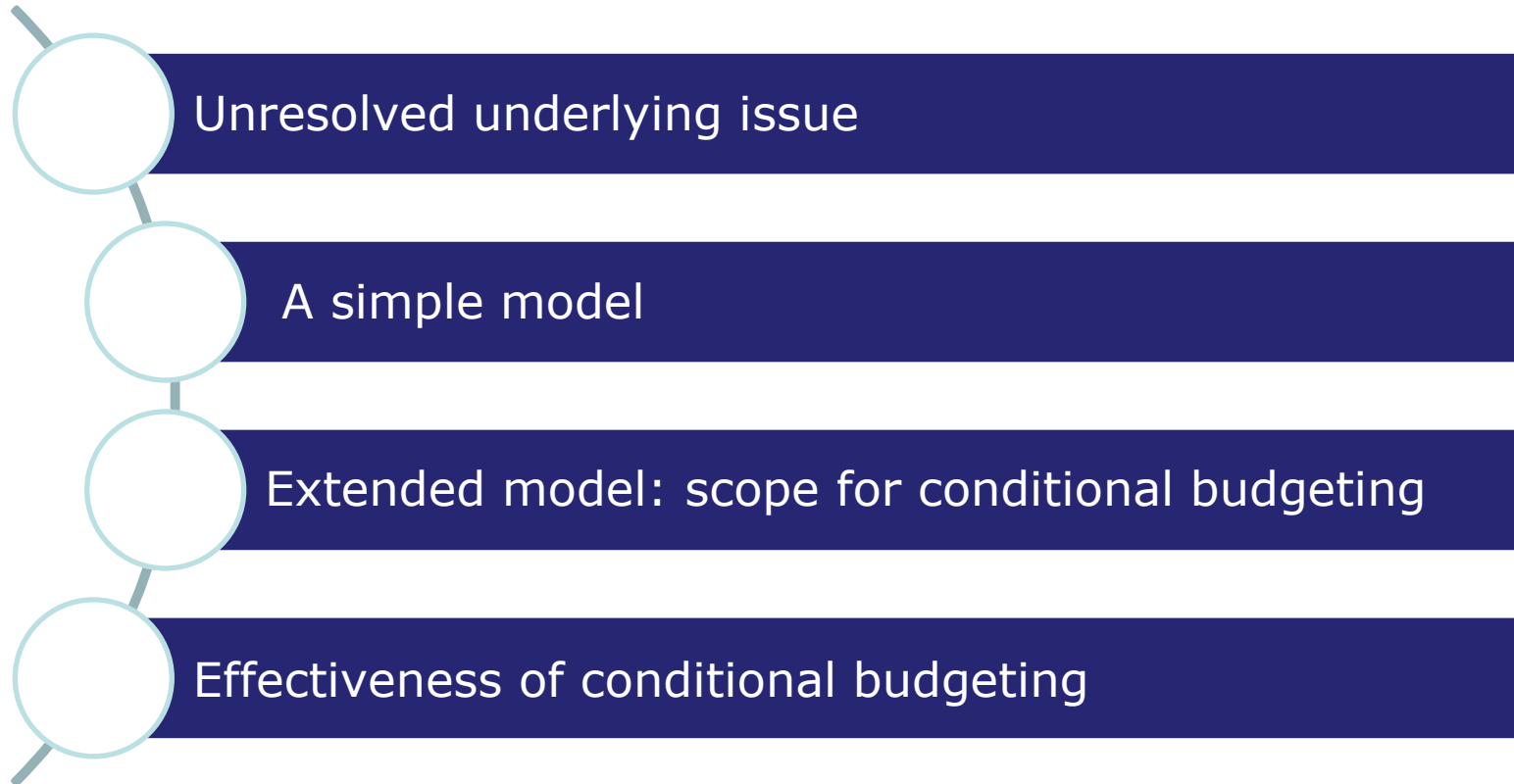# Broadening the perspective on the EU budget: Fiscal arrangements safeguarding the EU's capacity to act in an evolving geopolitical and economic context

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Banca d'Italia Public Finance Workshop
4-5 September 2025

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- Unresolved underlying issue

- A simple model

- Extended model: scope for conditional budgeting

- Effectiveness of conditional budgeting

Recurring but unheeded calls:
EU budget is too small! EU needs a CFC!

➢ ...

➢ 2015   Five Presidents' report

➢ 2016   Monti report

➢ 2024   Draghi report

Lack of credibility in recurring calls

"We cannot say we are more European than others when our debt is the obstacle for others to accept common solutions"

„To be more European with the money of others is something the others are not ready to accept"

25 March 2024, IEP@BU Webinar Series: The Future of the EU Institutions
Giuliano Amato, former Italian Finance Minister and Vice President of the Convention on the Future of Europe

Unresolved underlying issue

To: M. Lamfalussy

Copy to: Dr. Baer

From: Claudio Borio

Macro-fiscal policy co-ordination in an EMU

- the need to avoid disproportionate use of Community savings by one country;
- a possible bias towards lack of fiscal restraint;

Source: Archive of the Delors committee, DelC 5.4 Delors Committee documents:
https://www.ecb.europa.eu/ecb/access_to_documents/archives/delors/html/index.en.html
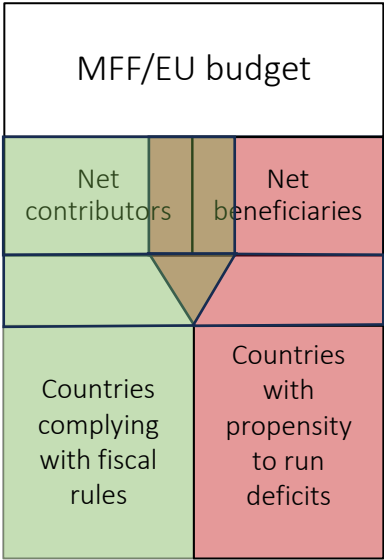
One way that this could happen would be if a particular government encountered refinancing difficulties. Since a certain part of claims on that government might result from earlier voluntary lending by residents of other Community countries, there could be strong political pressure throughout the Community to bail out the government in financial trouble. Such pressure might be difficult to resist, especially if the country facing refinancing problems was relatively large and if the EMU implied stronger solidarity ties. Through these bail-out arrangements, citizens of other member countries would effectively be taxed and their savings "exploited" by the national government concerned.

