

Adopted by  
the Board

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Position Paper

# Fiscal Policy

## I. Summary of key messages and policy recommendations

Over time, the EU has adopted mechanisms that constrain the ability of member states to define individual fiscal policies. These mechanisms, including the Stability and Growth Pact and its governance framework, have shown their limits and need to be reformed. Wellbeing, sustainability and intergenerational justice need to drive economic policy.

We are therefore calling on the European Commission and European governments to:

- Ensure that the economic governance framework has been revised **before the general escape clause<sup>1</sup> is deactivated** and redesign the policy around the use of the general escape clause to allow for greater flexibility in order to be better able to deal with crises.
- Replace the Stability and Growth Pact with a Sustainability and Wellbeing Pact including an **“Excessive Emissions Procedure”**, for member states that diverge from their NDC<sup>2</sup> paths and a similar procedure for countries unable to meet wellbeing targets.
- Replace debt reduction pathways with **“Green and Social Investment Pathways”** that force member states to invest in the just transition according to a newly developed green economy and brown economy typology.
- Replace the headline debt and deficit ceilings with more flexible **Fiscal Standards** in the long term that allow for a better assessment of a country's unique situation.
- Create **Independent Fiscal Boards** with strong democratic scrutiny and increase the accountability of the framework as

a whole through the inclusion of European and national parliaments and other stakeholder groups including youth.

## II. Introduction: we need to invest in a sustainable and social future now

### Europe needs to redirect its economy towards sustainability

European society is presented with a challenge: how can we redesign the economy in such a way that it contributes to the wellbeing of the people and the planet? How can the economy help improve the quality of life of young people and protect the only ecosystem where humans can live? How do we make a priority of tackling the climate crisis? How can we revise our economic system in order to do so and prioritise wellbeing, in a context of finite resources?

By putting nature, people and health first, we can steer the economy in the right direction and lay a new path. We can choose the road our societies will take. The road to a fair transformation, that leads to a sustainable, equitable future, is ahead of us. But it requires public investment and spending on a large scale, now and in the coming decade<sup>3</sup>.

The estimated needs for supplementary investment in Europe are huge: the European Commission puts them at over 400 billion euros per year until 2030. And this is an underestimation, based on current climate targets, which are themselves insufficient to get us on a 1.5 degrees trajectory<sup>4</sup>. Other studies, trying to measure more acutely the investment needs for the transition, arrive at much higher figures, around 850 billion euros per year (Wildauer et al., 2020)<sup>5</sup>.

1 The *general escape clause* is one of the two clauses that allow deviation from parts of the Stability and Growth Pact's preventive or corrective arms, either because an unusual event outside the control of one or more Member States has a major impact on the financial position of the general government, or because the euro area or the Union as a whole faces a severe economic downturn.

2 Nationally determined contributions (NDCs) are at the heart of the Paris Agreement and the achievement of its long-term goals. NDCs embody efforts by each country to reduce national emissions and adapt to the impacts of climate change. (UNFCCC)

3 For a more elaborate overview of investment needs, see European Youth Forum, The European Youth Blueprint To Recovery (2021). Available at: <https://www.youthforum.org/files/blueprint.pdf>

4 “It is not possible to quantify all green investment needs at the current stage, making the above estimate a conservative benchmark for adequate green investment levels. The above needs estimates do not yet include the foreseen increases in policy ambition, nor the strategies for various environmental objectives, some of which are currently under adoption or preparation.” Commission Staff Working Document, Identifying Europe's recovery needs, SWD(2020) 98 final, Brussels, 27.5.2020

5 Wildauer et al. (2020) ‘How to boost the European Green Deal's scale and ambition’, ICAE Working Paper Series, No. 111, Johannes Kepler University Linz, Institute for Comprehensive Analysis of the Economy (ICAE), Linz

## Fiscal Policy is key to enabling the changes we need

One option could be to expect the private sector to tackle this investment gap. After all, the necessary investment, goes the theory, should come from the financial sector, by installed investors and the free allocation of capital by the market, provided accurate and relevant tax and subsidy decisions internalizing the external costs of pollution. The investment thus becomes necessary, so the invisible hand will do its job and make the money flow towards the growing, dynamic sectors that need it: renewable energy, green mobility, sustainable housing, protection against climate-induced risks etc.

