

The European Union's new fiscal framework: a good start, but challenges loom

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Executive summary

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THE EUROPEAN UNION'S FISCAL FRAMEWORK, updated in April 2024, aims to strengthen fiscal sustainability and foster public investment. It requires countries to maintain or gradually reduce their public debts to no more than 60 percent of GDP, and ensures compliance with a 3 percent of GDP deficit limit and some safeguards. EU countries must submit Medium-Term Fiscal Structural Plans (MTFSPs) showing how they intend to comply.

MTFSPS FOR MOST EU countries have now been approved by the European Commission, on the basis that the fiscal paths in the plans are credible and increased public investment is foreseen even amid fiscal consolidation. However, macroeconomic assumptions in MTFSPs frequently deviate from the Commission's guidance, often reflecting optimistic growth projections. Overly optimistic assumptions risk deviations from approved fiscal paths, while disagreements about macro projections, which are central to debt sustainability analysis, could undermine the framework's credibility and hinder implementation at a later stage.

SEVERAL MTFSPS ASSUME higher stock-flow adjustments (SFAs) than included in the Commission's prior guidance, indicating that these countries must implement somewhat larger fiscal adjustments. Historical data shows large positive SFAs for many countries, suggesting that multi-year-ahead SFA projections should be extended to all countries, based on a transparent methodology.

THE PLANS INDICATE that greater planned fiscal adjustments tend to be associated with deeper cuts to public investment. The overall increase in public investment ratios remains below 0.2 percent of GDP according to the plans and Commission and OECD forecasts. While the EU's major investment gaps should primarily be addressed through private investment, public investment must also play a role. Innovative approaches, such as a new EU fund financed by common borrowing, are essential to boost investment in the EU.

THE UPDATED FISCAL FRAMEWORK'S long-term success depends on achieving consensus on macroeconomic assumptions, including the standardisation of methods to assess the growth impacts of reforms, while refining SFA methodologies and finding new ways to foster investment. Strengthening these elements will make the framework more credible and effective, enabling it to better guide fiscal policy and support sustainable growth.

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1 Introduction

Under the European Union's fiscal framework, each EU country must outline its fiscal and structural strategies in a so-called Medium-Term Fiscal Structural Plan (MTFSP), which must be submitted for endorsement to the European Commission and, ultimately, other EU governments in the Council of the EU. The framework, which seeks to ensure EU countries keep their debts manageable in order to prevent negative impacts on other EU countries and the EU as a whole, was updated in early 2024 and the first 22 MTFSPs were submitted, evaluated and, mostly, approved in late 2024 and early 2025. These were crucial steps, as their outcome could significantly impact the EU fiscal framework's credibility and effectiveness. Moreover, the fiscal plans are critical in their own right, as they influence the long-term public-investment strategies of EU countries and the structural transformation of their economies.

The main requirement of the EU's fiscal rules¹ is that, whenever a country's public debt exceeds 60 percent of GDP, it should be put on a fiscal trajectory that ensures its decline in line with a debt sustainability analysis (DSA). Additionally, the budget deficit must be reduced below 3 percent of GDP (if it exceeds this threshold) and then maintained below 3 percent. The framework also requires adherence to a set of safeguards for minimum deficit and debt reductions (Darvas *et al* (2024b) provides an evaluation).

MTFSPs must also detail reform and investment plans, which are pivotal in determining whether the standard four-year period allowed by the rules for fiscal adjustment can be extended to seven years. An extension is granted if the proposed measures are growth-enhancing, align with EU priorities and meet specific additional criteria.

In June 2024, ahead of the submission of national plans, the European Commission issued prior guidance in the form of 'reference trajectories' for countries with public debt exceeding 60 percent of GDP or deficits above 3 percent of GDP, and 'technical information' for other countries. These reference paths, derived from the EU's common methodology, incorporate variables including GDP growth, inflation and interest rates, and outline the required fiscal adjustments under the new framework on the basis of the DSA and the safeguards. EU countries can deviate from the macroeconomic assumptions underpinning the DSA if they offer transparent, sound and data-driven justifications.

Of the 22 MTFSPs submitted between September and November 2024, evaluations and approvals by EU institutions for 21 were wrapped up by late January 2025² (Hungary's plan was substantially revised and will be approved after a short delay³). Twenty plans were approved as submitted by the respective countries, while the approved trajectory for the Netherlands was based on the reference information prepared by the Commission because the plan did not meet the requirements (see section 2).

Austria, Belgium, Bulgaria, Germany and Lithuania have yet to submit their plans at time of writing, with the delay attributed to elections and the subsequent formation of new governments in these countries, hindering the MTFSP preparation process.

This policy brief examines the extent to which the 22 national fiscal adjustment plans submitted so far align with the European Commission's prescriptions, the consistency between

1 As set out in Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance, <http://data.europa.eu/eli/reg/2024/1263/oj>.

2 The French plan was submitted by the government of Michel Barnier in October 2024, but this government lost a motion of no confidence in December 2024. The new government, led by François Bayrou, retained the plan, including the cumulative net expenditure growth target of 5.41 percent from 2024 to 2029 (below the Commission's 8.2 percent reference path), but made a slight adjustment to the annual distribution by reducing the frontloading of net expenditure growth. See: https://economy-finance.ec.europa.eu/document/download/7d708f46-9a84-4cd6-881a-a3cf27a26211_en?filename=20250116_Letter_France_MTP_en.pdf.

3 Approval of the Hungarian plan is expected at an EU finance ministers' meeting on 18 February 2025; see <https://www.consilium.europa.eu/en/meetings/ecofin/2025/02/18/>.

the MTFSPs and the EU excessive deficit procedure (EDP) requirements, divergence between the plans' underlying macroeconomic assumptions and the Commission's prior guidance, and the extent to which the plans preserve or enhance public investment. We conclude by highlighting some risk factors that could affect the implementation of some approved plans and offering proposals to improve the functioning of the new framework.

2 The Commission's overall assessment

Of the 22 submitted plans, the two not approved at time of writing by the EU institutions are Hungary's initial plan and the Dutch plan. Hungary's initial plan was based on overly optimistic assumptions (see section 4), leading it to be revised substantially. The Netherlands has a debt ratio currently below 60 percent of GDP, but submitted an MTFSP projecting its debt ratio would surpass the 60 percent benchmark by 2033 and exceed 70 percent by 2038. Moreover, the Dutch government deficit was projected to exceed the Treaty reference value of 3 percent in 2029 and then gradually increase to 4 percent by 2038. These projections violate the EU rules (see footnote 1). The Dutch MTFSP stated that if the Commission and the Council deemed the plan non-compliant, *"the government sees a recommendation for an expenditure path on the basis of the technical information as proper implementation of the European fiscal rules,"* and that the Netherlands would waive its right to submit a revised plan. The Commission has issued such a recommendation, and the Council has endorsed this recommendation.

For the approved plans, the Commission expressed a highly positive view, judging the proposed fiscal paths as credible and aligned with the new fiscal rules.

While some countries proposed higher net expenditure paths than the Commission's prior guidance, these changes were deemed as justified by well-substantiated differences in assumptions. The Commission also highlighted that nationally financed public investment is expected to increase in the coming years, even amid fiscal consolidation, demonstrating the investment-friendly nature of the new framework.

Finland, France, Italy, Romania and Spain requested extensions of their fiscal adjustment periods to seven years. The Commission found these requests to be well-supported by the inclusion in their plans of reforms and investments that align with the framework's requirements.