Source: Archive of the Delors committee, DelC 5.4 Delors Committee documents:
https://www.ecb.europa.eu/ecb/access_to_documents/archives/delors/html/index.en.html

Unresolved underlying issue

Original Maastricht architecture

Post – 2008 architecture

Redistribution agreed ex ante

MFF/EU budget

Net contributors | Net beneficiaries

Fiscal performance

Countries complying with fiscal rules | Countries with propensity to run deficits

Fiscal rules + no-bail-out clause

Redistribution by (recurring) accidents in vulnerable countries

NO

Countries with high debt get financial support (EFSM, ESM, NGEU, SURE, SAFE)
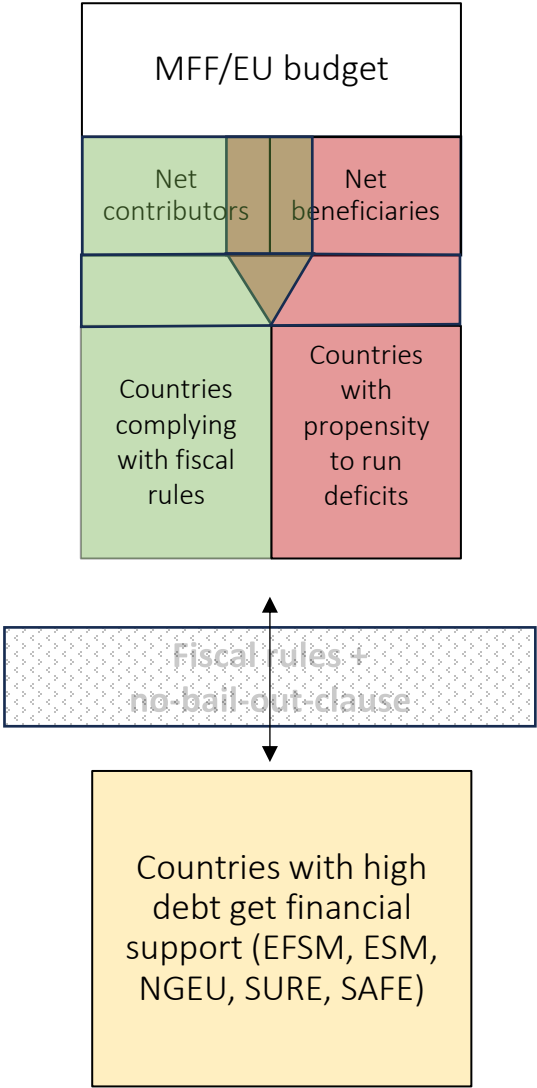
A simple model

2 groups of countries

- Group D: enjoys political + economic benefits from running deficits <u>in normal/good times</u>
- Group S: runs sustainable fiscal policies

SGP implementation takes place in three stages
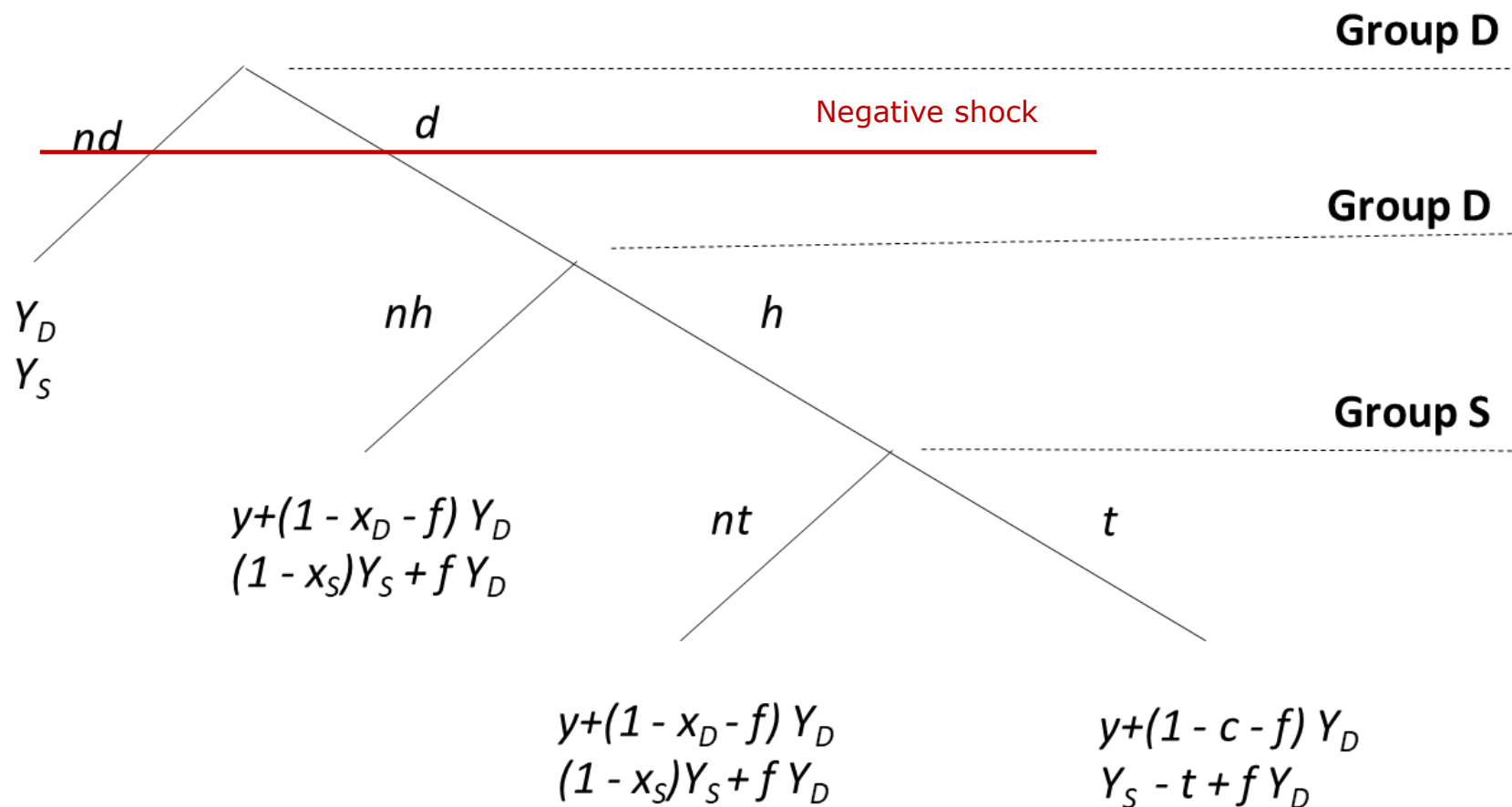
- Stage 1: Group D decides its fiscal policy course
- Stage 2: An economic shock hits and Group D decides whether to ask for help or not
- Stage 3: Group S decides whether to offer help and under which conditions

