EUROPE’S FISCAL FRAMEWORK – THE PEOPLE’S VIEW?
HOW AUSTERITY MADE US POORER AND LESS ABLE TO COPE WITH CRIOSES

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Published: October 2022

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1. INTRODUCTION

The set-up of Europe’s fiscal framework transformed the 2008 global financial shock into a self-made economic crisis and an unnecessarily prolonged recession. Instead of scaling-up transformative environmental investment that would have simultaneously catalysed a strong recovery, increased energy security, and boosted living standards, a policy of “austerity” won the day. Our analysis shows that European citizens have been left just under €3,000 a year worse off in their household incomes since the global financial crisis and that two out of three people polled agree EU fiscal rules should be changed to allow governments to increase spending on education, health and social care, and jobs.

Even though pursuing harsh austerity during a deep recession is completely at odds with mainstream economic theory,1 EU governments have followed this path leading to permanent scarring of incomes, reductions in capital spending, and cuts to social expenditures. They labelled these as necessary despite being entirely political choices. There has been scant public political debate around whether a different approach to fiscal policy could have resulted in a better outlook for social, economic, and environmental prosperity. More presciently, whether the decision to prioritise debt and deficit reductions over investment endangered the goals of achieving net zero and left Europe more vulnerable to energy price shocks. Indeed, the Covid-19 lockdown amounted to a further rolling back of the principles underpinning austerity. The EU’s fiscal framework2 should make us question the use of rules in the past if they can be ignored at critical moments.

All too often key decisions regarding the EU’s fiscal framework either take place behind closed doors or are left to technocrats.3 The voices of the general public have frequently been left out of the vital decisions that shape their economic future and day-to-day livelihoods.

To help foster a greater understanding of public opinion, inform the policymakers, and gain knowledge of the lived experience of Europeans, the New Economics Foundation and Finance Watch conducted a cross-country survey offering data from representative national samples of 5,000 citizens across Denmark, France, Germany, Ireland, and Italy. The survey entailed several questions regarding EU citizens’ views on austerity and the EU’s fiscal framework. This briefing examines the survey findings, in light of the recent macroeconomic analysis of the effects of austerity on household incomes, capital investment and climate targets, and wider social expenditure.
We find that against a backdrop of an austerity-stricken Europe, citizens have been left just under €3,000 worse off in their household incomes and have seen €1,000 less spent on their public and social services per person. Furthermore, an investment gap of over €500 bn has prohibited accelerated action on climate change and other investments to make the economy more resilient to shocks. Our survey suggests that 70% of Europeans are concerned about the impact the reimplemention of austerity could have, which appears largely due to the negative effects austerity has had in these nations.

However, 70% of Europeans are just as concerned about rising debt levels. This is important as our analysis shows that fiscal rules that led to austerity have not succeeded in bringing debt down. If the EU is to address its citizens’ concerns about debt, then austerity is not the answer. Instead, stronger social spending is more in line with European opinion with 64% agreeing that EU fiscal rules should be changed to allow governments to increase spending on education, health and social care, and jobs.

The timeliness of our survey and analysis is intended to help inform policymakers ahead of the European Commission publishing an orientation paper that lays out its suggested direction for the EU’s economic governance review, including the EU’s fiscal framework, the Stability and Growth Pact, and subsequent fiscal legislations. This review will determine the rules for government borrowing and spending once the escape clause that was triggered to allow increased spending in response to the Covid-19 crisis and the Russian invasion of Ukraine is closed at the end of 2023. Without a deep reform, governments may be forced to implement austerity policies once again. Our cross-national survey, however, indicates a clear desire for more fiscal flexibility, even from Europe’s most notoriously fiscally frugal country – Germany.

