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European governance: the new fiscal rules and social spending*

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The reform of the European fiscal rules came into force on 30 April 2024. The new rules, like the former ones, impose a depressive bias on domestic fiscal policies, leaving Member States' no fiscal room for manoeuvre. At the same time, the European Pillar of Social Rights sets ambitious targets for national social protection systems and requires an increase in social spending. A new form of governance would be required to prevent the fiscal rules from imposing restrictive fiscal policies to the expense of economic activity and, of more important, objectives (green transition, defence). This would require abandoning arbitrary targets for public deficits and debts and accepting, when needed, an increase in social contributions and taxation.

Keywords: *Fiscal rules, European fiscal governance, European social model, Social spending*

JEL codes: *E61, H53, I38*

1 INTRODUCTION

Since 30 April 2024, the reform of the European fiscal rules is effective. This reform, announced in 2018, had given rise to intense academic, institutional and political activity. In November 2022, the European Commission proposed to replace the existing rules with a single one: each Member State (MS) would control its public expenditure path in order to bring down its public debt level towards 60% of its GDP, according to a trajectory negotiated with the Commission. However, under pressure from Germany and the Nordic countries, numerical fiscal constraints were reintroduced. The European Parliament added clauses stressing the need to take account of environmental and social objectives, without changing the planned procedures. In the end, each MS will have to use domestic fiscal policy to reduce public debt, while social spending related to ageing population, investment spending for the green transition and military spending need to be raised.

In 2017, the EU MS adopted the European Pillar of Social Rights (EPSR), which sets ambitious targets for national social protection systems. These targets require some increase in social spending (mainly on pensions and long-term care but also, in some MS, on health, education, unemployment, family and welfare). This seems at odds with the objective of controlling public expenditure. There is a huge risk that the reformed rules

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will impose restrictive fiscal policies from 2025 onwards, to the detriment of economic activity and more important objectives (green transition, re-industrialisation, defence).

The first part of this study describes the new rules of European governance and shows that they leave no room for manoeuvre for Member States' fiscal policies. The second part analyses, for the largest EU countries, the social protection needs resulting in particular from the EPSR. The third part proposes a new form of governance, in line with the fundamental European objectives, which requires abandoning arbitrary targets for public deficit and debt and accepting an increase in social contributions and taxation.

2 THE REFORM OF EUROPEAN FISCAL RULES

In November 2022, the Commission published its proposal for a reform of the European fiscal rules (European Commission (EC) 2022). An agreement with the Council of the European Union and European Parliament negotiators was reached on 10 February 2024 (CUE 2024). The new rules were effective since 30 April 2024.

The text maintains the 3% of GDP ceiling for public deficits and the 60% of GDP target for public debt, with the justification that they were included in the Maastricht Treaty and cannot be called into question without a constitutional reform (EC 2022: 6).

2.1 A public debt trajectory

For each Member State, the Commission will carry out a debt sustainability analysis (DSA). By projecting trajectories of public debt over an adjustment period covered by a medium-term programme (four years, which can be extended to seven years) and ten years beyond, with unchanged taxation but taking into account the increase in net expenditure due to ageing populations, the Commission will study if these trajectories guaranty that the MS public deficit is falling and will be maintained below 3% of GDP and that its public debt is falling and converging towards *prudent levels*. Around their reference paths, the Commission will carry out stress tests¹ and stochastic analyses to verify the plausibility of maintaining the public deficit below the 3% threshold and of the decline in the debt ratio. These will have to be ensured with a probability of more than 70%. The medium-term plan will have to ensure 'by the end of the adjustment period, assuming that there are no further budgetary measures, the projected general government debt ratio is put or remains on a plausibly downward path, or stays at prudent levels below 60% of GDP over the medium-term' (CUE 2024: 9). The Commission would thus define a reference path for government debt, which would then be translated into a path for net government expenditure. This trajectory would be binding for Member States whose public debt exceeds 60% of GDP or whose public deficit exceeds 3% of GDP. It would be made available to other Member States for information purposes.

After a technical debate with the Commission, each Member State will have to present a medium-term fiscal–structural plan with a four-year horizon (which may be prolonged to seven-year), bringing together the current stability programmes and the national reform programmes. For countries whose debt exceeds 60% of GDP or whose deficit exceeds

1. A 0.25 GDP point fall in the Primary Public Balance, 1 percentage point rise in the spread between the interest rate and the growth rate, 1 percentage point rise in interest rate in one year with a rise in credit spreads for indebted MS.

3%,² the plan must ensure that the debt ratio follows the adjustment path agreed with the Commission, i.e., a continuous and plausible downward trajectory towards prudent levels, and that the government deficit falls below 3% of GDP or is maintained below that level, initially over a four-year period on the basis of the policies envisaged, and then over a longer period on a no-policy change basis. The fiscal effort must be linear (not carried over to the end of the period). The plan will be presented in the form of a trajectory for net public expenditure.

These projections (EC 2024a; 2024b) are still based on a questionable estimate of the potential growth of each MS (Mathieu and Sterdyniak 2015). They integrate MS' projections of the evolution of their age-related social expenditure. According to its proponents, the reform would allow differentiated treatment of Member States; the debt reduction constraint would be maintained but made more credible by adjusting it to the country's starting position.

