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*The new stability and growth pact and its implications for Italy,
France and Germany*

ABSTRACT: This article deals with the Stability and Growth Pact (SGP), an international agreement which came into force first in 1997, aiming to ensure fiscal discipline and sustainable long-term growth. The fundamental purpose of the Pact is therefore to combine “Stability” and “Growth” in the EU and, in particular, the Eurozone. The research aims to answer a fundamental question: whether the Pact has succeeded in ensuring the achievement of the ambitious objectives imposed. The focus will be on three Member States: Italy, France and Germany. The first part of the article discusses the birth and the first two reforms of the Pact, analyzing the advantages and critical issues of the original version and the first reform. This part will help arguing that, although it may seem sufficiently articulated and adequate to ensure fiscal discipline and sustainable growth, the Pact presents various critical issues, and its provisions have not been sufficient to achieve the ambitious objectives

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entrusted to it. The second part aims to analyze the unsatisfactory adaptation of the States to the Pact at a general level and, consequently, to explain the reasons for the general lack of fiscal discipline within the EU and the Eurozone, with main focus on Italy, France and Germany. This part will also discuss the German Debt Brake Rule and its weaknesses. In addition, the article presents the critical issues of the second reform, the 2022 reform proposal and the new EU SGP from 2024, and the suggestions put forward by various economists regarding aspects that the Pact should consider more to achieve the objectives imposed on it in the future. This research concludes that the Pact needs further revision and intends to provide possible alternative ideas to ensure a future of stability and growth in the Eurozone.

KEYWORDS: Stability and Growth Pact; finance policies; German debt brake; sovereign debt crisis

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1. Introduction

The Stability and Growth Pact (from now on SGP) is discussed widely in the literature. The birth of the euro was the outcome of an extraordinary

undertaking from a political, regulatory, economic, and, last but not least, logistical point of view. But it was also the beginning of a laborious legal process of convergence of the budgetary and public finance policies of the States, which led to the enactment of the SGP.

The approach of this article entails a certain degree of skepticism. Given the dramatically high level of debt in some countries in the eurozone, the author does not rule out another sovereign debt crisis - and this time not in smaller countries, crisis which does not necessarily have to lead to a bailout. The pandemic and the war in Ukraine led to the suspension of European fiscal rules from 2020 to 2023. Governments therefore had enough leeway and time to finance everything that had not necessarily been a priority, which resulted in the explosion of the sovereign debt of the EU member states. In 2021 and 2022, the European central banks bought up all new issues of the member states on the secondary market in terms of volume, thereby keeping the interest burden for the governments artificially low. The Eurosystem,¹ recorded losses of 56.6 billion euros in 2023. Of this, Bundesbank alone accounted for 21.6 billion euros, Banque de France 12 billion and Banca d'Italia 7 billion euros. The game changer of “whatever it takes” in the European sovereign debt crisis and the subsequent bond purchases, celebrated by politicians and on the financial markets, were heroic, but above all highly risky and ultimately very expensive. Politically, the losses that have already occurred and those that are still to be expected have not yet been dealt with. This game changer and the subsequent purchase programs have had a major impact on the Member States to postpone necessary structural reforms and favored lax fiscal policies.

¹ The ECB and the national central banks of the euro area.

The problem of public debt and the role of fiscal rules are just as relevant today – perhaps even more so – than they were 20 years ago, but also just as controversial as before. This is demonstrated by the ongoing discussion about problematic developments in Italy and France, about the Stability and Growth Pact and the question about the German debt brake.

The crucial difference to the discussion 20 years ago is the completely changed macroeconomic environment. The International Monetary Fund (IMF, 2024) warned about the escalation of public debt, including in the USA, which could lead to higher interest rates and become a burden or even a threat to the entire global economy. It also warned against further increasing budget deficits and high levels of debt in an environment of predicted lower economic growth. It can be assumed that medium-term global growth expectations will continue to fall. There are several reasons for this:

- weak productivity growth,
- demographic changes,
- the weak propensity to invest,
- only a slight expansion of world trade and
- higher interest rates.

Indeed, interest rates will remain higher in the medium term. The phase of extremely cheap financing of government debt and market-distorting low interest rates due to central bank interventions is likely to be over for the foreseeable future.

The high level of public debt is not just a European problem, but a global phenomenon. The IMF expects an average debt level of 120 percent of economic output for the so-called advanced economies in 2028, and 80 percent in the emerging countries. (IMF, 2024)

Since the 1990s, there has been a clear upward trend in public debt. For 2028, similarly high levels of debt are forecast in Italy at 140 percent of economic output. In France, the figure is between 100 and over 110 percent. Germany is the outlier in opposite direction, as the debt ratio in Germany will be around 60 percent.

After the European sovereign debt crisis, there have been no serious problems in the advanced economies in financing the sharp rise in debt levels. However, the market assessment can change suddenly in individual cases if access to the capital markets is denied overnight, a so-called “sudden stop” occurs because doubts arise about the ability of countries to service their debts, i.e. debt sustainability is no longer assured.

The situation is particularly critical in France and Italy. Interest payments are increasingly becoming a burden there. In the euro area, interest expenditure averages 2% of GDP, in Italy it is 4 %, and rising.

Interest rates were low for a long time. Real interest rates were below the GDP growth rate and - as already mentioned - central banks bought government bonds on a huge scale. This reduced the pressure on governments to pursue sound budgetary policies. It is therefore urgent that most countries not only think about the state of public finances, but also take action. The IMF recommends and expects that highly indebted countries bring their deficits and debts under control in order to be prepared for new shocks. However, the political willingness to raise taxes or to slow or even reduce spending in certain areas is unlikely to be particularly strong due to the weak growth.

The subject of this research work is the theme of the evolution of European economic governance from its origins to the most recent developments, due to the rampant Covid-19 pandemic that has called into question the previous legal framework of economic governance focused,

as already known, within rigid numerical constraints that have harnessed the action of Governments (and Parliaments) in a dense network of severe numerical parameters. Herein, the reference is to the reform of the Stability and Growth Pact (SGP). From this perspective, it seems necessary, at least in the first part of the research work, to focus on the analysis of the foundations within which the structure and functioning of European economic governance was based, at least until the outbreak of the pandemic, to understand the actual consequences of these reforms on the analyzed countries. To better define the relevance of the legal (and economic) debate on the future of fiscal discipline and the long-term sustainable growth in the EU, an analytical and critical study will be carried out on the relationship between the Member States and the European Union in the light of the SGP. In particular, a historical-comparative analysis will be conducted between Germany, France, and Italy aimed at outlining the needs for further revision and providing possible alternative ideas to ensure future stability and growth in the selected countries.

2. Literature review

2.1. The foundations of European budgetary governance. The first SGP

The EMU is an asymmetrical construction based on two pillars: a monetary pillar and an economic and budgetary pillar. The monetary pillar is a centralized competence, managed independently by the European Central Bank (ECB). The second pillar remains in the hands of the Member States, being supervised by the EU, in particular according to Article 126 of the Treaty on the Functioning of the European Union

(TFEU), which states that “Member States shall avoid excessive government deficits” and instructs the European Commission to “monitor the development of the budgetary situation and of the stock of government debt in the Member States to identify gross errors” (TFEU,2008). Protocol No. 12, annexed to the TFEU (European Union, 2016), specifies, among other things, the two reference values through which this budgetary discipline is applied (Gill, 1998): the consolidated gross public debt cannot exceed - or must tend towards - 60.0% of the gross domestic product (GDP) and, for its part, the public deficit² cannot exceed 3.0% of GDP. It is important to note that neither the 3 percent nor the 60 percent was a German invention during the negotiations on the Maastricht Treaty. Rather, a maximum deficit of 3 percent followed a French practice that was introduced under President Mitterrand. To counter the potentially negative consequences of this asymmetry, the Stability and Growth Pact (SGP) was adopted in 1997 (Council of the European Union, 1997), upon Germany’s request of (Dyson & Featherstone, 1999). This multilateral surveillance system, which implements Article 126 of the TFEU, aims to coordinate the budgetary policies of the EMU Member States to ensure that their public finances remain “sound” and, in this way, to prevent any financial difficulties in one state from spreading to others.

The first SGP, approved in 1997, mainly consists of the definition of the excessive deficit procedure (EDP), a preventive arm and a corrective arm (Bekker, 2021, p. 115). It aims to ensure continuity in compliance with the criteria for admission to the Monetary Union³ and to complement Article 126 of the Maastricht Treaty, which required Member States to avoid

² Article 12 of Protocol No. 12 defines the deficit public as the net financing requirement, as defined in the European System of National Accounts (ESA).

³ A deficit equal to a maximum of 3% of GDP and a debt/GDP ratio not exceeding 60%

excessive deficits, and was established mainly following Germany's initiative, given its doubts about the stability of the new currency.

Analyzing the Treaty on European Union, a national deficit is considered excessive when it exceeds 3% of GDP. Its identification is up to the Council based on a report prepared by the Commission, even if the limit is not actually exceeded, but some circumstances imply a risk of excessive deficit. However, the Pact specifies cases in which a slight excessive deficit is tolerated, such as a severe economic crisis, considered significant if it leads to a 2% drop in real GDP or a drop of at least 0.75% provided that it is particularly sudden or leads to a high loss relative to the past, or events uncontrollable by the states that have a significant impact on the fiscal budget.