In light of our findings, we argue that over the past decade the European policy approach to the deficit and debt has not been grounded in economic reality and, as our polling results show, has likely gone against the interests of the majority of Europeans. Austerity and overly rigid fiscal rules were ultimately a political choice, rather than an economic necessity. Policy choices and mistakes of the past mustn't be repeated; fresh thinking around the fiscal frameworks is urgently required. Lessons from the Covid spending packages could offer a model for dealing with the present energy and environmental crises.
2. EUROPE’S SOCIAL AND ECOLOGICAL CHALLENGES

The economy of the next decade and beyond is being created now, out of the energy emergency and the cost of living crisis left in its wake. The lack of social and economic resilience in Europe as the pandemic and ensuing cost of living crisis hit is an indictment of collective policy failure and the missed opportunity to recover from the 2008 financial crisis. Instead of scaling-up transformative social and environmental investment that would have simultaneously catalysed a strong recovery and improved resilience to future shocks, an agenda of austerity (in the form of cuts to public investment and expenditure) followed.8

The pursuit of fiscal austerity was considered the primary means of ensuring compliance with the fiscal rules – targets for public debt and borrowing over a medium-term horizon – underlying Europe’s main fiscal framework, the Stability and Growth Pact.9 Accordingly, despite some contention in the application of these rules, many European countries sought to prematurely and excessively cut back spending in attempts to bring fiscal deficits under the stipulated 3% of gross domestic product (GDP) limit and reduce debt-to-GDP levels above 60%.

Living standards, capital investment, and social sector spending were seriously affected, amongst many other progressive indicators. This has left us more vulnerable to the consequences of the current cost of living and future potential crises. We further demonstrate that by depressing economic activity, fiscal rules and austerity failed on their own terms leading to higher debt levels overall. The counterfactuals and analysis presented herein come with caveats and trade-offs; the intention here is to suggest that there is at least an alternative pathway that merits political debate.

2.1 STAGNATING LIVING STANDARDS

Contrary to mainstream economic policy prescriptions, European governments ran programmes of austerity, when interest rates were close to zero, during a deep economic recession.10 Fiscal consolidation (aiming to pay off debt through spending cuts and/or tax rises) and deficit reduction instead of growing the economy to reduce the debt burden became the primary targets for policymakers. A significant slump in output that led to a permanent fall in living standards followed.11,12,13

Rather than using fiscal policy to bring the economy back to its underlying potential, policymakers assumed that the economy would naturally bounce back to its full
capacity. But without support from fiscal policy to make up for declining private sector spending and investment (especially when monetary policy provided as much conventional support as possible with close-to-zero interest rates), there is no reason that such a recovery will take place. Indeed, reductions in government spending and investment may only make matters worse by reducing the economy’s capacity to bounce back.

Figure 1: Average EU citizen €2,891 worse off a decade after 2008 global financial crisis

Adjusted gross disposable income of households per capita EU 27 2000-2020, compared to the 2000-2008 (pre-crisis) trend.

Source: Authors' own calculations, Eurostat (2022)

This is because making spending cuts when private sector spending and investment are falling, can reduce demand for economic activity when it is most needed. This reduction in spending and investment can worsen the productivity of the economy, i.e., the difference between actual economic output and the potential if resources were used efficiently, leading to an underperforming economy. It can also increase company bankruptcies and lead to less investment in research and development, hurting the efficiency of production in the economy, and potentially exacerbating inflationary pressures in the future. In short, it can have hugely negative knock-on effects on the future path of GDP, employment, and disposable household incomes.

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European economic activity did not return to its pre-crisis trend – a permanent loss in income followed, instead of ‘just a delayed recovery’. By the time the Covid-19 pandemic struck, the real disposable income of every EU citizen was €2,891 worse off a year (or a total of €24,455 cumulatively since 2009) than they would have been had European countries continued to grow at the rate seen before the 2008 global financial crisis (Figure 1).

Across Europe, the shock to living standards was different for different member states (Figure 2). For example, in Germany, the average real disposable income was only 1% lower in 2020 when compared to its pre-2008 trend, while the Netherlands and Finland were 15% and 16% lower respectively. Despite the significant disparities across the EU 27, the shock and lack of a recovery in EU incomes have left families much more vulnerable to energy price rises and the cost of living crisis.

