

# FISCAL CONSEQUENCES OF THE SUSPENSION OF FISCAL RULES IN THE EUROPEAN UNION

Biljana Srdić Gojković<sup>1</sup>

Sanja Popović<sup>2</sup>

Marijana Đukić<sup>3</sup>

doi:[10.63356/978-99976-57-32-9\\_8](https://doi.org/10.63356/978-99976-57-32-9_8)

## Abstract

A specific feature of the European Economic and Monetary Union is centralized monetary policy under the competence of the European Central Bank and decentralized fiscal policy under the competence of the national authorities of the member states. In order to ensure the conduct of a sound fiscal policy by each member state, it was necessary to establish certain common rules for the conduct of fiscal policies at national levels, that is, to establish binding fiscal criteria, or more precisely fiscal limits, which are based on the principle of sustainable fiscal policy. However, the application of fiscal rules in the European Union was suspended in 2020 due to the crisis caused by the corona virus.

The main analysis and the aim of the research in this paper is the analysis of the impact of activation effects on the fiscal stability of the countries of the European Union. Descriptive and comparative analysis will determine the effects of the suspension of the fiscal rules of the European Union countries. The analysis shows the importance of the existence of fiscal rules for maintaining the fiscal stability of EU member states, which is one of the prerequisites for macroeconomic stability and economic growth.

**Key words:** Fiscal rules, GDP, deficit, public debt, fiscal consolidation.

**Jel:** JEL: E62, H62, F41

## INTRODUCTION

"General escape clause" was defined by the reform of the Stability and Growth Pact of the European Union (EU) in 2011, as part of the so-called "Pack of 6 measures" and it was activated for the first time in March 2020, due to the Covid-19 crisis.

The EU Stability and Growth Pact was redefined in 2011 and contains two clauses that allow member states to implement appropriate budgetary measures in extraordinary circumstances, namely the "extraordinary events clause" and the "general escape clause". The clauses allow derogation from parts of the Stability and Growth Pact in the event of events beyond the control of one or more member states that have a major impact on the financial position of EU states.

Because the Covid-19 crisis is an event that was beyond the control of governments with a major impact on the financial position of EU countries, the EC noted the possibility of applying clauses on extraordinary events.

However, the size of the fiscal efforts that were necessary to protect against the effects of the pandemic and support the recovery of the economy after that, required significantly greater flexibility in terms of the "general escape clause" which, due to the crisis in Ukraine, was extended until the end of 2023.

---

<sup>1</sup> University of Banja Luka, Faculty of Economics,

<sup>2</sup> University of Banja Luka, Faculty of Economics

<sup>3</sup> University of Banja Luka, Faculty of Economics

## LITERATURE REVIEW

In EU member states, fiscal rules based on the Maastricht criteria were introduced more than 30 years ago. According to the criteria, the public debt must not exceed 60% of GDP, and the annual budget deficit must not exceed 3% of the country's GDP. In order to respect the set fiscal limits on debt and deficit, and to strengthen fiscal discipline, European leaders adopted the Pact on Stability and Growth in 1997, which began to be implemented in 1999 (Delivorias, A., 2021).

From the moment the EU's fiscal rules were established until today, there have been numerous challenges and crises caused by extraordinary circumstances. Among the crises of a larger scale than the determination of EU fiscal rules, the global financial crisis from 2008, the Covid-19 crisis from 2020 and the economic crisis caused by the war in Ukraine in 2022 stand out. The global financial crisis 2008 tested the effectiveness of the fiscal framework of the European Union. The fiscal framework that existed before the global financial crisis was useful for the coordination of fiscal policy, but it did not prevent the creation of fiscal imbalances, so the weaknesses of the reformed Pact came to the fore. The deepening of the crisis in 2008 led to a recession. The recession was characterized by a decrease in economic activity, a drop in consumption and an increase in unemployment with a decrease in public revenues. The consequence of such a situation is the budget imbalance, which manifested itself in the form of a structural budget deficit and the growth of public debt (Krajišnik, M., Gligorić, D. and Gojković, B., 2019).