There is reason to doubt this is how things will happen. The past decade has shown us that the market has not, and is unlikely to favour the investments needed to steer the economy towards a system that puts our health and communities first. In reality, we see a big funding gap: the investments we need to transition fast enough to an economy that helps us to address our climate crisis are just not profitable enough to happen by the magic hand of free-market allocation of capital, given the lack of sufficient policy instruments forcing emitters and consumers to internalise the environmental and social costs of their production and consumption<sup>6</sup>.

Financial profit is not a great indicator of the impact that investments have on society. Businesses such as oil companies can be highly profitable, even while their activity has a negative impact on the climate, biodiversity or human health. At a macro level, we see similar peculiarities. For example, it is known that every oil spill boosts GDP growth.

Therefore, European governments and institutions have a key role to play. They are democratically-elected, legitimate actors with important financial and regulatory capacity, and their primary objective is not (or shouldn't be) the short-term rate of return of their investments, but the wellbeing and future of their citizens.

**Fiscal policy is an enabler of intergenerational equity.** Its redistributive effects counterbalance the trend that rewards past wealth, giving newcomers a chance to succeed in the economic sphere. Governments should use it as an economic tool to pursue social policies.

This is why we need to reassess what constitutes so-called responsible and sustainable fiscal policy. **Fiscal policy needs to serve societal goals, be better aligned with climate action and the transformation of our economies and societies towards an economy that works for the people and the planet. There will be no just and green transition without a consequent involvement of governments.**

This involvement, however, is hampered by outdated rules and regulations that constrain government spending in the European Union and the Eurozone. These rules, which originated in the 1990s and onwards, constitute the Stability and Growth Pact (SGP). They need to be reformed and replaced by a Sustainability and Wellbeing Pact.

## III. The EU's Economic Governance Framework: a critical look

### The framework ensures the "quality" of public finances

The European Union's economic governance framework aims to monitor, prevent, and correct problematic economic trends that could weaken national economies or negatively affect other EU countries (spillover effect). It was created to promote the "quality" and "sustainability" of public finances (not related to environmental or social sustainability)<sup>7</sup>. In other words, it intends to ensure governments do not overspend and do not pile up their debt.

This is the logic behind the Maastricht Treaty (Protocol 12) that sets numerical limits on what levels of government debt and deficit are "sustainable": a 60% ratio of government debt to its annual GDP and a deficit (revenue vs. spending) of 3% are the limits. These limits are

<sup>6</sup> McKinsey & Company, *Net Zero Europe – Decarbonization pathways and socioeconomic implications*, December 2020.

<sup>7</sup> Public finances here refers to the government's revenue (through taxation) and the government's expenditure (government spending and investment) of the public authorities.

meant to ensure the main goals of the economic governance framework: stability of public finances and economic growth, hence the name Stability and Growth Pact, which forms the core part of the framework.

In order to ensure these rules are respected and the targets are met (even though there have been many instances in which they were not), the Stability and Growth Pact is provided with two tools: the preventive arm and the corrective arm.

### The preventive arm: a surveillance framework

The EU surveillance framework is a part of the “preventive arm” of the Stability and Growth Pact. It consists of a set of objectives, rules and pathways for indicators in the budgets of national governments.

For example: when the economic conditions are favourable, the European Union sets goals for national budgets to reduce their deficits. These goals, called Medium-Term Budgetary Objectives (MTOs)<sup>8</sup>, come with a pathway: countries have to reduce their deficit by 1 or 2 percentage points this year, and a bit more next year, etc. When the economic conditions are less favourable, the pathways are less strict, so countries will have to reduce their deficits by 0.3 or 0.5 percentage points per year, etc.

The European Commission’s Directorate-General for Economic and Financial Affairs is tasked to oversee member states through a yearly process called the European Semester. The Commission provides an analysis of the macroeconomic situation in Autumn, then provides guidance for fiscal policy in Winter. National governments use these recommendations to submit their budgetary plans in Spring, and all this is adopted by the different legislative bodies in Summer.

