Media Briefing
EU reform of fiscal rules: will ministers back sufficient scope for public investments?
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The European Union's proposed fiscal rules hinder its capacity to combat climate change, promote crucial green manufacturing, and make eco-friendly solutions such as renewables, energy efficiency, and public transportation both affordable and accessible. The EU needs fiscal rules that account for the fiscal impacts of climate change and empower and incentivise governments to make quality green and social investments. Investors and credit rating agencies place greater emphasis on an economy's overall strength and resilience than on a nation's debt stock. Fiscal rules should therefore encourage quality investments that enhance their economic strength and resilience.

In this media Q&A, we briefly explain the political context of currently being discussed EU fiscal rules. A set of quotes is available at the end of the document.

What is happening?

European finance ministers have indicated that on 9 and 10 **November** they would make critical decisions regarding the reform of EU fiscal rules.

What is the proposal on the table?

In April 2023, the European Commission issued a legislative proposal to reform EU fiscal rules. The proposal put forward replaces the 'one size fits none' approach that required uniform debt reductions for countries with debt-to-GDP above 60%, with a more taylor-made approach that gives countries a 4 to 7 year adjustment period, in which they can invest to grow their economy and thereby reduce their debt-to-GDP ratio. The 3% deficit limit remains a hard limit on government spending. The proposals include some so-called numerical benchmarks, including a requirement for member states to adjust their budgets by a minimum of 0.5% of GDP annually until they reach the 3% deficit limit.

What are the positions of the main countries?

Some countries, particularly Germany, want to implement much stricter **numerical benchmarks**, including a requirement for countries to reduce their debt-to-GDP by 1% a year as of 2024. This would undermine the Commission's logic of more tailor-made debt and deficit reduction pathways entirely and likely result in spending cuts that have a negative impact on people, planet and the economy. This would increase the debt challenge for countries in the future.

Other member states want to ensure that all member states are able to trigger fair green public investments by allowing some form of investment exemption. The argument is that these investments are necessary to meet the EU's climate targets, but are also making the economy stronger and more resilient.

The European Parliament is also expected to reach an agreement on its position by the beginning of December.

What is the situation of the EU's fiscal rules today?

Since the COVID-19 pandemic hit, **fiscal rules have been temporarily paused,** but they are scheduled to **apply as of January 2024**. Alongside the Next Generation EU fund, the pause on the rules has allowed governments to invest more to avoid social and economic fallout of the COVID-19 pandemic and the Russian invasion of Ukraine.

According to the Commission, the EU still faces a significant gap in green investments to meet it's own EU climate targets and investments in social infrastructure to meet our social objectives.

What would be the impact of fiscal rules on green investments?

A recent study by the New Economics Foundation (NEF) shows that the EU's proposed fiscal rules would make it almost impossible for all but four European countries to debt-finance public investments to meet their climate commitments under the Paris Agreement.

The proposed changes in fiscal rules would mean particularly difficult budget decisions for many EU countries, especially for those with comparatively high debt or deficits like France, Italy, Spain, Belgium, Portugal, and Greece. If the EU is not able to increase green public investments in the just transition, the worsening climate crisis will increase climate-related fiscal risks (i.e. the budgetary impacts of climate change on public budgets).

Moreover, public investments are indispensable to ensure everyone has access to green and cost-saving solutions like rooftop solar and energy efficiency.

Why do green investments pay for themselves?

According to the IMF, green investments have an outsized multiplier effect compared to other public spending. Green investments can grow crucial green industries, make our economies more energy and material-efficient, and more resilient. This multiplier effect would allow the more indebted countries to be able to increase green investments by at least €135bn per year with debt still falling by the 2030s, according to a NEF analysis.

How would financial markets respond to more quality public investments?

Misinformed fear about financial markets' reactions to public debts cloud the debate on Europe's new fiscal rules. A recent report by Finance Watch showed that, with investors' demand for euro-denominated sovereign bonds twice as high as its supply, the debts we need to meet EU's climate and energy objectives can easily be absorbed by financial markets. Investors and credit rating agencies care less about the debt stock of a country than about its economy's overall strength and resilience and would welcome fiscal rules incentivising Member States to increase their economic strength and resilience with future-oriented investments and reforms.

Under the Commission's proposal, how big are the cuts that each EU country may face?

According to an analysis by ETUC, applying the current proposed rules would mean either a minimum of €45bn of cuts in 2024, or raising the equivalent amount through tax. German Finance Minister Christian Lindner supports even higher cuts to budgets. However, the International Monetary Fund (IMF) has found that, on average, such fiscal consolidation doesn't necessarily reduce a country's debt-to-GDP ratio.

