



EUROPEAN SYMMETRIC RULES

Reconciling economic and climate sustainability

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ABSTRACT

As negotiations on the Stability and Growth Pact have recently concluded, it is time to move to the next stage: agreeing on complementary rules aimed at ensuring compliance with our emission reduction targets. Together with the German think tank Dezernat Zukunft, we advocate the launch of a new negotiation cycle to create symmetric European rules, which are as concerned with economic as with climate sustainability.

European countries face a dual threat posed by budgetary constraints and climate change. They are falling behind on their emission reduction commitments, and the accumulation of crises has left them with a legacy of higher public debt levels. The new European fiscal rules aim to improve the fiscal sustainability of European countries, but what might be the consequences for the fight against climate change? Member States may be forced to cut back on investments in decarbonising their economies, even though the coming years are critical if we want to meet our climate goals.

In this paper, we remind that emission reduction targets are no less a European legal requirement than debt reduction targets. European fiscal rules are more restrictive than European commitments on emission reductions because the latter are not associated with explicit sanctions and monitoring procedures as strict as the European fiscal framework. Thus, there is an implicit hierarchy between emission reduction and debt reduction objectives, in favour of the second.

This Franco-German contribution therefore advocates the launch of a new cycle of negotiations to restore a balance of objectives. The goal of this negotiation would be to establish climate rules, complementary to European fiscal rules. The economic cost of a climate default and the presence of externalities between generations and Member States mean that these climate rules are just as legitimate as the existing fiscal rules.

What could climate rules look like? Climate rules could define result-oriented obligations. Emission reduction trajectories would be set, and Member States would have to publish plans outlining how they intend to invest to meet their long-term reduction targets. They could also define means-oriented obligations by establishing investment rules in the decarbonisation of economies, for example by setting a minimum percentage of GDP to be invested each year.

But the very form of the rules must also take into account their credibility and acceptability. We thus explore several mechanisms that would ensure compliance: either financial penalties modelled on the Stability and Growth Pact, or the non-payment of resources from a European Climate Fund. The creation of symmetric climate rules also involves the reform of

European carbon governance and the involvement of Independent Fiscal Institutions like the “Haut Conseil des Finances Publiques” in France to assess Member States’ action plans.

This proposal is the first part of a diptych. We believe that Europe should not merely adopt a punitive logic (via rules) but also give itself the resources to achieve its ambitions by creating a European Climate Fund to ensure compliance.

For these rules to be realistic, the negotiations must therefore cover two aspects: the total amount of resources to be mobilised in the EU, their origin and their allocation; as well as the definition of credible climate rules that could be accepted by the Member States. Initiating these negotiations will allow us to truly confront one of the thorniest questions in economic policy today: how to resolve the dilemma between planetary and fiscal exhaustion?



As the negotiations on the new Stability and Growth Pact have just concluded, it is now time to agree on symmetric rules aiming to respect our emission reduction objectives. In this paper, we advocate the launch of a new round of negotiations to establish symmetric European rules. These rules would make the obligation to respect climate sustainability as demanding as the one for fiscal sustainability, while agreeing on the means necessary to achieve it.

1. What are symmetric rules?

1.1. Why do we need symmetric rules?

European countries are faced with a dual threat, their climate and fiscal sustainability are at risk:

- On the climate side, most of their pledges and targets for investments are not in line with the objectives set at the 2015 Paris Climate Conference. According to Climate Action Tracker, even if we fulfil our pledges, the EU will collectively emit about 350 Mt of CO₂ more in 2030 than an ideal pathway to limit global warming to 1.5°C would allow (see Figure 1.a).
- On the fiscal side, public debt of European countries has been increasing since 2008 in European countries (see Figure 1.b) due to a series of crises. The two last ones, the COVID pandemic and the war in Ukraine, seem to have had a lasting effect on the fiscal flexibility of European countries, ending a decade of low financing costs.

These simultaneous threats create a dilemma. On the one hand, to reduce global warming, European countries will need to ramp up their investment to decarbonise their economies. In 2020, the European commission [estimated](#) that European countries needed to invest an additional 413 billion euros each year (2.6% of European GDP¹) just to reach their 2030 objectives. On the other hand, to balance their budgets in the coming years, many European countries will need to remain cautious. Estimates show that, to comply with the new fiscal rules, most European countries might need to improve their structural primary balance by more than 0.4 percentage points of GDP each year². The dilemma, then, is that European countries will have less room to invest in decarbonising their economies, especially as restrictive fiscal policies have a bias against investment (Novelli & Barcia, 2021³) which is easier to reduce than current spendings.