If member states fail to comply with these rules, there is a procedure meant to correct the imbalance.

### The corrective arm and the Macroeconomic Imbalance Procedure

Included in the European Semester are procedures for imbalanced situations.

The excessive deficit procedure is an action launched by the European Commission against any member state that exceeds the budgetary deficit ceiling. The procedure entails several steps, potentially culminating in sanctions, to bring a member state to reduce its budget deficit. All member states have gone through some of the steps of the procedure.

The debt-reduction benchmark, which was introduced in 2011, requires member states to reach the 60% debt-to-GDP value over twenty years. This is one of the most ill-famed procedures, as it forces governments to have budgetary surpluses over long periods. For example, the euro area taken as a whole has a debt-to-GDP ratio of 98.3%. Following this debt-reduction benchmark would mean that governments have a 1.1% annual fiscal surplus over the twenty-year period!

The macroeconomic imbalance procedure, embedded in the European Semester, is designed to prevent and correct risky macroeconomic developments. In practice, it forces countries in most cases to limit public spending and conduct “structural reforms”: reducing wage growth, increasing the threshold age for receiving a pension, promoting longer working hours, cutting funds to social services. This situation is publicly known as austerity.

### “A big surveillance machine” that focuses exclusively on a few macroeconomic indicators

The EU’s economic governance framework, described by critical voices as “a big surveillance machine”, focuses almost exclusively on macroeconomic indicators (GDP<sup>9</sup> growth, budget deficits, debt levels, account balances etc.) linked to the issue of debt. It is quite blind to other issues.

8 See more detailed explanations on MTOs on the European Commission’s website: <https://bit.ly/34r2i6N>

9 Gross domestic product (GDP) is the standard measure of the value added created through the production of goods and services in a country. (OECD)

Specifically, it does not account for environmental challenges or social issues. It established ceilings to spending, but not floors to spending that would force countries to invest in a just and social transition. This is a problem, as **there is a tension between meeting important social and environmental goals that require public spending and investment, and meeting strict debt rules in the current framework.**

## IV. 5 reasons why the current framework is unfit for young people and future generations

- I. The EU's fiscal framework contributed to constraining public spending and investments in several member states before the COVID-19 pandemic and will translate into austerity and cuts in public spending if applied again from 2023, at a time when it is more important than ever to tackle our social and environmental crises

Following the Great Recession and the European debt crisis that began in 2008, many Eurozone countries were forced to take austerity measures. Austerity is a set of fiscal measures aiming to reduce a public deficit, mostly through cuts in government spending.

The macroeconomic impact of such policies is well-known: improved credibility restores market confidence, reducing the cost of debt. However, at the same time, unemployment rates skyrocketed and inequalities widened. Previously poor and marginalised communities, including young people, suffered the bulk of economic pain. In July 2014, for instance, the EU's youth unemployment rate was at 22%, while the transgenerational unemployment rate was at 10.2%.

We see this disproportionate impact on young people in most crises. During the COVID-19 pandemic, for instance, youth unemployment rose 3 times faster than the general rate. Indeed, young people tend to have more precarious contracts, are the first to be let go, and suffer from various forms of discrimination (Moxon, Bacalso and Şerban, 2021)<sup>10</sup>.

The Stability & Growth Pact (SGP) shares responsibility for these policies. From the introduction of the European Semester in 2011 to 2018, the Commission made 105 separate demands of individual member states to raise the statutory retirement age and/or reduce public spending on pensions and aged care under the Stability and Growth Pact and the Macroeconomic Imbalance Procedure. It made 63 demands that governments cut spending on healthcare and/or outsource or privatise health services. Demands aimed at suppressing wage growth were put to member states on 50 occasions, while instructions aimed at reducing job security, employment protections against dismissal, and the collective bargaining rights of workers and trade unions were made 38 times.

In addition to routine demands to cut government expenditure on social services generally, the Commission also made 45 specific demands aimed at reducing or removing benefits for the unemployed, vulnerable people and people with disabilities, including by enacting punitive measures to force these individuals into the labour market - or, at least into becoming job seekers<sup>11</sup>.

