

European governance: the new fiscal rules and social spending¹

Catherine Mathieu and Henri Sterdyniak

On 20 December 2023, the EU Member States agreed within the Council of the European Union the reform of the European fiscal rules. On 10 February 2024, an agreement was reached with the European Parliament. This reform, announced in 2018, had given rise to intense academic, institutional and political activity. In November 2022, the European Commission proposed replacing the existing rules with a single one: each country would have to control the trajectory of its public spending so as to bring down the level of its public debt, according to a trajectory negotiated with the Commission, based on an analysis of its public debt sustainability (*Debt Sustainability Analysis*, DSA), carried out by the Commission. However, under pressure from Germany and the countries of Northern Europe, numerical fiscal constraints were reinstated. The European Parliament added clauses emphasising the need to take account of environmental and social objectives, without changing the planned procedures. Finally, the Member States (MS) will have to set themselves a target for reducing public debt in a situation where they will have to increase their military spending, their social spending in view of their ageing populations and their investment spending for the green transition. There is a great risk that the reformed rules will impose restrictive fiscal policies from 2024 onwards, to the detriment of economic activity and more important objectives (green transition, re-industrialisation, defence, development of the European social model). There is also a risk that the need to invest in defence and the green transition will lead to social protection spending being used as an adjustment variable.

In 2017, the EU adopted the European Pillar of Social Rights (EPSR), which sets ambitious objectives for social protection while respecting the autonomy of Member States. These targets require some increase in social spending (mainly on pensions and long-term care, but also, in some Member States, on health, education, unemployment, family and welfare). This may appear to contradict the objective of controlling public expenditure.

The purpose of this study is to analyse the economic and social impact of the new fiscal rules, in particular with regard to the evolution of social expenditure, and to propose governance rules that are more in line with fundamental European objectives. The first part describes the new rules of European governance. The second part analyses, for the largest EU countries, the social protection needs resulting in particular from the EPSR. The third part proposes the integration of social requirements into the DSA in order to define fiscal policies that are compatible with social and environmental requirements. This will undoubtedly require an increase in social contributions and in taxation on the income of the wealthiest individuals and on large companies.

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Part I: The reform of European fiscal rules

Before the reform

The introduction of the single currency was accompanied by the introduction of binding rules for the fiscal policies of the Member States (MS) of the euro area. Over time, these rules have been made more complex, tightened, relaxed... Member States' public deficits should not exceed 3% of GDP; public debts should not exceed 60% of GDP. Member States had to set themselves a medium-term objective: a structural deficit of less than 0.5% of GDP if their public debt exceeded 60% of GDP, or 1% of GDP if it was lower. Convergence towards this objective had to take place at a rate of more than 0.5% of GDP per year, measured by the reduction in the primary structural deficit as calculated by the Commission. Countries with a debt of more than 60% of GDP had to reduce it at a rate of one twentieth of the difference in this ratio per year. The growth rate of primary public expenditure (adjusted for structural changes in public revenue) could not exceed the growth rate of potential GDP (as estimated by the Commission). Member States were required to set up independent fiscal institutions (IFIs) to monitor compliance with these rules. Failure to comply with these rules would lead to an Excessive Deficit Procedure (EDP), which could theoretically result in a fine, but this has never happened.

For some economists and some countries, notably Germany and the Nordic countries, these rules were essential to prevent certain countries from using the protection of the single currency to pursue inflationary or unsustainable fiscal policies to the detriment of their partners and the stability of the euro area. For other economists and countries, these rules have imposed constraints that are incompatible with the need for macroeconomic stabilisation and public investment and have been responsible for the weak recovery in the euro area following the 2008 financial crisis².. The Commission recognised the questionable nature of these rules. At the same time, it had only the power to advise and to impose sanctions (the main sanction, in fact, being the rise in interest rates provoked by the markets after its critics). It agreed to move towards better rules, provided that its supervisory powers were strengthened.

In 2018, the Commission committed to propose a reform of the EU's economic governance framework in 2020. A huge creativity contest was then launched to propose new and more satisfactory rules (see Mathieu and Sterdyniak, 2021). A certain consensus emerged: the rules should above all guarantee the sustainability of public debt; each Member State should make a commitment on the evolution of its primary public expenditure (excluding expenditure on unemployment benefits, net of structural public revenue measures); this commitment, monitored by the Commission, should guarantee a decline in its debt ratio. However, the plans differed on crucial points (whether or not to include public investment; whether or not to converge more or less quickly towards a higher or lower public debt target). This consensus perpetuated dubious features: the priority given to the reduction of the debt ratio towards an arbitrary target; a commitment to the evolution of public finances that did not take account of the economic situation; a technocratic control by the Commission.

² There is a clear contrast between the United States (public deficit of 8.4% of GDP in 2023, but per capita GDP growth rate from 2007 to 2023: 18.7%) and the eurozone (public deficit of 3.6% of GDP in 2023, but per capita GDP growth rate from 2007 to 2023: 9.1%).

As a result of the pandemic, followed by Russian aggression against Ukraine, the fiscal rules were suspended for four years (from 2020 to 2023); their reform was postponed until 2024. In 2023, 12 of the 27 Member States had a public deficit above 3% of GDP; only 8 had a structural deficit below 1% of GDP; 12 had a debt above 60% of GDP, of which 6 exceeded 100% (Annex 1). The experience of 2011-13 shows that it would be counterproductive to ask them to get back on track quickly. There is a lot of uncertainty about potential output, which makes the re-implementation of fiscal rules even more problematic. In addition, the green and digital transition and re-industrialisation require a sharp increase in public spending, especially public investment. The ageing population and the EU's social ambitions make an increase in social spending desirable (High Level Group, 2023).

Difficult negotiations

In October 2021, the European Commission (European Commission, 2021) launched a consultation process on the reform of European economic governance. Germany and a coalition of so-called "frugal" countries (led by Austria and including the Netherlands, Finland, Slovakia, the three Baltic states, Denmark, Sweden and the Czech Republic) called for a return to strict, effectively enforced rules requiring public debt to be reduced to around 60% of GDP. The current rules are "necessary and reasonable... sound public finances are a central pillar of EU membership and a foundation of EMU... reducing excessive debts must remain a common goal... the sustainability of public debts must be ensured in anticipation of future shocks" (Blümel *et al.*, 2021).

Countries such as Spain, France and Italy wanted flexible rules that would allow countercyclical policies and would not impose austerity policies after 2023. The public debt constraint should be relaxed, for example by raising the limit to 90% (the eurozone average in 2023) and by giving Member States more time to return to this level. Above all, certain categories of spending should be excluded from the fiscal rules: investments that increase potential growth (including education and research spending), green transition spending, and even military spending for France (joined by some Eastern European countries following Russia's aggression against Ukraine), with the risk that only social spending will remain as an adjustment variable.

In November 2022, the Commission published its reform proposal (European Commission, EC, 2022). Based on academic debates, this draft proposed to replace the existing rules with a single one differentiated by country: each Member State would have to control its public expenditure path in order to reduce the level of its public debt according to a path negotiated with the Commission. This project was opposed by Germany and the frugal countries³, who feared that bilateral negotiations between a Member State and the Commission would lead to insufficient fiscal efforts and that the objective of keeping public debt below 60% of GDP would be forgotten. They called for surveillance to be multilateral and for the principle of equal treatment of all Member States to be reaffirmed. They made sure that numerical safeguards were always included in the rules. On 20 December 2023, the Council of the European Union adopted a new version that reduced the Commission's powers in favour of the Member States and the Council and relaxed the constraints for the period 2024-2027 (European Commission, EC, 2024 a, b, c). Without altering

³ See *German technical non-paper following up on selected issues identified by the ECOFIN conclusions* or the text signed by Germany, the Czech Republic, Austria, Bulgaria, Denmark, Croatia, Slovenia, the three Baltic States and Luxembourg.

the overall balance of the draft, the European Parliament had clauses added emphasising the need to take account of environmental and social objectives in the evaluation of national programmes. The Council and European Parliament negotiators reached an agreement on 10 February 2024, which was voted on by the Parliament on 22 April 2024.

The content of the reform

The reform sets itself ambitious and contradictory objectives. It stresses the "importance of reducing debt ratios and deficits to prudent levels in a gradual, realistic, sustained and growth-friendly manner ensuring leeway for counter-cyclical policies and addressing macroeconomic imbalances, while paying due attention to employment and social objectives. At the same time, the economic governance framework of the Union should be adapted to help address the medium-and long-term challenges facing the Union such as achieving a fair digital and green transition including the climate objectives set out in Regulation (EU) 2021/1119 of the European Parliament and of the Council, ensuring energy security, supporting open strategic autonomy, addressing demographic change, strengthening social and economic resilience and sustained convergence, and implementing the Strategic Compass for Security and Defence, all of which require reforms and sustained high levels of investment in the years to come" (European Commission, EC, 2024, a, page 3).

In fact, the text contains precise and binding elements on Member States' fiscal policies and more vague commitments on investments and reforms that should both support growth and meet social and environmental objectives. It requires both a reduction in debt ratios and growth-enhancing policies. It does not allow Member States to adapt their fiscal policies to the economic situation. The fiscal criteria are not modulated to take account of public investment expenditure linked to the green transition.

The reform is defined in three texts: the coordination of fiscal policies and multilateral surveillance (EC, 2024, a), the implementation of the EDP (EC, 2024, b) and the requirement for budgetary documents (EC 2024, c).

The reform reinforces a complicated set of negotiations and technocratic procedures between the Commission, the Council, the Council of the European Union (steered by the Economic and Financial Affairs Council), the European Parliament, with opinions from the European Fiscal Board, the Independent Fiscal Institutions (IFIs), the European Economic and Social Committee, and the call for interventions from parliaments and various organisations in each MS, which is supposed to ensure national ownership of the whole.

The text maintains the 3% of GDP limit for government deficit and the 60% of GDP target for government debt, which the Commission argues are enshrined in the Maastricht Treaty and cannot be called into question without constitutional reform (EC, 2022).

A technical trajectory?

For each Member State, the Commission will carry out a debt sustainability analysis (DSA, see Annex 2). By projecting public debt over an adjustment period covered by a medium-term programme (4 years, which can be extended to 7 years) and then beyond, with unchanged taxation but taking into account the increase in net expenditure due to ageing populations, the Commission will verify that the public debt of the Member States is falling and converging towards prudent levels and that the government deficit is falling and will be maintained below 3% of GDP. Around

the reference path, the Commission will carry out stress tests and stochastic analyses to verify the plausibility of maintaining the public deficit below the 3% threshold and of the decline in the debt ratio. These will have to be ensured with a probability of more than 70 %. The medium-term plan will have to ensure that the government debt ratio is “put or kept on a plausibly downward path by the end of the adjustment period at the latest, or stays at prudent levels below 60 % of GDP over the medium-term” (EC, 2024, a). The Commission would thus define a reference path for government debt, which would then be translated into a path for net government expenditure. This trajectory would be binding only for Member States whose public debt exceeds 60% of GDP or whose public deficit exceeds 3% of GDP. It would be made available to other Member States for information purposes.

In fact, in the name of debt sustainability, the Commission is referring to an unjustified demand for continuous debt reduction towards 60% of GDP (see Annex 3). It does not take into account the economic factors that justify an increase in the public deficit or public debt. Structurally, public debt is rising in all developed countries. In the future, a higher level of debt may be necessary to finance the green transition; this may be sustainable if household savings remain high. In the event of a major shock (as in 2020), government debt rises but remains sustainable thanks to the support of the ECB.

It should be noted that these projections are still based on a questionable estimate of potential growth. They are also based on Member States' projections of the evolution of their social expenditure, under the unrealistic assumption of fixed rates of social contributions and other resources allocated to social protection.

The logic of the process inevitably leads to the recommendation of a restrictive policy. Let us assume that potential growth is estimated at 3% per year. With an initial debt of 100% of GDP, reducing the debt ratio requires a deficit below 3%, but the primary balance may be in balance if the interest rate is equal to the growth rate in value terms, or in deficit (or surplus) by 1 percentage point of GDP if the interest rate is 1 percentage point below (or above) the growth rate. Should a primary surplus target of 1 percentage point of GDP be set to guard against the worst-case scenario?

Will a stable debt-to-GDP ratio of 100% be considered sustainable, or will the rules impose a target of 60%? This would mean requiring a primary surplus of at least 2 percentage points of GDP for 20 years. Is it necessary to adopt a restrictive policy today in order to guarantee a reduction in the debt ratio for all the risks taken into account in the stress tests, without taking into account the current situation of the country?

A fiscal-structural plan

After a technical debate with the Commission, each Member State will have to present a medium-term fiscal structural plan with a four-year horizon, bringing together the current stability programmes and the national reform programmes. This plan must respect the reference path transmitted by the Commission (or, if it deviates from it, provide "solid and data-based" arguments). For countries whose debt exceeds 60% of GDP or whose deficit exceeds 3%⁴, the plan must ensure that the debt ratio follows the adjustment path agreed with the Commission, i.e. a continuous and plausible downward trajectory towards prudent levels; that the government deficit

⁴ In 2024, it would concern 16 out of 27 MS.

falls below 3% of GDP or is maintained below that level (and, possibly, that macroeconomic imbalances are corrected), initially over a four-year period on the basis of the policies envisaged, and then over a longer period on a no-policy change basis. The fiscal effort must be linear (not carried over to the end of the period). The plan will be presented in the form of a trajectory for net public expenditure.