The emergence of imbalances pointed to the weaknesses of the EU's fiscal frameworks, which set limits on deficits in "bad times", without setting concrete rules for savings in "good times" (Martin, P, 2021). Bad experiences have led to numerous measures aimed at strengthening fiscal restraint and management measures. Thus, the Pact was changed again in 2011, when the Six Pack was adopted. The package of six measures was adopted with the aim of limiting the further accumulation of public debts, which were one of the causes of the Eurozone crisis, and to contribute to better fiscal discipline of the member states.

The 2019 COVID pandemic at the beginning of 2020 showed how non-financial and non-economic factors can affect economic trends and the economy on a global scale and cause a recession (Gojković, 2022).

In March 2020, the general escape clause was activated. More precisely, the fiscal rules of the EU have been suspended by the activation of the derogation clause in extraordinary circumstances caused by the Covid 19 crisis. The general escape clause has been extended until the end of 2023 due to the continuation of the economic crisis caused by the war in Ukraine. At the beginning of 2023, the process of reforming the fiscal framework of the EU was launched, which was the basis for fiscal management in the EU from 2024.

The extraordinary circumstances caused by the crises in 2020 and 2022 confirmed the need to consider redefining, i.e. adapting the existing fiscal rules of the EU to the new "post-pandemic" circumstances (Davoodi H. R, et. al. 2022). There was a need to strengthen and redefine EU fiscal rules by adopting features that make them more flexible, operational and enforceable. Consequently, in April 2023, the EC presented its legislative proposals for the reform of fiscal management in the EU. The proposals were agreed upon in December 2023.

The originally defined limits of 3% of GDP for the general government budget deficit and 60% of GDP for public debt remain, but allow more flexibility in fiscal adjustment (Council of the European Union, 2023). The key innovation is reflected in the introduction of spending plans that respect the specifics of each individual country, and are based on an analysis of debt sustainability by the EC.

Regardless of the effectiveness of the application of fiscal rules in recent years, fiscal rules have become a common occurrence (Eyraud, L. et. al., 2018). Ensuring a stable fiscal policy is a priority for all countries. Based on the results of years of application of fiscal rules in EU countries and the impact of fiscal stability on economic growth, it can be concluded that the same fiscal rules and their implementation do not ensure the same level of fiscal stability and equal opportunities to overcome fiscal difficulties in EU member states with different level of development (Gojković, B., 2022). How many negative consequences the activation of the clause on deviating from the fiscal rules had will be clearer on results base.

In the previous literature, there was no research that specifically looked at the effects application of the activation of the "general escape clause", which provides an additional contribution to this research.

## **RESEARCH METHODOLOGY**

This research analyzes the impact of the activation of the "general escape clause", i.e. the suspension of fiscal rules in extraordinary circumstances, on the fiscal stability of EU countries. The article is based on the collection and analysis of secondary data sources. The Desk Research method was used for data collection, since already existing external data were used to analyze the problem.

The data used for this research were taken from the Eurostat database. The basis is data on the public debt and fiscal deficit of the EU member states in the period before and after the activation of the "general escape clause". The time frame of the research refers to the period 2016-2023. years.

As a classic method of data processing and analysis, content analysis was used in the paper, which, based on the collected relevant literature, obtained the necessary data for the processing of the case and the realization of the research goal.

The methods of description and comparison were used to prepare the paper. The descriptive method is a research procedure with a focus on the description of processes and phenomena. Description is the process of simply describing or presenting facts, processes and objects. The method of description will be used to define basic concepts such as the concept of fiscal rules, budget deficit, public debt, "general escape clause", and the like. By applying the description method, the paper pointed out the importance of fiscal stability and the existence of fiscal rules in the EU member states.

A comparative analysis of the average level of debt and deficit (% of GDP in EU countries) for the period before and after the activation of the "general escape clause" determines whether and to what extent fiscal indicators have deteriorated. In the first step, the comparison is carried out by determining the common features of the investigated phenomenon, and then by determining the features by which these phenomena differ. In this way, comparison highlights what those phenomena have in common or what makes them different (Žugaj et al., 2006). The method of comparison is the procedure of comparing similar phenomena and facts, i.e. processes, and determining the intensity of similarities and differences between them. Therefore, comparison is the basic instrument of this analysis. It sharpens the researcher's "power of description and plays a central role in the formation of concepts, by bringing into consideration perceptible similarities and differences between cases" (Collier, 1993).

