil pay", *Politico*, April 6. Retrieved from https://www.politico.eu/newsletter/brussels-playbook/he-said-she-said-xi-said-fiscal-reform-scoop-making-big-oil-pay/

Heinemann, F. (2018) How Could the Stability and Growth pact be Simplified?, European Parliament PE 614.501. Available at: https://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614501/IPOL_IDA(2018)614501_EN.pdf

Hix, S. (2007) "The European Union as a polity(I)". In K. E. Jørgensen, M. Pollack, & B. Rosamond (Eds.), *The SAGE handbook of European union politics* (pp. 141–157). SAGE.

International Monetary Fund (2022), Reforming the EU fiscal framework – strengthening the fiscal rules and institutions, Departmental Paper DP/2022/014. Available at: https://www.imf.org/-/media/Files/Publications/DP/2022/English/REFFSFRIEA.ashx

Kriesi H, Bernhard L, Fossati F, et al. (2019) Introduction: shaping the debate on unemployment and the labor market. In: Bernhard L, Fossati F, Hänggli R, et al. (eds), *Debating Unemployment Policy: Political Communication and the Labour Market in Western Europe*. Cambridge: Cambridge University Press, pp. 3–28.

Kelemen and McNamara (2022) "State-building and the European Union: Markets, War and Europe's uneven political development", *Comparative Political Studies* 55(6): 963-991 https://doi.org/10.1177/0010414021104739.

Kydland, F.E. and Prescott, E.C. (1977) "Rules rather than discretion: the inconsistency of optimal plans", *Journal of Political Economy* 85(3): 473-492 https://www.jstor.org/stable/1830193

Jessoula, M, Natili, M. (2020) Explaining Italian "exceptionalism" and its end: Minimum income from neglect to hyper-politicization. *Soc Policy Adm*. 2020; 54: 599– 613 https://doi.org/10.1111/spol.12608.

León, M. and Pavolini, E. (2014) "'Social investment' or back to 'familism': the impact of the economic crisis on family and care policies in Italy and Spain", *South European Society and Politics* 19(3): 353–369 https://doi.org/10.1080/13608746.2014.948603.

Liboreiro, J. and Chadwick, L. (2023) "Fiscal rules: Germany and the Netherlands push for minimum debt reduction targets for EU countries", *Euronews*, April 16. Retrieved from: https://www.euronews.com/my-europe/2023/04/11/fiscal-rules-germany-wants-binding-debt-reduction-targets-for-eu-countries

Lorenzoni, G., Giavazzi, F., Guerreri, V. and D'Amico, L. (2023) "New EU fiscal rules and governance challenges", VoxEU.org, January 2.

Ma, Y. (2022) "Improved soft law implementation with national ownership: Evidence from the European semester", *Comparative European Politics* 20: 1–32 https://doi.org/10.1057/s41295-021-00253-6.

Manasse, P. and Katsikas, D. (eds) (2018) *Economic Crisis and Structural Reforms in Southern Europe. Policy Lessons*, Routledge, New York.

Martin, P., Pisani-Ferry, J. and Ragot, X. (2021) "Reforming the European fiscal framework", *Les Notes du Conseil d'Analyse Économique*, 63, April.

Miró, J. (2021) "Austerity's failures and policy learning: mapping European Commission officials' beliefs on fiscal governance in the post-crisis EU", *Review of International Political Economy* 28(5): 1224-1248 https://doi.org/10.1080/09692290.2020.1749868

Miró, J., Natili, M. and Schelkle, W. (forthcoming) "Money makes the world go round: how much difference do Recovery and Resilience Plans make to EU reform governance?".

Mohl, P., Mourre, G., Langedijk, S. and Hoogeland, M. (2021) "Does media visibility make EU fiscal rules more effective?", Discussion Paper 155, Luxembourg: Publications Office of the European Union. Available at: https://economy-finance.ec.europa.eu/document/download/9fa3e00d-6806-44a2-9325-18f14d2353dc_en?filename=dp155_en.pdf

Moreno, L. and Serrano, A. (2011) "Europeanization and Spanish welfare: the case of employment policy", in Guillén, A.M. and León, M. (eds) *The Spanish Welfare State in European Context*. Farnham: Ashgate, pp. 39–58.