These initial steps also addressed an important question that was left open in the legislation regarding the interplay between countries' MTFSPs and the deficit-based excessive deficit procedure (EDP – a process in which a country is pushed to correct debts and deficits that breach EU limits⁴). Under the framework as updated in April 2024, an EDP can be initiated if a country exceeds the 3 percent of GDP deficit criterion ('deficit-based EDP') or if it deviates from the prescribed net-expenditure path, which aims to reduce the debt ratio below the 60 percent of GDP benchmark ('debt-based EDP'). In 2024, only deficit-based EDPs were opened, while debt-based EDPs may be considered in later years once compliance with the net expenditure growth requirement can be assessed.

Pench (2024) argued that there was a risk that the adjustment paths prescribed in deficit-based EDPs may be less demanding than the debt-sustainability requirements of the MTFSPs would normally imply, paradoxically resulting in more favourable treatment of countries subject to an EDP, relative to countries that had already brought their deficits below 3 percent of GDP. So far, this risk has not materialised. The Commission carried out an integrated assessment of the MTFSPs it had received by November 2024 and the EDPs. This

4 See Council of the EU explainer on the excessive deficit procedure, <https://www.consilium.europa.eu/en/policies/excessive-deficit-procedure/>.

approach ensured consistency across these processes, and the EDP prescriptions were the same as the adjustment paths required from the MTFSPs based on the debt sustainability analysis and the safeguards. The assessments of euro-area countries' draft budgetary plans for 2025 were also integrated into the evaluation.

3 Differences in fiscal adjustment plans

The new fiscal framework relies on a single annual operational fiscal target: the growth rate of net expenditures⁵. This is the only indicator that matters for compliance.

However, each country's net expenditure-growth trajectory is derived using an interim variable, the structural primary balance (SPB) expressed as a share of GDP⁶. The SPB has a clear economic interpretation: an increase indicates fiscal consolidation, while a decrease signals fiscal expansion. It is also conveniently used as the target variable in the Commission's DSA calculations. While conceptually useful for *ex-ante* planning, SPB estimation based on historical data is subject to significant uncertainties, making it less reliable for annual operational fiscal target (Darvas, 2019).

In contrast, net expenditure growth is a more practical indicator for annual planning. It is largely under government control and requires minimal estimation⁷. However, unlike the SPB, any change in which is defined as a negative or positive 'fiscal impulse', net expenditure growth is not as easily interpreted in terms of fiscal consolidation or expansion. Depending on the expected growth rate, the same net expenditure growth could be expansionary (for slow-growing countries) or contractionary (for fast-growing countries). This complicates the interpretation of net expenditure growth in economic terms. It also offers a way for countries to comply with the net expenditure paths required by the European Commission, while planning less fiscal adjustment than envisaged by the Commission.

In their MTFSPs, Italy, Malta, Poland, Portugal, Slovakia and Slovenia proposed net expenditure paths that are identical or nearly identical to the Commission's prior guidance (Figure 1, panel A). France and Romania meanwhile proposed net expenditure growth below the Commission's guidance, indicating tighter fiscal policy planning.

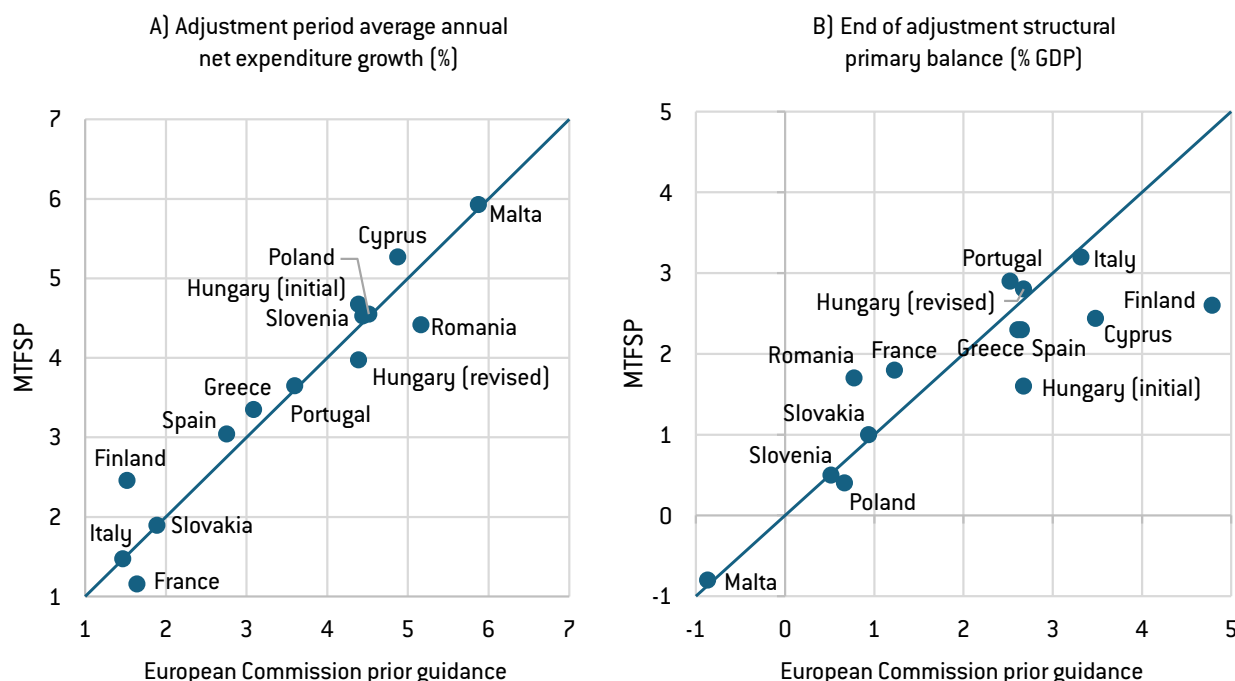
Five countries proposed net expenditure growth exceeding the Commission's recommendations. For Finland, the difference is almost 1 percentage point per year, nearly 7 percent over its seven-year adjustment period. Cyprus, Greece, Hungary (in its initial plan) and Spain proposed more modest extra increases of just under 0.3 percentage points per year, resulting in a cumulative deviation of approximately 1 percent over the four-year adjustment horizons for Cyprus, Greece and Hungary, and 2 percent over Spain's seven-year adjustment period. However, in its revised plan, the Hungarian government reduced the proposed net expenditure growth below the reference trajectory's value.

5 Net expenditure is defined as general government expenditures minus (1) interest expenditures, (2) changes in revenues attributable to discretionary revenue measures, (3) expenditures on EU programmes fully matched by EU funding, (4) national co-financing of EU programmes, (5) cyclical elements of unemployment benefit expenditures, and (6) temporary measures.

6 The structural primary balance is defined as general government budget balance minus (1) interest expenditures, (2) cyclical revenue developments, (3) cyclical expenditure developments, and (4) temporary measures.

7 The impact of discretionary revenue measures and the cyclical elements of unemployment benefit expenditures; see footnote 3.

Figure 1: Comparison of fiscal adjustment requirements, European Commission reference guidance and the MTFSPs



Source: Bruegel based on https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/national-medium-term-fiscal-structural-plans_en. Note: only countries that received a reference trajectory and submitted their MTFSPs are included. The solid line from the bottom left corner to the top right corner indicates equal values on the horizontal and vertical axes. Thus, whenever a dot is on this line, the MTSFP value matches the value from the Commission's prior guidance.

Thus, based on the net-expenditure growth path, which is the only indicator for assessing compliance with the new framework, nine countries that received a reference trajectory comply fully with the Commission's prior guidance. For three countries, the deviations are relatively minor, leaving only one country, Finland, with significantly higher proposed expenditure growth than the Commission's recommendations.

This indicates a promising start for the new fiscal framework. However, when looking into the details, some risks become apparent.