According to its proponents, the reform would allow differentiated treatment of Member States; the debt reduction constraint would be maintained but made more credible by adjusting it to the country's starting position. Its Keynesian opponents argue that this constraint has little economic basis and does not take into account the macroeconomic situation. Neo-liberal opponents feared that the objective of convergence of the debt to 60% of GDP would be forgotten. In fact, the system was ambiguous; the notion of prudent level is ambiguous; in the absence of precise figures for the public debt target and the speed of convergence, it could be either rigorous or lax.

The regulation (EC,2024, a) states that “each Member State should present a national medium-term fiscal-structural plan setting out its fiscal path as well as priority public investments and reforms that together ensure sustained and gradual debt reduction and sustainable and inclusive growth”. *The text does not specify the content of these reforms. It forgets that the main objective should be the green transition and not growth, so that the necessary reforms should have as their primary objective the fight against climate change, possibly at the cost of some reduction in growth.*

The European Parliament added: "Those plans should also include broader reforms and investments, including in relation to common priorities of the Union, namely the green transition, including the European Green Deal and the transition to climate neutrality by 2050 and through the implementation of the national energy and climate plans submitted pursuant to Regulation; the digital transition, including the Digital Decade Policy Programme 2030; social and economic resilience and the implementation of the European Pillar of Social Rights, including the related targets on employment, skills and poverty reduction by 2030; energy security; and the build-up of defence capabilities". *We can welcome the inclusion of European objectives, including social objectives, in the review of fiscal rules; we can also fear the widening of the scope of this technocratic procedure, which pays little heed to the principles of subsidiarity and is detached from national debates,*

The Commission would be more lenient with countries that comply with its instructions: " To ensure a more gradual debt reduction, the adjustment period can be extended by a maximum of three years if the Member State underpins its national medium-term fiscal-structural plan with a set of verifiable and time-bound reforms and investments that, taken altogether, as a general rule, are growth- and resilience-enhancing; support fiscal sustainability; address the common priorities of the Union; address relevant country-specific recommendations under the European Semester, including, where applicable, recommendations issued under the macroeconomic imbalance procedure". The adjustment period would then be seven years, instead of four.

A single indicator?

Taking into account the academic debate, the various indicators would be replaced by a single one: each country would have to monitor the evolution of its "net primary expenditure financed at national level that is to say: government expenditure net of interest expenditure, discretionary

revenue measures⁵, expenditure on Union programmes fully matched by revenue from Union funds⁶, national expenditure on co-financing of programmes funded by the Union, as well as cyclical elements of unemployment benefit expenditure". *The indicator appears to be expressed in terms of public expenditure (rather than government balance) in order to encourage Member States to reduce their debt by cutting expenditure rather than raising taxes. According to its proponents, the new indicator would have the advantage of avoiding a direct role for the estimation of potential output and the structural balance, which are constructed variables that are difficult to evaluate; its evolution is controlled by the government*⁷. Member States could allow automatic stabilisers to operate on the revenue side and on unemployment benefits. They would not be able to implement discretionary policies. However, the health crisis has shown that the necessary cyclical spending goes well beyond direct spending on unemployment benefits.

The text states: "The Council, on a recommendation from the Commission, shall adopt a recommendation setting the net expenditure path for the Member State concerned (article 16) ... The Council shall, on a recommendation from the Commission, recommend that Member State concerned presents to present a revised medium-term fiscal-structural (article 17) ...The Commission shall monitor the implementation of the national medium-term fiscal-structural plan and, in particular, the evolution of net expenditure. (article 21) ...The Council is expected to, as a rule, adopt the recommendations proposed by the Commission or to publicly explain its position (article 27)". *This would give the Commission direct control over national fiscal policies. However, according to the European treaties, each country must remain the master of its own fiscal policy, even if some coordination is necessary*⁸.

A new government could present a revised plan covering a new period of 4 or 5 years, depending on the normal length of the national legislature. However, the text states: "Taking into account the past adjustment of the Member State concerned or the lack thereof, the new reference trajectory shall not backload the fiscal adjustment effort and shall, as a rule, not lead to a lower fiscal adjustment effort" (article 27).

Increased surveillance

Surveillance would be strengthened compared to the current situation. The European Semester will include " the submission, assessment and endorsement of national medium-term fiscal-structural plans of the Member States, as well as the monitoring of their implementation through the annual progress reports". It will also include " the formulation, and the surveillance of the implementation, of the employment guidelines..., including the principles of the European Pillar of Social Rights... via the social scoreboard". *It should be noted that this wording allows the European institutions to intervene more directly in the field of social protection, which, according to the Treaties, is a national competence.*

⁵ This requires distinguishing between spontaneous growth in tax revenues and new measures. In the case of income tax, for example, does spontaneous growth correspond to a fixed tax scale, indexation to prices or to average household income?

⁶ Expenditure co-financed with the EU or financed by the EU are not taken into account, which makes no economic sense, but is intended to encourage MS to shift their expenditure to the EU level. Eurostat would have to measure them.

⁷ This is not entirely true, as there is also some "over-the-counter" spending (on health and family benefits). The indicator encourages the State to monitor the finances of local authorities and social security bodies.

⁸ For France, the constitutional principle of annuities precludes a binding four-year commitment.

The Excessive deficit procedure (EDP) would not be changed for the 3% rule. It would be strengthened for countries that deviate from the projected trajectories of debt or net public expenditure, or that fail to implement announced reforms or investments. It is specified that the Commission will consider "(d) progress in implementing reforms and investment, including in particular policies to prevent and correct macroeconomic imbalances and policies to implement the Union's common strategy for growth and jobs; (e) increased public investment in defence" (EC, 2024, b).

If no action is taken under the excessive deficit procedure, the amount of the fine will be reduced to 0.05% of GDP every six months in order to ensure the credibility of the sanction. The fine will no longer be reimbursed to the MS failing to obey the rules, but will become part of the Community budget.

Derogation clauses allowing deviations from the national plan due to exceptional circumstances (either global or national) with the approval of the Council are maintained, but these deviations "provided it do not endanger fiscal sustainability in the medium term" (article 25). *This is a vague formulation: does the increase in public debt ratios from 2019 to 2022 jeopardise fiscal sustainability?*

The role of the European Fiscal Board would be strengthened but would remain purely advisory. For the time being, the Commission has abandoned its plans for a European fiscal capacity, a European Treasury or a euro area finance minister who would have closely monitored national fiscal policies (as proposed, for example, by Buti and Messori, 2022). It did not propose that the EU should take responsibility for a larger share of public spending related to the energy, green or digital transition as a continuation of the Recovery and Resilience Facility (as advocated, for example, by Recovery Watch, 2023).

The role of the Independent Fiscal Institutions would also be strengthened; they would be responsible for assessing the government's macroeconomic and budgetary forecasts, assessing debt sustainability, assessing the impact of public policies on debt sustainability and on sustainable and inclusive growth, and monitoring their compliance with the EU fiscal framework (EC, 2024, a). Its opinion would be attached to the national fiscal-structural plan sent to the Commission. However, there is no possibility for the IFIs to question or simply assess the relevance of the policies imposed by the fiscal rules.

The national parliament, social partners, local authorities and various organisations should be consulted when the Plan is drawn up. Thus, according to the Commission, the European rules should benefit from greater national ownership. This is unlikely, given their complexity and lack of economic relevance: lowering the public debt ratio is not considered a priority in most MS.

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European countries urgently need public spending for the green transition and for their industrial policies. This should not be at the expense of social spending. Neither the Commission nor the Council wanted to open the Pandora's box of special treatment for public investment. Many economists had argued that public investment, validated by the EU as part of the green transition, should be exempted from the public deficit constraint (e.g. Truger, 2015, Darvas *et al.*, 2023, b).

According to the agreement, only investments financed by the EU or co-financed by the EU and Member States are excluded from the controlled deficit. Apart from this exception, investments (including green investments) are not deducted from the controlled public deficit, nor are their accumulation deducted from the controlled public debt. Although the Commission and the Council claim that Member States need to develop their investments to boost growth, to support the green and digital transition or to strengthen defence capabilities, they refuse to allow them to relax the numerical constraints⁹. Similarly, the Parliament has insisted on the importance of the European Green Pact and the European Social Charter, again without any explicit impact on these constraints. However, the agreement stipulates that these investments and expenditures will be taken into account in the assessment of the fiscal and structural plans and in the implementation of the EDP.

Surveillance of macroeconomic imbalances would be strengthened. It would take more account of the overall situation in the EU. Some Member States could be warned if their imbalances are detrimental to the euro area as a whole. Countries subject to an MIP (Macroeconomic Imbalance Procedure) will have to indicate in their medium-term Plan how they intend to correct them. But it does not seem that this surveillance should lead to recommending more expansionary policies to Member States with excessive external surpluses, whose public surpluses harm the other Member States in the zone. It is difficult to see how the bilateral negotiations between the Commission and each Member State would take account of the overall situation in the zone.

Numerical safeguards

Fearing that the bilateral negotiations between the Commission and each Member State would result in too lax path, Germany and the *frugal* countries succeeded in having *numerical safeguards* added to the reference trajectory (EC, 2024, a):

- MS whose deficit exceeds 3% of GDP will have to reduce their structural deficit by at least 0.5 percentage points per year. Defence spending alone will be eligible for some leniency. However, from 2024 to 2027, the primary structural deficit reduction will be considered.¹⁰
- Member States whose public debt exceeds 90% of GDP (is between 60% and 90% of GDP) must reduce it by at least 1 percentage point of GDP per year (0.5 percentage points per year) on average over the adjustment period. This constraint does not apply to countries with an EDP; it only takes effect when the country's EDP is declared closed.
- Member States will have to set a structural deficit target of less than 1.5% of GDP; they will have to reduce their primary structural deficit by at least 0.4 percentage points of GDP per year to come close to this target (0.25 percentage points for countries benefiting from a 7-year adjustment period).
- A control account would be established for each Member State, accumulating the differences between actual net expenditure and that projected in the fiscal-structural plan; an EDP would be triggered if the difference exceeds 0.3% of GDP in any year or 0.6% cumulatively.

These *safeguards* have destroyed the logic of the reform proposed by the Commission. They reintroduce the structural deficit and the change in the structural deficit, the calculation of which

⁹ The proposal by Darvas *et al* (2023,b) - to not include green investments approved by the EU in the measurement of the national fiscal effort, while including the debt they generate in the debt/GDP ratio reduction constraint-was a compromise that would have left little room for manoeuvre. It was not adopted.

¹⁰ In order to allow France (and others MS struck by the increase of interest charges) to be on target.

is uncertain. The constraint refers sometimes to the structural primary deficit, sometimes to the structural deficit and no longer to net primary expenditure, which complicates the rules.

Finally, Member States would lose control over their fiscal policy, which would be put on automatic pilot and would have to commit to a restrictive policy regardless of the economic situation.

A country with a public debt of 100% of GDP and nominal growth of around 3% (3.5%) would need a nominal deficit of less than 2% of GDP (2.5%) to reduce its debt by one percentage point of GDP per year. This rule is therefore pro-cyclical.

The objective of a structural deficit of 1.5% of GDP is certainly more satisfactory than the previous objective of 0.5%, but in the medium term it would imply a primary surplus of 1.5 percentage points of GDP for a Member State with a debt of 100% of GDP and paying an interest rate of 3% on its public debt.

In the very long run, this would imply a public debt of 50% of GDP for a country with nominal growth of 3% per year. There is no guarantee that the medium-term balance is compatible with a structural deficit of 1.5% of GDP (i.e. a primary balance with a 3% interest rate on public debt) and a debt-to-GDP ratio at 50%. It should be noted that the effort required depends on the inflation rate: at a real growth rate of 4%, the very long-term government debt should be only 37.5% of GDP and the primary balance should be in surplus by 0.5 percentage points of GDP.

1.1 Primary balance requirement

	Public balance 2023	Structural balance 2023*	Primary structural balance* (A) 2023	Public debt 2023	Demo-graphic effect 2027	Primary balance requirement (B)	Required adjustments (B)-(A)/(C)-(A)	Sustainable primary balance (C)
Euro zone	-3.6	-3.6	-1.9	90.0	0.3	1.5	3.4/1.4	-0.5
Germany	-2.5	-1.7	-1.2	63.6	0.4	0.7	1.9/0.6	-0.6
France	-5.5	-5.4	-3.7	110.6	0.0	1.5	5.2/3.2	-0.5
Italy	-7.4	-8.3	-4.5	137.3	0.2	1.9	6.4/3.8	-0.7
Spain	-3.6	-4.1	-1.6	107.7	0.3	1.8	3.4/1.1	-0.5
Netherlands	-0.5	-0.8	-0.2	46.5	0.3	0.5**	**/0	-0.2
Belgium	-4.4	-4.2	-2.3	105.2	0.2	1.7	4.0/1.8	-0.5
Austria	-3.3	-2.3	-1.2	77.8	0.8	1.7	2.9/0.8	-0.4
Sweden	-0.2	0.1	0.8	31.2	-0.3	0.0**	**/-1.0	-0.2
Denmark	3.1	3.6	4.1	29.3	0.7	0.8**	**/4.3	-0.2
Poland	-5.1	-4.5	-2.5	49.6	0.7	0.9	3.4/2.0	-0.5
Romania	-6.6	-6.0	-4.4	48.8	0.5	0.9	5.3/3.7	-0.7
Czech Rep.	-3.7	-2.9	-1.6	44.0	-0.3	0.0	1.6/1.4	-0.2

*According to Commission estimates, the euro area had a positive output gap of 1.2% in 2019. Its weak growth (0.8% per year) compared to 1.2% for potential GDP would have reduced the output gap to 0 only in 2023. In fact, it can be argued that the output gap is negative, by 1.2% on average, so that the Commission overestimates the structural deficits. **Countries not concerned as their debt is below 60% of GDP and their deficit below 3%.

