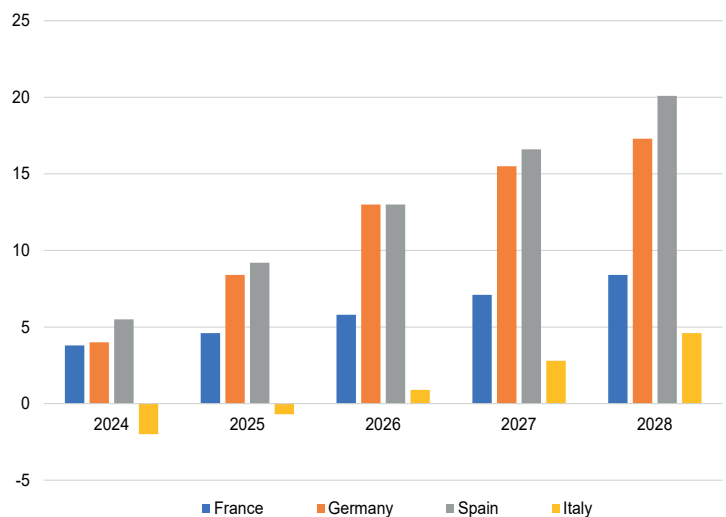


## The New EU Fiscal Framework: From Negotiation to Implementation

*Emmanuel Bordellès-Viala and Jacques de la Rue du Can*

- In April 2024, the new EU economic governance framework entered into force, the result of negotiations between the 27 EU Member States, the European Commission and the European Parliament that began back in 2022. This revised version of the Stability and Growth Pact (SGP) was intended to rectify the shortcomings of the previous framework namely its excessive inflexibility, doubts about its credibility after the sovereign debt crisis and then the COVID-19 pandemic, and its lack of investment incentives and structural reforms.
- Under this new framework, Member States commit to a multiannual fiscal path (see chart below) – complying with the requirements identified in a debt sustainability analysis – and to a set of reforms and investments.
- The commitments are now set out as part of the national medium-term fiscal-structural plan (MTFSP), and their implementation is reported on annually and monitored as part of preparing annual progress reports. If this path, which is based on a new single indicator – net primary expenditure – is not adhered to, or the ratio of government deficit to GDP exceeds the reference value of 3%, an excessive deficit procedure may be initiated.
- As the deteriorated geopolitical landscape has prompted Europeans to raise their national defence spending, the Commission has, since the first year of implementing these new rules, offered Member States the possibility to use national escape clauses to derogate from the Stability and Growth Pact if they so wish.

**Net primary expenditure paths recommended by the Council (cumulative growth, %)**



Source: European Commission.

How to read this chart: Net primary expenditure growth recommended by the European Council for Spain under its MTFSP was 5.5% in 2024 and a cumulative 20.1% for the 2023-2028 period.

# 1. The new EU fiscal framework, which came into force in 2024, is intended to address certain limitations of the Stability and Growth Pact

## 1.1 The fiscal framework set up in response to the sovereign debt crisis lost credibility given its excessive inflexibility and its lack of economic growth incentives

Common rules were progressively introduced in the 1990s within the European Union (EU) with a view to establishing a monetary union – a goal that was fully achieved in 2002. The 1992 Maastricht Treaty formally prohibited euro area Member States from financing public deficits via monetary means,<sup>1</sup> with monetary policy having the main – and common – objective of price stability. There was also a need to minimise the potential moral hazard of Member States using their membership of the euro area to increase their budget deficit without adversely affecting their lending conditions, and therefore taking advantage of a general reduction of the risk premium. There is a real risk that a Member State could implement an excessively expansionary fiscal policy by taking advantage of the protection afforded by the single currency, particularly when the size of its economy is small enough (relative to the entirety of the euro area) to only have a marginal effect on prices and rates. With this in mind, the Stability and Growth Pact was formally agreed on at the European Council meeting in Amsterdam in June 1997 to ensure the convergence and budgetary discipline of EU Member States.

The Pact first comprised two regulations<sup>2</sup> for ensuring compliance with the quantitative government deficit criterion (less than 3% of GDP) and government debt criterion (less than 60% of GDP) set out in the Maastricht Treaty.<sup>3</sup> The first regulation acts as the “preventive” arm of the Stability and Growth Pact: it introduces a procedure for fiscal surveillance to prevent Member States from deviating from the Maastricht criteria in any way. The second regulation acts as the “corrective” arm of the Pact: it clarifies the

implementation of the excessive deficit procedure<sup>4</sup> which is designed to correct the fiscal path of Member States that do not comply with the Maastricht criteria.

An initial reform of the Pact in 2005 introduced the concept of “medium-term objectives” (or MTOs): Member States were required to bring themselves into line with a structural deficit goal ranging from -1% to 0% of GDP depending on their fiscal position. This was to be done with a structural adjustment of at least 0.5% of GDP annually. This approach, based on these new criteria, bolstered the economic importance of the surveillance by making a distinction between structural imbalances and cyclical fluctuations. The European sovereign debt crisis, which drove Greece (2010), Ireland (2010), Portugal (2011), Spain (2012) and Cyprus (2012) to seek financial assistance from international sources, resulted in a tightening of the Pact’s rules. The 2011 “six pack”,<sup>5</sup> the 2012 Treaty on Stability, Coordination and Governance (TSCG) in the Economic and Monetary Union<sup>6</sup> and the 2013 “two pack”<sup>7</sup> stepped up ex-ante fiscal surveillance of euro area Member States. The six pack brought in a more automatic enforcement of sanctions under the excessive deficit procedure with financial sanctions of up to 0.2% of GDP. It also introduced the “twentieth” rule that stipulated that Member States with a debt of more than 60% of GDP were required to reduce the debt by at least one twentieth every year. The TSCG has established the budgetary “golden rule”, requiring Member States to enact in their domestic law – preferably at constitutional level – a structural deficit objective of no more than 0.5% of GDP, accompanied by an automatic correction mechanism in the event of a deviation. Lastly, the two pack stepped up ex-ante monitoring of the national budgets of euro area countries, requiring them to submit their respective draft budgetary plans to the European Commission before their adoption by national parliaments.