Panel B of Figure 1 reports the end-of-adjustment period SPB, a pivotal element of the framework. The EU rules (see footnote 1) require that after the end-of-adjustment period, debt ratios that exceed 60 percent of GDP must decline with at least a 70 percent probability and under pre-specified deterministic stress scenarios involving lower growth, higher interest rates and weaker primary balances, when “*there are no further budgetary measures*”. This requirement is operationalised in the Commission's DSA by assuming that the end-of-adjustment period SPB remains constant over the subsequent ten years, with adjustments only for changes in population ageing-related costs.

For the end-of-adjustment period SPB target, fewer countries align with the Commission's prior guidance. France, Malta, Portugal, Romania, Slovakia and Slovenia aim for SPB levels that meet or exceed the recommendations. Italy (0.1 percent of GDP) and Poland (0.26 percent) show relatively small gaps. However, significant shortfalls are evident in other plans. The largest gaps are observed for Finland (2.2 percent of GDP) and Hungary's initial plan (1.1 percent), while Spain (0.35 percent) and Greece (0.3 percent) and Poland (0.26 percent)

have smaller gaps⁸. The revised Hungarian plan raised the SPB target slightly above the reference trajectory's value.

To interpret the differences in adjustment compliance in terms of net-expenditure growth and SPB adjustment, it is useful to recall the formula used by the European Commission (2024a) to translate an SPB target into a net expenditure growth target:

Nominal net primary expenditure growth = (yearly) potential GDP growth + inflation (as measured by the GDP deflator) – required change in the SPB / primary expenditure-to-GDP ratio.

Thus, by assuming higher growth or inflation than what is included in the reference trajectory, a country can achieve the same expenditure growth with a lower fiscal adjustment in terms of the SPB. This outcome is intuitive: faster economic growth improves public-debt sustainability by increasing GDP and tax revenues, while simultaneously lowering the debt-to-GDP ratio due to a higher denominator. These effects reduce the fiscal adjustment required to bring down elevated debt levels.

Before analysing macroeconomic assumptions, we confirmed that the Commission, along with several countries, adhered to the formula noted above. However, there are notable exceptions.

Among the 22 countries that have submitted their MTFSPs, Croatia, Cyprus, Greece, Hungary, Ireland, the Netherlands and Slovakia included a lower net-expenditure path throughout the adjustment period than what the formula prescribes. France, Italy and Poland deviate from the prescribed path in 2025 but broadly align with it in subsequent years⁹. Denmark included a higher net expenditure path than what the formula prescribes.

There could be two reasons for net-expenditure growth being lower than permitted by the formula. First, it may reflect prudent planning if it is based on the assumption of an elasticity of revenue to GDP of less than one – meaning that a one percent increase in GDP is expected to result in less than a one percent increase in revenues. However, among the countries listed in the previous paragraph, only Cyprus, Greece and Italy adopted a lower elasticity. Second, it could indicate a greater fiscal adjustment, as the share of net expenditure in nominal GDP is projected to decline gradually, thereby increasing the primary balance. However, none of the countries with a lower expenditure path than that required by the formula planned a higher end-of-adjustment-period SPB than what is included in the reference trajectory (Figure 1, panel B). Thus, the second possible explanation cannot explain the discrepancy, which therefore remains a puzzle for a number of countries.

4 Differences in macroeconomic assumptions

Most countries deviated from the underlying assumptions of the prior guidance. This suggests significant disagreements among countries over the common methodologies for macroeconomic projections. Only Malta applied the same assumptions as the Commission for all eleven indicators summarised in Table 1.

8 There is also a 1.1 percent gap for Cyprus. However, the Commission's reference trajectory did not require Cyprus to implement a fiscal adjustment; instead, it would have permitted Cyprus to pursue an expansionary fiscal policy while still meeting all requirements. Despite this, the Commission chose not to indicate fiscal expansion in the reference trajectory, opting instead for an unchanged SPB. As a result, the lower SPB target in Cyprus's plan, compared to the reference trajectory, still complies with the requirements of the new framework.

9 The initial French plan opted for zero net-expenditure growth in 2025 to frontload fiscal adjustment, while the Polish plan aligned its 2025 net-expenditure path with the projections in its draft budget. Still, the net-expenditure paths in both plans remain inconsistent with their respective growth, inflation and fiscal-adjustment projections.

For the other countries, in some cases, the Commission assessed that deviations were well justified (number 2 with light blue colour in Table 1), while in some other cases, the Commission assessed that these deviations were largely irrelevant from the perspective of fiscal adjustment (number 3 with grey colour in Table 1). Some of the justified deviations resulted from updated data, since the Commission encouraged countries to base their plans on most recently available information compared with the prior guidance issued in June 2024.

Unjustified deviations in one or two indicators were detected for five countries (Croatia, Cyprus, France, Greece and Latvia). Hungary's initial plan likely included several unjustified deviations. However, the Commission did not publish an assessment of this initial plan. The revised plan was assessed as compliant with nine of the eleven indicators, while the deviations on the remaining two were deemed justified.

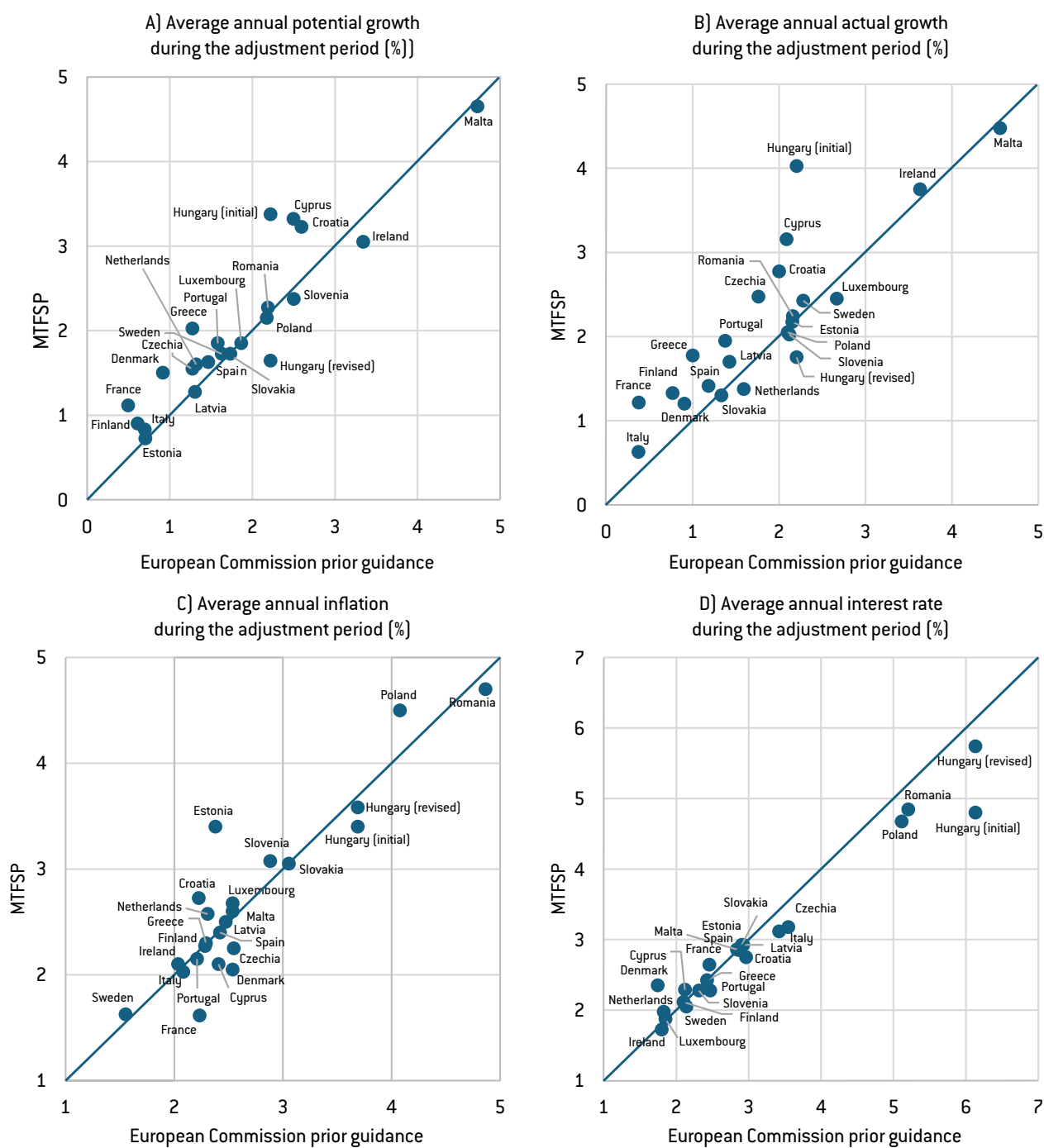
Table 1: Overview of deviations from Commission assumptions

