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THE QUEST FOR STABILITY AND GROWTH: ANALYZING THE IMPLICATIONS OF THE PACT

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Abstract

The thesis will present the analysis of the adopted Stability and Growth Pact that was put in place in 1997 by the member states of the European Union. An outline of the thesis includes: the historical background, purposes, and key objectives of the Stability and Growth Pact. The SGP assured fiscal responsibility and stability in participating member states. Such vital critiques of the SGP that are considered in the critical assessment of the effectiveness of the policy are its imposed constraints on fiscal mobility, lack of flexibility, and failure to sanction politically driven budgetary measures. It also examines the negative aspects that the SGP has resulted in on public investment, for example, the stringent pacts provided by the pact, which make it nearly impossible for the government to spend funds available on necessary expenditures. The final section of the paper critically examines the recent proposals and potential reforms of the SGP. The evolution that has been in place since the setup of SGP is looked at, and at the same time, recommendations for policy changes that would make the same more relevant and workable in the present economic environment are made. This was then concluded with a summary of findings and recommendations for potential policy change. The thesis aim is to provide a clear overview of the pact focusing on the ways in which it can be safely implemented.

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INTRODUCTION

The Stability and Growth Pact was born in 1997, and since then, it has been responsible for laying down some of the most significant foundational blocks of the fiscal framework of the European Union. It is controlled to effect member states into toeing the line while dealing with their budget matters in a disciplined way, besides ensuring economic stability by imposing limits on government deficits and national debt. Dealing with its history, the impact that has laid, and ongoing challenges that surround the functioning of the SGP, such a thesis is extremely pertinent to getting a comprehensive grasp of the role that the SGP plays in the larger context of the economic policy of the EU. It is within the first section that the base of knowledge which is necessarily required in order to appreciate the level of understanding and importance that the SGP has with respect to the economic model that the EU employs. Its origins can be traced as far back as the Maastricht Treaty, which was the first ever document to establish a criterion for economic convergence for the European economies that would exist in the Eurozone. The narrative goes further to explain the formal establishment of SGP, which was geared to ensure that fiscal discipline is maintained by controlling amounts of deficits in government budgets as well as national debt. History states major changes and amendments to this pact, in view of serious economic crises. These changes, and those to come, have given life and meaning to the terms and regulations in effect today for its implementation. This is an important part of setting out the storyline of how the SGP has evolved in response to the changing economic scene in the EU, and so it is this section that is emphasized here. In the rest of the section, the thesis elaborates on three main critical features that result from the pact: The SGP restrains fiscal maneuverability, it does not sanction politically motivated fiscal policies and finally, it discourages public investment. This section of the paper discusses how the draconian limitations imposed by the SGP in practical terms restrict the fiscal policy alternatives of member states, at times of severe economic contraction, exactly when more room might be needed to primarily jump-start growth or manage shocks. The second subsection empirically explores the ability of the SGP to enforce its rules on larger member states, which can potentially make use of political machinations to avoid such fiscal constraints. With that background, this paper looks at the many scenarios in which political influence has served to undermine the credibility of the pact and the consistency with which it has been applied across the different member states. Furthermore, especially in the area of Public Investment, the concern is more about how SGP fiscal restrictions would threaten public investment in Research and Development as well as economic infrastructures and other important areas of growth. The thesis answers the dilemma against the desire to maintain fiscal discipline and the need to finance important public services and measures. The text will then proceed to discuss the most current modifications that have been made to the agreement, as well as the primary suggestions for reform that have been made by specialists. In the first part of the last chapter, an analysis is made on some of the reforms and changes that have already been in an effort to make SGP more flexible and more responsive to economic realities in the member states of EU. The last section also puts forward various other recommendations to reform the SGP. These have been proposed from a myriad of sources: academic institutions, policy circles, and international organizations. Each helps to point out different ways that the pact's design and implementation can be better improved. On the table are some proposals demanding the creation of more detailed budgetary targets and exceptions, while others go as far as proposing a complete overhaul of the architecture of the pact to make it fit with the different economic conditions that exist across the EU.

The thesis focused on providing detailed knowledge regarding each of the areas mentioned above that SGP fulfills in the economic governance of EU. The thesis most critically discusses the achievements and constraints faced by SGP and explores possible ways of reforming it. This method, of course, is not only oriented towards the theoretical development of academic discussion but also aims to provide practical insights and possibly answers for policy makers.

1 HISTORY OF THE PACT

Introduction

Ever since its inception, the Stability and Growth Pact (SGP) had been crucial in designing the fiscal policies for the European Union (EU). The Stability and Growth Pact (SGP) was born as late as 1997 with an objective to bind the member countries to disciplined budgetary procedures. This was intended to be done for the cause of safeguarding economic stability and avoiding the occurrence of excessive government deficits. This is important to understand the background of the SGP as this helps to shed light on some of the core fiscal concerns/disparities in economic policy in the EU that led to the creation of the framework. The origins and development of the SGP may reveal more about the failures and weaknesses it was supposed to correct, as well as the underlying need for effective fiscal coordination and supervision in the region. This is best done through reviewing the history of the SGP.

1.1 HISTORY OF THE PACT

Before trying to underline the critics and what the pact means and contains for The European Union it is obligatory to make a quick sprint through the history of it. The Stability and Growth Pact (SGP) has notably transformed and evolved since its conception. It all began with the signing, on the 7 February of 1992, of the Maastricht Treaty which, first established euro as the common currency for the European Union member states and has established fiscal parameters: public debt levels maintained at 60% of Gross Domestic Product or on a path towards it, and a public deficit capped at 3%. This first appearance of a European Fiscal policy was necessary for nations belonging to the same currency. In 1997 the SGP was finally formalized and introduced to enhance the coordination and surveillance of national fiscal policy among the member states; this initiative was designed to ensure the debt and deficit limits set five years before. The pact was implemented with the first rules in 1998 quickly followed by corrective rules the following year, 1999 with the creation of a first framework for financial monitoring. It all went under a major change in 2005, which enabled for much greater account to be taken of single national realities and more adaptable economic rules to be added. With the eruption of the global financial crisis the pact necessitated further refinements which led to the creation of the '*Six Pack'* Laws in 2011, [1]these laws made the pact more predictable and inclusive by organizing the tracking of economic and fiscal regulation within semesters and by introducing standard requirements for national fiscal frameworks. The '*Fiscal Compact',* part of the Treaty of Stability Coordination and Governance (TSCG) in 2013, demanded national regulations to be targeted at the budgetary aims set by the SGP, this was even more reinforced by the '*Two Pact'* laws, which reinforced economic coordination and introduced new monitoring tools for the Euro Area member states; these provision mentioned were embodied in a revised '*Code of Conduct'* in 2016. Going back to 2014, the rules were revised which established that the legislations made were contributing positively to the fiscal consolidation in the European Union area. A year later, in 2015, the European Commission published guidelines on the application of the Pact rules aiming to strengthen ties between fiscal responsibility, structural reforms, investment, employment and growth, These guidelines were endorsed the same year by the European Council. The last 2020 review, which revised the '*Sick pact'* and '*Two pack'* rules, initiated a public consultation to continue the improvement of the EU's macroeconomic surveillance framework. This consultation was triggered and suspended due to the COVID-19 [2]pandemic which severely disrupted the fiscal and economic European landscape, and to mitigate this crisis governments implemented large-scale fiscal measures which significantly increased public debt levels, but that is another story. The pact was then re-launched and brought to the attention of the Commission and the public in October of 2021; this re-launch however did not include

[1] History of the Stability and Growth pact https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/history-stability-and-growth-pact_en

[2] Bordignon, M., & Scutifero, N. (2022, November 25). Il Patto di Stabilità e Crescita tra ieri e oggi. Osservatorio CPI. Retrieved from https://docenti.unimc.it/raffaella.coppier/teaching/2022/26456/files/unione-monetaria-europea-e-regole-fiscali/ocpi-PSC.pdf

any major reform or changes but it was more as a call for time to re-establish the thought of the rules after the major crisis that the pandemic caused.[3] By the end of 2023 the Ministers of Economy and Finance agreed to reforming the SGP. As of April of 2024, a new reform of The Stability and Growth Pact was enacted with a strong focus on Investment.