(1) This practice was already on the decline for a number of years; for example, in France, Act no. 73-7 of 3 January 1973 on the Banque de France strictly regulates the overdrafts granted by Banque de France to the French Treasury.

(2) Council Regulations (EC) No 1466/97 and No 1467/97.

(3) Article 126 of the Treaty on the Functioning of the European Union (Treaty of Lisbon), formerly Article 104 of the Treaty on European Union (Maastricht Treaty).

(4) The excessive deficit procedure may be initiated based on the deficit criterion when the deficit-to-GDP ratio of a Member State exceeds 3% in a non-exceptional or -temporary manner. The procedure may also be triggered on the basis of the debt criterion when the debt-to-GDP ratio exceeds 60% and the general government balance is not zero or there is not a general government surplus.

(5) The six pack is formed of five regulations and a directive: Regulations (EU) 1173/2011, 1174/2011, 1175/2011, 1176/2011 and 1177/2011, and Directive 2011/85/EU.

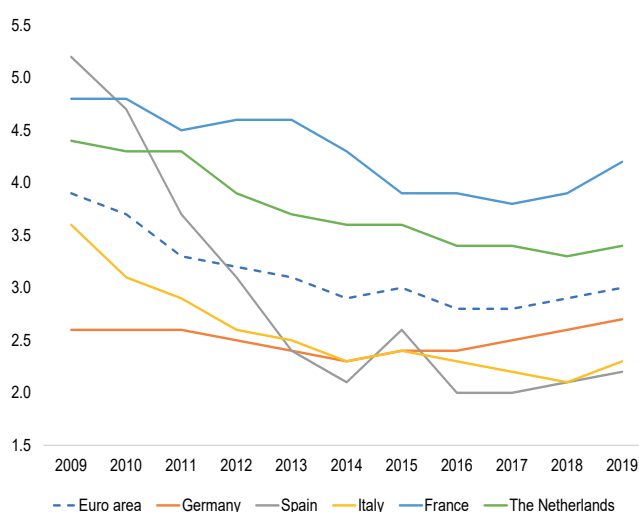
(6) The TSCG is an intergovernmental agreement signed in 2012 by EU Member States (except the United Kingdom and the Czech Republic) whose aim is to adopt a set of rules designed to reinforce budget discipline and improve the coordination of their economic policies.

(7) The two pack comprises Regulations (EU) No 473/2013 and No 472/2013.

Although the deficit of almost all Member States fell below 3% of GDP between 2010 and 2018, a number of shortcomings in the framework have called its credibility into question. Firstly, as the “twentieth” rule did not adequately account for the specific fiscal positions of each country, its strict application could have resulted in an unrealistic and procyclical fiscal adjustment being needed for the most indebted countries and aggravated economic fluctuations including in the most “disciplined” Member States, especially given that in 2019 12 Member States<sup>8</sup> had a government debt ratio exceeding 60% of GDP. In practice, the rule’s application never resulted in the initiation of an excessive deficit procedure based on the debt criterion, an indication of its lack of economic relevance. The former framework also did little to encourage public investment. In the wake of the 2008 financial crisis, particularly as a result of (i) the structural adjustment programmes rolled out in Member States receiving financial assistance, and (ii) Germany’s constitutional debt brake rule, the euro area stayed at the bottom of the economic cycle and suffered, in particular, from underinvestment (see Chart 1). This low point in economic activity lasted longer than in the United States for example (in 2016, total investment in the euro area reached roughly 88% of its 2010 level compared to 105% for the United States).<sup>9</sup> What is more, to assess the fiscal

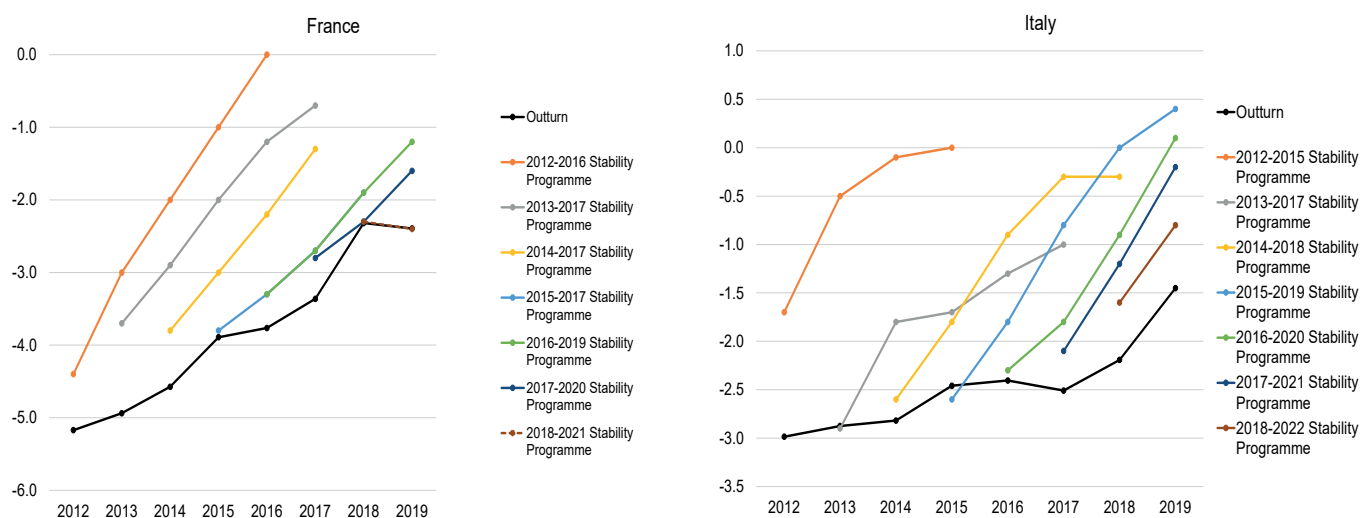
path of Member States, a myriad of indicators were used, some of which could not be directly observed (e.g. the structural deficit which is based on the concept of potential growth – the product of estimates and, occasionally, ex-post revisions), making fiscal management more difficult for Member States. Lastly, the surveillance procedure, based on the submission of stability programmes updated on an annual basis, caused the adjustment paths included in the programmes to quickly become outdated (see Chart 2).