¹ In 2022 euros.

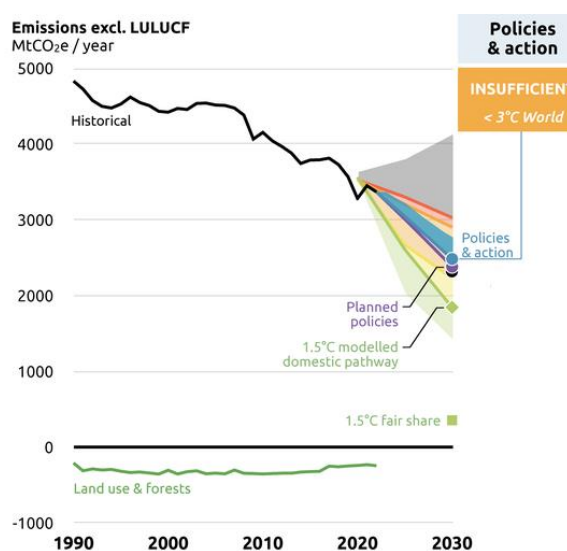
² According to the estimations by Darvas Z., Welsau L. & Zettelmeyer J. (2023). [A quantitative evaluation of the European Commission's fiscal governance proposal](#), *Bruegel Working Paper*, 16.

³ Novelli, A. C., & Barcia, G. (2021). [Sovereign risk, public investment and the fiscal policy stance](#). *Journal of Macroeconomics*, 67 (103263).

Figure 1 – Fiscal and climate sustainability

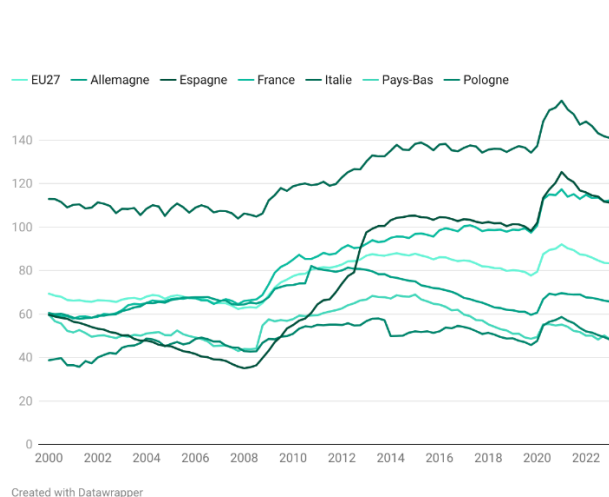
a) Our carbon budget is emptying fast

Evolution of EU GHG emissions between 1990 and 2030 according to different investment scenarios and how they relate to the intensity of global warming in 2100



b) Our fiscal space is limited

Evolution of the quarterly government debt as a percentage of GDP in six European countries between 2000 and 2024



Source: Climate Action Tracker and Eurostat.

The new European fiscal rules should allow European countries to improve their fiscal sustainability in the short term, but at what cost? The original aim of the new rules was to define tailored adjustment paths for each Member State thanks to a debt sustainability analysis (DSA). Thus, these rules were meant to be more flexible than the previous ones, which relied on strict numerical criteria (see [our analysis on this topic](#)). However, during the negotiations, these rules were toughened by the inclusion of multiple “safeguards” demanding minimal adjustments to public deficit and debt. This fiscal framework is biased against public investments as a financing tool for the transition: climate spending increases the debt-to-GDP ratio while climate regulations do not, and climate taxes even decrease it. Yet, as recent upheavals – from the Yellow Vests in France to the BBB in the Netherlands – have shown, taxes, cutting other investments to fund the transition, and regulations cannot be our only means of decarbonising our economy. The acceptability of these transition measures must also be considered. Voters (including among liberals, centre-right and far-right voters) have expressed a preference for public investment over regulation or carbon pricing¹. **Although subsidies are obviously not the only way to achieve the transition, the risk is that an exclusive focus on fiscal sustainability delays the transition**

¹ Abou-Chadi, T., Jansen, J., Kollberg, M., & Redeker, N. (2024). [Debunking the Backlash-Uncovering European Voters' Climate Preferences](#). Jacques Delors Institute Policy Brief.

and increases the likelihood of a disorderly transition when environmental pressures are felt.