[3] History of the Stability and Growth pact https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/history-stability-and-growth-pact_en

2 CRITICAL EVALUATION OF THE STABILITY AND GROWTH PACT

Introduction

The Stability and Growth Pact (SGP) represents one of the European Union's fiscal discipline pillars within EU member states. The rationale underpinning such a pact is to deter the emergence of an excess of budgetary deficits and debt accumulation, with the aim of fostering economic stability and growth within the Eurozone. Nevertheless, the SGP has received severe criticism, raising serious doubts as regards its efficiency and impact on the economies of its member states. Building on such a premise, the present chapter focuses on three key criticisms against the SGP, namely inhibition of fiscal maneuverability, failure to sanction political agenda-driven fiscal policies, and inhibition of public investment. First, hard-wired severe budget constraints in the SGP, which set close fiscal space for member countries by not allowing budget deficits below 3% of GDP and public debt over 60%, bind down the tools of fiscal policy for countries. The rigidity of fiscal tools results in a handicap, which belies the efforts of the member nations for effectively counteracting economic crises and cyclical downturns. In times of downturn, public expenditure normally has to be bolstered to absorb efficiency loss in the private sector, and boost growth and employment. In enforcing fiscal discipline, however, the tight fiscal rules of the SGP might bind down the policy space of the countries under economic distress, thus imposing austerity measures that deepen the downturns and leading to prolonged recovery periods. Secondly, the SGP fails to effectively punish the irresponsible political motives behind fiscal policy. Though rule-based, the strength of the SGP lies in trying to keep the rules loosely applied; the political power of the member states has, on occasion, influenced the SGP to avoid enforcing its rules. Occasionally, when the bigger economies like France and Germany have broken the rules without serious consequences, it has seriously damaged the credibility of the pact. Such inconsistency breeds resentment among the smaller, more adhering nations and weakens the overall credibility of the SGP. Political motives usually spark short-term fiscal policies designed for electoral gain more than for the benefit of long-term economic stability, which only further complicates the effectiveness of the SGP. Finally, when it comes to the limits of deficits and debt, the SGP often thwarts public investment, which is an integral component of long-term growth and development. If fiscal discipline continues to take precedence, there is no other way to make cuts in public expenditure than much-needed investment in infrastructure, education, research and development. These are rightly called productivity-enhancing investments and therefore foster innovation and ensure sustainable economic progress. By putting very tight constraints on public investment, the SGP might actually serve to stifle economic growth in the long run and lower competitiveness. The SGP is, in particular, meant to be designed in a manner that firmly assures not just fiscal discipline but also economic stability and growth in a fair and balanced manner. As the European Union continues to take new forms, its fiscal policies must also be governed properly and effectively so that it can correlate with the diverse characteristics of the member countries. Thus, the present chapter provides a comprehensive critic of the same and looks into how there is the need for a more flexible and consensual fiscal policy approach pertaining to the Eurozone.

2.1 An Overview of Criticism

The Stability and Growth Pact (SGP), as stated in the European Rule Book, is a set of rules designed to ensure financial discipline among European Union member states by limiting national debt levels and government economic shortfalls. Nevertheless, diverse sectors, broadly divided into political, economic, and technical, have critically reviewed the SGP since its establishment. Politically, many perceive the Pact as a tool that restricts national sovereignty in fiscal policy, leading to reluctance, particularly in countries with a strong tradition of public political intervention in the economy. The perception that a supranational entity imposes economic decisions fuels skepticism and creates a sense of unfairness, thereby intensifying political criticism. Economic criticism, on the other hand, focuses on its rigidity and lack of elasticity regarding the very different economic realities in the Union. Some experts tend to overlook the structural and cyclical aspects of individual economics when they discuss the 3 percent deficit limit and the 60 percent public debt limit. Furthermore, the challenge of restoring production and growth arises from the absence of economic stimulus during downturns. Doubters of the 'greater' Stability and Growth Pact refer to the weaknesses in the enforcement mechanism as major problems. The evidence clearly demonstrates the inconsistent application of the pact's articles, with certain countries receiving temporary exemptions and preferential treatment. This discrepancy, which presents a significant challenge, could potentially undermine the credibility and effectiveness of the targets. We previously discussed this issue, which can lead to unclear interpretations, making it challenging for governments to communicate their effective policies. We can single out the SGP among these heavily debated areas, as it aims to create a stable macroeconomic environment and ensure growth. It is highlighted that there are crucial concerns about modifying the EU's financial governance framework to facilitate automatic amendments: experts advocate for its development based on the need to introduce fresh alternatives. While some advocate for its eradication, an alternative approach involves diluting and reforming its fundamental principles while simultaneously introducing necessary innovations.

As previously stated, the Council decided in 2014 to investigate the possibility of applying the SGP's current rules in a more flexible manner without altering them. In recent years, there has been an increasing perception that the Pact's rules lack countercyclicality, are outdated, and are excessively complex. This is because, despite being relatively new, the Pact's rules are excessively stringent and fail to consider the significant changes in the global economic landscape in recent years. Consequently, enforcing these rules has become challenging due to their sometimes-excessive strictness and infrequent application. That is why the task will be to understand precisely what these rules and the recent change that the new reform brought to the pact say, and above all, it is important to see what the experts say now and what they said in the past about this set of directives in order to actually understand why there is so much criticism of the Stability and Growth Pact. We must understand whether the facts firmly and effectively support the pact's philosophy, and, consequently, whether member states should blindly adhere to and trust the SGP rules in every situation.[4] It is now time to go deeper into the issues.

[4] Arestis, P., McCauley, K., & Sawyer, M. (2001). The future of the euro: Is there an alternative to the stability and growth pact? Econostor. https://www.econstor.eu/bitstream/10419/54276/1/515519669.pdf

2.2 *The SGP limits fiscal maneuverability without flexibility.*

The European fiscal rules have always been clear, particularly the deficit cap of 3% of gross domestic product. Comparing the new Pact with the original Maastricht Treaty, the degree of simplicity has fallen and shifted to a more elaborate mechanism[5]. This transformation was driven by the need for Europe to cope with more modern and refined economic environments and the challenges of a continuously modernizing economy. The changes should aim to build a response to the more dynamic nature of the current economic condition, balancing technical precision with regulatory effectiveness. The concept of flexibility within fiscal frameworks plays a key role, especially when it comes to investment-enhancing policies. [6]Flexibility is a key element of fiscal policy as it allows governments to effectively adapt their fiscal strategies to the fast-changing economic conditions. Flexible policies allow the European Union or the states to react rapidly and appropriately to economic crises. The adaptability of the rules is crucial to maintaining fiscal equilibrium and sustainable growth. Furthermore, flexibility in fiscal rules, such as the ability to exclude particular expenses or, more importantly, apply countercyclical adjustments, allows governments to continue economic activity without being hindered by short-term economic constraints. The balance between immediate fiscal policy needs, medium-term[7] and long-term fiscal sustainability is essential and makes flexibility a crucial part of effective management, and the Pact lacks it, as it can be observed that flexible rules tend to be more complex and require more negotiations between the Commission and between stricter European states, as Germany, which

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[5] Marco Buti, Sylvester C. W. Eijffinger and Daniele Franco. 28 January 2003 . *DP3692 Revisiting the Stability and Growth Pact: Grand Design or Internal Adjustment?* CEPR.

