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1 Introduction

the MTFSPs and the EU excessive de cit procedure (EDP) requirements, divergence between the plans' underlying macroeconomic assumptions and the Commission's prior guidance, and the extent to which the plans preserve or enhance public investment. We conclude by highlighting some risk factors that could a ect the implementation of some approved plans and o ering proposals to improve the functioning of the new framework.

2 The Commission's o erall assessment

Of the 22 submitted plans, the two not approved at time of writing by the EU institutions are Hungary's initial plan and the Dutch plan. Hungary's initial plan was based on overly optimistic assumptions (see section 4), leading it to be revised substantially. e Netherlands has

approach ensured consistency across these processes, and the EDP prescriptions were the same as the adjustment paths required from the MTFSPs based on the debt sustainability analysis and the safeguards. e assessments of euro-area countries' draft budgetary plans for 2025 were also integrated into the evaluation.

3 Di erences in scal adjustment plans

e new scal framework relies on a single annual operational scal target: the growth rate of net expenditures[5]. is is the only indicator that matters for compliance.

However, each country's net expenditure-growth trajectory is derived using an interim variable, the structural primary balance (SPB) expressed as a share of GDP[6]. e SPB has a clear economic interpretation: an increase indicates scal consolidation, while a decrease signals scal expansion. It is also conveniently used as the target variable in the Commission's DSA calculations. While conceptually useful for *ex-ante* planning, SPB estimation based on historical data is subject to signi cant uncertainties, making it less reliable for annual operational scal target (Darvas, 2019).

In contrast, net expenditure growth is a more practical indicator for annual planning. It

Figure 1: Comparison of fiscal adjustment requirements, European Commission reference guidance and the MTFSPs

Source: Bruegel based on https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/national-medium-term-fiscal-structur-

have smaller gaps[8]. e revised Hungarian plan raised the SPB target slightly above the reference trajectory's value.

To interpret the di erences in adjustment compliance in terms of net-expenditure growth and SPB adjustment, it is useful to recall the formula used by the European Commission (2024a) to translate an SPB target into a net expenditure growth target:

Nominal net primary expenditure growth = (yearly) potential GDP growth + in ation (as measured by the GDP de ator) – required change in the SPB / primary expenditure-to-GDP ratio.

us, by assuming higher growth or in ation than what is included in the reference trajectory, a country can achieve the same expenditure growth with a lower scal adjustment in terms of the SPB. is outcome is intuitive: faster economic growth improves public-debt sustainability by increasing GDP and tax revenues, while simultaneously lowering the debt-to-GDP ratio due to a higher denominator. ese e ects reduce the scal adjustment required to bring down elevated debt levels.

Before analysing macroeconomic assumptions, we con rmed that the Commission, along with several countries, adhered to the formula noted above. However, there are notable exceptions.

Among the 22 countries that have submitted their MTFSPs, Croatia, Cyprus, Greece, Hungary, Ireland, the Netherlands and Slovakia included a lower net-expenditure path throughout the adjustment period than what the formula prescribes. France, Italy and Poland deviate from the prescribed path in 2025 but broadly align with it in subsequent years[9]. Denmark included a higher net expenditure path than what the formula prescribes.

ere could be two reasons for net-expenditure growth being lower than permitted by the formula. First, it may re ect prudent planning if it is based on the assumption of an elasticity of revenue to GDP of less than one – meaning that a one percent increase in GDP is expected to result in less than a one percent increase in revenues. However, among the countries listed in the previous paragraph, only Cyprus, Greece and Italy adopted a lower elasticity. Second, it could indicate a greater scal adjustment, as the share of net expenditure in nominal GDP is projected to decline gradually, thereby increasing the primary balance. However, none of the countries with a lower expenditure path than that required by the formula planned a higher end-of-adjustment-period SPB than what is included in the reference trajectory (Figure 1, panel B). us, the second possible explanation cannot explain the discrepancy, which therefore remains a puzzle for a number of countries.