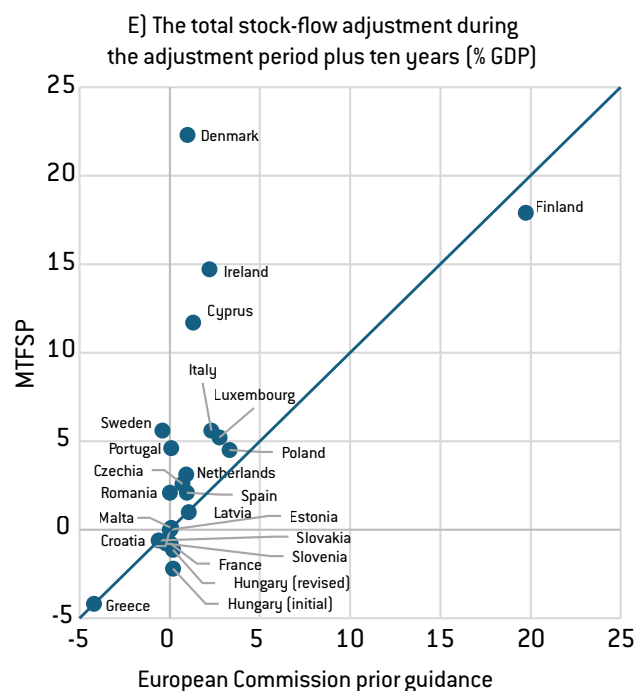
| Country | SPB in 2024 | Potential GDP growth | Actual GDP growth | GDP deflator growth | Interest rate | Revenue elasticity | Output gap closure | Fiscal multiplier | SFA | One-offs | Budget balance elasticity |
|-------------------|-------------|----------------------|-------------------|---------------------|---------------|--------------------|--------------------|-------------------|-----|----------|---------------------------|
| Croatia | 2 | 1 | 2 | 1 | 2 | 4 | 4 | 4 | 4 | 4 | 4 |
| Cyprus | 2 | 1 | 1 | 3 | 3 | 2 | 3 | 4 | 4 | 4 | 4 |
| Czechia | 2 | 2 | 3 | 2 | 2 | 3 | 4 | 3 | 3 | 4 | 4 |
| Denmark | 2 | 2 | 3 | 2 | 3 | 4 | 4 | 2 | 2 | 2 | 4 |
| Estonia | 2 | 4 | 2 | 2 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Finland | 3 | 2 | 4 | 4 | 4 | 4 | 4 | 4 | 2 | 4 | 4 |
| France | 2 | 1 | 3 | 2 | 3 | 4 | 3 | 3 | 3 | 3 | 3 |
| Greece | 2 | 1 | 4 | 4 | 4 | 2 | 4 | 4 | 4 | 3 | 4 |
| Ireland | 2 | 2 | 3 | 2 | 3 | 4 | 3 | 4 | 3 | 3 | 4 |
| Italy | 2 | 2 | 2 | 4 | 3 | 2 | 3 | 3 | 3 | 3 | 4 |
| Latvia | 1 | 3 | 3 | 3 | 3 | 4 | 4 | 4 | 3 | 4 | 4 |
| Luxembourg | 2 | 3 | 3 | 2 | 3 | 4 | 3 | 4 | 3 | 4 | 4 |
| Malta | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Poland | 2 | 3 | 3 | 2 | 2 | 4 | 4 | 3 | 3 | 4 | 4 |
| Portugal | 3 | 2 | 3 | 3 | 3 | 4 | 4 | 4 | 3 | 4 | 4 |
| Romania | 2 | 2 | 3 | 2 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Slovakia | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| Slovenia | 3 | 2 | 3 | 2 | 3 | 4 | 4 | 4 | 4 | 3 | 4 |
| Spain | 3 | 2 | 3 | 2 | 3 | 3 | 3 | 4 | 4 | 4 | 4 |
| Sweden | 2 | 2 | 4 | 3 | 3 | 4 | 4 | 4 | 4 | 3 | 4 |
| Hungary - revised | 2 | 4 | 4 | 2 | 4 | 4 | 4 | 4 | 4 | 4 | 4 |

Source: Bruegel based on European Commission assessments. Note: codes used: 1 - unjustified deviation; 2 - justified deviation; 3 - irrelevant deviation; 4 - no deviation/ no mention. The Netherlands is not included because the Commission's evaluation did not include the section 'Macroeconomic assumptions of the plan'.

We take a closer look at the five main economic assumptions underlying the DSA: potential GDP growth, actual GDP growth, inflation, interest rates and the so-called stock-flow adjustment (SFA). While the first four are standard economic variables, the SFA requires some clarification. In principle, the debt at the end of a year should be the sum of the debt at the end of the previous year and the budget deficit during the year. However, certain transactions, such as financial operations, valuation effects and statistical discrepancies can result in differences (see further details in the annex).

Figure 2: Comparison of five main DSA input variable assumptions in the European Commission's reference guidance and the MTFSPs





Source: Bruegel based on https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/national-medium-term-fiscal-structural-plans_en. Note: the solid line from the bottom left corner to the top right corner indicates equal values on the horizontal and vertical axes. Thus, whenever a dot is on this line, the MTSFP value matches the value from the Commission's prior guidance. The interest rate refers to the average interest rate on public debt, called 'implicit interest rate' in the jargon.

4.1 Potential and actual growth

The reference trajectory outlook was derived using the EU's commonly agreed methodologies¹⁰, yet several countries proposed GDP growth outlooks that exceeded the assumptions in the reference trajectory (Figure 2, panels A and B). Among these, Hungary's initial plan stood out with the largest gap: its MTSFP forecasted an average annual GDP growth rate of 4.0 percent, compared to the 2.2 percent assumed in the reference trajectory. Had the Commission published its evaluation of the initial Hungarian plan, it would most likely have concluded that the growth forecasts were excessive. The revised plan lowered the growth forecast to 1.8 percent, below the reference trajectory's 2.2 percent value. Other countries, including Cyprus, Finland, France, Greece, Italy, Portugal, Romania and Spain, also projected faster growth than the EU's methodological projections. Among the nine countries that did not receive a reference trajectory, five assumed faster growth than what the EU's methodology suggests.

Transitional provisions in the EU rules¹¹ allow EU countries to “use more stable series than the ones resulting from the commonly agreed methodology, provided that such use is duly justified by economic arguments and that the cumulated growth over the projection horizon remains broadly in line with the results of that methodology”. Finland applied this provision by assuming the same average potential growth rate over the 17-year projection horizon (the seven-year adjustment period plus 10 additional years). Subsequently, the Commission determined that Finland's deviation from the reference trajectory was justified. Growth assumptions were also found to be compliant in Italy, Spain, Romania and Slovenia. In contrast, for France, Cyprus and Greece, the Commission found the growth projections to be overly optimistic (Table 1).