The synthesis method was used in the final research phase of this article. By connecting the facts, which were reached by applying the previous methods, into one logical whole, conclusions were made about the importance of the existence of fiscal rules in the EU countries.

This is very important for maintaining fiscal stability, which is one of the basic conditions for macroeconomic stability and economic growth in general.

## RESULTS

A comparative analysis of the average level of the budget deficit and public debt before and after the activation of the "general escape" clause will determine whether and to what extent there has been a deterioration of fiscal indicators that are subject to fiscal rules. Based on that, the data of the average budget result and public debt for EU member states in the four-year period before the activation of the "general escape" clause, more precisely, the average for the period 2016-2019. year and the average for the indicated indicators in the period of validity clause, i.e. for the period 2020-2023. year.

**Table 1:** Net lending/net borrowing, percentage of GDP at current prices

Country	Average 2016-2019	Average 2020-2023	Difference of the average for the four-year period before and after the activation of escape clause	Difference 2023-2019
Austria	-0,4	-5,0	-4,6	-3,2
Belgium	-1,5	-5,7	-4,2	-2,9
Bulgaria	1,4	-3,4	-4,9	-5,1
Czechia	0,9	-4,5	-5,3	-4,1
Denmark	1,7	2,6	1,0	-1,5
Estonia	-0,4	-3,0	-2,6	-3,0
Finland	-1,1	-2,9	-1,9	-1,5
France	-3,0	-6,3	-3,3	-1,7
Greece	0,7	-5,4	-6,1	-3,2
Netherlands	1,2	-1,6	-2,8	-2,3
Croatia	-0,1	-2,5	-2,4	-0,3
Ireland	-0,1	-1,0	-0,9	0,4
Italy	-2,1	-7,9	-5,8	-3,8
Cyprus	-0,1	-0,7	-0,6	1,4
Latvia	-0,4	-4,9	-4,5	-2,7
Lithuania	0,4	-2,5	-2,9	-2,1
Luxembourg	2,1	-1,3	-3,4	-4,1
Hungary	-2,1	-6,7	-4,6	-3,8
Malta	1,7	-7,0	-8,7	-5,6
Germany	1,5	-3,2	-4,6	-3,7
Poland	-1,2	-4,6	-3,4	-5,1
Portugal	-1,3	-2,1	-0,8	0,7
Romania	-3,0	-7,3	-4,3	-2,0
Slovakia	-1,5	-4,6	-3,1	-4,5
Slovenia	-0,2	-4,7	-4,6	-4,4
Spain	-3,3	-6,4	-3,1	-1,0
Sweden	0,9	-0,5	-1,4	-0,7
<b>European Union</b>	<b>-0,8</b>	<b>-4,5</b>	<b>-3,7</b>	<b>-2,7</b>
<b>Euro area</b>	<b>-0,9</b>	<b>-4,8</b>	<b>-3,9</b>	<b>-2,6</b>