The current pandemic has led European countries to create unprecedented amounts of public debt to deal with the crisis. The risk that austerity measures may be back on the agenda is extremely high and is directly linked to the Stability and Growth Pact. Indeed, the rules that constrain government spending were deactivated in 2020 by using the General Escape Clause, but are set to come back into force in 2023, leading to the same self-imposed economic and social consequences as in the 2010s (the current average eurozone government debt to GDP ratio is 98%, which is well above the 60% rule).<sup>12</sup>

10 Moxon, D., Bacalso, C., and Şerban, A. (2021) 'Beyond the pandemic: The impact of COVID-19 on young people in Europe'. Brussels, European Youth Forum.

11 M. Schirdewan and E. Clancy (2020) 'Discipline and Punish, End of the road for the EU's SGP?' <https://bit.ly/3tYvrAv>

12 <https://tradingeconomics.com/euro-area/government-debt-to-gdp>

But as demonstrated after the Great Recession, **austerity is inefficient**. The structural adjustment programs, economic jargon for austerity measures, imposed by the “Troika” (European Commission, European Central Bank and International Monetary Fund) exacerbated the crisis. *“Austerity is always a drag on growth, and especially so in depressed economies”* (Oscar and Taylor, 2013)<sup>13</sup>, for the simple reason that the very real drop in aggregate demand<sup>14</sup> is in no way compensated by the hypothetical increase in private investment that market confidence is supposed to bring about.

Further, **austerity is unfair**; it increases existing inequalities. The pressuring of wages, pensions and social benefits has significant distributional effects. It decreases the share of income that goes to wages, and the aggregate demand shock increases long-term unemployment, both of which are heavily biased towards the low-income and middle-income classes.

These macroeconomic effects have real-life social impacts. Young people get stuck in unemployment or low-paying jobs. The decrease in funding for education, translated, for example, in a reduction of quantity and reach of scholarships for students, affects the quality and equity of education. Some get sick while funding for public healthcare is decreased. Others are marginalised by the reduction of public transport or are forced to migrate. Infrastructure maintenance, let alone adaptation to climate risks, is overlooked, with negative consequences on lives and property.

**The young generation and the ones to come are faced with a triple crisis:** an economic crisis that started unfolding in 2008, a socio-economic crisis that the pandemic brought about, and a climate crisis that is only beginning. These three crises are impacting us disproportionately, while we are the generations that are the least responsible for them. Restoring the SGP rules in 2023 would be an act of great intergenerational injustice.

## II. The SGP has led to rising inequality and a concentration of wealth in the hands of a few at the expense of the most vulnerable populations

In the context of low inflation and low GDP growth we are currently experiencing, real capital revenues tend to overperform labour, gradually tilting the balance in favour of past wealth; it takes only a small flow of new savings to increase the stock of wealth steadily and substantially<sup>15</sup>. In other words, when the return to capital is greater than economic growth over the long term, the ratio of wealth to income, and therefore inequality, increases. This trend is particularly visible on the housing market where younger generations are being “priced out”. Past wealth, here in the form of housing, becomes gradually less affordable to economic actors who live on wages.

Three tendencies may counter this gradual shift. Inflation nibbles away the real return on capital and restores a form of balance. However, it comes with other economic consequences and price stability is the primary mandate of the European Central Bank, making this option unconvincing. High GDP growth is another, but is probably not achievable, nor is it desirable as a primary policy goal.

Fiscal policy, on the other hand, is *“the most important tool at the disposal of member states for promoting fair redistribution of added value for society as a whole.”*<sup>16</sup> The positive effects of expansionary policy are threefold: government investment creates economic activity, and with democratic oversight can help transition towards more sustainable practises. Government expenditure funds the social transfers that prevent rising inequalities by directly redistributing wealth. Access to quality public services, such as education, plays a crucial role in reducing existing inequalities, and these can be targeted towards various communities, producing socio-economic inclusion.

13 Jordà, Òscar, and A.M. Taylor (2013) ‘The Time for Austerity: Estimating the Average Treatment Effect of Fiscal Policy’. NBER Working Paper No. 19414

14 Aggregate demand is the total demand for final goods and services in an economy at a given time. It is the sum of consumer spending, investment, corporate and government expenditure, and net exports.