Source: European Commission, Ameco, Spring 2024, own calculations.

In the long run, the stabilisation of the debt ratio requires a structural primary balance of zero if the interest rate is equal to the growth rate. In fact, EU fiscal rules are more restrictive than debt stabilisation. For simplicity's sake, let us assume that the fiscal rules require countries whose debt

exceeds 90% of GDP to cut it by 1 percentage point per year, those whose debt exceeds 60% of GDP by 0.5 percentage points per year, that the interest rate is prudently assumed to be 0.5 percentage points above the growth rate and that the demographic effect is taken into account. Under these conditions, the required fiscal effort relative to the situation in 2023 was 6.4 percentage points of GDP for Italy, 5.3 for Romania, 5.2 for France, 4.0 for Belgium, 3.4 for Spain and Poland and 2.0 for Germany (Table 1.1). These efforts will have to be made within 4 or 7 years. In any case, with the exception of Sweden and Denmark, there is no room for manoeuvre for the green transition, defence spending or improving the European social model.

It should be noted that this assessment does not account for the restrictive impacts that the fiscal policies pursued in most EU countries would have if not offset by expansionary policies in countries with external surpluses and by a sharp fall in interest rates; this recessive effect would reduce substantially the improvement in government balances. For France, for example, the required fiscal restraint is 5.2 percentage points of GDP, which means 0.75 percentage points of GDP per year, if France obtains a 7-years adjustment period. However, cutting public expenditure by 1 percentage point of GDP leads, on average, to a 1% fall in GDP, with a government balance improvement of 0.5 percentage points only. Thus, an annual fiscal effort of 1.5 percentage points of GDP would be necessary to reduce the government deficit by 0.75 percentage points of GDP per year, resulting in a 1.5 percentage points lower growth rate.

It is possible to propose less restrictive numerical criteria. For example, each MS would have to stabilise its public debt ratio, but with the hypothesis that the interest rates would be 0.5 percentage points below the growth rate and that future expenditure is financed by taxes (health, family, dependency, defence, green transition) or contributions (pensions, unemployment). The sustainable primary balance is then lower, but remains generally higher than the MS balance in 2023, by 3.8 percentage points for Italy, 3.2 for France, 1.8 for Belgium and 1.1 for Spain (Table 1.1).

In several articles on Internet, Olivier Blanchard recommends setting a primary surplus target of 1 point of GDP (to stabilise the debt-to-GDP ratio, considering the recurrence of major unforeseeable crises). It suggests that the effort needed to reach this level should be limited to 0.5 percentage points of GDP per year, so as not to damage economic activity too much. In our view, a restrictive fiscal policy is only necessary in a situation of excess demand, so as not to damage activity. Fiscal fetishism (setting numerical targets for public finance ratios) should therefore be abandoned in favour of functional finance: the government balance should be managed in such a way as to ensure full employment. From this perspective, it is difficult to predict what the necessary government balance will be in the future.

Other analyses

Darvas *et al.* (2023, a) carried out a detailed simulation of the new rules proposed by the Commission. France, with a structural primary deficit projected at 2.2 percentage points of GDP in 2024, would need to achieve a 0.3 percentage points surplus in 2028 to ensure the fall in its long-term debt ratio in the central projection, of 1.1 percentage points given the uncertainty around the level of interest rates, and of 2.3 percentage points to ensure a fall in its debt ratio in 2028¹¹ as compared with 2024. The total adjustment required for France would therefore be 4.6 percentage

¹¹ This figure is relatively low because France has claimed that net pension expenditure will fall after 2030.

points over four years, compared with 4.3 percentage points for Belgium, 4.0 for Italy, 2.5 for Spain, around 1 point for Austria, Germany and Portugal and zero for Greece and Portugal, which have already made the required adjustments. In 2028, the required primary surplus would range from 3.2 percentage points of GDP for Italy, 2.7 for Portugal, 2.3 for France, 1.8 for Belgium, 1.7 for Portugal to 1 percentage point for Germany. The impact of these restrictive policies on GDP growth is not taken into account and not described in the paper; with a multiplier of 1, French growth would fall by 1.15 points a year for 4 years. This paper shows that the procedures envisaged are complicated and can hardly be the subject of a national appropriation, that they lead to imposing restrictive policies that do not account for the economic situation, in the name of an objective - guaranteeing the reduction of public debt - that is not demanded by the financial markets and the importance of which should be compared with achieving full employment or financing the green transition.

Darvas *et al.* (2024, b) update their figures, based on forecasts for 2024. They find that the adjustment will have to be 5.3 percentage points of GDP for Romania, 4.2 for Italy, 3.8 for France, 3.6 points for Spain, Finland and Spain, and 3 for Belgium, all in 4 or 7 years. They do not question the macroeconomic consequences of these restrictive policies. They merely regret the inconsistencies introduced by the safeguards and the pro-cyclical nature of the 3% rule. The regret that the DSA procedure is opaque for member states, that increasing public investment does not explicitly give the right to leniency in terms of fiscal efforts to be made, and that countries under an EDP escape the debt reduction constraint.

The reform of the fiscal rules can be considered a failure. The system initially proposed allowed each Member State to negotiate its fiscal policy with the Commission. However, it was complicated by the Commission's plan to strengthen its position by using a questionable technical instrument, the debt sustainability analysis. Germany and the frugal countries refused to trust the Commission. They insisted on the reintroduction of numerical rules relating to the reduction of the debt ratio, the observed budget balance and the fiscal effort, so that in the end the system is even more complicated and rigid.

The regulation (EC, 2024, a) continues to focus on the technocratic control of fiscal policies, with the arbitrary objective of reducing the public debt level and the political objective of imposing reforms on reluctant Member States. Strictly applied, the new rules would deny national fiscal policies any room for manoeuvre. They do not ensure the coordination of the economic policies of the euro area Member States, taking into account the economic situation of each Member State and of the euro area as a whole, and they do not allow for the public investment needed for the green transition.

The implementation of its provisions will lead to opaque negotiations between EU and national technocracies, which are likely to converge on the need to impose neoliberal structural reforms and social spending cuts on the populations. There is a great risk that the reformed rules will impose restrictive fiscal policies in the EU after 2024, at the expenses of economic activity and more important objectives (green transition, reindustrialisation, social rights).

Part II: The EU's social objectives

The European Union is characterised by a specific model: the European social model. Overall, this model has not been called into question in recent years. On the contrary, public spending on social protection represented 27.2% of EU GDP in 2022, compared with 24.1% in 2000. While there was a significant decrease in Denmark and Sweden, there was a substantial increase in France, Italy, Spain, Belgium and Romania.

2.1. Social expenditure by function in 2022

As a % of GDP

	Social protection 2000	Social protection 2022	Pensions	Unemployment	Family. Housing assistance	Health	Education
EU	24.1	27.2	11.9	1.2	3.2	10.5	4.7
Euro zone	24.6	27.9	12.3	1.3	3.2	10.8	4.6
Germany	26.7	28.9	11.9	1.5	3.0	11.9	4.5
France	27.4	32.9	14.4	1.7	4.3	12.2	5.2
Italy	22.6	29.0	16.2	1.0	2.9	8.9	4.1
Spain	17.8	25.7	12.5	1.6	1.7	9.7	4.4
Netherlands	19.4	23.0	6.1	0.6	4.8	11.6	5.1
Belgium	22.7	28.4	11.2	1.2	4.1	11.8	6.3
Austria	27.9	29.9	14.4	1.2	3.3	11.0	4.8
Sweden	27.6	24.4	10.1	1.0	3.3	10.2	6.3
Denmark	29.0	26.9	7.2	1.4	5.7	12.3	5.3
Poland	21.6	22.2	10.8	0.2	3.8	7.2	4.6
Romania	14.6	18.2	9.6	0.0	2.1	6.1	3.2
Czech Rep.	19.3	22.8	8.4	0.1	2.5	11.4	4.9

Source: Eurostat

Thanks to the European Parliament, the regulation stipulates that the MS medium-term structural and fiscal plans will have to "ensure the implementation of investments and reforms responding to the main challenges identified in the framework of the European Semester, in particular in the country-specific recommendations, and in line with the common priorities of the Union: (i) a fair green and digital transition, consistent with the European Climate Act; (ii) social and economic resilience, including the European Pillar of Social Rights; (iii) energy security; (iv) strengthening defence capabilities; and (v) strengthening crisis management capabilities".

The evolution of social spending (pensions, long-term care, health care, education) is at the centre of the public expenditure projections through the analysis of public debt sustainability in the Debt Sustainability Monitor 2023, which in turn is based on the Ageing Report 2024. The Ageing Report and the DSA present developments as governments anticipate them, with the risk that some countries may present programmes that include future cuts in social spending in order to ease the constraints on their current fiscal policies. For our part, we will discuss the social spending requirements needed to meet the requirements of the EPSR, taking into account current unmet needs (in particular child and elderly poverty in some countries) and future needs in view of ageing populations.

European objectives

The European Social Model has clear objectives, set out in the European Pillar of Social Rights and reiterated in the recent report "The Future of Social Protection and of the Welfare State in the EU" (HLG, 2023).

They fall into two categories. Firstly, it is essential to guarantee the well-being of each individual. This includes covering the costs of health and education, ensuring a satisfactory standard of living for children and their families, providing a satisfactory level of replacement income for the unemployed, guaranteeing a minimum income for all, and ensuring a standard of living for pensioners that corresponds to their earned income. This programme has nothing to do with economic growth. It is not a social investment, but it is essential from the point of view of public welfare.

Secondly, some social expenditures contribute in the long term to higher levels of activity and productivity. Care services for very young children encourage mothers to work, create jobs and can help to improve children's cognitive skills. Spending on poor families enables their children to live in a favourable environment. Spending on education increases the productivity of workers. Spending on health, especially occupational health, and on vocational training extends the length of careers, thereby both increasing employment and reducing pension costs. Family policies may increase the fertility rate. These social investments undoubtedly impact growth, although measuring their impact is challenging¹².

It is a fact that some social institutions have the power to reduce the available labour force and thus activity. These institutions either directly or indirectly affect the labour force. Directly, they do so by offering early retirement schemes or allowing mothers of young children to withdraw from the labour market. Indirectly, they affect the labour force through unemployment benefits or minimum income schemes, as liberal economists assert. The European social model chooses to maintain these systems and accept the risk of reducing the number of people available for work in the name of individual well-being. However, this reduction is of little importance if the economy is not at full employment. Everyone has the right to a decent job. Everyone also has the obligation to work, but society can exempt some people from this obligation.

The EU has set itself the goal of increasing production and employment. This is the best way to finance social protection and employment is the best protection against poverty. On the other hand, environmental constraints require that we pursue moderate, sustainable growth (or even de-growth for certain products). Working shorter hours and retiring relatively early may be social choices. This contradiction must be managed. We must implement a policy of sobriety. This will entail reducing high and middle incomes, sharply reducing conspicuous or polluting consumption, increasing social jobs in health and education, and introducing a carbon tax, compensated for low incomes people. This will limit the need for cash benefits. There is still the issue of health care spending, the growth of which must not be reduced.

¹² It is important to distinguish between social investment, as defined here, which is essentially operating expenditure, and investment as defined in the national accounts.

The European Pillar of Social Rights

The European Pillar of Social Rights (EPSR), adopted in 2017, includes 20 commitments, seven of which directly concern social protection.

11) Childcare and support to children. a) Children have the right to affordable early childhood education and care of good quality. b) Children have the right to protection from poverty. Children from disadvantaged backgrounds must be given to specific measures to enhance equal opportunities.

13) Unemployment benefits. The unemployed have the right to adequate activation support from public employment services to (re)integrate in the labour market and to adequate unemployment benefits of reasonable duration, in line with their contributions and national eligibility rules. Such benefits shall not constitute a disincentive for a quick return to employment.

14) Everyone lacking sufficient resources has the right to adequate minimum income benefits ensuring a life in dignity at all stages of life, and effective access to enabling goods and services. For those who can work, minimum income benefits must be combined with incentives to (re)integrate into the labour market.

15) Old age income and pensions. a) Workers and the self-employed in retirement have the right to a pension commensurate with their contributions and ensuring an adequate income. Women and men must have equal opportunities to acquire pension rights. b) Everyone in old age has the right to resources that ensure living in dignity.

16) Health care. Everyone has the right to timely access to affordable, preventive and curative health care of good quality.

17) Inclusion of people with disabilities. People with disabilities have the right to income support that ensures living in dignity, services that enable them to participate in the labour market and in society, and a work environment adapted to their needs.

18) Long-term care. Everyone has the right to affordable long-term care services of good quality, in particular home-care and community-based services.

In 2021, the European authorities summarised the principles of the Pillar in three objectives for 2030:

- 78% of people aged 20 to 64 in employment (compared with 75.6% at the end of 2023, but 67.7% at the end of 2013). *Given past trends, this target easily achievable.*
- 60% of adults taking part in training each year (compared with 46.5% in 2022 and 40% in 2011). *This target is ambitious compared to current trends.*
- Reducing the number of people living in poverty or social exclusion by 15 million (the number fell from 105 million in 2015 to 95 million in 2018, mainly due to Eastern European countries, and has fluctuated around this level since then). *Once again, the target is ambitious compared to current trends, as much as no great policy was defined.*

This summary omits a substantial part of the EPSR's objectives, particularly those related to child protection, and the adequate level of unemployment and pension benefits. The poverty reduction strategy is not clearly defined, leaving open the question of whether it will rely on work incentives increases in universal benefits or assistance. EU authorities tend to prioritize employment objectives over those of social protection, in the strict sense of the term.

