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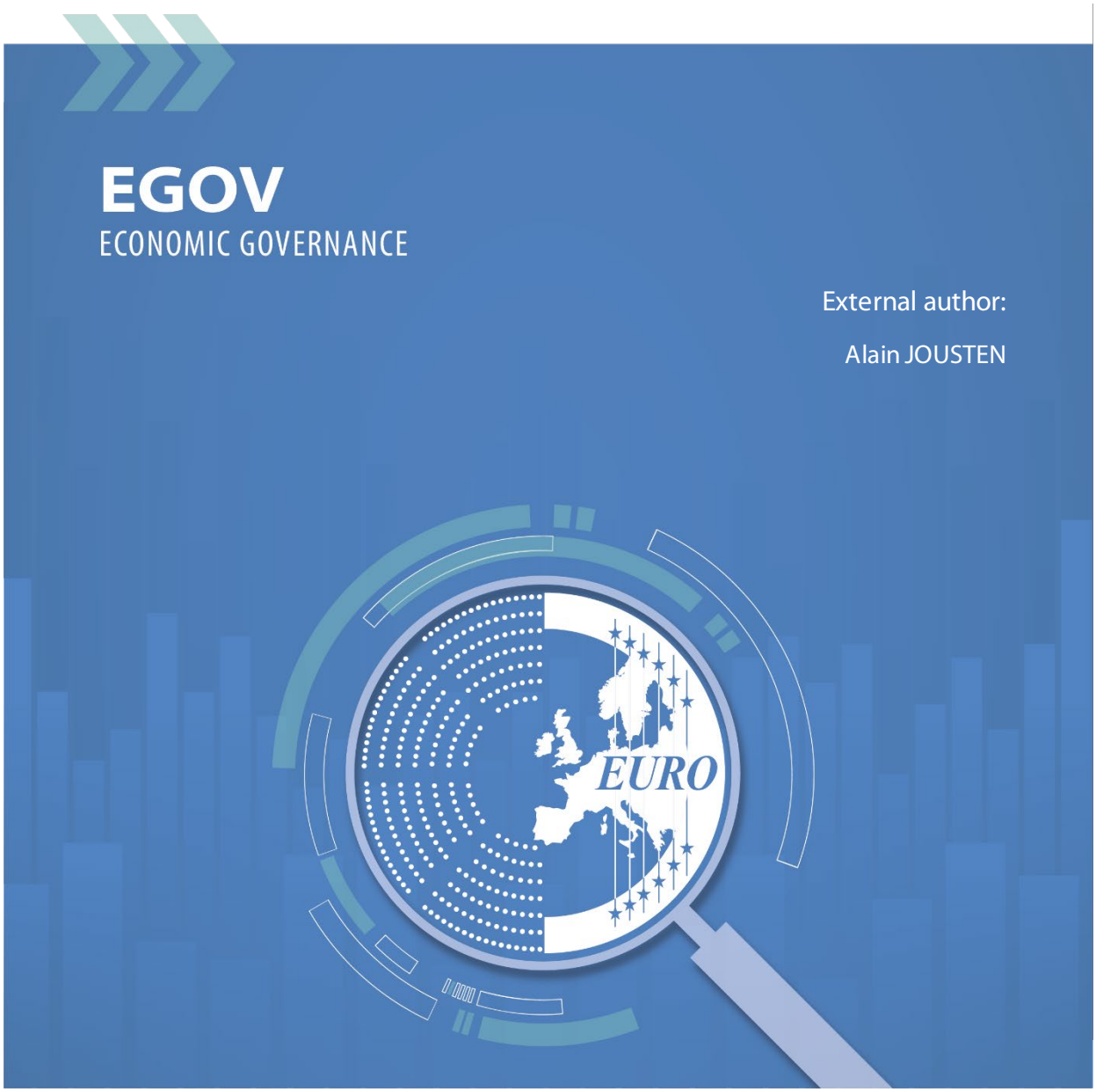
Debt Sustainability Analysis Methodology in the EU's New Economic Governance Framework: An assessment



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Debt Sustainability Analysis Methodology in the EU's New Economic Governance Framework: An assessment

Abstract

This paper discusses issues with using a DSA framework as a fiscal rule anchor. It introduces key concepts to guide the reader's understanding and highlights concerns about numerous assumptions that are inevitable in DSA calculation. The paper highlights structural issues, including asymmetry in how megatrends of aging, environmental change and a changing security and defence needs are incorporated into the framework.

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CONTENTS

LIST OF ABBREVIATIONS

DSA	Debt Sustainability Analysis
EC	European Commission
ECB	European Central Bank
EP	European Parliament
EU	European Union
GDP	Gross Domestic Product
IMF	International Monetary Fund
SPB	Structural Primary Balance

LIST OF BOXES

EXECUTIVE SUMMARY

The recently reformed European Union economic governance framework has led to broader changes at the technical level. Though the headline debt and deficit thresholds remain unchanged, their exact meaning and the way to evaluate progress towards them have undergone profound conceptual change. Debt sustainability analysis (DSA) is henceforth on the front stage as the main anchor of fiscal policy formulation. DSA is a powerful tool for assessing the sustainability of public finances over time. DSA explicitly recognises the dynamic and risky environment that Member States face along various margins.

Using DSA for formally anchoring fiscal policies as part of a fiscal rule is challenging. We distinguished two types of challenges. First, those that are related to the use of the DSA methodology in a fiscal rule. Second, those relating to specific expenditure items.

While most of the technical assumptions regarding the use of the DSA model could be qualified as plausible, there are many equally (and sometimes more) plausible alternatives. Fundamental issues regarding the cyclical adjustment of variables and the key role played by the unobservable (primary) structural balance do subsist in the new governance framework.

As a corollary, there is substantial room for the Commission to influence the DSA model's output and the associated net expenditure trajectory. Even at later stages of interactions with Member States and other EU institutions, the Commission keeps a powerful discretionary role – including during the surveillance phase. This accumulation of discretionary power risks affecting the relevance of the initial DSA exercise.

Regarding the treatment of megatrends in the DSA framework, an asymmetry can be noted: whereas ageing-related spending trends are explicitly integrated in a hybrid forward-looking way, the same does not apply for either climate or resilience and defence spending. More specifically, the way aging spending is included leads to more constraints on fiscal policymaking, with little gain in terms of controlling implicit pension promises. For other megatrends, little to no incentives are given for more investment, with the current fiscal rule rather hampering explicit public investment.

Benchmarked against the triple objectives of simplicity, flexibility and credibility, the outcome is not convincing. Rather than being simple, the framework leads to numerous additional dimensions of discretionary power and uncertainty – for Member States and citizens alike. Though flexibility is present, it mostly comes in two conceptual variants: either through not fully transparent exchanges between the Commission and the Member States, or through more drastic tools *de facto* bypassing the rule itself (activation of escape clauses; debt guarantees, etc.). Ultimately, credibility is not given and will have to be established by the rule's operational adequacy in practice.