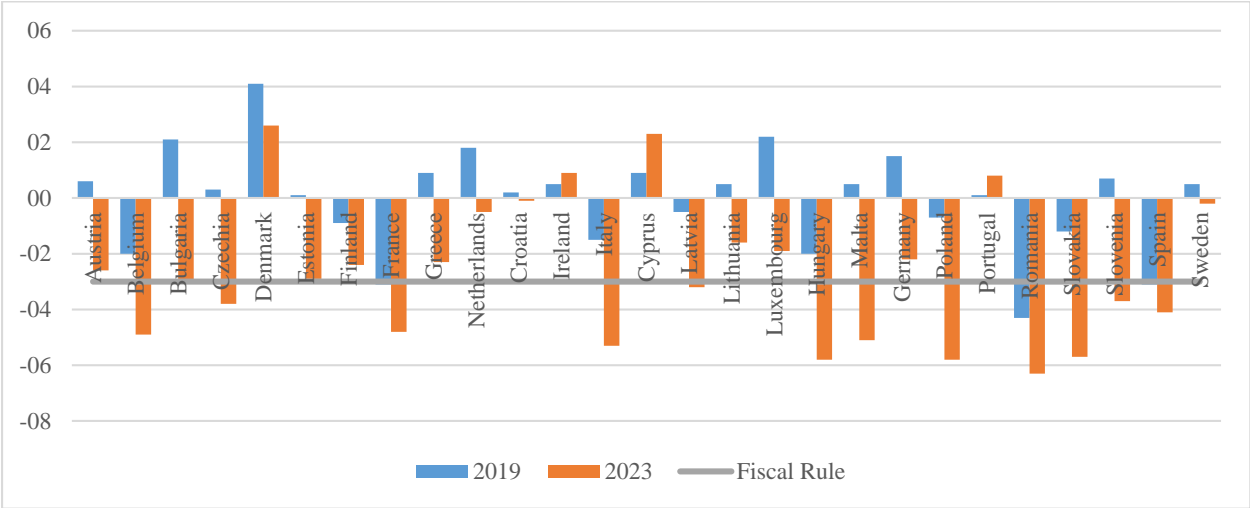
**Source:** Authors' calculation, based on Eurostat data.

Note: In 2<sup>nd</sup> and 3<sup>rd</sup> column (-) means budget deficit, (+) means budget surplus, while in 4<sup>th</sup> and 5<sup>th</sup> (-) means worsening budget balance (increase in the deficit or reducing surplus) while (+) means improvement of budget balance.

The analysis of the data from the previous table shows that due to the activation of the general escape clause in almost all EU countries, there was an increase in the level of deficit compared to the average level of deficit in the period before the activation of the clause. More precisely, all EU countries, except Denmark, during the period of application of the general escape clause recorded an increase in the budget deficit on average.

The following graph shows the level of the budget deficit as a percentage of GDP in the year before the activation of the clause, i.e. in 2019, and the level of the budget deficit as a percentage of GDP in 2023, in relation to the deficit level of 3% of GDP as is determined by the fiscal rule.

**Graph 1:** Net lending/net borrowing, % of GDP, in 2019 and 2023, by EU countries



Source: Authors’ calculation, based on Eurostat data.

The analysis of the previous graph shows that in 2019, about 11% of the member states deviated from the fiscal rule related to the deficit level (France, Romania and Spain), and in 2023, 44% of the member states deviated from the fiscal rule (Belgium, the Czech Republic, France, Italy, Latvia, Hungary, Malta, Poland, Romania, Slovakia, Slovenia, Spain). More than half of the countries that deviate from the fiscal rule on the budget deficit are developed EU countries.

Analysis by individual EU countries shows that the deviation from the established deficit limit is significantly higher in 2023 compared to 2019. More precisely, the average deficit level for countries that deviate from the fiscal rules in 2019 is 3.5%, and in 2023 the average deficit for the 12 countries that deviate from the fiscal rules is 4.6%.

In 2023, Romania had a budget deficit of 6.3% of GDP, which is twice as much as the fiscal rule. The above confirms that due to the activation of the clause there was a deterioration of the budget result, i.e. an increase in the budget deficit for EU member states.

The impact of the suspension of the rules on the level of public debt of the EU member states was also analyzed. The following table shows the average public debt for EU member states in the four-year period before and after the activation of the general escape clause.