In fact, in the name of debt sustainability, the Commission refers to an unjustified demand for continuous debt reduction towards the arbitrary level of 60% of GDP. It does not take into account the economic factors justifying a public deficit or an increase in public debt. Structurally, public debt is rising in most developed countries. In the future, a higher debt level may be necessary to finance the green transition; this may be sustainable if household savings remain high. In the event of a major shock (like in 2020), government debt rises but remains sustainable thanks to the support of the ECB.

The new rules, like the previous ones, require MS to comply with arbitrary public finance criteria that have no macroeconomic justification and do not account for the domestic economic situation. Is it necessary to adopt a restrictive policy today in order to guarantee a fall in the debt ratio for all the risks considered in the stress tests, without taking into account the current situation of the MS? It is unnecessary to adopt a restrictive policy today in order to guarantee a reduction in the debt ratio for all the risks considered in the stress tests, without accounting for the current situation of the MS. The process inevitably leads to the recommendation of restrictive fiscal policies.

The regulation (CUE 2024: 2) states that: 'Each Member State should present a national medium-term fiscal-structural plan setting out its fiscal path as well as priority public investments and reforms that together ensure sustained and gradual debt reduction and sustainable and inclusive growth'. The European Parliament succeeded to add: 'Those plans should also include broader reforms and investments, including in relation to common priorities of the Union, namely the green transition, including the European Green Deal and the transition to climate neutrality by 2050, the implementation of the European Pillar of Social Rights, including the related targets on employment, skills and poverty reduction by 2030; energy security; and the build-up of defence capabilities'. *We can welcome the inclusion of European objectives, including social objectives, in the review of the national fiscal policies; we can also fear the extension of the scope of this technocratic procedure, which pays little attention to the principles of subsidiarity and is detached from national debates.*

The Commission will be more lenient with MS complying with its instructions: 'To ensure a more gradual debt reduction, the adjustment period can be extended by a maximum of three years if the Member State underpins its national medium-term fiscal-structural plan with a set of verifiable and time-bound reforms and investments that are growth- and resilience-enhancing; support fiscal sustainability; address the common priorities of the Union; address relevant country-specific recommendations under the European Semester, including, where applicable, recommendations issued under the

2. In 2024, it would concern 16 out of 27 MS.

macroeconomic imbalance procedure' (CUE 2024: 13). *Thus, the Commission is entitled to judge the entirety of Member States' policies* (see Schuberth 2024).

2.2 A single indicator

Taking into account the academic debate, the various indicators would be replaced by a single one: each country would have to monitor the evolution of its 'net primary expenditure financed at national level that is to say: government expenditure net of interest expenditure, discretionary revenue measures, expenditure on Union programmes fully matched by revenue from Union funds,³ national expenditure on co-financing of programmes funded by the Union, as well as cyclical elements of unemployment benefit expenditure' (CUE 2024: 3).

The indicator appears to be expressed in terms of public expenditure (rather than government balance) in order to encourage Member States to reduce their debt by cutting expenditure rather than raising taxes. According to its proponents, the new indicator would have the advantage of avoiding a direct role for the estimation of potential output and the structural balance, which are difficult to evaluate, but we have seen that the DSA is based on an estimate of potential growth. Member States could allow automatic stabilisers to operate on the revenue side and on unemployment benefits. They would not be able to implement discretionary policies. However, the COVID crisis has shown that the necessary cyclical spending goes well beyond direct spending on unemployment benefits.

The text states: 'Upon a recommendation from the Commission, the Council shall adopt a recommendation setting the net expenditure path of the Member State concerned (article 17) The Council is expected to, as a rule, follow the recommendations and proposals of the Commission or publicly explain its position (article 27)'. *This gives the Commission direct control over national fiscal policies. However, according to the European treaties, each country must remain the master of its own fiscal policy, even if some coordination is necessary.*

2.3 Increased surveillance

The excessive deficit procedure (EDP) remains unchanged as far as the 3% rule is concerned. It is strengthened for countries deviating from the projected trajectories of debt or net public expenditure, or failing to implement announced reforms or investments. If no action is taken under the excessive deficit procedure, the amount of the fine will be reduced to 0.05% of GDP every six months in order to ensure the credibility of the sanction. The fine will no longer be reimbursed to the MS failing to obey the rules but will become part of the Community budget.

Derogation clauses allowing deviations from the national plan due to exceptional circumstances (either global or national) with the approval of the Council are maintained, but these deviations must 'not endanger fiscal sustainability in the medium term' (Article 25). *This is a vague formulation. One might wonder, for example, whether the increase in public debt ratios from 2019 to 2022 jeopardises fiscal sustainability.*

For the time being, the Commission has abandoned its plans for a European fiscal capacity, a European Treasury or a euro area finance minister who would have closely monitored national fiscal policies (as proposed by Buti and Messori 2022). It did not

3. This makes no economic sense but is intended to encourage MS to shift their expenditure to the EU level.

propose that the EU should take responsibility for a larger share of public spending related to the green or digital transition as a continuation of the Recovery and Resilience Facility (as advocated by Recovery Watch 2023).