The current rules thus appear to be what they are: founded on a political compromise rather than on economic or budgetary first principles.

1. INTRODUCTION

KEY FINDINGS

The European Union's new economic governance framework has recently entered into force. Debt sustainability analysis (DSA) is henceforth on the front stage as the main anchor of fiscal policy formulation. This paper discusses issues with respect to the use of a DSA framework as an explicit anchor for a fiscal rule. First, it introduces concepts and terminology that are essential for the understanding of debt sustainability analysis and key issues therewith. Debt indicators are shown to be neither unique nor with unequivocal policy implications. Second, it highlights that the numerous assumptions that are inevitable in a DSA calculation can be a cause of concern. While these might all be plausible, equally or more plausible alternatives may exist. Third, it highlights structural issues with respect to how the megatrends of aging, environmental change and a changing security and defence needs are (asymmetrically) incorporated into the framework. Our discussion highlights an accumulation of a large degree of discretionary power in the hands of the Commission.

The recently reformed European Union economic governance framework led to broader changes at the technical level. Though the headline debt and deficit thresholds, that are by now well entrenched in the public sphere, have remained unchanged at 60% and 3% of GDP respectively, their exact meaning and the way to evaluate progress towards them have undergone profound conceptual change.

Debt sustainability analysis (DSA) is henceforth on the front stage as the main anchor of fiscal policy formulation. While DSA previously mostly served as an ex post analytical tool for surveillance, DSA will from now on be used to anchor fiscal policymaking and planning in a forward looking way. The chosen path is one of differentiating the required fiscal adjustments based on each Member State's specific debt levels, economic growth prospects, and anticipated future budgetary burdens such as ageing-related expenses and interest payments. It falls short of explicitly taking country-level interdependencies of adjustments into account.

Against this background, the current report provides an assessment on the European Commission's (EC) DSA methodology as used in the revised EU economic governance framework. The provided discussion is technical and refers to specific and general assumptions made in the context of the framework. It does not attempt to provide an overall assessment of the broader benefits of a fiscal rule (see for example, Darvas et al, 2024, or Kopits, 2023).

The structure of the report is as follows. To position the debate and some of the relevant dimensions to the debate, section 2 provides background on underlying key debt and fiscal policy concepts. Sections 3 and 4 are the core of the report. In section 3, a series of issues with the DSA methodology are identified that concern both the general DSA conceptual framework and its specific application in the EU economic governance framework. Section 4 identifies issues with the framework in view of the three megatrends of demographic ageing, climate change and geo-political and economic fragmentation. Specific challenges and insufficiencies are identified regarding the rule-based framework's ability to properly address them. Section 5 concludes the report.

The analysis in this paper draws on a detailed examination of the Commission's DSA methodology as outlined in the Debt Sustainability Monitor 2023, complemented by analysis of the new economic governance framework's legal texts. The paper further benefits from comparative analysis with DSA approaches used by other international institutions, particularly the IMF.

2. BACKGROUND

Under the EU economic governance framework, DSA is used to determine each in each Member State's required fiscal adjustment to satisfy the newly reinstated and revised budgetary rules of the Stability and Growth Pact (SGP).

While the use of DSA methodology for evaluating the sustainability of government budget policy is not new – as witnessed by their extensive use both by the EC and other national and international organisations such as notably the International Monetary Fund (IMF) - this cannot be said of their use as an anchor for a fiscal rule.

Before delving into the specifics of the DSA methodology applicable to the new economic governance framework, it seems warranted to take a step back and consider some bigger picture questions starting from the notion and the use of debt, the delimitation of government debt, the question of what debt sustainability means and what conceptual and practical purposes DSA serves in the context of a fiscal rule.

2.1. Explicit and implicit debt

In general, debt accrues because of borrowing. Borrowing is per se not a problem, as it allows economic agents (consumers, firms and governments) to shift resources across time. Absent large pre-existing financial assets, debt is often the only way that numerous investments are possible: energy saving investments are a case in point, where upfront costs are offset by future energy savings. However, when taken too far, debt levels can become a problem in terms of solvency and in terms of sustainability – particularly an issue when projects or programmes are large and risky, and payoffs low or uncertain. At this stage, there is little difference between public and private sector debt, as both can fundamentally be exposed to these risks.

Debt does not have to be explicit – implicit debt also matters. Beyond loans or financial debt instruments, debt can also be implicit in the form of a promise to pay that falls short of being legally recognised as a debt instrument. Implicit debt, by its very nature might be more easily reneged upon, and hence its value is less clearly established than the one of conventional debt instruments. Prime examples are future social security pay-out promises. Promises of future pension pay-outs are an even more specific example of the latter, as such entitlements are most frequently not explicit debt, nor assimilated to it, but hard to (fully) renege upon. [1]

Excluding implicit debt levels from debt analysis means that debt figures are only partially representative of the true overall indebtedness of the government. When considering social security, these numbers are sizeable. Deboeck and Eckefeldt (2020) provide estimates of implicit pension liabilities for the European Union in the years 2014 and 2015. Their estimates show that accrued-to-date liabilities, i.e. pension claims of current retirees as well as already accrued pension claims of current workers, can plausibly be estimated at close to 250% of GDP for the EU as a whole – with numbers ranging from more than 350% for France to less than 40% for Denmark. Numbers are even larger when considering open group liabilities, and when including other social security benefits. [2]

Beyond debt levels, it is also changes thereto that matter. Here, implicit debt like its explicit counterpart raises the same fundamental debt sustainability issues – particularly in a world of increasing longevity

[1] Reforms of future benefit rules do however have the potential to substantially alter the level of this implicit debt.

[2] Precise implicit debt estimates are heavily dependent on life tables and on real interest rate assumptions but provide an order of magnitude.

and demographic aging with large levels of pre-existing implicit debt. This does not mean that both forms of debt are perfectly interchangeable – as one might be harder to renege upon than the other – but merely that they both contribute to the picture.[3]

Similar arguments apply to contingent debt and debt guarantees. Both are distinct from explicit and implicit debt as their realisation depends on a specific contingency or on the materialisation of a downward risk. Though different, they share some features of explicit and implicit debt as they could be legally binding or not. In any case, they potentially represent an important risk factor for public debt levels, for debt dynamics and for government finances more broadly. Box 1 summarizes these concepts.

Box 1: Different forms of government debt

Government debt can take on multiple forms, it can be explicit or implicit, it can be due in any circumstance or only due in some contingencies. The classification of individual items in the various categories heavily depends on the scope of the government units considered. For example, from a conceptual point of view, a given unsustainable explicit debt of a specific subnational government unit should likely be classified as an explicit (contingent) debt for another national government if a strict fiscal solidarity clause is binding. On the other hand, it could merely represent an implicit contingent debt (of an amount to be determined) when no such solidarity rule applies.