The preventive arm enshrined in Regulation No 1466/97 (European Commission, 1997) is aimed at countering the distortion of the deficit of the various countries through the presentation by each state of its own MTO⁴, that is, the fiscal balance that it aims to achieve in the medium term assuming neutral economic conditions. In this regard, automatic stabilizers are essential, that is, mechanisms that make fiscal policy spontaneously countercyclical since, in the event of a recession, there is a drop in tax revenue from profits and income and an increase in various subsidies, including unemployment. This effect translates into a worsening of the deficit and the spontaneous generation of an expansionary fiscal policy. Considering this, the MTO should be lower than the maximum threshold allowed for the deficit, so that even during phases of cyclical downturn, it is not exceeded.

In 2001, the Pact required each Member State to bring a balanced fiscal budget with a maximum tolerance of a deficit equal to 0.5% to reduce the

⁴ Medium-Term budgetary Objectives

debt-to-GDP ratio as quickly as possible, to create wider scope for maneuvering the deficit in the event of an economic recession and to address the problem of population ageing. Concerning mutual surveillance, stability programs play an important role since they require each Member State to provide indications on the fiscal policy strategies, they intend to implement to reach the MTO. The Commission evaluates these programs, and the Council can request their modification if they are not sufficient to ensure the achievement of the MTO or if their economic assumptions are judged unrealistic.

The corrective arm applies when the requirements of the preventive arm are not met, and the Council considers that a Member State is at risk of an excessive deficit. The Council then adopts a series of increasingly detailed recommendations and, if these are not respected, imposes sanctions. These initially consist of a non-interest-bearing deposit that can vary from 0.2 to 0.5% of GDP depending on the difference between the state deficit and the maximum threshold allowed and other measures reported in the Treaty of the European Union, such as the obligation to publish additional information before the issuance of securities and restrictions on requesting loans from the European Investment Bank. If the excessive deficit is not eliminated within two years of the imposition of the non-interest-bearing deposit, this deposit is converted into an effective sanction.

However, when looking at the evolution of deficits from 1997 to 2004, it is clear that the new rules have not brought about significant improvements in the establishment of fiscal discipline in the Eurozone. Between 1992 and 1997, when the fiscal positioning of the States was determined by the EU entry criteria, there was an improvement in the cyclically adjusted primary surplus of 2.7%, which testifies to more restrictive fiscal policies. Between 1997 and 2004, on the contrary, the

cyclically adjusted primary surplus decreased by 2% due to the relaxation of the fiscal policies in almost all the States⁵, despite some of them having a deficit in compliance with the Pact, but very close to the maximum allowed threshold. Furthermore, Table 1 shows that it is possible to observe a general increase in deficits, demonstrating the relaxation of fiscal policies.

Table 1. Evolution of the budget balances after the introduction of the Pact (% of GDP)

	1997	1998	1999	2000	2001	2002	2003	2004
Belgium	-2.0	-0.6	-0.4	0.2	0.6	0.1	0.4	0.1
Germany	-2.7	-2.2	-1.5	1.3	-2.8	-3.7	-3.8	-3.7
Greece	-6.6	-4.3	-3.4	-4.1	-3.6	-4.1	-5.2	-6.1
Spain	-3.2	-3.0	-1.2	-0.9	-0.5	-0.3	0.3	-0.3
France	-	-2.7	-1.8	-1.4	-1.5	-3.2	-4.2	-3.7
	3.0							
Ireland	1.1	2.4	2.6	4.4	0.9	-0.4	0.2	1.3
Italy	-2.7	-2.8	-1.7	-0.6	-3.0	-2.6	-2.9	-3.0
Luxembourg	2.9	3.2	3.4	6.2	6.2	2.3	0.5	-1.1
Netherlands	-	-0.8	0.7	2.2	-0.1	-1.9	-3.2	-2.5
	11.1							
Austria	-1.8	-2.4	-2.3	-1.5	0.3	-0.2	-1.1	-1.3
Portugal	-3.6	-3.2	-2.8	-2.8	-4.4	-2.7	-2.9	-2.9
Finland	-1.3	1.6	2.2	7.1	5.2	4.3	2.5	2.1
Eurozone	-2.7	-2.3	-1.3	0.1	-1.7	-2.4	-2.8	-2.7

⁵ except for Denmark and Finland

Denmark		0.4	1.2	3.3	2.6	3.2	1.7	12	2.8
Sweden		-0.9	1.8	2.5	5.0	2.5	-0.3	0.2	1.4
United Kingdom		-2.2	0.1	1.0	3.8	0.7	-1.7	-3.4	-3.2
EU-15		-2.5	-1.7	-0.7	1.0	-1.1	-2.2	-2.8	-2.6
pm		-2.5	-1.7	-0.7	-0.3	-7.7	-2.2	-2.8	-2.6
Excluding UMTS proceeds									
Cyclical component ¹²⁾		-0.4	-0.1	0.2	0.8	0.6	0.1	-0.4	-0.3
Cyclically adjusted budget balance		-2.1	-1.6	-0.9	0.2	-7.7	-2.3	-2.4	-2.3

Source: Langenus, 2005, p.72.

Six countries failed to comply with the SGP. This resulted in major degradations of their budget balances: Portugal (in 2001, -4.4% of GDP), Germany (in 2002, -3.7% of GDP), France (in 2002, -3.2% of GDP), the Netherlands (in 2003, -3.2% of GDP), Greece (in 2003, -5.2% of GDP), and Italy (in 2004, -3.0% of GDP). The first SGP was not very strict in its implementation, which could be seen in early 2002 when, despite the Commission's recommendations, the Council refused to issue early warnings to Germany and Portugal. However, in 2003, EDPs were launched because of the breach of the 3% limit. Once again, instead of issuing "notices" according to the Commission's recommendations, the Council only drew "conclusions" both for Germany and France, which

were supposed to correct their deficits by 2005. Thus, the Council decided in its decisions of 21 January 2003 (European Commission, 2003a) and June 3, 2003 (European Commission, 2003b), not to follow the Commission's proposal and to suspend the procedure, considering the measures adopted by these two States to reduce their deficit as being satisfactory. This decision, subsequently condemned by the Court of Justice of the European Union (CJEU), led in 2005 to the first reform of the SGP, considered too strict and not taking sufficient account of economic circumstances (CJEU, 2004).

The weakness of the corrective arm was evident since the process that culminated with the imposition of sanctions was particularly long, complex, and, above all, not automatic. It depended on decisions of the Council which, historically, has made choices that are difficult to understand, ignoring recommendations of the Commission and not imposing sanctions on states with an excessive deficit or on the verge of reporting it, as in 2004 for France and Germany, a factor that undermined confidence in the transparency of the corrective arm.

Finally, a further critical issue is represented by the fact that the rules refer to annual targets and they incentivize states to undertake non-current measures that improve current deficits at the expense of future ones. This expedient clearly conflicts with the concept of fiscal discipline.

2.2. The reforms of SGP from 2005 and 2011

Due to several critical issues previously highlighted, the Pact was reformed in 2005. The 2005 reform marked the start of more methodological refinement, many detailed provisions and thus more complicated and

complex rules. The most significant change in the preventive arm concerns the definitions of MTO (Mostacci, 2020). Each country was given specific fiscal targets based on its debt-to-GDP ratio and potential growth to allow more room for maneuver during economic downturns and thus ensure the sustainability of public finances. In case a country was characterized by high potential growth and a low debt-to-GDP ratio, a deficit of 1% was tolerated, otherwise a balanced fiscal budget was required.

As regards the corrective arm, the exceptional circumstances that allowed a country with a deficit greater than 3% not to be considered in excessive deficit were extended to include any period of negative growth or long periods of positive growth, but significantly below the potential level. In addition, the “other relevant factors” useful in avoiding the procedure associated with excessive deficit were defined, even if for a limited threshold and for a limited period. To this end, variables such as potential growth, debt sustainability, the level of public investment, the quality of public finances and the fiscal effort made by the State in a period of favorable economic conditions were highlighted.

Furthermore, three novelties can be found in the transition to MTO. The first concerns the request to the States that do not satisfy the MTO of an average annual decrease in the deficit to a 0.5% GDP ratio. Generally, a more accentuated decrease was required in the periods in which the output gap was positive even if this obligation was not absolute since the states could justify actions that deviate from it in the stability programs. The second concerns the tolerance of deviations towards the MTO or in the adjustment path, guaranteed in the presence of structural reforms with a positive and verifiable impact on the sustainability of public finances and provided that the deficit does not exceed the maximum threshold allowed

by the Pact. Finally, the third one explicitly states that both the MTO and the speed of adjustment were measured without considering the influence of the business cycle and temporary measures.

It is also useful to mention suggestions from the Council that facilitate the improvement of the implementation of the Pact, such as better multilateral surveillance, greater collaboration between states, the Commission and the Council, continuity of state objectives in the event of a government change and the use of realistic macroeconomic assumptions and reliable statistics on public finances.