[6] Martine Guerguil, Pierre Mandon, Rene Tapsoba. (Januray 22, 2016) *Flexible Fiscal Rules and Countercyclical Fiscal Policy* . IMF Working Papers

[7] European Central Bank. Medium-Term orientation.
https://www.ecb.europa.eu/mopo/strategy/medium-term-orientation/html/index.en.html

advocated for uniform rules for all the European Union, [8]Though it was created to ensure fiscal prudence and sustainability within the EU, the effect of the Stability and Growth Pact has often been that of limiting the fiscal policy space of member states. Because it is rigid, there is not much room for states to spend on long-term beneficial projects or on important counter-cyclical measures when facing recession and crisis. The possible increased flexibility of some of these constraints could easily be achieved by the entry into force of cyclically adjusted targets or by the exclusion of profitable investments from the deficit. There is also the problem of fiscal flexibility and fiscal rules in line with the need to achieve continuous growth and stability in the EU. It is no easy task that needs to be performed in the establishment of a system ensuring fiscal discipline while, at the same time, maintaining the ability of governments to respond to the economic challenges they face.[9]

2.3 *The SGP does not sanction fiscal policies driven by political agendas.*

Before going into the issue, it is first needed to assess what the Economic and Monetary Union is, as it plays a crucial role in the subchapter. The Economic and Monetary Union (EMU), founded in 1992, is a union made to unify under one roof, the European Union, all the economies of the member states. EMU incorporates a shared monetary policy and a common currency, the Euro, which implies the coordination of all economic policy among all the member states [10].The Stability and Growth Pact has often

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[8] Bruni, F. (2023, 07 28). *Patto di Stabilità e (vera) Crescita*. https://www.ispionline.it/it/pubblicazione/patto-di-stabilita-e-vera-crescita-137336?gad_source=1&gclid=Cj0KCQjw-_mvBhDwARIsAA-Q0Q4-5HsPNfv8Ar84qYbr4j4f2oZzkDsqjNJR1kSUabKqXEQy-kX026waAooeEALw_wcB

[9] Buti, M. (2023, 12 07). Nuovo Patto, la Commissione teme vincoli troppo restrittivi. Il Sole 24 Ore

[10] European Commission. What is the Economic and Monetary Union? (EMU). https://economy-finance.ec.europa.eu/economic-and-monetary-union/what-economic-and-monetary-union-emu_en

faced repeated criticism and shown remarkable difficulties in its implementation. All the member states, including the major members of the European Monetary Union, did not follow instructions to achieve a structural balance during fiscal economic cycles. The famous limit of keeping the deficit at 3% of GDP has proved to be not an easy objective, and the member states involved have not been effective, at least not entirely. [11]This has raised questions about the future sustainability of the pact and its effectiveness in stabilizing national economies in times of fiscal and monetary uncertainty. The difficulty of the Union enforcing the rules raised quite a number of doubts among experts about its effectiveness and the need for reforms to make the enforcement framework more adaptable and less costly to the different economic realities of the European Union. The implementation of the rules of the SGP involves considerable costs for a variety of reasons,[12] making the process so challenging for EU member states that most of the time implementation happens. One of the most "expensive" aspects is the requirement for detailed and periodic surveillance of national fiscal policies to ensure conformity; this requires significant investment in tracking and analysis tools. Compliance with the debt and deficit parameters imposed by the Stability and Growth Pact would frequently force governments to embark on harsh policy-enacting measures that could have a negative impact on the economy in the long term, which would cause an even more severe crisis by slowing economic growth and development. Most importantly, the necessary reforms to the SGP standards may also encounter political resistance. Another costly process that should be taken under analysis is the adaptation of national legislative economic structures to EU directives. The process is not only time-consuming, but it also requires a significant amount of resources to ensure full compliance with the Pact requirements. Financial sanctions for non-compliance represent an additional economic burden for

[11] Anthony Annett. (21 July 2006*). Enforcement and the Stability and Growth Pact: How Fiscal Policy Did and Did Not Change Under Europe's Fiscal Framework*. International Monetary found working paper

[12] Camilla Mariotto. (03 December. 2021). *The Implementation of Economic Rules: From the Stability and Growth Pact to the European Semester.* JCMS. https://doi.org/10.1111/jcms.13265

Member States already suffering to maintain monetary and fiscal balance. These fines can further aggravate a country's fiscal situation as they are too standardized, which makes them unusable. These costs not only affect public finances but also limit the ability of the EU to respond flexibly to economic needs. The difficulty in sanctioning member states who infringe the SGP is also embedded in the fragile balance between European requirements and singular national sovereignty [13],as most governments are resistant to taking penalties from the Union as they fear that these sanctions may be unpopular and potentially disruptive for their economies. This translates into a preference within the Union to privilege negotiation over direct sanctions. Furthermore, the decision-making procedure of the Council can lead to a more careful and conciliatory approach, which manifests itself in an atmosphere of mutual tolerance towards transgressions to maintain unity among members, especially in moments of financial distress. This whole situation raises questions about the fundamental credibility and efficiency of the Stability and Growth Pact if rules are consistently disregarded and sanctions are never enforced because, paradoxically, too costly.

2.4 The SGP Inhibits public investment

The vital importance of public investment stretches far beyond economic development, reaching key aspects of social life and governance. In today's states, especially in our complicated European setting, public investment in different areas plays a key role in maintaining social, economic, and governance order. In Europe, public investments are often combined with policies and funds, allowing, at least in theory, for increased political and economic integration between the member states. Public investment is thus not only a means to stimulate economic growth but also an imperative tool to build more just, competitive, and equal economic realities. This being said, why does the SGP discourage public investment?

[13] Annett, A., Decressin, J., & Deppler, M. (2005). *Reforming the Stability and Growth Pact*. INTERNATIONAL MONETARY FUND.

Maintaining budget positions 'close to balance or in surplus' [14]implies that capital spending will be financed by operating current revenue. So it would be no longer possible to spread the costs of an investment project among all generations of tax-payers who benefit from it; this may lead to a disincentive to engage in projects that would produce benefits and, during periods of fiscal assessments, would result in a major discrepancy between current revenue and costs.[15] This dynamic can limit the government of a member state's ability to invest in long-term initiatives that do not deliver immediate payoffs, so in times of strict fiscal parameters or crises, governments may have to favor short-term interventions to provide short-term gains at the expense of those with longer-term benefits. This could create cycles in which opportunities for innovation and improvement are systemically neglected. To alleviate these problems, it may require a more flexible attitude toward public budget management that allows debt-financed investments, especially for long-term projects. While fiscal prudence is critical, it is equally crucial to find a balance that does not dissuade long-term visionary projects. Excluding public investment expenditure from the fiscal rules appears weak for at least three reasons. [16]First of all, not all public investment is profitable, and not all current spending is detrimental; for example, investment in research, environmental stability, and education could be very productive. Secondly, excluding investment expenditure from the rules could lead to an unnatural conversion of current expenses into investment spending. Last but not least, there is no existing proof that fiscal crises are impacted by a high level of public debt, other than borrowing to finance public investment. Evidence suggests that

[14] Sylvester Eijffinger Daniele Franco Marco Buti, (25, January, 2003). *DP3692 Revisiting the Stability and Growth Pact: Grand Design or Internal Adjustment.* CEPR. https://cepr.org/publications/dp3692

[15] Marco Buti, Sylvester C. W. Eijffinger and Daniele Franco. 28 January 2003 . *DP3692 Revisiting the Stability and Growth Pact: Grand Design or Internal Adjustment?* CEPR.