	Realised/non-contingent	Contingent
Explicit debt	• Government bonds • Borrowing through loans	• Debt guarantee for state-owned enterprise • Fiscal solidarity schemes in federal states • Deposit insurance
Implicit debt	• Pension obligations and future social security payouts • Present value of (future) recurrent costs of public investments • Non-refunded Value Added Tax credits	• Unsustainable debt from a state-owned enterprise or an essential public or private utility (railway, road, etc.) • Unsustainable finances of other national or subnational government entities • Debt from future bank bailouts

Similarly, explicit and implicit debt relating to the entities from the broader public sector, and state-owned enterprises in particular, raise non-trivial classification issues. Finally, public-private partnerships raise similar classification issues – the subject of much debate and dispute.

Source: presentation by the author

2.2. What constitutes government debt?

What constitutes government debt? While the question might appear simple at first sight, it is not so obvious at the conceptual level. Several dimensions matter, both in terms of the scope of public sector entities that are covered and in the specific debt indicator used.

[3] Holzmann and Jousten (2012) discuss the issue of legacy pension debt in the context of a sustainability-enhancing pension reform.

While in the EU the focus lies on the consolidated general government as the reference unit – netting out intra-government positions – other delimitations of the scope might be warranted for conceptual reasons. For example, if substantial explicit or implicit contingent or non-contingent liabilities reside with the broader public sector (financial or non-financial), such as for example in state owned enterprises, such debt might be highly relevant for the government's fiscal position. Similar conceptual arguments prevail for government guarantees issued to private investors as they could be – and sometimes are – activated.

Finally, the issue of what exactly constitutes debt still needs to be resolved. The easiest way to consider this issue is to compare it to a classical corporate balance sheet – where debt is merely one indicator on the liabilities side, which has a counterpart on the assets side. As such, various indicators of debt can be defined, ranging from gross debt to indicators increasingly netting out various asset categories.[4] All of these indicators have their value. For example, when focusing on debt rollover and refinancing issues, gross debt is of prime importance. When focusing on the net fiscal position of a country, a netted value might be more adequate.[5] A well-known case study is Singapore, with a large gross public debt of over 162% of GDP, which is largely outweighed by the value of financial assets the government holds leading to a net public debt that is negative.[6] In the EU budgetary surveillance context, the focus lies on gross debt. This is the debt composed of financial liabilities related to currency, deposits, debt securities and loans, with no netting occurring for assets owned by the government.

2.3. Debt sustainability and why it matters

The concept of a government's debt sustainability intuitively resembles the notion of solvency: the ability to meet all payment obligations current and future without going into default, into arrears or requiring external intervention. It is however broader than solvency in that it also often takes the impact on growth and development of the country into account – as absent such additional considerations any debt level could be rationalised by sufficiently large assumed primary surpluses in the (far-away) future. The IMF, for example, in its debt sustainability assessment of low-income countries *"(…) uses a composite indicator that considers a country's historical performance, outlook for real growth, remittance inflows, international reserves, and other factors."* [7] For example, the IMF often combines DSA results with other indicators, such as sources of government funding – both in terms of their term structure and their origin (domestic versus foreign).

The DSA explicitly recognises the dynamic and risky environment that countries face along various margins. Therefore, such analysis is usually repeated regularly (for example, yearly), and reference scenarios are enriched with stochastic simulations as well as shock scenarios to reflect the realization of various types of risks (interest rates, etc.).

The DSA as a tool for micro-fiscal analysis is not new. DSA has been part of the toolbox of public finance economists at national and international level for a number of years. Internationally, for example, the IMF has extensively been using DSA analysis in both surveillance and programme contexts as a means

[4] Gross government debt corresponds to financial liabilities related to currency, deposits, debt securities and loans.

[5] The process of netting might have to be nuanced, as the ability of a country to use these assets to cover debts could be limited by their liquidity or possible swings in asset valuation. Nonetheless, opting for gross debt represents an extreme assumption. See, for example the discussion in Bouabdallah et al (2017).

[6] For a quick summary of indicators on Singapore see https://www.imf.org/external/datamapper/profile/SGP.

[7] https://www.imf.org/en/About/Factsheets/Sheets/2023/imf-world-bank-debt-sustainability-framework-for-low-income-countries.

of gauging fiscal sustainability and its potential impact on balance of payments. Recognising the very different realities faced by countries belonging to different income-level groups, it has developed two toolkits for low income and market access countries.[8] In the EU context, the European Commission has also ample experience in using DSA as a tool of projecting plausible debt and deficit pathways in a surveillance and program context.

2.4. Debt and fiscal rules

Numerical fiscal rules are a common approach of anchoring a fiscal policy objective. They often refer to debt, deficit, expenditure or revenue targets, including the pathways of reaching them in case of deviations.[9] In practice, fiscal rules range from "mere" domestic revenue mobilisations objectives (often in low-income countries) to more general debt rules, sometimes excluding specific items (such as investments). The long-standing European gross consolidated government debt and deficit criteria (of 60 and 3% of GDP respectively) are just an illustration of a specific form of fiscal rule.

2.5. DSA as part of a fiscal rule: a new game

The reformed EU economic governance framework constitutes a major innovation in the field of fiscal rules.[10] It introduces a forward-looking DSA tool for anchoring and constraining short-to-medium-run fiscal policy in the context of an *a priori* formal and binding procedure. Technically, this is challenging.

In practice, the Commission is tasked with performing a DSA for all Member States according to a common methodology with the view of putting the their projected government debt ratio on a downward path or keeping it at a prudent level – with a series of so-called "safeguards" and transition provisions applicable.[11] Whereas a classical DSA is used for evaluating the debt pathway, or the response of this pathway to various policy alternatives or shocks, the current approach goes one step further in utilising the DSA for determining a Member-State-specific adjustment path (net expenditure path) that the Commission proposes to reach the said debt stabilisation goal.

Member States are in control of specific policy measures they envision to reach the net expenditure pathway. Member States further have the right to objectively challenge the proposed pathway and its underlying assumptions – hence the need for a replicable, predictable, and transparent DSA by the Commission.

Ultimately, an agreement needs to be reached between the Commission, the Council and the Member State on a final net expenditure trajectory which will become the sole binding rule for the Member State.[12] The European Parliament also plays an important role, as outlined by articles 27 and 28 of regulation (EU) 2024/1263. Among others, it has the right to scrutinise the Commission's methodology for assessing debt sustainability through the economic dialogue process outlined in Article 28.

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[8] For the most recent revision of the IMF rules on DSA for market access countries and the template, see https://www.imf.org/en/Publications/DSA/sovereign-risk-and-debt-sustainability-analysis-for-market-access-countries.

[9] For a discussion of how fiscal rules anchor medium term fiscal frameworks, see IMF (2024).

