

# OPINION ON THE FISCAL GOVERNANCE REFORM OF THE EUROPEAN UNION

OPINION 1/24

July 3<sup>rd</sup>, 2024





Independent Authority  
for Fiscal Responsibility

The mission of the Independent Authority for Fiscal Responsibility, AAI (AIReF) is to ensure strict compliance with the principles of budgetary stability and financial sustainability enshrined in Article 135 of the Spanish Constitution.

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Date of publication: July 3<sup>rd</sup>, 2024

# TABLE OF CONTENTS

<b>TABLE OF CONTENTS</b> .....	<b>3</b>
<b>EXECUTIVE SUMMARY</b> .....	<b>5</b>
<b>1. INTRODUCTION</b> .....	<b>11</b>
<b>2. DESCRIPTION OF THE HIGHLIGHTS OF THE NEW FISCAL FRAMEWORK</b> .....	<b>15</b>
2.1. The reform of the Pact Regulations.....	15
2.2. A preliminary calibration for Spain of the new fiscal rules with AIReF projections.....	19
2.3. The reform of Directive 2011/85 on national fiscal frameworks...25	
<b>3. FOUR KEY IMPROVEMENTS IN THE REFORM OF THE EU FISCAL FRAMEWORK</b> 31	
3.1. It explicitly places sustainability at the heart of the new rules with a differentiated vision for each country. ....	31
3.2. It strengthens the medium-term dimension, preserving investments	32
3.3. It streamlines the operational indicators for fiscal monitoring.....	34
3.4. Complexity is relocated and placed in a more appropriate area.	38
<b>4. FOUR CRITICAL CHALLENGES POSED BY THE REFORM</b> .....	<b>41</b>
4.1. Achieving a real strengthening of national ownership .....	41
4.2. The interaction between the EU framework and national frameworks.....	43

4.3. Comprehensive view of the sustainability of public finances at the level of the different territorial governments.....	45
4.4. Investment needs, is the current treatment within the framework sufficient?.....	51
<b>5. PROPOSALS AND CONCLUSIONS.....</b>	<b>53</b>
<b>REFERENCES.....</b>	<b>57</b>

# EXECUTIVE SUMMARY

The economic governance of the European Union (EU) is made up of a set of rules and institutions that have been created since 1992 with the aim of preventing and correcting fiscal and macroeconomic imbalances that may jeopardise the proper functioning of this area and, in particular, of the Economic and Monetary Union. In February 2024, the EU institutions and governments reached an agreement on the reform of the fiscal governance framework, which is structured around the Stability and Growth Pact. In contrast to previous review processes, this time it is a far-reaching reform, the result of in-depth reflection and negotiation at an EU level.

The reform of the EU fiscal framework entered into force on April 30<sup>th</sup>, 2024. Accordingly, Member States will be required to submit the first round of national medium-term fiscal-structural plans in September. The process has culminated in a framework that presents important new aspects with respect to the previous one, both in terms of the underlying consensus on the role and design of fiscal policy, and in terms of its practical implementation. The reform has been shaped by the recognition of a macroeconomic environment that is very different from the one in place when the original Pact was designed, both in terms of lower growth, a greater presence of shocks and significant public spending and investment needs to cope with a complex geopolitical environment and other trends such as climate change and ageing populations.

The main principles of the reform can be summarised in the four points listed below:

- (i) The new framework is anchored in an analysis of country-specific risks to debt sustainability. This entails a medium- to long-term perspective on the public finance situation so that adjustment commitments are differentiated across countries and are

- determined not only by the starting position, but also by future pressures associated, for example, with ageing.
- (ii) Adjustment commitments are established through a single operational variable, primary expenditure net of discretionary revenue measures, cyclical unemployment and expenditure financed entirely from EU funds, as well as national co-financing expenditure. This variable is more predictable and controllable by fiscal authorities than the concept of the structural balance (and its variation) on which the previous framework was based. The use of ceilings on net primary expenditure helps to create room for manoeuvre in upturns or if windfall revenues occur, while the exclusion of cyclical unemployment is intended to leave room for automatic stabilisers to operate.
  - (iii) To incorporate the lessons learned during the fiscal consolidation phase that followed the financial and sovereign crisis, the system includes incentives for investment and growth-enhancing reforms in the form of a longer adjustment horizon; in addition, two escape clauses are included, both at a European and country level, to allow fiscal policy to play a stabilising role in exceptional circumstances.
  - (iv) Finally, the aim is to improve compliance with the fiscal framework by strengthening each country's commitment to its adjustment path (so-called national ownership) and to develop credible enforcement mechanisms.

In contrast to some proposals that considered diluting the barrier between the preventive and corrective arms of the Pact, the reform preserves both procedures, although the adjustment variable will always be the net primary expenditure path. The reform also introduces some provisions aimed at ensuring consistency between the size of the adjustments required in the preventive and corrective arm.

In addition to amending the Stability and Growth Pact Regulations, the reform also introduces changes to Directive 2011/85 on National Fiscal Frameworks. This Directive was introduced with the aim of improving national budgetary processes to complement the European framework of rules by strengthening the accountability of Member States. Among other elements, it provided the first impetus for the creation of Independent Fiscal Institutions (IFIs), such as AIRcF, in euro area countries, with the aim of reducing information asymmetries between citizens and governments and increasing the reputational costs for the latter of poorly designed public finances.

The most recent amendments to the Directive on National Fiscal Frameworks focus on three aspects: improving budgetary statistics, aligning national

budgetary frameworks with the reform of the Pact and preserving the role of the IFIs. In particular, it codifies the minimum standards to be provided to these institutions in terms of independence, funding, revenue allocations and access to relevant information to fulfil their mandate. In terms of the tasks assigned to IFIs, European legislation sets the minimum standards and leaves each country the power to specify in detail the mandates of their respective Institutions. However, in addition to the task of analysing, endorsing and producing the annual and multi-year macroeconomic forecasts that accompany budgetary planning documents and checking compliance with national rules, a new task is explicitly introduced, consisting of analysing the consistency, coherence and effectiveness of the national fiscal framework.

The reformed Preventive and Corrective Arm Regulations entered into force on the day of their publication in the Official Journal of the EU, while the deadline for transposition of the Directive into national law runs until December 2025. The Regulations are immediately applicable to all EU Member States as of April 30<sup>th</sup>, the day of their publication in the Official Journal of the EU. For its part, the Directive will have to be transposed into national legislation within approximately one and a half years, while respecting the integrity of its objectives.

Applied to Spain, the new fiscal rules will require, according to AIRcF's current estimates, a fiscal adjustment of 0.63 points of GDP per annum over the period 2025-2028 or 0.43 points per annum over the period 2025-2031, in the event that the adjustment period is extended to seven years, linked to the performance of reforms and investments. This adjustment will set out in a path of primary expenditure net of revenue measures committed to for the next four years. Compliance with this fiscal path will ensure with a high probability that the public debt-to-GDP ratio of our economy will fall in the medium and long term, even in more unfavourable scenarios than the one considered as the central scenario. However, certain methodological details of the new framework have yet to be made public, which could lead to changes in these calculations. Similarly, changes in the forecasts affecting the baseline position could also change these estimates.

In AIRcF's opinion, the reform of EU economic governance entails four fundamental improvements that can enhance the rationality and effectiveness of the way fiscal policy is planned and supervised. First, the reform explicitly places sustainability at the heart of the new fiscal rules, which makes sense given the current high levels of debt, with a differentiated country-by-country view and a strengthening of medium-term planning. Moreover, the new framework seeks a better balance between fiscal consolidation and economic growth by seeking to preserve investment. Another key innovation is the streamlining of the operational indicators used for fiscal policy monitoring, as unobservable variables such as the structural fiscal balance play a less central role in the new

framework. Finally, calibrating the necessary adjustment in the new framework remains complex as it requires numerous forward-looking inputs (including medium-term potential growth, trend revenue and expenditure, the impact of ageing on public spending, etc.). However, the complexity is relocated to a more justified, diagnostic setting, rather than to the implementation and monitoring side, which relies on a single operational variable - net primary expenditure.

At the same time, its implementation at the national level poses four significant challenges. The first relates to the target of strengthening national ownership of the adjustment path. Achieving this will not only require the political commitment of the government presenting the medium-term plan, but also that of all institutions and stakeholders with responsibilities for fiscal policy - especially in a country with such a high degree of decentralised spending as ours. The fact that the plans must be established for a minimum period of four years, with no possibility of revision except in exceptional circumstances - including a possible change of government - makes it advisable to seek consensus on the measures underlying these plans.

The second challenge relates to the need to adapt our national fiscal framework to update it and make it consistent with the reform of the Pact. The transposition of the reform of the Directive on National Fiscal Frameworks provides an opportunity to update Spanish legislation on financial sustainability. These amendments - which should contribute to reducing discrepancies between the national and EU frameworks - will have to be adopted by December 31<sup>st</sup>, 2025. Empirical evidence suggests that IFIs are well placed to contribute to the assessment of national budgetary frameworks, in line with the task set out in Article 8a(5)(d) of the reformed Directive, related to assessing the robustness, consistency and effectiveness of the national budgetary framework.

In addition to the challenge of establishing national rules consistent with the European framework, there is also the challenge of distributing the targets and their implementation among the different tiers of government. The level of decentralisation of the General Government in Spain makes it all the more necessary for both frameworks to be coherent and consistent. Unlike in other countries, this process of distributing fiscal policy targets is more complex due to the high degree of decentralisation in Spain and the need to address it bearing in mind that the possible reform of the regional and local financing system and the extraordinary financing mechanisms could have significant effects on this distribution.

A final challenge will be to reconcile debt reduction and growing public spending and investment needs, in a context where, on the one hand, the latter are large and growing (defence, industrial policy, climate change, digital



transition, ageing of the population) and, on the other hand, a real common central capacity at a European level is still lacking.

AIRcF makes the following proposals to address these challenges:

1. Publish the Commission's reference trajectory so that the different regional and local tiers of government and other institutions can be aware of it. Similarly, the subsequent negotiation process with the European Commission, prior to the presentation of the medium-term fiscal-structural plans, should be transparent and consensual.
2. The dissemination of the specific technical analyses for Spain, necessary to be able to carry out a robust and transparent diagnosis of the adjustment needs of our economy, prior to each round of approval of the medium-term fiscal-structural plans.
3. Immediately initiate dialogue with all General Government sub-sectors to reach a consensus on a distribution of targets that guarantees compliance with the commitments acquired at a European level from the earliest stages of implementation of the fiscal-structural plan.
4. Address the process of reforming the national fiscal framework and, in particular, the distribution of targets across the General Government, together with the reform of the regional and local financing system and the extraordinary financing mechanisms, as the only way to achieve a comprehensive solution to these three closely related aspects.
5. Address medium-term fiscal planning in a comprehensive manner, making explicit the estimated investment needs of the Spanish economy and the measures designed to meet them.

AIRcF notes that in order to promote national ownership, it has been recommending in its reports, for example in the Report on the 2023 Rebalancing Plan, that all institutions, relevant national stakeholders and representatives of the different regional and local levels should be involved in the design of the new fiscal-structural plans. AIRcF also highlights the recommendation issued in the Report on the Initial Budget of the General Government for 2024 to start work on reforming the national framework to ensure consistency and coherence with European rules.



# 1. INTRODUCTION

**The main function of the Independent Authority for Fiscal Responsibility (AIReF) is to ensure the financial sustainability of the General Government (GG).** Issuing opinions is one of the tools that Organic Law 6/2013, of November 14<sup>th</sup>, on the establishment of AIReF grants this institution to carry out its functions. Specifically, Article 23 identifies the long-term sustainability of public finances as one of the specific issues that may be the subject of an Opinion.

**The design of the fiscal governance framework is a key element for the sustainability of public finances.** Fiscal governance frameworks now exist in more than 90 countries around the world (Debrun *et al.*, 2018). Their existence is anchored in the evidence that unlimited discretion on the part of governments leads to neglect of public sector solvency (deficit bias) and can end up resulting in dangerously high levels of public debt. Fiscal frameworks thus introduce constraints on said discretion that force individual governments to own the intertemporal budgetary constraint. In a monetary union, the existence of a common fiscal framework is all the more necessary for governments to own the consequences of their fiscal policy decisions for the rest of the countries in the union.

**At the EU level, the fiscal framework is set out in the Stability and Growth Pact (hereinafter, the Pact)**<sup>1</sup>. This aims to promote sound and sustainable public

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<sup>1</sup> The Stability and Growth Pact is composed of Regulation 2024/1263 (repealing Regulation 1466/97, which regulates the preventive arm), Regulation 1467/97 (corrective arm) and the Council Resolution of June 17<sup>th</sup>, 1997 on the Stability and Growth Pact.

finances as a means to strengthen the conditions for price stability on the one hand, and for robust and sustainable growth on the other.

**Since 1997, the Pact has been revised several times with mixed results.** When the Coronavirus crisis broke out, the Pact was a legacy of successive reforms that since the early 2000s incrementally added different rules and procedures (García Perea & Gordo, 2016). This incremental evolution resulted in a complex and barely operational framework, with pro-cyclical tendencies, where medium-term planning was more formal than binding in practice, and fiscal targets of a merely aspirational nature.