15 Piketty, T. (2013) ‘Capital in the 21st Century’. Harvard University Press, USA.

16 Dimitrov, P. (2017). ‘Wealth inequality in Europe: the profit-labour split between member states’. European Economic and Social Committee <https://bit.ly/3fYpKu5>

By strongly constraining the ability of governments to use fiscal policy to counterbalance the economic trend described above, the Stability and Growth Pact and its framework have made a major contribution to the rising inequality in Europe. This inequality is multifaceted, but the bonus given to past wealth hampers dearly the ability of young people to provide for themselves today, and in the future. It is a strong driver of intergenerational inequality.

### III. The framework has not effectively encouraged the member states to invest sufficiently in the just transition so far, nor to end environmentally harmful subsidies, because the current rules do not distinguish between the types of investment

The EU's current fiscal framework is indifferent to the quality of spending. It reinforces fiscal policy short-termism by forcing cuts regardless of the member states' socio-economic needs, of the importance of quality public investment for sustainability and human rights, and long-term risks, such as climate or health crises. For example, it does not make a difference between environmentally harmful and transition-friendly investments. However, the quality of investments is key for the transition and a safe future. For example, the EU and the member states must end fossil fuel and other environmentally harmful subsidies.

Hence, the EU's economic governance framework needs to be designed in a way that ensures that EU and national budgets don't support activities that harm the climate and the environment. It must also ensure that public money is guided towards projects, industries and research sectors that support the transition towards a sustainable society.

The EU currently lacks the infrastructure required to reduce its greenhouse gas emissions quickly and substantially and to reach the goal of limiting global warming this century to meet the Paris Agreement. A fiscal framework should encourage such investments and be the enabler for the transition.

Under the current rules, public spending in climate action could mean that investments have to be cut in other areas such as social affairs, education, wellbeing and health, creating trade-offs that are detrimental to building a wellbeing economy, or that we would need to dramatically increase government revenues. Besides, studies show that spending large amounts to address the EU's green investment gap is unlikely to create debt sustainability problems in the EU27<sup>17</sup>.

#### **The cost of investing now is, by all accounts, inferior to the cost of failing to do so.**

If only considering fiscal risk, the real burden on young and future generations (i.e. those not yet born) will emerge from the absence of timely, resolute action. Transitioning to a framework of public spending that accounts for these risks is necessary for young and future generations to prosper. This is because the costs of emissions to current and future generations are not borne by those who produce them today.

The UK's Office for Budget Responsibility presented to the British Parliament in July 2021 a report on fiscal risks which analyses in-depth "the risks to the public finances presented by climate change including a range of scenarios illustrating the fiscal impact of different ways to get to net-zero by 2050"<sup>18</sup>. The results speak for themselves. When comparing the amount of public debt necessary to cope with a scenario in which action to mitigate climate change is taken late (late action scenario) to an early action scenario, the fiscal watchdog finds that acting late results in a 23% increase in public debt in 2050, compared to early action.

17 "Debt-to-GDP ratios are likely to fall in response to the strong economic impulse generated by additional public investment spending. We therefore classify additional public investment spending in the EU27 as sustainable fiscal policy", in: R. Willdauer, S. Leitch, J. Kapeller, 'Is a €10 Trillion European Climate Investment Initiative Fiscally Sustainable?', Foundation for European Progressive Studies, October 2021

18 Office for Budget Responsibility, Fiscal risks report, London, July 2021

#### IV. The framework is based on a flawed economic model that dates back to the 1990s and has been challenged ever since

The European economic framework strives to deliver objectives on sustainable public finance positions and avoiding macroeconomic imbalances. These are worthy causes, but the 1990s framework is outdated, based on flawed assumptions that have been disproved both by theory and by empirical evidence.