[10] The new framework consists of two regulations (EU 2024/1263 and 2024/1264) and one directive (2024/1265). https://eurlex.europa.eu/eli/reg/2024/1263/oj, https://eur-lex.europa.eu/eli/reg/2024/1264/oj, https://eurlex.europa.eu/eli/dir/2024/1265/oj

[11] Safeguards are additional conditions and constraints that deviate from the pure logic of a DSA. Transitory provisions relate to the first iteration of the exercise for the period 2024-2027, particularly with respect to the interest burden.

[12] In case of absence of agreement, the original Commission-proposed trajectory becomes binding.

Transparency is therefore crucial for the Parliament to be able to fully play its role of democratic scrutiny of the process.

The new economic governance framework thus illustrates an explicit policy choice of European policymakers for one specific budgetary anchoring model. Such model represents neither the sole possible incarnation of such fiscal rules, nor is it conceptually superior to alternatives. The specific choices do however raise a certain number of concerns that we discuss in the following sections.

3. GENERAL ISSUES WITH THE BASIC DSA FRAMEWORK

3.1. DSA as a fiscal anchor

Designing a good fiscal rule is a challenging task. The objective of a fiscal rule is to provide an anchor for fiscal policy. In line with Debrun and Jonung (2019), three key dimensions are identified. First, the rule must be seen as a credible anchor. Expressed differently, its design and its implementation can be either sustained by voluntary compliance or by force of binding commitments and applicable punishments. Second, the rule must be flexible, as it would be hard to overemphasise the role of shocks and the dynamic nature of our economies, particularly in current times. Third, the rule should be simple, to allow both policymakers and the wider public to adhere to it. Unfortunately, these three dimensions form a trilemma, with either credibility, flexibility, or simplicity suffering.

Prior to the new economic governance rules, the European fiscal architecture showed its limits.[13] Examples abound: Member States did not respect the rules without any noticeable consequences (credibility); the rule sometimes exerted procyclical effects because of a purely annual approach (credibility-flexibility); in the face of major shocks, the general escape clause had to be activated (flexibility); the rule was hard to read as the unobservable indicator of structural primary balance (SPB) played key role (simplicity); suspension of the rule faced with major shocks. While none of these examples alone are sufficient to invalidate the rule, as even the general escape clause was part of the rule, their combined effect ultimately led to a track record of successive reform and ultimately suspension *de facto* rendering the rule itself an antonym of what a fiscal rule is meant to be.

The new economic governance framework addresses some of these concerns – though it would clearly be illusionary to believe that it addresses them all.[14] On the positive side, the new rules take a medium-term perspective instead of a purely annual one with Member States' plans elaborated for a period of 4 or (up to) 7 years. By taking a decidedly forward-looking approach even beyond these plans, the framework tries to surmount issues of pro-cyclicality and better takes Member-State-specific evolutions into account. Furthermore, it puts the decision-power on specific policies firmly into the hands of Member States improving potential for adherence. Finally, by focusing on a net expenditure pathway, it puts the emphasis on a more observable macro-fiscal indicator.

Whether the new framework delivers on its objectives, and what it implies for Member States in practical terms is essentially an empirical question and remains to be seen. Calculations by Darvas et al (2023 and 2024) provide useful numerical analysis of this now DSA anchor. They illustrate how different Member State situations could and would translate into adjustment requirements. They further provide a broad assessment of the improvements of the new economic governance framework over the old, in the process highlighting some strengths and weaknesses.

Specific aspects regarding the framework and its assumptions do however continue to hint at remaining and potentially important problems. In what follows, we focus on selected issues linked with the DSA itself.

[13] See ECA (2018) for an insightful evaluation of the preventative arm of the SGP.

[14] For a more detailed discussion, see Darvas et al (2024).

3.2. Net expenditure as a reference or is it the SPB that ultimately matters after all?

While the use of net expenditure paths as the single operational target in the new fiscal framework might be appealing because of its apparent simplicity, this enthusiasm should be nuanced. On the one hand, the regulation's net expenditure is much less observable than one might think. On the other hand, its use in the framework raises questions.

Under the terms of the regulation, net expenditure is defined by netting out one-off elements as well as by subtracting the cyclical component of unemployment insurance. Revenues from new discretionary revenue measures are also subtracted in this netting process, as are several other expenditure items are also subtracted: expenditure on programs of the EU fully matched by revenue from EU funds, national expenditure on co-financing of programs funded by the EU.

Subtracting cyclical components as stipulated in Regulation (EU) 2024/1263 *de facto* means that some statistical filtering or *ad hoc* decisions must be applied as to what exactly represents a one-off and how exactly the cycle influences unemployment insurance spending. Though maybe well-established procedures are applied, these are not manipulation and negotiation-proof.

When determining the reference trajectory with the DSA, a different definition is used. Specifically, in the Commission's DSA, the concept of net expenditure growth and the one of required change structural primary balance (SPB) are mechanically linked (see Box 2).

Box 2: EC Formulaic specification of nominal net primary expenditure growth

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

Source: EC (2024a), p. 114.

The SPB is essentially a de-cycled version of the primary balance – the structural component after a process of statistical/econometric filtering. It adjusts the overall government balance (net of interest) for the impact of the economic cycle, as well as for temporary measures taken by governments (one-off revenues or capital transfers). As detailed in EC (2024a), *"The cyclical component reflecting the effect of automatic stabilizers is calculated as the product of the output gap and country-specific budget balance semi-elasticities agreed with the Member* States and used for budgetary surveillance under the SGP."

The technical reason for this formulaic approach is obvious given the Regulation refers to both net expenditure paths and the SPB as control variables. Furthermore, the Commission's DSA model is based on the SPB.

The chosen approach has two major consequences: First, both forms of removing the cycle are conceptually not equivalent and could give very different results, as subject to different rationales – one based on an EU Regulation the other one on a technical statistical filtering. Second, while the DSA functions without netting out some types of EU (co-)financed expenditure, the operational indicator does net them out – providing a conceptually inconsistent treatment of these expenditures.

The proclaimed difference between the two indicators in the new economic governance framework is thus rather tenuous: in the DSA, the path of net expenditure is assumed to follow… a formulaic transformation of the SPB! Ultimately, this implies that the pathway against which Member States are being monitored is essentially an SPB-derivative – furthermore with a different composition on the constraint side than on the control variable side. This raises very practical concerns: how will a real-

world net expenditure path be compared to a DSA-based net expenditure trajectory? The picture is further blurred by the presence of the safeguards…

Ultimately this issue even raises the question of knowing how far effective compliance or non-compliance with the agreed upon trajectory should be considered as compliance or non-compliance with the underlying logic of the fiscal rule. Potentially, Member States could be pushed into some forms of expenditure rather than other, not because of their superiority in terms of debt sustainability, improvements in equality or growth potential, but rather because of an inconsistent classification and or a specific statistical way of dealing with the economic cycle.