Extensive form

Group D

nd *d*

Negative shock

Group D

Y_D
Y_S

nh *h*

Group S

$y+(1 - x_D - f)\,Y_D$
$(1 - x_S)Y_S + f\,Y_D$

nt

t

$y+(1 - x_D - f)\,Y_D$
$(1 - x_S)Y_S + f\,Y_D$

$y+(1 - c - f)\,Y_D$
$Y_S - t + f\,Y_D$

Main conclusion: enforcement dilemma

In event of large shock, Group S will provide financial support if asked by D **because $t < x_S\,Y_S$** ($x_S\,Y_S$ economically and politically the worst possible outcome)

Group D will ask for financial support if $c < x_D$. Policy conditions cannot be too strict (corollary: non-EU power may offer help which reduces x_D)

If Group D has a blocking minority in Council, sanctions will not be applied: $f=0$. Hence, the decision of D mainly depends on the policy conditions in the event of a major shock: $y < c\,Y_D$

Extension of simple model
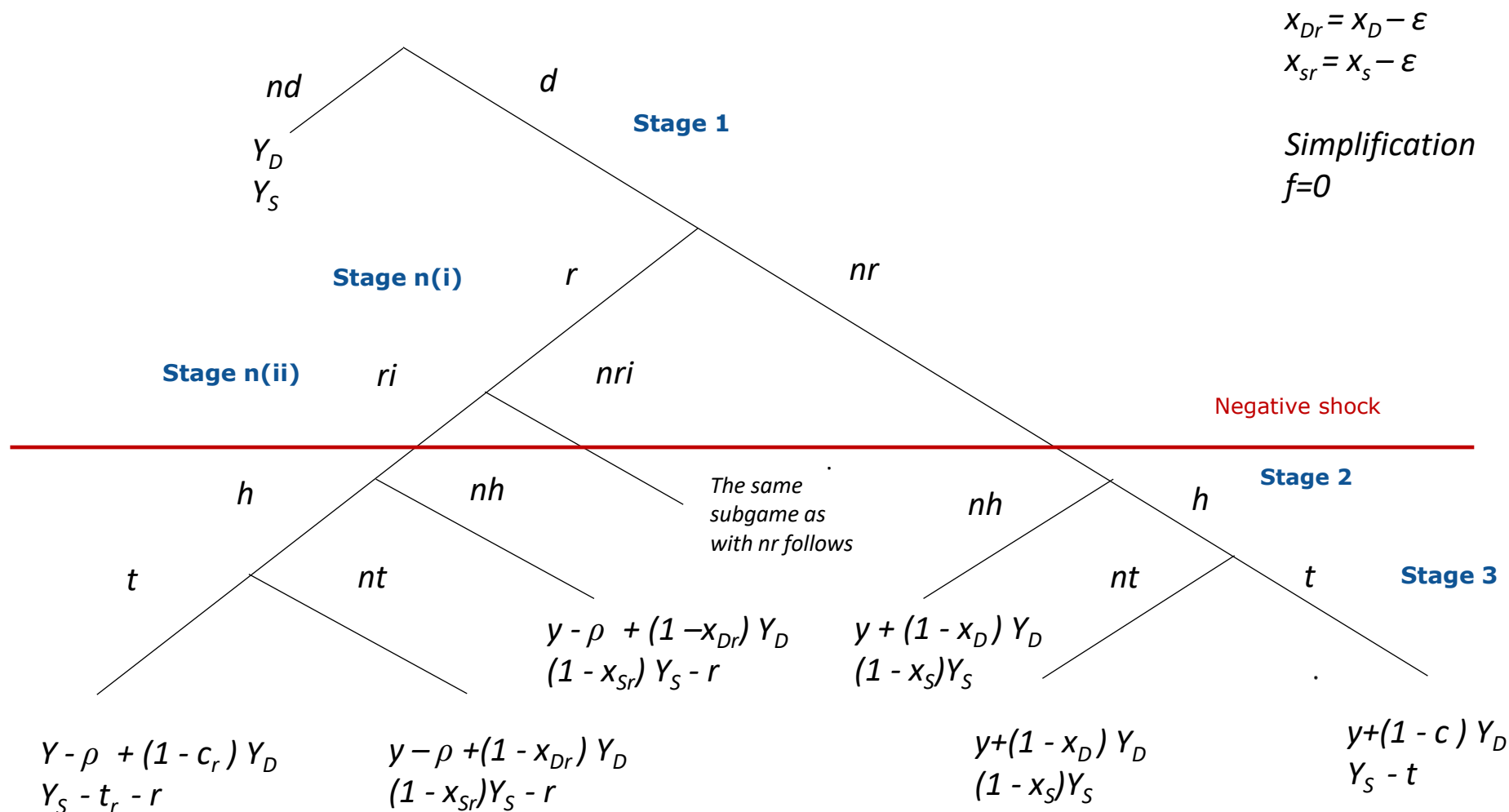
2 groups of countries

- Group D: enjoys political + economic benefits from running deficits
- Group S: runs sustainable fiscal policies

SGP implementation takes place in three + 2 stages

- Stage 1: Group D decides its fiscal policy course
- Stage n(i) Group S decides whether to grant r subject to reforms and investments,
- Stage n(ii) Group D decides on help r which produce net costs ρ
- Stage 2: An economic shock hits and Group D decides whether to ask for help or not
- Stage 3: Group S decides whether to offer help and under which conditions