¹⁰ See Darvas *et al* (2023) for a summary of the EU methodologies used to make these projections.

¹¹ Article 36(f) of EU Regulation 2024/1263; see footnote 1.

4.2 Inflation

The inflation assumptions in nine plans align closely with the reference trajectory assumptions. However, some countries deviate from these benchmarks: Poland and Slovenia assumed higher inflation, while France and Hungary projected lower inflation than the reference values.

In some cases, the impacts of deviations on the DSA counterbalance each other. For instance, France projects higher growth but lower inflation, resulting in a nominal GDP growth trajectory similar to the reference path.

4.3 Interest rate

Similarly, interest rate projections in most plans are broadly consistent with the reference trajectory assumptions, with notable exceptions. Hungary's initial plan was also overly optimistic in this regard, as it anticipated a significantly lower interest rate, 1.3 percentage points below the reference trajectory on average from 2025 to 2028, but the revised plan narrowed the gap to 0.4 percentage points. Poland and Romania also projected lower interest rates, by approximately 0.4 percentage points.

4.4 Stock-flow adjustment

There are also significant deviations in the stock-flow adjustment (SFA) assumptions compared to the reference path. The Commission assumed relatively small SFAs up to two years ahead for 24 countries, yet for three specific cases, Finland, Greece and Luxembourg, the reference guidance included SFA projections for two decades ahead.

Twelve countries projected higher values than the Commission's reference trajectory – some significantly so – while six countries adopted the Commission's value, and four countries assumed somewhat lower values. Finland and Hungary's initial plans projected SFAs approximately 2 percentage points of GDP lower, and Slovenia assumed an SFA 0.8 percentage points of GDP lower, which enhances the debt sustainability projections for all three countries. For Finland, reducing the SFA from 20 percent of GDP to 18 percent appears less significant, given that Finland planned by far the highest SFA adjustment among all countries (Figure 2, panel E). In Hungary's initial plan, however, lowering the SFA from zero to minus two percent may have been seen as another overly optimistic assumption, which was later revised upwards in the updated plan.

In contrast, six reference trajectory countries (Cyprus, Italy, Poland, Portugal, Romania and Spain) and six other countries (Czechia, Denmark, Ireland, Luxembourg, the Netherlands and Sweden), anticipated higher SFAs than the reference trajectory, some quite substantially. This means that for a given fiscal adjustment in SPB terms, the debt ratio at the end of the ten-year period following the adjustment period compared to that projected by the European Commission is expected to be between 1 percent and 10.4 percent of GDP higher for the six reference trajectory countries, and between 2 percent and 21 percent higher for the six other countries. If these countries are correct with their SFA assumptions, this also means that the Commission should have required somewhat higher end-of-adjustment-period primary balances and net-expenditure growth to comply with the DSA criteria. The additional annual fiscal adjustment requirement in terms of the SPB is much smaller than the increase in the debt ratio and depends on the timing of SFA adjustments. For example, if SFAs emerge only during the adjustment period, then a total SFA of 10 percentage points of GDP could imply an increase of about 0.1 percent of GDP in the SPB target for most countries. However, if positive SFAs also occur throughout the ten-year post-adjustment period as well, a somewhat higher increase in the SPB would be required. This might extend the period before the public debt ratio falls below the 60 percent of GDP benchmark and thus the respective countries will remain subject to the safeguards until then.

The higher SFA assumptions in the twelve plans compared to the Commission's prior guidance suggest that the respective EU governments took an honest approach in designing their plans. They could have opted for the lower SFA suggested by the Commission, which

would have implied less fiscal adjustment. Instead, they chose to incorporate higher SFA assumptions, some of which are much higher, meaning they must plan for somewhat greater fiscal adjustments.

5 Public investment

One of the main objectives of the fiscal framework as updated in April 2024 is to safeguard public investment during fiscal consolidation, as past consolidation efforts often led to cuts in public investment. The framework incentivises investment by allowing an extension of the fiscal adjustment period from four to seven years, thereby easing the pace of consolidation. To qualify for this extension, governments must propose reforms and investments that, “*as a general rule, taken altogether*”, foster economic growth, enhance fiscal sustainability, align with common EU priorities, address relevant European Semester country-specific recommendations and result in an increase in nationally financed investments.

5.1 The nationally financed public investment rate is projected to be cut in more than a third of countries

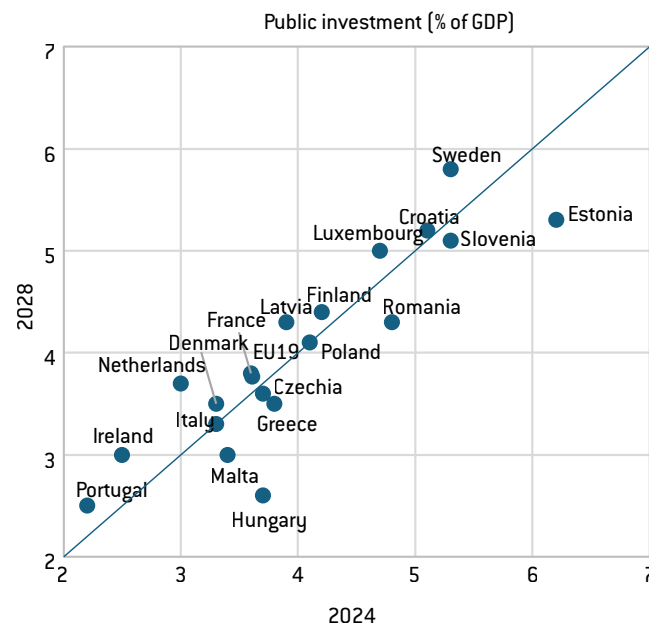
The Commission found that EU countries “*have set out in their Medium-Term Plans that they will maintain or increase investment over the plan horizon*” (European Commission, 2024b, page 4). However, we find this conclusion exaggerated, as more than a third of the EU countries that reported projections for nationally financed public investment as a share of GDP actually planned reductions.

Three of the 22 countries (Cyprus¹², Slovakia and Spain) did not report nationally financed investment projections up to 2028. Among the 19 countries that did report investment plans up to 2028, ten plan to increase their public investment rate, two expect it to remain unchanged, and seven anticipate a reduction between 2024 and 2028 (Figure 3). We compare 2024 (the last year before fiscal adjustment begins under the new fiscal framework) with 2028 (the last year of the plans) to assess whether public investments are maintained or reduced during the upcoming fiscal consolidation period¹³.

12 Cyprus reported zero nationally financed public investment in all six years from 2023 to 2028, which must be an error. The *Erratum to the annex of the Cyprus medium-term fiscal-structural plan* published on 3 February 2025 did not include information about the nationally financed public investment either.

13 Graph 1 on page 13 of European Commission (2024c) included a chart that compares 2023 with the average for 2025–2028, citing the “*European Commission 2024 autumn forecasts*” as its source. This chart includes data for the three countries (Cyprus, Slovakia and Spain) that did not report nationally financed investment projections up to 2028 in their MTFSPs. In our analysis, we compare 2024 with 2028 and rely on investment plans reported in the MTFSPs.

Figure 3: MTFSP projections for nationally financed public investment as a share of GDP, 2024 and 2028



Source: Bruegel based on the MTFSPs. Note: Cyprus, Slovakia and Spain did not report projected public investment for 2028 and are not included in the figure. For Hungary, there was no indication of whether the revised plan also changed the public investment outlook, so we only show the initial plan for this country.