[16] Cottarelli, C., & Galli, G. (n.d.). *Review of the EU economic governance framework: a focus on the revision of the SGP fiscal rules*. https://osservatoriocpi.unicatt.it/ocpi-SGP%20reform.pdf

fiscal risks are biased by gross debt, whatever the origin. [17] It is important to acknowledge that the quality of public spending plays a key role in evaluating the impact on countries economic outlooks. A thoughtful analysis should not consider the quantity of debt but the effectiveness and location of where it is deployed. Targeted spending can stimulate growth and improve long-term financial stability. A more mature approach to rules should therefore consider not only the volume of debt but also the sustainability of both current and future government spending. Further consideration of the topic requires examining how budgetary policies directly influence a government's ability to respond to immediate and long-term needs. The debate on public investment goes far deeper than simple national accounting; it reaches the core of a country's socioeconomic development. Furthermore, the inclusion and exclusion of certain spending items from the fiscal rules can significantly distort the perception of a nation's debt and economic health. To illustrate this, critical infrastructure such as roads, telecommunications, and bridges can be referred to; these infrastructures may end up requiring large amounts of investment, but the benefits accrued are appreciable over long-term periods or even decades. When governments are not obliged to reduce investment in such areas of fiscal constraints, then they can be motivated to increase spending, which can drive development and growth in society. On the other hand, creating an environment to ease the flow of investments will also attract more individual investors who will put their personal savings elsewhere. Nevertheless, a watchful eye is necessary to not exceed public debt, which may not be sustainable in the future. However, these types of current expenditures, which are designated as current, do have largely long-lasting impacts on human capital and other societal metrics that gauge people's quality of life. Rudely imposing deficits in the domestic budget to match fiscal rules could have damaging short-term and future effects

[17] Giavazzi, F., Guerrieri, V., & Lorenzoni, G. (2022, January 15). Riformare il sistema fiscale europeo: la gestione del debito | L. D'Amico, F. Giavazzi, V. Guerrieri, G. Lorenzoni e C. H. Weymuller. Lavoce.info. https://lavoce.info/archives/92568/riformare-il-sistema-fiscale-europeo-la-gestione-del-debito/

on the country's economic prosperity[18]. Additionally, the macro-economic pluses of societal expenditure in such areas may be greater than the just start-up costs, something that a mere assessment of future expense criteria could imply.[19]

The issue of how best to protect fiscal discipline and also mobilize resources for the future is a tough one to negotiate. It requires the analyses on a case-by-case basis. The challenge for decision-makers is twofold: On one hand, the relationship between public debt and economic constraints is a challenging balance to maintain; policymakers must use restraint in fiscal consolidation policies and allow for space for growth without overburdening the public with stringent austerity policies. On the other hand, they have to plan wisely to provide the required investments to ensure the sustainability and resilience of their economies in the long term.

[18] Oliver Blanchard, Francesco Giavazzi (23 February 2004) DP4220 Improving the SGP Through a Proper Accounting of Public Investment. CEPR. https://cepr.org/publications/DP4220

[19] Hansen, M. A. (2015). *Explaining deviations from the Stability and Growth pact: power, ideology, economic need or diffusion?* https://www.jstor.org/stable/43864153

3 WHAT CAN BE DONE?

Introduction

What would have been an indispensable ingredient of the fiscal policy of the European Union was that the Stability and Growth Pact was adhered to over a long period of time. Still, taking into account the fact that the economic scenario is undergoing a dynamic and periodic change nowadays, financial crises are in evidence, and it has become an extremely important matter to bring massive changes to make the SGP more efficient and flexible. The package was built to ensure sustainable economic conditions and sound public finances among all the member states.

The SGP will have to be reviewed and overhauled to increase its efficacy. The area of focus in reviewing and overhauling the SGP shall have to be the flexible and reasonable incorporation and enforcement of the parameters of sustainable growth. It is crucial to establish a process that is open to the recommendations of experts in the field of economics. This is based on the understanding that analyzing observations and conducting calculations can lead to the creation of policies that not only address current fiscal crises but also aid in forecasting future economic scenarios based on the most likely uncertainties in fiscal parameters. The Stability and Growth Pact (SGP) can only be implemented as a solid and anti-fragile framework and serves the purpose of motivating long-term economic stability and growth in the area of the European Union if the revisions are prescribed by the experts.

3.1 WHAT HAS CHANGED?

In this chapter, we make closer scrutiny to reforms put in place regarding the European fiscal framework. In particular, the thesis will focus on the move away from the previous Stability and Growth Pact to the new laws proposed. It is worth noting that such changes, which have been officially in place since the month of April 2024, will present a scope of a change in the way the European Union will be conducting fiscal control and economic policy. The amendments are just an attempt to make up for any deficiencies that might have been present in the former structure and one that would better position the Union at handling all the economic issues faced currently and likely to be faced in the future, The debate aims at understanding best the further-reaching consequences that the reforms of the "Old Pact," with its "Commission Proposal" and "New Rules,"[20] have for the member states and their capacity to effectively maintain sustainable growth and stability. Such a description of the changes made is both timely and critical when one needs to understand how the landscape of economic policy will be changing in the age of the European Union post-pandemic and beyond. Modifications relating to the Stability and Growth Pact in the European Union attract divergent opinions from economists, politicians, and even member states. Some insist on the pact being deeply revised, turning it into quite a flexible and appropriate document according to the new economic conditions in post-pandemic Europe. Others view this task hopefully because just slight revisions of the rules already in operation or more effective enforcement would be enough. Deep reform advocates are incensed that the SGP already includes such draconian debt and deficit constraints that they have ceased to operate. With governments under more intense than ever, fiscal pressure to deliver support for the recovery and to invest in the future, these calls come for deep reform. They postulate that this would be a more elaborate list of criteria that could differentiate between current expenditure and expenditure in investments and which, simultaneously would be able to respond more accurately to the economic cycle. On the other hand, there is another part of the community who demand for the basic framework of the SGP to be kept as such. The basic premise under which such a group of stakeholders argues is with regards to the need for fiscal discipline; the avoidance of high levels of debt accumulation and subsequent financial maintenance of the country to remain stable. They argue that rather than completely re-writing the treaty, the rules should be made more stringent in their enforcement. As such, the central thematic concern revolves around the way in which the means through which the implementation and enforcement of the agreement can most effectively be amended in order to bring desired change. [21]The different viewpoints

[20] Marco Buti, Marcello Messori (24 December 2023). *Nuovo patto di stabilità, ecco quale può essere l'impatto sull' Italia* . Il Sole 24 Ore.

[21] Bini Smaghi, L. (2022, 02 24). La Riforma del Patto di Stabilità e Crescita: Ce n'è veramente bisogno? Retrieved April 12, 2024,

underline the complexity of fiscal governance in a union as diverse as the European Union, where the economic conditions and objectives, as well as the levels of fiscal health, vary so greatly among member states. But the debate goes on to try to find consensus that underpins fiscal responsibility yet brings in enough flexibility to sustain growth and stability within its economy. The latter was characterized by very strict respect of 1/20 rule where the concentration was first and foremost on both short-term and long-term fiscal viability. At least the new approach which was tabled by Commission contains the inclusion of more dynamic changes to those variables. These adjustments adapt to both economic cycles as well as bettering the technical methodologies applied in the assessment [22]of fiscal sustainability. [23]The new guidelines again bring forward that there be increased prominence on the relative importance on continued quantitative reviews and technical adjustments of fiscal monitoring toward the direction of increased sophistication and adaptability. [24]Reforms and Investments Incentives: Prior, the incentives were temporal and awarded in messages of 2015. That strategy is now tilted due to the proposal to the inclusion of the fundamental incentives within the framework of seven-year national plans. It reveals a more organized and long-

https://www.lorenzobinismaghi.com/pdf/La_Riforma_del_Patto_di_Stabilit%C3%A0_e_Crescita_LBS.docx.pdf.

[22] Marco Buti, Marcello Messori (24 December 2023). *Nuovo patto di stabilità, ecco quale può essere l'impatto sull' Italia* . Il Sole 24 Ore.