Natili, M. and Jessoula, M. (2019) "Children against parents? The politics of intergenerational recalibration in Southern Europe", *Social Policy Administration* 53: 343– 356 https://doi.org/10.1111/spol.12473.

Natili, M. and Jessoula, M. (2022) "The Southern European welfare model". In *De Gruyter Contemporary Social Sciences Handbooks*, Edward Elgar, pp. 101-118.

Pavolini, E. Leon, M., Guillén, A.M. and Ascoli, U. (2015) "From Austerity to Permanent Strain? The EU and Welfare State Reform in Italy and Spain," *Comparative European Politics* 13: 56-76 https://doi.org/10.1057/cep.2014.41.

Pench, L.R., Deroose, S., Mourre, G. and Carnot, N. (2018) "EU fiscal rules: root causes of its complexity", *VoxEU – CEPR*, September 14. Available at: https://cepr.org/voxeu/columns/eu-fiscal-rules-root-causes-its-complexity

Rodden, J. (2005) *Hamilton's Paradox: the Promise and Peril of Fiscal Federalism,* Cambridge: Cambridge University Press.

Sacchi, S. and Roh, J. (2016) "Conditionality, austerity and welfare: Financial crisis and its impact on welfare in Italy and Korea" *Journal of European Social Policy* 26(4): 358–373 https://doi.org/10.1177/09589287166572

Schmidt, V.A. (2016) "Reinterpreting the rules 'by stealth' in times of crisis: a discursive institutionalist analysis of the European Central Bank and the European Commission", *West European Politics* 39(5): 1032-1052 https://doi.org/10.1080/01402382.2016.1186389.

Susana J., Jorge de Jesus, M.A. and Nogueira, S. (2016) "Information brokers and the use of budgetary and financial information by politicians: the case of Portugal", *Public Money & Management* 36(7): 515-520 https://doi.org/10.1080/09540962.2016.1237152

Spielberger, L. (2023) "The politicisation of the European Central Bank and its emergency credit lines outside the Euro Area", *Journal of European Public Policy* 30(5): 873-897 https://doi.org/10.1080/13501763.2022.2037688

Tassinari, A. (2022) Labour market policy in Italy's recovery and resilience plan. Same old or a new departure?, *Contemporary Italian Politics*, 14:4, 441 457 https://doi.org/10.1080/23248823.2022.2127647.

Truchlewski, Z., Ganderson, J. and Schelkle, W. (2022) "Buying time for democracies? European Union emergency politics in the time of COVID-19", *West European Politics* 44(5-6): 1353-1375 https://doi.org/10.1080/01402382.2021.1916723.

van den Noord, P. (2023) A Targeted Golden Rule for Public Investments?, European Parliament, PE 733.740. Available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2023/741492/IPOL_STU(2023)741492_EN.pdf

Zeitlin, J. and Vanhercke, B. (2018) "Socializing the European Semester: EU social and economic policy coordination in crisis and beyond", *Journal of European Public Policy* 25(2): 149–174. https://doi.org/10.1080/13501763.2017.1363269.

ANNEX 1

Table A1: Key differences between the 2022 Commission Communication and the 2023 Commission Proposal for a Regulation on the preventive arm of the SGP