The reform described above, however, does not seem to have represented progress in resolving some previously existing critical issues. It can be noted that more detailed provisions have made the corrective arm more complex, granting further room for interpretation to the Council and providing legal alibis to prevent an automatic application of the rules. Excessive deficits were rarely effectively countered with concrete measures, and the implementation times of corrective measures were longer. Furthermore, the consideration of initial levels of debt and growth raised doubts about the fair treatment between Member States and the absence of precise rules in the transition to the MTO, given countries the possibility to justify any deviations in the stability program, made this aspect probably more lacking compared to the original version of the Pact. Finally, the measures suggested for better governance were abstractly useful but insufficiently practical to solve the problems posed by the original version of the Pact.

These critical issues and, above all, the sovereign debt crisis made a new reform necessary, implemented through two new agreements:(1) “Six Pack”, which entered into force on 23 November 2011, a comprehensive package of six measures of secondary legislation of the European Union,

and (2) the “Two Pack” in 2013, and a new treaty, the Fiscal Compact Treaty. Their aim was to give the Pact greater effectiveness (Menguy, 2024). Specifically, concerning the “Six Pack”, these are Regulations no. 1173/2011 (European Union, 2011a) and 1174/2011 (European Union, 2011b), the first on the implementation of budgetary surveillance and the second on measures for the correction of macroeconomic imbalances, which find their legitimacy in Article 136 TFEU and therefore apply only to the countries of the EURO area; Regulations 1175/2011 (European Union, 2011c), 1176/2011 (European Union, 2011d), and 1177/2011 (European Union, 2011e). These base their legitimacy on Article 121 and 126 TFEU and apply to all countries and regulate the surveillance of the 1997 budgetary policies as amended in 2005, the excessive deficit procedures, and the effective implementation of budgetary surveillance in the Member States. Also, a Directive is foreseen, No. 85/2011 (European Union, 2011f), concerning the requirements for budgetary frameworks of the Member States.

The Six Pack also introduced the European Semester⁶, a cycle of economic policy coordination at the EU level, applying the preventive and corrective arm that established common minimum rules for national budgetary frameworks (Capati & Christiansen, 2024), to make them more comparable with each other and facilitate understanding and the underlying dialogue between European and national institutions (Massart, 2022). The “Two Pack” has instead strengthened the Commission's supervisory role through Regulation (EU) No 472/2013 (European

⁶The European Semester begins in November with a preparatory phase: the European Commission publishes its Annual Growth Survey, which contains the socio-economic actions it considers to be priorities for the coming year, as well as its Alert Mechanism Report, which aims to take stock of the macroeconomic situation in the Member States with regards to EDP.

Union, 2013a) and 473/2013 (European Union, 2013b). In addition to it, another international treaty came into force, the so-called Fiscal Compact (Treaty on Stability, Coordination and Governance), the main novelty of which was the request to include the objective of a balanced budget in national legislation (Markakis, 2020).

The main innovations introduced by the latter concern the definition of economic priorities by the Commission through the “Annual Growth Programme”, specific deadlines for the assessment of stability programmes and the submission by each state of national reform programmes setting out the political priorities for growth and employment on which the Commission issued recommendations considered by the Member States when preparing the national budgets.

As for the corrective arm, this package extended its application also based on the debt criterion since the states exceeding the maximum threshold allowed were required to reduce their debt by an average of 5% per year compared to the excess between the registered debt and the maximum threshold allowed. Furthermore, it had the merit of formally reducing the power of the Council, since the Commission's proposals were then adopted by the Council through reverse qualified majority voting, according to which such proposals had to be implemented unless most votes weighted considering the size of the states, voted against them. This measure appears to be an effective response to situations such as the failure to implement the excessive deficit procedure against France and Germany in 2004, also because it does not consider the votes of the countries directly involved.

It then established a maximum annual increase in public spending depending on the MTO of each State and it introduced the procedure for macroeconomic imbalances to identify and eliminate macroeconomic

imbalances harmful to the states and the EU. Its core was the Alert Mechanism Report through which, based on various macroeconomic indicators (such as the evolution of labor costs and unemployment), the Commission identified states in potential difficulty and the Council imposed, after various recommendations, sanctions equal to a maximum of 1% of GDP according to the reversed qualified majority principle.

The Two Packages were integrated into the European Semester because the latter provided that each state presented its own budget project, which was then assessed by the Commission, which could request its reformulation in case of conflict with the provisions of the Pact. This agreement also contained two proposals meant to counter the externalities caused by fiscal policies in a monetary union.

The first aimed to strengthen the budgetary surveillance of countries receiving financial assistance, including on a precautionary basis, or affected by significant financial instability, by giving the Commission the right to propose to the Council that these countries request further macroeconomic adjustment programmes. The second required the States under the corrective arm to provide additional information to the Commission on the measures taken to correct the excessive deficit, depending on the stage of their excessive deficit procedure. This measure aimed to encourage collaboration between countries and the Commission so that the latter would be more aware of the specific risks that increase the deficits of each State. In fact, it was given the right to issue recommendations directly to these countries so that they could implement measures useful for avoiding financial sanctions, giving greater importance to the preventive role of the EU (European Commission, 2013).

As for the Fiscal Compact, it required each country to adopt the German debt brake rule to make fiscal discipline a national obligation at the

expense of the pursuit of conflicting domestic interests and the tendency of states to consider the Commission as an obstacle to national sovereignty.

In addition, it required each Member State to submit its budget law to the scrutiny of an independent fiscal council established by it to reveal any unreasonable assumptions. It also promoted the creation of the “European Fiscal Advisory Board,” capable of consulting with the independent fiscal councils to monitor fiscal developments in the Member States (Baldwin & Wyplosz, 2019).

The sequence of reforms has not had the expected effect. The short-term changes have rather led to political uncertainty. This was exacerbated by almost annual changes in the interpretation of the rules, although the regulations themselves remained unchanged in terms of content. This applies, for example, to the years 2013-2019. From 2020, the rules were suspended due to the pandemic. There were additional and methodological changes, special regulations, exceptions and repeated targeted relaxations to address the political sensitivities of some countries. This approach counteracted the reform intentions of 2011 and 2013⁷.

It is clear that the multiple reforms have not resulted in greater clarity or stringency. Not every reform represents an improvement. Compared to the original concept, the rules have become increasingly complicated, complex and opaque. There is then no need to be surprised at the

⁷Example: In 2015, the rules were further refined by measuring the structural adjustments needed to achieve the MTO in terms of the output gap and the debt level. It also allowed for lower adjustment requirements in return for structural reforms and additional public investment.

Example: For 2018, the Commission introduced a so-called “margin of discretion” by further reducing the requirements for structural adjustments. This approach was further strengthened in 2019.

complete ineffectiveness and the further increase in debt. It is difficult even for experts to understand the rules in every detail (Kamps & Leiner-Killinger, 2019). A sign of the complexity is a Vade Mecum of over 95 pages with methodological explanations and procedural steps. (European Commission, 2019a) This applies to the past and it applies in particular to the current changes to the Stability Pact, as they have now been finally adopted by the European Parliament and entered into force in 2024.

2.3. Precautions on compliance with the Pact in Germany. The Debt Brake Rule

Between 2011 and 2023, Germany significantly increased its compliance score to 0.75, which was higher than the 0.55 it had recorded during the entire Pact period. This improvement is mainly the result of implementing a fiscal policy rule, the Debt Brake Rule, starting in 2011 (Grimm et al., 2024). This rule requires the fiscal budgets of the federal states and the federal government to be balanced, with the federal government alone being allowed to record a structural deficit of up to 0.35% of GDP. If this exceeds this threshold, the excess is recorded as debt in a special control balance, while structural balances below the maximum threshold are credited positively to the control balance. When the debt recorded in that case exceeds 1.5%, the federal government is required to eliminate it in a manner “appropriate to the cyclical situation”. Finally, the rule has an emergency clause that can provide for the suspension of the rule in the event of unforeseeable situations. The rule’s strengths are its simplicity, which avoids different interpretations, its focus on structural balance that accounts for automatic stabilizers, and the flexibility it gives the federal

government to adjust based on the economic situation, including waiting for more favorable circumstances if needed (Schuster et al., 2024).

However, this rule has recently shown its weaknesses in the context of the growing need to invest in green and digital transition and to support innovation. Indeed, not everyone is aware of the changed environment and is doing business as in the past or even beyond. In simple terms, it was a question of whether fiscal policy should be based on “a golden rule or an iron rule” (Feld & Reuter, 2022). The major criticality was the transfer in 2023 of 60 billion euros unused in 2021, and useful to counteract the negative effects of COVID within the Energy Supply and Climate Protection Fund, useful to finance energy transition and climate protection.

This practice was criticized by the opposition, which stressed the constitutional illegitimacy of the government to dispose of such a sum, stating that a similar maneuver could have created a dangerous precedent for the financing of future crises. This would have allowed the maximum threshold imposed on the deficit to be greatly exceeded and a large debt to be accumulated in a crisis period, using it for radically different purposes over extended periods.

In Germany, too, the debate about the debt brake has been heated since the Federal Constitutional Court’s ruling (Federal Constitutional Court, 2023) of 15 November 2023 has become more intense and controversial. Many considered the debt brake to be out of date and characterized it as investment blocker. In view of the major tasks of climate protection, green transformation, digitalization, resilience of value chains, infrastructure, and the expansion of security in the face of external threats, there was no other option than to either abolish the debt brake, reform it, or at least open it up to more state investment.