**In parallel, the supranational framework was complemented by the strengthening of national frameworks with the introduction of new rules and the creation of Independent Fiscal Institutions.** In Spain, the Constitution was reformed in 2011 to accommodate the impossibility for the State and the Autonomous Regions to incur a structural deficit that exceeds the margins established, where appropriate, by the European Union for its Member States. This complex framework was unable to prevent a widespread increase in public debt and the design of a pro-cyclical fiscal policy in most countries. Thus, the debate around the need to reform the Pact had intensified markedly in the years immediately preceding the pandemic (Wieser, 2018; Bénassy-Quéré *et al.*, 2018). In the aftermath of Covid, the need for reform became even more pressing.

**Moreover, the last decade has witnessed important changes in the macro-fiscal environment compared with the situation prevailing at the time of the adoption of the Maastricht Treaty.** In particular, potential growth has declined considerably, heterogeneity in the fiscal positions of individual Member States (MS) has widened and a multitude of tail risks have materialised. At the same time, growing spending and investment needs to cope with geopolitical conflicts, climate change, digitalisation, industrial policy, in addition to those associated with ageing populations, have been identified.

**This latest reform of the fiscal framework is the result of an intense process of reflection and negotiation at an EU level.** The process started with the first public consultation in February 2020 which was interrupted by the outbreak of the pandemic. A new consultation<sup>2</sup> was launched in October 2021 and in the second half of 2022, the Commission published a Communication outlining the main principles of the reform. These can be summarised in four principles: (i) adopting a country-differentiated, risk-based approach to public debt sustainability, with the objective of ensuring sustained and realistic debt reduction through a single operating variable; (ii) creating strong incentives for investment and reforms that promote sustainable growth; (iii) strengthening

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<sup>2</sup> See AIRcF's contribution to the European Commission's public consultation on the reform of the European fiscal framework. Working Paper 1/2022.

country ownership of the adjustment path; and (iv) developing credible enforcement mechanisms for the fiscal framework. Finally, in April 2023 the Commission published its proposal for the reform of the Regulations that make up the preventive and corrective arm of the Pact, as well as the Directive on National Fiscal Frameworks. These proposals for legislative texts were negotiated within the Council in the second half of 2023, until agreement was reached in December. This was followed by trilogues with the European Parliament, which were concluded with the final agreement reached on February 9<sup>th</sup>.

**In view of the recent entry into force of the EU economic governance reform, this Opinion assesses the new fiscal framework from the point of view of sustainability, highlighting the most relevant improvements and the challenges posed by its application in the Spanish economy.** First, it describes the content of the reform and provides a calibration of the adjustments it would entail from 2025 onwards, taking into account AIReF's macro-fiscal projections. Second, it highlights the elements that represent a clear improvement in the new framework in relation to the previous one and that represent an opportunity for better medium-term fiscal planning in our country. Next, this Opinion assesses the challenges that the reform of the fiscal framework poses for Spain. Lastly, it reiterates the recommendations made by AIReF in various reports and considers some proposals and conclusions.



# 2. DESCRIPTION OF THE HIGHLIGHTS OF THE NEW FISCAL FRAMEWORK

## 2.1. The reform of the Pact Regulations

**The main aspects that the reform of the Pact implies for a high-debt country like Spain can be grouped around nine points:**

1. **National medium-term fiscal-structural plans become** the main element of fiscal commitments. They also set out countries' reform and investment commitments for a four-year period. These plans will be proposed by the Member States, on the basis of a reference trajectory drawn up by the European Commission following guidelines common to all countries.<sup>3</sup> They will be set out in fiscal adjustment paths and reform and investment commitments reflecting national preferences. Unlike the current Stability or Convergence Programmes, the fiscal-structural plans will remain fixed for a four-year horizon and can only be modified in exceptional circumstances -

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<sup>3</sup> Moreover, for countries with debt levels below 60% of GDP and a deficit below 3% of GDP, the Commission will provide "technical information" at the request of the MS on the structural primary balance necessary to ensure that the deficit is maintained below 3% of GDP over the medium to long term without additional measures being taken. In addition, the technical information shall be consistent with the deficit resilience safeguard referred to in Article 8.

including a change of government<sup>4</sup>. The current practice of an annual review of commitments and medium-term planning documents, which has contributed to reducing the effectiveness and credibility of the debt reduction strategy, will therefore disappear. Instead, each year in spring, Member States will present a Progress Report reflecting progress in achieving the committed path, reforms and investments.

2. The fiscal commitments contained in these plans are set out in a **path of primary expenditure net of revenue measures**, calibrated on a country-specific basis. The spending path thus becomes the only relevant indicator for the purposes of fiscal monitoring in the EU. In other words, the aim is to establish limits on the growth of discretionary primary expenditure, provided that no revenue measures are introduced to finance it.
3. The **adjustment period will be four years. This period can be extended up to seven years** if the MS commits to a set of specific and verifiable reforms and investments that support growth and fiscal sustainability, addressing priorities identified at an EU level.

In the case of high debt countries such as Spain, the submission of these plans is preceded by a number of steps: first, there is a technical exchange between the Commission and the Member State which provides an opportunity to discuss the most recent statistical information available and the country's economic and fiscal outlook; second, the Commission provides the MS with a reference trajectory for net primary expenditure over a four- or seven-year adjustment period; then, there is technical dialogue between the MS and the Commission to ensure that the fiscal-structural plan submitted by the MS complies with the applicable requirements (see below). If the MS decides to present a higher expenditure path than that contained in the Commission's reference trajectory, it must justify this with sound economic arguments and support it with data to back up the difference.

4. The **calibration of the committed spending path**, different for each country, should ensure *ex ante* that, once the adjustment period is over, the public debt-to-GDP ratio will follow a downward path with a high probability, even in adverse scenarios. At the same time, it should ensure that the General Government deficit is reduced (and maintained) below 3%.

Accordingly, the adjustment path is calibrated on a country-by-country basis, taking into account the country's starting fiscal position and also the future projections of the relevant macro-fiscal variables in a set of scenarios.

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<sup>4</sup> Countries whose national legislatures have a five-year term may submit five-year fiscal-structural plans.



Accordingly, the uncertainty surrounding future debt projections is explicitly introduced (see Section 2.2).

Moreover, the expenditure path must satisfy these common safeguards *ex ante* for a country receiving a reference trajectory and whose structural deficit is above 1.5%, such as Spain:

- a. the public debt ratio is reduced over the adjustment period by at least 1 percentage point (pp) on average per annum (0.5 pp for countries with a debt ratio between 60% and 90% of GDP).
- b. the fiscal effort during the same period should be at least proportional to the total adjustment that needs to be addressed.
- c. in addition, the adjustment should continue (after the completion of the first round of medium-term fiscal-structural plans) or be extended in size (in the case of a country that in the first round obtained an adjustment resulting from the DSA or debt safeguard of less than 0.25-0.40 pp) until a structural deficit not exceeding 1.5% of GDP is achieved, at a rate of at least 0.4%<sup>5</sup> if the adjustment is undertaken over four years or 0.25% if it is undertaken over seven years.

**It is important to stress that compliance with these conditions and safeguards is only relevant in the *ex-ante* dimension, when calibrating the adjustment path.** Once the expenditure path is agreed for the four years of the fiscal-structural plan, MS' compliance with the Pact obligations will be assessed exclusively against the expenditure indicator. In other words, what is required by the debt safeguard, for example, is not verification *ex post* (at  $t+5$ ) with observed data that in the period from year  $t$  to year  $t+4$  there was in fact a fall in the debt ratio of 1 pp on average per annum. Instead, what is required by this safeguard is that in year  $t-1$ , when the expenditure path is calibrated and taking into account the projections available at that time, the adjusted expenditure path is consistent with a projected reduction in the debt ratio of at least 1 pp on average per annum.

5. The reform includes a **new category of escape clause, specific to each country**, which can be activated by the Council in the event of exceptional circumstances beyond the control of the MS concerned and with a significant impact on its public finances. The general escape clause is maintained to address severe crisis situations affecting the euro area or the EU as a whole<sup>6</sup>.

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<sup>5</sup> This effort is in terms of the structural primary balance.

<sup>6</sup> With the reform, the quantitative indicators for the activation of the general escape clause disappear, as had been the case with the corrective arm Regulation.

6. Another important element is the **special consideration of certain categories of expenditure**, which has evolved in the different stages of negotiation. Initially, the Commission's proposal did not include the special consideration of any type of nationally-financed expenditure, beyond interest and cyclical unemployment spending, which are traditionally excluded from the expenditure rules because their evolution is outside the decision-making capacity of governments and fiscal authorities.

Special consideration of some expenditure was introduced in the Council negotiations, albeit with limited scope and always with regard to the corrective arm of the Pact. Specifically, it provides for the increase in defence investment to be taken into account when the Commission proposes the opening of an Excessive Deficit Procedure (EDP). Moreover, while the minimum annual effort in the case of an EDP will be calculated in terms of the overall structural balance, during the period 2025-2027 and as an exception to this general rule, the primary structural balance, i.e. net of interest, will be calculated instead.

Finally, as a result of the negotiation with the European Parliament, national co-financing of EU funds is excluded from the calculation of the net primary expenditure path for fiscal monitoring purposes, without limit, which discourages the strategic use of co-financing to comply with the expenditure path while contributing to achieving the EU targets implemented through the common budget.

7. The reform provides for the creation of a **control account** in which deviations (over or under) of observed net primary expenditure in relation to committed expenditure will be recorded.
8. As regards the **Excessive Deficit Procedure**, the possibility of opening the EDP for countries with a deficit exceeding the reference value of 3% of GDP (deficit-based EDP) remains unchanged. For the opening of the EDP for non-compliance with the debt criterion, deviations from the net primary expenditure path will be taken into account. This replaces the previous 1/20 rule, which was never applied because of the unrealistic adjustments it advocated and its marked pro-cyclicality. In particular, the opening of a debt EDP will be based on the existence of debt levels exceeding 60% of GDP, a deficit exceeding the reference value by 0.5% of GDP, and a value of deviations - of net primary expenditure from the committed path - recorded in the control account exceeding the annual or cumulative limits established (0.3% of GDP annually and 0.6% cumulatively).

In the event of the opening of an Excessive Deficit Procedure, the corrective expenditure path should ensure that the deficit falls or is sustained below 3% within the deadline established by the Council. In

particular, for countries for which an EDP is opened on the basis of the deficit criterion, the corrective expenditure path should be consistent with an annual structural effort of at least 0.5 pp (over the period 2025-2027 this benchmark is considered in primary terms). If the EDP is opened under the debt criterion, the corrective path should be at least as demanding as the one established in the preventive arm, while correcting as a general rule the deviations accumulated in the control account.

9. **Finally, as regards entry into force**, a transitional regime is established for the submission of the first fiscal-structural plans this year. Therefore, the Commission will have to submit the reference trajectories to the Economic and Financial Committee by June 21<sup>st</sup> at the latest and the MS will submit their plans no later than September 20<sup>th</sup>, 2024 - unless the MS and the Commission agree on an extension of this deadline for a reasonable period of time.

## 2.2. A preliminary calibration for Spain of the new fiscal rules with AIRcF projections

**The calibration of the expenditure path depends on future debt projections under a range of scenarios, including adverse ones.** The medium-term orientation and forward-looking nature of the new fiscal framework means that calibrating the net primary expenditure path that leads to a reduction in debt with a high probability requires a multitude of inputs of a technical nature. Specifically, estimates of potential growth in the medium and long term (at least until  $t+14$  or  $t+17$ ), demographic forecasts and forecasts of the expenditure pressures associated with ageing and a quantification of the impact of the reforms and investments implemented at the time of drawing up the fiscal-structural plan, among other elements, will be necessary<sup>7</sup>. AIRcF has been working in recent years to improve its medium- and long-term sustainability analysis so that it is now in a good position to offer its own estimate of all these inputs.

**In particular, the first aspect to be decided to calibrate the new framework is the length of the adjustment period, which can range from four to seven years.** AIRcF's simulations present the results for the four-year scenario and the seven-year scenario, with the intention of providing an estimation range for the adjustment required in the new framework.

**The new framework calibrates the adjustment considering the uncertainty surrounding the variables driving debt evolution.** According to the European

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<sup>7</sup> The impact of reforms and investments underlying the extension of the adjustment period are not incorporated in the DSA. The plan should contain some information on their impact, but this is not necessary for the calibration of the net expenditure path.