Although EU countries urgently need public spending for the green transition and for their industrial policies, neither the Commission nor the Council wanted to open the Pandora's box of special treatment for public investment. Many economists had argued that public investment, validated by the EU as part of the green transition, should be exempted from the public deficit constraint (e.g., Truger 2015; Darvas et al. 2023; Van den Noord 2023). According to the reformed rules, only investments financed or co-financed by the EU and Member States are excluded from the controlled deficit. Other (including green) investments are not deducted from the controlled public deficit, and their accumulation is not deducted from the controlled public debt. Although the Commission and the Council claim that Member States need to boost growth-enhancing investments to support the green and digital transition, they refuse to relax the numerical constraints.⁴ Similarly, the European Parliament has stressed the importance of the European Green Deal and the European Social Charter, again without any explicit impact on these constraints.

2.4 Numerical safeguards

Fearing that the bilateral negotiations between the Commission and Member States would result in too lax a path, Germany and the *frugal* countries succeeded in adding *numerical safeguards* to the reference trajectory (CUE 2024, Articles 7 and 8):

- MS whose deficit exceeds 3% of GDP will have to cut their structural deficit by at least 0.5 percentage points per year. However, from 2024 to 2027, the primary structural deficit will be considered.⁵
- Member States whose public debt exceeds 90% of GDP (stands between 60% and 90% of GDP) must reduce it by at least 1 percentage point of GDP per year (0.5 percentage points per year) on average over the adjustment period. This constraint does not apply to countries under an EDP; it only takes effect when the EDP is closed.
- Member States will have to set a structural deficit target of less than 1.5% of GDP; they will have to cut their primary structural deficit by at least 0.4 percentage points of GDP per year to come close to this target (0.25 percentage points for countries benefiting from a seven-year adjustment period).
- A control account would be established for each Member State, accumulating the differences between actual net expenditure and that projected in the fiscal–structural plan; an EDP would be triggered if the difference exceeds 0.3% of GDP in any year or 0.6% cumulatively.

These safeguards destroyed the logic of the reform proposed by the Commission. They reintroduce the structural deficit and the change in the structural deficit, the calculation of which is highly uncertain. The constraint refers sometimes to the structural primary deficit, sometimes to the structural deficit and no longer to net primary expenditure, which complicates the rules.

4. However, in February 2025, the Commission proposed that the Council allows Member States to increase their defence spending outside the constraints of the fiscal rules.

5. In order to allow France (and other MS hit by increasing interest payments) to meet the target.

2.5 A required austerity

In the long run, the debt ratio stabilisation requires a structural primary balance of zero if the interest rate is equal to the growth rate. In fact, EU fiscal rules are more restrictive than debt stabilisation (Darvas et al. 2024b).

For simplicity's sake, let us assume that the fiscal rules require countries whose debt exceeds 90% of GDP to cut it by 1 percentage point per year, those whose debt exceeds 60% of GDP by 0.5 percentage points per year; the interest rate is assumed to be 0.75 percentage points above the growth rate, and the ageing effect is taken into account.⁶ Under these conditions, the required fiscal effort relative to the situation in 2023 reaches 7 percentage points of GDP for Romania, 6.8 for Italy, 5.1 for France, 4.8 for Belgium, 4.5 for Spain, 4.3 for Poland and 3.0 for Germany (Table 1). These efforts have to be made within four or seven years. In any case, with the exception of Sweden and Denmark, there is no room for manoeuvre for the green transition, defence spending or improving the European social model.

This assessment does not account for the restrictive impacts that the fiscal policies implemented in most EU countries would have if not offset by expansionary policies in countries with external surpluses and by a sharp fall in interest rates; this recessive effect would substantially reduce the improvement in government balances.

For France, for example, the required fiscal restraint is 5.1 percentage points of GDP, i.e., 0.7 percentage points of GDP per year if France obtains a seven-year adjustment period. However, assuming a fiscal multiplier at 1, cutting public expenditure by 1 percentage point of GDP leads, on average, to a 1% fall in GDP, and the government balance to be improved by 0.5 percentage points only. Thus, an annual fiscal effort of 1.4 percentage points of GDP would be necessary to reduce the government deficit by 0.7 percentage points of GDP per year, resulting in a 1.4 percentage point lower growth rate.⁷

The question is therefore: should EU countries pursue restrictive policies for seven years when they do not have excessive demand, when their external balance is in surplus and when they have needs in terms of social, military and green spending?

The reform of the fiscal rules can be considered a failure (see also Schuberth 2024). The revised framework is even more complicated and rigid than previously. The rules continue to focus on technocratic control of fiscal policy, with the arbitrary objective of reducing public debt and the political objective of imposing reforms on reluctant Member States. Member States would lose control over their fiscal policies, which would be put on automatic pilot and would have to commit to restrictive policies regardless of the economic situation. The new rules do not ensure the coordination of the economic policies of the euro area Member States, taking into account the economic situation of each MS and of the euro area as a whole: they do not allow for the public investment needed for the green transition.

6. Some countries, such as France, have announced restrictive pension policies to stabilise the ratio of social expenditure to GDP while others, such as Belgium or Spain, accept an increase in social spending due to ageing population.

7. Heimberger et al. (2024) take into account the cross-border spillover effect of restrictive fiscal policies and show that debt targets will not be met due to output falls.