The German Constitutional Court agreed with the criticism and froze the entire amount intended to finance planned expenditure previously financed through a deficit exceeding the permitted limits. For this reason, the Debt brake rule was suspended in 2023, for the fourth year in a row, underlining its inadequacy to address the currently dominant investment needs in the green (REPowerEU) and digital transition, defense (Re-Arm Europe⁸), preventing the financing of useful investments due to stringent deficit limits. As scholars admit, “more defense spending may be necessary, but economically, it is not growth enhancing. It is more likely to increase public debt” (Priewe, 2024, p. 11), but in the “White Paper for European Defense and the ReArm Europe Plan/Readiness 2030”, the Commission “has invited Member States to activate the national escape clause of the Stability and Growth Pact, which will provide them additional budgetary space to increase their defense spending, within the EU fiscal rules.”(European Commission, 2025)According to this document, “to safeguard fiscal sustainability, the deviation will be limited to: (1) Increase in defense expenditure only, taking as a starting point the statistical category ‘defense’ in the classification of the functions of government (COFOGs); (1) Up to a maximum of 1.5% of GDP for each year of activation of the national escape clause; (3) For a period of four years.” (European Commission, 2025)

2.4. The 2022 Reform

The main problem of the 2011 reform coincided with the failure to achieve a balance between fiscal discipline and flexibility, due to the impossibility

⁸There are discussions to change the name of Re-Arm Europe to Readiness 2030

of the states subjected to the corrective arm to use the automatic stabilizers during recessions and the consequent constraint to implement pro-cyclical fiscal policies to respect the imposed limits. This criticality, although a characteristic of the Pact since its inception, was accentuated in this version due to the introduction of the debt rule and the abrupt adjustment it required regardless of the economic conditions of each state in a period in which indebtedness had increased dramatically at a general level. Furthermore, this rule was inadequate, as a decline in the debt-to-GDP ratio could result from economic expansion alone, which discouraged States from pursuing structural adjustments during growth periods. This runs counter to the core logic of the Pact, which—as previously emphasized—requires fiscal consolidation during favorable times to ensure sufficient fiscal space to address future recessions. About the Fiscal Compact, it can be noted, as already underlined earlier, that it was substantially imprecise, since it required that the German debt brake rule be considered as a model in the constitution of the states (Schmidt, 2022). However, many countries adopted complex fiscal rules not written into the constitution and tended not to conform to the principles imposed by it, also due to lower-level laws (Baldwin & Wyplosz, 2022). Furthermore, even if a more widespread compliance with the rule had been ensured, it would probably have prevented dedicating the right attention to investing in the green and digital transition, proving inadequate to the role of “golden rule”, representing instead an “iron rule”.

Due to the issues mentioned and the challenges posed by the pandemic, the Pact was suspended in 2020, and the Commission put forward a reform proposal in November 2022 (Buti & Messori, 2022) with the idea of simplifying the rules to ensure greater applicability. Regarding the preventive arm, the maximum thresholds for deficit and debt remain

unchanged. However, the European Commission now classifies Member States based on their debt risk. This assessment relies on a debt sustainability analysis, which uses the government's cumulative budget constraint. This is an accounting identity that considers revenues and expenditures over time. Its purpose is to prevent excessive deficit accumulation and ensure debt sustainability. The analysis models debt evolution over a sufficiently long-time horizon to approximate the concept of debt sustainability. However, the proposed four-year period, although representing an improvement over the annual reduction requested with the previous reform, remains excessively short and does not eliminate the already analyzed danger of counter-cyclical fiscal policies several times. Following the preparation of the plan by the Commission, the States can present a counterproposal indicating the structural reforms that they intend to implement to reduce indebtedness, requesting an extension of another three years in the adjustment programs. The approval of this counterproposal is up to the Council, after hearing the opinion of the Commission and, in the event of a negative outcome, the plan originally presented by the Commission becomes binding for the country in question.

The officially established adjustment path is based on observing a trajectory for net expenditure, an indicator developed to achieve transparency and simplicity. However, by excluding from expenditure the revenues from newly imposed taxes, interest payments on debt, and unemployment-related spending that fluctuates with the economic cycle, the approach does not mark a substantial shift from the cyclically adjusted primary balance. As a result, it does not represent real progress toward greater transparency. This is because the indicator remains difficult to measure accurately. Furthermore, the debt sustainability analysis implies

the formulation of hypotheses by the Commission on the evolution of the interest rate on the debt, GDP growth, and deficits for each state. These variables are highly unpredictable, and in fact, this translates into the attribution of the power to the Commission to establish the circumstances that guarantee the sustainability of the debt through arbitrary assumptions that are difficult to base on historical series and in the loss of sovereignty of the Member States, contrary to the declared objectives.

At the intergovernmental level, following the European Commission's legislative proposals of April 2023, an agreement within the Ecofin Council was reached on 20 December 2023 on the reform of the fiscal rules underpinning the EU SGP. On the 30th of April 2024, the new EU SGP "entered into force following an approach based on country-specific fiscal adjustments" (Cacciotti & al. 2024, p. 1), consisting of three measures: Regulation (EU) 2024/1263 repealing Council Regulation (EC) No 1466/97 (European Union, 2024a); Council Regulation No. 1467/97 on EDP (corrective arm) which was amended; Directive 2011/85/EU also amended.

The first proposal of the Commission was based on the assessment of the level of risk of national public finances, and it eliminated the general numerical safeguards that characterized the old Stability Pact, focusing the model on a bilateral dialogue between individual states and the Union. This paradigm shift was partly tempered with the reintroduction of some numerical safeguards by the Council, at the request of Germany that was skeptical towards a system based on adjustment criteria that did not rest on any quantitatively measurable element.

However, the basic idea remained that the adjustment of imbalances is based on two aspects: (1) a technical assessment conducted by the Commission, and (2) a subsequent bilateral negotiation between the

Commission and the State concerned. The final formula, therefore, tries to reconcile the presence of numerical/statistical rules with a bargaining system that represents the element of novelty (and flexibility) of the new Pact.

In detail, the quantitative criteria have been eliminated, namely the convergence of the structural balance towards the MTO and the annual reduction of 1/20 of the debt to GDP (Pench, 2024). The elimination of the MTO is of great importance since this way the budget balance no longer serves as a reference parameter for the assessment of the national financial situation. Instead, net expenditure is considered for this purpose. In essence, the new Pact goes beyond the budget balance criterion to replace it with that of primary expenditure containment, thus representing a “paradigm shift” (Hertner, 2023). This calls for a new orientation in the setting up of fiscal policy, in the budget instruments to be used, in the methods of coordination between the various institutional actors, and in the role of each of them.

The new national medium-term fiscal-structural plans (MTPs) that will replace the stability programmes and reform programmes of the Member States, will have to provide for a trajectory for the evolution of public expenditure over 4 or 5 years (the “adjustment period”), which may be extended by another 3 years, making it possible to place (or maintain), (1) the public debt below 60% of GDP⁹, and (2) the public deficit below 3.0% of GDP.

The budgetary trajectories will now be defined based on a debt sustainability analysis (DSA), which will make it possible for each Member State to determine the adjustments necessary to ensure the sustainability of public finances in the medium term (4/5 years long, extendable by

⁹ or on a downward slope

additional 3 years) and also the compliance with the objectives of the European Treaties. This tool should make it possible to strengthen the economic logic of the budgetary framework, by considering parameters with a direct impact on the sustainability of public finances, in particular growth, changes in the interest burden, and the cost of ageing.

However, at the request of the “frugal” states, safeguard clauses were introduced to ensure minimal adjustments to converge towards the targets of the treaties:

- “Ensure that debt decreases by a minimum annual average of 1 percentage point if above 90% of GDP and 0.5% if between 60% and 90%;
- Ensure that Member States reach a deficit level that provides a common resilience margin of 1.5% of GDP through a minimum annual adjustment of 0.4 percentage points of GDP, reducible to 0.25 percentage points in case the adjustment period is extended” (European Parliament, 2024).

The reduction of sanctions is intended to increase the likelihood of their actual application, and therefore their credibility. In fact, the entry into force of this new framework should have major consequences on preparing the national budgets for 2025. Member States will indeed have to submit their first national plans by 20 September 2024.

For instance, the application of the revised SGP could result, for France, in an “adjustment of the structural primary balance of 1.1% of GDP per year between 2025 and 2028”, which would imply a budgetary effort of around €30 billion/year for 4 years. If the “adjustment period would be extended to 7 years, this would amount to 0.4% of GDP per year”, which means around €12 billion per year. In addition to France, Italy would also

have to reduce its expenditure or increase its tax revenues significantly to comply with the new budgetary rules.

As already seen above, the new European budgetary rules which entered into force on 30 April 2024 will be fully applicable from 2025. The new rules of the Stability and Growth Pact establish a balanced budget framework adapted to the new economic reality, contributing both to the sustainability of public finances and to long-term growth. The rules will thus be more credible and realistic, and will integrate incentives for reforms and investments. In this respect, the National Medium-Term Fiscal-Structural Plans are intended to replace the stability programmes and national reform programmes specific to the previous framework.