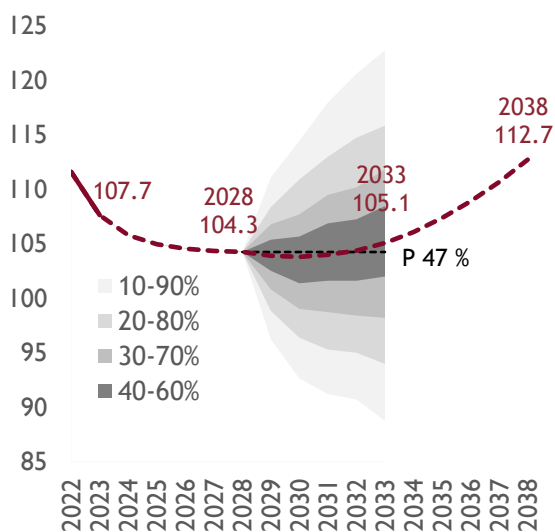
Commission's guidelines published in its *Debt Sustainability Monitor (2023)*, which reflects the methodology for analysing the sustainability of public debt that will underpin the reference trajectories of the different countries, uncertainty is introduced through two complementary tools (i) stochastic debt projections and (ii) deterministic sensitivity scenarios that include an unfavourable evolution of some of the variables that condition the dynamics of public debt. For it to be considered plausible that debt is on a downward path, the following conditions must be met :

- i. Stochastic projections: the path must show a downward trajectory, with a **minimum probability of 70%**, in the five years after the end of the adjustment period.

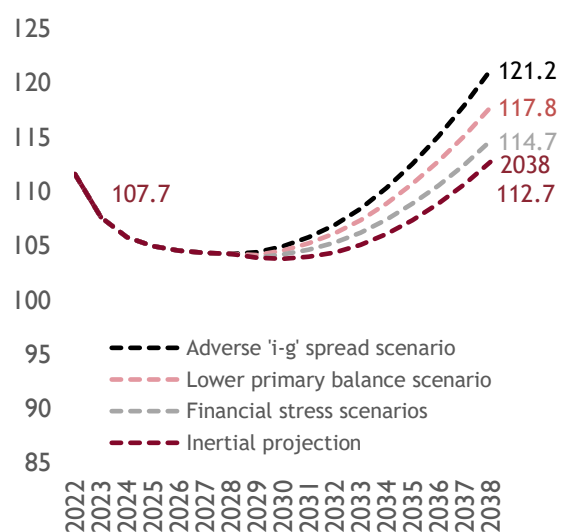
Considering the four-year adjustment period 2025-2028, the debt ratio should fall five years later (i.e. in 2033) below the starting position baseline (104.3% in 2028) with a degree of probability of at least 70%. In the baseline projection - without adjusting the expenditure path - the ratio would stand at 105.1% according to AIRcF's projections. Not only does this value not imply a reduction, but it shows that the debt ratio has a 53% probability of increasing. It will thus be necessary to reach a public debt-to-GDP ratio of 95% to meet the condition, which would imply **an annual linear adjustment of the primary balance of 0.36 pp of GDP over the four years of the adjustment period**, up to a total of 1.44 cumulative points.

Figure 1. Baseline scenarios for the evolution of public debt

1a. Baseline scenario for debt evolution with uncertainty bands from 2028 onwards



1b. Baseline scenario for debt evolution and worst-case scenarios from 2028 onwards



Source: AIRcF

ii. More unfavourable deterministic scenarios: the path should show **a downward trajectory in the ten years after the end of the adjustment period under more pessimistic assumptions** on the determinants of the evolution of the debt ratio. The variables on which the negative shock is defined and its calibration are defined in the *Debt Sustainability Monitor 2023*<sup>8</sup>, giving rise to the following scenarios:

- 1) Financial stress scenario
- 2) Adverse interest rate-growth differential ('i-g') scenario
- 3) Lower (structural) primary balance scenario

The shocks are introduced in the year following the end of the adjustment period - i.e. from 2029 or 2032 onwards depending on whether the duration of the plan is four years or extended to seven years - by projecting the debt ratio on the basis of these more adverse assumptions.

For the purposes of this simulation, the path is considered to be downward when the debt ratio over a ten-year horizon after the end of the adjustment period (2038 in a four-year plan or 2041 in a seven-year plan) is lower than in the previous year (2037 or 2040) under the most adverse scenario, which in this simulation is defined by the "adverse interest rate-growth differential (i-g) scenario". Satisfying this condition implies an **annual linear adjustment<sup>9</sup> of the structural primary balance of 0.63 points of GDP over four years**, up to a total of **2.52 points of GDP**, or of **0.43 points of GDP if the duration of the plan is extended to seven<sup>10</sup> years**, up to a total of **3.01 points of GDP**. Both adjustments ensure compliance with the path following a downward trajectory with a minimum probability of 70% in the five years after the end of the adjustment period, with the probability rising to above 80%.

<sup>8</sup> The *Debt Sustainability Monitor 2023* is available at [https://economy-finance.ec.europa.eu/publications/debt-sustainability-monitor-2023\\_en](https://economy-finance.ec.europa.eu/publications/debt-sustainability-monitor-2023_en)

<sup>9</sup> The annual adjustment incorporates a fiscal policy feedback effect through a fiscal multiplier of 0.75, which means that a fiscal consolidation of 1 percentage point of GDP reduces GDP by 0.75 percentage points in the same year compared with the baseline scenario. This effect is eliminated gradually over three years. Following the EC approach, the value of the multiplier and its time profile are derived from Carnot, N. & de Castro, F. (2015), 'The discretionary fiscal effort: an assessment of fiscal policy and its output effect'. Fiscal consolidation is assumed to have no effect on potential output. The negative output gap will reduce the primary balance according to the semi-elasticity of the budgetary balance to the output gap, with a value of 0.597 for the case of Spain.

<sup>10</sup> To ensure a more gradual debt reduction, the adjustment period can be extended by a maximum of three years if the Member State supports its medium-term fiscal-structural plan with a set of verifiable and time-bound reforms and investments that, as a rule, are broadly growth-enhancing and resilient, support fiscal sustainability, address the common priorities of the Union and take into account the country-specific recommendations addressed to the Member State in the framework of the European Semester.

Figure 2. Primary structural adjustment that meets the most restrictive condition of the new framework, under a four- and seven-year plan.

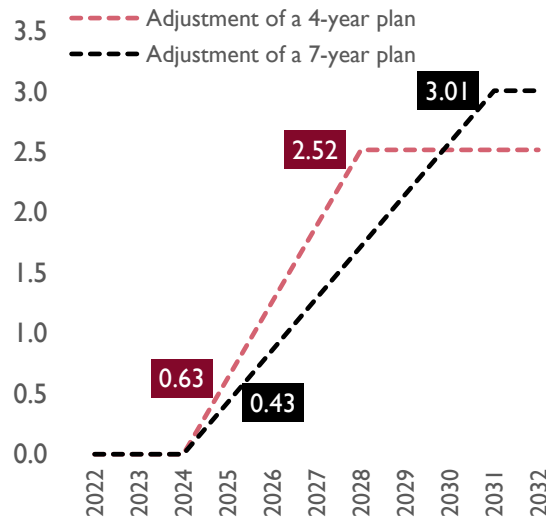
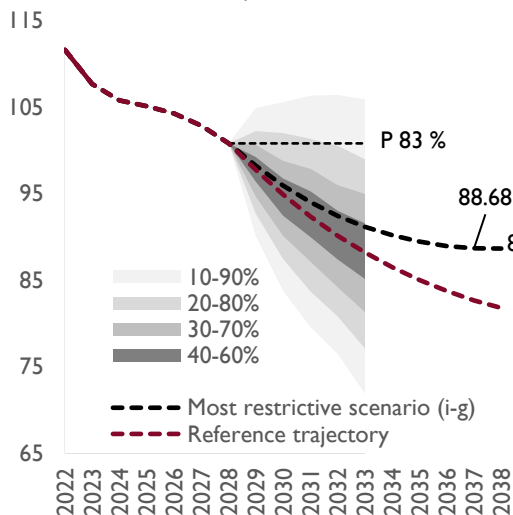
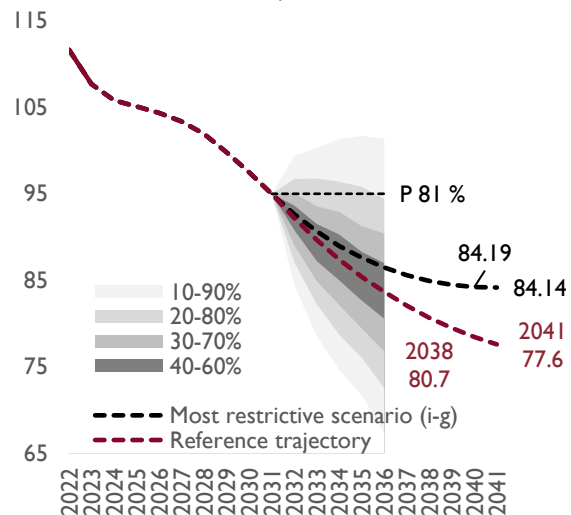


Figure 3. Four- and seven-year reference trajectories

3a. Reference trajectory, uncertainty bands and more restrictive scenario in a four-year adjustment plan of 0.63 points



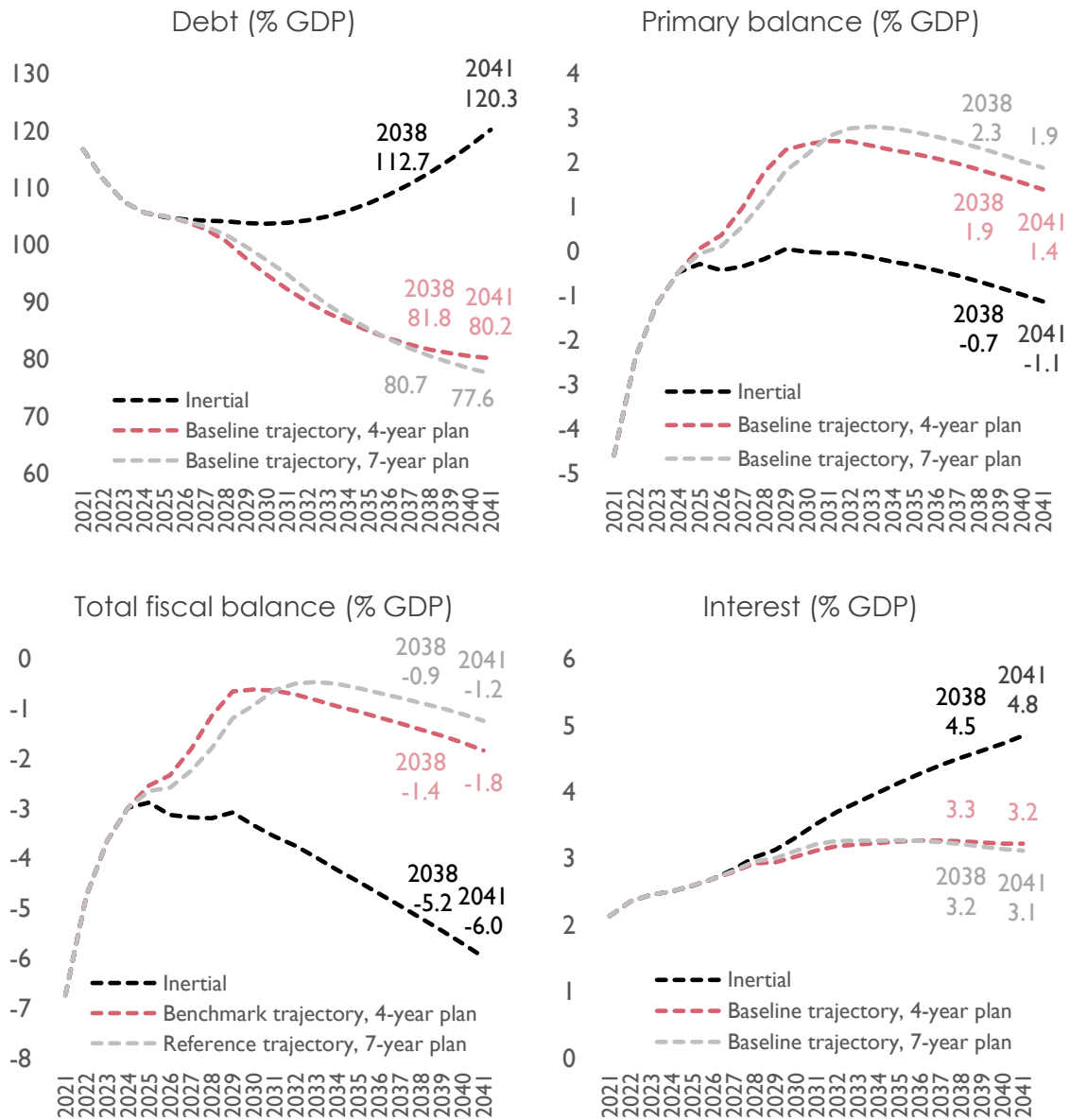
3b. Reference trajectory, uncertainty bands and more restrictive scenario in a seven-year adjustment plan of 0.43 points



Source: AIReF

Looking at the evolution of the fiscal balances underlying these debt paths, it can also be seen that the adjustment (which is calibrated linearly and therefore constant over the period) ensures that the deficit is reduced to below 3% over the period and remains below this threshold in the medium term. Compliance with the debt safeguard is also ensured (average fall of more than 1 pp between 2025-2028 or 2025-2031).