In its initial design of 1997, with the 3%-of-GDP deficit threshold as the central anchor, the SGP focused on the prevention of spillovers from excessively high deficits, which could undermine price stability in the Economic and Monetary Union and affect the effectiveness of the monetary policy. However, public debt is not inherently “good” or “bad”. The numerical ceilings of the Stability and Growth Pact may have been based on the prevailing standards of 1997 in the EU, but both thresholds are arbitrary<sup>19</sup>.

They are not grounded in economic theory, as there is no proof that an economy performs better under or over the thresholds<sup>20</sup>. Debt sustainability is a complex notion that stems from a varied range of factors<sup>21</sup>. These two ratios are among them, but as important are future government revenues, the fiscal risks of the government, the cost and maturity of debt, the difference between interest rates and growth rates and the types of debt holders.

**Also, taking debt and spreading its repayment across generations is not the only way to finance necessary investments for a sustainable future, and alternative, fairer financing mechanisms must be considered.**

Going back to high GDP growth rates in Europe is neither possible nor desirable. Absolute decoupling of economic growth from environmental pressure has not sufficiently been achieved in the past and is highly unlikely to be in the future. We are already overproducing in a lot of sectors with a lack of demand<sup>22</sup>.

As we also conclude in the 2021 Youth Progress Index: *“No country can claim to have succeeded in implementing a model of development that is sustainable both socially and environmentally, and does not put at risk the livelihoods of future generations. So that begs the question, even more, to rethink how we look at progress: should we consider something as progress at all, if it impacts so negatively on our planet’s future, and on the future wellbeing?”*<sup>23</sup>

#### V. Member states’ budgets are legally a national competence but the SGP has considerable overreach despite being untransparent

The decision-making procedure under the SGP is secretive and thus far away from being a transparent and democratic process. There is a lack of democratic oversight. In addition, the indicators under the SGP, Macroeconomic Imbalance Procedure and ‘structural reform’ framework have enabled the Commission to significantly impact public policy areas that legally fall under the competence of the member states under the Treaty on the Functioning of the European Union (TFEU), such as pensions and the provision of healthcare.

In addition, the rules do not apply equally among member states. When it comes to the implementation of the Stability and Growth Pact and Macroeconomic Imbalance Procedure

19 SCHUBERT, C., ‘Wie das Maastricht-Kriterium im Louvre entstand’, in: Frankfurter Allgemeine Zeitung, September 26, 2013. Quoted in Suttor-Sorel, Fiscal Mythology Unmasked, Finance Watch, July 2021

20 For more on the arbitrary nature of the thresholds, see Priewe, J. (2020) ‘Why 60 and 3 percent? European debt and deficit rules - critique and alternatives’, in: IMK Studies 66-2020, IMK at the Hans Boeckler Foundation, Macroeconomic Policy Institute.

21 Debt sustainability refers to whether a country can service the costs of debt over time. So in the case of unsustainable debt, the burden of debt repayment can overwhelm a country’s finances, which in turn can lead to default (such as in the case of the Greek debt crisis) or lead to macroeconomic imbalances (which is essentially the same as an unsustainable debt).

22 Mayrhofer, J. and Wiese, K. (2020) ‘Escaping the growth and jobs treadmill: a new policy agenda for post-coronavirus Europe’. Brussels, European Environmental Bureau, European Youth Forum. Available at <https://www.youthforum.org/news/escaping-the-growth-and-jobs-treadmill-a-new-policy-agenda-for-post-coronavirus-europe>

23 Lisney, J. (2021) ‘Youth Progress Report 2021’. Commissioned by the European Youth Forum. Brussels.



through the European Semester, the Commission has repeatedly decided against proceeding with the prescribed steps or imposing sanctions, for political reasons. For example, when Germany and France repeatedly breached the rules between 2001 and 2005, there were no consequences.

European decision-making regarding economic plans to deal collectively with climate change, digitalisation and inequality should be transparent.

The context-specific design of the Recovery and Resilience Facility contrasted with the top-down, surveillance-focused approach that prevails in the European Semester. The success in creating plans that are tailored to the specific situations of member states, while falling in line with wider goals like the 37% for the green transition and the do-no-harm principle are reasons to be optimistic about the ability of EU institutions and member states to coordinate efficient, forward-looking fiscal policy.