	2022 Communication	2023 legislative proposal
Trajectory of debt-to-GDP ratio	"The agreed multiannual net primary expenditure path should ensure that debt is put or kept on a downward path at the latest by the end of the adjustment period or stays at prudent levels"	"The technical trajectory shall ensure that: (a) the public debt ratio is put or remains on a plausibly downward path, or stays at prudent levels; […] (d) the public debt ratio at the end of the planning horizon is below the public debt ratio in the year before the start of the technical trajectory"
National net expenditure growth below medium-term output growth	Not mentioned.	""The technical trajectory shall ensure that […] national net expenditure growth remains below medium-term output growth, on average, as a rule over the horizon of the plan."
Timing of consolidation efforts	"The path would be set in a way to ensure that a significant part of consolidation needs are met within the adjustment period and not left to future governments."	"The technical trajectory shall ensure that […] the fiscal adjustment effort over the period of the national medium-term fiscal-structural plan is at least proportional to the total effort over the entire adjustment period"
Revision of the plans	"the possibility for Member States to revise the plan only after a minimum period of four years. This minimum adjustment period could be lengthened to match the national legislature, if Member States so wish. The plan could be revised earlier in case of objective circumstances making the implementation of the plan infeasible […] Frequent revisions would undermine the credibility of the plans as an anchor for prudent policies."	"A Member State may request to submit a revised national medium-term fiscal-structural plan to the Commission before the end of its adjustment period if there are objective circumstances preventing the implementation of the original national medium-term fiscal-structural plan or if the submission of a new national medium-term fiscal-structural plan is requested by a new government."

Table A1 cont'd	**2022 Communication**	**2023 legislative proposal**
Prohibition to backload consolidation efforts in case of revision	Not mentioned.	"the new technical trajectory shall not allow backloading of the fiscal adjustment effort and shall not lead to a lower fiscal adjustment effort."
Failure to comply with commitments underpinning an extension of the adjustment period	"Member States could request a more gradual adjustment path by putting forward a specific set of priority reforms (…) In case of non-implementation of those commitments, a new enforcement tool would lead to a revision of the adjustment path towards a stricter path."	"Where a Member State has been granted an extension of its adjustment period but fails to satisfactorily comply with its set of reform and investment commitments underpinning the extension […] the Council may on a recommendation from the Commission, recommend a revised net expenditure path with a shorter adjustment period."
Financial sanctions	"The effective use of *financial sanctions* would be de-constrained by lowering their amounts."	Not mentioned.
Reputational sanctions	*"Reputational sanctions* would be enhanced. For example, Ministers of Member States in EDP could also be required to present in the European Parliament the measures to comply with the EDP recommendations."	"Where the Council addresses a recommendation to a Member State pursuant to Article 23(2) in the event of a significant risk of deviation from the net expenditure path, the European Parliament may offer the opportunity to that Member State, to participate in an exchange of views."
Role of national parliaments	Not mentioned.	"Each national medium-term fiscal-structural plan should mention its status in the context of national procedures, notably whether the plan was presented to the national parliament and whether there has been parliamentary approval of the plan. The national medium-term fiscal-structural plan should also indicate whether the national parliament had the opportunity to discuss the Council recommendation"

Table A1 cont'd	**2022 Communication**	**2023 legislative proposal**
Role of independent fiscal institutions	"Independent fiscal institutions could provide an *ex-ante* assessment of adequacy of the plans […] (they could) provide an assessment of *ex-post* compliance of budgetary outturns with the agreed multiannual net primary expenditure path and, when applicable, an assessment of the validity of explanations regarding deviations from the path. The Commission and the Council […] could take into account the assessment of independent fiscal institutions"	"Each national independent fiscal institution […] shall provide an assessment of compliance of the budgetary outturns data reported in the progress report referred to in Article 20 with the net expenditure path. Where applicable, each national independent fiscal institution shall also analyse the factors underlying a deviation from the net expenditure path."

Source: Authors' elaboration based on European Commission (2022) and European Commission (2023c). The table focuses on the recitals of the legislative proposal as they set out the political intentions.

ANNEX 2

The EU polity

The Norwegian Stein Rokkan (1999) and the American Charles Tilly (1990) have studied 500 years of state formation to understand the origin and evolution of the European state system. We take inspiration primarily from Bartolini (2005) and Ferrera (2005), who applied Rokkan's theory to European integration. In a recent open access article (Ferrera, Kriesi and Schelkle, 2023), we have spelled out our view as an alternative to established integration theories.