Among the five countries that requested extensions to seven-year adjustment periods, Spain did not include public-investment forecasts for 2028, the final year of its plan¹⁴, though the Commission’s assessment reported such numbers citing the source “*Medium-term fiscal structural plan of Spain and Commission’s calculations*”. For the other four countries that requested an extension, only the MTFSP was cited as a source in the Commission’s evaluation. For Spain, the Commission suggested 2.7 percent in 2028, the same value as in 2024. Finland and France projected a slight increase in the investment rate from 2024 to 2028, Italy expects its rate to remain unchanged at 3.3 percent of GDP, while Romania plans a reduction from 4.8 percent to 4.3 percent of GDP over the same period (Table 2). The Commission concluded that all five countries met the requirement “*to maintain the nationally financed investment levels realised on average over the period covered by the recovery and resilience plan*”¹⁵.

Table 2: Nationally financed public investment as a share of GDP in the five countries that requested adjustment period extensions

| | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 |
|---------|------|------|------|------|------|------|------|------|------|
| Finland | 4 | 4.2 | 4.7 | 4.5 | 4.6 | 4.4 | NA | NA | NA |
| France | 3.5 | 3.6 | 3.9 | 4.0 | 3.9 | 3.8 | 3.7 | NA | NA |
| Italy | 2.9 | 3.3 | 3.1 | 2.9 | 3.3 | 3.3 | 3.2 | NA | NA |
| Romania | 3.2 | 4.8 | 5.3 | 5.6 | 4.8 | 4.3 | 4.1 | 3.6 | 3.2 |
| Spain | 3 | 2.7 | NA | NA | NA | NA | NA | NA | NA |

Source: Bruegel based on the MTFSPs.

14 Note that, somewhat counterintuitively, the regulation sets the horizon of all plans to four years, even when the adjustment period is extended to seven years.

15 As stipulated in Article 36(1(d)) of Regulation (EU) 2024/1263; see footnote 1.

5.2 Countries planning greater fiscal adjustment also plan to reduce public investment more

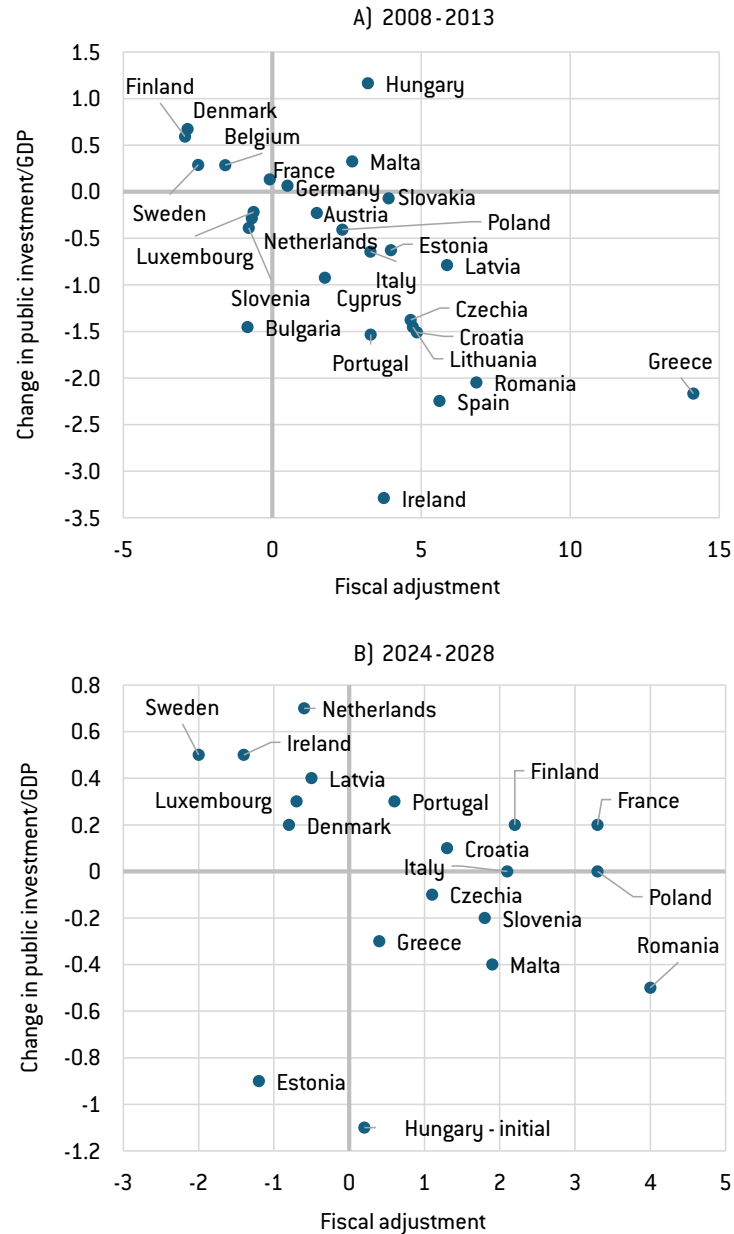
In the aftermath of the 2008 global financial crisis and the euro crisis of the early 2010s, EU countries that implemented larger fiscal adjustments tended to cut public investment more significantly (Figure 4, panel A). A similar pattern is evident in the MTFSPs: countries planning greater fiscal adjustment also plan to reduce public investment more (Figure 4, panel B).

There are three notable exceptions to this trend: Estonia, Hungary's initial plan and France. Estonia had the highest nationally financed public investment rate in 2024, at 6.2 percent of GDP (Figure 3), which may explain a reduction in its investment rate despite the expected fiscal expansion. Hungary's initial plan, meanwhile, did not include significant fiscal adjustment (in terms of the SPB) and this plan was based on overly optimistic assumptions. The revised plan does include fiscal consolidation amounting to 2.2 percent of GDP from 2024 to 2028, and the underlying macro assumptions were modified to approximate the reference trajectory assumptions, making the initial plan's association irrelevant. Unfortunately, the revised plan does not provide indications of changes in public investment, preventing us from incorporating its data. France is also an outlier, as the country intends to implement one of the largest fiscal consolidations and some increase in the public investment rate.

Cross-country regressions suggest that the intentions embodied in the MTFSPs represent an improvement compared to actual outcomes following the global and euro-area crises, with smaller cuts to public investment now than in the past for a given fiscal consolidation effort. During the earlier episode, a one percentage point increase in the SPB was associated with a 0.18 percentage point decline in the public-investment rate (based on data from 27 EU countries). In contrast, according to the current plans, the projected decline over the next four years is about one-third lower at 0.13 percentage points of GDP after a one percentage point increase in the SPB (based on data from 17 EU countries including France but excluding Estonia and Hungary).

Monitoring actual public-investment developments in the coming years, in light of the intentions expressed in the plans, will be essential to assess whether the risk of public investment cuts during fiscal consolidation episodes – highlighted by Darvas and Wolff (2023) and Darvas *et al* (2024b) – has been mitigated under the new fiscal framework.

Figure 4: Fiscal adjustment is still related to the change in public investment



Source: Bruegel based on the MTFSPs. Note: the vertical axis in panel A represents the change in total public investment from 2008 to 2013, whereas in panel B it is the nationally financed public investment from 2024 to 2028, expressed as percent of GDP in both cases. The horizontal axis represents the change in the structural primary balance (% of GDP) from 2008 to 2013 in panel A, and from 2024 to 2028 in panel B. For Hungary, there was no indication whether the revised plan also changed the public investment outlook, so we only show the initial plan for this country in panel B.

5.3 Public investment outlook

Taken together, for the 19 countries¹⁶ that reported investment plans up to 2028 in their MTFSPs, nationally financed public investment is intended to rise slightly from 3.61 percent of GDP in 2024 to 3.77 percent in 2028.

Forecasts made by the European Commission in November 2024 and the Organisation for Economic Co-operation and Development in December 2024 – for the period up to 2026 – also predict only a minor increase in public investment rates (Table 3). Similarly,

¹⁶ These 19 countries account for 59 percent of EU GDP.

small changes are projected for private investment, with the Commission expecting a slight increase and the OECD forecasting a slight decline over the same period.