4 Di erences in macroeconomic assumptions

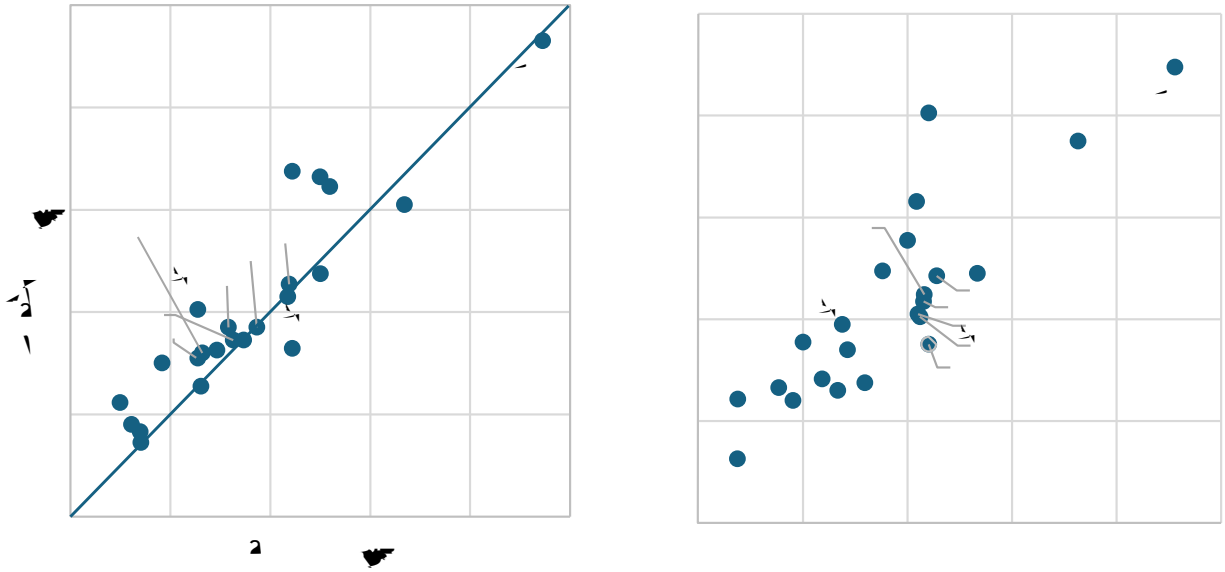
Most countries deviated from the underlying assumptions of the prior guidance. is suggests signi cant disagreements among countries over the common methodologies for macroeconomic projections. Only Malta applied the same assumptions as the Commission for all eleven indicators summarised in Table 1.

For the other countries, in some cases, the Commission assessed that deviations were well

8 ere is also a 1.1 percent gap for Cyprus. However, the Commission's reference trajectory did not require Cyprus to implement a scal adjustment; instead, it would have permitted Cyprus to pursue an expansionary scal policy while still meeting all requirements. Despite this, the Commission chose not to indicate scal expansion in the

justi ed (number 2 with light blue colour in Table 1), while in some other cases, the Commission assessed that these deviations were largely irrelevant from the perspective of scal adjustment (number 3 with grey colour in Table 1). Some of the justi ed deviations resulted from updated data, since the Commission encouraged countries to base their plans on most

Figure 2: Comparison of the main DSA input variable assumptions in the European Commission's reference guidance and the MTFSPs



Source: Bruegel based on

4.2 In ation

e in ation assumptions in nine plans align closely with the reference trajectory assumptions. However, some countries deviate from these benchmarks: Poland and Slovenia assumed higher in ation, while France and Hungary projected lower in ation than the reference values.

In some cases, the impacts of deviations on the DSA counterbalance each other. For instance, France projects higher growth but lower in ation, resulting in a nominal GDP growth trajectory similar to the reference path.

4.3 Interest rate

Similarly, interest rate projections in most plans are broadly consistent with the reference trajectory assumptions, with notable exceptions. Hungary's initial plan was also overly optimistic in this regard, as it anticipated a signi cantly lower interest rate, 1.3 percentage points below the reference trajectory on average from 2025 to 2028, but the revised plan narrowed the gap to 0.4 percentage points. Poland and Romania also projected lower interest rates, by approximately 0.4 percentage points.

4.4 Stock- o adjustment

ere are also signi cant deviations in the stock- ow adjustment (SFA) assumptions compared to the reference path. e Commission assumed relatively small SFAs up to two years ahead for 24 countries, yet for three speci c cases, Finland, Greece and Luxembourg, the reference guidance included SFA projections for two decades ahead.

Twelve countries projected higher values than the Commission's reference trajectory – some signi cantly so – while six countries adopted the Commission's value, and four countries assumed somewhat lower values. Finland and Hungary's initial plans projected SFAs approximately 2 percentage points of GDP lower, and Slovenia assumed an SFA 0.8 percentage points of GDP lower, which enhances the debt sustainability projections for all three countries. For Finland, reducing the SFA from 20 percent of GDP to 18 percent appears less signi cant, given that Finland planned by far the highest SFA adjustment among all countries (Figure 2, panel E). In Hungary's initial plan, however, lowering the SFA from zero to minus two percent may have been seen as another overly optimistic assumption, which was later revised upwards in the updated plan.