The coming years are particularly critical if we want to achieve our climate objectives and prevent a disorderly transition. Investing early and gradually increasing the burden over time is preferable to leaving this responsibility to future policy makers. A delayed and disorderly transition would have a positive impact on growth and the fiscal sustainability of Member States in the short term, but will be more painful after. The Bundesbank estimated that waiting until 2030 to decarbonise the European economy would lead to more economic growth in the short term but will cause the economy to decline in the longer term compared to an orderly alternative where we invest right now (see Figure 2)¹. In France, the Banque de France finds very similar results²: GDP would be 2 points lower in 2050 if we start decarbonising only in 2030.

Therefore, in the longer term, climate and fiscal sustainability support each other. This creates a case for “symmetric” rules that would ensure that climate sustainability is taken care of and would counterbalance the strict fiscal rules. The objective of these rules would not be to bypass fiscal rules but to be sure that they are not at the expense of climate sustainability. Doing so, they are targeting another type of debt, the climate debt, that countries are accumulating when they fail to effectively decarbonise their economy. A temporary increase in investment is not necessarily a threat to fiscal sustainability if it does not make debt levels explode (Blanchard, 2023)³. **Reforming the European fiscal rules to accommodate green investment when an agreement has just been reached after many months of negotiation is impossible in the short term.** It means we will have to make the most of existing margins, including an extension of the adjustment period to seven years, but also that we need to open a new round of negotiations to create symmetry in the rules between fiscal and climate objectives.

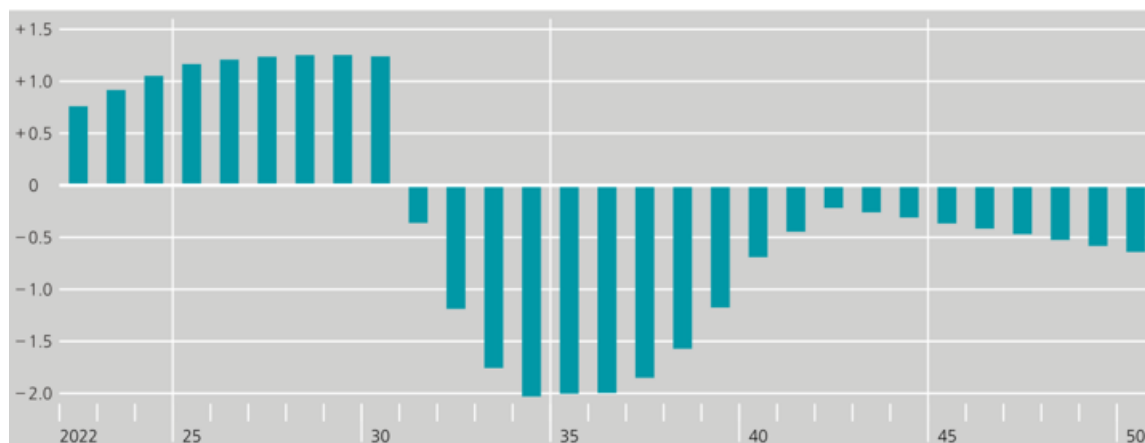
¹ Deutsche Bundesbank (2023). [The Environmental Multi-Sector DSGE model EMuSe: A technical documentation](#).

² de Gaye A. & Lisack N. (2022). « Too little, too late » : Impact d'une transition climatique désordonnée, *Bloc-note Eco de la Banque de France* – Billet n°255.

³ Blanchard, O. (2023). [If markets are right about long real rates, public debt ratios will increase for some time. We must make sure that they do not explode.](#) *PIIE Realtime Economics*.

Figure 2 – A disorderly transition is not desirable

Difference in real gross valued added expressed in relation to the baseline between a disorderly and an orderly transition, in percentage points.



Source: Bundesbank calculations based on the DSGE model EMuSe and transition scenarios provided by the Network for Greening the Financial System

1.2. The legal basis for symmetric rules

Implementing climate rules is not only a necessity to better align our economic policies with our decarbonisation objectives, but also reflects a legal requirement at the European level.