Table 1 Primary balance requirement

	Public balance 2023	Structural balance 2023 ^a	Primary structural balance ^a (A) 2023	Public debt 2023	Ageing effect 2023–2030	Primary balance requirement (B)	Required adjustments (B)–(A)
Eurozone	-3.6	-3.6	-1.9	88.9	0.2	1.3	3.2
Germany	-2.6	-2.1	-1.3	62.9	0.7	1.7	3.0
France	-5.5	-5.4	-4.0	109.9	-0.7	1.1	5.1
Italy	-7.2	-8.2	-4.5	134.8	0.3	2.3	6.8
Spain	-3.5	-3.9	-1.5	105.1	1.2	3.0	4.5
Netherlands	-0.4	-1.0	-0.3	45.1	0.7	1.0	1.3 ^b
Belgium	-4.2	-4.1	-2.1	103.1	0.9	2.7	4.8
Austria	-2.6	-2.6	-1.4	78.6	1.4	2.5	3.9
Sweden	-0.5	0.2	0.9	31.5	0.2	0.4	^b
Denmark	3.3	4.1	4.8	33.6	1.4	1.6	^b
Poland	-5.8	-4.7	-2.6	49.7	1.4	1.7	4.3
Romania	-6.5	-6.2	-4.3	48.9	2.3	2.7	7.0
Czech Republic	-3.8	-3.2	-1.9	42.4	-0.5	-0.2	1.7

Notes: ^aAccording to the Commission estimates.

^bCountries not concerned as their debt is below 60% of GDP and their deficit below 3% of GDP.

Sources: European Commission, Ameco Autumn 2024, own calculations.

3 THE EU'S SOCIAL OBJECTIVES

The European Union is characterised by a specific model: the European social model. Overall, this model has not been called into question in recent years. On the contrary, public spending on social protection represented 31.9% of EU GDP in 2022, compared with 28.9% in 2000. While there were significant decreases in Denmark and Sweden, there were significant increases in France, Italy, Spain, the Netherlands, Belgium and Romania (Table 2).

The evolution of social spending is at the centre of the public expenditure projections through the Debt Sustainability Monitor 2023 (EC 2024a), itself based on the 2024 Ageing Report (EC 2024b), which embeds developments announced by the governments, with the risk that they plan social spending cuts in order to ease the constraints on their current fiscal policies. For our part, we will discuss the social spending requirements needed to meet the requirements of the European Pillar of Social Rights (EPSR), considering unmet current and future needs related to ageing populations as, thanks to the European Parliament, the MS medium-term fiscal–structural plans will have to ‘ensure the implementation of investments and reforms responding to the main challenges identified in the framework of the European Semester ... in line with the common priorities of the Union ... (ii) social and economic resilience, including the European Pillar of Social Rights’ (CUE 2024: 2).

3.1 EU objectives

The European social model has clear objectives, set out in the European Pillar of Social Rights in 2017 (see the below box). They fall into two categories. First, it is essential to guarantee the well-being of each individual. This includes covering health and education costs, ensuring a satisfactory standard of living for children and their families, providing a satisfactory replacement income level for the unemployed, ensuring a standard of living for pensioners in line with their earned income and guaranteeing a minimum income for all. These objectives are not social investment, but they are essential for the population welfare.

Second, some social spending contributes to higher output and productivity levels in the long run. Childcare services encourage mothers to work, create jobs and improve children's cognitive skills. Spending on poor families enables their children to live in a favourable environment. Spending on education contributes to a rise in labour productivity. Spending on health, especially occupational health, and on vocational training extends the length of careers, thereby both increasing employment and reducing pension costs. Family policies can increase the birth rate. These social investments undoubtedly have a positive impact on growth, even if it is difficult to measure. Darvas et al. (2024a) assess the impact that social investment policies (increasing childcare facilities, improving the quality of education, increasing the number of highly skilled workers) could have on potential growth and hence on fiscal constraints. These effects appear to be uncertain and small for most countries.

The role of social protection as social investment is reaffirmed in a recent report published by the EU on ‘The Future of Social Protection and of the Welfare State in the EU’ (High Level Group 2023): family support; childcare for 1- to 3-year-olds; support for young people (18–23); vocational training and unemployment benefits to enable flexible employment, especially in view of the green and digital transition; employment of young people, women, disabled people and migrants; transition to retirement; and support for old-age care (which should not be left to women in the family) – all these measures have a double dividend, reducing the need for social protection by creating more and better jobs and increasing activity, which, in turn, increases the funding base: ‘A well-designed and

BOX 1 THE EUROPEAN PILLAR OF SOCIAL RIGHTS

The European Pillar of Social Rights includes 20 principles, 7 of which directly apply to social protection, including:

(11) Childcare and support to children. (a) Children have the right to affordable early childhood education and care of good quality. (b) Children have the right to protection from poverty. Children from disadvantaged backgrounds must be given to specific measures to enhance equal opportunities.

(13) Unemployment benefits. The unemployed have the right to adequate activation support from public employment services to (re)integrate in the labour market and to adequate unemployment benefits of reasonable duration, in line with their contributions and national eligibility rules. Such benefits shall not constitute a disincentive for a quick return to employment.

(14) Everyone lacking sufficient resources has the right to adequate minimum income benefits ensuring a life in dignity at all stages of life, and effective access to enabling goods and services. For those who can work, minimum income benefits must be combined with incentives to (re)integrate into the labour market.

(15) Old age income and pensions. (a) Workers and the self-employed in retirement have the right to a pension commensurate with their contributions and ensuring an adequate income. Women and men must have equal opportunities to acquire pension rights. (b) Everyone in old age has the right to resources that ensure living in dignity.