**Table 2:** Gross public debt, percentage of GDP at current prices

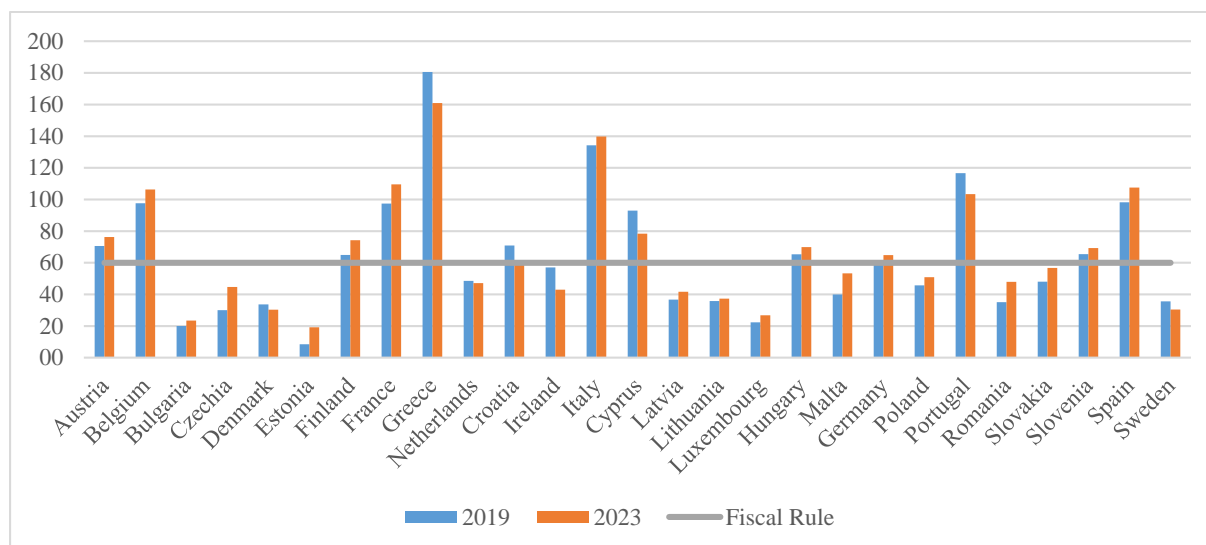
Country	Average 2016-2019	Average 2020-2023	Difference of the average for the four-year period before activation and after the activation of escape clause	Difference 2023-2019
Austria	76,5	80,1	3,5	5,7
Belgium	101,1	107,6	6,5	8,7
Bulgaria	24,1	23,7	-0,4	3,5
Czechia	33,2	42,2	8,9	14,7
Denmark	35,2	34,6	-0,6	-3,4
Estonia	9,0	18,5	9,6	10,7
Finland	65,9	73,7	7,8	9,4
France	97,8	112,2	14,4	12,2
Greece	181,8	183,9	2,1	-19,7
Netherlands	55,0	50,9	-4,1	-1,5
Croatia	75,0	73,5	-1,5	-10,1
Ireland	65,5	50,0	-15,5	-14,1
Italy	134,4	145,9	11,5	5,6
Cyprus	97,0	94,6	-2,4	-14,6
Latvia	38,2	42,2	4,0	5,0
Lithuania	37,1	41,3	4,2	1,5
Luxembourg	21,2	25,2	4,0	4,4
Hungary	70,4	75,0	4,6	4,6
Malta	46,5	53,0	6,5	13,3
Germany	63,9	67,2	3,3	5,2
Poland	49,9	52,8	2,8	5,2
Portugal	123,9	118,8	-5,1	-13,2
Romania	35,7	47,6	11,9	12,8
Slovakia	50,3	58,6	8,3	8,7
Slovenia	72,1	73,9	1,8	3,9
Spain	100,8	114,1	13,3	9,3
Sweden	39,7	34,9	-4,8	-5,2
<b>European Union</b>	<b>82,7</b>	<b>87,1</b>	<b>4,5</b>	<b>3,7</b>
<b>Euro area</b>	<b>89,2</b>	<b>94,8</b>	<b>5,5</b>	<b>4,6</b>

**Source:** Authors' calculation, based on Eurostat data

Note: In 4<sup>th</sup> and 5<sup>th</sup> (-) means reducing the level of indebtedness while (+) means rising the level of public debt.

The analysis of the data shown in the previous table shows that due to the activation of the general escape clause for a large number of EU countries, there was an increase in public debt as a percentage of GDP in relation to the average level of debt in the period before the activation of the clause. More precisely, in 70% of EU member states, the debt as a percentage of GDP is higher in the period of activation of the clause compared to the average of the same for the period 2016-2019. year.