The issue of environmental sustainability has played a significant role in the EU policy-making process. Articles 11 and 191 to 193 in the Treaty on the Functioning of the European Union (TFEU) define the EU’s wide-ranging competences in all areas of environmental policy like water and air pollution or waste management. The EU’s environmental policy has four guiding principles as specified in the TFEU¹, namely precaution, prevention and rectifying pollution at source, as well as the “polluter pays” principle. The EU’s capacity to act is constrained by the subsidiarity principle and the need for unanimous agreement in the Council on certain matters, including those involving fiscal policy, which highlights the close link between fiscal and climate sustainability.

Combatting climate change is an explicit objective of the EU’s environmental policy stated in Article 191 paragraph 2 of the TFEU. Moreover, the EU has ratified the Paris Agreement with the goal to keep the increase in global average temperature well below 2°C compared to pre-industrial levels, and to continue efforts to limit it to 1.5°C. EU-wide coordination is necessary because national action is unlikely to achieve optimal outcomes for the climate crisis that knows no borders. Additionally, EU-action allows to better coordinate the effects on growth, labour, and fairness of

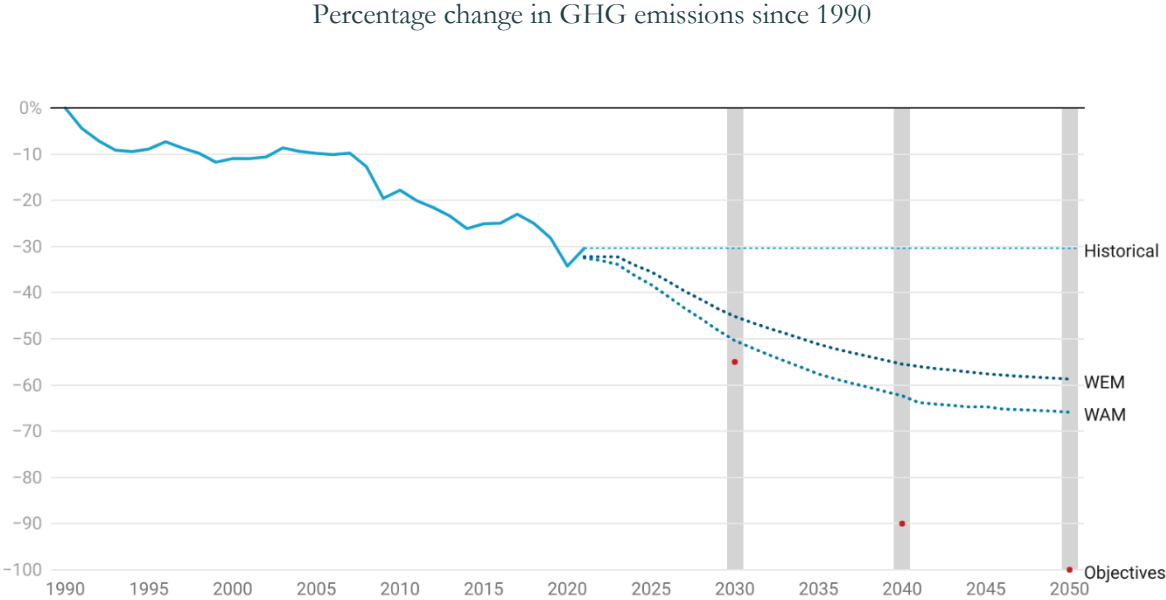
¹ Article 191 paragraph 2.

global climate policies among Member States. If the EU speaks with one voice, it can also make climate diplomacy more effective on the international stage.

In line with these objectives and commitments, the EU has adopted the [European Climate Law](#), which entered into force in July 2021. The European Climate Law is a key element of the European Green Deal and reaffirms the EU’s legal obligation to be carbon-neutral by 2050. It also included a provision for the interim target to reduce net greenhouse gas by at least 55% by 2030, compared to 1990 levels. To complement this goal, the Commission proposed another in February 2024: a reduction of 90% of net greenhouse gas emissions by 2040 compared to 1990. However, this target is not yet binding. It will be up to the next Commission to make a legislative proposal after the European elections, which will then have to be adopted by the Member States (unanimously) and the European Parliament.

Despite the binding emission reduction objectives, the EU is far from achieving them. Figure 3 shows the historic and projected greenhouse gas emissions in the Union for a scenario with existing measures (WEM) and if additional policy measures to reduce emissions are implemented (WAM). What becomes clear is that besides a declining trend, the emission projections, even in a scenario with additional policy measures, miss the binding 2030 and 2050 targets as well as the proposed 2040 objective by a wide margin. However, there is currently no explicit sanction mechanism in the EU climate legislation, which jeopardises its credibility.