The plan, presented by each Member State for the period 2025-2028, includes a budgetary trajectory aimed at bringing public debt relative to GDP onto a sustainable and plausible downward trajectory via a credible recovery of public finances over the next few years. The use of a debt sustainability analysis tool (Debt Sustainability Analysis or DSA) will make it possible to differentiate adjustment trajectories between Member States, taking into account the great heterogeneity of debt levels within the European Union, but also the different prospects in terms of growth or demography. The use of the DSA is supplemented by common safeguards which make it possible to ensure a minimum adjustment to converge towards the targets of the Treaties on debt and deficit.

The new framework provides incentives for the implementation of investments and structural reforms. These incentives are provided by the possibility of obtaining an extension of up to three additional years of the budgetary adjustment period, to bring it from four to seven years. This extension results in a smoothing over time of the requirements for budgetary consolidation when Member States make commitments to

reforms and investments contributing to the sustainability of public finances, to the improvement of potential growth or to the priorities of European objectives such as the ecological and digital transitions and the strengthening of defense capabilities. Finally, the rules applying in the event of an excessive deficit remain unchanged compared to the previous budgetary framework but are temporarily adapted to take account of the context of increase in interest rates and debt burden. An excessive deficit procedure may be opened when a Member State exceeds the target of 3% of GDP nominal deficit. The Commission must then recommend a correction path, consistent with a minimum structural adjustment of 0.5% per year as a reference, as in the rules of the previous framework. However, flexibility has been introduced for the years 2025 to 2027: the minimum adjustment reference of 0.5% per year in structural terms may be lowered to reflect the increase in the interest burden when a Member State carries out significant reforms and investments.

The timeline of the evolution of the Stability and Growth Pact over time can be seen in Figure1:

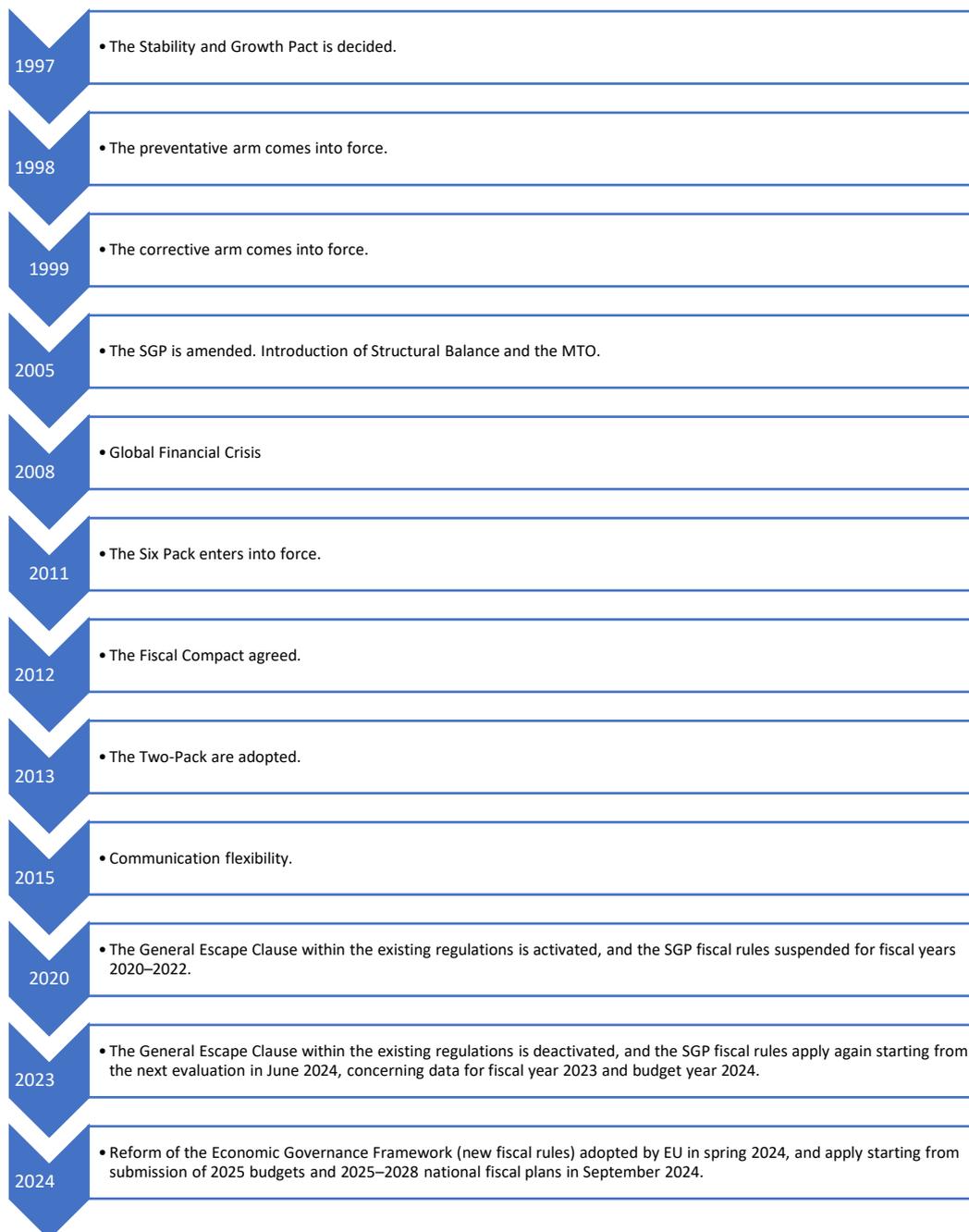


Figure 1. The timeline of the Stability and Growth Pact evolution over time

Source: the author

Summing up, the financial rigor principles introduced with the first amendment to the Pact have imposed over the years the progressive recovery of public accounts and the control of financial balance, but they immediately raised political and public opinion reactions due to their rigidity (Zeitlin & Vanhercke, 2018; Vanheuverzwijn & Crespy, 2018).

Alongside the rigor of the quantitative criteria and the strictly financial conditionalities, the positive effects of which have been underestimated, in the author's opinion, the Pact is characterized by a lack of incisiveness, both in terms of financial and economic effects.

As for the former, after the reforms of the Six and Two Pack, sanctions have never been imposed, and indeed the two times that they came closest, for France in 2015 and for Spain and Portugal in 2016, only linguistic (and political) acrobatics avoided them (Gros, 2016).

In practice, flexibility clauses were added to indicators that were immediately contested, which reduced the objective of system stability without, however, meeting with the approval of public opinion and the states that benefited from them, but - on the contrary - adding complexity and further reducing transparency, so much that already in 2015 (European Commission, 2015) the Commission provided an interpretation of the Pact to exploit greater flexibility and in 2017 (European Commission, 2015) it put forward a first proposal for amendment.

It is useful to recall in this regard how, over the years the policies subject to monitoring and recommendations have broadened their spectrum: from macroeconomic to microeconomic ones starting from 2015-2016, up to broader public policies, such as sustainable development and environmental and digital transition, starting from 2017-2018, to the point that the 2022 Semester was not only coordinated with the Recovery and

Resilience Facility, but also with the United Nations Sustainable Development Goals. In 2019, exactly one year before the WHO declared a pandemic, the same Commission that would then take charge of the design and implementation of NextGenerationEU declared that it wanted to ensure greater coherence between economic policies and the use of European Union funds, through greater coordination between the European Semester and the European Union funding (EuropeanCommission,2019).

In the authors' opinion, the most important analytical tool in the adjustment process is debt sustainability analysis. The key parameters for this are the interest rate, GDP growth and the primary surplus or deficit, which are included in econometric models, the result of which is of course dependent from the underlying assumptions, which themselves leave a great deal of room for discretion.

In addition, the new rules are to be better enforced. Risk-based monitoring is to be introduced, differentiated according to the respective budgetary situation of each member state. Following a German demand, the EU Commission wants to set up a control account to record deviations from the agreed budgetary policy path and to demand corrections, including by initiating an excessive deficit procedure. And - last but not least - the role of the Fiscal Council at European level should be strengthened.

3.Research

3.1. Reforms of the SGP in 2024. The Italian, French, and German Perspective

Italy, like France, has been facing an EU deficit procedure again since June 2024, and the same is expected for 2025. The country is not expected to have a budget deficit of less than three percent of GDP until 2026 at the earliest. Giorgia Meloni, prime minister of Italy, had initially refused to agree to the reform of the SGP, using the ratification of the amendment to the European Stability Mechanism (ESM) as a means of pressure. The head of government and her finance minister, Giancarlo Giorgetti (Lega), criticized the new regulation of the SGP as being hostile to investment and demanded, among other things, that investments in green and digital transformation be allowed to be excluded from annual new debt. Ultimately, however, Italy agreed with the SGP.

The SGP of 30 April 2024 includes the obligation to adhere to a "reference path" set by the European Commission for the medium-term structural development of government expenditure (net primary expenditure), which should, however, consider the specific circumstances of a country's debt sustainability. In clear terms, this means that a debt level of over 60 percent of GDP must be put on a declining path and the public deficit must be reduced to below three percent of GDP within four to seven years. To ensure debt sustainability (Debt Sustainability Safeguard), the projected public debt ratio must fall by one percentage point of GDP annually if it exceeds 90%, which is Italy's case. For a debt ratio between 60-90% of GDP, an average annual reduction of 0.5 percentage points is necessary. However, the threshold of 60% of GDP according to the SGP is not met by many EU Member States, either in 2023 or 2024.