Figure 4. Baseline projection and reference trajectories under a four-year 0.63 points of GDP adjustment plan and a seven-year 0.43 points of GDP adjustment plan

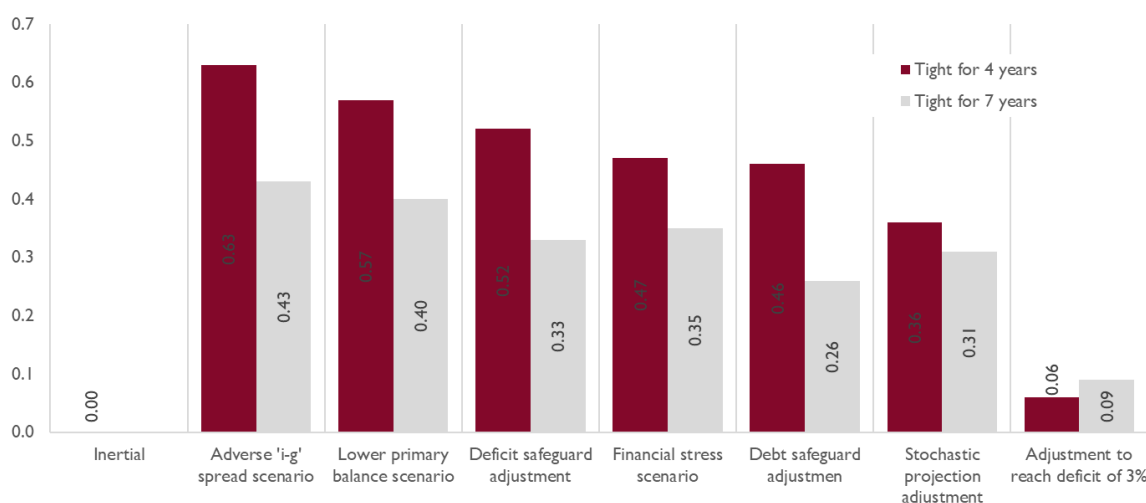


Source: AIRcF

The following table presents the adjustment required in a four-year and seven-year plan to satisfy all the conditions to be met by the reference trajectory under the framework of the new rules.

Figure 5. Adjustments needed to meet the different requirements<sup>11</sup> of the new framework under a four- and seven-year plan

Requirement	4-year plan			7-year plan		
	Adjustment	Debt (% GDP) 2038	Debt (% GDP) 2041	Adjustment	Debt (% GDP) 2038	Debt (% GDP) 2041
Inertial	0,00	112,7	120,3	0,00	112,7	120,3
Adverse 'i-g' spread scenario	<b>0,63</b>	<b>109,8</b>	116,5	<b>0,43</b>	106,0	<b>111,3</b>
Lower primary balance scenario	0,57	90,1	91,0	0,40	88,1	87,5
Deficit safeguard adjustment	0,52	87,2	87,2	0,33	93,3	94,4
Financial stress scenario	0,47	89,6	90,4	0,35	86,6	85,5
Debt safeguard adjustment	0,46	95,0	97,4	0,26	89,6	89,5
Stochastic projection adjustment	0,36	84,7	84,0	0,31	82,9	80,5
Adjustment to reach deficit of 3%	0,06	81,8	80,2	0,09	80,7	77,6



Source: AIRcF

<sup>11</sup> The necessary annual adjustments have been calibrated to a four- and seven-year plan for each of the requirements of the new framework, defined as follows:

- (i) *Adverse 'i-g' differential scenario*: the difference between market interest rates and nominal GDP growth increases permanently by 1 pp compared with the baseline scenario
- (ii) *Lower primary balance scenario*: worse evolution of the primary balance (0.5 points of GDP) over the projection horizon
- (iii) *Deficit safeguard adjustment*: adjustment of 0.40/0.25 points per annum (over four/seven years) in the event the structural deficit exceeds 1.5%: The calibration has been performed by applying a fiscal multiplier of 0.75, and it has therefore been necessary to increase the adjustment by a few hundredths of a point to reduce the primary balance by 0.40/0.25 points on average.
- (iv) *Financial stress scenario*: applies a temporary (one-year) additional increase in issuance rates of 1 pp + 0.06 \* (act-90 debt) as a high-debt country, for a total increase of 2.08 pp.
- (v) *Debt safeguard adjustment*: reduction of 1 point of GDP per annum on average over the adjustment period
- (vi) *Stochastic projection adjustment*: the path must follow a downward trajectory with a minimum probability of 70% in the five years after the end of the adjustment period.
- (vii) *Adjustment to reach deficit of 3%*: at the end of the adjustment period, the total deficit should be below 3% of GDP.

These adjustments have been calculated taking into account a fiscal multiplier of 0.75.



The results of the *ex-ante* adjustment show that while in the baseline scenario the debt ratio in 2038 (112.7%) would be 5 points higher than in 2023 (107.7%), with an adjustment of 0.63 points per annum for four years, the debt ratio would decrease by 26 points in 2038 compared with 2023, to 81.8% (31 points lower than in the baseline scenario). Similarly, an adjustment of 0.43 points per annum over seven years would bring the ratio to 80.7% over the next 15 years.

Determining the fiscal path requires an additional step: translating the adjustment in terms of GDP points into a maximum growth rate of net primary expenditure. This is not a trivial aspect from a methodological point of view because, even starting from the same quantification of the necessary adjustment, the determination of the maximum expenditure growth rate may be affected by the revenue and expenditure path underlying the baseline forecasts of the primary deficit. According to the methodology used and AIRcF's current forecasts, the adjustment of 0.63 pp of GDP over four years would correspond to average growth in primary expenditure of 2.3% over the period 2025-2028, while the adjustment of 0.43 pp over seven years would correspond to average growth in primary expenditure of 2.7% over the same horizon.

### 2.3. The reform of Directive 2011/85 on national fiscal frameworks.

**The reform of the EU fiscal framework has been undertaken as a comprehensive legislative package which, in addition to amending the Pact Regulations, also introduces changes to the Directive on National Fiscal Frameworks** (hereafter, the Directive). This Directive, initially adopted in 2011, was intended to harmonise the characteristics of national fiscal frameworks in all EU countries, in order to create a second line of defence to strengthen compliance with the Pact's obligations<sup>12</sup>. However, the 2011 Directive only established minimum requirements regarding the need to include independent macroeconomic forecasts and to strengthen the medium-term dimension of national fiscal frameworks, so its transposition was very heterogeneous. For this reason, various institutions and the academic world called for a revision of the Directive aimed at strengthening national ownership of fiscal commitments, so that national legislation should contain provisions to (i) avoid the existence of excessive deficits, (ii) strengthen the medium-term dimension of national frameworks as

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<sup>12</sup> Economic Governance Review. Report on the application of Regulation (EU) Nos. 1173/2011, 1174/2011, 1175/2011, 1176/2011, 1177/2011, 472/2013 and 473/2013 and Council Directive 2011/85/EU [eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020SC0210](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020SC0210)

an instrument to achieve a better combination of fiscal discipline and growth<sup>13</sup> and (iii) strengthen the role of Independent Fiscal Institutions.

**The reform of the Directive focuses on three aspects:** the improvement of budgetary statistics, the adaptation of medium-term budgetary frameworks and Independent Fiscal Institutions (IFIs). The overall deadline for transposition of the Directive is just under two years and ends on December 31<sup>s</sup>, 2025.

In relation to **budgetary statistics**, the reform of the Directive emphasises several aspects:

- a. On the one hand, it encourages Member States to establish accounting systems that fully and consistently cover all General Government sub-sectors and contain the information necessary to generate accrual-based data.
- b. It introduces the obligation to publish information on the operations carried out by bodies and funds which, while part of the General Government, are not included in the budget.
- c. Lastly, it also assesses the obligation to publish information on contingent liabilities, including – as far as possible - those that may arise from climate change and natural disasters.

In addition, the Directive provides for **the adaptation of national medium-term frameworks**, which requires the amendment of the national provisions governing them, introducing the following new features:

- a. The fiscal targets in the national medium-term budgetary framework need to be consistent with those set out in the reformed Pact.
- b. The national medium-term framework will need to describe the policies - including reforms and investments - that will allow the budgetary variables to evolve from their projection on a no-policy-change basis to the targets in the previous point.
- c. The national medium-term framework should assess how the planned policies affect the medium- and long-term sustainability of public finances, as well as sustainable and inclusive growth. As far as possible, this analysis should take into account the macro-fiscal risks stemming from climate change, including its environmental and distributional impacts.

**As regards the role of national IFIs, the Commission's initial proposal included a more balanced interaction between rules and institutions within the national**

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<sup>13</sup> European Court of Auditors (2019). "EU requirements on national budgetary frameworks: need to further strengthen them and to better monitor their application"; Xavier Debrun & Wolf Heinrich Reuter (2022). "Fiscal is local. EU standards for national fiscal frameworks". VOXEU column.

**fiscal framework - strengthening the tasks of the latter - in a mutually reinforcing way.** In addition to codifying a set of minimum standards that should guarantee the independence of IFIs and provide them with the necessary elements to carry out their functions, the Commission's proposal also set out a set of new tasks. These included the production or endorsement of annual and multi-year budgetary forecasts, the production or endorsement of the debt sustainability analyses underlying the medium-term plans and the monitoring of compliance with the fiscal rules of both the national and EU frameworks. It also included the production or endorsement of annual and multi-year macroeconomic forecasts, despite the fact that this is already a task performed by a large number of IFIs in the EU and that, in the case of the euro area, is included in Regulation 473/2013 and in the Fiscal Compact. As it is now legislated in a Directive applicable to all EU Member States, the production or endorsement of macroeconomic forecasts becomes a task to be performed by all IFIs, including those outside the euro area.

**This Commission proposal came in a global context of an intensification of the number of IFIs and their functions.** According to the IMF, the number of IFIs has doubled in the last decade to 51 institutions (Davoodi *et al.*, 2022).

**There is now ample evidence that IFI activities can improve the quality of fiscal debates and increase national ownership of the commitment to sustainable public finances** (European Commission, 2023). This has led to the fact that, although existing European legislation on the subject has set minimum standards, national legislation and frameworks have tended to broaden and deepen the mandate and tasks performed by these institutions, as well as strengthen their legal status and independence. The expanded mandates are in many cases based on endorsement tasks, compliance with rules, policy costing, analysis of long-term sustainability, assessments of public spending and the production of regulatory fiscal policy recommendations. The diversity of tasks performed in practice by European IFIs is reflected in the work carried out by AIRcF, as well as within the EU IFI Network in 2022<sup>14</sup>.

**From a theoretical point of view, the institutional strengthening of IFIs is argued to be due to the lack of incentives for governments to own their intertemporal budget constraint, which manifests itself in biases towards deficits and the procyclicality of fiscal policy.** The empirical evidence available on the role played by IFIs in realigning these incentives can be grouped into five categories:

- Optimism bias: governments tend to be optimistic in their macroeconomic forecasts, which can lead to higher-than-expected deficits. Frankel & Schreger (2013) analyse 34 countries over 15 years and

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<sup>14</sup> See "Independent fiscal institutions in the European Union" AIRcF Technical Paper 1/2021 and "The capacity of national IFIs to play an enhanced role in EU Fiscal Governance", EU IFI Network (2022).

- conclude that IFIs help reduce the optimism bias by producing or endorsing macroeconomic forecasts.
- Procyclicality of fiscal policy: the limited ownership of the intertemporal budget constraint means that only in times of crises or shocks do financing constraints emerge for governments. This can reduce access to financial markets and lead to pro-cyclical policy. Chrysanthakopoulos & Tagkalakis (2022) find evidence that the presence of IFIs makes it possible to bring forward the corrections in periods of expansion and thus reduce procyclicality.
  - Compliance with fiscal rules: anticipating compliance with fiscal rules is complex because of the many interactions that occur outside the government's reach, as well as the impact of unannounced discretionary decisions taken throughout the budget cycle. However, the provision of objective data and reports by IFIs raises a government's reputational risk in relation to non-compliance. In this regard, Beetsma *et al.* (2019) point to empirical evidence suggesting that the presence of an IFI is associated with a higher degree of compliance with fiscal rules.
  - Spending reviews: Spending reviews carried out by various IFIs help to improve the quality of the fiscal debate. Căpraru *et al.* (2023) point out that the performance of spending reviews of public expenditure has a positive and persistent effect on its efficiency.
  - Borrowing costs: the relationship between a country's debt level and its borrowing costs is non-linear as a multitude of elements interact. However, the empirical analysis of Pappas & Kostakis (2020) suggests that fiscal supervision and enforcement of fiscal rules by IFIs tends to improve sustainability and thus lower the borrowing costs of public debt.

**In short, empirical evidence suggests that the presence of strong and functionally autonomous IFIs has become a key element in fostering credibility and commitment to sustainability, leading to lower borrowing costs and more efficient spending.** The Commission's proposal for the reform of the Directive therefore included a harmonisation of core aspects of national IFIs through a Directive applicable to all EU Member States. On the one hand, this allowed those countries with less mature institutions to strengthen the autonomy and resources of their IFIs and, as a result, to take on a greater number of functions. On the other hand, extending the mandate of the IFIs allowed the interrelationship between fiscal rules and institutions within national frameworks to be strengthened, in a context in which, in addition, the aim is to increase national ownership of the whole fiscal framework.