Figure 2: EU citizens affected differently by the 2008 global financial crisis


Source: Authors’ own calculations, Eurostat (2022)

2.2 LACK OF INVESTMENT AND THE GREEN INVESTMENT GAP

The cost of living is rising due to increasing global demand for gas out of the pandemic, further exacerbated by a shortage of supply. But it is also partially due to a lack of investment as a result of austerity policies. For example, in the Euro area collectively governments have spent roughly zero on capital investments since 2011 (outside of
maintenance costs); in fact, it has been negative in Germany.\textsuperscript{20} If public capital investment had increased at its pre-2008 rate, just before the pandemic struck, the stock of government infrastructure would have doubled – i.e., €533 bn bigger by Q4 2019 (Figure 3). Had there been a priority to invest in domestic and renewable energy resources rather than pursue fiscal austerity, European families would most likely be a lot less vulnerable to energy price rises.

The EU Commission’s most recent estimate of the ‘green investment gap’ is €490 bn per year. Other estimates suggest annual investments of up to €855 bn (excluding transport) in the EU 27 could be required to tackle climate change alone (thus precluding investments needed to thwart wider environmental breakdown). By its own standards, the EU Commission is only set to mobilise a third of this investment from both private and public sector sources.\textsuperscript{21} Outside of the unprecedented scale of investment needed, the type of recovery and green transition Europe needs is unlikely to be either on time, democratic, or fair without unlocking public finance for investment on a transformational scale.

Figure 3: EU public investment expenditure (outside of maintenance costs) has flattened over the last decade

\textit{Cumulative public investment net of depreciation since Q1 2002, € million quarterly, for Euro area 19 countries, compared to pre-2008 trend.}

:\textbf{Source: Authors' own calculations, Eurostat (2022) and Klein (2022).}
2.3 THE DECLINE OF SOCIAL SPENDING

With governments cutting their spending, the social sector budget took a significant hit – especially in the first part of the last decade. Adjusting for inflation and population size, social sector spending fell dramatically from 2010 before recovering to previous levels by 2015 (expenditure on health and education fell after 2010 and only recuperated to earlier levels 5 and 8 years later, respectively), then growing to new highs by 2019. However, had real social sector spending taken its pre-crisis trajectory, EU governments would be spending an additional €1,000 per person by 2019 (Figure 4). Before the crisis (2000–2009), real public expenditure on all socially relevant sectors increased at an average of 2.4% a year, only to fall by two-thirds to 0.80% for the following decade (2010–2019).

Figure 4: Expenditure in social sectors has barely recovered to pre-crisis levels


Source: Authors’ own calculations, Eurostat (2022)
Over 95.4 million people out of the EU’s 440 million population are officially registered as being at risk of living in poverty – while one in four children face poverty and social exclusion.\textsuperscript{22,23} Unemployment in the euro area remains stubbornly high, at nearly 10\% in 2021 (excluding Germany).\textsuperscript{24} The International Monetary Fund (IMF) estimates that the surge in energy prices would raise European families’ cost of living by 7\%, on average in 2022 without any specific policy response.\textsuperscript{25} This underestimates the highly regressive nature of price rises, imposing a heavier burden on low-income households because they spend a larger share of their budget on electricity and gas.\textsuperscript{26} Without effective targeted fiscal support, millions more risk falling into poverty and the standards of living of the majority of Europeans will continue to stagnate.

Furthermore, providing more than social transfers to those on low incomes can be used to shape the future of the economy. Spending on education, health, and community infrastructure are also investments that improve the productive capacity of the economy. A smarter, healthier, and well-connected population can more flexibly adapt to global economic shocks while reducing their prevalence internally. Public investment and expenditure targeted at those on low incomes have some of the highest fiscal multipliers, i.e., they provide the greatest positive impact on growth of any type of government spending.\textsuperscript{27,28} Policymakers should, therefore, be much more cautious when cutting social spending as this will lead to a large fall in growth.

\textbf{2.4 FISCAL RULES FAILING ON THEIR OWN TERMS}

As highlighted in Section 2.1, and supported by an array of academic evidence,\textsuperscript{29} austerity and fiscal rules depressed economic activity by withdrawing crucial spending and investment amid private sector weakness and a recession. The cuts to spending and investment at the height of the crisis contributed to and prolonged the decline in economic activity. Figure 5 shows a strong negative correlation between the reduction in the government’s primary balance (the fiscal surplus/deficit excluding net interest payments on public debt) and economic output from 2009 to 2019. This decline in national income would consequently lead to a fall in tax receipts and an increase in the deficit. Thus increasing the debt, while a reduction in GDP would lead to a higher debt-to-GDP ratio overall. As shown in Figure 6, the countries that pursued greater austerity and cuts to public expenditure ended up with higher, rather than lower, debt levels.