In addition, there is the requirement of a deficit resilience safeguard. The aim is to create a buffer for periods of economic weakness. To achieve this, the structural deficit, i.e., the deficit adjusted for cyclical effects, should not exceed 1.5 percent of GDP. Budgetary adjustments must

therefore continue until this value is reached. The European Trade Union Confederation has calculated that the new regulations for Italy could mean annual budget savings of 25.4 billion Euros over four years or 13.5 billion Euros over seven years. At the same time, this could mean budget savings of (26,1bn) for 4 years and 14,2bn for 7 years for France. Meanwhile, in Germany's case, this could mean annual budget savings of 11 billion Euros over four years or 5,8 billion Euros over seven years. Therefore, these three countries (together with Spain) “would have to make the biggest annual cuts to meet the deficit reduction targets within four years”(European Trade Union Confederation, 2024).

Table 2. Four versus seven-year austerity plan for France, Italy, and Germany

France	26,1	14,2
Italy	25,4	13,5
Germany	11	5,8

Source: European Trade Union Confederation, 2024

The French perspective. France is characterized by a high level of public spending compared to other EU member states. France amounted to 57% of GDP in 2023, compared to 49% on average in the European Union (Eurostat, 2025a). This percentage has increased by more than €300 billion since 2019 to deal with the various crises and support households and businesses.

In 2024, the expected public deficit would be 6.1 % of GDP, after 5.5% in 2023, i.e. a deterioration of -0.6 pt of GDP (Eurostat, 2025a). This deterioration is mainly explained by a decline in the structural balance, the cyclical balance being stable compared to 2023. In the absence of measures, the structural balance would have fallen by -1 point of GDP in 2024 compared to 2023, mainly due to (i) the spontaneous dynamism of

local authority spending in both operating and investment, (ii) the evolution of old-age benefits supported by the revaluation in 2024 based on 2023 inflation and by unfavorable demographics, (iii) a spontaneous dynamism of compulsory levies lower than the activity in value (iv) an increase in the debt burden as a result of the past increase in interest rates, and (v) an increase in disbursements from the future investment program. These effects would however be mitigated by the gradual withdrawal of the exceptional measures taken to protect households and businesses from rising energy prices. This spontaneous deterioration in the structural balance was mitigated by the measure taken in February 2024 by the Government to cancel by decree €10 billion in credits from ministries, the freezes carried out during the year and the expected moderation at the end of the year of local spending following a sharp increase in the financing requirement.

In 2025, the public balance would improve significantly compared to 2024 and reach -5.0% of GDP (Eurostat, 2025a). Compared to a counterfactual situation where no measures were taken, the balance would have been around -7% of GDP: thus, the effort to redress public accounts amounts to nearly 2 points of GDP, or around €60 billion, two-thirds of which relates to expenditure. Increased efforts to reduce public spending will involve all sub-sectors of public administrations: a reinforced effort on expenditure by the State and its operators, control of expenditure by social security administrations, and various resilience and smoothing measures for local finances in a multi-annual logic. Particular attention will be paid to expenditure intended for the most vulnerable, for whom health, education and social cohesion services are essential. Similarly, spending cuts will directly involve local authorities, finding in a partnership

approach the fair share that each must play in the collective effort to control public finances.

These efforts should enable France to gradually bring the deficit below the threshold of 3% of GDP by 2029 and to exit the excessive deficit procedure opened in the summer of 2024.

In 2024, the interest burden on the sovereign debt will represent, for France, more than 50 billion euros, the second largest budget item after school education. While this amount is expected to increase sharply due to rising interest rates, as debt securities are gradually refinanced, France would experience the largest change in GDP points among European states, by more than 1% by 2030. Unsurprisingly, this particularly degraded situation is explained by the weight of a debt stock that is continually growing, marked by the accumulation of deficits, and which, without a resolute reorientation of budgetary policy, is not expected to decrease in the years to come. Adding to these elements, the uncertain institutional context opened by the dissolution of the National Assembly on June 9, 2024, which resulted in a significant increase in the credit premium demanded by investors of more than 10 basis points.

France's debt burden is expected to increase by more than one point of GDP by 2029, with a deteriorated position among European states.

The perspective of the selected countries. Since the summer of 2022, there has been a sharp rise in interest rates applied to sovereign securities, due to the gradual increase in the interest rate by the ECB, from -0.5%¹⁰ to 4.0%¹¹, resulting in an increase in the 10-year interest rates of the main states in the Eurozone, as shown in Table 3.

¹⁰ July 2022

¹¹ in September 2023

Table 3. Evolution of interest rates applied to 10-year sovereign bonds of the selected Member States of the euro area between February 2022 and February 2025 (%)

	France	Germany	Italy
February 2022	0.68	0.15	1.79
February 2025	3.15	2.41	3.58

Source: ECB, 2025.

However, this monetary tightening did not have a significant impact on sovereign rates, except for an episode of financial stress concerning Italy in the fall of 2023. In this context, France's rate compared to Germany remained stable, at around an average of 0.66 basis % between February 2022 and February 2025. However, Italy's rate compared to Germany was much higher, at around an average of 1.40 basis % between the same period.

The differentiated trajectories of interest charges in the Eurozone reflect the evolution of public debt and the structural deficit of European States and, more particularly, the deterioration of Italy's and France's public finances compared to their partners, particularly Germany.

Rising interest rates mean a dramatic change in the conditions under which governments can meet their financing needs. Figure 2 shows that among the selected countries, debt levels have been rising steadily, except for Germany. For most countries, except Greece, debt started to stabilize and decline from 2014 onwards. As shown below, debt surged in 2020 at the beginning of the pandemic. We see that debt levels relative to the GDP exceed the debt levels that led to the so-called 2010 debt crisis in Europe.

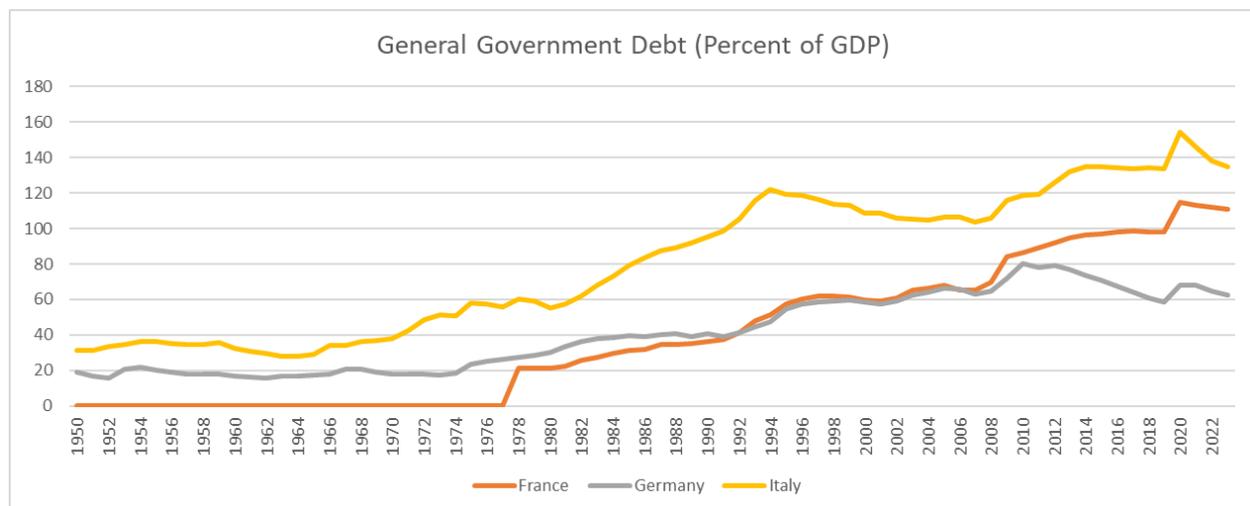


Figure 2. Dynamics of the General Government Debt in Italy, France, and Germany between 1950-2023 (% of GDP)

Source: IMF 2024.

Thus, rate hikes can become dangerous given that debt levels are now higher than during the 2008-2012 sequence. However, the interest rates on the debt that different countries have had to assume have also varied from one country to another. Referring to the period between December 2021 and December 2022, we see that rates have evolved unevenly throughout this year. The cases of Greece and Italy are worth mentioning as the highest interest rates have also undergone larger increases, around or even above 3% for the obligation at 10 years (the benchmark bond). Although there is no direct correlation between interest rate levels before 2022 and the pace of their growth, it can be observed that the return to more restrictive policies accentuates the disparity between European economies. In this vein see Table 4, below.