**However, the possibility of a more balanced interaction between rules and institutions within national frameworks was watered down in the Council Agreement.** In particular, the reform of the Directive finally adopted sustains the common minimum standards that should guarantee the independence of the

IFIs along with a reduced list of tasks. In relation to those proposed by the Commission, it provides for the production, analysis and endorsement of annual and multi-year macroeconomic forecasts; the assessment of compliance with national fiscal rules; the assessment of the consistency, coherence and effectiveness of the national budgetary framework, and the possibility of appearing, upon invitation, before the national parliament. While the very nature of IFIs makes it reasonable for these institutions to monitor the consistency, coherence and effectiveness of the national budgetary framework, as guarantors of the sustainability of public finances, this monitoring is now expressly entrusted in the Directive. In the context of the decentralisation of public finances in the Spanish economy, the performance of this function on a sound regulatory basis will be essential for improving coordination and ensuring that all tiers of government contribute to the design of sound public finances and compliance with the European fiscal framework.

**In relation to the preventive and corrective arms of the Pact, the Directive, after its passage through the Council, includes the possibility for national governments to request the IFI, if they consider it appropriate at their own discretion, to prepare certain ex-post reports.** In particular, it sets out the possibility for the government to request from the IFI an assessment of the progress report and the reasons for deviations from the committed expenditure path. Moreover, following the passage through Parliament, the possibility is added that the macroeconomic assumptions and the endorsement or production of the annual and multi-year macroeconomic forecasts already included in the reform of the Directive on National Fiscal Frameworks – in addition to Regulation 473/2013 and the Fiscal Compact for IFIs in the euro area – will also be reflected in an opinion accompanying the medium-term fiscal-structural plan. Eight years after the entry into force of the regulations, this report will be mandatory, provided that the IFI has sufficient capacity.

**Lastly, the Directive stresses that IFIs may issue reports on the performance of their tasks.** These reports are subject to the "comply or explain principle". In the event that the government deviates from the recommendations issued by the IFI, it must explain the reasons within a maximum of two months<sup>15</sup>.

**Following the negotiation of the fiscal reform, the Commission's initial proposal to clearly extend the tasks of the IFIs and strengthen their role in national budgetary frameworks has been watered down, while recognising the need to gradually increase their analytical capacity.** The preservation of the role of IFIs is reflected in Recital Eight of the reformed Directive, as well as in Recital 27 of the new Preventive Arm Regulation. As some authors point out, this contrasts with what is envisaged for the European Fiscal Board (EFB): while EU governments have promoted a strengthening of the EFB's oversight of the

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<sup>15</sup> In our case, however, the deadline for responding to recommendations is one month.

European Commission, they have been less diligent when it comes to strengthening the oversight of their own national fiscal councils (Zettelmeyer, 2023).

**In this regard, it should be noted that AIReF has very solid legislation at a national level that has enabled it to develop sufficient capacity to play a relevant role in the future framework, facilitating calculations of the numerous elements of a technical nature on which it is based.** In fact, the European Commission's SIFI indicator<sup>16</sup> places AIReF as one of the four IFIs in the EU with the greatest scope and breadth in the tasks performed, in terms of both monitoring compliance with fiscal rules, macroeconomic forecasts, budgetary forecasts, sustainability evaluation, promoting fiscal transparency and recommendations on fiscal policy. This SIFI indicator is - together with the quality of national budgetary frameworks and the strength of national fiscal rules - one of the three pillars of the European Commission's assessment of national fiscal governance.

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<sup>16</sup> SIFI stands for "Scope Index of Fiscal Institutions".

It is one of the indices that make up the European Commission's fiscal governance database, which can be consulted at the following link: [https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/fiscal-governance-database\\_en](https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/fiscal-governance-database_en).

# 3. FOUR KEY IMPROVEMENTS IN THE REFORM OF THE EU FISCAL FRAMEWORK

Having described the main elements of the reform of the EU fiscal governance framework, this section sets out the four most important improvements it entails in AIReF's opinion.

## 3.1. It explicitly places sustainability at the heart of the new rules with a differentiated vision for each country.

**The fiscal policy choices to be made at a particular point in time depend to a large extent on the future projections of a set of variables that ultimately impact on public debt and on the uncertainty surrounding these projections.** This is one of the fundamental premises underlying the new framework: short- and medium-term fiscal targets depend on the evolution of debt over (and also beyond) the planning horizon. To the extent that fiscal targets are derived on a country-specific, country-by-country basis from an analysis of current and future public debt, the new framework makes this analysis explicit and transparent - including the macro-fiscal projections that feed into it.

**In relation to the previous framework, it is not so much that this sustainability dimension was absent, but that it was poorly implemented through the notion of the medium-term structural objective (MTO).** Maintaining public finances within the MTO was the ultimate requirement of the previous fiscal framework. In

principle this was to ensure that, in the future - taking into account the costs of ageing, the level of debt and the shocks that a given economy was likely to experience - public finances would remain sound.

**However, by crystallising the analysis into a structural balance target, the connection between the fiscal target and the evolution of debt was diluted and became less explicit.** Moreover, while it was initially considered that the MTO could be differentiated by country – reflecting the different sustainability risks of each country – from the Fiscal Compact onwards, the structural balance targets became much more homogeneous than the differentiated analysis of increasingly divergent public indebtedness seemed to suggest.

**In response to this situation, the new framework includes country-specific and differentiated calibration of fiscal adjustment requirements, determined by a debt sustainability analysis (DSA).** On this occasion, each MS (and the Commission) will have to make explicit the medium- and long-term macro-fiscal projections involved in this analysis. This greater transparency and differentiation in countries' assumptions and projections can strengthen the legitimacy of the required adjustments by supporting them in a more robust way, illustrating the long-term benefits of the agreed paths. All of this can support their implementation. As highlighted in the simulation in Section 2.2, meeting the condition of eliminating risks around debt evolution (ensuring that it falls with sufficient probability and under different adverse scenarios) implies compliance with the additional deficit and debt safeguards. In that regard, therefore, the safeguards are redundant, at least at present.

### 3.2. It strengthens the medium-term dimension, preserving investments

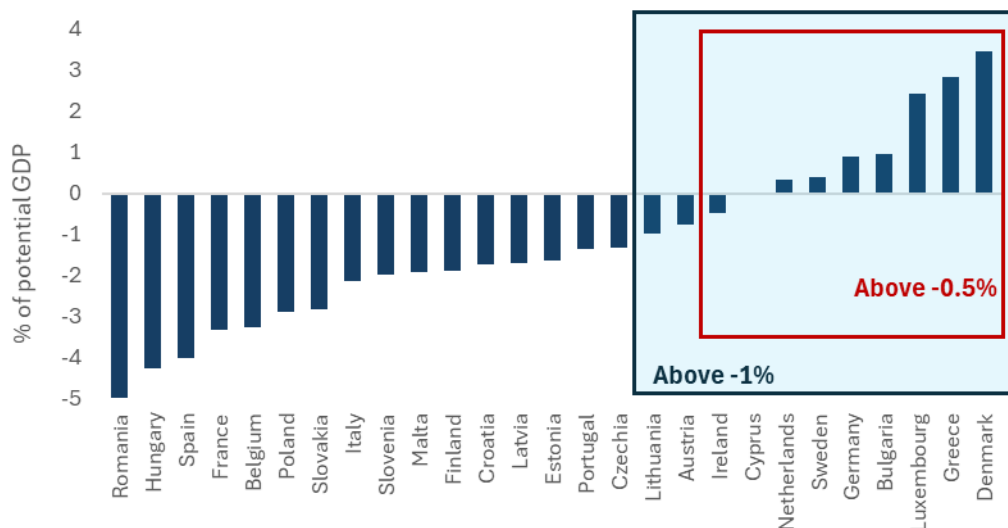
**In principle, the previous framework already included a medium-term dimension, from the moment the Stability and Convergence Programmes began to be drawn up with the reform introduced by the European Semester.** However, more than a decade later, the evidence in the vast majority of EU countries suggests that these four-year documents have essentially been a formality, rather than a genuine medium-term fiscal policy planning exercise. In particular, the evidence from the analysis of the successive Stability and Convergence Programmes presented during the period 2011-2019 shows continuous revisions, poor predictability and poor results.

**After eight years of supposed medium-term planning, in 2019 most EU countries remained substantially off their structural balance targets.** Moreover, between 2011 and 2019, the average revision of the planned fiscal effort in the EU was 0.3 pp, both at one year and at three years. Thus, medium-term planning, as carried out under the previous framework, did not contribute either to anchoring



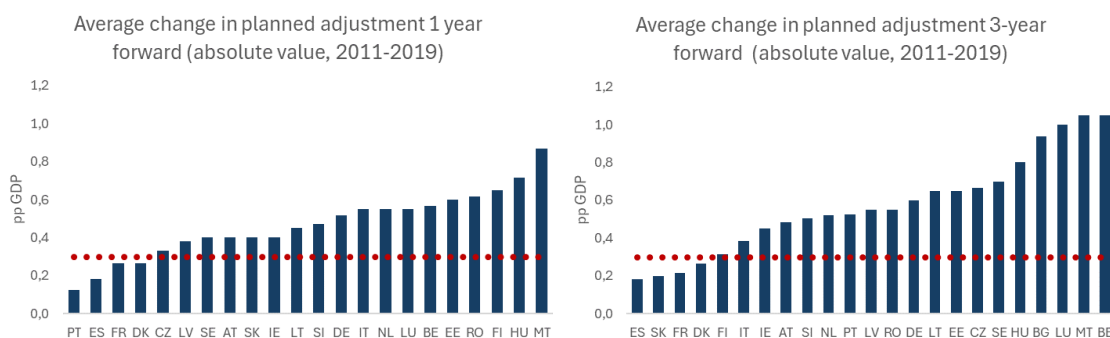
expectations about fiscal policy or to cleaning up the underlying position of public finances in a large number of EU countries (Rodriguez *et al.*, 2021).

Figure 6. Structural fiscal balance in 2019, % potential GDP



Source: Rodriguez *et al.*, 2021

Figure 7. Revisions in planned fiscal adjustments at one year and three years



Source: Rodriguez *et al.*, 2021

This variability of the medium-term plans in the past is associated with the fact that planning documents were adopted once a year and amended on a recurring basis with each edition, rather than remaining fixed.

**In contrast to the previous system, the new framework establishes that medium-term plans will not be adopted or revised every year, but will be adopted for a period of four years and will remain fixed during that time.** They can only be revised if there are objective circumstances that prevent the implementation of the current plan or in the event of the formation of a new government. An MS intending to amend it will have to make a formal request to the Commission to do so.

**Furthermore, the new framework includes the possibility of extending the adjustment period<sup>17</sup> in the case of certain reforms and investments.** It also establishes the obligation to provide information on the level of nationally-financed public investment over the plan period. This focus on investment could avoid unintended consequences on the composition of public finances associated with the previous round of adjustments. In particular, the ratio of public investment to GDP contracted by over 1 percentage point in the euro area, from 3.7% before the financial crisis to 2.6% in the middle of the last decade.

### 3.3. It streamlines the operational indicators for fiscal monitoring

**One of the key innovations brought about by the reform of the EU fiscal framework is the streamlining of the operational indicators used to monitor fiscal policy.** This streamlining operates in two dimensions: in terms of the number of indicators and in terms of the type of indicator.

**In relation to the number of indicators, the previous framework involved four different variables, two for each arm of the Pact:** debt and deficit operated in the corrective arm, while the structural balance and the expenditure benchmark were the references of the preventive arm. This was in addition to the indicators applicable under each Member State's national framework. Accordingly, at any given time, a country such as Spain was required to meet five fiscal targets at the same time: the two from the applicable arm of the Pact, the national expenditure rule, the national debt rule and the adjustment in the structural balance included in the national framework. In other words, the design of a draft Budget had to ensure that, *ex post*, the observed data reflected compliance with these five variables which, despite sharing similarities, also had important differences in terms of their definition and/or the calibration of their adjustment.

**This greatly hindered the transparency of the framework and was detrimental to compliance:** enforcement processes that focus on different indicators tend to be very complex. The accumulation of indicators and targets blurred the fundamental purpose of the rules and paved the way for selective and opportunistic action.

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<sup>17</sup> In the case of reforms or investments, the adjustment period would be extended to a maximum of seven years, but the horizon of the Plan is not extended, and will in any case be four or five years depending on the length of the legislature in each country.