(16) Healthcare. Everyone has the right to timely access to affordable, preventive and curative healthcare of good quality.

(17) Inclusion of people with disabilities. People with disabilities have the right to income support that ensures living in dignity, services that enable them to participate in the labour market and in society, and a work environment adapted to their needs.

(18) Long-term care. Everyone has the right to affordable long-term care services of good quality, in particular home-care and community-based services.

robust welfare state, taking redistribution seriously, is an economically productive asset in a knowledge-based economy and an ageing society The financial sustainability of the welfare state critically depends on the number of people in employment and how productive they are, as well as revenue being raised fairly from all potential sources of finance. But the reverse is also true: welfare policies can help maximise employability and productivity' (High Level Group 2023: 82). The report proposes to improve the progressivity and fairness of the entire tax and benefit system by developing new sources of financing, such as wealth taxation, taxation of the intangible economy and green taxation, and by combating tax evasion and fraud.

3.2 Trends in social protection expenditure

The 2024 Ageing Report gives a projection of economic and social demographic trends in the MS to 2070. The economic projections are based on trend assumptions. The most important assumptions are as follows: the gender gap in participation rates is expected to narrow but to remain high in Italy, Romania and the Czech Republic; the participation

Table 2 Social expenditure by function in 2022 as a % of GDP

	Social protection ^a 2000	Social protection ^a 2022	Public pensions	Unemployment	Family, housing, assistance	Health	Education
EU	28.9	31.9	11.9	1.2	3.2	10.5	4.7
Eurozone	29.3	32.5	12.3	1.3	3.2	10.8	4.6
Germany	30.8	33.4	11.9	1.5	3.0	11.9	4.5
France	33.0	38.1	14.4	1.7	4.3	12.2	5.2
Italy	26.9	33.1	16.2	1.0	2.9	8.9	4.1
Spain	21.9	30.1	12.5	1.6	1.7	9.7	4.4
Netherlands	24.0	28.1	6.1	0.6	4.8	11.6	5.1
Belgium	28.2	34.7	11.2	1.2	4.1	11.8	6.3
Austria	33.1	34.7	14.4	1.2	3.3	11.0	4.8
Sweden	34.7	30.7	10.1	1.0	3.3	10.2	6.3
Denmark	35.3	32.2	7.2	1.4	5.7	12.3	5.3
Poland	27.2	26.8	10.8	0.2	3.8	7.2	4.6
Romania	17.7	21.4	9.6	0.0	2.1	6.1	3.2
Czech Republic	23.7	27.7	8.4	0.1	2.5	11.4	4.9

Notes: ^aIncluding health and education spending. Green denotes value above the EU average, and red denotes value below the EU average.

Source: Eurostat.

rate of older people is expected to increase in France and Italy but to remain low in Poland and Romania and relatively low in Belgium and Austria; and immigration is expected to fall to 1 million per year but to remain relatively high in Italy, Spain and Austria. In countries where the unemployment rate is above 6.7%, it is expected to decrease towards this level. Employment rates remain low in Romania, Italy, Belgium and Poland. As a result, the economic dependency ratio, in terms of 'pensioners/employees' ratio, will rise in all countries, especially in Italy, Spain, Romania and Poland, with both demographic issues and a low level of female employment (Table 3). Labour productivity will converge across Member States, with labour productivity growth rising by 1.3% per year in the long-term; this implicitly assumes that technological progress will offset environmental constraints.

For a selection of EU countries, we have compared, for each broad category of social expenditure, the trends described in the 2024 Ageing Report, on the basis of the information provided by national administrations, with the trends allowing to comply with the EPSR (Mathieu and Sterdyniak 2024). We will focus below on expenditure on pensions and on combating poverty.

3.3 Pension expenditure

All EU countries must face the reality of an ageing population. This inevitably leads to a social choice between postponing the retirement age, lowering the relative level of pensions and increasing social contributions. Pension benefits cannot be structurally financed by public borrowing. Therefore, the debate on pension trends in each MS is perpendicular to the debate on public deficit targets.

The starting point varies significantly from one MS to another. The effective retirement age ranges from 61/62 in Belgium, France and Austria to 64/65 in the Netherlands, Sweden and Denmark (Table 4). However, an early retirement age can reflect a social choice or result from poor management of employees. Older people's income is equal in Italy, Spain and Romania to that of the rest of the population. In stark contrast, it is 25% below in the Netherlands, Belgium, Denmark and the Czech Republic. The old-age

Table 3 Employment rates and economic dependency ratios

	Employment rate (20–64)		Inactive +65/employment	
	2022	2050	2022	2050
EU	74.7	78.0	44.6	63.4
EZ	74.1	78.1	45.9	64.0
Germany	80.7	81.2	41.5	55.5
France	74.0	78.9	48.8	63.1
Italy	64.8	70.4	58.3	80.0
Spain	69.6	76.8	45.7	72.0
Netherlands	82.9	86.2	36.0	46.8
Belgium	72.1	75.6	44.8	56.0
Austria	77.3	81.1	38.9	58.5
Sweden	82.3	83.6	37.5	46.3
Denmark	80.2	81.5	38.9	46.6
Poland	76.9	76.3	38.1	66.3
Romania	68.3	68.6	47.5	74.0
Czech Republic	81.3	79.2	39.2	60.9

Source: 2024 Ageing Report.

poverty rate is lower than that of the rest of the population in France and Italy, whereas it is much higher in Germany, the Netherlands, Belgium and the Czech Republic. Public spending on pensions is particularly high in Italy, France and Austria, and particularly low in Denmark and the Netherlands, two countries with occupational systems, which do not prevent a low standard of living among the elderly.