Figure 3 – EU historic and projected greenhouse gas emissions and targets



Note: WEM stands for “with existing measures” and describes the projected emissions path if no further policy changes are made. WAM stands for “with additional measures” and is a scenario where the Member States adopt additional policies to reduce their emissions. The red dots are the EU emission targets.

Source: European Environmental Agency

All greenhouse gas emissions in the EU are regulated in one way or another. Around 40% of emissions are covered by the Emissions Trading Scheme (ETS) and the remaining 60% by the Effort Sharing Regulation (ESR). In the case of the ETS, the EU limits the quantity of certificates auctioned on the carbon market based on reduction targets for 2030. The ESR defines annual carbon budgets for each Member State, which are differentiated by their GDP per capita¹. The Commission has scheduled compliance checks for 2027 and 2032. If a Member States exceeds these legally binding annual allocations, they can be penalised with additional emission reductions in the following period.

Climate sustainability is not simply a nice-to-have but a key objective of the European Union. As of today, there are ambitious and legally binding emission reduction objectives on different levels. However, the EU is far from achieving them and does not provide itself and the Member States with the necessary means to change this. In addition, while a breach of the fiscal rules has serious consequences, there are no defined and explicit financial sanctions for missing the emission targets, which strongly limits their credibility in general and vis-à-vis the strict fiscal requirements.

1.3. The rationale behind symmetric rules

1.3.1. The Stability and Growth Pact (SGP)

Theoretical and empirical arguments

The rationale behind fiscal rules was set out in the Delors Report: without rules, financial markets can exert a disciplinary influence but “to some extent”. According to the report, access to a large capital market “may for some time even facilitate the financing of economic imbalances” and, in subsequently, rather than leading to a gradual adjustment of borrowing costs, markets perceptions can change abruptly, and “result in the closure of access to market financing”.

Fiscal rules can also be justified by the need to balance conflicting incentives between Member States. Some countries could be tempted to maintain too large deficits because some of the cost of those deficits (*via* higher inflation, which pushes the central bank to raise interest rates) are born by other Member States. Some countries could also be tempted to run too small deficits because in an integrated economy they would prefer if the other countries to incur deficits. They would profit from the additional demand this creates without having to worry about repaying the debt, that sits on someone else's balance sheet.

A last theoretical argument can be added: fiscal policy creates a “common pool problem” (Geneva report 13, 8). Individuals or groups who gain the most from each additional euro spent by public authorities are not the same as those who incur the additional cost to finance it, because fiscal policy is redistributive. This implies two things. Firstly, those who benefit have an incentive

¹ [Regulation \(EU\) 2021/1119](#) and [Regulation \(EU\) 2023/857](#).

to advocate for increased spending, knowing that the financial burden falls on others. On the revenue side, voters would prefer others (often future generations) to pay for the expenses they benefit from today. The intergenerational aspect is often cited as a central justification of the SGP: “to prevent the political process from favouring additional consumption today at the expense of future wealth, the implication being that there will be less consumption for future generations.” (*ibid.*, 9). Similarly, in the case of debt reduction and fiscal adjustment, citizens would prefer others to bear the adjustment cost. Fiscal rules can therefore be understood as a results-oriented solution, as opposed to procedural approaches, which focus on decision-making processes and aim to internalise the externalities related to the common pool problem for decisionmakers. They set specific objectives that policymakers must meet to comply with the rules.

Resolving economic policy contradictions: avoiding ineffective monetary policy

However, to understand the fiscal rules, it is also necessary to put them into their specific context. When the European Union was preparing for the transition to the euro, there were growing concerns about a deterioration of public finances (Kopits & Symansky, 1998¹). Many countries were close or above the objective of a 60% debt-to-GDP ratio. Furthermore, since the second half of the 1970s (see Buti & Van den Noord, 2004² for a literature review), the role of fiscal policy as a Keynesian stabilisation tool had been questioned (for example Barro 1974³), and its potential responsibility in causing inflation had been highlighted (Sargent & Wallace 1981⁴ or the fiscal theory of price level). The context is important and calls today for the establishment of climate rules; these must be examined this time in the light of accelerating global warming and emission reduction targets (as shown in sections 1.1 and 1.2).