Table 4. Interest rate developments by analyzed countries between December 2021 and December 2022

	December 2021	December 2022	Difference
Germany	-0.38	2.09	2.47
France	0.05	2.62	2.54
Italy	1.05	4.26	3.21

Source: ECB, 2025

To get a full picture of the evolution of monetary policies, one must also consider the other side of quantitative easing policies: central bank bond purchase programmes. As for government bonds, this bond purchase policy was developed into two programmes: the Public Sector Purchase Program (PSPP) and the Pandemic Emergency Purchase Program¹² (PEPP) (ECB, 2025). These programmes enabled the purchase of public and private debt securities, thus providing liquidity to financial agents. By purchasing government bonds, it generated demand for them, thereby reducing the cost of debt for governments, while sending a signal that in the event of instability in government bonds, the ECB would eventually intervene. These programmes have been the source of much controversy, as they would have confined the ECB to the role of an ordinary central bank, whereas the ECB's particularity compared to other banks is precisely that it cannot finance the Member States directly. In this regard, it should be emphasized that the ECB has an ambivalent relationship here: in addition, it generates stability for the financial markets, it plays a creditor role towards the countries. In fact, this institution has even generated profits at the expense of the Member States (which it has in principle, invested to launch new purchasing programs).

Table 5. Distribution of purchases of the PSPP asset program

¹² It needs to be mentioned that reinvestments under this program were fully stopped at the end of 2024.

Germany	24.27%
France	19.47%
Italy	16.17%

Source: ECB, 2025

Table 6. Distribution of purchases of the PEPP asset program

Germany	23.95%
France	18.05%
Italy	17.29%

Source: ECB, 2025

Alongside interest rate hikes, asset purchase programs were reduced throughout 2022 until they were completely terminated at the end of the year. Understanding the role played by these programs for each country also provides insight into the level of exposure of these countries to financial markets in the current context of rising debt. For the data summary, we have made the same selection of countries as used above. First, we look at the distribution of purchases across selected member countries. The data reflects some correspondence between the size of economies and access to asset purchase programs. But what does this imply for the indebtedness of individual countries?

Table 7. Proportion of public debt included in the PSPP purchase program on total debt by selected countries

Germany	33.06%
France	19.95%
Italy	18.07%

Source: ECB, 2025

Table 8. Proportion of public debt included in the PEPP purchase program on total debt by selected countries

Germany	19.17%
France	10.57%
Italy	10.55%

Source: ECB, 2025

Table 9. Addition of the proportions of public debt included in the PSPP and PEPP purchase programmes to the total debt by selected countries

Germany	19.17%
France	10.57%
Italy	10.55%

Source: ECB, 2025

If we compare the weight of debt purchase programmes in the total public debt of the same selection of countries, the picture is different. First, Germany's case is striking, with 52.23% of its respective debt included in the sum of the two programmes. Although it has been the scene of multiple demonstrations of opposition to the purchase programmes because it would deviate from the ECB's initial mandate of not financing Member States, it is the country that has benefited the most from this program. We can assume that the change in asset purchase policy will affect to a greater extent countries that participate the most in both programmes, as they will no longer benefit from the ECB's effect as "buyer of last resort". This change will clearly not affect all countries in the same way and will also depend on factors such as the financial strength of each country as perceived by financial markets.

It is also necessary to make a remark regarding Italy. In addition to taking into account the participation of Italy in the debt purchase program, it is necessary to consider that this state is the largest beneficiary of the NextGenerationEU program, which is partly composed of mutualized

debt at the European level. This may imply that in the future its financing needs will be slightly cushioned by access to this mutualized financing.

In addition to this, more recently, between 2019 and 2024, recent crises have increased the divergence in terms of public debt and structural deficit between the economies of the eurozone, in particular between:

- Germany, on the one hand, with a debt of less than 80% of GDP and a structural deficit well below 3%;
- France, Belgium, and Italy, on the other hand, with public debt exceeding 100% of GDP and a structural deficit exceeding 4%.

The highest ratios of government debt to GDP at the end of the second quarter of 2024 were recorded in Greece (163.6%), Italy (137.0%), and France (112.2%), Germany recording a lower ratio (61.9%).

Table 10. Ratios of government debt to GDP 2024-Q3

Germany	62.4
France	113.8
Italy	136.3

Source: Eurostat, 2025b.

The evolution of the ratios of government debt between 2019-2023 for the three Member States analyzed of the EU can be seen in the following Figure3.

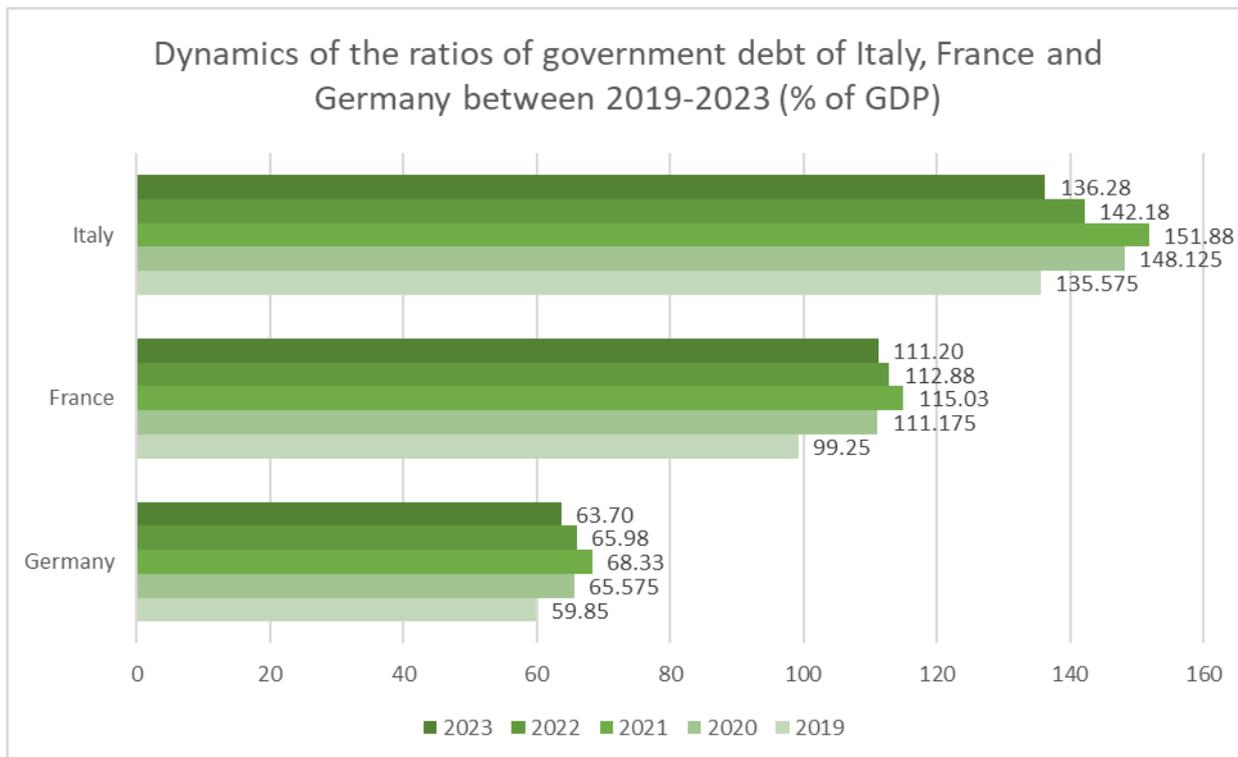


Figure 3. Dynamics of the ratios of government debt to GDP in Italy, France, and Germany between 2019-2023 (% of GDP)

Source: own calculation from Eurostat, 2025b.

These differentiated trajectories constitute a risk for the cohesion of the euro area, while the commitment to real convergence would nevertheless be necessary given the tightening of monetary policy initiated in response to the inflationary crisis and whose easing should be very gradual according to some academics (Ferreira, Abreu & Louçã, 2025; Brkić, 2025). In this regard, the Court underlines that the financing conditions of countries with high indebtedness have deteriorated sharply since 2022: the 10-year rates of Italy and France compared to Germany have thus seen a sharp increase, by more than 40 basis points and more than 20 basis points respectively.

In the long term, the continued increase in the stock of debt, under the effect of the accumulation of deficits, particularly in the recent period, explains the situation in France and Italy.

France's debt is expected to exceed 2,560 billion euros in 2024, compared to 1,760 billion euros in 2018. Considering all public administrations combined, the French debt represented 3,100 billion euros at the end of 2023. Three years after the end of the health crisis, France's public debt ratio remains at a historically high level, at 110.6% of GDP, significantly above its 2019 level. Also, there is a slippage in the public deficit observed in 2023, at 5.5% of GDP compared to a French Government forecast of 4.9%.

According to IMF forecasts, in contrast to the vast majority of the European countries, France would not experience any debt reduction by 2029 compared to 2020, with a debt ratio that would remain higher than 110% of GDP. As a reminder, France had the same level of debt as Germany before the 2008 financial crisis, and the same level of interest charges. Currently, Germany's debt ratio is back at 64% of GDP and is expected to continue to fall in the years to come, with its interest charges increasing only very moderately.

If the increase in the debt stock is therefore the determining factor in the growth of the interest burden, the rise in rates, linked to the normalization of monetary policy compared to the end of the 2010s, represents an aggravating factor. The gradual increase by the European Central Bank (ECB) of its deposit rate, from -0.5% in July 2022 to 4.0% in September 2023, has thus resulted in a clear increase in sovereign interest rates over the same period. While France was borrowing at 1% over 10 years in April 2022, this rate was 2.87% in April 2024. On July 8, despite the ECB's

deposit rate shift to 3.75% in June, the rate on French 10-year debt stood at 3.15%.