The 2024 Ageing Report (Table 5) shows that while some countries (Italy, Spain, Belgium, Romania and the Czech Republic) accept an increase in pension expenditure in

Table 4 *Determinants of pension expenditure in 2022*

	Effective retirement age ^a	Relative income 65+ ^b	Replacement rate ^b
EU	62.5	0.90	0.58
Germany	63.6	0.84	0.48
France	61.5	0.93	0.60
Italy	62.5	0.98	0.74
Spain	61.9	1.01	0.75
Netherlands	64.5	0.73	0.55
Belgium	61.2	0.75	0.47
Austria	61.3	0.95	0.57
Sweden	65.0	0.81	0.57
Denmark	64.2	0.77	0.47
Poland	62.7	0.89	0.61
Romania	n.d.	0.97	0.52
Czech Republic	63.1	0.73	0.49

Notes: ^aOECD database. ^bEurostat.

Table 5 *Evolution of pension expenditure according to the 2024 Ageing Report*

	Pension expenditure, as a percentage of GDP		Effective retirement age		Public pension/gross salary		
	2022 ^a	2050 ^b	2023	2050	2023	2050	As a %
EU	11.4	12.1 (12.9)	63.6	65.3 (+1.7)	43.2	38.0	-12.0
Eurozone	11.9	12.6 (13.5)	63.8	65.6 (+1.5)	42.8	37.7	-12.0
Germany	10.2	11.0 (13.1)	64.2	65.3 (+1.1)	43.0	36.0	-16.3
France	14.4	13.7 (14.6)	62.5	64.8 (+2.3)	47.1	40.6	-13.8
Italy	15.6	15.5 (17.0)	64.2	66.9 (+2.7)	69.3	56.6	-18.3
Spain	13.1	17.3 (17.8)	64.0	66.4 (+2.3)	64.1	56.5	-11.9
Netherlands	6.5 (+4.0)	7.9	65.9	66.6 (+0.7)	37.8	39.0	+3.2
Belgium	12.7	14.8 (16.0)	62.7	64.2 (+1.5)	46.4	44.8	-3.4
Austria	13.7	14.0 (15.0)	62.2	63.6 (+1.4)	55.5	48.5	-12.6
Sweden	7.4 (+2.0)	7.0 (8.1)	65.0	66.4 (+1.4)	36.0	32.4	-10.0
Denmark	8.3 (+4.0)	7.8 (9.4)	64.9	67.7 (+2.8)	41.1	32.4	-21.1
Poland	10.2	10.7 (15.3)	63.1	63.1 (0)	44.5	28.8	-35.3
Romania	8.5	10.5	62.9	64.0 (+1.1)	33.9	32.8	-3.2
Czech Republic	8.7	10.6 (11.6)	62.2	63.5 (+1.3)	42.7	41.1	-3.8

Notes: ^aBetween (); Private pensions.

^bBetween (); level needed to obtain a more satisfactory benefit ratio (see Mathieu and Sterdyniak 2024).

Source: 2024 Ageing Report.

view of demographic trends, others (Sweden and France) claim that they will significantly reduce their expenditure. Four countries (Denmark, Italy, Spain and France) expect a sharp increase in the effective retirement age, the plausibility of which will have to be assessed.

In almost all countries, the benefit ratio (pension/salary) is expected to fall sharply, undermining the equality of living standards between pensioners and workers. This is due to unsatisfactory indexation mechanisms (on prices rather than on wages) or due to sustainability factors (which, however, should affect the retirement age rather than the level of pensions). We have looked at the rise in public spending needed to limit the decrease in the benefit ratio (Austria, Sweden, France, Poland, Spain and Italy), stabilising its level (Germany and Denmark) or increasing where it is too low (Belgium, the Czech Republic and the Netherlands). The results can be seen in Table 5.

3.4 Family and welfare policies

Issues of family and welfare policies are not addressed in the 2024 Ageing Report, as is often in EU analyses. However, most EU countries have serious fertility issues and lifting all children out of poverty is a necessity according to the EPSR. The poverty rate has tended to rise in the euro area countries, with significant increases in France, the Netherlands, Austria and Sweden, whilst decreasing slightly in Belgium and more substantially in Poland (Table 6). The target set by the European authorities is a poverty rate at around 14% in the euro area by 2030, which is not very ambitious. France, the Netherlands, Sweden and Austria were below 14% in 2007 and are above it in 2022. The child poverty rate is higher than for the whole population in France, Italy, Spain and Austria; it is above 12% in most countries but lower in Denmark.