**Graph 2:** Gross public debt, % of GDP, in 2019 and 2023, by EU countries



**Source:** Authors' calculation, based on Eurostat data.

The previous graph shows the level of public debt as a percentage of GDP in the year before the activation of the clause, i.e. in 2019, and the level of public debt as a percentage of GDP in 2023, in relation to 60% of GDP, which is the level defined by the fiscal rule public debt.

Analysis of debt data by individual EU member state shows that the same countries deviate from the fiscal rule on debt both before and after the activation of the general escape clause. More precisely, in 2019, 12 of them (Austria, Belgium, Finland, France, Greece, Croatia, Italy, Cyprus, Hungary, Portugal, Slovenia, Spain) deviate from the debt level established by the fiscal rule, while in 2023, the same 12 countries and Germany has a public debt above 60% of GDP. Of the countries that deviate from the fiscal rule related to public debt, 66% are developed EU countries.

Debt and deficit data clearly show that the suspension of the rules has led to a deterioration of the EU's fiscal stability. The analysis showed that the activation of the clause, that is, the suspension of the fiscal rules, had a greater negative impact on the deficit level than on the debt level. The fact that the general escape clause will be deactivated to a certain extent has prevented a greater growth of debt and deficit. In other words, the temporary suspension of fiscal rules indirectly influenced the growth of debt and deficit to a certain extent to be lower than it would have been if fiscal rules had not been established, which indicates the importance of the existence and application of fiscal rules. Based on the results, it is concluded that the existence and observance of fiscal rules is extremely important for preserving fiscal stability because sustainable and stable public finances are an important factor in economic growth.

The activation of the general escape clause, given the extraordinary circumstances that required state intervention, was justified. But the results show that the suspension of fiscal rules is unacceptable in the long run. The growth of debt and deficit due to the suspension of the rules indicates that it is necessary to restore their application as soon as the circumstances that were the reason for the activation of the suspension stabilize.

During the period of permitted deviation from the fiscal rules, consumption in the EU member states increased sharply, which supported economic activity. However, the long-term maintenance of a high budget deficit requires finding ways to finance it, which limits economic growth. It can be assumed that, if fiscal rules did not exist in the future, countries would continue to face budget deficits and high public debt, which would have a negative impact on

the liquidity of the economy, the size of investment activity and the overall dynamics of economic trends.

In the coming period, EU countries will face challenges that require constant and significant public investments, related to the green and digital transition and the strengthening of European security capacities. Also, it is certain that the financing conditions in the following fiscal years will not be favorable. This implies the possibility of public debt growth. In addition, the multi-year accumulation of the budget deficit had negative effects on the increase in public debt. This debt trend, especially for EU countries that currently have a high level of debt, is unfavorable for growth in the long term. This shows how important the importance of fiscal discipline and limits on state borrowing is. This type of restriction can be established by applying fiscal rules.

After deactivating the "general escape" clause, fiscal consolidation of the EU countries will follow. Fiscal consolidation after the crises represents a great challenge both for the EU as a whole and for its individual member states. Considering the importance of fiscal stability, especially in countries with a lower level of development, it is concluded that the introduction of differentiated fiscal rules can have greater effects on fiscal stability than their suspension. This is concluded because the results showed that the suspension of fiscal rules has an impact on the sharp growth of deficit and debt.

The price of preserving the stability of public finances at the price of lower but more stable economic growth is a cheaper and safer option compared to the short-term high economic growth at the cost of implementing fiscal consolidation. This is especially important because the problem of a high level of deficit is most often done by additional debt.

## CONCLUSION

The reason for activating the general escape clause is to enable member states to finance the costs of the Covid 19 crisis and implement measures to preserve economic activity and employment. The 2022 crisis caused by the war in Ukraine caused the extension of the general escape clause. And then the EU countries continued to implement an expansive fiscal policy in order to preserve the living standards of the population and economic activity. That expansive fiscal policy was reflected in the increase in the budget deficit and public debt of the EU member states, which undermined fiscal stability and slowed down the countries' economic growth.

Effective management of public debt and budget deficit is of great importance for economic growth and its sustainability in the future. Credible and binding fiscal rules, as well as appropriate instruments for their application, are crucial for stable EU public finances.