While these correlations do not necessarily imply austerity was the direct cause of lower growth and higher debt levels, it does show that austerity certainly didn’t help achieve

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\textsuperscript{h} Authors’ own calculations, based on Eurostat (2022). Inspired by Kelin (2019).
lower debt and higher growth for the countries most affected. Accordingly, fiscal rules in their current form predominantly failed on their own standards – rather than reducing debt levels following the 2008 global financial crisis, higher debt levels overall ensued.\textsuperscript{30}

As explored in sections 2.1 to 2.3, the main experience of fiscal rules for Europeans has been policies that suppress growth by cutting back on social spending and reducing investment in the economy. This has not only led us to be less resilient to economic shocks but also led to a visible decline in living standards for many, particularly poorer, Europeans. Furthermore, as Figures 5 and 6 show, these policies appear to be counterproductive – countries that made great fiscal sacrifices have done worse in terms of growth and in terms of debt.

Figure 5: Low growth and budget cuts went hand-in-hand in major European economies

*Change in cyclically adjusted primary balance and change in GDP for European high-income economies (IMF), 2009-2019.*

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\includegraphics[width=\textwidth]{figure5.png}
\end{center}

\textit{Source: Authors' own calculations based on IMF (2022)}
Europe’s fiscal framework – the people’s view?

Figure 6: The countries that cut their budgets the most saw the biggest increases in their debt-to-GDP ratios in major European economies

Change in cyclically adjusted primary balance and change in the debt-to-GDP ratio (%) for European economies, 2009-2019.

\[ y = 2.7394x - 4.3726 \]

Harsher fiscal consolidation  
Change in Cyclically Adjusted Primary Balance (%)

Source: Authors’ own calculations based on IMF (2022)

What we are left with is a Europe suffering from chronic underinvestment due to adherence to strict fiscal rules with nothing to show for it. This failure to provide good outcomes has no doubt influenced the opinions of EU citizens on how fiscal policy is conducted. As we explore in the next section there is clear disapproval of policies that have reduced the welfare of European citizens.
3. CITIZEN’S SURVEY

To help better understand the views of people living in Europe as a result of fiscal policy, the New Economics Foundation and Finance Watch surveyed EU citizens’ views on austerity and the EU’s fiscal framework. The cross-country survey offer data from representative national samples of 5,000 European citizens’ across Denmark, France, Germany, Ireland, and Italy. Despite certain limitations (i.e., the sample lacks input from Central and Eastern European countries), to our knowledge, it is one of the first cross-national surveys of this size on the European experience of austerity and fiscal rules. We do not take the sample results as conclusive; further research is required, but these findings may offer important indicative insight into the lived experiences of many Europeans – especially when considered alongside other macro-economic data.

3.1 AUSTERITY IS AN OVERWHELMING CONCERN FOR EUROPEANS

The primary results of the cross-national survey largely vindicate our analysis by showing general frustration with the policy approach taken. The vast majority of respondents (70%) were either ‘very concerned’ or ‘quite concerned’ about the EU enforcing a return of austerity to reduce their borrowing and debt levels.

While there were some regional disparities, these findings held across the board. In Germany, which under Angela Merkel had been one of the sternest advocates for stringent fiscal rules, nearly two-thirds (63%) of respondents were concerned overall (Figure 8). Indeed, broadly speaking, German politicians are some of the strongest proponents of a swift return to fiscal rules – namely the EU’s 3% cap on annual deficit and its 60% debt-to-GDP threshold – with stricter enforcement and only some wriggle room for the pace of debt reduction.

Around three-quarters of all people who expressed an opinion in Italy (84%) and Ireland (78%) said they were concerned about austerity. This above-average concern is likely because Italy had to cut its borrowing in half and Ireland reduced its borrowing by over 10% of GDP due to EU-enforced policies in 2009–2015. The effects of these policies are detailed by Oxfam, with families pushed into poverty with lower welfare payments and higher taxes in Ireland and a reduced safety net for vulnerable groups in Italy leading to an increase in poverty and inequality.