**Chart 1: Investment expenditure of euro area Member States (as measured by the gross fixed capital formation, as a % of GDP)**



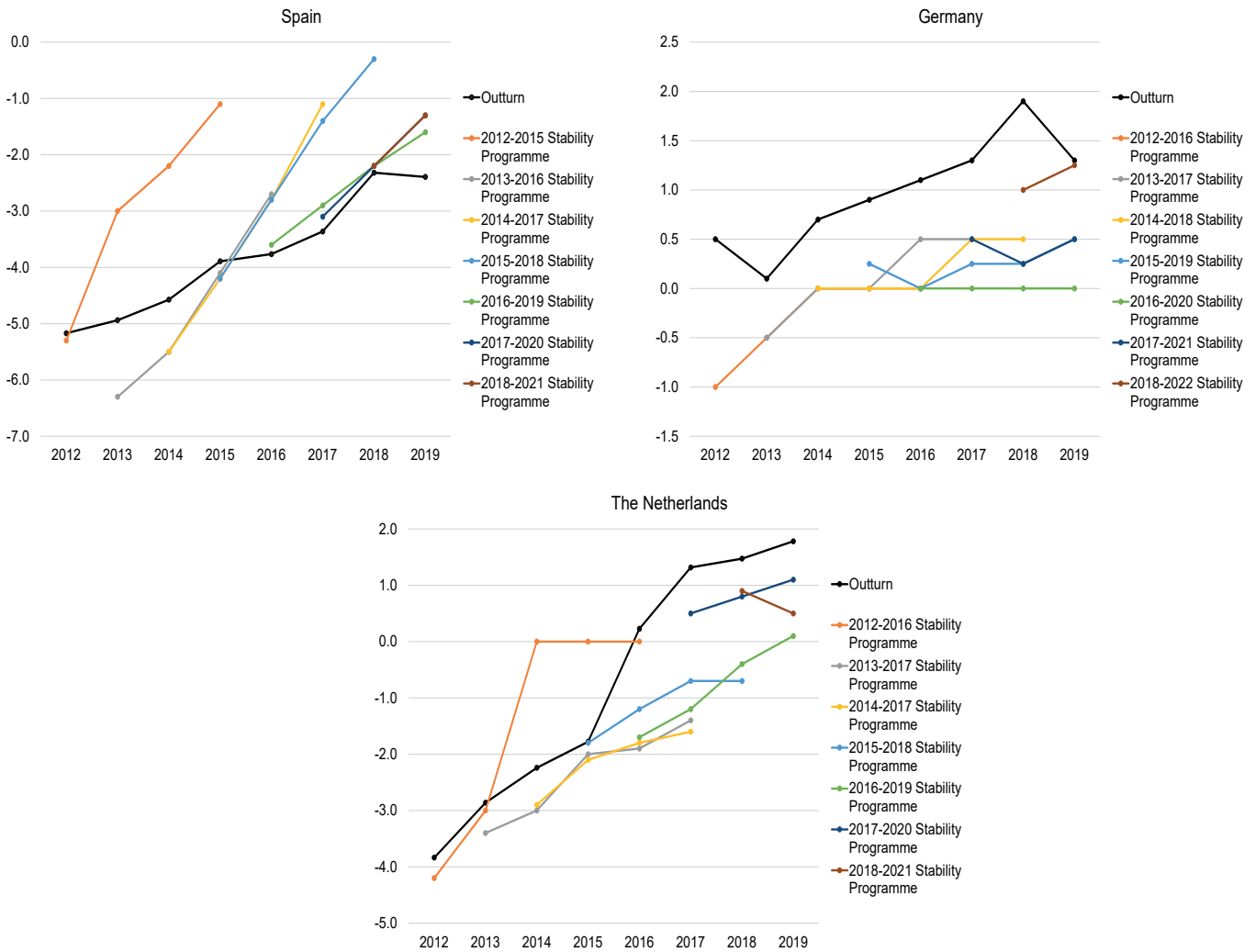
Source: Eurostat.

**Chart 2: Deviations from general government balance objectives set in stability programmes and the balances over the 2012-2019 period (% of GDP)**



(8) Austria, Belgium, Croatia, Cyprus, Finland, France, Greece, Hungary, Italy, Portugal, Slovenia and Spain.

(9) See European Central Bank (2016), “The recovery of investment in the euro area in the aftermath of the great recession: how does it compare historically?”, *Research Bulletin*, Issue 28.



Sources: Eurostat and Member State stability programmes

How to read this chart: In the 2012-2015 Stability Programme, France set a general government balance objective of 0% of GDP in 2016. For the 2016 outturn, the deficit ended up amounting to 3.8% of GDP.