Any polity can be defined by three elements: 1) its boundaries, which can be territorial but also functional, for instance its regulations extending beyond its borders; 2) its binding authority, which can be centralised and hierarchical or devolved and shared; 3) its political system of bonding, primarily through participation rights and public welfare provision. The European Union exhibits a unique configuration of these elements, making it an own category compared to unitary states and (con-)federations (Table A2). But we see an advantage in analysing the EU as a polity rather than merely a very close integration scheme, to understand why it is both so crisis-prone and so resilient. Here, we are more interested in polity features relevant for fiscal governance.

Table A2: Configurations of polity features relevant for fiscal governance.

	Boundaries	**Binding authority**	**Bonds of loyalty**
Unitary state (e.g. France, Slovenia)	Exclusive first-order territoriality	Encompassing, coercive monopolistic structure with centralised public finances	Solidarity and identity based on core state powers and citizenship
Federation (e.g., Belgium, Germany)	Exclusive first-order territoriality	Multi-level structure, shared monopoly of coercion with devolved public finances	Solidarity and identity based on shared core state powers and citizenship
Confederation (e.g. NATO)	Fluid second-order territoriality and functionality	Multi-level structure, coercively weak structure with common public finances	Solidarity and identity based on territorial and functional interests
Compound polity (e.g. European Union)	Fluid second-order (e.g. EA and non-EA members) territoriality and functionality	Multi-member and multi-level structure, shared coercive powers in public finances	Solidarity based on a common legal order and re-insurance of states; identity based on residency rights of EU citizens

Source: Adaptation of Ferrera et al (2023 : Table 1)

In terms of boundaries, the EU can be seen as a confederation, its monetary union being smaller than the EU while its regulatory polity extends beyond the confines of the EU. But despite deriving its budgetary resources largely from the member states, it has in turn some authority over national budgetary policies. Loyalty has a stronger institutional basis in that a common legal order and even re-insurance in the case of catastrophic events, like a systemic financial crisis and a pandemic, are provided by the polity; the RRF is an example of that as are the extraordinary monetary interventions of the European Central Bank. Free movement comes with residency rights that confer social citizenship on EU citizens living in another member state. This includes entitlements to contributory social insurance for employed EU citizens and their families.

REFERENCES:

Bartolini, S. (2005) *Restructuring Europe: Centre Formation, System Building and Political Structuring between the Nation-State and the European Union.* Oxford: Oxford University Press.

Ferrera, M. (2005) *The Boundaries of Welfare* .Oxford: Oxford University Press.

Ferrera, M., Kriesi, H. and Schelkle, W. (2023) "Maintaining the EU's compound polity during the long crisis decade", *Journal of European Public Policy* (online, Open Access). https://doi.org/10.1080/13501763.2023.2165698

Rokkan, S. (1999) *State Formation, Nation-Building, and Mass Politics in Europe: The Theory of Stein Rokkan,* ed. by P. Flora, S. Kuhnle, and D. W. Urwin. Oxford: Oxford University Press.

Tilly, C. (1990). *Coercion, Capital, and European States,* AD 990-1990. Cambridge, Mass.: Basil Blackwell.

This briefing paper assesses the Commission proposal to monitor reforms and investments in member states through fiscal governance. Major innovations, such as an expenditure rule and reputational sanctions, are discussed in relation to the stated objectives, with a focus on social resilience. These innovations are welcome, but we also see a need for sharing authority with national stakeholders to increase loyalty to the policy process
This document was provided by the Economic Governance and EMU Scritiny Unit at the request of the ECON Committee).

PE 741.526
IP/A/ECON-ED/IC/2023-024

Print ISBN 978-92-848-0496-2 | doi: 10.2861/611869 | QA-04-23-424-EN-C
PDF ISBN 978-92-848-0495-5 | doi: 10.2861/68131 | QA-04-23-424-EN-N