Overall, it is good news that at the aggregate EU level, public investment is not expected to be cut in the coming years. However, the modest increases planned in the MTFSPs and forecasted by the European Commission and OECD suggest that public investment will not play a significant role in closing the EU's investment gaps.

Table 3: Investment forecasts for the EU (% GDP)

A) November 2024 European Commission forecast for 27 EU countries

| | 2023 | 2024 | 2025 | 2026 |
|---------|-------|-------|-------|-------|
| Public | 3.53 | 3.66 | 3.76 | 3.77 |
| Private | 18.51 | 17.66 | 17.62 | 17.77 |
| Total | 22.05 | 21.32 | 21.38 | 21.54 |

B) December 2024 OECD forecast for 24 EU countries

| | 2023 | 2024 | 2025 | 2026 |
|---------|-------|-------|-------|-------|
| Public | 3.53 | 3.68 | 3.77 | 3.86 |
| Private | 18.55 | 17.64 | 17.47 | 17.53 |
| Total | 22.08 | 21.32 | 21.25 | 21.39 |

Source: European Commission (2024b) and OECD (2024). Note: investment is defined as gross fixed capital formation. The OECD does not provide forecasts for Bulgaria, Cyprus and Malta.

6 Appraisal

Several features of the MTFSPs and the Commission's evaluation suggest that the new fiscal framework has had a promising start:

The net expenditure paths in the MTFSPs are closely aligned with the prescriptions of the reference trajectories, indicating that countries plan to implement the necessary fiscal adjustments.

The MTFSPs and the deficit-based excessive deficit procedures (EDPs) were evaluated jointly and consistently, ensuring that the deficit-based EDP does not become a loophole that allows lower fiscal adjustment than what the DSA requires for the MTFSPs (see section 2; Pench, 2024).

The evaluation process successfully identified two plans that were largely non-compliant with the regulation: the Netherlands, which projected an increase in its public debt ratio from below 60 percent of GDP to over 70 percent, and a rise in the budget deficit from below 3 percent of GDP to 4 percent; and Hungary, which initially submitted a plan based on overly optimistic assumptions and did not include fiscal adjustment in terms of the SPB.

Some aspects of the plans suggest that many EU countries approached the drafting process with sincerity. For example, several countries incorporated higher stock-flow adjustments than those proposed by the Commission and opted for a lower revenue elasticity to GDP growth than the Commission's unitary assumption, making fiscal adjustments more demanding. Additionally, the plans acknowledge that greater fiscal consolidation often comes with greater cuts to public investment.

However, the assumptions made by EU countries in their MTFSPs frequently deviate from those underlying the Commission reference trajectories, which involves some risks. In particular, the plans often include more optimistic growth assumptions, while some plans

foresee lower interest rates. Since the implementation of fiscal strategies will depend solely on compliance with the approved net-expenditure paths, one could argue that deviations in the underlying assumptions are less critical, because the net-expenditure path calculated by the Commission is already aligned with the required fiscal adjustments based on the commonly agreed methodology for deriving these assumptions. For instance, even if a country adopts an overly optimistic growth outlook, it may not pose a problem if those optimistic projections do not materialise, as the reference trajectory and thus the approved net-expenditure path was grounded in more realistic growth assumptions and will deliver the required fiscal adjustment. However, if a country plans for higher growth but growth turns out to be lower, then budget revenues will also be lower, leaving fewer fiscal resources for public spending relative to the plan. Such a situation might lead to political tensions and may necessitate mid-course corrections that bring political and economic challenges.

The discrepancies in the underlying assumptions have broader implications for the effective functioning of the new fiscal framework.

First, these deviations suggest significant disagreements between countries and the Commission on the common methodologies for macroeconomic projections. Since macroeconomic projections are central to the fiscal framework, particularly the DSA, such disagreements could undermine the framework's credibility and hinder its smooth implementation at a later stage when the adequacy of the Commission's forecasts and national forecasts can be compared. To address this, it is essential to revise and improve the methodology, fostering a stronger consensus among all stakeholders.

Second, the frequent positive deviations of growth assumptions from the trajectory based on the common methodology might reflect countries' expectations that their planned reforms and investments will boost growth – yet unfortunately, the plans are not always clear on which reforms are taken into account in their projections and which ones are not. Currently, planned reforms and investment matter only for assessing whether the adjustment period can be extended from four to seven years, but these planned measures do not influence the growth path in the reference trajectory. As highlighted by Darvas *et al* (2024a), this is a sub-optimal practice and the EU currently lacks a single methodology to quantify the growth impact of planned reforms. In the absence of a single methodology, countries often rely on their own methodologies or make various assumptions without supporting calculations. Developing a common methodology for assessing the growth impact of reforms is crucial for ensuring consistency and comparability across EU countries.

Third, stock-flow adjustments (SFAs) to the public debt stock often receive insufficient attention, despite their significant implications for public-debt development. In the Commission's reference trajectory projections, relatively small SFAs are included for 24 EU countries, and these are projected only one or two years ahead, with Finland, Luxembourg and Greece being the only countries with projections extending for two decades¹⁷. However, the cumulative impact of 1998-2024 SFAs on the debt ratio was positive for almost all EU countries and raised the debt ratio by at least ten percent of GDP for 16 countries (see the annex). Moreover, several MTFSPs included higher SFAs than the Commission's assumptions, extending beyond two years. Therefore, the Commission's current practice of considering SFAs for only three countries for longer horizons should be extended to all EU countries, and the methodology behind SFA projections should be clarified.

Achieving consensus on these three foundational elements – macroeconomic projections, growth impacts of reforms and SFA methodologies – is vital to ensure that the DSA

17 Finland's projected SFA is about 20 percent of GDP over the next two decades. This largely reflects the prudent practice of accumulating pension system surpluses as assets to finance future pensions, which enhances the sustainability of the public pension system, and thereby public debt sustainability. However, Finland faced the highest end-of-adjustment-period SPB target according to the Commission's prior guidance (Figure 1, panel B) due to the debt safeguard provision (Article 7 of EU Regulation 2024/1263). Without the debt safeguard, Finland's target SPB would be by about 3 percentage points of GDP lower. This reflects the absurdity of the debt safeguard, which requires a harsh fiscal adjustment from a country that improved its debt sustainability.

and the fiscal framework are robust, credible and widely accepted. Such enhancements will strengthen the framework's effectiveness in guiding fiscal policy across the EU.

Finally, the EU faces major investment gaps, which should primarily be addressed through private investment, but public investment must also play a role. One of the main objectives of the fiscal framework is to incentivise public investment. However, past fiscal consolidation episodes have often led to cuts in public investment, and according to the MTFSPs more than a third of EU countries plan to reduce nationally financed public investment over the next four years. Greater planned fiscal adjustments tend to be associated with deeper cuts to public investment. Among the 19 countries that disclosed investment plans, public investment as a share of GDP is projected to rise by less than 0.2 percentage points from 2024 to 2028. This modest planned increase, combined with the minor growth in public investment forecasted by the European Commission and the OECD, suggests that public investment is not expected to play a significant role in closing the EU's substantial investment gaps, and investment might fall after the expiry in 2026 of NextGenerationEU, the EU's post-pandemic initiative that has provided significant economic recovery funding.

Identifying alternative approaches to boost public investment, such as creating an EU fund financed through borrowing as a successor to NextGenerationEU, is essential to addressing the significant investment gaps facing the EU.