The report: "The future of social protection and of the Welfare State in the EU".

The report: "The future of social protection and of the Welfare State in the EU" was written by a group of European experts at the initiative of the Commission's DG Employment, Social Affairs and Inclusion. It set out four major trends for the welfare state: demographic change; changes in work (the weakening of the wage relationship); technological change (digitisation and AI); climate change and the green transition.

The report states: "A well-designed and robust welfare state, taking redistribution seriously, is an economically productive asset in a knowledge-based economy and an ageing society.... The

financial sustainability of the welfare state critically depends on the number of people in employment and how productive they are, as well as revenue being raised fairly from all potential sources of finance. But the reverse is also true: welfare policies can help maximise employability and productivity”.

The report makes it clear that social protection and labour market regulation are social investments. It is the case for family support, for 1-3 years old childcare, support for young people (18-23); vocational training and unemployment benefits to enable flexible employment, particularly in view of the green and digital transition; of employment of young people, women, disabled and migrants; transition to retirement; support for old-age care (which should not be left to women in the family). The report shows that social investment can have a double dividend. It can reduce the need for social protection by creating more and quality jobs. It can also increase activity, which in turn increases the funding base.

The Group is committed to improving the progressiveness and fairness of the entire tax and benefit system, by developing new sources of financing, such as wealth taxation, taxation of the intangible economy, green taxation, etc. and also by fighting against tax evasion and fraud.

What are the trends in social protection expenditure?

Pension expenditure

All EU countries must face the reality of an ageing population. This inevitably leads to a social choice between postponing the retirement age, lowering the relative level of pensions and increasing social contributions. It is simply not viable to finance pension benefits structurally from the public deficit. Therefore, the debate on pension trends in each Member State is perpendicular to the debate on public deficit targets.

2.2 Determinants of pension expenditure in 2022

	Retirement age* (years)	Relative income 65+ **	Replacement rate **	Net replacement rate *
EU	62.5	0.90	0.58	68.1 (72.0)
Germany	63.6	0.84	0.48	55.3 (69.5)
France	61.5	0.93	0.60	71.9
Italy	62.5	0.98	0.74	82.6
Spain	61.9	1.01	0.75	86.5
Netherlands	64.5	0.73	0.55	93.2
Belgium	61.2	0.75	0.47	60.9 (73.8)
Austria	61.3	0.95	0.57	87.4
Sweden	65.0	0.81	0.57	65.3
Denmark	64.2	0.77	0.47	77.3
Poland	62.7	0.89	0.61	40.3
Romania	n.d.	0.97	0.52	n.d.
Czech Republic	63.1	0.73	0.49	58.9

Source: * OECD, the figure in brackets indicates the replacement rate including compulsory private systems; ** Eurostat. There are some inconsistencies between the last three columns, particularly for the Netherlands.

The starting point varies significantly from one MS to another. The effective retirement age ranges from 61/62 in Belgium, France and Austria to 64/65 in the Netherlands, Sweden and Denmark (table 2.2). However, an early retirement age is a social choice or the result of poor management of employees. Older people’s income is equal in Italy, Spain and Romania to that of the rest of the

population. In stark contrast, it is 25% lower in the Netherlands, Belgium, Denmark and the Czech Republic. The old-age poverty rate is lower than that of the rest of the population in France and Italy whereas it is much higher in Germany, the Netherlands, Belgium and the Czech Republic. Public spending on pensions is particularly high in Italy, France and Austria, and particularly low in Denmark and the Netherlands, two countries with occupational systems, which do not prevent a low standard of living among the elderly).

The Ageing Report 2024 reveals that while some countries (Italy, Spain, Belgium, Romania and the Czech Republic) accept the need to increase pension spending in view of demographic trends, others (Sweden and France) claim to have succeeded in significantly reducing their spending. Four countries (Denmark, Italy, Spain and France) are banking on a sharp increase in the effective retirement age, the plausibility of which will have to be assessed.

2.3 Evolution of pension expenditure according to the Ageing Report 2024

	Pension expenditure as a percentage of GDP		Age of departure		Public pension/gross salary		
	2022	2045*	2023	2050	2023	2050	As a %
EU	11.4	12.1 (13.2)	63.6	65.3 (+1.7)	43.2	38.0	-12.0
Eurozone	11.9	12.7 (13.8)	63.8	65.6 (+1.5)	42.8	37.7	-12.0
Germany	10.2	11.0 (12.4)	64.2	65.3 (+1.1)	43.0	36.0	-16.3
France	14.4	13.9 (14.7)	62.5	64.8 (+2.3)	47.1	40.6	-13.8
Italy	15.6	16.5 (17.7)	64.2	66.9 (+2.7)	69.3	56.6	-18.3
Spain	13.1	16.9 (17.2)	64.0	66.4 (+2.3)	64.1	56.5	-11.9
Netherlands	6.5	7.9	65.9	66.6 (+0.7)	37.8	39.0	+3.2
Belgium	12.7	14.6 (15.9)	62.7	64.2 (+1.5)	46.4	44.8	-3.4
Austria	13.7	14.2 (15.0)	62.2	63.6 (+1.4)	55.5	48.5	-12.6
Sweden	7.4	7.0 (7.7)	65.0	66.4 (+1.4)	36.0	32.4	-10.0
Denmark	8.3	8.3 (10.3)	64.9	67.7 (+2.8)	41.1	32.4	-21.1
Poland	10.2	10.6 (13.6)	63.1	63.1 (0)	44.5	28.8	-35.3
Romania	8.5	10.6	62.9	64.0 (+1.1)	33.9	32.8	-3.2
Czech Republic	8.7	10.0 (11.2)	62.2	63.5 (+1.3)	42.7	41.1	-3.8

Source: Ageing Report 2024 *Between (). evolution with a satisfactory benefit ratio.

In almost all countries, the benefit ratio (pension/salary) is set to fall sharply, so that parity in living standards between pensioners and working people will be less and less assured. This decline is due to unsatisfactory indexation mechanisms (on prices rather than wages) or to sustainability factors (which should however affect the retirement age rather than the level of pensions). We will look at the impact, country by country of a policy that guarantees the level or even the rise in the benefit ratio.

In Germany, the standard of living of the elderly is already 15% lower than that of the rest of the population and the poverty rate is 4 percentage points higher. The retirement age will rise from 66 in 2023 to 67 in 2029. The Ageing Report forecasts a 16% fall in the ratio of public pensions to wages, mainly due to the sustainability factor, which reduces the level of pensions when the demographic ratio rises, the contribution factor, which reduces the level of pensions when contribution rates (compulsory and voluntary) rise, and the fall in survivors' pensions linked to the fall in the marriage rate. However, this fall would be mitigated by the development of private voluntary occupational or personal pensions schemes, which cover around 66% of employees. Until 2025, the replacement rate cannot fall below 48% for a standard career. In addition, the

government has expressed its wish to stabilise the relative decline in pensions, while the trade unions are calling for an increase. Maintaining the ratio of public pensions to net wages by financing the increase in pensions through an increase in contributions would raise pensions-to-GDP ratio to 12.4% in 2045.

In France, the retirement age is gradually being raised from 62 to 64, with the full rate remaining at 67, but the required contribution period is being increased from 42 to 43 years. The relative decline in pension levels would be ensured by indexing entitlements and pensions to prices rather than wages and by a sustainability factor in supplementary schemes. The projection in the Ageing Report 2024 is in line with the projection of the Conseil d'orientation des retraites, assuming labour productivity will grow by an annual 1%. Thanks to a relatively satisfactory level of minimum pensions, the elderly are better protected against poverty than the population as a whole. The relative standard of living of the elderly is satisfactory but on a downward trend. We will reduce the relative decline in the pension/wages ratio to 7%, which would require pensions to represent 14.7% of GDP in 2045.

In Italy, the standard of living of the elderly is similar to that of the population as a whole. The projection in the Ageing Report foresees a sharp increase in the effective retirement age (2.7 years) as the normal retirement age rises from 67 in 2023 to 69 in 2045. The notional defined contribution system ensures that pension levels fall as people live longer in retirement. Pensions are in principle indexed to prices, but above a certain level they were underindexed in 2022-23. It should be noted that while gross pensions represent 15.6% of gross GDP, net pensions represent only 12.6%. Italy's demographic decline is such that some reduction in the ratio of pensions to wages is inevitable. We will limit it to 9% (instead of 18% in the projection), so that the share of pensions should be 17.7% in 2045.

In Spain, the standard of living of retired people is the same as that of the whole population. The normal retirement age will increase by 2 months per year to 67 in 2027, but people who have contributed for 38.5 years will be able to retire at 65. The projection includes a significant increase in the retirement age (+2.3 years by 2050). Pension benefits depend on the salaries of the best 25 (soon to be 27) years, revalued by the consumer price index. According to the projection, the share of pensions in GDP will rise from 13.1% in 2022 (gross, 12% net) to 16.9% in 2045, despite a 12% fall in the pension-to-salary ratio. We have limited this fall to 9%. Pensions would then account for 17.2% of GDP.

In the Netherlands, the standard of living of the elderly is much lower than that of the population as a whole, and the poverty rate is much higher. The retirement age is already high. The normal retirement age will be 67 in 2024 and will increase in line with life expectancy at 65; it could reach 68 in 2040; 69 in 2057. In 2022, public pensions (a flat-rate first pillar) represented 6.5% of GDP; the second pillar (funded occupational) represented 5.1%; these figures would rise to 7.9% and 5.3% in 2045. The pension/salary ratio would fall from 67% in 2022 to 64% in 2045, but the fall would concern the second pillar, while the ratio for the public system would remain stable. Therefore, we do not question the *Ageing Report* projection.

In Belgium, the standard of living of the elderly is relatively low and their poverty rate is high. The statutory retirement age will rise from 65 in 2022 to 66 in 2025 and then to 67 in 2030. This gives credibility to an increase in the effective retirement age by 1.5 years. The projection foresees a quasi-stable pension/salary ratio, with the positive effects of the postponement of the retirement

age being offset by the negative effects of price indexation and the mediocre careers of the new retirees. From a normative point of view, we assume a 5% increase in this ratio, which would bring the share of pensions in GDP to 15.9% in 2045.

In Austria, the standard of living of the elderly is satisfactory; the poverty rate is similar to that of the rest of the population. The retirement age is relatively low (65 for men, 60 for women, with a full pension) and the projected increase is small. The projection foresees a 12.5% decline in the relative level of pensions, which we limit to 5%, bringing the share of pensions in GDP to 15%.

Sweden has a high retirement age and plans to increase it slightly by raising the minimum age for a contributory pension from 63 to 64 and for a guaranteed pension from 66 to 67. The relative living standard of the elderly is low. The relative pension ratio is projected to fall by 10%. We keep this ratio.

In Denmark, the standard of living of the elderly is significantly lower than that of the population as a whole. The effective retirement age is already high and is projected to rise significantly. The statutory retirement age is projected to rise from 67 at present to 69 in 2035 and 74 in 2070 (with early retirement possible 3 years before this age, but with a financial penalty). The projection includes a sharp decline in public pensions, which would be partly offset by an increase in occupational pensions. Overall, the pension/salary ratio would fall by 7.4%. We include a 5% increase, i.e. a stable pension/salary ratio for public pensions, which would amount to 10.3% of GDP in 2045.

In Poland, the elderly are poorer than the rest of the population. The projection does not include an increase in the retirement age, which is 60 for women and 65 for men. The projection includes a fall in the relative level of pensions of more than 30%, which is hardly acceptable. Stabilising this level would bring pension expenditure to 13.6% of GDP.

In Romania, the relative living standards of the elderly are satisfactory. The projection includes a moderate increase in the retirement age and a stable pension/salary ratio. We do not change it.

In the Czech Republic, older people have a lower standard of living than the population as a whole and are more likely to be poor. The projections include a moderate increase in the retirement age. It includes some decline in the pension-to-salary ratio. A 10% increase in this ratio would raise the share of pensions in GDP to 11.2%.

Long-term care expenditure

Long-term care expenditure are difficult to predict because they depend on institutional factors (organised care, public or private, provided in kind or in cash, or left to the family) and on the dependency rate of the elderly. The latter can be subject to two extreme hypotheses: dependency rates are fixed at a certain age, or they vary with life expectancy; the 2024 Ageing Report has opted for a median hypothesis.

As table 2.4 shows, differences in LTC expenditure between countries depend more on the generosity index (GI) than on the share of very old people in the population. The GI is high in Sweden, Denmark and Belgium and low in Poland and Romania. The Ageing Report's central projection reduces the apparent generosity of the system (due to the proportion of dependents among the elderly) and maintains inequalities. The report also proposes a projection leading to upward convergence in coverage rates and costs per dependent, which is probably too generous in the Netherlands. There is a large gap between the central projection and the 'generous' projection:

1.8 percentage points at the euro area level, but 4.2 percentage points for the Netherlands, 2.8 for Spain, Poland and Romania, 2.2 for France, 2.1 for Belgium and Sweden.