3.3. The role of government revenues

Government revenues play a special role in the new economic governance framework, even if per se they are not a control variable. Nonetheless, they are important drivers of fiscal dynamics. While the SPB takes the full revenue side of the government into account, net expenditure in the new EU economic governance framework only nets out specific type of revenue items, namely discretionary revenue measures.

In practice this raises two issues that we will discuss in turns.

First, what exactly are "discretionary revenue measures" in the net expenditure concept? A plausible assumption would be to consider discretionary revenue measures as newly taken measures that generate (or lose) revenues. [15] They can be transitory or structural. In the non-discretionary part of revenues, at least some types of revenues are dependent on underlying economic variables – such as income or consumption - and thus heavily depend on the economic cycle. Specifically, progressive taxes as well as business taxes are known to act as automatic stabilizers – just as do unemployment benefits on the expenditure side. Expressed differently, discretionary is not the same as structural – hence not all discretionary new revenues could or should be considered as structural.

Similarly, the limit between a discretionary and a non-discretionary revenue measure is non-trivial – hence what should or should not be included in net expenditure is rather a decision rather than a mere categorisation. Consider the case of three policy measures: an ad hoc income "crisis" surtax, a decision to increase tax rates on existing tax brackets and the non-indexation of tax brackets. Which one of the three could or should be considered as a discretionary measure is not an obvious call from a tax policy perspective – as all three are in a way discretionary. The problem even runs deeper as similar arguments could be constructed at the border between taxes and benefits: an activation policy targeting higher employment rates would lead to benefit decrease and potentially a lower recourse of specific tax benefits targeted at the inactive or unemployed. While the former would favourably be reflected in the net expenditure measure, the latter would not. Feher and Jousten (2018), for example, provide an overview of the interplay between pensions and taxes.

Second, the broader question arises as to how the surveillance framework more generally deals with revenues and their projections? For the DSA, the answer is simple – though different from the above. Here, the only thing that matters is the SPB. Improving revenues matter insofar as they are structural revenue increases – irrespectively of whether they are discretionary or not. For example, a pre-existing progressive income tax system with non-indexed brackets gives rise to an increase in real tax revenues in the face of inflation because of bracket creep – with no discretionary decision needed.

[15] No specific definition is provided neither in the regulation nor in EC (2024a).

For the DSA, tax measures are thus always relevant. In a reform perspective, this has implications for DSA purposes: If a fiscal adjustment is needed, it can be achieved through any expenditure or revenue measure, for the latter if it raises the revenue (tax) to GDP level above the originally prevailing one – whether discretionary or not. [16]

In the new economic governance framework, this burden of adjustment seems to be entirely shifted to the net expenditure indicator. Hence, the labelling of revenue changes is important for surveillance. This in turn raises the potential for a mismatch between what is labelled a new discretionary revenue measure, and what is one in underlying economic terms. While such distinctions can to some degree be addressed in the dialogue phase between the EC and the Member State, it is an illustration of the limits of the framework's basic design.

Even stronger, what if the simulated revenue trajectory of the DSA turns out incorrect over the surveillance phase? The question is clearly relevant as deviations can occur for a variety of reasons, if only errors in predicting the baseline responsiveness of the various tax instruments to changes in their respective tax basis.

Under the Commission's standard annual DSA analysis, any change on the structural revenue side feeds through to the net expenditure trajectory – whether discretionary or not. [17] Following this logic, a worsening of the SPB in the surveillance phase should conceptually quasi-automatically lead to an increase in the net expenditure effort – to stay on the anchoring downward debt path.

The same conclusion does however not ensue when focusing on the net expenditure indicator of the Regulation. [18] Strictly speaking, non-discretionary changes in revenues do not enter the picture. As such, for example, a revision of technical revenue elasticities could, in theory, lead to higher debt path. [19]

Combined, these revenue considerations illustrate how the role of revenues effectively leads to a loss of readability of the rule – with simplicity further hampered by the various safeguards. Expressed differently, there is a conceptual uncertainty regarding the way modifications to revenue projections would impact the required fiscal adjustment path. Through a complicated and non-linear process, it could either act in a way close to the spirit of the fiscal rule targeting debt and deficit reduction or be closer to the letter of the rule regarding the adjustment path. Ultimately, this issue even raises the

[16] In the adjustment scenario of the Commission's DSA, the only point where a stable revenue to GDP ratio is explicitly referred to is for the 10-year post-adjustment phase – however without any further explanation as to why such an assumption might be adequate given potential effects from the preceding adjustment phase. Also, no explanation is given as to how this would be achieved given that tax to GDP ratios in the adjustment phase are endogenous.

[17] For a concise discussion of cyclical adjustments see, for example, Box 13 in ECB (2012).

[18] In this argument, we leave aside the working of the various safeguards that could become binding in such cases, and hence could limit the scope for fiscal decision-making – and of the net expenditure rule at the same time!

[19] A question-and-answer document prepared by the Commission outlines what would be considered revenue shortfalls on discretionary measures outside of the control of the member state that would not require adjustment of the net expenditure effort. While providing some guidance, it is neither explicitly detailed in the DSA methodology nor the regulation, nor does it cover any form of revenue shortfall even on non-discretionary items. https://economy-finance.ec.europa.eu/document/download/cf44e673-b4c6-4846-9c07-5506cd155e2b_en?filename=2023-01-05%20EGR%20clarifications%20to%20Member%20States.pdf.

spectre of pro-cyclical policies, which the *exposé des motifs* of the Regulation (EU) 2024/1263 explicitly desired to avoid.[20]

3.4. The choice of the base period for projections

The adjustment path proposed by the Commission based on its DSA, and the adjustment path finally validated by all relevant parties will differ – for technical reasons, but also for pure timing issues.

Timing-wise, even if Member States and the Commission were to agree on all methodological assumptions, their estimates will necessarily differ because of the different point in time that the projections are done at. Potential GDP and cyclical adjustments to budget items are known to be heavily dependent on the precise starting point and the accuracy of the underlying statistical information. In the past, such estimates have turned out to be volatile in some situations.[21]

A repeat of the DSA at the consensus-finding stage might thus have value as otherwise a real risk exists that either the Commission baseline or the proposal of the Member State is simply out of synch. While in normal times, such differences could be dismissed as marginal, in current times of multiple and successive shocks and crisis, this can no longer automatically be assumed.

A similar issue incidentally arises with respect to the surveillance phase that will last up to 7 years, once the net expenditure paths have been agreed – or the original one has been applied by default. Here again, as time lapses, information is revealed, hence rendering the initial DSA and the net expenditure path based on it ever less relevant for controlling either the debt level or the deficit level. In practice, and leaving aside the role of any safeguards as specified in the new rules, one could easily imagine situations where Member States would respect their net expenditure path, but miss debt and deficit targets – thus a situation of full compliance without the desired debt or deficit effects can occur.