	Minimum annual cut required (Euros) in 2024
Belgium	2.7 billion
Bulgaria	423 million
Czechia	1.3 billion
Estonia	180 million
Spain	6.6 billion
France	12.2 billion
Italy	9.5 billion
Latvia	195 million
Malta	84 million
Hungary	851 million
Poland	3.2 billion
Romania	1.4 billion
Slovenia	294 million
Slovakia	548 million

How to avoid cuts and foster a resilient economy? Our recommendations:

1. **Incentivise quality green and social investments:** Socially just green spending should be excluded from deficit, debt and expenditure limits, emphasising the

importance of long-term prosperity, resilience, and a speedy just transition to net-zero.

2. **Avoid 'one-size-fits-none' debt and deficit reduction benchmarks:** Such benchmarks are economically counterproductive while disincentivising essential investments and reforms.
3. **Adhere to the "Do No Significant Harm" principle:** Fiscal policies should align with environmentally responsible practices to minimize adverse impacts on the planet.
4. **Embrace green budgeting** in national budgetary framework, to enhance transparency about how public budgets contribute to or contradict climate and environmental goals. This includes requiring member states to estimate the green investment gap to meet the EU's climate targets.

What happens now? Next political steps

The European Commission's legislative proposal from April 2023 marked an initial step toward reforming EU fiscal rules. However, it continues to predominantly focus on debt reduction and arbitrary deficit limit, falling short in mobilizing investments for climate action, industrial policy, inequality and poverty reduction. The European Parliament and the Council of Ministers are shaping their respective positions on the fiscal rules.

- **In the European Parliament,** Esther de Lange (EPP) and Margarida Marques (S&D) are co-leading as rapporteurs. Their draft report, which was published on 13 October, is currently under review by MEPs in the Economic and Monetary Affairs (ECON) committee. A vote in the Committee on Economic and Monetary Affairs is scheduled for 4 December.
- Meanwhile, **in the Council**, the primary debate revolves around the degree of strictness in 'one-size-fits-none' numerical debt and deficit reduction targets. Countries such as France, Italy, and Poland argue for more flexibility to invest in green initiatives and military projects. The Spanish Presidency put forward a compromise proposal early in October which included the proposal that countries with a debt-to-GDP ratio above 60 percent would have to slash the excess by a set minimum number of percentage points per year on average over a 14 to 17-year period. This was however rejected by Germany which remains a staunch advocate for the strictest fiscal rules. Other fiscally conservative countries like Denmark and the Netherlands have also proposed compromise solutions, which have also been rejected by the German Finance Minister. **The Spanish Presidency is set to propose a new compromise ahead of next week's ECOFIN.**

Negotiations between the Council and Parliament are set to commence after they formulate their positions, with the **aim of concluding these negotiations by February 2024 at the latest.** The Parliament will need some weeks to sign off a deal before the Parliament enters recess ahead of the June 2024 European Parliament elections.

Quotes:

Sebastian Mang, Senior Policy and Advocacy officer at the New Economics Foundation (NEF), said: "Not all debt is equal, debt incurred to finance the green transition pays for itself. It can transform our economies, attracting new green manufacturing, creating good quality jobs and reducing the cost of living through more efficient homes, more accessible public transport and better public services. Those that want to unnecessarily restrict public investments stand in the way of a speedier and more equitable transition."

Ludovic Voet, Confederal Secretary at the European Trade Union Confederation, said: "Europe can pioneer the much-needed socio-ecological transformation of our economy and ensure a just transition for all. The new European architecture should provide the European Union and its member states with the tools to invest, while ensuring adequate safeguards to protect the most vulnerable people and maintaining quality public services. The European Union cannot afford austerity. We must act collectively, in solidarity, for the better for all, and get out of ideological postures."

Ludovic Suttor-Sorel, Senior Research and Advocacy Officer at Finance Watch, said: "Europe stands at a crossroads. To build a resilient, sustainable future, we must prioritise qualitative public investment over arbitrary debt limits. Contrary to prevailing misconceptions, it's not the size of the debt but the strength and resilience of a country's economy and institutions that truly matters to financial markets. By focusing on future-oriented fiscal rules, we not only secure Europe's prosperity but also earn the trust of investors and creditors, ensuring that future generations inherit opportunity, not just obligations."

Isabelle Brachet, Fiscal Reform Policy Coordinator at Climate Action Network Europe, said: "Our fossil fuel-based economy is the main driver of climate change, and climate extreme weather events, in turn, adversely impact public budgets and the economy. It is time for our Finance Ministers to play their part by designing fiscal rules that contribute to fighting the shared biggest threat today: climate change."

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