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iii The fieldwork for this survey was conducted between 18th and 23rd February 2022, notably before the Russian invasion of Ukraine.
Figure 7: Seven out of ten European citizens surveyed were concerned about a possible return to austerity to reduce debt levels.

*How concerned are you, if at all, about the potential impact of economic austerity if the EU tries to force governments to cut borrowing to reduce their debts over the next five years? Aggregated response from survey respondents (excludes don’t knows) in Germany, France, Italy, Ireland, and Denmark, 2022.*

Source: NEF and Finance Watch Poll of EU citizens (2022)

As shown in Section 1, the dampening impact austerity has had on growth has meant households have lost out on just under €3,000 in yearly income or just under €25,000 in total since 2009. Austerity reduced incomes and growth across EU nations. This helps explain why a considerable majority of the responses are concerned. While not everyone was pushed into poverty, it appears people felt worse off and would like to avoid it being reimplemented.
Europe’s fiscal framework – the people’s view?

Figure 8: Roughly two out of three (63%) in Germany are concerned about austerity to reduce borrowing and debt levels

How concerned are you, if at all, about the potential impact of economic austerity if the EU tries to force governments to cut borrowing to reduce their debts over the next five years? Response (excludes don’t knows) at country level, 2022.

Source: NEF and Finance Watch Poll of EU citizens (2022)

3.2 EUROPEANS WANT MORE FLEXIBILITY FOR SPECIFIC ACTIVITIES

Unsurprisingly, just under two out of three of the respondents (64%) agreed the EU’s fiscal rules should be changed to allow governments to increase spending on education, health and social care, and jobs (Figure 9). This rises to 74% in Ireland and 78% in Italy, two of the countries hit hardest by austerity measures in the aftermath of the 2008 financial crash.

This finding might be particularly important given policymakers that are open to changing the fiscal rules tend to suggest that flexibility is primarily needed to support investments in decarbonisation, technology, and defence. These findings suggest that the €1,000 per person cuts to social spending do not have public support.

In times of fiscal consolidation, austerity has primarily meant spending cuts on the social sector rather than tax rises on the rich, which can be seen as an ideological bias of austerity, rewriting and worsening the social settlements across European countries at the expense of the most vulnerable in society. Meanwhile, the richest have been able to get away relatively unchanged due to their lack of reliance on public services.


Figure 9: Two out of three people polled agree EU fiscal rules should be changed to allow governments to increase spending on education, health and social care, and jobs

Overall level of agreement or disagreement with the following statement: I believe that the EU economic rules should be changed to allow governments to increase spending on better education, health and social care, and jobs.

Aggregated response (excludes don’t knows) from Germany, France, Italy, Ireland and Denmark, 2022.

64% Agree

Source: NEF and Finance Watch Poll of EU citizens (2022)

Therefore, the overwhelming political consensus on using fiscal rules to promote higher spending for better quality public service is likely due to Europeans recognising that the quality of their public services has fallen in recent years from lack of investment/direct cuts. It also suggests there probably isn’t much appetite to cut these back further than the €1,000 already cut per person and continue to underinvest.

In the meantime, the proportion of respondents (57%) believing the rules should be changed to allow more spending to thwart climate breakdown outweighed those that disagreed (14%) fourfold (Figure 10). Indeed, nearly two-thirds (64%) of the respondents from Italy, France, and Ireland suggested more fiscal flexibility was required for greater spending on green infrastructure and innovation.

Meanwhile, just over one in ten respondents (10% and 12%) indicated that rules didn’t need changing for greater spending on public services and climate change, respectively (Figure 11). In Germany, only one in seven of those polled (14%) disagreed that the rules on how much the government borrows should be changed, a potentially significant number for Olaf Scholz’s centre-left government as it attempts to radically alter its energy policy.39 In Denmark, traditionally one of the EU’s Frugal Four, fewer than one in
six (16%) of those surveyed disagreed that the rules should be changed to allow for greater spending to tackle climate change.