[23] Buti, M. (2023, 12 07). Nuovo Patto, la Commissione teme vincoli troppo restrittivi. *Il Sole 24 Ore*

[24] Marco Buti, Marcello Messori (24 December 2023). *Nuovo patto di stabilità, ecco quale può essere l'impatto sull'italia* . Il Sole 24 Ore.

term approach drive of economic reforms and investments.[25] The new regulations maintain this essential nature, but they apply much more flexibility. On the other hand, it would allow different combinations of elements in a manner that could really accommodate both short- and medium-term requirements. It is worth noting, therefore, that anti-deficit policies have moved from a very pro-cyclical stance under the old accord to a more balanced approach under the guideline in place. This the commission urges for the most anti-cyclical policy implementation level achievable to minimize the consequences of the economic downturns on the budgetary policies. But on the other hand, it warns that there are potential contradictions because of the number of quantitative restrictions set. It is evidence that a very delicate equilibrium is in place between strict fiscal discipline and the realisms on the ground in the economy. Due to warnings of the potential inconsistencies, the new rules are overly anti-cyclical. Both the old and the new pacts recognize the importance of granting each country a certain independence regarding the conduct of its fiscal policies. The maximum tolerance likely to be suggested to regional variations will be that proposed by the Commission in the new pact. Although the new rules continue to encourage high tolerance, they also warn against the dangers that are created by quantitative constraints. This posture has been slightly modified in the new standards.[26] Simplification of the Rules The proposal by the Commission responded to the complexity in the previous agreement detected. The objective of the proposal is streamlined toward the simplification of the rules governing the fiscal system with addition of uniformity and obvious quantitative relationships. Much facilitated by the new rules, the potential lowering administrative constraints member states are placed under and bring ease of compliance by them to a more effective level. Applicable rules: The legislative rigidity of the previous agreement has given way in the new framework to an approach with a lot more flexibility, which will allow for the planning to be done easily over multiple years while allowing a push for greater adaptiveness. This was aimed at

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[26] Arestis, P., McCauley, K., & Sawyer, M. (2001). *The future of the euro: Is there an alternative to the stability and growth pact?* Econostor. https://www.econstor.eu/bitstream/10419/54276/1/515519669.pdf

putting into consideration the different economic environments of the member states and with the objective of a pluralistic fiscality governance approach that takes an inclusive one. A few Aspects of Politics Credibility and Consistency of Rules: The old agreement emphasized the need to keep very high credibility through strict incentives and clear consequences laid upon the non-compliant members. On the other hand, the new proposed law emphasizes cooperation and breeds regulatory incentives in pursuit of an environment holding a more cooperative spirit and far less punitive force. The new rules reflect a problem-solving and flexible approach to fiscal governance as opposed to the dogmatic and pragmatic one. The moderate degree of centralization introduced by the new rules contrasts with the minimal degree of centralization under the previous agreement, which is for the most part preserved by the proposal developed by the Commission. This intermediate approach possibly points toward the need for a compromise in state autonomy and, at the same time, establishes that the fiscal plan of the EU as a whole is consistent with itself. The change from the old European Pact to the new Pact is, in such a way, a basic evolution in the range of the range of the fiscal policy of the European Union for the EU. The new rules are to be more flexible, adaptable, and accommodative with more ease the aspirations of the member states as it seeks to remain irrevocably committed to the fundamentals of fiscal sustainability and economic stability. [27]Because of this reformist wave, the EU has gained potential through which it can develop its capacity in navigating through complex economies to facilitate stronger growth and stability.[28] In this sense, the two more relevant objectives of the mentioned proposals are: on one side, to enhance the sustainability of public debt, and on the other, to achieve sustainable and inclusive growth. The European Commission's recommendations are intended to reform the present fiscal framework in such a way that it will serve two prime purposes: that of improving public debt sustainability and of enhancing sustainable and inclusive growth in all member states. In this regard, it is pretty unfortunate that enhanced public debt levels are due to the COVID-19 crisis, which in

[27] Lorenzo Bini Smaghi. (19 May 2023) . *Il rischio di un patto ancora più rigido.* https://lavoce.info/archives/101153/il-rischio-di-un-patto-ancora-piu-rigido/

[28] Banca Centrale Europea. Bollettino economico 1/2024.

turn means that the system has to be reshaped. It is against this background that the requirements for addressing the said weaknesses are established. Further, the recommendations seek to make the European Union more competitive by quickly transitioning to an economy that is environmentally friendly, digital, inclusive, and resilient, ultimately increasing the EU's ability to combat future challenges. The new rules would help implement critical reforms and investments that reduce high public debt ratios in a realistic, progressive, and sustained manner. [29]This was underlined in President von der Leyen's 2022 State of the Union Address.[30] The objective of the reform is that economic governance be simplified, with national ownership raised, refocused on the medium term, and enforced in a transparent single EU framework. The proposed measures build upon substantive amounts of reflection and broad consultation. Higher level of national ownership, explicit as well as comprehensive plans for the medium term. Among the recommendations of the Commission, one of the most significant features is to create national fiscal-structural plans for the medium term. Member states should prepare and submit such plans, including their fiscal targets, the actions to be undertaken to counteract macroeconomic imbalances, and priority reforms and investments over at least four years. On that basis, the Commission will examine those plans under the common EU standards, with the Council finally granting them. Goals for fiscal reform in a single medium-term strategy should encompass investment and reform. Such integration will go a long way in raising the level of national ownership by providing more flexibility to Member States in defining their fiscal adjustment paths and their commitments to reform and investment. Annual progress reports will be used with a view to facilitating more effective monitoring and implementation of the agreements.[31] The

[29] Banca Centrale Europea. Bollettino economico 1/2024.

[30] European Commission press Release (26 April 2024) . *Commission proposes new economic governance rules to fit for the future.* https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2393

[31] Bini Smaghi, L. (2022, 02 24). *La Riforma del Patto di Stabilità e Crescita: Ce n'è veramente bisogno?* Retrieved April 12, 2024, from

European Semester, therefore, will be the central coordination framework for economic and employment policies, including the newly introduced procedure for the surveillance of fiscal policies. Simplified and customized regulations in regard to the many financial challenges. The recommendations, hence, are for more risk-based surveillance that concurrently puts in on the sustainability of public debt and that makes growth sustainable and inclusive, taking into consideration that the 27 member states of the European Union have very distinct fiscal situations, challenges, and economic outlooks. This strategy will follow one EU framework, the provisions of which are made as transparent as possible. The multi-year expenditure targets, specified in terms of member-state fiscal adjustment routes, shall be considered the only operational indicator for fiscal surveillance, and the result shall be simplified budgetary rules. The Commission has published a country-specific "technical trajectory" in the case of the Member States in which the government deficit is over three percent of the gross domestic product (GDP) or public debt exceeds sixty percent of their GDP. This will ensure that the debt is on a plausibly downward path or that it remains at prudent levels and that the deficit remains below three percent of GDP for the medium term. The Commission shall provide technical information for those Member States whose government deficit does not exceed three percent of their GDP and whose public debt does not exceed sixty percent. This supports the discharge of the clear medium-term objective of keeping the government deficit below the reference value of three percent over the medium term. Such paths and statistics will provide benchmarks for Member States while setting their expenditure targets over long periods. This will ensure the long-run sustainability of debts under the implementation of standard protections, with the reference values for deficit and debt remaining unchanged at 3% and 60% of GDP. Provided that the deficit remains above three percent of the GDP, the public debt to GDP rate should be falling from the end of the plan period versus the start of the plan period. In this interval, at least the fiscal adjustment that must be put in place will be five percent of the GDP within one year. In addition, Member States qualifying for extended budget adjustment must provide for the condition that the fiscal effort should