In contrast, six reference trajectory countries (Cyprus, Italy, Poland, Portugal, Romania and Spain) and six other countries (Czechia, Denmark, Ireland, Luxembourg, the Netherlands

Figure 3: MTFSP projections for nationally financed public investment as a share of GDP, 2024 and 2028

5.2 Countries planning greater fiscal adjustment also plan to reduce public investment more

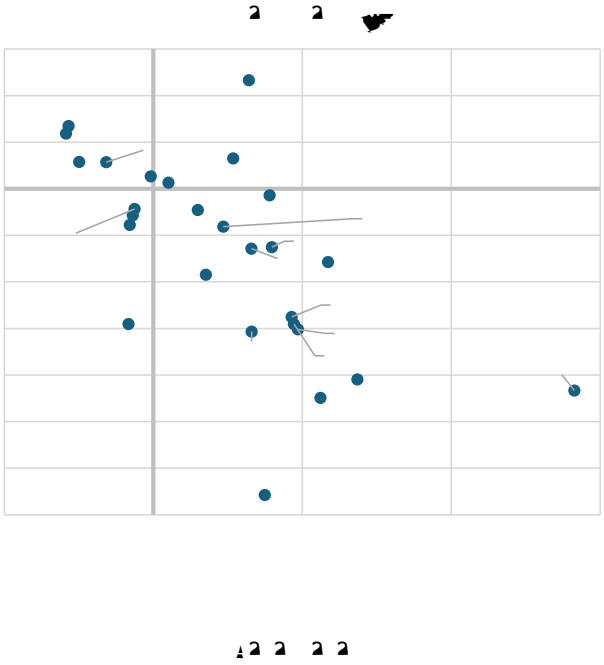
In the aftermath of the 2008 global financial crisis and the euro crisis of the early 2010s, EU countries that implemented larger fiscal adjustments tended to cut public investment more significantly (Figure 4, panel A). A similar pattern is evident in the MTFSPs: countries planning greater fiscal adjustment also plan to reduce public investment more (Figure 4, panel B).

There are three notable exceptions to this trend: Estonia, Hungary's initial plan and France. Estonia had the highest nationally financed public investment rate in 2024, at 6.2 percent of GDP (Figure 3), which may explain a reduction in its investment rate despite the expected fiscal expansion. Hungary's initial plan, meanwhile, did not include significant fiscal adjustment (in terms of the SPB) and this plan was based on overly optimistic assumptions. The revised plan does include fiscal consolidation amounting to 2.2 percent of GDP from 2024 to 2028, and the underlying macro assumptions were modified to approximate the reference trajectory assumptions, making the initial plan's association irrelevant. Unfortunately, the revised plan does not provide indications of changes in public investment, preventing us from incorporating its data. France is also an outlier, as the country intends to implement one of the largest fiscal consolidations and some increase in the public investment rate.

Cross-country regressions suggest that the intentions embodied in the MTFSPs represent an improvement compared to actual outcomes following the global and euro-area crises, with smaller cuts to public investment now than in the past for a given fiscal consolidation effort. During the earlier episode, a one percentage point increase in the SPB was associated with a 0.18 percentage point decline in the public-investment rate (based on data from 27 EU countries). In contrast, according to the current plans, the projected decline over the next four years is about one-third lower at 0.13 percentage points of GDP after a one percentage point increase in the SPB (based on data from 17 EU countries including France but excluding Estonia and Hungary).

Monitoring actual public-investment developments in the coming years, in light of the intentions expressed in the plans, will be essential to assess whether the risk of public investment cuts during fiscal consolidation episodes – highlighted by Darvas and Wolff (2023) and Darvas *et al* (2024b) – has been mitigated under the new fiscal framework.

Figure 4: Fiscal adjustment is still related to the change in public in estment



Source: Bruegel based on the MTFSPs. Note: the vertical axis in panel A represents the change in total public investment from 2008 to 2013, whereas in panel B it is the nationally financed public investment from 2024 to 2028, expressed as percent of GDP in both cases. The horizontal axis represents the change in the structural primary balance (% of GDP) from 2008 to 2013 in panel A, and from 2024 to 2028 in panel B. For Hungary, there was no indication whether the revised plan also changed the public investment outlook, so we only show the initial plan for this country in panel B.

5.3 Public in estment outlook

Taken together, for the 19 countries[16] that reported investment plans up to 2028 in their MTFSPs, nationally nanced public investment is intended to rise slightly from 3.61 percent of GDP in 2024 to 3.77 percent in 2028.