Figure 10: Europeans support a change to fiscal rules that increases spending to thwart climate breakdown 4x more than those that oppose it

Overall level of agreement or disagreement with the following statement: I believe that the EU economic rules should be changed to allow governments to increase spending on green infrastructure and innovation to enable them to tackle climate change. Aggregated response from Germany, France, Italy, Ireland, and Denmark (excludes don’t knows), 2022.

Source: NEF and Finance Watch Poll of EU citizens (2022)

Indeed, our polling suggested that the fiscal flexibility demonstrated throughout the pandemic should be continued as it will enable countries to rebuild and adequately recover. Since the start of the pandemic, the general escape clause has been implemented giving countries a temporary amnesty on fiscal rule requirements. The pandemic illustrates that the EU can exhibit flexibility when it comes to debt and borrowing when needed. Our polling shows that a large majority of people (63%) would like the rules to continue to be flexible in this way, while only 12% disagreed (Figure 12).

This finding seems to support recent comments made by the President of the European Commission, Ursula von der Leyen. In discussing reform to the fiscal rules, Leyen (2022) tacitly dissociated herself from the era of austerity by suggesting that the Covid spending packages not only offered a “boost to our economic confidence” but also a model for dealing with the present energy and environmental crises.40
Figure 11: Across the board, very few people disagreed that a change in Europe’s fiscal rules is needed

*Overall level of disagreement with the following statements: I believe that the EU economic rules should be changed to allow governments to (1) increase spending on better education, health and social care, and (2) jobs to increase spending on green infrastructure and innovation to enable them to tackle climate change. Country-level responses, 2022.*

Source: NEF and Finance Watch Poll of EU citizens (2022)

These findings appear particularly salient given a return to current rules would imply over half of current EU member states would be breaking the fiscal rules and have to be put on suggested policy paths of fiscal consolidation. This would most likely limit their capacity to improve public services and respond to the pressures of climate change.
Europe’s fiscal framework – the people’s view?

Figure 12: The fiscal flexibility demonstrated throughout the pandemic should remain to help rebuild and recover

Overall level of agreement or disagreement with the following statement: The EU has temporarily lifted the rules limiting government borrowing to enable governments to deal with the coronavirus crisis. The rules should continue to be flexible after the pandemic to enable countries to rebuild. Aggregated response from Germany, France, Italy, Ireland, and Denmark (excludes don’t knows), 2022.

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Source: NEF and Finance Watch Poll of EU citizens (2022)

3.3 DEBT LEVEL STILL REMAINS A CONCERN

While the survey suggests a clear demand for change to the EU’s fiscal framework, this does not mean that respondents were not concerned about the levels of debt. More than two-thirds of respondents were concerned about the levels of debt accrued during the Covid-19 pandemic – with the highest levels of concern coming from Italy and Ireland potentially related to their more severe experiences of austerity as mentioned (Figure 13). These concerns are largely understandable, especially given governments will be borrowing more to support families and businesses throughout the cost of living crisis.

Importantly, however, the anxiety surrounding debt levels should be contextualised against concerns over returns to austerity and a desire for more flexible fiscal rules, especially to secure full employment and improved public services, and given our results in Section 2 showing that higher debt levels have worsened due to austerity. While there is a strong case that current debt levels are not necessarily dangerous or bad for growth, there are several ways of managing debt levels over time outside of the fiscal austerity approach taken in the aftermath of 2008 (further discussed in the conclusion section).
Europe’s fiscal framework – the people’s view?

Figure 13: Despite wanting change – debt levels are still a significant concern to Europeans

How concerned are you about the current levels of government debt? Country-level responses (excludes don’t knows), 2022.

Source: NEF and Finance Watch Poll of EU citizens (2022)

3.4 LACK OF UNDERSTANDING AROUND EUROPE’S FISCAL RULES REMAINS

Lastly, our results also showed that only 10% of our respondents said they had a good understanding of the EU’s fiscal rules. Meanwhile, the majority of Europeans (57%) surveyed said they don’t understand the fiscal rules (Figure 14). This goes up to 70% for respondents from Germany, which is interesting given their elected representatives hard-line stance on fiscal rules.