Figure 8. Outline of the fiscal framework applicable to Spain before the reform

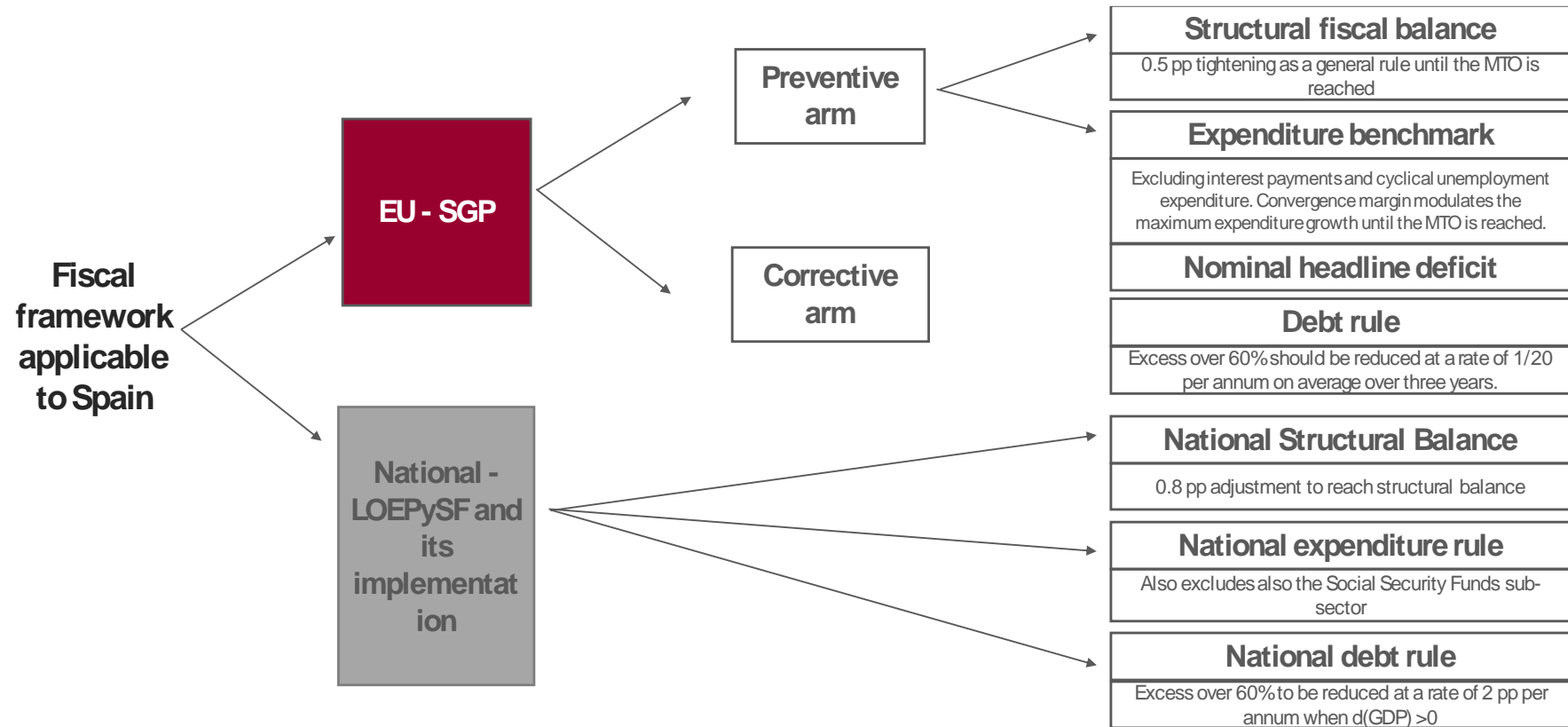
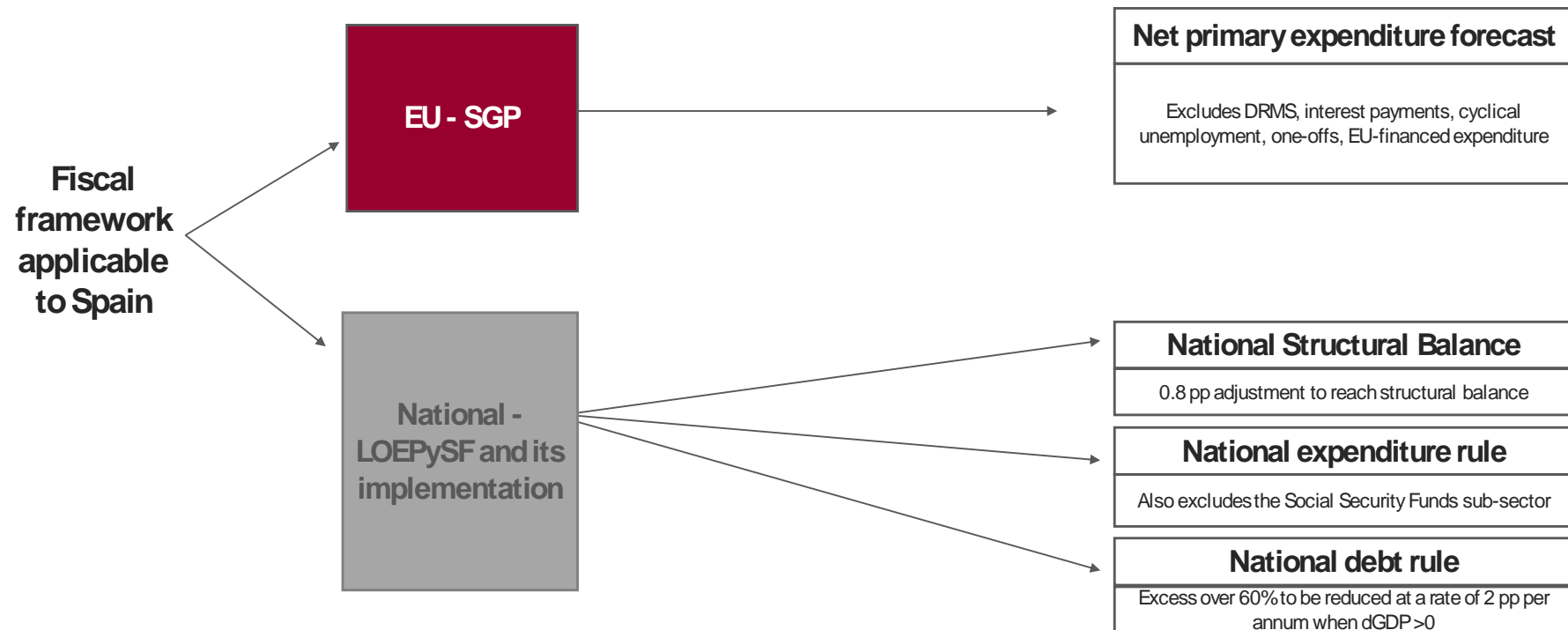


Figure 9. Outline of the fiscal framework applicable to Spain after the reform



**With the reform, the EU framework now has a single relevant indicator for fiscal monitoring purposes in the EU.** Once the adjustment path has been calibrated, the budget only has to ensure that primary expenditure net of revenue measures does not exceed the agreed limit. It is once again important to highlight that the safeguards are only relevant *ex-ante*, at the time of calibration of the adjustment, but compliance with them will in no case be required *ex-post*; the *ex-post* assessment only focuses on the expenditure path.

**In terms of the type of indicator, the fact that the whole EU framework now pivots around a net primary expenditure path, rather than a target for the structural balance (or the change in this balance) has four additional advantages.**

- First, *ex ante*, the adjustment will be defined on a more observable variable and therefore surrounded by less uncertainty as to its starting position and its required change. This was not the case with the structural fiscal balance in the past. Indeed, the volatility of structural balance estimates made it difficult to set adjustment requirements for a horizon beyond the year (even within the year, the structural balance variation requirement had to be "frozen" to prevent changes in structural balance estimates between the spring and autumn forecasts from resulting in a mismatch in adjustment requirements). Given the volatility of the estimates of this indicator - and therefore the variability of the distance from the MTO target and the effort required to achieve it - the most appropriate strategy was to change the medium-term plans each year so as to be able to adapt them from year  $t+1$  onwards. In other words, it would not have been possible to strengthen the medium-term dimension through fixed medium-term plans if the system had remained anchored to a structural fiscal balance indicator as it has been until now.
- Second, the net primary expenditure target facilitates *ex ante* monitoring, i.e. the verification of whether or not the draft budgets presented by the government (and subsequently approved by parliament) comply with EU fiscal requirements. A fiscal target in terms of an expenditure path aligns better with the budgetary tools. It therefore allows a more transparent and direct correspondence to be established between the macro-fiscal target on the one hand and the ultimate instrument of fiscal policy, which is the expenditure budget and discretionary revenue measures. This is a substantial difference from the previous framework: translating a target in terms of the structural balance into a budgetary-type limit required several intermediate steps - including the setting of stability targets in terms of the nominal deficit - which were often not made explicit at the time of budgeting. The fact that the correspondence between decisions on budgetary tools and the ultimate target in budgetary terms was not transparent made *ex-ante* monitoring difficult.

- Third, the new indicator also facilitates the monitoring of the implementation of fiscal policy during the year of execution. The comparison between the expenditure execution and the limit applicable to each year of the net primary expenditure path is simpler than under the previous framework. Therefore, it will also be easier to determine the size of any additional measures that may need to be implemented to meet the targets.
- Finally, the use of a net primary expenditure path together with national and general escape clauses will make the system less pro-cyclical compared with the previous framework. Although, in principle, the structural balance is inherently an estimate of the public finance position net of the cyclical effect, the evidence highlights that its real-time estimate (the relevant one for fiscal policy planning and implementation) has a cyclical bias. In expansionary phases, for example, revenue tends to react more strongly to the cycle than standard semi-elasticities reflect and *vice versa* (giving rise to so-called revenue windfalls or shortfalls)<sup>18</sup>. These distortions disappear with the change to the indicator in terms of net primary expenditure, from which certain cyclical spending such as unemployment benefits is also excluded, thus allowing the automatic stabilisers to operate. Similarly, the replacement of the 1/20 debt reduction rule of the previous framework is another factor that contributes to reducing pro-cyclicality.

### 3.4. Complexity is relocated and placed in a more appropriate area

**The extent to which the reform actually contributes to a simplification of the EU fiscal framework, a stated target from the outset, has been questioned in various forums.** In some respects, the proposed reform implies a clear simplification – in particular as regards the number and type of indicator relevant for fiscal monitoring purposes. In other respects, such as the calibration of the expenditure path that will be required, the reform clearly involves complex analysis and calculations.

**In this regard, AIRcF's assessment is positive: the new framework simplifies what needs to be simplified and introduces complexity in the aspects that require sophisticated analysis.** In other words, it introduces complexity in the diagnosis of the present and future situation of public finances and simplifies the treatment to be followed by each MS as a result of that diagnosis. This means that complexity

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<sup>18</sup> Similarly, it has been shown that estimates of potential GDP also follow a certain cyclical pattern that eventually has an impact on the output gap.

is better placed within the framework - and therefore more justified - than in the previous model.

**For an economy in the preventive arm, the repealed version of the Pact involved a simple, semi-automatic diagnostic mechanism, implemented by means of the matrix of requirements.** It was sufficient to determine the level of debt and output gap of an economy to find the adjustment that was required in the corresponding box of the matrix. The calibration of the fiscal requirement was therefore straightforward. However, this simplicity came at the cost of an *ad hoc* mechanism for diagnosing adjustment needs, with little basis in economic analysis and, therefore, with gaps in terms of legitimacy and enforceability.

**In contrast, the treatment to be followed – i.e. the fiscal adjustment requirement – was very complex because of the volatility and to some extent the procyclicality of the underlying variable: the structural balance.** This introduced a host of complexities in the implementation of the framework (e.g. the freezing of requirements, the correction of the change in the structural balance with the so-called "alpha" and "beta" parameters, etc.). These corrections – which were applied once the adjustment was determined – had to be introduced on the fly, in successive amendments to the Pact's Code of Conduct and its Vade Mecum as the inadequacy of the structural balance as an operational variable of the fiscal framework became clear.

**This situation is reversed with the reform.** In the diagnostic phase, various aspects of economic analysis are introduced, which are complex due to their technical nature, so that the calibration of the adjustment path is solidly grounded from the point of view of macro-fiscal analysis. The treatment is instead stated in respect of a simpler and more suitable variable for fiscal monitoring purposes, which will, in principle, require fewer *ex-post* interventions that would complicate the framework in the implementation phase.

**This repositioning of complexity by eliminating it from the treatment and placing it in the diagnosis (i.e. eliminating it from the operational indicator and bringing it into the calibration of the adjustment) is one of the most favourable aspects of the framework reform.**





# 4. FOUR CRITICAL CHALLENGES POSED BY THE REFORM

In addition to the favourable aspects described in the previous section, the reform of the EU's fiscal governance framework entails four decisive challenges, which are described below.

## 4.1. Achieving a real strengthening of national ownership

**This is one of the objectives of the reform as put forward since the Commission's first Communication in 2022, which seeks to incorporate certain aspects of the governance of the Recovery and Resilience Facility (RRF) that received favourable feedback into the fiscal framework.** Specifically, this involves the possibility for Member States to design their own plans, within common guidelines applicable to all, instead of having to incorporate an adjustment designed and calibrated exclusively by the Commission and then approved by the Council.

**If the design of the RRF governance can, in part, be extrapolated to the fiscal area, so can the recent experience in its implementation.** In this area, one of the lessons to be drawn from the process of drawing up the National Recovery and Resilience Plans is the limited participation of other stakeholders and institutions in their design - beyond the government and the Commission - due, among other factors, to the very short timeframes that governed their preparation.