However, ownership and design would greatly be improved with much stronger democratic and civil society participation at all stages, which was not the case with the RRP<sup>24</sup> either, as also the Youth Forum's members can testify to.

The distributional impacts of investments and reforms discussed under the Semester need more attention than what happened under the RRP.

**In summary, the current fiscal framework is flawed and will lead to disastrous consequences for young and future generations if it is not reformed in a way that makes it suitable for 21st-century challenges.**

## V. 5 policy demands for a better economic governance framework

### Better timing: No reactivation of the rules before new rules come into force

Going back to the austerity rules is dangerous for European societies as well as for the economic recovery. We know this because we have done

it before. The rules are suspended but are likely to come back into force on 01 January 2023.

The legislative process on the review of the EU's economic governance system and fiscal rules is likely to take longer than a year, so we might be facing automatic austerity.

The general escape clause can be maintained until an agreement is reached and new rules come into force. We demand that the European Commission make recommendations in this favour to the Council.

In any case, the European Commission's guidelines for 2023 national budgetary policy, expected for the end of Winter 2022, must show lessons were learnt from the past as described above.

Strong fiscal stimulus has shown its efficiency to support society and its economy during the pandemic. Government investment is still needed to deal with the medium and long term effects of the pandemic, and with the climate crisis.

In the longer term, as the general escape clause has shown its relevance for dealing with the economic impact of the pandemic, its use should be eased. Both national escape clauses and general escape clauses need to be redesigned to facilitate their activation.

### Better goals: Put climate, environmental and social goals before GDP growth and macroeconomic stability

The suspension of the current fiscal rules was needed and must be maintained. But as the Commission clearly states itself, "the scale of the fiscal effort needed to protect European citizens and businesses from the consequences of this crisis, and to support the economy following the pandemic, requires the use of more far-reaching flexibility under the Stability and Growth Pact."<sup>25</sup>

This is why we call for the transformation of the Stability and Growth Pact into a Sustainability and Wellbeing Pact.

24 "Consultation on the preparation of NRRPs has been very limited in almost all countries", in: *Participation of civil society organisations in the preparation of the EU National Recovery and Resilience Plans*, Civil Society Europe, December 2020.

25 European Commission (2020) Communication to the Council on the activation of the general escape clause of the Stability and Growth Pact. Brussels

Replacing the policy fixation on economic growth with a focus on human and ecological welfare must be the key priority of the new economic governance framework. The current fixation on GDP as a national and societal success indicator is a deliberate construction that can be changed. We need to recognise that there is no value in maximising consumption. GDP growth no longer significantly increases our wellbeing and is jeopardizing our future as Greenhouse Gas (GHG) Emissions have shown to be impossible to decouple from economic growth at a sufficient scale<sup>26</sup>. Further, GDP growth is an ill-suited yardstick for societal progress as it does not reflect social rights and environmental impacts.

While macroeconomic stability remains important, the biggest threat is possibly no longer debt, but indeed the potential of the climate crisis to destabilize economies. GHG emissions are jeopardising our future. They should be a part of 'the great surveillance machine', as well. Therefore, we call for the creation of an Excessive Emissions Procedure, for member states that diverge from their NDC paths.

The Excessive Emissions Procedure is a proposal that fits with a vision for society in which the needs and rights of all are met within the means of the planet; a vision where everyone, including future generations, can fulfil their needs and realise their rights while ensuring that this does not overshoot Earth's natural resources and fundamental life-supporting systems such as a stable climate and fertile soils<sup>27</sup>. This is a much more valid model to base our common policies on than the 3% and 60% rules.

Therefore we are calling on the European Commission and European governments to replace the targets with meaningful indicators on the wellbeing of people and the planet. A myriad of alternative indicators already exist measuring 'wellbeing' or 'welfare' such as the European Commission's "quality of life" indicators, and the European Youth Forum's 'Youth Progress Index'. Yet such indicators are seldom used in policymaking.

Targets for 2030 have also been set by the European Pillar of Social Rights: 78% of the population aged 20 to 64 should be in employment, 60% of all adults should be participating in training every year, and 15 million fewer people should be at risk of poverty or social exclusion. All these are worthy, fit for purpose objectives. We demand that they be treated with the same scrutiny as the 3% and 60% rules currently are, including them in processes like the European Semester.