## 1.2 Inflationary crises and the pandemic were the reason these fiscal rules were suspended from 2020 to 2023, reviving the debate on their potential revision

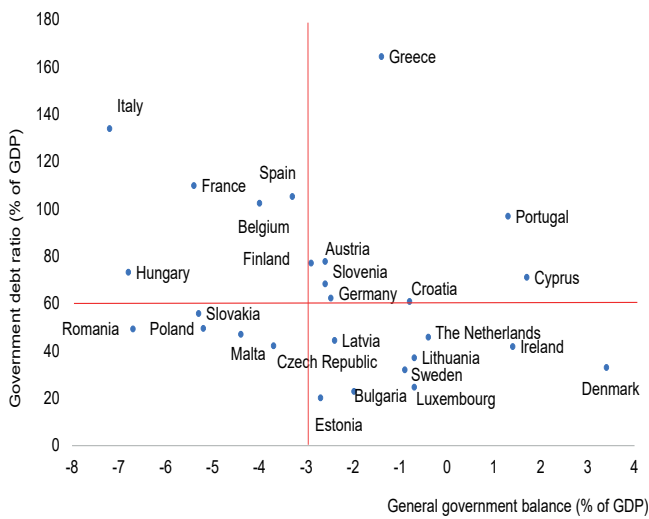
In 2019, the Commission launched a review of the economic governance framework to assess the effectiveness of EU fiscal rules. In 2020, the COVID-19 pandemic triggered a sharp drop in business activity and a stratospheric rise in government spending to address the weakened European economies and healthcare requirements. The aggregate government deficit in the euro area jumped from -0.5% of GDP in 2019 to -6.7% in 2020, and the corresponding government debt from 77.5% in 2019 to 89.5% the following year. The Council of the European Union, on the proposal from the European Commission,

addressed the emergency by activating the “general escape clause” contained in the Stability and Growth Pact, which was then extended to cope with the inflationary impacts of the Russian invasion of Ukraine, suspending fiscal surveillance until late 2023.

In the aftermath of this double economic shock, the fiscal landscape was defined by widely varying deficit and debt levels (see Chart 3) that would be difficult to reconcile with the reintroduction of fiscal surveillance under the former framework. This paved the way for a new version of the Pact. It was against this backdrop that the Commission published a communication<sup>10</sup> setting out its proposed orientations for a reform of the EU economic governance framework. The reform’s architecture was approved by the EU Heads of States or Government at the European Council meeting of 23 March 2023.

(10) Commission Communication of 9 November 2022 on orientations for a reform of the EU economic governance framework.

**Chart 3: General government balance and government debt to GDP ratio in the European Union – 2023 (last year of the general escape clause being in force to address the COVID-19 pandemic)**



Source: Eurostat.

### 1.3 A year of work has led to a consensus on basing the new rules on the principles of differentiation, national adoption and balancing sustainable public finances with investment

As the legislative initiative was the responsibility of the European Commission, it published a proposal on 26 April 2023 consisting of a new regulation for the preventive arm, an amendment of the regulation on the corrective arm and an amendment of the Council directive on budgetary frameworks of Member States. The set of proposals sought to strengthen debt sustainability and promote sustainable and

inclusive growth across all Member States with effective economic surveillance conducted within a joint multilateral framework.

Under the Spanish Presidency of the Council of the European Union in the second half of 2023, negotiations held within the Economic and Financial Affairs Council (ECOFIN) – which brings together finance ministers – resulted in the adoption of a general approach<sup>11</sup> by the Council in December 2023. This approach maintained the architecture of the Commission’s legislative proposal while also introducing additional quantitative safeguard clauses.<sup>12</sup> Following an agreement reached with the European Parliament, the three legislative texts<sup>13</sup> entered into force on 30 April 2024.<sup>14</sup>

The negotiations and preparatory work for the new framework were based on three guiding principles. The first, the principle of differentiation stipulates that the framework can adapt its fiscal adjustment needs to the specific macroeconomic situation of each Member State rather than enforcing a standardised application of quantitative rules. This principle underpins the notion that the paths of Member States can be adjusted based on reform and investment commitments undertaken as part of common EU priorities. The principle of national adoption involves Member States being able to propose their own adjustment paths based on their macroeconomic assumptions as part of an in-depth dialogue with the Commission. Lastly, the principle of simplification is intended to make the rules easier to understand and to streamline the indicators used for fiscal surveillance.

(11) A political line taken by the Council of European Union serving as a mandate for the presidency of the Council during trilogues.  
 (12) These are safeguard clauses on debt sustainability and deficit resilience set out below.  
 (13) Regulation (EU) 2024/1263 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, Regulation (EU) 2024/1264 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, and Directive (EU) 2024/1265 amending Directive (EU) 2011/85 on requirements for budgetary frameworks of the Member States.  
 (14) The two regulations resulting from the reform are directly applicable and do not need to be enacted in the national legislation of Member States, unlike the revised directive.

## 2. The new framework is now based on the preparation of a multiannual path using a more operational indicator as part of a debt sustainability analysis

### 2.1 The new preventive arm includes investment incentives and structural reforms

The new governance framework is now based on the publication of a medium-term fiscal-structural plan (MTFSP) by Member States. This plan covers four or five years depending on the term of the legislature of each Member State.<sup>15</sup> Under these plans, Member States undertake to adhere to a multiannual fiscal path set for the entire duration of the plan expressed as the change in net primary expenditure (see Box 1). Monitoring is conducted through annual progress reports (APRs). Member States also commit, where necessary, to a set of reforms and investments that can justify an extension of their fiscal adjustment period<sup>16</sup> (see below).

The medium-term fiscal-structural plans and the annual progress reports<sup>17</sup> reflect a paradigm shift in multiannual fiscal planning since the fiscal paths that Member States are committed to adhering to are now set for a four or five-year period based on a more operational metric and are recommended by the Council. Unlike the previous framework, the path to which a Member State adheres is not intended to be updated on a yearly basis. Nevertheless, Member States provide an update of their macroeconomic forecasts and public finances at the very least for the current year in their annual progress reports. This allows for a comparison of the budget outturn results and the updated forecasts with the path recommended by the Council and, therefore, for the latter to assess compliance with the commitments.