2.4 Long-term care expenditure as a % of GDP

	Proportion of 80+ years old	2023	2070	2070 convergence	GI 2022*	GI 2070
EU	6.1/13.0	1.7	2.6	4.4	0.28	0.20/0.34
Euro zone	6.5/13.0	1.8	2.6	4.5	0.28	0.20/0.35
Germany	7.3/11.7	1.9	2.3	3.2	0.26	0.20/0.27
France	6.0/12.6	1.9	2.6	4.8	0.32	0.21/0.38
Italy	7.6/14.5	1.6	2.1	3.2	0.21	0.14/0.22
Spain	6.1/14.9	0.8	1.7	4.5	0.13	0.11/0.30
Netherlands	4.9/10.9	1.2	3.4	7.6	0.24	0.31/0.70
Belgium	5.5/11.3	2.3	4.1	6.2	0.42	0.20/0.36
Austria	5.9/12.1	1.6	3.1	4.5	0.27	0.26/0.37
Sweden	5.4/10.7	3.2	4.4	6.3	0.59	0.41/0.58
Denmark	5.1/11.9	3.0	6.2	6.6	0.59	0.52/0.55
Poland	4.3/15.0	0.5	1.4	4.2	0.12	0.09/0.28
Romania	4.4/13.1	0.3	0.7	3.5	0.07	0.05/0.27
Czech Republic	4.3/11.9	1.5	2.9	4.4	0.35	0.24/0.37

*GI is measured by dependency expenditure in GDP divided by the proportion of the population aged over 80.
Source: Ageing Report 2024, own calculations.

Health expenditure

2.5 Public health expenditure as a % of GDP

	2023	2070	2070 at risk	Life expectancy 2020
EU	6.7	7.3	8.4	80.6
Euro zone	6.9	7.6	8.1	81.6
Germany	7.7	8.2	9.0	80.7
France	8.4	9.1	9.9	82.3
Italy	6.1	6.4	7.2	82.8
Spain	5.8	7.1	7.9	83.2
Netherlands	5.8	6.5	7.1	81.7
Belgium	6.1	6.8	7.5	81.8
Austria	7.8	8.9	9.9	81.4
Sweden	7.0	7.7	8.6	83.1
Denmark	7.0	7.8	8.7	81.3
Poland	4.4	5.5	6.6	77.2
Romania	4.5	5.2	6.5	75.1
Czech Republic	5.8	6.6	7.6	79.0

Source: Ageing Report 2024, own calculations.

The *Ageing Report* projects health care expenditure on the basis of changes in the age structure of the population, bearing in mind that there are two major uncertainties: the autonomous development of technological progress and the relationship between age and health care expenditure: does health care expenditure increase with age, with proximity to death or with generation? The 2024 Ageing Report does not consider the most pessimistic solution (in terms of health expenditure). Besides, it does not consider an upward convergence of health expenditure in

the Eastern European countries. It should be noted, however, that the link between health expenditure and population health, as summarised by life expectancy, is loose (see the case of Spain). We will retain the "at risk" scenario.

Education expenditure

Projections generally include some decline in the share of education expenditure due to the decline in the number of young people in most countries (Table 2.6). However, enrolment rates are relatively low in France and Romania, and expenditure per pupil is low in Romania. We estimate the additional expenditure required to raise these rates to 88% and 27% respectively. This calculation suggests that many countries should take advantage of the demographic downturn to increase enrolment rates and expenditure per pupil rather than reduce education spending (France, Italy, Spain), while Eastern European countries should increase their spending.

2.6 Education expenditure as % of GDP

	2022	2045	2045 corrected	Expenditure/student *	% students 5-24	% 5-24 population
EU	4.4	3.9	4.4	25.7	82.7	20.7
Euro zone	4.3	3.9	4.45	24.8	83.8	20.7
Germany	4.3	4.4	4.7	25.9	85.5	19.4
France	4.8	4.1	4.8	25.5	78.9	23.8
Italy	3.8	3.2	3.8	24.7	81.8	18.8
Spain	4.1	3.4	4.0	23.3	87.6	20.1
Netherlands	4.9	4.1	4.5	24.6	88.2	22.6
Belgium	5.6	4.9	4.95	28.2	87.5	22.7
Austria	4.6	4.1	4.45	28.4	80.8	20.0
Sweden	5.8	5.2	5.2	27.2	92.3	23.1
Denmark	5.8	5.3	5.3	28.1	90.7	22.7
Poland	3.9	3.7	4.7	23.9	80.3	20.3
Romania	2.5	2.5	5.2	16.7	68.6	21.8
Czech Republic	4.1	4.2	4.9	24.6	81.2	20.5

*% of GDP divided by the % of students in the population.

Expenditure on unemployment-related benefits

Expenditure on unemployment-related benefits are not covered in the *Ageing Report*. They are relatively low in most countries (1.2% of GDP on average). Given their unemployment rates, Italy and the Eastern European countries are characterised by a low level of protection for the unemployed. Eventually, for countries with a higher unemployment rate and a satisfactory level of benefits, convergence towards an unemployment rate of 6% could lead unemployment expenditure to converge towards 1.2%/1.4% of GDP. This would imply expenditure to be cut by 0.3 percentage points of GDP in France, 0.2 percentage points in Spain, and increased by 0.7 percentage points in Italy and the Czech Republic, by 1 percentage point in Poland and more than 1 percentage point in Romania.

Family and welfare policies

These issues are not addressed in the *Ageing Report 2024*, as is often the case in EU analyses. However, many EU countries have serious fertility problems. However, lifting all children out of poverty is an absolute necessity

2.7 Unemployment expenditure in 2022

	Unemployment rate, %	employment benefits, % of GDP	Ratio
EU	6.2	1.2	0.19
Euro zone	6.8	1.3	0.19
Germany	3.1	1.5	0.48
France	7.3	1.7 (1.4)	0.23
Italy	8.1	0.5 (1.2)	0.06
Spain	12.9	1.6 (1.4)	0.12
Netherlands	3.5	0.6	0.17
Belgium	5.6	1.2	0.21
Austria	4.8	1.2	0.25
Sweden	7.5	1.0	0.13
Denmark	4.5	1.4	0.31
Poland	2.9	0.2 (1.2)	0.07
Romania	5.6	0.0 (1.2)	0
Czech Republic	2.2	0.1 (0.8)	0.05

Source: Eurostat, own calculations.

2.8 Poverty rate

	Global		16 -	65+	At work
	2007	2022	2022	2022	2022
Eurozone	16.1	16.8	19.8	17.3	8.4
Germany	15.2	14.8	14.7	18.3	7.2
France	13.1	15.6	21.6	12.5	7.5
Italy	19.5	20.1	25.6	17.8	11.5
Spain	19.7	20.4	27.7	18.7	11.7
Netherlands	10.2	14.5	12.5	17.1	5.0
Belgium	15.2	13.2	13.5	17.9	3.6
Austria	12.0	14.8	18.9	14.9	8.2
Sweden	10.5	16.0	16.2	15.7	7.5
Denmark	11.7	12.4	9.8	13.2	5.9
Poland	17.3	13.8	13.5	15.2	9.1
Romania	24.6	21.2	26.1	19.5	14.5
Czech Republic	9.6	10.2	11.6	16.0	3.4

Source: Eurostat.

Overall, the poverty rate has tended to rise in the euro area countries, with significant increases in France, the Netherlands, Austria and Sweden, and some decreases in Belgium and more substantially in Poland (Table 2.8). The target set by the European authorities is a poverty rate at around 14% in the euro area by 2030, which is not very ambitious, but no precise strategy has been defined. Only the Czech Republic, Denmark and Belgium have reached the target. France, the Netherlands, Sweden and Austria were below 14% in 2007 and will be above it in 2022.

The child poverty rate is higher than for the whole population in France, Italy, Spain and Austria; it is above 12% in most countries; it is lower in Denmark. There is no EU target for child poverty. The poverty rate among the elderly is lower than for the total population in France and Italy and much higher in Germany, the Netherlands, Belgium and the Czech Republic.

The severe material deprivation rate has hardly fallen in the euro area, with Spanish and Romanian

children being particularly at risk. Over the same period, it has fallen significantly in Eastern European countries (Table 2.9).

2.9 Severe material deprivation rate

	Global		16 -	65+
	2007	2020	2020	2020
Eurozone	5.6	5.7	6.3	3.6
Germany	4.8	5.6	5.9	3.9
France	4.7	5.0	6.1	2.4
Italy	7.0	5.9	5.5	4.1
Spain	3.5	7.0	9.1	3.2
Netherlands	1.7	2.1	2.8	0.8
Belgium	5.7	3.9	4.5	1.5
Austria	3.3	2.7	4.7	1.0
Sweden	2.2	1.8	3.0	0.3
Denmark	3.3	2.4	2.2	1.1
Poland	22.3	2.6	2.1	2.9
Romania	38.0	15.2	21.7	14.2
Czech Republic	7.4	2.4	3.2	1.5

Source: Eurostat

2.10 Ratio between the standard of living of families and couples in 2022, as a %.

	2 children	3 children
Eurozone	80.4	64.6
Germany	82.0	62.2
France	90.0	65.7
Italy	76.7	61.8
Spain	88.2	55.0
Netherlands	92.3	78.6
Belgium	86.4	70.4
Austria	80.8	61.1
Sweden	79.8	64.9
Denmark	91.1	78.1
Poland	85.2	69.7
Romania	72.3	48.9
Czech Republic	75.9	62.4

Source: Eurostat.

In all EU countries, the standard of living of families with children is significantly lower than that of couples: the difference is around 20% for families with two children, and 35% with three children (as the mother often reduces her working hours). Here too, the Netherlands and Denmark have the most satisfactory results (table 2.10). A strong increase in family benefits and in female employment would be necessary, particularly in Italy, Spain and Romania.

At the same time, some countries lag far behind in the provision of childcare for young children: Germany, Austria, Italy and the Eastern European countries for 0-3 years and the Eastern European countries for 3-6 years (table 2.11). Here too, the Netherlands and Denmark stand out as models.

2.11 Percentage of children in formal childcare in 2022

	0-3 years	3-6 years
Euro area	48	92
Germany	25	90
France	56	92
Italy	31	94
Spain	49	97
Netherlands	72	97
Belgium	53	98
Austria	23	92
Sweden	54	98
Denmark	75	93
Poland	16	77
Romania	12	69
Czech Republic	7	80

Source: Eurostat

Minimum incomes are very low in Germany, Sweden and the Eastern European countries. Only in Denmark is it close to the 60% poverty threshold. Admittedly, the need for welfare spending is lower in countries close to full employment, but the EU should set a target for minimum income as a percentage of median income (at 50%?) for all Member States.

2.12 Poverty threshold and minimum income (single person) in 2022

	Poverty Threshold*	Minimum Income*	Ratio	Welfare /Housing Social spending
Germany	1246	446	36%	0.9/0.3
France	1153	575	50%	1.3/0.8
Italy	930	500	54%	1.5
Spain	841	452	54%	0.7
Netherlands	1478	1079	73%	2.5 / 0.4
Belgium	1366	1024	75%	1.7 / 0.2
Austria	1393	950	68%	1.1 / 0.1
Sweden	1335	414	31%	0.8 / 0.3
Denmark	1663	1573	95%	1.3 / 0.6
Poland	551	84	15%	1.1
Romania	295	29	11%	0.6
Czech Republic	607	147	24%	0.8 / 0.2

*in euros per month; ** in % of GDP. Source: Eurostat

It would be desirable for the Ageing Reports to include expenditure on families and on combating poverty. We have confined ourselves here to setting the target that each country should spend half of the 4.3% of expenditure on families/housing and assistance that France spends.

What assessment?

The 2024 *Ageing Report* provides an estimate of the increase in age-related expenditure assuming a continuation of current policies. Although population is ageing in all countries, the prospects vary considerably. Spain, and to a lesser extent the Netherlands and Belgium, are forecasting a significant increase in spending. France and Sweden, on the other hand, are expecting a small

decrease. Last, Poland and Romania show very little catching up.

2.12 Evolution of social expenditure according to the 2024 Ageing Report

	Expenditure 2022	Pensions	Health	Long-term care	Education*	Expenditure 2045
EU	24.4	+0.7	+0.2	+0.5	-0.4	25.4 (+1.0)
Euro zone	25.1	+0.9	+0.2	+0.5	-0.4	26.3 (+1.2)
Germany	24.3	+0.8	+0.0	+0.5	+0.2	25.8 (+1.5)
France	29.9	-0.5	+0.1	+0.4	-0.7	29.2 (-0.7)
Italy	27.3	+0.9	+0.1	+0.3	-0.6	28.0 (+0.7)
Spain	23.9	+3.8	+1.0	+0.4	-0.7	28.4 (+4.5)
Netherlands	21.0	+1.4	+0.5	+1.2	-0.7	23.4 (+2.4)
Belgium	26.8	+1.9	+0.4	+0.9	-0.8	29.2 (+2.4)
Austria	27.7	+0.5	+0.8	+0.8	-0.5	29.3 (+1.6)
Sweden	23.6	-0.4	+0.1	+0.6	-0.5	23.3 (-0.3)
Denmark	24.4	0.0	+0.1	+2.0	-0.5	26.0 (+1.6)
Poland	19.1	+0.4	+0.7	+0.4	-0.2	20.4 (+1.3)
Romania	15.8	+2.1	+0.1	+0.2	0	18.1 (+2.3)
Czech Republic	20.6	+1.3	+0.1	+0.7	+0.1	22.8 (+2.2)

Source: Ageing Report 2024

Table 2.13 provides an assessment of the social expenditure needed, according to our estimates, to meet the EPSR requirements. They lead to a high degree of convergence in social expenditure in the broad sense, with the lowest figures corresponding to countries with private pension systems. It should be borne in mind that these assessments are fragile and that Member States are sovereign in social matters.