Fiscal rules guide economic policies in the direction of stability and long-term sustainability of public finances. Also, the national responsibility of each member state is extremely important. Responsible fiscal behavior with the application of fiscal rules contributes to: greater budget discipline and transparency, rationalization of revenues and expenditures, more efficient use of budget funds, lower budget deficit and public debt.

## LITERATURE

1. Collier, D. (1993). *The comparative method*. In A. W. Finifter (Ed.), *Political science: The state of the discipline* (pp. 105–119). American Political Science Association.
2. Council of the European Union. (2023). *Review of economic governance: Council agreed on reform of fiscal rules*. Retrieved from <https://www.consilium.europa.eu/en/press/press-releases/2023/12/21/economic-governance-review-council-agrees-on-reform-of-fiscal-rules/>

3. Davoodi, H. R., Elger, P., Fotiou, A., Garcia-Macia, D., Han, X., Lagerborg, A., Lam, W. R., & Medas, P. (2022). *Fiscal rules and fiscal councils: Recent trends and performance during the pandemic*. IMF Working Paper No. 22/11. International Monetary Fund.
4. Delivorias, A. (2021). The Maastricht Treaty, the Treaty on Stability, Coordination and Governance, and the Stability and Growth Pact. European Parliamentary Research Service.
5. European Commission. (2024). Retrieved from [https://commission.europa.eu/index\\_en](https://commission.europa.eu/index_en)
6. European Parliamentary. (2020). The 'general escape clause' within the Stability and Growth Pact: Fiscal flexibility for severe economic shocks. Briefing 27-03-2020. Retrieved from [https://www.europarl.europa.eu/thinktank/en/document/EPRS\\_BRI\(2020\)649351](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2020)649351)
7. Eurostat. (2024). Retrieved from <https://ec.europa.eu/eurostat>
8. Eyraud, L., Debrun, X., Hodge, A., Lledó, V., & Pattillo, C. (2018). *Second-generation fiscal rules: Balancing simplicity, flexibility, and enforceability*. IMF Staff Discussion Note. Retrieved from <https://www.imf.org/external/datamapper/fiscalrules/sdn1804-on-second-generation-fiscal-rules.pdf>
9. Gojković, B. (2021). Fiscal consolidation and economic growth in countries of different levels of development of the European Union. *Acta Economica*.
10. Gojković, B. (2022). The impact of the COVID-19 crisis on the fiscal stability of the Republic of Srpska. *Economics*, 10(1). <https://doi.org/10.2478/eoik-2022-0006>
11. Bruegel. (2024). *Unblock fiscal rule reform: EU should reinstate its excessive deficit procedure*. Retrieved from <https://www.bruegel.org/first-glance/unblock-fiscal-rule-reform-eu-should-reinstate-its-excessive-deficit-procedure>
12. Kopits, G., & Symansky, S. (1998). *Fiscal policy rules*. International Monetary Fund. Retrieved from <https://www.elibrary.imf.org/display/book/9781557757043/C1.xml>
13. Krajišnik, M., Gligorić, D., & Gojković, B. (2019). Effects of fiscal consolidation in Western Balkan countries. *Proceedings of Rijeka School of Economics*. <https://doi.org/10.18045/zbefri.2019.2.527>
14. Martin, P., & Ragot, X. (2021). When and how to deactivate the SGP general escape clause?. IPOL, In-depth analysis requested by the ECON committee.
15. European Commission. (2023). Regulation of the European Parliament and the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97. Retrieved from [https://economy-finance.ec.europa.eu/document/download/6d456c53-5267-4519-a958-8f4723f92f6a\\_en?filename=COM\\_2023\\_240\\_1\\_EN.pdf](https://economy-finance.ec.europa.eu/document/download/6d456c53-5267-4519-a958-8f4723f92f6a_en?filename=COM_2023_240_1_EN.pdf)
16. Žugaj, M., Dumčić, K., & Dušak, V. (2006). *Temelji znanstvenoistraživačkog rada: metodologija i metodika* (2. dopunjeno i izmijenjeno izdanje). Sveučilište u Zagrebu, Fakultet.