Minimum incomes are very low in most EU countries (Table 7), except in Denmark and the Netherlands where they are close to the 50% poverty threshold. This does not comply with principle 14 of the EPSR: 'Everyone lacking sufficient resources has the right to adequate minimum income benefits ensuring a life in dignity'. The Council of the European Union recommended 'that income support of persons lacking sufficient resources reaches

Table 6 Poverty rates

	Global		0–16	65+
	2007	2022	2022	2022
EU	19.9	16.5	19.0	17.3
Eurozone	16.1	16.8	19.8	17.3
Germany	15.2	14.8	14.7	18.3
France	13.1	15.6	21.6	12.5
Italy	19.5	20.1	25.6	17.8
Spain	19.7	20.4	27.7	18.7
Netherlands	10.2	14.5	12.5	17.1
Belgium	15.2	13.2	13.5	17.9
Austria	12.0	14.8	18.9	14.9
Sweden	10.5	16.0	16.2	15.7
Denmark	11.7	12.4	9.8	13.2
Poland	17.3	13.8	13.5	15.2
Romania	24.6	21.2	26.1	19.5
Czech Republic	9.6	10.2	11.6	16.0

Source: Eurostat.

Table 7 60% poverty threshold and minimum income in 2022

	Poverty threshold, euros per month ^a	Minimum income, % of median income ^b	
		Single	Couple, 2 children
Germany	1246	37	45
France	1153	36	35
Italy	930	42	36
Spain	841	42	34
Netherlands	1478	55	43
Belgium	1366	41	37
Austria	1393	39	45
Sweden	1335	44	36
Denmark	1663	47	55
Poland	551	21	37
Romania	295	5	18
Czech Republic	607	37	30

Notes: ^aEurostat. ^bOECD.

Table 8 Evolution of social expenditure according to the 2024 Ageing Report

	Expenditure 2022	Pensions	Health	Long-term care	Education	Expenditure 2050
EU	24.4	+0.7	+0.3	+0.6	-0.4	25.5 (+1.1)
Eurozone	25.1	+0.7	+0.3	+0.6	-0.4	26.4 (+1.3)
Germany	24.3	+1.0	+0.1	+0.5	+0.1	25.9 (+1.6)
France	29.9	-0.7	+0.1	+0.5	-0.7	29.2 (-0.7)
Italy	27.3	-0.1	+0.2	+0.5	-0.6	27.3 (+0.0)
Spain	23.9	+4.2	+1.1	+0.5	-0.7	29.2 (+5.3)
Netherlands	21.0	+1.3	+0.6	+1.4	-0.7	23.5 (+2.5)
Belgium	26.8	+2.1	+0.5	+1.2	-0.7	29.2 (+2.4)
Austria	27.7	+0.3	+1.0	+1.0	-0.5	29.5 (+1.8)
Sweden	23.6	-0.4	+0.1	+0.7	-0.6	23.6 (+0.0)
Denmark	24.4	0.0	+0.2	+2.2	-0.7	25.7 (+1.3)
Poland	19.1	+0.5	+0.8	+0.3	-0.1	20.8 (+1.7)
Romania	15.8	+2.0	+0.7	+0.3	+0.1	18.8 (+3.0)
Czech Republic	20.6	+1.9	+0.2	+0.8	+0.2	23.8 (+3.2)

Sources: 2024 Ageing Report, own calculations.

a level which is at least equivalent to the national-at-risk-of poverty threshold or to the monetary value of necessary goods and services, including adequate nutrition, housing, healthcare and essential services, according to the national definitions⁷ (CUE 2023).

It would be desirable for the next Ageing Reports to include expenditure on families and on combating poverty. We have limited ourselves to setting for each MS the target of closing half of the gap between their expenditure and the average of the three best performing countries (Denmark, Netherlands, France), adjusted for the change in the share of young people (0–19 years) in the population.⁸

8. These assumptions are embedded in Table 9, column 6.

Table 9 Changes in social expenditure according to EPSR needs

	Pensions	Health	Long-term care	Education	Family support	Unemployment	Expenditure 2050/2022	Expenditure 2050 ^a
EU	+1.5	+0.8	+1.0	+0.0	+0.5		+3.8	35.7
Eurozone	+1.6	+0.9	+1.1	+0.1	+0.5		+4.3	36.8
Germany	+2.9	+0.7	+0.8	+0.3	+1.0		+5.7	39.1
France	+0.2	+0.7	+1.0	+0.2	-0.2	-0.3	+1.6	39.7
Italy	+1.4	+0.7	+1.0	-0.1	+0.5	+0.8	+4.3	37.4
Spain	+4.1	+1.7	+1.1	-0.1	+1.2	-0.3	+7.3	37.4
Netherlands	+1.4	+1.1	+1.2	-0.1	-0.3		+3.3	31.4
Belgium	+3.3	+1.0	+0.9	-0.7	+0.0		+4.5	39.2
Austria	+1.3	+1.7	+1.4	-0.1	+0.5		+4.7	39.2
Sweden	+0.7	+0.8	+1.2	-0.6	+0.5		+2.5	33.2
Denmark	+1.1	+0.9	+2.0	-0.7	-0.5		+2.8	35.0
Poland	+5.1	+1.8	+1.4	+0.3	+0.0	+0.4	+9.0	35.8
Romania	+2.0	+1.9	+1.0	+2.2	+1.1	+1.2	+9.4	30.8
Czech Republic	+2.9	+0.9	+1.1	+0.4	+1.0	+0.5	+7.6	35.3

Notes: ^aIncluding family support and unemployment benefits.

Source: Own estimates (Mathieu and Sterdyniak 2024).