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https://www.lorenzobinismaghi.com/pdf/La_Riforma_del_Patto_di_Stabilit%C3%A0_e_Crescita_LBS.docx.pdf not be postponed to future years.[32] General—and country-specific—escape clauses will allow for deviations from the expenditure commitments to be made in case of an unusual or severe downturn in the economic climate of a Member State. [33]The council shall decide as to the clauses that are to be activated and deactivated; such a decision will be adopted on a proposal from the commission. Enabling reforms and investments for priorities of the European Union. It is an agenda of reforms and investments regarding the green and digital transitions to build economic and social resilience and enhance Europe's security capacity. A robust public investment of dimensions huge and long-term in each one of these objectives is necessary over the coming years.[34] The credibility of the ambitions to reduce the debt, in turn, relies on these reforms that are successful in producing growth-sustainable and inclusive. From that perspective, one can see how reforms and investments are beneficially interacting, precisely the premise on which the Next Generation EU Recovery and Resilience Facility is based. On the other hand, they are targeted to facilitate implementation by the Member States of essential reform and investment projects, and specifically, to encourage them subject to clear and transparent criteria, to have agreed to implement the package of reform and investment favorable to more growth-focused gradual correction of budgetary imbalances. Enforcement to Be More Efficient and Effective Effective rules need strict enforcement. Apart from the fact that these proposals are considering placing greater ownership in the hands of the Member States regarding the medium-term programs designed for their national economies, they also provide for a more severe enforcement mechanism to ensure the commitments made under the said plans are kept. An automatic excessive deficit procedure shall be activated

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[32] Bini Smaghi, L. (2022, 02 24). *La Riforma del Patto di Stabilità e Crescita: Ce n'è veramente bisogno?* Retrieved April 12, 2024, from https://www.lorenzobinismaghi.com/pdf/La_Riforma_del_Patto_di_Stabilit%C3%A0_e_Crescita_LBS.docx.pdf

[33] Banca Centrale Europea. Bollettino economico 1/2024.

[34] European Commission press Release (26 April 2024) . *Commission proposes new economic governance rules to fit for the future.* https://ec.europa.eu/commission/presscorner/detail/en/ip_23_2393

in the case a member state strays from the fiscal adjustment path agreed upon. This applies to member states with severe problems of public debt. In the case of underperformance, the period of budgetary adjustment agreed may also be reduced if the commitments to reform and investment that underpin a more extended period of budgetary adjustment are not delivered. Given the highly delicate junction in which the European Union economy finds itself right now, there is a great deal of interest in obtaining a speedy agreement for modifying the European Union fiscal rules, along with the other elements of the economic, regulatory framework. Therefore, the Council, acting on behalf of the European Council, has requested that the legislative process be finalized by 2023. The European Commission strongly calls on the European Parliament and the Council to reach a final agreement on the points for which necessary legislative measures remain to be settled to respond effectively to the ensuing challenges. These are the ideas of a nature-wide initiative directed towards making public debt sustainable and encouraging growth that would be sustainable and inclusive in the whole EU. The new regulations combine structural and budgetary changes, including effective enforcement, to make a more resilient and competitive European economy by fixing deficiencies in the existing framework.

3.2 CONTEMPORARY PROPOSALS

The agreement has come under attack due to the alleged inflexibility of the agreement, universal-scope approach, and capacity to control asymmetric economic shocks in different member states. This criticism gained momentum thanks to the global financial crisis which occurred in 2008 and thereafter the sovereign debt crisis experienced in the Euro Area. In other words, it has underlined the need for a fiscal framework that is more flexible and can respond to a variety of economic scenarios.[35]

[35] Darvas, Z., Welslau, L., & Zettelmeyer, J. (2022, November 30). *The European Commission's fiscal rules proposal: a bold plan with flaws that can be fixed*. Bruegel. https://www.bruegel.org/blog-post/european-commissions-fiscal-rules-proposal-bold-plan-flaws-can-be-fixed

A result of all these shortcomings is the apparent tsunami of solutions that has appeared from most institution and economic experts, all with the ultimate aim of making the SGP more efficient and flexible. Suggestions go from very simple modifications to wholesale overhauls that proffer substantial changes to the way fiscal regulations are put and applied inside the European Union. This subchapter reviews the voluminous and trenchant criticism that has been heaped upon the SGP. It also indicates a selection of reform proposals that have been considered, in one way or another, as possibly remedying the deficiencies of the SGP. By considering all these criticisms, the flavor of the debate going on about the future of fiscal governance within the European Union is sensed. This is a method of laying ground for the appraisal of the feasibility of these proposed reforms and the possible impact that such reforms could bring about. The Stability and Growth Pact is part of the fiscal discipline framework in the European Union for its member countries, directing members to keep government deficits and debt stocks within set ceilings. In contrast, it would not be wrong to say that with changing economic realities upstream and downstream, powerfully reinforced by global shocks such as the recent and ongoing COVID-19 pandemic, it has become evident that states need to adopt a flexible rather than a rigid and automatic fiscal framework. This paper examines the different kinds of reforms listed within the definition of reforming the SGP to make it more effective and relevant. Especially with its international dimensions taken into account, the SGP is considered to have preserved fiscal stability in Europe. The pact, on the other hand, can be made better by a few alterations—adjustments that would take into account the particular economic conditions and problems under which each of the member states operates. Proposed reforms encourage a better balance, enhancing the seriousness of fiscal laws, but at the same time, they provide enough flexibility to allow adjustments to be made according to conditions at the national level. Put in other words, what is posted is the adjustment of medium-term budgetary objectives to country characteristics like public debt levels and economic instability. This very approach deals full frontally with the criticism that the theoretically universally applicable model of the SGP is unfortunate in its lack of reflection on differing economic circumstances extant in the EU member states. For instance, it could be that greater flexibility in cyclically adjusted budget deficits is provided to countries with low debt or fiscal liabilities. This would allow room for more fine-tuning of the fiscal policy still within the overarching aims of the SGP. Among the proposed changes, one of the most important items is transparency. The objective of such reforms is to give more credibility to the SGP and reduce temporary financial measures, which might lead to a result where the reality of the finances of a nation might be hidden.[36] This will gradually be achieved by making fiscal accounts more transparent. This increased transparency would then allow for a more realistic assessment of the company's financial performance and also check manipulative accounting methods. The principles further encourage better enforcement and monitoring systems that would ensure adherence to the rules mentioned above. This can be particularly well brought to the fore in periods of economic booms when the very concept of the need for fiscal discipline is thrown to the winds. It also provided tools to correct fiscal policy transgressions in ways that the current SGP framework does not dissuade to a sufficient extent when circumstances are financially ripe. Saving for rainy days and sanctions for early deviations were mentioned in this respect as instruments to promote responsible financial management. This is even more pertinent for the reserves relating to rainy days, as these would buffer economies to stay afloat during collapse and refill during expansion. Third and final set of recommendations: the budgetary rules should be applied sympathetically. For this, it would be necessary to distinguish between the technical judgments and political judgments for the SGP; have the European Commission make the technical judgments, with the political judgments kept within the Council. A type of differentiation that might mitigate the influence of national interest on fiscal discipline, thus leading to increases in the integrity and efficiency of the SGP. There is so much labor put into making responsive, transparent, and efficient the fiscal framework of Europe[37]; the package of amendments to the Stability and Growth Pact stands on this realization. The

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[36] Sylvester Eijffinger Daniele Franco Marco Buti, (25, January, 2003). *DP3692 Revisiting the Stability and Growth Pact: Grand Design or Internal Adjustment.* CEPR. https://cepr.org/publications/dp3692

[37] Sylvester Eijffinger Daniele Franco Marco Buti, (25, January, 2003). *DP3692 Revisiting the Stability and Growth Pact: Grand Design or Internal Adjustment.* CEPR. https://cepr.org/publications/dp3692

European Union can ensure that fiscal administration is solid, sensitive to the dynamic economic realities of the individual countries, and further allows enhancements in transparency; improvements in enforcement and flexibility should be implemented. [38]This change, in the long run, will help in cementing the economic underpinnings of the European Union and promoting sustained growth and stability throughout the union.