2.13 Changes in social expenditure according to EPSR needs

	Pensions	Health	Long-term care	Education	Family support	Unemployment	Expenditure 2045/2022	Expenditure 2045
EU	+1.8	+0.7	+1.0	+0.0	+0.7		+4.2	28.6
Euro zone	+1.9	+0.8	+1.1	+0.1	+0.6		+4.5	29.6
Germany	+2.2	+0.5	+0.9	+0.4	+0.7		+4.7	29.0
France	+0.3	+0.6	+1.1	0.0	0.0	-0.3	+2.0	31.9
Italy	+2.1	+0.5	+0.7	0.0	+0.8		+3.9	31.2
Spain	+4.1	+1.2	+1.1	-0.1	+1.3	-0.2	+7.4	31.3
Netherlands	+1.4	+0.9	+1.2	-0.4	-0.4		+2.7	23.7
Belgium	+3.2	+0.9	+0.9	-0.6	+0.1		+4.5	31.3
Austria	+1.3	+0.9	+1.2	-0.1	+0.5		+2.8	31.5
Sweden	+0.3	+0.6	+1.0	-0.6	+0.5		+1.8	25.4
Denmark	+2.0	+0.7	+1.2	-0.5	-0.6		+2.1	26.5
Poland	+3.4	+1.5	+1.1	+0.8	+0.3	+1.0	+8.1	27.2
Romania	+2.1	+0.6	+0.9	+2.7	+1.2	+1.2	+8.7	25.1
Czech Republic	+2.5	+0.7	+1.1	+0.8	+0.9	+0.7	+6.7	28.3

Part III: A new fiscal governance in the EU?

The European Union currently faces several priorities. The first one is to organise the green transition, which will require substantial public investment and public subsidies.

The green transition requires an active industrial policy to decarbonise existing processes, to invent low-carbon production processes and products, and to develop industries compatible with the green transition (electric cars, wind turbines, solar power plants, heat pumps, etc.). Some Member States also need a strategy for re-industrialisation in the face of competition from China and the United States. The green transition induces increased uncertainties in terms of economic developments and much of the risk has to be borne by the Society.

The green transition should certainly be guided by the European authorities, as with the Green Pact, but a large part of the decisions and expenditure remain at national level.

The second priority is to maintain and develop the European social model, which, given population ageing and the gap with the EPSR's social targets, requires increases in social spending. In this area, more than anywhere else, decisions have to be taken at national level, even if the EPSR sets common objectives.

Following the Russian invasion of Ukraine, the need to increase military spending has risen.

So far, the level of public debts and deficits has not led to economic imbalances in the euro area, except in the case of Greece. Overall, the euro area runs an external surplus. Before the inflationary shock caused by the rise in commodity and energy prices, Member States were in a situation of insufficient demand, which forced the ECB to set very low and sometimes negative interest rates and Member States to maintain high public deficits, at least for those countries that could not support demand with an external surplus.

In this situation, the European debate on fiscal rules is irrelevant. There is little justification for imposing rigid numerical constraints on Member States in terms of debt or public deficit, without considering the economic situation and structural investment needs. The new fiscal rules are a continuation of the previous ones, without any real improvement. They risk creating unnecessary tensions between the EU institutions and the Member States, as well as between the Member States themselves; they introduce a depressive bias into Member States' fiscal policies; there is a great risk that social spending will become an adjustment variable for fiscal constraints. The EU should opt for another governance framework, and, in a transitional phase, manage the existing rules with flexibility.

Our conclusions are in line with those of Mang and Caddick (2024): the new fiscal rules are incompatible with social needs and with the investments required by the green transition. However, Mang and Caddick (2024) only consider the investments needed to meet social needs, whereas we consider all spending, including current spending.

What strategy?

Firstly, the euro area countries should be able to benefit from the guarantee provided by the single currency; the still remaining interest rate differentials between Member States¹³ should be reduced through clear statements by the ECB and the European Council.

An often suggested strategy is to try to increase potential growth. Accelerating the increase in female and older workers towards those of the best performing countries in relation to the projections of the *DSA report* could lead to an increase in GDP in 2045 of around 7.8% in Romania, 6.3% in Italy, 3.2% in Spain, 2.9% in Poland, 2.1% in Belgium, 1.9% in Austria and 1.5% in France. However, given the social factors involved, such an acceleration is unlikely.

A more promising approach is that of Darvas *et al.* (2024, a), who assess the positive impact that social investment policies could have on potential growth and thus on fiscal constraints: an increase in childcare facilities, an improvement in the quality of education and an increase in the number of highly skilled workers. However, the effects are uncertain and small for all countries.

There is therefore no alternative to a three-tier strategy. Social spending must aim to achieve a high level of social protection, in line with Member States' policy choices and in accordance with the provisions of the European Pillar of Social Rights. Of course, part of this spending is social investment, but spending that is not social investment should not be reduced. The increase in social spending must be in line with population ageing, and also with national policy choices to perfect the social system: a minimum standard of living for children, a higher standard of living for 18-23 years old, a guaranteed minimum income, unemployment benefits in relation to earned income, retirement at a satisfactory age with a relatively satisfactory level of pension in relation to earned income. Depending on their nature, social expenditures must be financed structurally through taxes (health care, assistance) or social contributions (pensions, unemployment benefits), so that their discussion has little to do with the issues of public deficit or debt.

As far as public spending on the green transition is concerned, one could imagine it being taken over by the EU (as an extension of the Next Generation EU, see Recovery Watch, 2023). This would have the advantage that it would be controlled, that it would be part of an overall strategy and, above all, that, being financed at EU level, it would increase neither the public deficit nor the public debt of the Member States. In addition, the revenues from the carbon tax or the Carbon Border Adjustment Mechanism (CBAM) could be communitarised and used to finance this expenditure. However, raising the debt to EU level is nothing more than an accounting device; logically, the Community debt should be shared between the Member States. Member states may disagree on the strategy to combat global warming. Finally, the carbon tax and the CBAM will ultimately be paid by consumers in the Member States, and the Member States must be able to manage this revenue in order to introduce compensatory measures for the poorest households and to finance their investments (renovation of housing, purchase of an electric car).

Public investment, especially investment in the green transition, may be financed by public borrowing. From this point of view, the preferred indicator is the structural government balance (corrected for the inflationary depreciation of debt) compared with net public investment (including subsidies to private investment). Ultimately, however, the macroeconomic equilibrium

¹³ Italy pays a higher interest rate on its public debt than France (0.8 percentage points on current issuance, and even more in the past), costing it 1.8 percentage points of GDP in 2023 (table A.1).

should determine the desirable path for the deficit (and hence the debt level). This must be compatible with a broadly interpreted inflation target and an interest rate target below nominal GDP growth. Thus, an increase in savings by private agents should allow an increase in the public deficit; moreover, at full employment, an increase in public investment needs may require an increase in taxation and an increase in interest rates to discourage private investment. While national fiscal policies should be coordinated within the European institutions, the latter cannot impose unjustified numerical rules. A country may only be encouraged to change its policy if it can be shown that it is harmful for other Member States (e.g. by being too restrictive or by inducing excessive competitiveness gains or an excessive external surplus). Within this framework, it may be desirable for Member States to adopt similar policies (in the event of economic depression or generalised overheating), but it may also be necessary for divergent policies to be recognised as necessary. The reduction of public deficits should be undertaken with caution if it leads to a fall in demand; it should be accompanied by lower interest rates.

It may appear necessary to increase taxation. However, the objective of reducing public debt without reducing demand (too much), which implies increasing taxes on the richest, is in contradiction with the objective of reducing demand in order to combat inflationary pressures. A choice will have to be made.

This tax increase will be difficult in Member States where the tax ratio is already high (France, Austria, Finland, Italy, Belgium, Denmark). This increase will therefore have to be seen as fair; it is still likely to be opposed by the people concerned (as we could see in France with the *Gilets Jaunes* protests).

In this area, the measures to be taken are well known. The question is one of political will. On the household side, this means introducing a tax on the highest levels of wealth, effectively taxing financial capital gains and increasing inheritance taxes (e.g. to help young people from working class families); on the corporate side, taxing all profits at a minimum rate of 25% (or even 33.3%), combating tax optimisation, taxing financial transactions; and finally, taxing CO₂ and polluting activities to finance the green transition (Box 1).

Box 1: Some possible tax revenues.

According to Capelle-Blancard (2023), a financial transactions tax with a broad base and at a rate of 0.5% could raise around €50 billion for EU countries (0.35% of GDP), taking into account the reduction in transactions.

According to Zucman (2024), a 2% tax on the wealthiest could raise around \$340 billion globally, €76 billion (0.5% of GDP) for EU countries (assuming that a quarter of the tax is collected in the EU).

According to Barake *et al.* (2021), an international agreement to tax multinational profits at 25% could raise €190 billion for EU countries (1.4% of GDP).

An additional carbon tax of €100 per ton would raise €350 billion at EU level (or 2.5% of GDP, authors' evaluation), but would generate an inflationary shock that some households would have to compensate for.

Under the European Treaties, direct taxation remains the exclusive responsibility of the Member States. However, tax harmonisation is necessary to prevent tax evasion. The EU should resist the temptation of certain Member States to become tax and regulatory havens. It should also put an end to tax competition that allows to cut taxes on the richest and multinational companies. The European authorities only have the power to make recommendations. But they must use it wisely and forcefully. This is essential to prevent the objective of cutting public deficits and debts from undermining the European social model.

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Annex 1: Member States' fiscal situation

Despite the Maastricht Treaty limit of 60% of GDP, public debts in euro area countries, which had fallen from 73.5% of GDP in 1996 to 66% in 2007, rose to 86% in 2010 (after the financial crisis) and werestill at 86% in 2019 (with restrictive fiscal policies leading to weak growth). At the same time, public debt in the US rose from 66% of GDP in 1996 to 108% in 2019. In both the US and the EU, low inflation and real interest rates meant that public deficits and rising debt were necessary to offset weak demand. As a result of the pandemic, followed by the Russian aggression of Ukraine, EU fiscal rules were suspended for four years (from 2020 to 2023). Member states accumulated large public deficits and debts; in 2023, public debt reached 90% of GDP in the euro area (124% in the US).

There are large disparities within the EU: public debt exceeds 60% of GDP in 12 countries (exceeding 90% in six countries: Greece, Italy, France, Spain, Belgium and Portugal); it is below 60% in 15 countries (and below 30% in 5 countries: Bulgaria, Denmark, Estonia, Luxembourg and Sweden).

A 1 Public finances in 2019 and 2023 As a % of GDP

	2019		2023					
	Public balance	Public Debt	Public balance	Interest rate on debt	Structural balance (primary)	Public Debt	External balance	Growth 2023/2019
Euro zone	-0.6	86.0	-3.6	1.9	-3.6 (-1.9)	90.0	2.9	3.3 ¹
Germany	1.5	59.6	-2.5	1.4	-1.7 (-1.2)	63.6	6.0	0.7
France	-2.3	97.4	-5.5	1.55	-5.4 (-3.7)	110.6	-2.0	1.6
Italy	-1.5	134.2	-7.4	2.8	- 8.3 (-4.5)	137.3	1.1	3.5
Spain	-3.1	98.2	-3.6	2.3	-4.1 (-1.6)	107.7	3.5	2.5
Netherlands	1.8	48.6	-0.5	1.3	-0.8 (-0.2)	46.5	10.1	6.6
Belgium	-2.0	97.6	-4.4	1.9	-4.2 (-2.3)	105.2	0.2	5.8
Austria	0.6	70.6	-3.3	1.5	-2.3(-1.2)	77.8	1.8	1.1
Sweden	0.5	35.6	-0.2	2.2	0.1 (0.8)	31.2	5.7	6.4
Denmark	4.1	30.3	3.1	1.6	3.6 (4.1)	29.3	10.7	8.3
Poland	-0.7	45.7	-5.1	4.2	-4.5 (-2.5)	49.6	2.4	10.7
Romania	-4.3	35.1	-6.6	4.1	-6.0(-4.4)	48.8	-3.8	8.2
Czech Republic	0.3	44.7	-3.7	2.95	-2.9 (-1.6)	44.0	2.4	-0.2
United Kingdom	-2.5	85.7	-5.9	3.4		101.3	-3.5	1.8
United States	-6.6	107.8	-8.4	3.6		124.3	-3.1	8.1
Japan	-3.0	236.4	-5.4	0.55		249.8	3.8	1.2

¹ 2.5% excluding Ireland. Source: Ameco, Spring 2024

The euro area public deficit was 3% of GDP in 1997; it fell to 1.3% in 2000, then rose to 3.1% in 2003 (after the burst of the dotcom bubble); it was 0.7% in 2007, but due to the financial crisis it rose 6.3% in 2010; it fell to 0.4% in 2018. The COVID crisis led the deficit to increase again, and reach 7.1% of GDP in 2022; before falling to 3.6% in 2023. Public deficits fluctuations naturally reflect economic activity fluctuations.

In 2019, 2 countries (Spain and Romania) had public deficits above 3% of GDP; in 2023 they were 11. Only 8 of the 27 EU countries had a structural deficit below 1% of GDP. Conversely, 5 countries had structural primary deficits above 3% of GDP (Italy, France, Romania, Malta,

Slovakia). The non-EU countries (the United States, the United Kingdom, Japan) are largely outside the EU fiscal criteria.