Forecasts made by the European Commission in November 2024 and the Organisation for Economic Co-operation and Development in December 2024 – for the period up to 2026 – also predict only a minor increase in public investment rates (Table 3). Similarly,

16 ese 19 countries account for 59 percent of EU GDP.

small changes are projected for private investment, with the Commission expecting a slight increase and the OECD forecasting a slight decline over the same period.

Overall, it is good news that at the aggregate EU level, public investment is not expected to be cut in the coming years. However, the modest increases planned in the MTFSPs and forecasted by the European Commission and OECD suggest that public investment will not play a signi cant role in closing the EU's investment gaps.

Table 3: In estment forecasts for the EU (% GDP)

A) November 2024 European Commission forecast for 27 EU countries

	2023	2024	2025	2026
Public	3.53	3.66	3.76	3.77
Private	18.51	17.66	17.62	17.77
Total	22.05	21.32	21.38	21.54

B) December 2024 OECD forecast for 24 EU countries

	2023	2024	2025	2026
Public	3.53	3.68	3.77	3.86
Private	18.55	17.64	17.47	17.53
Total	22.08	21.32	21.25	21.39

Source: European Commission (2024b) and OECD (2024). Note: investment is defined as gross fixed capital formation. The OECD does not provide forecasts for Bulgaria, Cyprus and Malta.

6 Appraisal

Several features of the MTFSPs and the Commission's evaluation suggest that the new scal framework has had a promising start:

e net expenditure paths in the MTFSPs are closely aligned with the prescriptions of the reference trajectories, indicating that countries plan to implement the necessary scal adjustments.

e MTFSPs and the de cit-based excessive de cit procedures (EDPs) were evaluated jointly and consistently, ensuring that the de cit-based EDP does not become a loophole that allows lower scal adjustment than what the DSA requires for the MTFSPs (see section 2; Pench, 2024).

e evaluation process successfully identi ed two plans that were largely non-compliant with the regulation: the Netherlands, which projected an increojturltojathseiesork has h

foresee lower interest rates. Since the implementation of scal strategies will depend solely on compliance with the approved net-expenditure paths, one could argue that deviations in the underlying assumptions are less critical, because the net-expenditure path calculated by the Commission is already aligned with the required scal adjustments based on the commonly agreed methodology for deriving these assumptions. For instance, even if a country adopts an overly optimistic growth outlook, it may not pose a problem if those optimistic projections do not materialise, as the reference trajectory and thus the approved net-expenditure path was grounded in more realistic growth assumptions and will deliver the required scal adjustment. However, if a country plans for higher growth but growth turns out to be lower, then budget revenues will also be lower, leaving fewer scal resources for public spending relative to the plan. Such a situation might lead to political tensions and may necessitate mid-course corrections that bring political and economic challenges.

e discrepancies in the underlying assumptions have broader implications for the e ective functioning of the new scal framework.

First, these deviations suggest signi cant disagreements between countries and the Commission on the common methodologies for macroeconomic projections. Since macroeconomic projections are central to the scal framework, particularly the DSA, such disagreements could undermine the framework's credibility and hinder its smooth implementation at a later stage when the adequacy of the Commission's forecasts and national forecasts can be compared. To address this, it is essential to revise and improve the methodology, fostering a stronger consensus among all stakeholders.

Second, the frequent positive deviations of growth assumptions from the trajectory based on the common methodology might re ect countries' expectations that their planned reforms and investments will boost growth – yet unfortunately, the plans are not always clear on which reforms are taken into account in their projections and which ones are not. Currently, planned reforms and investment matter only for assessing whether the adjustment period can be extended from four to seven years, but these planned measures do not in uence the growth path in the reference trajectory. As highlighted by Darvas *et al* (2024a), this is a sub-optimal practice and the EU currently lacks a single methodology to quantify the growth impact of planned reforms. In the absence of a single methodology, countries often rely on their own methodologies or make various assumptions without supporting calculations. Developing a common methodology for assessing the growth impact of reforms is crucial for ensuring consistency and comparability across EU countries.

ird, stock- ow adjustments (SFAs) to the public debt stock often receive insu cient attention, despite their signi cant implications for public-debt development. In the Commission's reference trajectory projections, relatively small SFAs are included for 24 EU countries, and these are projected only one or two years ahead, with Finland, Luxembourg and Greece being the only countries with projections extending for two decades[17]. However, the cumulative impact of 1998-2024 SFAs on the debt ratio was positive for almost all EU countries and raised the debt ratio by at least ten percent of GDP for 16 countries (see the annex). Moreover, several MTFSPs included (. I)9 -6.9 (iet)1 (en As on the t1 (e)a)1 (ommis)TJ39.-4 (es)222s rea1 (in)4 (ptions w

and the scal framework are robust, credible and widely accepted. Such enhancements will strengthen the framework's e ectiveness in guiding scal policy across the EU.