#### Box 1: Net primary expenditure (NPE)

NPE is the new aggregate for which the nominal growth rate constitutes the main ex-post monitoring indicator for the fiscal paths of Member States. NPE represents the total general government expenditure, net of the following items:

- Interest expenditure.
- Discretionary revenue measures i.e. the new measures to raise or lower taxes and social security contributions: this exclusion means that NPE is a neutral aggregate with regard to the choice of fiscal consolidation instruments, since a tax hike will have the same effect as an equivalent reduction in expenditure.
- Government expenditure financed by transfers of EU funds.
- National expenditure on co-financing of programmes funded by the EU, corresponding to the obligatory portion of national co-financing that rounds out the financing for EU programmes.
- Cyclical unemployment expenditure.
- One-off and temporary measures implemented in response to one-time large-scale events that disrupt the management of public finances (e.g. class-action suits regarding disputed taxes, losses on government-backed loans).

a. For more information on the public finances indicators and their interpretation, see J. de la Rue du Can, E. Bordellès-Viala et al. (2025), "Relecture structurelle du déficit : quels indicateurs pour piloter les finances publiques ?", *DG Trésor Working Paper* no. 2025/02 (in French only).

(15) The new provisions of the preventive arm of the Pact are set out in Regulation (EU) 2024/1263.

(16) Member States that do not request an extension of their adjustment period must in any case submit their MTFSP containing a set of reforms and investments addressing the main challenges identified under the European Semester, the implementation of which does not have such an incentive effect.

(17) These initiatives supplant the stability programmes and national reform programmes.

NPE has been adopted primarily because of its operational nature, in the sense that the year-on-year change in its value is primarily attributed to the decisions of government authorities, whether they relate to new expenditure or fiscal measures, as opposed to non-discretionary factors (e.g. cyclical effects, spontaneous growth in revenue, interest rate hikes or cuts) that make the general government balance or the structural balance indicators less operational. Changes in NPE can therefore be more directly attributed to governmental actions,<sup>a</sup> serving as an effective metric for fiscal surveillance.

Nevertheless, the nominal balance is still a key metric in ex-post fiscal surveillance as crossing the 3% deficit ratio threshold is still a trigger factor for an excessive deficit procedure. In addition, a Member State subject to the excessive deficit procedure must still meet the Council's recommended deadline to return below the 3% deficit ratio threshold.

The path is constructed in such a way as to gradually bring the general government balance to a level that can guarantee the sustainability of the debt and prevent any excessive debt over the long term, including in the event of adverse economic shocks. For Member States that exceed the 60% debt ratio to GDP or the 3% deficit ratio to GDP, the Commission has developed a reference path that includes the minimum fiscal adjustment compatible with the framework's requirements, using its own macroeconomic assumptions.<sup>18</sup> However, under the preventive arm, new EU fiscal rules explicitly authorise Member States to use their own assumptions when preparing their paths. In this respect the path proposed by the Member State may deviate from the Commission's proposed path if economic arguments justifying these deviations are provided. The validity of these arguments is discussed as part of technical discussions between the Member State and the Commission prior to the submission of the plan and in the Member State's medium-term fiscal-structural plan.

The fiscal path is constructed based on three groups of parameters:

- The duration of the adjustment period (four to seven years): the adjustment period is the number of years that the Member State has to carry out the

fiscal adjustment required to fulfil the conditions set by the framework. This period is set at four years by default, but it can be extended by up to three years subject to the Member State's commitment to a relevant set of reforms and investments fulfilling predefined criteria.<sup>19</sup> In practice, this extension triggers a reduction in the annual adjustment required for a Member State over the four or five years of its plan. This arrangement is intended to offset the disincentives on public investment introduced by the previous framework (see section 1.1).

- A Debt Sustainability Analysis (DSA) prepared by the Commission: following the adjustment period and for the ten following years, without policy changes,<sup>20</sup> the path must comply with two criteria:<sup>21</sup> (i) the general government debt to GDP ratio must follow a downward trend or remain under the 60% of GDP threshold and (ii) the government deficit ratio must stay below 3% of GDP. These criteria must be verified in the central scenario, in the adverse deterministic scenarios (macroeconomic and financial shocks) and in most (at least 70%) of the stochastic scenarios<sup>22</sup> over five years (see Box 2).

(18) For the other Member States, the Commission sends technical information on request.

(19) Article 14 of Regulation (EU) 2024/1263: the set of reforms and investment commitments must: (i) entail a long-term improvement of the growth potential of the Member State; (ii) support fiscal sustainability; (iii) address the common priorities of the Union; (iv) address the relevant country-specific recommendations, and; (v) ensure that the planned overall level of nationally financed public investment over the period covered by the national medium-term fiscal-structural plan is not lower than the medium-term level.

(20) In the Commission's methodology, a no policy-change path refers to a path with a primary structural adjustment of zero.

(21) Article 6 of Regulation (EU) 2024/1263.

(22) Unlike deterministic scenarios, these scenarios are based on random shocks adjusted based on the Member States' past shocks.

- **Safeguard clauses:** in addition to the requirements under the DSA, the fiscal path must meet two additional quantitative criteria that may tighten the terms of the recommended adjustment: (i) as from the year preceding the start of the adjustment period or the date on which the EDP is scheduled to be lifted (if the latter is later than the former) and until the end of the adjustment period, the path must ensure that the general government debt to GDP ratio falls by at least 1 GDP percentage point every year while this ratio exceeds 90% and by at least 0.5 percentage points of GDP while this ratio exceeds 60% (the debt sustainability safeguard);<sup>23</sup> (ii) the path must also include an annual primary structural adjustment of at least 0.4 percentage points of GDP (reduced to 0.25 percentage points of GDP if the adjustment period is extended) while the structural deficit is still above 1.5% of GDP (the deficit resilience safeguard).<sup>24</sup>

In a departure from the previous framework based on common numerical objectives applicable to all Member States, this approach factors in the different economic situations of Member States as the initial fiscal situation and the macroeconomic and public finance assumptions selected when preparing the path ultimately determine the extent of the adjustment recommended through the set of aforementioned criteria. For example, the growth in net primary expenditure will be greater for a Member State whose initial public finances position is favourable (Germany for instance, see chart on cover page) or whose growth is strong (Spain).