On the one hand, this is unsurprising given the complexity of the fiscal framework in the EU. On the other hand, it supports the general premise of this briefing that much of the discussion around the fiscal framework has happened behind closed doors and been left to technocratic decision-makers. Despite this lack of involvement, the rest of our results show that Europeans believe that the fiscal rules need fixing. Whether this is a reflection of the investment, social spending, and income gaps outlined in Section 2 or an acknowledgement that the fiscal rules haven’t worked as intended is unclear. What is clear is that there is a desire to reform fiscal rules to allow the EU to transform its environment while improving health, education, and social care and providing good jobs.
Europe’s fiscal framework – the people’s view?

Figure 14: Majority of Europeans do not understand EU fiscal rules

To what extent do you understand the EU’s rules limiting government borrowing in your country? Response at country level, 2022.

Source: NEF and Finance Watch Poll of EU citizens (2022)
4. CONCLUSION

The pursuit of fiscal consolidation during a deep recession after the 2008 global financial crisis, under the guise of austerity and the basis of narrow fiscal rules, led to lower living standards. Furthermore, those fiscal rules failed on their own terms – rather than reducing debt levels following the 2008 global financial crisis, higher debt levels and economic stagnation ensued. Instead, the fiscal rules meant European governments seemingly accepted permanent scarring of incomes, reductions in capital spending, and cuts to social expenditures as if there was no alternative. At the same time, ultimately, the post-2008 approach to fiscal policy was not based on mainstream macroeconomic policy prescriptions and thus left European economies less able to cope with the consequences of the pandemic and the current cost of living crisis.

While the spending packages put together to deal with the Covid pandemic and now the looming energy and cost of living crisis could offer a model for dealing with environmental and energy crises, powerful voices are pushing for a return to the status quo. These voices are calling for a swift re-introduction of the old, outdated fiscal rules, which would require significant fiscal tightening for the majority of European countries (that borrowed significantly to deal with the pandemic and cost of living crises) under the European Commission’s excessive debt procedure.

Evidence from our cross-country survey suggests that 70% of Europeans are concerned about a re-introduction of the fiscal rules in their current form. The polling suggests public opinion is in favour of government spending to help create new jobs, increase the quality of public and social services, and help thwart environmental breakdown. The political consensus on using fiscal rules to promote higher spending for better quality public service is likely due to Europeans recognising that the quality of their public services has fallen in recent years from lack of investment/direct cuts. Nevertheless, our findings did suggest that 75% of European citizens have worries about the relative size of the debt levels facing European countries – yet as our analysis shows, current fiscal rules and austerity are certainly not the best way to deal with this.

While there is a strong case that current debt levels are not necessarily dangerous or bad for growth, there are several ways of managing debt levels over time outside of fiscal austerity (cuts to public spending and investment). For example, growth-enhancing investments through borrowing may create new jobs and boost economic activity, while creating more tax receipts for the government over time (i.e., growth-enhancing investments will pay for themselves). Longer-dated bonds could be issued to allow inflation to gradually erode the original amount borrowed. Interest rates can be kept
artificially low through several regulatory (e.g. credit guidance) or monetary policy tools (e.g. yield curve control or tiering of reserves). Governments could tax more over time alongside the loosening of fiscal rules – especially on the wealthy, or the entities that experienced windfall gains during the pandemic and current cost of living crisis.\(^\text{42}\)

Of course, there are trade-offs to all these approaches, but the point here is that reducing debt levels does not necessarily have to mean a short-term reduction in borrowing, especially a reduction that is brought about by a reduction in public spending. These are policy choices, that in the past have been seemingly guided by narrow political ends rather than the latest standard economic or environmental thinking.

Policy choices and mistakes of the past mustn’t be repeated; fresh thinking around the fiscal frameworks is urgently required. Lessons from the Covid spending packages to deal with the present energy and environmental crises seem like a good place to start.
ENDNOTES

1 Wren-Lewis, S. (2018). The lies we were told: Politics, economics, austerity and Brexit. Policy Press.
9 Ibid.
Europe’s fiscal framework – the people’s view?

36 Ibid.
Europe’s fiscal framework – the people’s view?