Some countries have both a government deficit and an external deficit (France, Romania, the US, the UK). Others have an external surplus despite a public deficit (Italy, Spain).

EU countries have committed themselves to raising their expenditure on defence to 2% of GDP. Greece stands at 2.6%, the three Baltic states at 2.2%, Romania and France, at 1.8%, are close to this level. This would require an increase in military spending of around 0.8 percentage points of GDP for most countries.

A 2. Public total expenditure on defence, in 2022, as % of GDP

EU	1.3
Euro zone	1.2
Germany	1.0
France	1.8
Italy	1.3
Spain	1.1
Netherlands	1.3
Belgium	1.0
Austria	0.6
Sweden	1.6
Denmark	1.2
Poland	1.6
Romania	1.8
Czech Republic	1.0

Source: Eurostat

Annex 2: EU analysis of public debt sustainability

The public debt sustainability analysis (DSA) is based on the method described in European Commission (2024): "Debt Sustainability Monitor 2023" (DSM 2023). The analysis incorporates the macroeconomic projections of the EU's Economic Policy Committee and the social expenditure projections of the 2024 Ageing Report. It starts from a baseline projection for 2022-2033, with a projection of potential growth (necessarily questionable) and an assumption that the output gap will close in 3 years. Inflation is based on market expectations, then set at 2% after T+10 (2033). The long-term interest rate is based on market expectations and is set at 4% after T+10. The short-term interest rate converges to 2% in nominal terms. The differential between the short-term and long-term interest rates is quite surprising. The primary budget balance, PBB, for each MS is set at its projected value for 2024, to which the net costs of ageing as described in the Ageing Report is added. In the alternative scenarios, the public expenditure multiplier as a deviation from the PBB is set at 0.75. Sustainability is assessed over three horizons.

Short-term sustainability is assessed by means of a short-term indicator S0, which is based on various public finance indicators (fiscal balances and debt levels according to different definitions), financial indicators (interest rates, private debt) and external indicators (current account balance, competitiveness, net foreign assets). The DSM 2023 does not identify any country as being at risk. However, Italy (25.5% of GDP), France (21%), Spain (19.5%) and Belgium (16%) are highlighted for their gross borrowing requirements in 2024.

B. 1 Short-term sustainability

	S0	Interest rate*	S&P rating
Germany	0.16	2.34	AAA
Netherlands	0.12	2.60	AAA
Ireland	0.13	2.75	AA-
Finland	0.20	2.81	AA+ (AA)
France	0.38	2.82	AA-
Austria	0.09	2.84	AA+ (AA+)
Belgium	0.27	2.90	AA-
Portugal	0.32	3.00	BBB+
Spain	0.41	3.17	A-
Greece	0.31	3.27	BB+
Croatia	0.21	3.32	BBB+
Slovakia	0.38	3.43	A
Italy	0.35	3.67	BBB

*10-year government bonds rate on 25 March 2024. *Source:* DSM 2023

The S0 indicator is not perfectly correlated with the interest rate differential on financial markets. Financial markets appear very indulgent towards France and, on the contrary, wary of Italy, which suffers from an interest rate differential of 0.85 percentage points compared to France, which has a more unfavourable S0 indicator. In 2020, 11 countries were marked at risk for short-term sustainability, but the risk has not materialised.

Medium-term sustainability is assessed using a benchmark projection that assumes an unchanged PBB after 2024 (excluding spending linked to demographic factors). This results in a sharp increase in debt for the countries with a significantly negative SPB in 2024 (Slovakia,

Belgium. France) or that are forecasting an increase in demographic-linked spending (Slovakia. Portugal. Spain). Debts tend to rise for all countries as a result of the expected increase in the differential between the interest rate and the growth rate.

B.2 Debt levels in the reference scenario; in % of GDP

	Debt Level		SPB	Demographic effect
	2023	2034	2024	2034
Ireland	43	31	0.8	1.2
Netherlands	47	53	-0.5	1.4
Slovakia	57	115	-5.1	2.1
Croatia	61	61	-1.2	-0.3
Germany	65	64	-0.2	1.3
Finland	74	95	-1.0	0.3
Austria	76	81	-0.7	1.4
Portugal	103	83	2.1	2.1
Belgium	106	123	-2.4	0.9
Spain	107	118	-1.0	1.7
France	110	130	-2.4	0.1
Italy	140	164	-0.9	1.0
Greece	161	116	2.0	-0.1

Source: DSM 2023

In order to assess the plausibility of the projection, the study also assesses the fiscal consolidation space, i.e. the gap between the projected SPB and the average SBB achieved in the past. This information is of little interest as it devalues countries such as Greece and Portugal that have improved their SPB in the recent past and favours countries that have not (Belgium, France, Finland, Slovakia).

Alternative projections assume that the deficit remains at its average past value in each country, that the consolidation efforts announced for 2023 and 2024 are not implemented, that the interest rate is permanently higher and that, following a financial shock, interest rates rise in countries with a high debt ratio.

Around the reference projection, stochastic shocks are run to assess a probability interval for the debt level in 2028 and the risk that the debt ratio will be higher than in 2023. These shocks affect the SPB, the GDP growth rate and short and long-term interest rates. The method is questionable because it does not take into account the responses of the fiscal and monetary authorities or the acceptability of an increase in this ratio in the event of large common shocks. Similarly, a higher interest rate is likely to be accompanied by higher demand and therefore higher SPB, which is not taken into account. The method does not distinguish between harmful increases in the public deficit and increases necessary for macroeconomic stabilisation.

Long-term sustainability is assessed by two indicators: S2 assesses the fiscal effort required to stabilise the debt ratio in the long term (by 2070), and S1 shows the immediate effort in terms of the primary budget balance (PBB) needed to reduce the debt ratio to 60% by 2070.

In the long term, public debt is stable when the primary balance is equal to the debt ratio multiplied by the interest rate-growth differential. S2 is equal to the difference between the PBB in 2024 and the sum of the stabilising balance and the costs of ageing, as shown in the Ageing Report. The assessment of the demographic costs varies greatly between countries. Some forecast a sharp fall

in the relative level of pensions (France, Italy), while others forecast a certain catching-up (Netherlands, Czech Republic) or the continuation of a trend increase (Belgium, Spain). This factor should be taken into account. If MS forecasting an increase in the burden of pensions are prepared to finance it by increasing contributions, they should do so. The DSM report forecasts an interest rate-growth rate differential of around 0.5 percentage points over time. This means that a country stabilising its debt at 100% of GDP should have a PBB of 0.5% of GDP. The effort required would be significant for most countries, but relatively minor in France and Italy, given the assumption of a sharp fall in the relative level of pensions.

B.3 Indicator S2 Fiscal effort required to stabilise the debt ratio, in % of GDP

	Total	Initial position	Demographic cost
EU	2.9	1.4	1.4
Euro zone	3.0	1.5	1.4
Germany	2.0	0.5	1.5
France	3.1	3.1	0.0
Italy	0.9	1.9	-1.1
Spain	5.9	1.9	4.0
Netherlands	4.5	1.7	2.8
Belgium	6.7	3.1	3.6
Austria	3.3	1.1	2.2
Sweden	-0.6	-1.2	0.7
Denmark	-1.7	-2.5	0.8
Poland	3.8	2.7	1.1
Romania	3.7	3.5	0.2
Czech Republic	4.8	0.8	4.0

Source: DSM 2023

S1 represents the immediate fiscal effort required to stabilise public debt at 60% of GDP in the long term. The countries that need to make a major effort are the same. The method does not assess the impact on GDP of such fiscal policies being implemented progressively (according to S2) or immediately (according to S1), simultaneously in Europe.

B.4 Indicator S1 Fiscal effort required to stabilise the debt ratio at 60% (in % of GDP)

	Total	Initial position	Back to 60%	Demographic cost
EU	2.6	1.0	0.4	1.2
Euro zone	2.8	1.0	0.6	1.2
Germany	1.2	0.0	0.1	1.2
France	3.5	2.5	1.0	0.0
Italy	3.4	2.0	1.5	0.0
Spain	5.4	1.3	0.9	4.0
Netherlands	2.8	1.1	-0.3	2.0
Belgium	5.3	2.2	1.0	2.1
Austria	2.5	0.5	0.8	1.6
Sweden	-2.2	-1.6	-0.7	0.1
Denmark	-2.7	-2.9	-0.7	0.8
Poland	3.2	2.5	-0.1	0.8
Romania	4.7	3.4	-0.2	1.5
Czech Republic	3.0	0.8	-0.3	2.9

Source: DSM2023

The implementation of the DSA under the new rules is detailed in Part II of DSM2023. For the first implementation, the adjustment path will take place from 2025 to 2028. It should guarantee that, after the adjustment period, the debt ratio will be on a downward trajectory for the following 10 years, even if one of the negative shocks occurs: 0.25 percentage points of GDP fall in the PBB in the first two years, 1 percentage point rise in the interest rate- growth differential, a financial shock (1 percentage point rise in interest rates in one year, rise in credit spreads for indebted countries), with a probability of over 70%. The trajectory must therefore satisfy the three numerical safeguards.

Annex 3: Sustainable levels of public deficit and debt

There is no academic consensus on the definition of desirable (or optimal) levels of public debt and deficit. The 3% and 60% levels in the European treaties have no precise economic justification. The same applies to the new target of a structural deficit of 1.5%, which only makes sense as a safeguard against the 3% level.

A first benchmark would be the stability of the public debt to GDP ratio. However, this ratio has risen in the past in most developed countries, i.e. between 1997 and 2023 from 73% to 90% in the euro area, from 44% to 102% in the United Kingdom, from 64% to 124% in the United States and from 105% to 250% in Japan. Should we assume that this increase reflects a persistent imbalance in public finances? It has not led to excess demand; it has not forced central banks to set excessive interest rates (higher than the growth rate). Should we not consider that it was implicitly desired by private agents who needed a risk-free financial asset?

Consider a country with a trend growth rate in value terms of 3.25%. A stable public debt of 60% (90%) of GDP requires a public deficit of 1.95% (2.92%) of GDP. If the nominal interest rate is also 3.25%, the primary structural balance must be zero. But this does not indicate the desirable level of debt. As the real interest rate is theoretically an increasing function of the public debt ratio in long-run equilibrium, we can assume that the desirable debt level is that which achieves the golden rule of growth, i.e. the equilibrium between the interest rate and the growth rate. In the past, however, the real interest rate has not risen with the public debt level, suggesting that the public debt level implicitly desired by private agents has risen. Moreover, the interest rate has been significantly lower than the growth rate; such a configuration can give room for manoeuvre to fiscal policy; a 1 percentage point differential allows a permanent primary deficit of 0.9 percentage points for a country with a debt of 90% of GDP.

According to the Golden rule of public finance, it is legitimate to borrow to invest in order to ensure intergenerational equity. More precisely, the structural public deficit must be equal to net public investment plus the inflation-induced depreciation of public debt (Mathieu and Sterdyniak, 2012). The Golden rule requires public debt to be valued net of public capital. Thus, the rule, in terms of outstanding, is: public debt should not exceed public capital.

In 2024, the euro area government balance appears to be slightly higher than the optimal balance according to the golden rule (Table C.1). This is partly due to inflation, which is above the 2% target. In France, Belgium and Italy, however, the deficit remains excessive by more than one percentage point of GDP. However, it is likely that the Commission overestimates the structural balance in these countries (see note 14).

The Golden rule is crucial today, when large public investments are needed for the green transition. It would prevent these investments from being cut in times of fiscal austerity. However, this raises the issue of the definition of public investment. Subsidies for private investment can probably be added. Some argue that the national accounts definition should be expanded to include all spending that increases potential growth (including spending on education and research), but economic policy must have other, more important goals: reducing greenhouse gas emissions, protecting biodiversity. For this reason, some argue that the golden rule should preferably be extended to expenditure that are part of the green transition, although here too there are difficulties of definition (gas, nuclear power, electric SUVs, etc.). Conversely, others argue that green investments do not generate productive assets and should therefore

not be deducted from the current deficit. Moreover, public consumption of capital is difficult to measure, especially if we include the human capital generated by spending on education.

C.1 Deviation of public balances from the balances corresponding to the golden rule in 2024

In % of GDP, excluding inflation in %.

	Public balance	Cyclical Balance	Net public investment	Public debt	Inflation	Debt Depreciation	Difference
	(a)	(b)	(c)			(d) (d')	(a)-(b)+ (c)+(d) or (d')
Euro zone	-3.0	0.0	0.5	90	3.0	2.7 (1.8)	0.2 (-0.7)
Germany	-1.6	-0.4	0.0	64	3.5	2.2 (1.3))	1.0 (0.1)
France	-5.3	-0.3	0.6	111	2.7	3.0 (2.2)	-1.4 (-2.0)
Italy	-4.4	0.6	0.5	137	2.2	3.0 (2.7)	-1.5 (-1.8)
Spain	-3.0	0.6	0.8	108	3.2	3.0 (2.2)	-0.2 (-1.0)
Netherlands	-0.3	-0.6	0.3	46	3.7	1.7	1.1
Belgium	-4.4	0.0	0.7	105	2.5	2.6 (2.1)	-1.1 (-1.6)
Austria	-3.1	-0.6	0.7	78	4.1	3.2 (1.6)	0.2(-1.4)

Source: European Commission, AMECO Spring 2024, authors' calculations.

(d) is evaluated with the effective inflation rate, (d') with a 2% inflation rate.