These criteria allow for a multiannual path for changes in net primary expenditure to be set for the entire duration of the plan (four or five years), which will be compared with the results of the Member State's budget outturn. While the methodology for constructing the path is still complex, it results in a genuinely simpler budget outturn since monitoring of the path revolves solely around the net primary expenditure indicator. In turn, the actual adjustments of the nominal balance and structural balance permitted by the plan are only set ex-ante, and may – at a given value of net primary

expenditure – be higher or lower than expected over the duration of the plan depending on the economic environment and spontaneous changes in revenue.

Member States present their net primary expenditure paths to the Commission, who will assess the path within six weeks. Acting on the Commission's recommendation, the Council of the European Union adopts a recommendation approving the fiscal-structural plan of the Member State concerned (the net primary expenditure path and, if applicable, the set of reform and investment commitments underpinning an extension of the adjustment period).

The implementation of the Council's recommendation that approves the Member State's MTFSP is monitored every year during the period set out in the planning as part of the process of preparing the annual progress reports. This retrospective report is intended to document compliance with the path for net primary expenditure outturn for the previous year and, as a forecast, at least for the current year, as well as monitoring of the reforms and investments related to the commitments undertaken by the Member State. Deviations from the path approved by the Council are factored into a control account, and when its authorised deviation limits are exceeded an excessive deficit procedure may be initiated based on the debt criterion (see section 2.2). Failure to comply with the reform and investment commitments underpinning an extension of the adjustment period may result in the Council, on the recommendation of the Commission, proposing a stricter net primary expenditure path with a shorter adjustment period to the Member State.

Lastly, this preventive framework sets out possible options for revising the MTFSPs at the request of Member States in two cases: (i) if a government is newly elected, a Member State may put forward a new plan for a four- or five-year period; or (ii) if objective circumstances hinder the implementation of the plan, during the period covered and no later than 12 months before the end of the plan, a Member State may submit a revised plan to the Commission that runs up to the end of the initial plan's term.

(23) Article 7 of Regulation (EU) 2024/1263.

(24) Article 8 of Regulation (EU) 2024/1263.

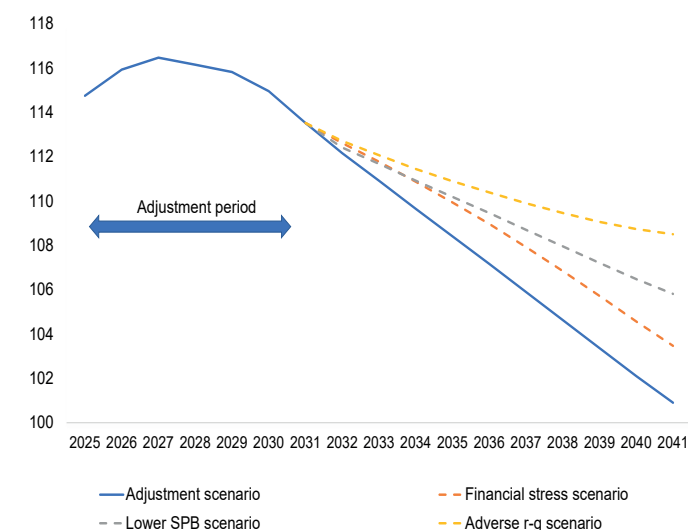
## Box 2: Methodology of the European Commission's debt sustainability analysis

The Commission uses debt sustainability analysis (DSA) methodology to set the net primary expenditure path that will be recommended for each Member State.

The deterministic adjustment scenario provides a projection of the debt path following the plan, with no further adjustments and based on the macroeconomic assumptions (interest rate, growth, inflation and elasticity of taxes and social security contributions) that are deemed “central”. This central scenario is rounded out by several adverse scenarios:

- The “financial stress” scenario gives a projection for a temporary shock of a 1 pp interest rate hike in the year following the end of the adjustment period.
- In the lower structural primary balance (SPB) scenario, the SPB is reduced permanently by 0.5 pp of GDP the year following the end of the plan.
- Under the “adverse r-g” scenario, the debt-stabilising primary balance is increased on a sustained basis via a 1pp increase of difference between the market interest rates and nominal GDP growth.
- Lastly, for the stochastic scenario, 2,000 shocks affecting fiscal, macroeconomic and macro-financial variables are generated. This produces a distribution of paths for the corresponding debt.

**Chart 4: Change in government debt to GDP ratio (as a % of GDP) in the DSA deterministic scenarios for France's MTFSP (2025-2029)**



Source: DG Trésor.

Converting the structural adjustment – set using the change in net primary expenditure – is therefore based primarily on potential growth in nominal terms over the adjustment period:

$$\begin{aligned}
 & \text{Net primary expenditure growth} \\
 & = \text{potentiel GDP growth} + \text{inflation} - \frac{\text{required change in the SPB}}{\text{net primary expenditure} - \text{to} - \text{GDP ratio}}
 \end{aligned}$$

### 2.2 The corrective arm has adapted to the post-COVID 19 budgetary environment

The excessive deficit procedure is a mechanism designed to give Member States failing to comply with the quantitative Maastricht criteria the opportunity to correct their fiscal paths before the procedure is escalated (which may involve financial sanctions). However, the shocks triggered by fiscal measures introduced to address the COVID-19 pandemic in 2020 and the energy crisis significantly increased the

debt ratios of Member States. In 2023, these ratios exceeded 60% of GDP for 14 Member States: the initiation of an excessive deficit procedure based on this one criterion, resulting in the application of the “twentieth” rule (see above), would have potentially triggered excessive fiscal consolidation which also does not factor in the effect of reducing the debt of each Member State. Under the new framework, Member States may trigger the excessive deficit procedure if their deficit exceeds 3% of GDP (deficit criterion remaining unchanged) or if their debt ratio

exceeds 60% of GDP and if they deviate from the net primary expenditure path recommended to them by the Council (new debt criterion). For an excessive deficit procedure to be initiated based on the debt criterion, the deviation must exceed the annual (0.3% of GDP) or cumulative (0.6% of GDP) deviation thresholds of a control account that records the deviation from the Council's recommended path in points of GDP. This control account is reset to zero every time a new MTFSP is adopted. The procedure for initiating the mechanism based on the debt criterion has as a result been overhauled, but not when based on the deficit criterion.