### Better criteria: Integrate a typology for investments to incentivise green and social investments

Besides ill-suited goals, the Stability & Growth Pact (SGP) generally does not distinguish types of expenditure, which are conducive to societal and environmental wellbeing. The "Excessive Emissions Procedure" must therefore be complemented by green and social investment pathways that would replace debt reduction pathways.

If a member state fails to comply with targets set for wellbeing and greenhouse gas emission reductions, it should be mandated to invest in a just transition in line with the EU's commitment to limit global warming to 1.5 degrees in the Paris Agreement.

The green and social investment pathways must be supported by a typology of public investments that are contributing towards this goal. Activities listed in Art. 8 of the Just Transition Fund Regulation could be a good starting point for such a typology. Such a new typology mustn't lead to "greenwashing", i.e. pushing the boundaries of what can be classified as a green investment. One way to do so is by complementing the EU green taxonomy with a "brown" taxonomy to define undesirable investments that harm climate, nature and the environment.

Such pathways would function in a different logic to another proposal for change called the golden rule or green golden rule (GGR). The golden rule

26 European Environmental Bureau (2019) 'Decoupling Debunked', Available at: <https://eeb.org/wp-content/uploads/2019/07/Decoupling-Debunked.pdf>

27 Raworth, K. (2017) 'Doughnut Economics: Seven Ways to Think Like a 21st Century Economist'. Vermont: White River Junction. USA

seeks to exempt certain activities in accounting to debt rules. However, they are not exclusive. By freeing green investment and expenditure from the constraints of the Stability and Growth Pact, a green golden rule would also give some leeway to governments to set a transition path towards a more sustainable future.

### Better measurements: Replace the arbitrary rules and replace them with more flexible standards

In the longer term, the Treaty on the Functioning of the EU (TFEU) should be amended to replace the reference values of 3% deficit and 60% debt with more flexible standards. Such standards would be general objectives seeking to avoid excessive fiscal imbalances, without setting numbers in stone.

Such fiscal standards could be based on debt sustainability analyses by independent fiscal research institutions and take into account specific national contexts including investment needs in line with the policy changes described above.<sup>28</sup>

### Better processes: Increase democratic accountability of rules

In order for fiscal standards to work, we require strong national ownership of the overall objectives of the EU's economic and budgetary policy, and of their relationship with national policy decisions. It also calls for strong Independent Fiscal Boards that are seen as trustworthy on the national level as well as by the other member states and the European Commission. These boards could provide the research, and serve as a network in the EU to share good practices.

In addition, the role of national and European parliaments in the decision-making processes should be increased to ensure legitimacy and accountability. For example, the European Parliament Committee on Economic and Monetary Affairs should be strengthened with special information rights and scrutiny responsibilities.

The complete European Parliament should also be involved in the development and monitoring of economic and fiscal policies. There also has to be further attention to local and regional dimensions due to regional differences. All this calls for revising a one size fits all approach.

Finally, there should be a much better inclusion of all stakeholders groups, including young people, in the discussions around economic plans to deal collectively with climate change, digitalisation and inequality. More specifically, there needs to be a stronger involvement of civil society in the European Semester process on the EU as well as member state level. For example, there should be reinforced structured mechanisms for civil society participation (e.g. through transparent and institutionalised prior consultations) within the Semester such as the country recommendations or the annual sustainable growth survey. Existing mechanisms are also quite discretionary and could benefit from a more robust structure.

We believe these five policy demands can be a real game-changer, delivering an enabling framework to increase the wellbeing of Europe's people and the planet. By putting social and environmental goals first, and considering sound fiscal policy as a tool to bring about the economic changes that society needs, we believe that the European Union's institutions and governments would be equipped to bring about a fair and just transition.

<sup>28</sup> See e.g. Blanchard, Alvaro Leandro and Jeromin Zettelmeyer, 'Redesigning the EU Fiscal Rules: From Rules to Standards' (2021), *Economic Policy*, Vol. 36, Issue 106, April 2021.