Scope for conditional budgeting

Extensive form of extended simple model

$$x_{Dr} = x_D - \varepsilon$$
$$x_{sr} = x_s - \varepsilon$$

Simplification
f=0

Stage 1

nd | d

Y_D
Y_S

Stage n(i) | r | nr

Stage n(ii) | ri | nri

Negative shock

h | nh | *The same subgame as with nr follows* | nh | h | **Stage 2**

t | nt | nt | t | **Stage 3**

$y - \rho + (1 - x_{Dr}) Y_D$
$(1 - x_{Sr}) Y_S - r$

$y + (1 - x_D) Y_D$
$(1 - x_S) Y_S$

$Y - \rho + (1 - c_r) Y_D$
$Y_S - t_r - r$

$y - \rho + (1 - x_{Dr}) Y_D$
$(1 - x_{Sr}) Y_S - r$

$y + (1 - x_D) Y_D$
$(1 - x_S) Y_S$

$y + (1 - c) Y_D$
$Y_S - t$

Larch, M. (2025) The RRF approach: A way to overcome the impasse towards a bigger EU budget, Bruges European Economic papers No. 47.
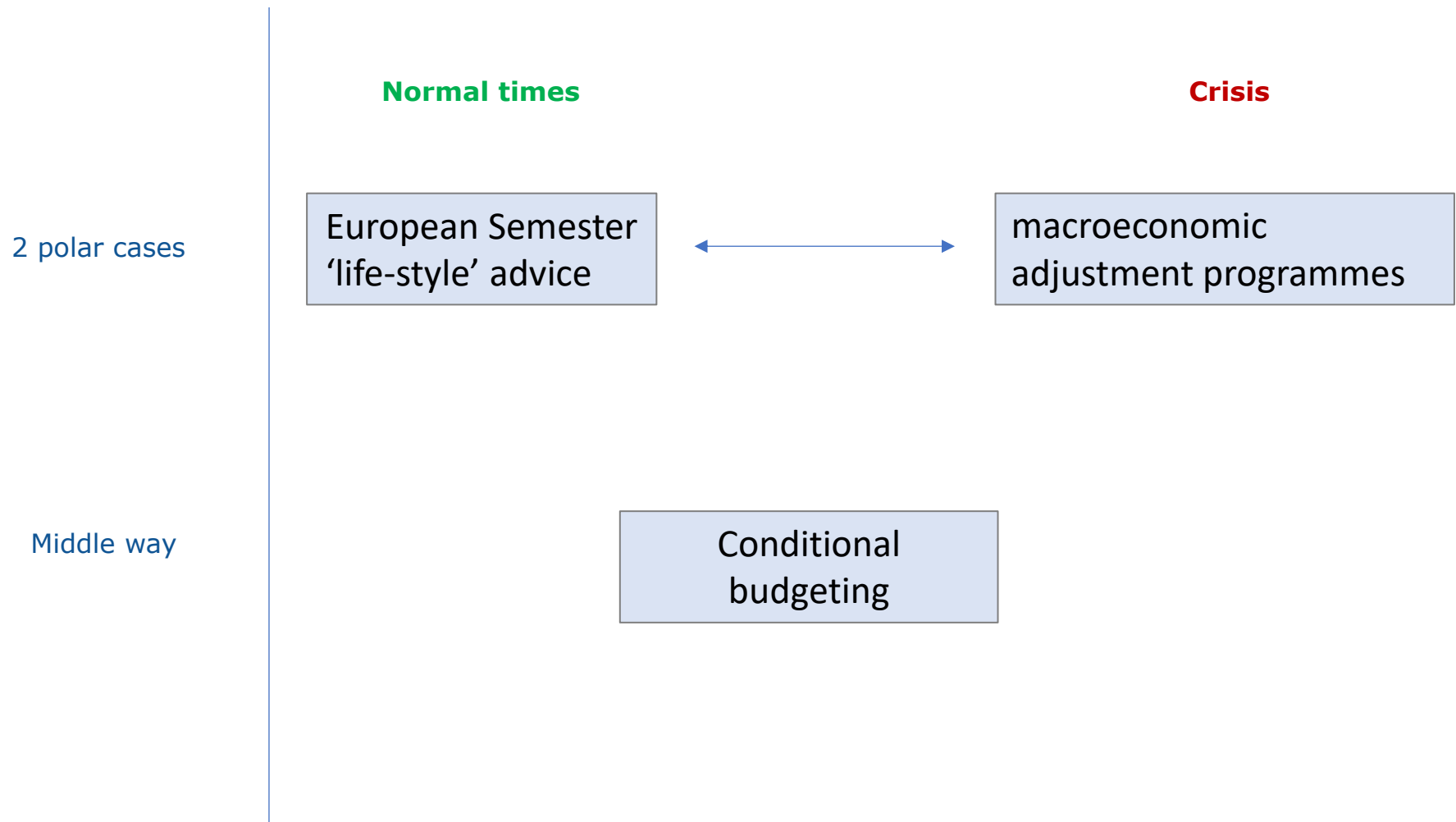
Main conclusions of extended model

Group S offers **additional transfers r in normal times in return for investments and reforms** if costs are smaller than those incurred to avert a meltdown of the system: $Y_S(x_s - \varepsilon) + r < t$. **Effectiveness of reforms and investment is crucial.**