3.5. Which assumptions for interest rates – time for educated guesses?

Interest rates data are not perfectly stable and predictable. Interest rates are based on market rates and subject to change as market situations change – which in turn can be influenced by decisions of EU institutions.

The issue of determining a valid interest rate is particularly tricky when considering a situation where one simulates a counterfactual, like what is required under the new EU economic governance framework. Current market interest rates of a country reflect current market expectations for said country, and according to EC (2024) they are further *"assumed to converge over a 10-year horizon to country specific values reflecting financial markets' expectations. Beyond this horizon, they further converge over a long horizon to common values in line with the latest Ageing Report"*. The question hence arises in how far the current market expectations already integrate any potential fiscal adjustments that would become applicable under the adjustment program. Here, we are confronted with a situation where applying a common methodology to all Member States might well end up leading to very different outcomes: situation blind is not situation neutral. In one country, markets might already price in a pathway of reform, and hence possibly lower required returns, whereas for another country the same might not apply. Interest rates could further be affected by adjustment of market rates as a result of the consensus finding process itself.

[20] The ultimate empirical importance depends on how different the change in the SPB will be as compared to the change in net expenditures pathway, which in turn depends on how large the elasticity of the tax revenues is to the tax base.

[21] For a brief discussion, see for example ECB (2012).

This is why one could argue that different assumptions are needed when considering major counterfactual scenarios with respect to interest rates as compared to those that are maybe valid for a general DSA exercise – maybe there is a case to be made for educated guesses to improve truthfulness.[22]

3.6. Which assumptions on inflation and GDP deflator?

In most standard DSA models, inflation is measured by the GDP deflator – not the consumer price index (CPI). While this assumption might be adequate given the macro- and rather longer-term nature of the exercise, it nonetheless raises specific questions that are well-known to DSA practitioners.

GDP deflator and consumer price indices can decouple over the short-term. By itself, this is unsurprising as though they both measure different price trends, they ultimately display similarities. While the consumer price index measures the price trend in goods and services bought by consumers, the GDP deflator concerns all goods and services as reflected in the GDP.

While the GDP deflator highly covaries with the consumer price index over a longer horizon, the same does not hold true in the short term, particularly in the face of terms of trade shocks. Hansen et al (2023) proposes a detailed analysis of the recent pandemic and energy shocks in the Euro area – and show large differences between the two indicators. Similar observations have been made in other countries across the world, both for the current crisis as for previous ones.

This matters for deficits, debt and DSA. While the DSA is anchored on the deflator, many of the current expenditure and tax items are not linked to the deflator, but rather to some other base, often dependent on some form of consumer price or wage index. For example, numerous benefits (and some taxes) are explicitly indexed to the CPI. Others are effectively linked to wages or alike – which in turn again often respond to consumer prices (either through practices of automatic indexing or collective or individual wage-setting that takes consumer price trends on board).

Extrapolating a short-term fiscal policy from a long-term DSA therefore becomes a noisy process – again with a potential procyclical behaviour if sticking to the formula. Fiscal policy practitioners are clearly aware of the conceptual tension between short-term budgetary trends following one set of price indicators and medium-to-long term structural indicators. Any assumption in the DSA framework on how the deflator and consumer prices compare has immediate practical consequences for the model and hence for policymaking.

The EC's Debt Sustainability Monitor EC (2024a) provides little to no detail on this aspect. That the issue is highly relevant can be inferred from a related field, namely the quantification and projection of aging costs in the EU. In the most recent vintage of the aging report EC (2024c), the issue appeared in several country reports. For example, Marvel and Stork (2023) noted counterintuitive effects of inflation on pension expenditure for Czechia (see Box 3), and similar issue was highlighted in the Belgian country fiche (Federal Planning Bureau, 2023).

[22] See, for example, Guzman and Stiglitz (2024).

Box 3: A note on counterintuitive effects of inflation on pension expenditure for Czechia

> *"Higher inflation scenario surprisingly reduces public pension expenditure, even though higher inflation rates translate into higher pensions through indexation. The effect of lower spending is due to the construction of the scenario, where higher inflation primarily means a higher GDP deflator and only a relatively smaller increase in consumer inflation. This results in a higher increase in the denominator in the form of nominal GDP and a relatively smaller increase in the numerator influenced by the consumer inflation. Thus, expenditure as a share of GDP declines despite its higher nominal value."*

Source: Marvel and Stork (2023)

3.7. The power of discretion

The choices to be made regarding interest rates and inflation are just two illustrations of a much broader and deeper issue, namely of what information is used as input to formulate the starting point, and what information is used to project forward. Clearly, the technical difficulty of determining the best-suited information is inherent in any projection or forward-looking simulation exercise – not only this specific one.

From an economic point of view, incentives to strategically use assumptions however appear particularly evident in the EU's new economic governance framework. As projections have to be made not only based on current policies, but also on sometimes sizeable adjustments, applicable parameter values are hard to determine. The European Court of Auditors (ECA) already pointed this out in its report ECA (2023) where it identified a distinct threat to the new arrangements as prone to discretion both on the side of the Commission and the Member State. While Member States must justify deviations from assumptions from the EC frame, the overall architecture leads to a risk of discretionary power, with an ensuing risk of dilution both of the technical anchor and the implementation thereof. Pench (2023) further details this point: "*This is because the starting point for the Commission's projections are standard assumptions for the estimate of potential output, notably excluding the effects of reforms and investments (other than those already included in the Commission's short-term forecasts). The Commission's projections also incorporate one-size-fits-all assumptions on the closure of the output gap, the response of (non-discretionary) revenue to the cycle and the size of multipliers. Inflation and interest rates are also projected based on (market-derived) assumptions.*(…) *To allow for this, the fiscal governance reform proposals envisage a technical dialogue phase, involving national authorities and the Commission services, before the official submission to the Commission of national medium-term plans.*"

The Commission's referral to standard assumptions partially addresses this concern. For example, it bases key assumptions in the DSA exercise on findings of other working groups such as the Aging Working Group or the Output Gap Working Group. While this approach can be justified on the grounds of their respective technical comparative advantage on specific issues, it does not resolve the problem of having to make assumptions on counterfactual scenarios. Going forward, recital 21 of regulation (EU) 2024/1263 details that a working group on debt sustainability should "*explore possible methodological improvements, including on the underlying assumptions*". According to the text, the working group should be composed of experts from the Commission, the ECB and of Member States – and should include observers from the European Fiscal Board and European Stability Mechanism. While such a working group may be laudable *per se*, the question of whether, when and how the future workstream of this (to be operationalised) working group would translate into either effective methodological changes or revised assumptions remains open.

Discretionary power also extends to assumptions regarding interdependencies between Member States, given the country-by-country approach in producing the DSA, in determining the reference trajectory and in agreeing on national fiscal adjustment plans. Specifically, there is no explicit feedback loop between different Member States' adjustment paths and programmes. While this is understandable for technical reasons, it does cause a very real risk of procyclicality, in addition to representing an increase of discretionary power in the hands of the Commission.