**In this regard, it should be stressed that the concept of national ownership is not equivalent to that of political commitment by a given government at a given moment in time.** The latter could be considered a necessary, but not sufficient,

condition for there to be true national ownership of the committed path, especially in a country like ours with a high degree of decentralisation of primary expenditure (i.e. of the new operational variable).

**Convening a national consensus around a given medium-term plan is important** because the greater the support from different institutions and stakeholders, the greater the perceived legitimacy of the resulting adjustment path and the greater its likelihood of success. Especially in a context where the medium-term plan will, in principle, no longer be modifiable until it expires.

**Forging such a consensus takes time and also requires sound, independent, non-partisan, technical analysis to back it up.** To a large extent, the reform is anchored on the principle that the legitimacy of the adjustment is based on the soundness of its calibration and diagnosis which, as considered above, draws on complex tools that need to be fed with country-specific projections.

**Under the current framework, the European Commission will consider a preliminary diagnosis through the reference trajectory. However, the reference trajectory suffers from two fundamental shortcomings in terms of framing the national debate:** on the one hand, the reference trajectory will not, in principle, be made public until the medium-term plan is presented, which will not serve the purpose of forging a prior consensus with other institutions beyond the government; and, on the other hand, it is based on homogeneous methodologies and assumptions for all EU countries<sup>19</sup>.

**This generalist approach by the Commission can be a starting point for diagnosis, but it must necessarily be complemented by a more country-specific analysis, such as that provided by national IFIs,** which are, by definition, specialists in the public finances of their respective economies. Particularly in a fiscal context as decentralised as Spain's, where the work of an IFI is necessary to analyse the consistency of the commitments of the different authorities with the European fiscal framework and the effectiveness of the national framework in achieving the ultimate goal of sustainability.

**Consequently, AIReF proposes the following to the Ministry of Economy, Trade and Enterprise and the Ministry of Finance to address this challenge:**

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<sup>19</sup> Some of these homogeneous assumptions are decisive when the Commission projects the baseline debt forecast for the different countries, beyond its forecast horizon that goes up to t+2. It is constructed under the assumption – the same for all MS – that the output gap closes between t+2 and t+5 so that from t+2 onwards the structural primary balance remains constant and the total balance moves according to the cyclical component, which in turn derives from the closing of the output gap. The latter implies that the estimate of the level of the output gap at t+2 will play an important role in the projection of debt on a no-policy-change basis between t+2 and t+14 (or t+17) and hence for the resulting adjustment needed to place debt on a plausible downward path.

- **Publish the Commission's reference trajectory so that the different regional and local tiers of government and other institutions can be aware of it. Similarly, the subsequent negotiation process with the European Commission, prior to the presentation of medium-term fiscal-structural plans, should be transparent and consensual.**
- **The dissemination of the technical analyses specific to Spain, necessary to be able to carry out a robust and transparent diagnosis of the adjustment needs of our economy, prior to each round of approval of the medium-term fiscal-structural plans.**

Lastly, it is important to remember that in order to promote national ownership, AIReF has been recommending in its reports, as in the Report on the Rebalancing Plan, that all institutions, relevant national stakeholders and representatives of the different regional and local tiers should be involved in the design of the new fiscal-structural plans.

## 4.2. The interaction between the EU framework and national frameworks

**As in the vast majority of EU economies, EU fiscal rules coexist with national rules in our country.** These two levels of fiscal rules constitute another dimension of complexity. In the past, discrepancies have arisen between the Pact and national fiscal rules, which, in some cases, originated in the very definition of the fiscal variable targeted by the rule. This is the case, for example, of the expenditure rule in our national framework, both as regards the calculation of the reference rate and the specification of the expenditure variable. Moreover, the evolution of the interpretation of the Pact has not been reflected in the evolution of the interpretation of national rules, leading to inconsistencies. Since 2012, between one-third and one-half of EU IFIs have on occasion experienced a substantial difference between their assessment of the respective Member State's compliance with EU fiscal rules and the equivalent assessment of the European Commission<sup>20</sup>. This has complicated the tasks of all institutions involved and has allowed some Member States to relax the interpretation of the stricter commitments stemming from national rules, thus undermining their credibility.

**The misalignment between the two frameworks (national and EU) is exacerbated by the reform of EU fiscal governance, as two frameworks inspired by different consensuses would coexist.** If nothing is done to change this, a framework anchored in the consensus that was forged after the financial crisis will continue to apply at a national level. This can be characterised as a model that sought to gain credibility and improve its implementation through a twofold mechanism:

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<sup>20</sup> See EU IFI Network (2023) paper, "Working in the same or different directions? Assessing the relationship between EU and domestic fiscal frameworks".

(i) an intense codification of fiscal rules, understood both in terms of the number of applicable legislative provisions and in terms of their rank in the legal order - constitutional and organic law; and (ii) fiscal adjustments that in their initial design were often overly ambitious and then recurrently changed or simply not complied with.

**This national framework, whose contribution to sound fiscal policies has been questioned both in its design and practical implementation, will coexist with the reformed EU framework, which is anchored in a new consensus.** In particular, the new framework is based on the idea that it is more effective – and ultimately more credible – for consolidation plans to be based on realistic targets, stable over the medium term and easily reconcilable with budgetary aggregates, accompanied by other reforms and investments that underpin growth and thus strengthen fiscal consolidation measures.

**The discrepancies between the two frameworks have thus increased following the reform of the Pact, with the risk of undermining the credibility of one or both of the two applicable frameworks.** A specific example, applied to the case of Spain, would be posed by the effective – but not legal – validity of the structural balance target set out in Organic Law 2/2012 of April 27<sup>th</sup> on Budgetary Stability and Financial Sustainability (hereinafter, Organic Law 2/2012), as opposed to the new deficit resilience safeguard. According to AIReF's current estimates, once the first adjustment period is completed (assuming it is carried out over four years), a structural deficit of 0.5% would be reached in 2028. As this figure is lower than 1.5%, it may not be necessary to make a new round of adjustments under the EU framework. On the other hand, it would be necessary to continue with fiscal consolidation in order to achieve the budgetary stability target, which Article 3.2 of Organic Law 2/2012 defines as a structural balance or surplus. It is worth considering, at this point, whether the corresponding government would continue with the fiscal consolidation effort to comply with the national provision or, once the EU commitments have been met, would consider the need for adjustment to be complete.

**At the same time, the application of the current national expenditure rule is not equivalent to the path of primary expenditure net of revenue measures under the new European fiscal framework.** The first difference is that the new framework's path affects the whole of the General Government, while the national expenditure rule is applied individually to each authority, with the exception of the Social Security Funds. There are also significant differences in the calculation of the reference rate, since the national rate is based on the medium-term potential growth of the economy, whereas in the new framework the path is inherently derived from the debt sustainability analysis. Finally, there are other discrepancies in the exclusions for the calculation of the operational variable, as well as, in principle, in its practical implementation, but these would, in theory, be

easier to reconcile than the discrepancies in the scope and definition. In addition, its application will also have to be adapted to the reality of the different tiers of government.

**In this regard, it seems essential to take advantage of the transposition of the Directive to update the national fiscal framework and introduce amendments to resolve discrepancies with EU rules.** Empirical evidence suggests that national IFIs are well placed to contribute to the diagnosis of what needs to be adapted - also in line with the task of evaluation of the national framework attributed by the Directive. In this context, a transposition group has been formed within the EU IFI network to monitor the work of adapting the different national frameworks and identify best practices.

**Consequently, AIReF proposes that the Ministry of Finance should immediately start dialogue with all public authorities to reach a consensus on a distribution of targets that will ensure compliance with the commitments made at a European level from the earliest stages of the implementation of the fiscal-structural plan.**

**It also reiterates the recommendation issued in the Report on the Initial Budget of the General Government for 2024 to start work on reforming the national framework to ensure consistency and coherence with European rules:**

- **Initiate dialogue and work with all public authorities, both bilaterally and through existing multilateral mechanisms for economic policy coordination such as the National Commission for Local Administrations and the Fiscal and Financial Policy Council or, where appropriate, the Conference of Presidents, with the aim of laying the foundations for reforming the national fiscal framework and to reach a consensus on the distribution of fiscal rules.**

### 4.3. Comprehensive view of the sustainability of public finances at the level of the different Autonomous Regions and Local Governments

**In addition to the challenge of establishing national rules consistent with the European framework, there is also the challenge of distributing the targets and their implementation among the different tiers of government.** The level of decentralisation of the Spanish General Government makes it all the more necessary for both frameworks to be coherent and consistent. Unlike in other countries, this process of distributing fiscal policy targets entails greater complexity due to the high degree of decentralisation in Spain. Moreover, it will be necessary to take into account the impact of the possible reform of the

regional and local financing system and of the extraordinary financing mechanisms on this distribution, given the interrelation between these areas.

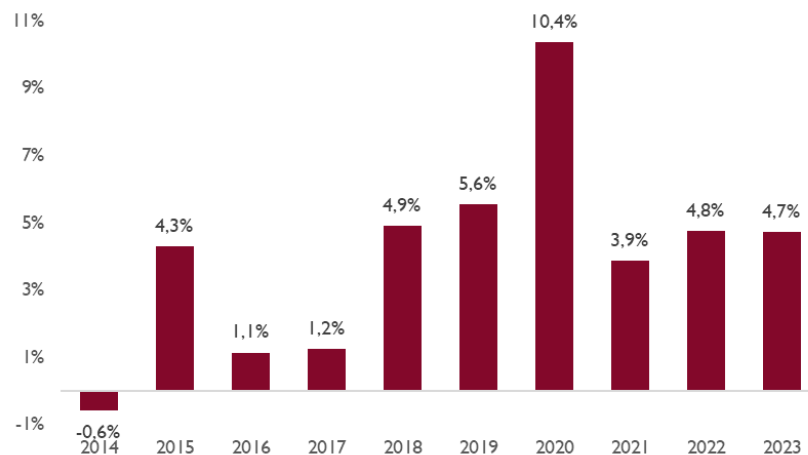
**The previous imbalances make it advisable to address the reform of the national fiscal framework in conjunction with the regional and local financing system and extraordinary financing mechanisms.** The application of the current fiscal framework shows that the setting of non-feasible targets discourages efforts to reduce deviations from the target. Moreover, the persistence of certain arguments such as the underfunding of certain Autonomous Regions and Local Governments or the excessive debt burden weakens the applicability of the corrective mechanisms provided for in the fiscal framework.

**In the Spanish case, less indebted authorities manage more expenditure than other more indebted ones, which could generate resistance to contribute towards debt reduction.** Currently, Autonomous Regions and Local Governments have 18% of the public debt compared with 74% of Central Government, but manage almost half of the expenditure (44%). This dichotomy between the target variable (debt) and the control variable (expenditure) could generate resistance on the part of the least indebted authorities to limit the growth of their spending in order to contribute to debt sustainability.

**However, there are reasons to argue that all General Government authorities should contribute to debt consolidation.** On the one hand, the Central Government is taking over part of the deficit of the Social Security Funds due, among other factors, to the transfer of the financing of spending deemed not to specifically fall under the remit of the Social Security Funds. In addition, it bore the cost of measures to first fight the pandemic crisis and then the price crisis, which explains a significant part of the increase in debt. On the other hand, a large part of the debt of the Autonomous Regions is in the hands of the Central Government through the extraordinary financing mechanisms. Moreover, the revenue of the Autonomous Regions (mostly from the financing system) has grown in a similar way to that of the General Government as a whole since 2013. Lastly, although the Central Government has a greater margin to act on revenue, the Autonomous Regions also have tax-raising capacity.

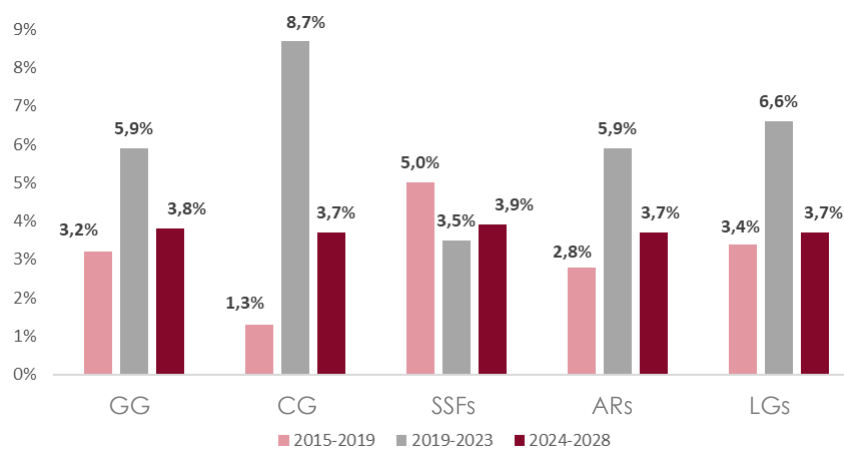
**Moreover, it does not seem feasible to achieve the commitments of the new European framework at an aggregate level by concentrating the restraint of net expenditure solely on the most indebted authorities.** Most of the headline deficit and debt is concentrated in the Central Government and in some Autonomous Regions. However, the Central Government manages expenditure that amounts to 22% of GDP of the national total, although it only has discretionary power over a quarter of this expenditure. Similarly, the Autonomous Regions, where 70% of their expenditure is on education, health and long-term care, are influenced by demographic pressures on the latter two items, which is also the case for pension spending managed by the Social Security Funds.