3.5 What assessment?

The 2024 *Ageing Report* provides an estimate of the increase in age-related expenditure assuming a continuation of current policies (Table 8). Although population is ageing in all countries, the prospects vary considerably from one country to another. Spain and, to a lesser extent, the Netherlands and Belgium project a significant increase in social spending. France and Sweden, on the other hand, expect a small decrease, despite their ageing population. Lastly, very little catching up is expected from Poland and Romania.

Table 9 provides an assessment of the social expenditure needed to meet the EPSR requirements according to our estimates.⁹ They lead to a high degree of convergence in social expenditure, with the lowest figures corresponding to countries with private pension systems. It should be borne in mind that these assessments are fragile and that Member States are sovereign in social matters. However, taking the EPSR objectives seriously would imply a substantial increase in social spending, on average, 4 points of GDP from 2022 to 2050.

4 A NEW FISCAL GOVERNANCE IN THE EU?

The European Union currently faces several priorities. The first one is to implement the green transition, which requires an active industrial policy. Member States also need an industrialisation strategy in the face of increased competition from China and the United States. The green transition entails higher uncertainties in terms of economic development; a large part of the risk has to be borne by the society, so by public finances. The second priority is to maintain and develop the European social model, which, given population ageing and the gap with the objectives of the EPSR, requires an increase in social spending. Following the Russian invasion of Ukraine, increasing military spending became a third priority. The 4 percentage points of GDP needed on average to develop the European social model in line with the principles of the EPSR come on top of the 1.6 percentage points required for the green transition (according to Mang and Caddick 2024)¹⁰ and now also to the 1.0 percentage point required for the European military effort.

The level of public debts and deficits has not led to economic imbalances in the euro area, except in the case of Greece in 2010–2015. In 2024, the EU ran an external surplus of around 3.6 points of GDP. Before the inflationary shock in 2022, due to the rise in commodity and energy prices, Member States were in a situation of insufficient demand and too low inflation rate. This forced the ECB to set very low and sometimes negative interest rates and the MS to maintain high public deficits, at least for those where demand was not supported by an external surplus. In this situation, the EU debate on fiscal rules is irrelevant. There is no justification for imposing rigid numerical constraints on Member States in terms of public spending, public debt and public deficit, without considering the economic situation and structural investment needs.

A four-pillar strategy is needed. Social spending should aim at a high level of social protection, in accordance with Member States policy choices and in line with the provisions of the European Pillar of Social Rights. Of course, social spending is partly social investment, but other social spending should not be reduced. Social spending must be

9. See Mathieu and Sterdyniak (2024) for more details.

10. Our conclusions are in line with those of Mang and Caddick (2024): the new fiscal rules are incompatible with social needs and the investments required by the green transition. However, Mang and Caddick (2024) only consider the investments needed to meet social needs, whereas we consider all spending, including current spending.

financed structurally through taxes or social contributions, so discussing it has little to do with public deficit or debt issues.

Certainly, as proposed by the Commission, the increase in military spending should not be taken into account when applying numerical fiscal rules. However, from the point of view of macroeconomic balance, they may require an increase in taxation.

For the green transition, taxation and regulation must ensure that green investments are profitable while brown investments are discouraged; the carbon tax should be set at a high level and its increase should be announced and guaranteed. The carbon tax and the Carbon Border Adjustment Mechanism (CBAM) will ultimately be paid by consumers in each MS; so, each MS must be able to manage these revenues in order to introduce compensatory measures for the poorest households and to finance their investments (housing renovation, electric vehicles).

Part of public investment, especially in the green transition, could be financed by public borrowing. According to the 'golden rule of public finances', the structural public balance (corrected for debt depreciation due to inflation) should be equal to net public investment (including subsidies to private investment). Ultimately, however, the desirable path for the public deficit (and hence for the debt level) should be determined by macroeconomic considerations: it should be compatible with a broadly interpreted inflation target and an interest rate target close to nominal GDP growth. An increase in private savings should allow for an increase in the public deficit. Moreover, at full employment, an increase in public investment requires an increase in taxation in order to avoid a rise in inflation or interest rates. It is, therefore, not possible to determine in advance what part of public investment will be financed by public borrowing.

National fiscal policies should be coordinated within the European institutions, but these institutions cannot impose arbitrary numerical rules. A country should be encouraged to change its policy only if this policy is harmful to other Member States (by being too restrictive or by generating excessive competitiveness gains or excessive external surplus). Public deficits should be cut only in times of excessive demand, and this should be accompanied by lower interest rates.

Taxation may need to be increased, which would require a strong political will. On the households' side, this could mean introducing a tax on the highest wealth levels, effectively taxing financial capital gains and increasing inheritance taxes (e.g., to help young people from working class families); on the companies' side, taxing all profits at a minimum rate of 25% (or even 33.3%), combating tax optimisation, taxing financial transactions and, finally, taxing CO₂ and polluting activities to finance the green transition.

The European Treaties clearly state that direct taxation remains the exclusive competence of the Member States. However, tax harmonisation is necessary to prevent tax evasion. The EU should prevent some Member States to be tax and regulatory havens. It should also put an end to tax competition on the wealthiest and multinational companies. European authorities can only make recommendations in these areas, but they should do this wisely and forcefully. This is essential to prevent the fiscal rules' objective of cutting public deficits and debts from undermining the European social model.

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