Group D **accepts transfer r** if costs of implementing investments and reforms do not exceed those of the alternative: $\rho + (x_D - \varepsilon)Y_D < c\, Y_D$. **Effectiveness of investment and reforms is crucial**.
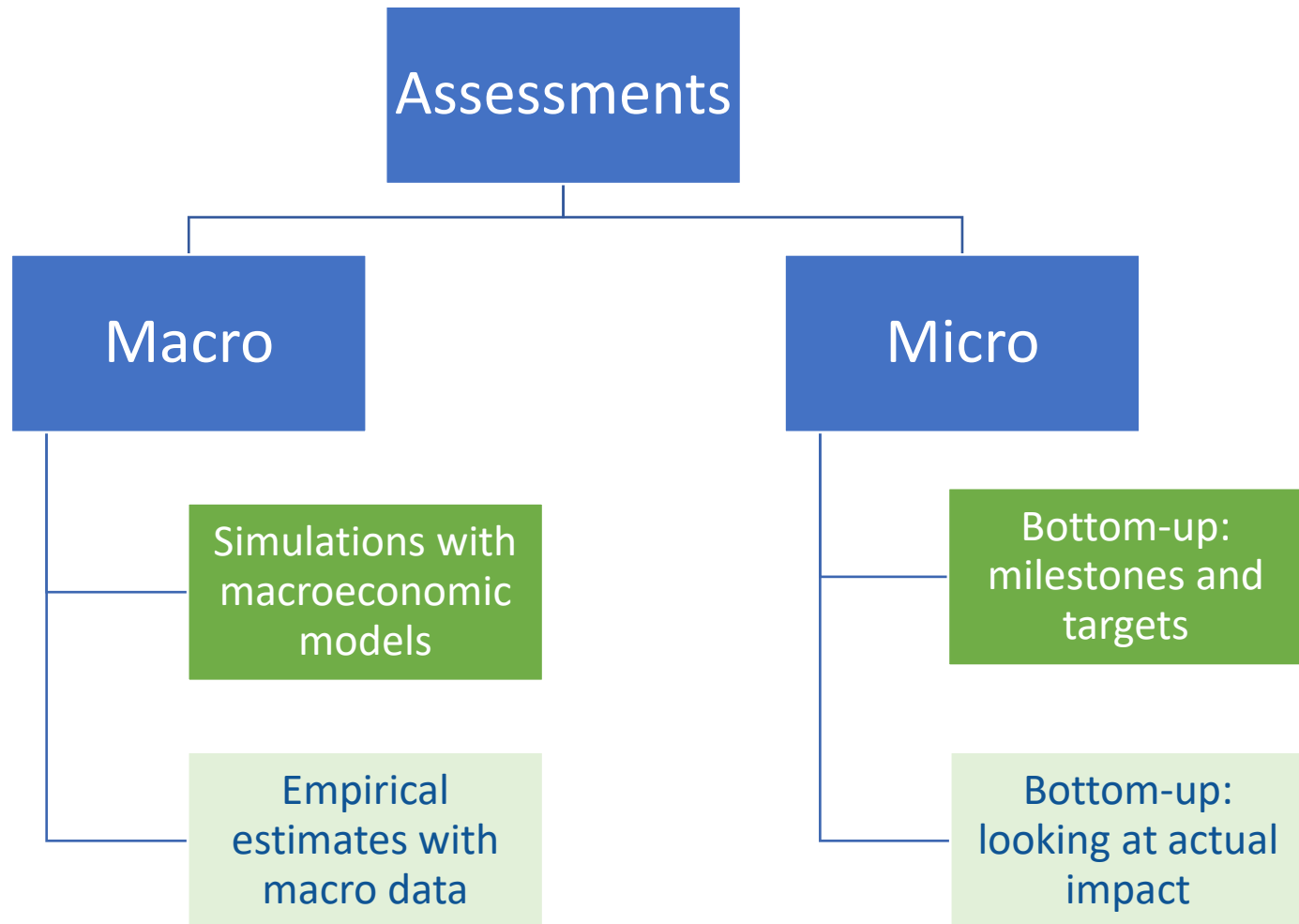
Group D **could accept the deal and not follow through**. However, in that case, given the conditionality arrangement, r would not be released. Back to basic model.

Scope for conditional budgeting

Implications for EU economic governance

Normal times   **Crisis**

2 polar cases

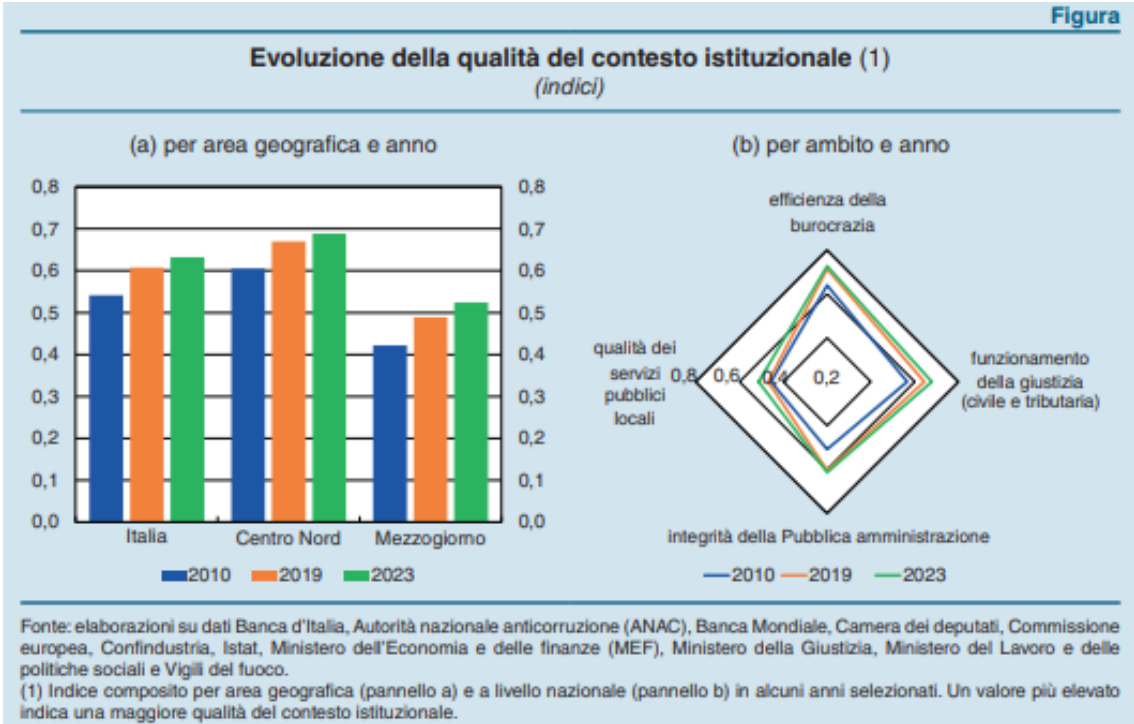| European Semester 'life-style' advice | ⟷ | macroeconomic adjustment programmes |

Middle way

Conditional budgeting

Effectiveness of conditional budgeting (RRF experience)

Effectiveness of conditional budgeting (RRF experience)

Top-down: looking at actual impact – institutional quality

The case of Italy (single largest beneficiary of RRF)

Figura

Evoluzione della qualità del contesto istituzionale (1)
(indici)