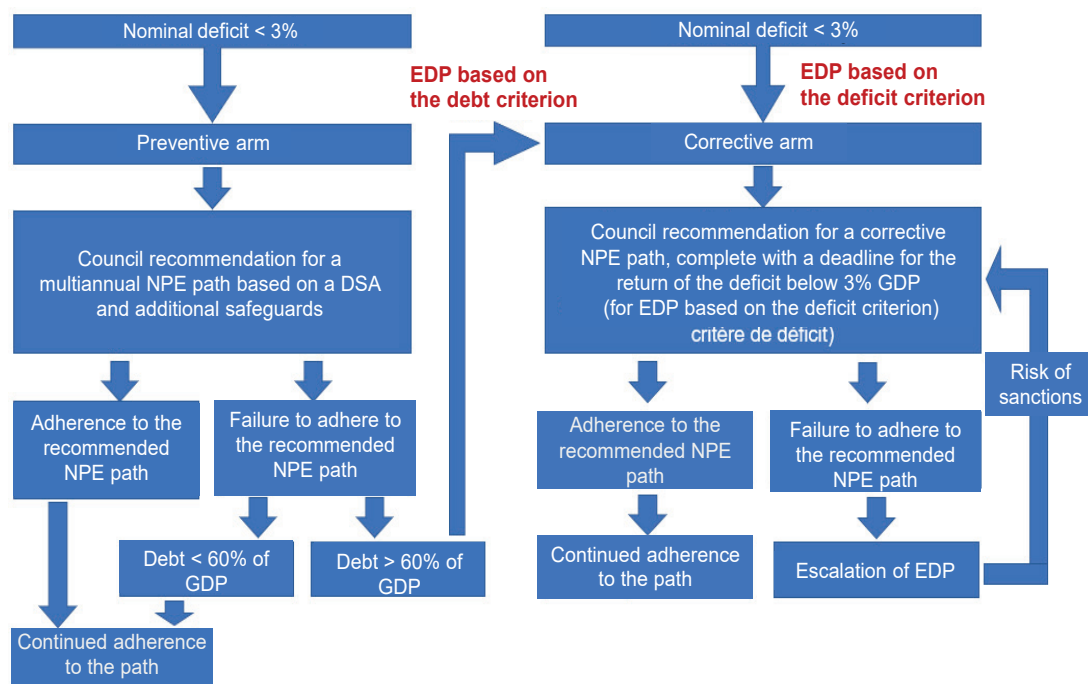
The conditions for constructing recommended correction paths are based on the debt sustainability analysis methodology set out in section 2.1. In addition, when an excessive deficit procedure is initiated based on the deficit criterion, the correction path must be consistent with a minimum structural adjustment of 0.5% of GDP per year. However, the framework has been temporarily relaxed so that the increase in interest expenditure is not factored into this adjustment of the years from 2025 to 2027 so as to ease pressure on Member States whose debt service is set to increase over this period (deferred effect of the hike in interest rates in the post-COVID 19 period). These requirements, defined ex-ante when plotting the correction path, are not verified ex-post using the outturn, with the change to the NPE being the sole surveillance metric.

The procedure and the various stages of scaling up the excessive deficit procedure remain unchanged and are based on Article 126 of the Treaty on the Functioning of the European Union. However, the reform adjusted the procedure's rules. The procedure comes into play when a Member State is considered to not have taken "effective action" to end the excessive deficit. Under this new framework, assessment of the effective action in revenue or expenditure terms focuses on adherence to the NPE path: if a Member State is seen to deviate from the recommended correction path, the Commission will conduct an overall assessment which may consider, in addition to the extent of the

deviation, any mitigating or aggravating circumstances. If the correction path of the Member State subject to the excessive deficit procedure is not adhered to on repeated occasions, it may be given formal notice and ultimately fines may be imposed. The format of these fines has been changed to a more gradual imposition with greater credibility (up to 0.05% of GDP every six months rather than 0.2% of GDP). The escalation of the excessive deficit procedure is therefore not contingent on achieving nominal deficit targets but solely on adherence to the NPE path. This is to avoid a sudden and procyclical slowdown in the event of deteriorating macroeconomic forecasts. The conditions for closure (abrogation) of the excessive deficit procedure still however require the nominal deficit to fall back down below 3% of GDP (excessive deficit procedure under the deficit criterion) and adherence to the correction path for the procedure's duration (excessive deficit procedure under the debt criterion).

This overhaul of the excessive debt procedure reflects a paradigm shift enacted by the reform. In the former framework, ex-post fiscal surveillance was based on the commitment to achieving results relating to the attainment of quantitative nominal "anchor" indicators like deficit or debt, the changes in which were partly determined by factors that fell outside the public authorities' scope of action (external macroeconomic shocks, risks for the tax and social security contribution elasticity to GDP). The "budget credibility" of Member States therefore lay in their ability to attain these targets in spite of short-term risks, a feat that has become complex in an increasingly uncertain economic environment. In the new framework, Member States' fiscal credibility is based on a best-effort obligation, with Member States being sanctioned solely on their (in) ability to control their NPE based on the path plotted, disregarding their deficit targets in the event of adverse non-discretionary circumstances. In turn, under this framework Member States are not authorised to lower their structural effort in the event of adverse non-discretionary circumstances (e.g. buoyant economic conditions, elasticity of taxes and social security contributions exceeding 1 and a windfall gain excluding taxes and social security contributions).

**Chart 5: Structure of the preventive and corrective arms of the revised Stability and Growth Pact**



Source: DG Trésor.