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Annex: A closer look at stock-flow adjustments

In principle, the debt stock at the end of a year (D_t) should be equal to the debt stock at the end of the previous year (D_{t-1}) minus the budget surplus (or net lending/net borrowing in statistical terms, denoted as S_t):

$$(1) \quad D_t = D_{t-1} - S_t$$

where all variables are measured in current local prices. When there is a surplus ($S_t > 0$), the debt stock decreases, and when there is a deficit ($S_t < 0$), the debt stock increases. However, this expression rarely holds exactly due to various factors referred to collectively as stock-flow adjustments (SFA):

$$(2) \quad D_t = D_{t-1} - S_t + SFA_t$$

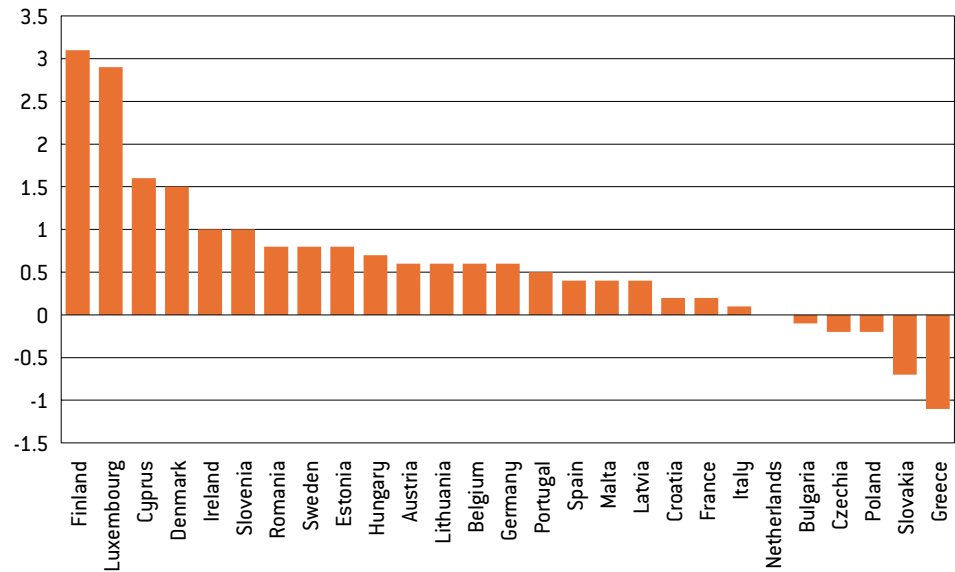
Stock-flow adjustments include three main categories (Eurostat, 2024):

- Net acquisition of financial assets: financial transactions in assets do not contribute to the deficit but result in increases or decreases in the stock of debt;
- Debt adjustment effects, which consist of: (a) transactions in liabilities excluded from the government debt definition; (b) valuation effects, such as issuances above or below nominal value, (c) changes in foreign-currency debt value due to exchange rate fluctuations or the reclassification of entities within or outside general government;
- Statistical discrepancies: these arise from differences in data sources and may indicate issues with data quality.

Graph II.2.1 of Annex II.2 of European Commission (2024a) shows that several countries experienced an average stock-flow adjustment (SFA) of at least 1 percent of GDP between 2000 and 2022, resulting in an increase in their debt ratios of over 20 percent of GDP during this period. Finland and Luxembourg stood out with an average SFA close to 3 percent of GDP, implying a cumulative SFA adjustment of approximately 60 percent of GDP from 2000 to 2022, which explains why the Commission incorporated in its projections SFAs for these two countries, as well for Greece, for two decades ahead.

Figure 5, which updates Graph II.2.1 of the European Commission (2024a) to cover a slightly longer period, confirms the existence of substantial SFA values over the past 26 years, with a general tendency for these adjustments to be positive.

Figure 5: Average annual SFA values in 1998-2024 (percent of GDP)



Source: Bruegel based on the November 2024 AMECO dataset. Note: the 2024 values correspond to Commission forecasts.

To quantify the impact of the 1998–2024 SFAs on 2024 debt levels, we decompose the change in debt from end-1997 to end-2024 using equation (2):

(3)

$$SFA_{1998-2024} = D_{2024} - D_{1997} + \sum_{t=1998}^{2024} S_t$$

where all variables are expressed in current price local currency units. To express this as a share of GDP, we divide it by the 2024 value of GDP in current price local currency units:

(4)

$$\frac{SFA_{1998-2024}}{GDP_{2024}}$$

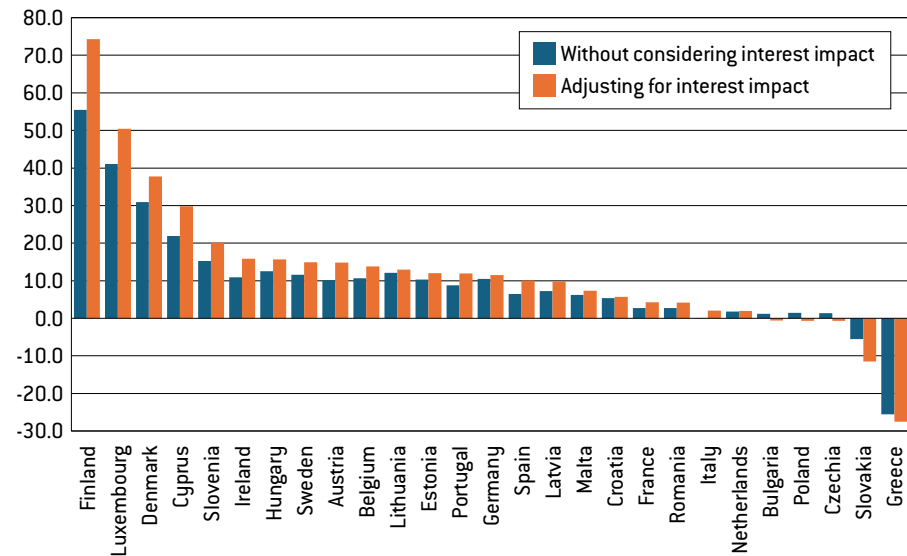
This value is plotted as the first column in Figure 6.

However, this approach underestimates the impact of SFAs on debt because, in the absence of positive SFAs, the debt level would have been lower, leading to reduced interest payments on the debt. The interest impact can be estimated by assuming that the additional debt resulting from SFAs accrued interest at the average rate applied to the total debt stock (referred to as the ‘implicit interest rate’). By calculating the extra interest payments caused by SFAs for each year from 1998 to 2024 and adjusting the budget balance to exclude these payments, we obtain the adjusted budget balance, denoted as S_t^* .

Using S_t^* , instead of S_t , in equation (3) allows us to generate an alternative estimate of the 1998–2024 SFA’s impact on the 2024 debt stock. Dividing this value by the 2024 GDP yields a second series, plotted as the second column for each country in Figure 6.

This alternative estimate might overstate the impact of SFAs (whenever SFA is positive) because it does not account for potential budget revenues linked to the net acquisition of financial assets resulting from some SFAs. Therefore, the true impact likely lies between the two estimates shown in Figure 6.

Figure 6: The impact of 1998-2024 SFAs on the 2024 debt level (percent of 2024 GDP)



Source: Bruegel based on the November 2024 AMECO dataset.

For Finland, the two estimates set a range from 55 percent to 74 percent of GDP. Given that Finland's debt ratio is projected to be 83 percent of GDP in 2024, the majority of this is attributable to SFAs.

At the opposite end of the spectrum, Greece experienced a significantly negative SFA impact, primarily because of the restructuring of Greek public debt in 2012 and further downward debt adjustments from 2013 to 2015. Excluding the Greek SFAs for the years 2012-2015, the SFAs from the remaining years would have increased Greece's 2024 debt ratio by 18 percent of GDP.

This leaves Slovakia as the only country with a cumulatively negative SFA over the 1998-2024 period. While a few countries exhibit a cumulative SFA impact close to zero, there are 16 EU countries for which SFAs during 1998-2024 raised their debt ratios by 10 percent of GDP or more, underlying that SFAs tend to increase the debt ratios of EU countries.