(a) per area geografica e anno

(b) per ambito e anno

Fonte: elaborazioni su dati Banca d'Italia, Autorità nazionale anticorruzione (ANAC), Banca Mondiale, Camera dei deputati, Commissione europea, Confindustria, Istat, Ministero dell'Economia e delle finanze (MEF), Ministero della Giustizia, Ministero del Lavoro e delle politiche sociali e Vigili del fuoco.
(1) Indice composito per area geografica (pannello a) e a livello nazionale (pannello b) in alcuni anni selezionati. Un valore più elevato indica una maggiore qualità del contesto istituzionale.
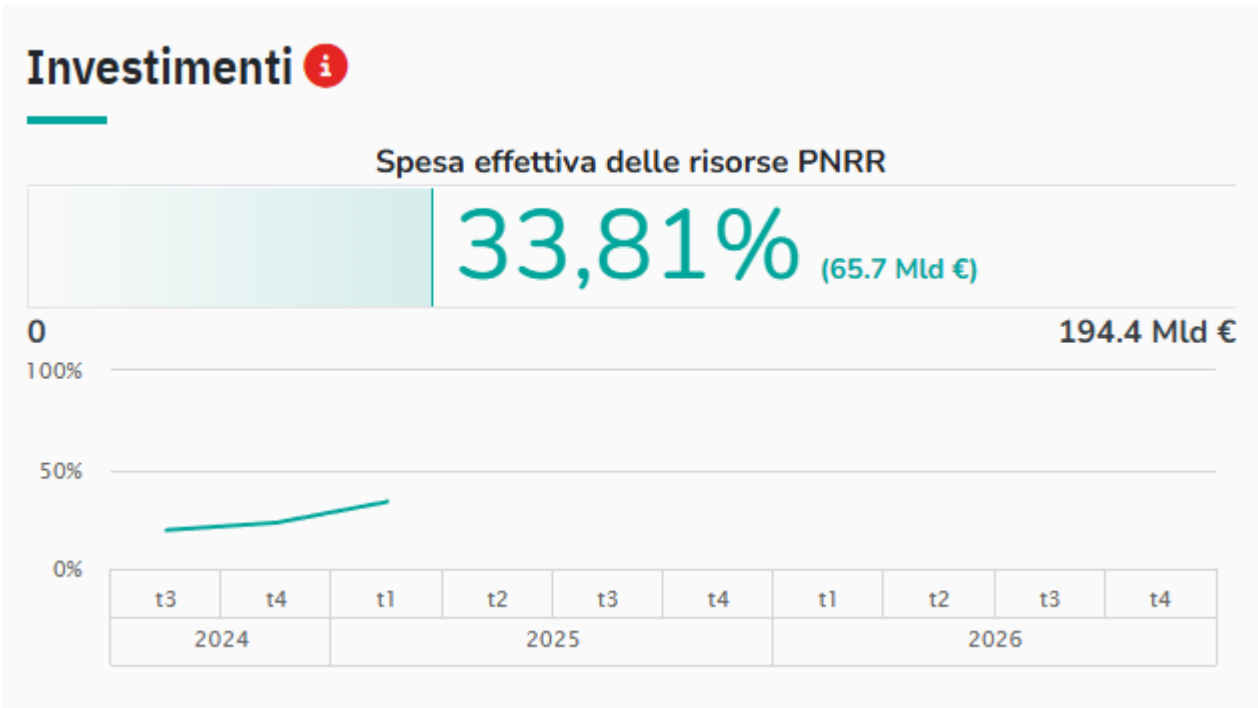
Source: Banca d'Italia annual report 2024

Effectiveness of conditional budgeting (RRF experience)

Bottom-up: looking at actual impact – spending

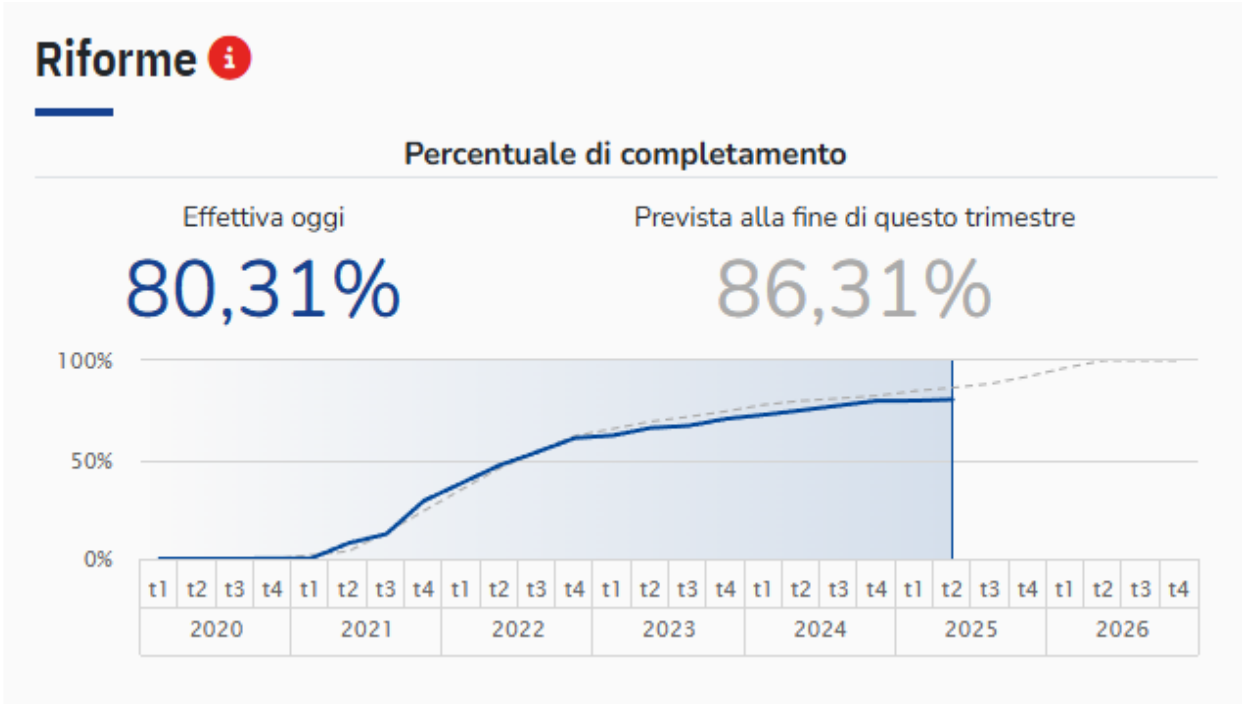The case of Italy (single largest beneficiary of RRF)