More recent hypothesis regarding possible changes that could be made to the SGP have been proposed, for example, a complete suggestion of how to change the SGP is supplied by Weymuller, Lorenzoni, Giavazzi, Guerrieri, D'Amico. The proposal would alter fiscal laws and set up a European Debt Management Agency, to be responsible also for the management of pandemic debt. [39]This falls under the first heading of a plan to modernize and simplify the fiscal laws regulating the SGP. It is over time that a growing consensus has it that the rules currently available are not only outdated but also need to be excessively complex. They have failed to countercycle properly and sufficiently. The COVID-19 epidemic, which led to the "activation" of the general escape clause and the suspension of the SGP regulations for the first time, showed that reform of these rules would be needed, with the expectation that they would resume in full by January 2023. The Plan proposes setting a limit on the rate at which primary spending will increase, to be set for three years at a time and to continue updating until reached, for the idea behind this kind of strategy is that it provides a predictable course toward public finances, thereby assuring the investors' confidence and generating financial stability. The debt-to-GDP ratio will also involve the realization of average reduction in the level that will be selected to cover a ten-year time horizon. Therefore, the debt will further be segmented into its components consisting of fast and slow adjustment components with different adjustment

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[38] Arestis, P., McCauley, K., & Sawyer, M. (2001). *The future of the euro: Is there an alternative to the stability and growth pact?* Econostor. https://www.econstor.eu/bitstream/10419/54276/1/515519669.pdf

[39] Weymuller, C., Lorenzoni, G., Giavazzi, F., Guerrieri, V., & D'amico, L. (2022, January 14). *Revising the European fiscal framework, part 1: Rules*. CEPR. https://cepr.org/voxeu/columns/revising-european-fiscal-framework-part-1-rules

speeds so as to enhance its management. The counter-cyclicality would be through the implementation of a rule that soothes out fiscal efforts over a medium-term aim and revises spending growth trajectories every three years. This ensures that adjustments to fiscal policy are gradual and in response to prevailing conditions in the economy, which does away with early tightening during times of recession and excessive spending at boom times. Further, such a formalization system would help countries demand lower rates of debt adjustment as and when required so that the rules also remain adaptable and responsive to circumstances. [40]The proposal incorporates a golden rule, which places priority on expenditure directed toward the future and forms a key component of the idea. This rule ensures that when long-term growth-promoting investments and public goods are financed, they are excluded from the spending limit; in other words, they permit some expenditures to escape the spending straitjacket. The strategy is to find a compromise between the need for necessary future growth and stability in investment, on one hand, and the stringency of present fiscal policy, on the other. For the second point in the plan, the creation of a European Debt Management Agency should be put in place to manage some national governments' debts. The EDMA would support the ECB in conjunction with this for the stabilization of the European debt markets; it will help reduce the overall cost of Union's total debts. The EDMA would buy national debts over time at market prices fractioned on the GDP of each state, thus borrowing money itself to fund those purchases. The idea is to pour stability into the debt markets as well as reduce the total costs for the Union. The EDA would exchange its previously issued national bonds for the commitments of member countries to provide funds to its budget, over time, fully meeting the net needs of the agency.[41] This plan has several key benefits, major of which

[40] Giavazzi, F., Guerrieri, V., & Lorenzoni, G. (2022, January 15). *Riformare il sistema fiscale europeo: la gestione del debito | L. D'Amico, F. Giavazzi, V. Guerrieri, G. Lorenzoni e C. H. Weymuller*. Lavoce.info. https://lavoce.info/archives/92568/riformare-il-sistema-fiscale-europeo-la-gestione-del-debito/

[41] Giavazzi, F., Guerrieri, V., & Lorenzoni, G. (2022, January 15). *Riformare il sistema fiscale europeo: la gestione del debito | L. D'Amico, F. Giavazzi, V. Guerrieri, G.*

are to reduce the debt burden on debt payments and create fiscal space for the Union. To help these efforts by the ECB, the European Debt Authority would allow the ECB to focus on monetary policy without ignoring the stability of national debt markets. Through the separation of monetary and fiscal obligations, this could lead to a higher understanding of how risk is shared and an empowerment of the general fiscal structure. The idea speaks towards this problem that such EDA contributions may give rise to the fact that it will be considered senior to the national debt and such perception can be disastrous for market perceptions. In this respect, the authors argue that reinforcing the fiscal backstop of the European Union would positively affect the repaying abilities of the member states, thus offsetting any adverse effect that could result from its perceived seniority. Besides, this is a proposal for strong governance and openness, which will prevent the possibility of "backdoor mutualization" and ensure proper management in the efficient way of the European Union's debt. There is the reformation of the Stability and Growth Pact, which will be implemented with the proposed reforms that have been made in order to make it flexible, transparent, and efficient in fostering sustainable growth and debt reduction. It would be needed, therefore, to revise the laws governing the present and future fiscal system of the European Union so as to ensure good fiscal administration that supports economic resilience and stability and to create a European Debt Management Agency. [42]The changes to the SGP are indeed very indispensable for setting up a more stable and integrated European fiscal framework to ensure that the SGP stays relevant and strong in a changing global economy.[43]

Even though the European Commission has already submitted its proposal for a deep reform of the Growth and Stability Pact (SGP), which would mean a structural change in the assessment of fiscal policies in the euro area, two fundamental benchmarks

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Lorenzoni e C. H. Weymuller. Lavoce.info. https://lavoce.info/archives/92568/riformare-il-sistema-fiscale-europeo-la-gestione-del-debito/

[43] Pench, L. R. (2024, January 19). *The New Stability and Growth Pact: Innovation and Continuity in the Light of Next Generation EU*. Search eLibrary :: SSRN. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4691440

upon which the SGP has traditionally depended are a 3% of GDP limit for budget balances and a 60% of GDP ceiling on public indebtedness. Both of these limits are essentially the same. Indeed, they were often criticized, as was referred into the thesis, for being arbitrary and not enforcing an actual degree of budgetary discipline amongst the member states, even though the benchmarks were straightforward with no convoluted explanations. [44]To provide a more sophisticated and less prone to criticism solution to fiscal policy, the new proposal includes a creeping in of a benchmark for expenses. The article by Charles Wysplosz subjects the proposed expenditure benchmark to a detailed analysis of its potential effects on fiscal discipline and comparison with the cyclically adjusted budget balance CAB.[45] The benchmark of expenditure will ensure that enhanced public spending is in line with numerous factors, namely new measures on taxes, cyclical unemployment spending, and output sponsored by the EU. This is to ensure that enhanced public spending is compatible with debt consolidation. This is a policy that in the past has been considered as a complement to the CAB in the SGP reform of 2011. Designed to clear up assumptions for the assessment of fiscal policy, the policy is based on actual data rather than estimations of economic conditions underpinning the policy. There are quite several processes involved in the determining of the expenditure benchmark. The process initially churns out the adjusted expenditure, which is the primary spending minus the amount for debt service, one-off net tax income, cyclical unemployment spending, and EU-financed spending. The second result would be the net adjusted expenditure, which is determined by subtracting changes in revenue or those changes in revenue, which are very clearly the government's discretionary decision. The other benchmark for

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[44] Bruni, F. (2023, 07 28). *Patto di Stabilità e (vera) Crescita*. https://www.ispionline.it/it/pubblicazione/patto-di-stabilita-e-vera-crescita-137336?gad_source=1&gclid=Cj0KCQjw-_mvBhDwARIsAA-Q0Q4-5HsPNfv8Ar84qYbr4j4f2oZzkDsqjNJR1kSUabKqXEQy-kX026waAooeEALw_wcB

[45] Charles Wyplosz (March 2023). *The European Commission's expenditure benchmark.* Centre For Economic Policy Research . https://cepr.org/publications/policy-insight-121-european-commissions-expenditure-benchmark

expenditures is a norm that clearly states net expenditure growth as less in magnitude than potential GDP growth. In conclusion, the fiscal effort measures deviance from such a standard and advises on the appropriateness or inappropriateness of government spending. Isn't this benchmark, however, laden with a number of complications and potential hazards, even though its main purpose is to give a more faithful and clear measurement to fiscal policy?. The viewpoint of Wyplosz is that it is not only more complex and less precise compared to the CAB but also does not have an excellent logical background and can lead to policy measures that may be harmful. As Wyplosz addresses further, the benchmark is complicated and less noticeable compared to the CAB, besides it is lacking a sound logical basis for choice.[46] The fact that the benchmark attaches itself to adjusted spending and net adjusted expenditure makes it a complication that allows two simplifications and, as such, difficulty in understanding the actual fiscal situation. That the cyclical adjustment of the expenditure benchmark is confined to unemployment benefits while, at the same time, ignoring the more cyclical character of government revenues means the methodology is devoid of considering the significant impact of cyclical fluctuations on the overall spending of the public sector. The latter is pegged on the average rate of growth of GDP over 10 years, inclusive of the next four years' projections, and elasticities of the revenues and expenditures relative to the output gap in the amendment to the primary budget balance caused by cyclical reasons, adding more to the cocktail of imprecision and uncertainty. This has become known as the cyclically adjusted budget balance (CAB) and was a vital feature of the process applied to the assessment of fiscal policy. For the expenditure benchmark, the adjustments are somewhat more involved. These adjustments include those for unemployment benefits, one-off expenditure adjustments, and adjustments for EU-sponsored expenditures. "Empirical research has demonstrated that though the fiscal effort (derived from the expenditure benchmark) and the changes in the CAB often happen next to each other, the two differ reasonably very much when in a crisis. With a difference like this during these times of economic stress, the dependability of the expenditure benchmark is doubtful.