### 3. The first year of the framework’s implementation saw the coordinated activation of national escape clauses to cope with rising defence spending

Following the adoption of the legislative package on 30 April 2024, 22 Member States submitted their MTFSPs to the Commission in autumn 2024.<sup>25</sup> At the ECOFIN Council meeting of 21 January 2025, the Council adopted its recommendations, approving the plans assessed by the Commission. The Council also adopted correction paths in relation to EDPs initiated in spring 2024 for the Member States concerned.<sup>26</sup> Ultimately, eight Member States requested an extension of their adjustment period in exchange for making commitments regarding a set of reforms and investments.<sup>27</sup> In spring 2025, Member States submitted their first annual progress reports, setting out their adherence to the budgetary path and compliance with reforms and investments for 2024.

In its communication of 19 March 2025,<sup>28</sup> the European Commission proposed a partial and temporary

suspension of fiscal rules as from the first year of their implementation to help increase national defence spending. This new suspension involves the activation of national escape clauses (NEC) and only applies to Member States that submit a request that is approved by the Commission and the Council of the European Union.<sup>29</sup> This mechanism is therefore more targeted than the instrument rolled out during the COVID-19 pandemic, both in terms of the range of Member States involved and the expenditure categories affected by the suspension of the fiscal rules.

Although these NECs are set forth in the revised Stability and Growth Pact, the Commission’s proposal for a targeted clause on defence spending deviates from the clause activation procedures set out in the regulation. The Commission’s proposal results in no fiscal surveillance of national defence spending for

(25) Austria, Belgium, Bulgaria, Germany and Lithuania submitted their MTFSPs later in 2025 either because of elections taking place or governments being formed. The ECOFIN Council has adopted its recommendations, approving the plans throughout the year.  
 (26) Belgium, France, Hungary, Italy, Malta, Poland, Romania, and Slovakia. Austria and Finland have subsequently also had excessive deficit procedures opened against them and the Council has adopted a recommendation establishing a correction path for the two countries.  
 (27) Austria, Belgium, Finland, France, Germany, Italy, Romania and Spain.  
 (28) Commission Communication of 19 March 2025, *Accommodating increased defence expenditure within the Stability and Growth Pact*.  
 (29) At the time of writing, 17 Member States have requested the activation of the escape clause: Austria, Belgium, Bulgaria, Croatia, Czechia, Denmark, Estonia, Finland, Germany, Greece, Hungary, Latvia, Lithuania, Poland, Portugal, Slovakia, and Slovenia.

the 2025-2028 period<sup>30</sup> – particularly for spending incurred under the Security Action for Europe (SAFE) instrument<sup>31</sup> – with a cap of 1.5% of GDP per year compared to 2021 level. Meanwhile fiscal surveillance is maintained for the remainder of net primary expenditure.

As a result, for Member States subject to the Pact's preventive arm, deviations from the NPE path recommended by the Council or the reference value of a 3% deficit ratio will not necessarily result in an EDP being initiated (respectively under the debt and deficit criteria) if these deviations are the product of a rise in defence spending, subject to the aforementioned cap of 1.5% of GDP. Similarly, for Member States subject to the corrective arm, the deviations from the correction path will not necessarily trigger an escalation of the procedure if they can be justified by an increase in defence spending.

In addition, the activation of the NEC triggers additional restrictions being lifted with the suspension of safeguard clauses on debt sustainability and deficit resilience. With these quantitative safeguards removed, Member States – for whom these clauses tightened adjustment requirements – can benefit from additional fiscal headroom. Lastly, the control account introduced to guarantee surveillance of NPE outside the defence sector will only have a multiannual component, meaning that the annual deviation limit of 0.3% of GDP will not be applicable.

The coordinated activation of NECs has enabled the fiscal framework to demonstrate its adaptability in a deteriorated geopolitical environment. The year of 2028, which will mark the end of the activation period for NECs and the submission of a new wave of MTFSPs, will therefore be a test for the sustainability and credibility of the new rules.

- (30) The scope of defence spending adopted for surveillance draws on the Classification of the Functions of Government (COFOG), an international standard used by Eurostat that classifies general government expenditure data from the system of national accounts based on the various objectives or purposes for which the funds are used. This indicator is different from its NATO counterpart in its scope (in particular pensions paid out to military veterans and civilian staff of the Ministry for Armed Forces are also included in the definition of defence spending according to NATO but not for Eurostat) and because Eurostat's indicator operates on an accruals basis rather than a cash basis.
- (31) Security Action For Europe is a financial instrument providing up to €150bn in loans to EU Member States to support the European defence industry through joint procurement. It has been effective since 2026.

**Publisher:**

Ministère de l'Économie,  
des Finances  
et de la Souveraineté  
industrielle, énergétique et  
numérique

Direction générale du Trésor  
139, rue de Bercy  
75575 Paris CEDEX 12

**Publication manager:**

Dorothee Rouzet  
tresor-eco@dgtresor.gouv.fr

**English translation:**

Centre de traduction  
des ministères économique  
et financier

**Layout:**

Mimose Mellia  
ISSN 1962-400X  
eISSN 2417-9698

**Recent Issues in English****April 2026**

No. 385 World Economic Outlook in Spring 2026: Global Economy Confronted with a New Energy Shock


French Treasury (DG Trésor) International Forecasting Teams

**March 2026**

No. 384 The Financial Situation of the Defence Technological and Industrial Base Since the Onset of the War in Ukraine

Quentin Bon, Jean de Livonnière and Raphaël Lafrogne-Joussier

<https://www.tresor.economie.gouv.fr/Articles/tags/Tresor-Eco>

 Direction générale du Trésor

 @DGTresor

To subscribe to *Trésor-Economics*: [bit.ly/Trésor-Economics](https://bit.ly/Trésor-Economics)

*This study was prepared under the authority of the French Treasury (DG Trésor) and does not necessarily reflect the position of the Ministry of Economy, Finance and Industrial, Energy and Digital Sovereignty*