Investimenti

Spesa effettiva delle risorse PNRR

33,81% (65.7 Mld €)

0   194.4 Mld €

	t3	t4	t1	t2	t3	t4	t1	t2	t3	t4
	2024		2025				2026			

Sourse: Openpolis.it

Effectiveness of conditional budgeting (RRF experience)

Bottom-up: looking at actual impact – reforms

The case of Italy (single largest beneficiary of RRF)

Riforme ⓘ

Percentuale di completamento

Effettiva oggi

80,31%

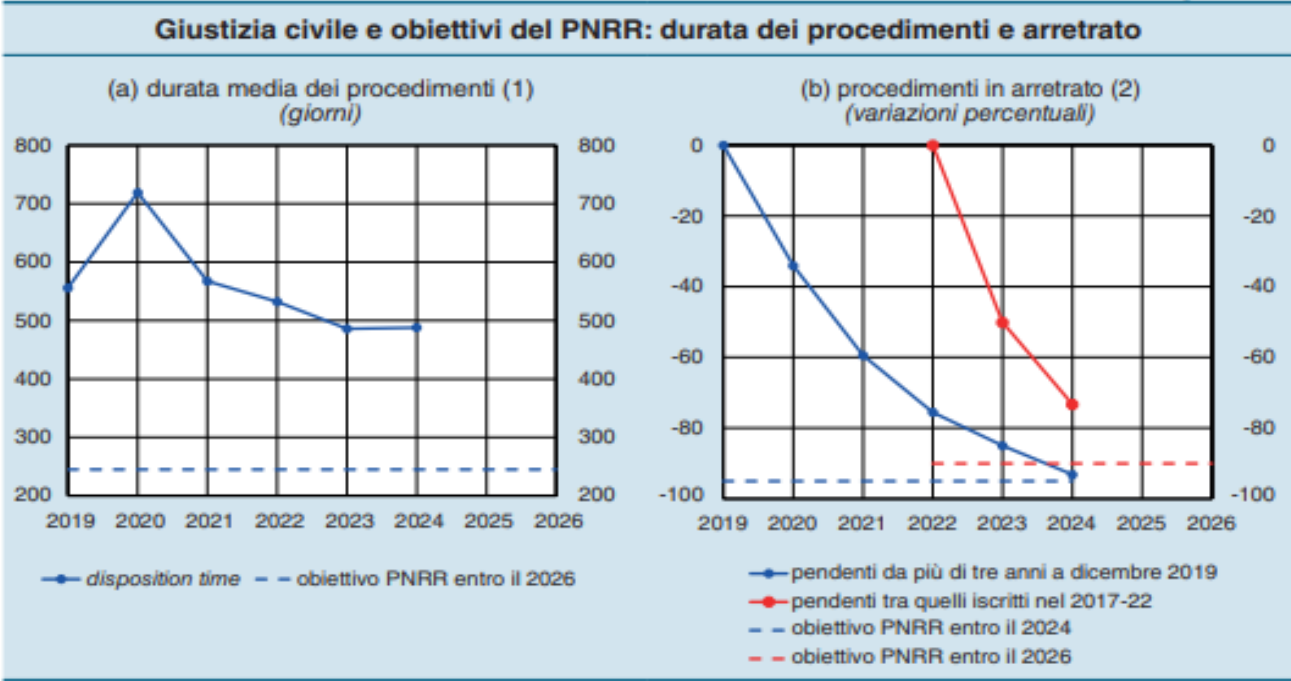**Prevista alla fine di questo trimestre**

86,31%

Source: Openpolis.it

Effectiveness of conditional budgeting (RRF experience)

Bottom-up: looking at actual impact - civil judicial system

The case of Italy (single largest beneficiary of RRF)

Figura 11.1

Giustizia civile e obiettivi del PNRR: durata dei procedimenti e arretrato

Fonte: elaborazioni su dati del Ministero della Giustizia.
(1) La linea continua blu rappresenta la durata dei procedimenti civili contenziosi negli uffici giudiziari di primo grado, quella tratteggiata rossa l'obiettivo del PNRR da raggiungere entro giugno del 2026 (245 giorni, corrispondenti a una riduzione del 56 per cento rispetto al 2019). La durata del procedimento è misurata con il *disposition time*, ossia il tempo medio di definizione dei procedimenti che si ottiene confrontando lo stock di quelli pendenti alla fine dell'anno con il flusso dei procedimenti definiti nell'anno stesso. – (2) Le linee continue rappresentano la percentuale di riduzione dell'arretrato, con riferimento ai procedimenti iscritti prima del 2017 e ancora pendenti a dicembre del 2019 (linea blu) e a quelli iscritti tra il 2017 e il 2022 e ancora pendenti a dicembre di quest'ultimo anno (linea rossa); le linee tratteggiate rappresentano i relativi obiettivi del PNRR, corrispondenti rispettivamente a una riduzione dell'arretrato del 95 per cento entro dicembre del 2024 (linea tratteggiata blu) e del 90 per cento entro giugno del 2026 (linea tratteggiata rossa).
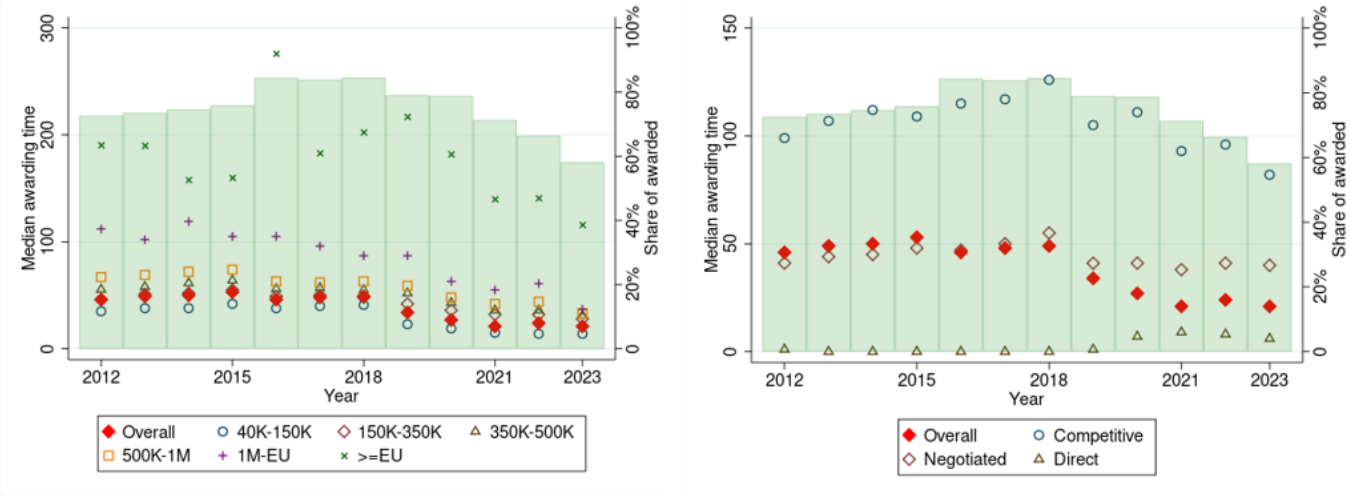
Source: Banca d'Italia annual report 2024