Finally, the EU faces major investment gaps, which should primarily be addressed through private investment, but public investment must also play a role. One of the main objectives of the scal framework is to incentivise public investment. However, past scal consolidation episodes have often led to cuts in public investment, and according to the MTFSPs more than a third of EU countries plan to reduce nationally nanced public investment over the next four years. Greater planned scal adjustments tend to be associated with deeper cuts to public investment. Among the 19 countries that disclosed investment plans, public investment as a share of GDP is projected to rise by less than 0.2 percentage points from 2024 to 2028. is modest planned increase, combined with the minor growth in public investment forecasted by the European Commission and the OECD, suggests that public investment is not expected to play a signi cant role in closing the EU's substantial investment gaps, and investment might fall after the expiry in 2026 of NextGenerationEU, the EU's post-pandemic initiative that has provided signi cant economic recovery funding.

Identifying alternative approaches to boost public investment, such as creating an EU fund nanced through borrowing as a successor to NextGenerationEU, is essential to addressing the signi cant investment gaps facing the EU.

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Figure 5: A erage annual SFA alues in 1998-2024 (percent of GDP)

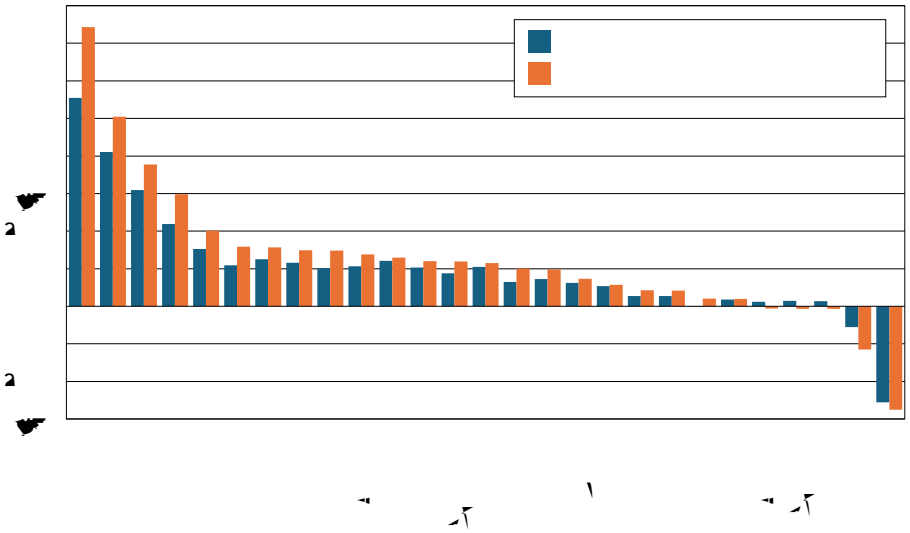
Source: Bruegel based on the November 2024 AMECO dataset. Note: the 2024 values correspond to Commission forecasts.

To quantify the impact of the 1998–2024 SFAs on 2024 debt levels, we decompose the change in debt from end-1997 to end-2024 using equation (2):

(3)

where all variables are expressed in current price local currency units. To express this as a

Figure 6: The impact of 1998-2024 SFAs on the 2024 debt le el (percent of 2024 GDP)



Source: Bruegel based on the November 2024 AMECO dataset.

For Finland, the two estimates set a range from 55 percent to 74 percent of GDP. Given that Finland's debt ratio is projected to be 83 percent of GDP in 2024, the majority of this is attributable to SFAs.

At the opposite end of the spectrum, Greece experienced a signi cantly negative SFA impact, primarily because of the restructuring of Greek public debt in 2012 and further downward debt adjustments from 2013 to 2015. Excluding the Greek SFAs for the years 2012-2015, the SFAs from the remaining years would have increased Greece's 2024 debt ratio by 18 percent of GDP.

is leaves Slovakia as the only country with a cumulatively negative SFA over the 1998-2024 period. While a few countries exhibit a cumulative SFA impact close to zero, there are 16 EU countries for which SFAs during 1998-2024 raised their debt ratios by 10 percent of GDP or more, underlying that SFAs tend to increase the debt ratios of EU countries.