Furthermore, the Golden rule is not a macroeconomic stabilisation rule. Governments must be able to adjust their fiscal policies for cyclical reasons. Conversely, a country should not increase its public investment by financing it through the public deficit if there are no savings available, as there is a risk that this investment will generate excess demand, higher inflation and interest rates. Finally, there is a risk that focusing on investment spending will lead to reduced funding for social spending.

There are three key considerations:

- *Equity between generations*: net investments can be financed by the public deficit as long as the interest rate does not exceed the growth rate (Sterdyniak, 2022). They should not be if they require an interest rate higher than the growth rate. At the same time, the costs of greenhouse gas emissions and environmental damage must be significantly increased.
- *In the event of fiscal consolidation*, Member States should be encouraged to maintain public investment and to cut spending elsewhere (and possibly to raise taxes). This is a legitimate concern, bearing in mind that consolidation is only justified if there is excess demand for goods, and not because of arbitrary standards of public balance or debt.
- *Macroeconomic equilibrium*: excess demand for goods must be avoided; at full employment, an increase in green investment must be offset by a fall in consumption (if not, in brown investment), and therefore by an increase in taxes. This cannot be considered by an objective of reducing public debt, but must be done by a precise assessment of the supply/demand balance. The problem is that it is difficult to predict the necessary level of public deficit required in the medium term.

In conclusion, the investments necessary for the green transition must be undertaken. For other public spending, a social trade-off must be made between public spending and private spending, i.e. taxes and social contributions. The public deficit (and therefore the public debt) must make it possible to achieve the production level corresponding to full employment with an interest rate

equal to the growth rate. This implies that the structural budget will eventually be in balance, but does not give us a precise figure for the public debt level, which must match the desire of private agents to hold it. There is no point in clinging to arbitrary deficit and debt targets when the current level does not introduce any macroeconomic imbalance.

From a macroeconomic equilibrium perspective, the public deficit (and therefore public debt) may be necessary to ensure that demand equals supply, with an interest rate lower than the growth rate, inflation close to the Central Bank's target and a desirable external balance. Economic policy coordination should analyse the situations of the Member States: should ask countries with too high surpluses (or deficits) to adopt more (or less) expansionary policies or ask all countries to adopt less (or more) expansionary policies to allow the interest rate to fall (or rise). The analysis must be global before being applied to each MS. Furthermore, the example of the United States suggests that a country (or a group of countries) can dare to implement an expansionary policy which, as experiences shows, does not lead to a sharp rise in inflation, but does boost potential growth by increasing investment and the labour force..

Public debt sustainability

Fiscal policy is considered unsustainable if it induces the risk of a loss of control over public finances, which would lead to high inflation, a debt default or a sudden and costly change in economic policy. However, a policy that increases public debt as a result of weak private demand or the desire of households to hold more risk-free assets cannot be considered unsustainable. It does not *a priori* pose a problem of sustainability: if private agents decide to increase their spending, the government must be prepared to cut its deficit. It is unwise to raise the issue of sustainability by prolonging ad infinitum an expansionary policy that is by definition temporary.

Let d be the amount of public debt relative to GDP, $r-g-\pi$ the real interest rate corrected for growth, and s the primary public balance. Public debt evolves according to: $d = (1+r-g-\pi) d_{-1} - s$. Therefore, debt stabilisation requires that: $(r-g-\pi) d = s$. Given that s_M is the maximum possible primary public surplus, public debt sustainability requires that, taking into account all possible macroeconomic scenarios, the probability that the State will be unable to stabilise its debt (and therefore that $(r-g-\pi) d > s_M$) is practically zero. The future value of the real interest rate corrected for growth is the key factor here, but predicting this value is difficult. If it is negative, any primary deficit will enable the debt to be stabilised. The debt ratio converges towards the value $-s/(r-g-\pi)$. Thus, for $(r-g-\pi) = -2\%$ and $s = -3\%$, public debt converges towards 150% of GDP. The question becomes: is such a level of debt acceptable to the financial markets? Conversely, with an initial debt of 150% of GDP, if $r-g-\pi$ rises to 2%, the government should be able to increase the budget balance to a surplus of 3%. This may not be a problem if the rise in interest rates is the result of favourable economic conditions, but this is more difficult if it is the result of an unfounded reaction by the financial markets, which could prove to be self-fulfilling.

Thus, the sustainability of public finances depends on private demand (which can make deficits and high debts necessary), monetary policy (which can maintain low interest rates and accept inflation to facilitate public financing, i.e. fiscal dominance which runs the risk of high inflation if the State has an unrealistic objective in terms of the unemployment rate ; which can maintain its inflation target in order to force the government to adopt more restrictive policies; i.e. monetary dominance, which runs the risk of unsustainability if the government does not give in), fiscal policy

(it should be noted that the question of dominance does not arise if the government and the Central Bank have the same objectives in terms of inflation and activity), and the financial markets (which can increase interest rates for fear of defaulting on the debt, thereby rendering the debt effectively unsustainable).

There is little point in considering that public debt must not exceed the cumulative future surpluses anticipated in the public balance, since these surpluses cannot be anticipated, independently of economic trends in general and debt trends in particular, since the State is not constrained to reduce public debt to zero, whatever the time horizon envisaged; its constraint is to always be able to maintain the public balance at a level compatible with macroeconomic equilibrium.

The question of debt sustainability does not arise in a monetarily sovereign country, where the Central Bank is independent, but guarantees the financing of public deficits. The risk of default on public debt does not exist; there only is a risk of losing control of inflation and of the level of the exchange rate, a risk which is limited, in fact, by implicit coordination between the Central Bank and the State, i.e. the proximity of their objectives: the State must renounce a policy of supporting activity which would generate inflation unacceptable to the Central Bank.

In the eurozone, it is the ECB that proclaims the unsustainability of a Member State's policy, as shown by the examples of Greece (which the ECB did not support) and Italy (which it does support). It is therefore impossible to assess the risk of insolvency using stochastic models and to *predict* the interest rates that the public securities of the various Member States must bear as a result¹⁴. How can we assess the probability that a government in one MS will decide to pursue an expansionary policy that will be opposed by the ECB? Conversely, the example of the Covid crisis shows that the ECB accepts the increase of public debt when it is macroeconomically justified.

¹⁴ Contrary to what Blanchard, Leandro, and Zettelmeyer (2021) prescribe.

Annex 4: Growth projections in the 2024 Ageing Report

The report is based on a large number of more or less controversial assumptions.

- Fertility rates in EU countries would rise to 1.6 children per woman (from 1.5 at present).
- Life expectancy at birth would rise from 79.6 to 84 years for men and from 84 to 88 years for women in 2050.
- Immigration is expected to fall to 1,000,000 per year. It would be relatively high in Italy, Spain and Austria.

Overall, the population of the EU would be stable between 2022 and 2045, with some growth in Ireland, Belgium, Luxembourg, Malta and Sweden, linked to the assumption of relatively high immigration, and a sharp decline in Latvia, Lithuania, Bulgaria, Greece, Hungary and Romania, as a result of low birth rates and high emigration.

- The activity rate of 20-24year olds would increase by 3 to 4 percentage points, with no convergence between Belgium-Italy on the one hand and Germany-Austria-Denmark on the other hand. There is some room for improvement in some countries, but this is at odds with the longer education (except through the development of apprenticeships, which are not directly productive).
- The activity rate for men is expected to remain low in Italy.
- The gender gap in activity rates is expected to narrow but to remain high in Italy, Romania and the Czech Republic.
- The activity rate of older people is expected to increase in France and Italy, but to remain low in Poland and Romania and relatively low in Belgium and Austria.

There is room for improvement in some countries: male employment (Italy, Belgium); female employment (Italy, Spain, Netherlands, Romania, Czech Republic); older workers (France, Italy, Belgium, Austria, Poland, Romania). However, the high rate of part-time work among women detracts from the good employment performance of Germany, the Netherlands and Austria.

D.1 Current and forecast activity rates

	Young people (20-24)		Men (25-64)		Women (25-64)		Older workers (55-64)	
	2021	2070	2021	2070	2021	2070	2021	2070
Germany	71.5	78.8	91.4	92.0	82.8	86.4	74.1	77.9
France	64.6	69.2	92.3	91.7	84.0	87.8	59.7	75.9
Italy	43.1	45.6	87.3	88.1	67.3	71.8	56.5	76.3
Spain	53.2	56.5	91.3	90.2	75.4	83.7	64.4	77.5
Netherlands	83.6	89.1	96.6	94.8	85.1	88.2	73.8	84.2
Belgium	47.4	51.2	89.7	91.0	81.1	85.3	57.1	70.6
Austria	73.8	77.9	92.3	93.4	85.6	89.8	58.4	69.4
Sweden	72.8	75.1	93.9	94.2	88.2	90.1	82.5	85.5
Denmark	73.1	78.6	90.5	91.3	83.7	88.3	75.3	86.6
Poland	55.5	59.0	92.5	92.4	82.1	85.6	56.0	61.9
Romania	46.7	45.5	90.7	92.7	70.0	69.9	45.6	56.5
Czech Republic	49.5	52.7	95.8	95.6	81.1	80.3	71.6	75.0

Source: DSM2023.

The projection assumes that each country will reach an econometrically estimated equilibrium unemployment rate by 2027. This equilibrium unemployment rate will then vary according to

structural factors such as the unionisation rate, the activation of employment policy, and the gap between net and super-gross wages. These elements are assumed to improve in countries where the performance is mediocre. As a result, in countries where the equilibrium unemployment rate is estimated to be above 6.7%, it will converge to 6.7% after 2032. However, this favourable assumption will not apply to countries such as Italy, Greece and Spain in the first 10 years.

D. 2 Part-time work and unemployment rate

	Part-time rate	Unemployment rate		
	2022	2022	2032	2050
Euro zone	12.3	5.7	6.1	6.0
Germany	17.2	3.1	4.1	4.1
France	10.4	7.3	7.5	6.7
Italy	10.8	8.1	9.6	6.7
Spain	7.1	12.9	11.7	6.8
Netherlands	29.4	3.5	3.6	3.6
Belgium	15.9	5.6	5.9	5.9
Austria	18.7	4.8	4.6	4.6
Sweden	13.4	7.5	6.7	6.6
Denmark	13.4	4.5	4.0	4.0
Poland	3.0	2.9	3.1	3.1
Romania	2.2	5.6	6.2	6.2
Czech Republic	3.5	2.2	2.8	2.8

Source: Eurostat, DSM2023.

The economic dependency ratio, in the sense of pensioners/employees, is increasing in all countries, particularly Italy, Spain, Romania and Poland. Italy, Romania and Spain have reached a high level, with both demographic problems and a low level of female employment.

D.3 Economic dependency ratio.

	Inactive +65a /employment	
	2022	2045
EZ	46	62
Germany	41	55
France	49	62
Italy	58	79
Spain	46	67
Netherlands	36	48
Belgium	45	55
Austria	39	56
Sweden	38	42
Denmark	39	47
Poland	38	58
Romania	47	71
Czech Republic	39	57

Source : DSM2023

Between 2012 and 2022, labour productivity growth was very low in the eurozone countries, at 0.45% per year overall, but practically zero in France. It has remained stronger in Sweden and in the United States (1% per year), while a strong catching-up process took place in central and eastern EU countries

(table D3). The projection assumes convergence in labour productivity between eurozone Member States; then, in the long term, labour productivity growth would rise to 1.3% per year (o+86% by 2070) in the advanced economies from 2022 to 2030, it would gradually increase to reach this level. While these assumptions seem pessimistic in the short term for France, they are problematic in the medium to long term for all countries. They implicitly assume that technical progress will make possible to relax ecological constraints and to raise productivity gains in services. The issue of how to adjust to slower growth has not been raised, nor has that of the content of growth.

D.4 Labour productivity gains and GDP growth, in % per year

	Labour productivity			Growth rate: 22/70	
	2012-22	2022-30	31-40	GDP	GDP Per capita
Eurozone	0.45	0.9	1.3	1.2	1.2
Germany	0.45	1.0	1.3	1.1	1.1
France	0.03	0.2	0.8	1.1	1.1
Italy	0.25	0.6	1.1	1.1	1.3
Spain	0.25	0.5	1.2	1.2	1.2
Netherlands	0.5	0.5	1.1	1.3	1.2
Belgium	0.45	0.5	1.0	1.3	1.1
Austria	0.1	0.8	1.2	1.3	1.3
Sweden	1.0	0.8	1.2	1.6	1.6
Denmark	0.9	1.1	1.2	1.3	1.3
Poland	2.5	2.9	2.8	1.5	1.8
Romania	4.5	3.4	3.0	1.7	2.2
Czech Republic	1.4	1.2	1.9	1.5	1.5

Source: DSM2023

The projection assumes that inflation will quickly return to 2% while long-term interest rates will remain at 3.5% from 2032, so that the interest rate-growth rate differential will be positive at close to 0.5%; leaving interest rates at 2.8% would have made it possible to keep the interest rate-growth rate differential at -0.7%. This amounts to 1.2 percentage points of GDP for a country with a debt at 100% of GDP. Moreover, even if the assumption of the end of long-term interest rate differentials in the euro area is satisfactory, their management in the medium term, based on a model which does not explain the current differentials, is bizarre: the differential between France and Germany rises from 0.4 percentage points in 2024 to 1.1 in 2032 and then falls to 0 in 2052; the differential between Italy and Germany rises from 1.9 in 2022 to 2.0 in 2032 and then falls to 0 in 2052.