Bottom-up: looking at actual impact – public procurement

The case of Italy (single largest beneficiary of RRF)

Figure 2: Awarding time of **Public** works contracts between 2012 and 2023

Source: Own calculations based on data from the ANAC.

Source: Banca d'Italia annual report 2023

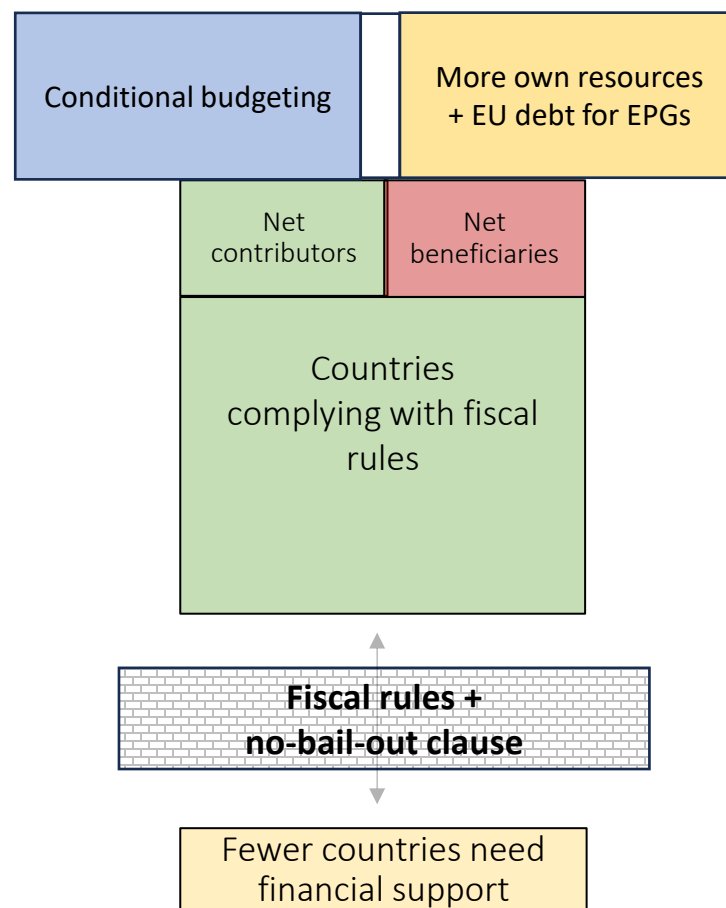# Scope for a bargain

Post – 2008 architecture

Possible post – 2027 architecture

Redistribution agreed ex ante

Fiscal performance
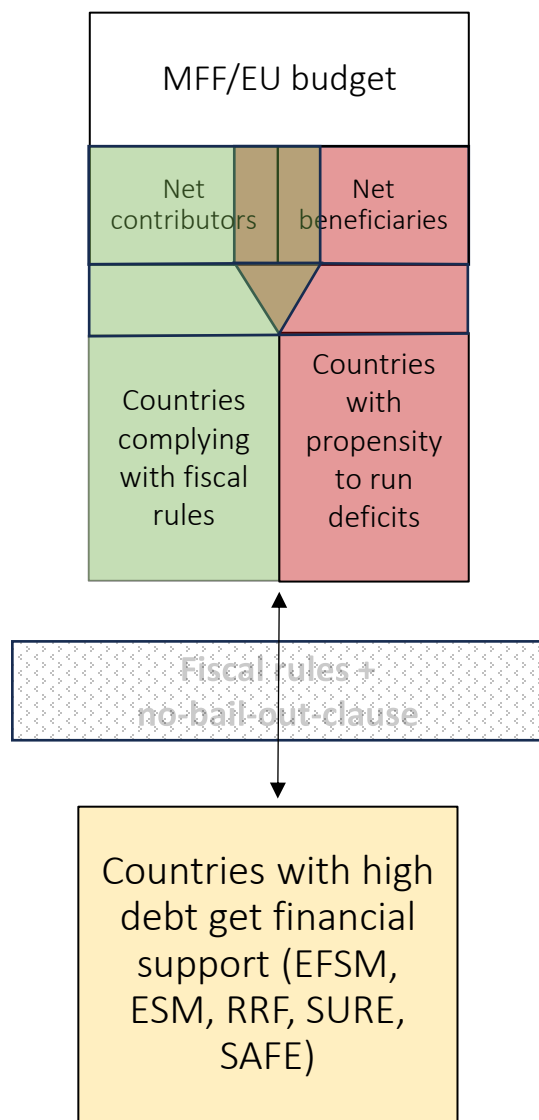
De facto redistribution by (recurring) accidents in vulnerable countries

MFF/EU budget

Net contributors | Net beneficiaries

Countries complying with fiscal rules | Countries with propensity to run deficits

Fiscal rules + no-bail-out-clause

Countries with high debt get financial support (EFSM, ESM, RRF, SURE, SAFE)

MFF/EU budget

Conditional budgeting | More own resources + EU debt for EPGs

Net contributors | Net beneficiaries

Countries complying with fiscal rules

Fiscal rules + no-bail-out clause

Fewer countries need financial support

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Thanks for your time!

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