As a result, a major error margin remains as neither projected aging costs, nor the output gap, nor interdependencies, nor assumptions on inflation and interest rates are endogenous to the policy changes that are the essence of the fiscal adjustments to the fiscal rule. Expressed differently: rather standard-looking assumptions might turn out to be less well-established than they would be in appearance merely because they are used outside of their own conceptual reference frame.

The existence of a technical dialogue phase is meant to address some of these concerns – but it is problematic on its own. First in terms of timing, as the dialogue phase is available before the submission of the Member States' medium-term plans, but after the elaboration of the baseline DSA: *de facto*, the net expenditure trajectory prepared by the Commission anti-dates this dialogue with all possible inadequacies or biases thereof. Second, it is a further illustration of the large degree of discretionary power in the hands of the Commission. While technically necessary given the insufficiencies of the legal and regulatory framework, it is problematic from the points of view of simplicity and credibility.

4. THE NEW ECONOMIC GOVERNANCE FRAMEWORK AND MEGATRENDS

The EU, like many other parts of the world faces the combined effect of three megatrends: demographic ageing, climate change and geo-political and economic fragmentation. Regulation (EU) 2024/1263 clearly recognises these challenges, and details them further. In Article 13, it stipulates that Member States should address in their medium-term plans: "(…) *the following common priorities of the Union: (i) a fair green and digital transition, including the climate objectives (…); (ii) social and economic resilience, including the European Pillar of Social Rights; (iii) energy security; and (iv) where necessary, the build-up of defence capabilities*." Beyond the three megatrends, the topics of fairness, energy security, resilience and defence are also mentioned.

In what follows, we discuss some issues relating to how the DSA methodology treats these items. While important differences exist between the various topics, they share some common features as they generally involve intertemporal issues with rather long horizons, involving large shifts of resources across time, with potentially large and heavily uncertain impacts on welfare and redistribution.

4.1. Ageing

As outlined in the background section, debt conceptually includes both explicit and implicit elements. Under a DSA framework, be it for general debt stability purposes or for anchoring fiscal policymaking, the full inclusion of implicit debt could be justified insofar as it is considered difficult to renege upon, and hence close to explicit debt – and this despite any quantification problems of the said debt.

The Commission's DSA opts neither for full inclusion, nor full exclusion – opting instead for a hybrid solution. On the one hand, it excludes the implicit debt level from the debt trajectory. On the other, it includes projected future net expenditure pressures on aging-related programmes – be they social security related or other – in the reference trajectory. A corollary is that even in the no-fiscal-policy-change scenario, ageing costs would still be assumed to evolve as demographic ageing progresses. For example, this means that any imbalance between expenditures and revenues on pensions in any given year will contribute to the binding of that year's budget deficit and debt thresholds – potentially requiring discretionary fiscal adjustment.

While one can justify this treatment of ageing expenditures as plausible, it is neither a neutral nor the unique choice. Three concerns are worth mentioning.

First, by copying Ageing Working Group Outputs as inputs into the DSA, one effectively assimilates them to binding commitments. This assumption might or might not be plausible. In some Member States, assuming an unreformed system might involve expenditure trajectories that are implausible as leading to imbalances elsewhere. An obvious case could be an unsustainable (as insolvent) pension program. Another equally problematic case would be a sustainable but socially and politically unacceptably small projected pension system (leading to extreme levels of poverty or inequality).

Second, in light of the baby boomers ongoing or imminent retirement in many countries, the chosen methodology implies that the costs of the demographic transition are effectively front-loaded as explicit debt-financing of this transition is rendered impossible. This affects countries asymmetrically, with those with more mature social security systems and with faster ageing populations being more severely constrained than those with younger populations and/or less mature or smaller pension systems.

Third, nothing effectively prevents the build-up of more implicit ageing-related debt – in spite of the above mechanism. While front-loading adjustments, on a yearly basis, implicit debt could still be

accruing in the background for period exceeding the projection horizon of 10 years for the standard DSA, or 14 to 17 years for the new economic governance variant.

4.2. DSA and investments

Climate change represents one of the main challenges facing governments all across the globe. Challenges go hand in hand with massive needs for investment – with many of these investments having large upfront costs, with benefits much more broadly spread across time. Similar concerns relate to digital investments.

Whether green or digital investments generate sufficient benefits to pay for themselves in a net present value sense is an open empirical question – and clearly relates to desirable justifications for having debt discussed in the background section. While in some areas this looks plausible, in others this is maybe less the case.

In sum, even in the presence of positive net present value investments, intertemporal fiscal concerns are raised as spending is front loaded and any benefits (sometimes heavily) backloaded – a feature also pointed out in EC (2024b).

The new fiscal framework takes a somewhat ambiguous approach with respect to such investment. Though formally endorsing it, in practice such investments do play at two key junctures with respect to DSA: First, investment (and reform) commitments are factors that can potentially lead to an extension of the adjustment period from 4 to up to 7 years – upon evaluation by the Commission. Second, as investments enter the net expenditure trajectory exactly like other forms of current spending, Member States with higher public debt challenges will comparatively have less room for and less incentives to initiate investment. Combined, these two practical effects give little incentives for investment (beyond those that could "buy" an extension of the duration of the adjustment phase), as any extra investment comes at the cost of even larger sacrifices in terms of other current net expenditure.[23]

As investments and other spending offset each other one for one in the DSA – the current procedure effectively means that the default option underlying the reference trajectory is 0 extra investment – an assumption also implicitly reflected in potential growth estimates. Extra investment thus comes at a cost, as Member States must decide to sacrifice other expenditures for it, but little to no payoff. Notice that this is the opposite of ageing expenditures where Member States reference trajectories include ageing costs upfront and Member States can choose to compress them by a similar one-for-one logic.

Furthermore, the DSA framework ignores second round effects – that are identified by the EU Commission itself as important. Aphecetche (2024) provides a telling example: "*Some climate transition measures could lead to the erosion or dilution of tax bases through second-round effects on public revenues. For example, some transition measures are aiming to reduce the use of fossil fuels, reducing public revenues taken from excise taxes on petrol and diesel if they are successful.*" The same author insists on the importance of a global approach, including the various megatrends: "*Anticipating such a decrease, and moving forward in the transition, governments will need to ensure effective economy-wide carbon pricing instruments and put in place fiscal policies that can increase public revenues or reduce public expenditures. Such choices should also be made taking into consideration structural changes, such as ageing populations and the related erosion of the tax base, increased healthcare costs, technological disruptions affecting labour markets and tax bases, the need for substantial investment in education and infrastructure, as well*

[23] See Darvas et al (2024) for more details.

as addressing the growing demands for social services and the challenges posed by globalisation and income inequality." The example provides yet another illustration of the importance of the discussion of section 3.3 regarding the imperfect inclusion of government revenues in the framework.