Figure 10. Evolution of primary expenditure net of revenue measures (% change)



Source: AIReF

Figure 11. Sub-sector breakdown of the evolution of primary expenditure net of revenue measures (% change)



Source: AIReF

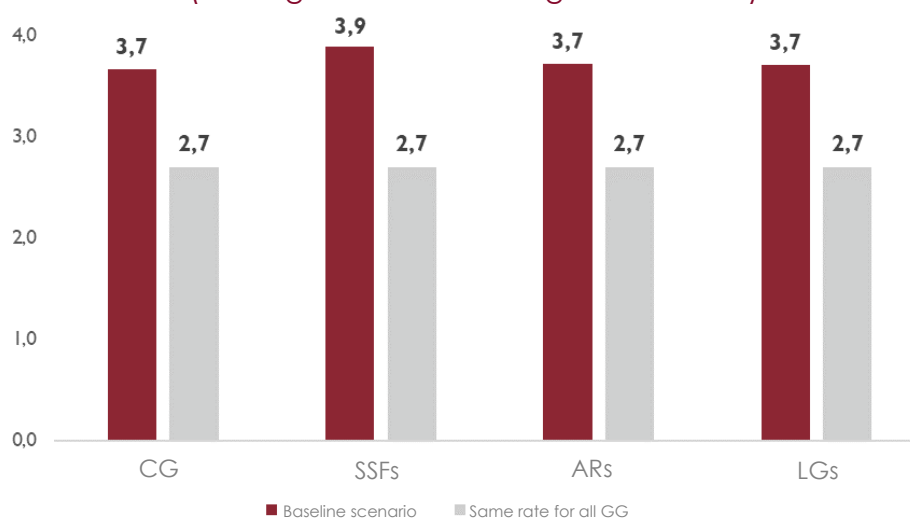
**The regional and local distribution of fiscal rule targets should ideally comply with a series of basic principles of coherence, simplicity, transparency, feasibility and compliance with debt sustainability.** There are multiple options for this distribution of commitments made at a European level, but it is not an easy task. In this regard, a balance should be found between making it feasible for all authorities to comply with the fiscal rules and, at the same time, for them to make an adequate contribution to debt sustainability. Furthermore, it would also be desirable to strike a balance between, on the one hand, the simplicity of the rules, which results in greater transparency at the cost of not taking into account any differentiating circumstances, and, on the other hand, an overly complex

system where a host of factors are taken into consideration. At any event, it is essential to ensure coherence in the sense that the individual compliance of all the authorities must imply the aggregate compliance of the General Government as a whole with the commitments undertaken in the context of the European fiscal framework.

**Among the many options available for this distribution, the option most similar to the current rules would be to consider the same net expenditure growth rate for all General Government authorities.** In this case, all General Government authorities, including the Social Security Funds, which up to now fell outside the national expenditure rule, would contribute to a greater or lesser extent to the adjustment. However, a greater effort would have to be made by those with higher baseline growth in their expenditure, as is the case of the Social Security Funds, due to the dynamics of pensions, and the Autonomous Regions, due to the evolution of expenditure on health and education.

**This uniform distribution has advantages such as transparency and simplicity, but would lead to vertical and horizontal imbalances.** Setting the same rate for all General Government authorities has the advantage of simplicity and transparency, giving continuity to the current expenditure rule as it would be largely similar. However, by not taking into account the initial situation, the distribution would lead to vertical imbalances between the different sub-sectors (it would lead to a surplus in all sub-sectors except the Central Government) and horizontal imbalances between the Autonomous Regions (it would lead to greater heterogeneity in terms of balance).

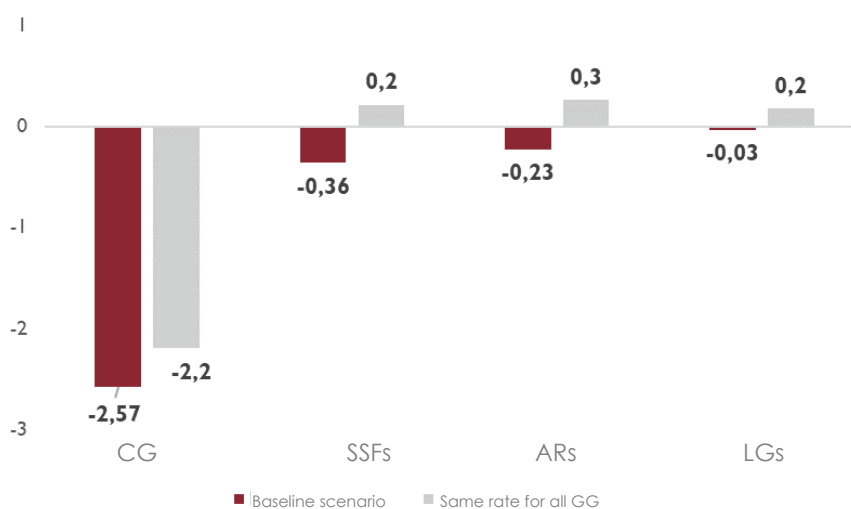
Figure 12. Primary expenditure net of revenue measures  
(average annual % change 2024 - 2028)



Source: AIReF



Figure 13. Fiscal balance in 2028 (% GDP)



Source: AIReF

**The application of the same reference rate for all General Government authorities would maintain the previous imbalances even in the event of a reform of the regional financing system with greater revenue for the Autonomous Regions.** A reform of the regional financing system in this sense would change the revenue and expenditure levels of the Central Government downwards and those of the Autonomous Regions upwards. It would therefore improve the feasibility of the Autonomous Regions complying with the single reference rate, while worsening the feasibility for the Central Government. Only if the Autonomous Regions do not make use of the spending margin in the year of entry into force of the reform would the previous imbalances in terms of deficit and the sustainability problems of the most indebted Autonomous Regions be corrected. Along the same lines, with regard to the extraordinary financing mechanisms, it would be necessary to consider how the write-off of regional debt would raise the debt and deficit level of the Central Government in favour of the Autonomous Regions, which, while alleviating the debt problems of some Autonomous Regions, would not relieve debt at the aggregate level of the General Government as a whole.

**In view of these results, it is advisable to consider distribution alternatives that set rates differentiated according to the sub-sector and the situation of the authority.** This perspective opens up multiple possibilities for differentiated treatment of authorities according to their fiscal position. First, it is worth considering the most appropriate rate for those authorities with a healthy deficit and debt situation. Some options would be the rate in their baseline scenario, nominal GDP or an indicator linked to the potential growth of nominal GDP. Authorities with imbalances might be required to make an adjustment which is both feasible and also allows them to clean up their accounts in the medium term. In this case, it

would be necessary to find a balance between feasibility and the resolution of imbalances in deficit and debt. In the Local Government sub-sector, the large number of units makes it difficult to differentiate situations beyond the application of local finance regulations (budget balance and limiting their overall debt according to its ratio to current revenue). However, it would be desirable to differentiate between large Local Governments and the others. As for the Social Security Funds, the setting of the reference rate for the sub-sector should be consistent with its own expenditure rule defined in the last reform. Finally, the approach of differentiated rates makes it necessary to have a year-end rule to ensure that individual compliance guarantees compliance at the aggregate level.

**When opting for the different alternatives of differentiated distribution, their impact on the feasibility of the targets and the sustainability of the General Government should be analysed.** With this type of distribution option, all General Government authorities would have to moderate the growth of their primary expenditure net of revenue measures, thus contributing to compliance with the aggregate target. In turn, the fiscal rules framework could help alleviate vertical and horizontal imbalances in terms of both deficits and debt to a greater or lesser extent depending on the parameters established.

**However, until the reform of the national fiscal framework is addressed in a comprehensive manner, previous imbalances and feasibility problems would not be solved.** Differentiated distribution could accentuate the feasibility difficulties for the Central Government. In addition, the Autonomous Regions that have greater imbalances would not be able to rectify their balances in the medium term or converge towards debt at 13% of GDP in the long term. In this regard, a reform of the financing system with greater revenue for the Autonomous Regions would make it possible to reduce the vertical imbalance and partly correct the horizontal imbalances, but it would increase the problem of the feasibility for the Central Government.

**Consequently, AIRcF proposes that the Ministry of Finance should meet this challenge in the following way:**

- **Address the process of reforming the national fiscal framework and, in particular, the distribution of targets among the General Government authorities, together with the reform of the regional and local financing system and the extraordinary financing mechanisms, as the only way to achieve a comprehensive solution to these three closely related areas.**

#### 4.4. Investment needs, is the current treatment within the framework sufficient?

**The investment needs facing EU countries in the coming years are very substantial.** The legislative texts of the reform refer to the investment effort that will be required to address the green and digital transition, ensure energy security, reinforce defence capabilities and strengthen countries' economic and social resilience.

**The new framework includes incentives for investment and the undertaking of reforms, in the form of an extension of the adjustment period from four to seven years.** Also excluded from the expenditure path is the co-financing of projects carried out with traditional European funds – in addition to those financed entirely with EU funds, including the NGEU programme. The corrective arm will also include defence spending among the relevant factors to be taken into account when deciding whether to initiate the Excessive Deficit Procedure. In turn, the reform of the preventive arm considers that medium-term fiscal-structural plans should contain information on estimated public investment needs, including those related to the EU's common priorities.

**However, in the absence of a common central capacity to address part of the investment needs required to meet these challenges, reducing debt levels in this context poses a key challenge for sustaining investment.**

**Consequently, AIRcF proposes that the Ministry of Economy, Trade and Enterprise and the Ministry of Finance should meet this challenge in the following way:**

- **Address medium-term fiscal planning in a comprehensive manner, making explicit the estimated investment needs of the Spanish economy and the measures envisaged to meet them.**



# 5. PROPOSALS AND CONCLUSIONS

The new EU fiscal framework provides an opportunity to improve the way fiscal policy is planned and implemented across the EU. This is thanks to four key improvements proposed by the reform:

- a. It explicitly places debt sustainability at the heart of the new rules, with a differentiated approach by country.
- b. It strengthens the medium-term dimension, fostering investment.
- c. It streamlines operational indicators for fiscal monitoring, both in terms of the number and the type of indicator, and
- d. It places complexity in a more appropriate and justified setting.

However, its effective implementation at a national level poses a number of challenges. To address these challenges, AIReF puts forward the following proposals in the context of this Opinion:

1. To the Ministry of Economy, Trade and Enterprise and the Ministry of Finance: publish the Commission's reference trajectory so that the different tiers of government and other Institutions can be aware of it. Similarly, the subsequent negotiation process with the European Commission, prior to the presentation of the medium-term fiscal-structural plans, should be transparent and consensual.
2. To the Ministry of Economy, Trade and Enterprise and the Ministry of Finance: the dissemination of the specific technical analyses for Spain, which are necessary in order to carry out a robust and transparent

- diagnosis of the adjustment needs of our economy, before each round of approval of the medium-term fiscal-structural plans.
3. To the Ministry of Finance: initiate dialogue immediately with all General Government sub-sectors to reach a consensus on a distribution of targets that guarantees compliance with the commitments acquired at a European level from the earliest stages of implementation of the fiscal-structural plan.
  4. To the Ministry of Finance: address the process of reforming the national fiscal framework and, in particular, the distribution of targets across the General Government, together with the reform of the regional and local financing system and the extraordinary financing mechanisms, as the only way to achieve a comprehensive solution to these three closely related aspects.
  5. To the Ministry of Economy, Trade and Enterprise and the Ministry of Finance: address medium-term fiscal planning in a comprehensive manner, making explicit the estimated investment needs of the Spanish economy and the measures envisaged to meet them.

AIReF also reiterates the recommendations made in several reports in line with the proposals made:

1. In order to promote national ownership, AIReF has been recommending in its reports, as in the Report on the Rebalancing Plan, that all institutions, relevant national stakeholders and representatives of the different regional and local levels should be involved in the design of the new fiscal-structural plans.
2. In its Report on the Initial Budget of the General Government for 2024, it made a recommendation that refers both to the need for coordination between all General Government authorities in order to achieve the targets of the fiscal-structural plan and promote true national ownership, and to the need to reform the national fiscal framework to improve its degree of consistency and coherence with the European framework: "Initiate dialogue and work with all General Government authorities, both bilaterally and through existing multilateral mechanisms for economic policy coordination such as the National Commission for Local Administrations and the Fiscal and Financial Policy Council or, where appropriate, the Conference of Presidents, with the aim of laying the foundations for the reform of the national fiscal framework and reaching a consensus on the distribution of fiscal rules".

The transposition of the reform of Directive 2011/85 on national fiscal frameworks provides an opportunity to update Spanish legislation on financial sustainability

and introduce the necessary amendments to reduce discrepancies with the EU framework.

AIReF is particularly well placed, within the EU IFIs and national institutions, to contribute to the diagnosis of what needs to be adapted - also in line with the new task established by the Directive.

President of AIReF

A handwritten signature in blue ink, appearing to be 'C. Herrero Sánchez', written in a cursive style.

Cristina Herrero Sánchez





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