Technical fiche

The new European fiscal rules in a nutshell

The European Parliament will be asked in the week of 22nd. April to give its opinion on two regulations, one relating to the so-called preventive arm of the Stability Pact (co-decision with the Council), the other to the corrective arm (consultation only).

A. Preventive arm of the Stability Pact

The "preventive arm" regulation applies to all countries, albeit in different ways depending on whether they comply with the two reference values (60% for the debt/GDP ratio and 3% for the deficit as a % of GDP) or fail to comply with at least one of them.

It should be noted that there is no automaticity between exceeding the reference values and being in "excessive deficit" (see corrective arm below).

Fiscal-structural plan

All countries must present a “fiscal-structural plan”. This plan mainly includes a path for primary structural public expenditure (PSE), i.e. expenditure after deduction of interest, cyclical expenditure (unemployment insurance in particular), expenditure financed by a transfer from the Community budget and co-financing of Community programs. Increased revenues resulting from discretionary measures (e.g. raising tax rates, broadening the tax base) should also be deducted from net expenditure in line with current practice (Vade Me Cum of the Stability Pact, P.27).

The PSE are at the heart of public policy funding: it determines the number of civil servants, their purchasing power and that of pensioners, public health, social aid, economic subsidies, aid to households of all kinds, purchases of goods and services and government investment, aso.

The PSEs are the sole reference indicator for assessing compliance with the fiscal rules during the implementation of the plan, in both preventive and corrective terms.

The fiscal structural plan should also contain explanations on the contribution of reforms and investments to transition, social, climate and energy objectives and, if necessary, to strengthening defense capabilities.

The plan shall be assessed by the Commission and endorsed by the Council.

The Commission or the Council can issue recommendations to a country that does not present a plan meeting the conditions set or does not respect the agreed plan. However, when the country is not formally declared to be in "excessive deficit", these recommendations - if issued at all - only have reputational consequences.

Calculating the primary structural expenditure (PSE) trajectory

The rules first determine a path for the structural primary balance (SPB), which is translated in a second step into a path for the PSE. The SPB is defined as the “all in” headline balance minus the interest payments, the cyclical expenditure (unemployment insurance and the expenditure financed by a transfer from the Community budget.

Trajectory of the structural primary balance (SPB)

The SPB trajectory is calculated for a multi-annual period comprising an initial sub-period, defined as the adjustment period. The rule is an adjustment period of 4 years that can be extended up to 7 years at the request of the Member State, subject to a commitment to structural reforms and an investment program meeting a certain number of conditions. These conditions include strengthening potential growth and the resilience of the economy, ensuring the sustainability of public finances, and maintaining a minimum level of investment.

The path of the SPB is determined so that the debt-to-GDP ratio, the 'all-in' fiscal balance, the structural balance (including interest but net of cyclical spending) and the SPB itself meet several conditions listed below. The accounting relationships that exist between the various variables require assumptions to be made about medium/long-term "potential" GDP growth, interest rates and the inflation rate for the entire period, including the period beyond the adjustment period (at least 5 years beyond the adjustment period).

Following conditions apply cumulatively:

- For all countries, the trajectory of the SPB shall plausibly ensure that at the end of the 4- or 7-year adjustment period the public debt to GDP ratio will decline for as long as it is above 60% and then be maintained at a prudent level below 60%. Plausibility is assessed using a probabilistic method in which interest rates and 'potential' growth rates fluctuate randomly around central values.
- For all countries, the structural balance (including the expected interest charge) must converge to a level sufficiently below the reference value of 3% of GDP at the end of the adjustment period and be maintained at this level over the medium term to prevent the “all in” headline balance from exceeding this threshold only with a low probability (for example in the event of a severe recession).
- Countries whose debt exceeds 60% or 90% of GDP must achieve a SPB that will enable them to reduce the debt to GDP ratio by 0.5 or 1 percentage point of GDP respectively, on average over the adjustment period.
- Countries with deficits in excess of 3% of GDP must have, or be approaching at a sustained pace, a structural deficit (including interest charges) of no more than 1.5% of GDP. The pace is defined for the structural balance excluding interest (SPB). The pace is 0.4% of GDP when the adjustment period is 4 years and 0.25% when the adjustment period is 7 years.
- The effort must not be postponed until the end of the adjustment period**.**

Translation of the SPB trajectory into a primary structural expenditure (PSE) trajectory

By construction, the maximum % change in net expenditure is equal to medium-term potential GDP growth in % per annum minus the annual adjustment of the SPB required by the rule in % of GDP divided by the share of expenditure in GDP (i.e. the required change in the balance in euros divided by net expenditure in euros). In other words, the increase in net expenditure is limited by the projected medium-term increase in output less the amounts needed to achieve the required annual increase in the balance (Vade Me Cum of the Stability Pact, P.30). It should be noted that the exclusion of co-financing introduced at Parliament's request in no way reduces the limits set on the growth of PSEs and merely places the effort on a slightly narrower base.

B. Corrective arm of the Stability Pact

A country may be declared by the Council to be in "excessive deficit" based on its level of debt or of deficit.

The Commission reports to the Council on whether to initiate **a debt based** excessive deficit procedure if the latter is greater than 60% **AND** the “all in” headline balance is not in surplus or close to zero **AND** the country is not respecting its PSE path (with a certain margin of tolerance). When a debt based excessive deficit procedure is launched, a new PSE path is defined. This new path shall close the accumulated gap to the previous PSE and meet all the conditions defined for the preventive arm.

The Commission reports to the Council on whether to initiate a **deficit based** excessive deficit procedure if the deficit exceeds 3%, unless the excess is minor and temporary, or due to exceptional factors of a general nature (recession in the EU or euro area) or events beyond the control of the government. When an excessive deficit procedure based on the level of the deficit is opened, a new trajectory is defined for the PSEs, which must meet at least the conditions defined for the preventive arm and ensure that if the "all-in" headline deficit is above 3% of GDP, the structural deficit (including interest) is reduced by at least 0.5 points of GDP per year. However, for the years 2025, 2026 and 2027, this reduction will be applied to the primary structural balance, thereby attenuating the constraint (increases in the interest burden will not need to be offset).

When a Member State does not respect its commitments under an excessive deficit procedure, it is exposed to recommendations with a high reputational cost and, as a last resort, financial sanctions.