Given the pace of debt refinancing, the effects of the rise in rates on the interest burden are not yet fully perceptible. This impact should materialize gradually in the coming years. In this respect, on 31 October 2024, both Italy and France “submitted their first national medium-term fiscal-structural plan, following Articles 11 and 36(1), point (a) of Regulation (EU) 2024/1263” (Council of the European Union, 2025b). However, due to the political context, on 16 January 2025, France sent “an adapted fiscal path reflecting the new 2025 deficit target announced by the Prime Minister, following the appointment of a new government on 23 December 2024. The plan covers the 2025–2029 period and presents a fiscal adjustment spread over seven years” (Council of the European Union, 2025c).

In this context, France’s (-5.5%) and Italy’s (-7.4%) debt are currently at the heart of discussions with the Eurozone partners. Indeed, the return of the European budgetary framework, suspended following the health crisis, reintroduces strong constraints, both in terms of prevention and corrective measures. In fact, on 19 June, the European Commission launched an excessive deficit procedure against 7 Member States, including France and Italy (European Council, 2024). On 21 January 2025, the Council adopted recommendations for seven member states under the excessive deficit procedure, including France and Italy (European Council, 2025). For France, “The Council recommendation establishes that France should put an end to the excessive deficit situation by 2029. France should ensure that the nominal growth rate of net expenditure does not exceed 0.8% in 2025, 1.2% in 2026, 1.2% in 2027, 1.2% in 2028 and 1.1% in 2029.” For Italy, “the Council recommends that Italy should put an end

to the excessive deficit situation by 2026. Italy should ensure that the nominal growth rate of net expenditure does not exceed 1.3% in 2025 and 1.6% in 2026” (Council of the EU, 2025a). The timeline for the deficit-based excessive deficit procedure is to be seen in Figure 4.



Figure 4. The timeline for the deficit-based excessive deficit procedure

Source: European Council, 2024.

The combination of preventive and corrective rules would imply a primary structural adjustment, i.e., excluding debt charges, of 0.6 points of annual GDP, in the case of an adjustment period extended to 7 years, from 2024 to 2031, or around €20 billion each year. It should be noted that any intervention by the ECB is expressly subject to compliance with the

European budgetary framework, even if the Governing Council has some room for interpretation.

It must be admitted that, at the European level, the rules of the Stability Pact have been controversial since it was introduced in 1997/98. France has never complied with the rules. Italy has never been able or willing to reduce its debt level below 100 percent of economic output since euro was introduced- despite unilateral political commitments. In spite of the SGP adopted in 2024, many technical details are still open, which will trigger new discussions, especially when one looks at the analytical considerations of the EU Commission on determining the economic sustainability of the debt of individual countries.

Most countries regularly missed the set targets (see table 11).

Table 11.Distance to the country-specific MTOs between 2011-2018

	2011	2012	2013	2014	2015	2016	2017	2018
Germany	-0.6	0.4	0.8	1.6	1.6	1.6	2.0	1.7
France	-5.0	-4.3	-3.4	-3.0	-2.3	-1.4	-1.7	-1.7
Italy	-3.3	-1.3	-0.7	-0.8	-0.6	-1.4	-1.7	-1.7

Source: AMECO database, 2018 and own calculations¹³

This applies to the medium-term objectives and to the deficit ceiling of 3%. Only Luxembourg achieved the medium-term objectives from 2011 to 2018, followed by Germany. In France and Italy there was always a considerable gap between the country-specific objectives and the actual budget deficit.

According to calculations made by Hans-Werner Sinn, there were 221 violations of the 3% deficit criterion between 1999 and 2020, of which

¹³The numbers represent the distance of the structural balance from the country-specific MTOs. Green means these countries achieved their MTO (in this case Germany) and red means they didn't achieve their MTO (Italy and France).

146 were unlawful, i.e. not justifiable on economic grounds (Sinn,2024). France is the leader with 18 unauthorized violations out of a total of 19, followed by Greece with 11 unauthorized violations and among the euro countries Portugal, Spain and Italy with 10 violations each. Germany had 4 permitted and 4 unauthorized violations. None of this ever resulted in any consequences. There were never any sanctions.

4. Discussions

(1) Is there a sense of *simplification or of more transparency with regards to the new SGP*? The previous rules were already far too complex, too complicated, too flexible, unenforceable and ultimately ineffective. Instead of simplifying the rules, defining them well and making them more transparent, everything is now much more opaque and, as a result, more lax. A great opportunity has been missed to reduce the complexity and return to simpler rules that the public can also understand. But perhaps that was not the intention at all.

(2) The decisions taken will not help to slow down or reduce the excessive debt in many Member States, and particularly in France and Italy. There are far too many elements that stand in the way of sound public finances. The focus is on flexibility and discretionary decisions by the Commission justified with “growth”. The crucial question, however, is how is growth generated? And this is where you end up with ever-increasing debt, which simply does not lead to sustainable growth. This reverses the original philosophy of the SGP. The starting point for the fiscal rules was to ensure stability as a prerequisite for sustainable economic growth. Now, in the

interests of France and Italy (and other member states which are in the same position) debt-financed growth is supposed to lead to stability.

(3) One gets the impression that the aim was not to achieve solid public finances, but to increase the power of the EU Commission. Its role was strengthened politically and functionally, and it was given additional discretion. Under its supervision, national “budget, reform and investment plans” are combined in a single plan. That sounds a little too much like a planned economy with the Commission as the central office. The previous multilateral monitoring procedure was weakened. Admittedly, it didn’t work, but putting the emphasis on bilateral monitoring by the highly politicized Commission is not productive. With the help of the EU Commission, the new rules allow higher public debt.

(4) The new role of the EU Commission is also reflected in the increased scope for borrowing granted to member states if they align their national budgets with the political priorities defined at European level. A group of economists sees this possibility as a way of steering national budgets by the Commission. (Feld et al., 2023).

(5) With the expected further increase in debt, doubts about the economic sustainability of the debts of several euro countries - especially Italy, but also France-are growing. It must be remembered that only three countries in the euro area have an AAA rating, among them being also Germany (next to the Netherlands and Luxembourg). A further increase in debt in countries that are already very highly indebted will lead to higher interest rates and, in extreme cases, to market access being made more difficult or denied. Then Europe will be in the next sovereign debt crisis.

5. Conclusions

The article provides evidence that suggests a negative answer to the research question, which aims to examine whether the Pact has succeeded in ensuring stability and sustainable growth in the selected countries.

In particular, the article highlights a contradictory result characterizing the original version of the Pact, namely a general relaxation of fiscal policies despite some states reporting deficits close to the maximum threshold allowed. This result, mainly attributable to the incorrect assessment of the extent of growth in the early 2000s, led to calculations based on unfounded estimates and imprecise statistics regarding fiscal indicators. Furthermore, the first part criticizes the complexity of the corrective arm, further accentuated with the 2005 reform due to the introduction of new circumstances useful to avoid its application.

The research clarifies through empirical evidence how the provisions of the Pact are, at least numerically, too frequently ignored due to, among other factors, the reluctance of States to accept a key principle of the Pact, namely the creation of fiscal space in periods of expansion to face future periods of recession.

The analysis also highlights some critical issues, even for countries with a high rule compliance index. In particular, the German debt brake rule turns out to be excessively focused on “stability” and insufficiently focused on “growth” since it hinders the investments necessary for the green and digital transition.

Finally, the article highlights how the 2011 reform imposed pro-cyclical fiscal policies on states characterized by high levels of debt and how the application of a single rule for all countries suffered from practical difficulties, while the 2024SGP has the merit of focusing more on the debt criterion and its evolution for each state. Nevertheless, the determination

of the evolution of debt demonstrates an arbitrary process due to the uncertainty connected to the variables that influence it, and the proposed forecasting analysis period turns out to be excessively short and unable to eliminate the threat of implementing pro-cyclical fiscal policies to respect the debt reduction path.

In the longer term, in the face of rising economic, geopolitical, and environmental challenges, it is important to restore budgetary room for maneuver to be able to absorb the consequences of future crises. A primary surplus of around 1 point of GDP would therefore be necessary. In the absence of a recession, budgetary policy should, in principle, generate surpluses to benefit from a more favorable situation ahead of shocks.

Consequently, my recommendations are that a debt stabilization and deficit reduction strategy must be urgently implemented. Failing this, there is a risk of even more drastic measures being imposed by the European authorities in the event of a crisis in confidence in the markets. Therefore, a first set of recommendations calls for an effort to reduce the public deficit as of the next draft finance bill, to return to below the level of 3% of GDP by 2027, and to return to a primary budget surplus by 2030.

Furthermore, in a particularly unstable period, a better understanding of debt security holders is necessary. This more detailed understanding of the debt holding structure must aim to protect French and Italian debt from exposure to, or even dependence on, a specific type of investor. This is the purpose of the second series of recommendations, which proposes implementing a system for identifying holders of public debt securities and conducting an annual review of their composition to maintain a range of holders that is sufficiently diverse in terms of nature and geographical

origin. France's and Italy's interest burden cannot continue indefinitely on their divergent trajectory from that of their European partners.

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