[46] Charles Wyplosz (March 2023). *The European Commission's expenditure benchmark.* Centre For Economic Policy Research . https://cepr.org/publications/policy-insight-121-european-commissions-expenditure-benchmark

The CAB is believed to be much more precise and dependable compared to a host of other similar measures because of the ease and the fact that it is established enough. Such change is worth appreciating, given that the suggested switch goes toward a medium-term perspective and is more concerned with debt pathways than annual budget balances. This allows for more flexibility to accommodate cyclical variations and other shocks, but it does not sacrifice the long-term perspective in maintaining debt sustainability. The flip side is that the complexity of the expenditure benchmark may work against this shift, according to Wyplosz. Given the fact that the CAB addresses the average fiscal performance in the medium term rather than an annual occurrence of volatility, this is an indicator that is more appropriate to the strategy. Broader objectives that would be achieved by a reformed SGP are efficiency, transparency, and simplicity. According to Wyplosz, for these objectives to be achieved, the CAB is superior to the expenditure benchmark. The CAB is also better because it is transparent, with established methodologies that are available for comparison, compared to the expenditure benchmark, which is less transparent and relatively incomprehensible due to many adjustments and using non-standard expressions and terminologies. The ad hoc form the expenditure benchmark has assumed for annual surveillance is not remarkably coherent with the new framework that the Commission proposes to implement in the medium to long term. In other words, this reform of the SGP wants to reach simplicity, efficiency, and transparency, which probably would be impossible to achieve with the complexity of the expenditure benchmark taken to date. The CAB is more suited, in this case, for the suggested refocusing because it is more precise and direct in its approach. Although the spending benchmark and the CAB both deliver the same policy outputs, with their results being very close, the CAB is preferred for several reasons. Compared to benchmark output, CAB is more straightforward, has a proven successful record, and is an easily read and precise measure of the fiscal policy stance. The CAB approach is very much related to the envisaged shift to the medium-term perspective, focusing on debt pathways rather than annual budget balances.[47]The developed spending benchmark tool of annual

[47] Charles Wyplosz (March 2023). *The European Commission's expenditure benchmark.* Centre For Economic Policy Research . https://cepr.org/publications/policy-insight-121-european-commissions-expenditure-benchmark

monitoring creates complexities that cloak the actual fiscal stance and serve to undercut the purposes of the reform. In other words, it is to make things simpler, more transparent, and effective. To guarantee a more credible and transparent assessment of fiscal discipline in the euro area, it is imperative for the author to give the reform of the SGP the utmost priority, according to the CAB, as the principal indicator of sound fiscal policy.

CONCLUSION

This thesis looked into detail of the SGP first designed in 1997, and later formed an important part of the European Union fiscal control framework. The Stability and Growth Pact (SGP) was designed in order to ensure that member states of the European Union observed fiscal discipline by limiting government deficits and national debt. In spite of it serving this basic function, the SGP has been awash with a lot of criticism coupled with calls for its reform. This emanates from the perception of inflexibility that the SGP accords to problems arising from political investment and economic progress. The SGP dates back to 1992, and the first strokes of any fiscal policy for the EU members were sketched in the Maastricht Treaty and then detailed in a formal agreement dating from 1997, with a few amendments. It dates the historical development of the SGP to 1992. Most major reforms, in the name of Six Pack Laws of 2011 and Fiscal Compact of 2013, happen to be reactions to economic crises which revealed the necessity of a more flexible fiscal framework. A unique goal of any restructure in the architecture is the continuity of enhancements in coordination and surveillance of national policies on fisc, also to support the primary goal of SGP, ensuring budgetary discipline. Three critical flaws of concern when one critically examines SGP include:. These rest in constraint of financial maneuverability, an inability to apply effective sanctions for politically decided fiscal policies, and stop public investments. Indeed, hard fiscal limits that bound deficits at 3% of GDP and debt at 60% of GDP restrain the room at the disposal of the member state to financially expand while engaging in counter-cyclical action. This bound makes the game very rigid, therefore, only worsening an economic slump and making a recovery drawn out before an economy can fully expand. The most influential member states, like France and Germany, which have breached the rules at many points in time without being highly penalized, do not work smoothly, especially through this enforcement mechanism of the SGP. This presents a contradiction, weakens the SGP's credibility, and causes hostility among small and submissive member states. Besides, public investment is crucial to growth and long-term development in the country. The thesis expounds that the SGP has negativeness with regard to public investment. Inflexible fiscal requirements often result in curtailment of some key investments like education, research, and infrastructure, among others, which in turn slows innovations down and brings a decrease in competitiveness. Certainly, the great majority of these reform proposals do respond to such criticisms, with differences ranging from relatively small changes right through to a complete transformation of the entire SGP framework. These reforms that had been proposed were those making it much more flexible, open, and indeed enforced. The most important suggestion is the adoption of the European Debt Management Agency model whose main reason shall be to improve the effectiveness with which national debt is managed and to assist the European Central Bank in its attempt to stabilize the debt market. This is then complemented with the fact that the thesis incorporates a whole history of the older as well as new suggestions by experts. This chapter describes how expert opinions on what an SGP should look like have developed from early proposals to the latest thinking about reform. This has the scholars working into the pulse proposals, and with continuous debate and analysis, they come up with the point that it should be put on concerns to determine the future of the Pact of Agreement and what it has in store for us. It is likely April 2024's latest reforms moving toward a more flexible and responsive fiscal system. These reforms focus on the fitting of different economic situations prevailing among the Member States in fostering sustainable growth and stability, while at the same time maintaining fiscal discipline. Apart from the one allowing flexibility to the Member States to change their fiscal policy in line with the economic cycle, the current rules emphasize the importance of investments in programs targeting long-term growth. Economic flexibility must go hand-in-hand with fiscal discipline; hence the policy is a balancing act. As far as the clock is ticking without any respite, stability and long-term growth of the European Union and SGP depend on how much it stands by and delivers in this changing economic world. Most significantly, it is well-observed that the Stability and Growth Pact has to be reformulated in a manner through which its applicability and effective strategy toward achieving economic growth and stability are not subjected to a loss even as the EU goes on to become dynamic with the passage of time. The Stability and Growth Pact has remained an essential part of the formation of the fiscal policies of the member states of the EU. Be that as it may, it has introduced several very important issues only because it is rigid and inflexible. Nevertheless, if the SGP is to bind strength in fiscal discipline with fostering growth and investment, the reforms that it has proposed and brought in will have to be looked at in this light: an effort to deal with the problems that have been identified. In respect of this, both the ongoing discussion and the proposed reforms reflect this living and complex nature that fiscal governance in the European Union takes on. This aspect is emphatic in a way that believes that the fiscal framework should be built in such a manner that it is flexible and adaptive enough to manage intelligently different economic conditions of the member states.

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