Such concerns with respect to fiscal rules and investment are not new: In this line, Blesse et al (2023) explore the opportunities and consequences of a special treatment for such investments by neutralising them from the working and constraints of the SGP through an ad hoc "golden rule".

In sum, the current DSA framework has no "golden rule" provision. It seems particularly ill-equipped for dealing with major challenges that are clearly far from marginal. Substantial Member State investments in the climate and digital transformations might be needed – and may warrant increases in debt for properly vetted projects. While applying the same treatment to all forms of expenditure (whether investment or current) might be a perfectly defensible strategy when thinking about an extra marginal investment (e.g., in improving local sports infrastructure), it looks like inappropriate in the present context. This is all the more problematic as an application of both the general and country-specific escape clauses might not be directly justifiable for facilitating such investments given the long-term nature and predictability of the problem.

4.3. DSA, defence and resilience

The changing geopolitical and economic landscape leads to a need for a more resilient EU. This applies to its social and economic structures where substantial spending needs are likely to arise not only in the areas of poverty and inequality reduction, but also in ensuring adequate access to key resources such as housing, clean water and energy. Similar challenges are present in the field of defence spending, where confronted with a new geopolitical environment, Europe will likely have to spend substantially more than it has done in the past decades. In what follows we focus on defence spending, for the ease of argument, but similar issues can be discussed for the other mentioned expenditure areas.

From a budget perspective, defence spending is treated just like any other form of expenditure even though it is declared a priority area. While this might look a natural choice, it leads to two specific issues.

First, with defence spending currently rising and projected to rise further over the near-to-medium term – be it because of agreements of NATO members to raise spending to a minimum of 2% of GDP and/or for other national motivations – choosing not to integrate these spending trends explicitly into the reference trajectory could lead to a systematic underestimation of expenditure when elaborating the trajectory, possibly causing systematic deviations over the adjustment period.

Second, beyond the structural increase, defence spending also relates to rather short-term imperatives. While the general and country-specific escape clauses might be able to deal with these issues, it is unclear whether activating them in the face of an ongoing conflict at the time of introduction would not prove the ineffectiveness of the budget rules *ad absurdum*.

4.4. Contingent liabilities and debt guarantees as escape routes?

Faced with an overall rather rigid, and broadly non-stimulating approach to investments and strategic spending, Member States could be incentivised to look for alternatives – contrary to the spirit of the fiscal rule.

One such *de facto* escape clause exists: contingent liabilities and debt guarantees as the DSA does not explicitly take such liabilities and guarantees into account – neither in terms of the debt level, nor in

terms of the adjustment path. It merely addresses them as additional risk factors in the overall debt sustainability risk assessment.

As contingent debt and loan guarantees are extensively used as a policy tool both by Member States and the EU overall, leaving them out in a blanket way seems unjustified. This blanket exclusion could tempt Member States to resort to such financing to bypass constraints, irrespectively of whether the spending is warranted or not. In fact, even if their use is fully justified for non-fiscal-rule reasons, they do in any case have fiscal consequences.

5. CONCLUSIONS AND RECOMMENDATIONS

The DSA is a powerful tool for assessing the sustainability of public finances. DSA explicitly recognises the dynamic and risky environment that Member States face along various margins.

Using DSA for formally anchoring fiscal policies as part of a fiscal rule is challenging. We distinguished two types of challenges. First, those that are related to the use of the DSA methodology in a fiscal rule. Second, those relating to specific expenditure items.

Our discussion highlights areas of concern in the new EU economic governance framework. Our conclusion can be summarised as follows: while most of the technical assumptions regarding the use of the DSA model could be qualified as plausible, there are many equally (and sometimes more) plausible alternatives. Fundamental issues regarding the cyclical adjustment of variables and the key role played by the unobservable (primary) structural balance remain unchanged as compared to the previous economic governance framework.

Expressed differently, the Commission has substantial room to consciously or subconsciously influence the outputs of the DSA model in terms of the net expenditure trajectory. This power is further cemented at later stages during technical exchanges, as well during the formal tripartite negotiations. Finally, even in the surveillance phase, where the binding trajectory necessarily becomes increasingly out of sync with reality, the Commission has a discretionary role – that possibly renders the entire technical exercise less relevant in the first place.

Regarding the treatment of megatrends in the DSA framework, an asymmetry can be noted: whereas ageing-related spending trends are explicitly integrated in a hybrid forward-looking way, the same does not apply for either climate or resilience and defence spending. For aging-related spending, the inclusion is tendentious: it merely projects current rules forward, without discriminating in terms of their credibility, it further disregards changes to the implicit debt. Furthermore, the technical approach used to include aging spending leads to more constraints on fiscal policymaking, with little to no gain in controlling implicit debt. For other megatrends, little to no incentives are given for more investment, with the current fiscal rule rather hampering explicit public investment – with a *de facto* preference for alternatives such as loan guarantees.

Benchmarked against the triple objectives of simplicity, flexibility and credibility, the outcome is not convincing. Rather than being simple, the framework leads to numerous additional dimensions of discretionary power and uncertainty – for Member States and citizens alike. Though flexibility is present, it mostly comes in two conceptual variants: either through not fully transparent exchanges between the Commission and the Member States, or through more drastic tools *de facto* bypassing the rule itself (activation of escape clauses; use debt guarantees, etc.). Ultimately, credibility is not given and will have to be established by the rule's operational adequacy in practice.

The current rules thus appear to be what they are: founded on a political compromise rather than on economic or budgetary first principles. Behind a façade of simplification and ease of surveillance, major conceptual issues remain – both regarding the methodology and specific assumptions.

Two key policy conclusions ensue. First, there is an urgent need for conceptual-level follow-up. Whether the envisioned working group is the adequate forum remains to be seen – particularly given that the framework itself might require adjustment. Second, the Parliament has an important role to play in actively overseeing the process, including on key modelling aspects as well as on assumptions entering the analysis. At the technical level, Parliament's competent committee can directly scrutinise the DSA methodology through economic dialogues with the Commission and has guaranteed access to methodological documentation. At the policy level, Parliament can examine both medium-term

fiscal-structural plans and their underlying DSA assumptions through committee and plenary-level dialogues with EU institutions. This combination of technical and policy oversight, complemented by Parliament's connection to the European Fiscal Board through consultation rights on appointments, could serve as a cornerstone of democratic legitimacy. Active use of these oversight tools is crucial to prevent the DSA process from drifting into lack of transparency and technocracy – particularly given the large discretionary power of the Commission identified in this report.

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This paper discusses issues with using a DSA framework as a fiscal rule anchor. It introduces key concepts to guide the reader's understanding and highlights concerns about numerous assumptions that are inevitable in DSA calculation. The paper highlights structural issues, including asymmetry in how megatrends of aging, environmental change and a changing security and defence needs are incorporated into the framework.

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