Lastly, the fiscal rules were in theory about solving policy dilemmas and combining different objectives. The Council resolution that went along with the Stability and Growth Pact argued that it will strengthen “the conditions for price stability”, but also “for sustainable growth conducive to employment creation”. But in practice, it was about circumventing potential institutional conflicts, ensuring that the monetary policy was effective and avoiding contagion effects. European policymakers became increasingly worried about the risk of fiscal dominance: the ECB was created with a clear “rule” (its mandate to maintain price stability at 2%), but fiscal institutions were subject to no such rule, which raised concerns that this might eventually threaten the price stability objective. It was therefore a matter of preserving the role of the central bank as the guarantor of price stability and making “fiscal discipline a permanent feature of the EMU” (Buti & Van den Noord, 2004). **This led to the “Brussels-Frankfurt consensus”: fiscal policy**

¹ Kopits G. & Symansky S. (1998). [Rationale and Institutions](#), In: *Fiscal Policy Rules*, IMF.

² Buti, M. & van den Noord P. (2004). [Fiscal Policy in EMU: Rules, Discretion, and Political Incentives](#), *European Economy Economics Papers*, 206, European Commission.

³ Barro, R. J. (1974). [Are Government Bonds Net Wealth?](#) *Journal of Political Economy*, 82(6), 1095–1117.

⁴ Sargent T.J. & Wallace N. (1981). [Some Unpleasant Monetarist Arithmetic](#), *Quarterly Review*, Federal Reserve Bank of Minneapolis, 5.

supports the central bank's objective. Fiscal rules thus allowed for a hierarchy between objectives.

The need to hierarchise different objectives is today even more pressing than before. Fiscal policy is currently subject to clear rules, which are more constraining for national authorities than meeting the emission reduction targets. It is an implicit hierarchisation of objectives between fiscal and climate sustainability.

1.3.2. What would be the rationale of climate rules

The reasoning behind the establishment of fiscal rules can be applied to climate rules, while the theoretical arguments in their favour are even stronger. Both types of rules aim to address two similar issues: avoiding a common pool problem and resolving political contradictions.

There is a “common pool problem” problem in the case of the climate because those who benefit from the marginal utility of CO₂ emissions (through their consumption or production) are not the same as those who bear the cost (in terms of economic cost and well-being):

- Firstly, there is an even stronger *intergenerational aspect* than with fiscal rules as the cost of a climate default is much higher than the cost of an economic default. We even observe that certain socio-professional demographics behave non-rationally: they resist the transition to greener practices, even though climate change is most likely to threaten the future of their profession.
- There is also a *strong inequality effect*, as the lowest incomes are the most exposed to climate change. According to [Insee](#), in France, the areas most exposed to abnormal heat also house nearly 1.2 million people living below the poverty line, often in poorly insulated housing. Those areas also have a high number of jobs in construction and agriculture, which are particularly hard when temperatures are abnormal. This is why setting up climate rules is also essential to ensure a just transition.

Instead of pushing for a higher deficit, the “climate common pool problem” is that some actors are pushing for a higher “carbon deficit”, i.e. the right to maintain or expand polluting activities. This can take two forms:

- On the “revenue” side, it leads certain interest groups, who benefit economically or in terms of lifestyle from polluting activities to **lobby to keep “brown” activities thriving**. For example, ExxonMobil is known to have funded research and organisations questioning climate change science as early as the 1970s and opposing regulatory efforts to reduce greenhouse gas emissions.
- Another illustration of the problem is when **populations resist adapting to climate change because it has a cost for them**, in terms of well-being or purchasing power. In this case, they feel that the cost of adaptation is too high and call for a slowdown in transition policies; this can be fueled by political movements trying to win votes by

capitalising on popular anger. This has been recently pointed out as Greenblaming by the think tank *Construire l'écologie* (see [Greenblaming, la construction de l'épouvantail écologique, 2024](#)) and illustrated by numerous citizen movements (Yellow Vests, EU farmer protests, BBB in the Netherlands).

There is a way out of these issues, but it has an economic cost that cannot be ignored. Regarding the “brown” sectors, this can be done through regulation, public investment to decarbonise them or guaranteed loans to facilitate the industry’s adaptation. Regarding popular anger, in order to avoid an increase in inequalities (real or perceived) and the emergence of social movements, green policies need to be made politically acceptable¹, for example through state support to people who lose their jobs (see the [proposal of the Institut Avant-garde of a wage insurance](#)). This conclusion could lead us to believe that there is a dilemma between economic and climate sustainability.

However, setting climate rules would oblige us to resolve this dilemma by imposing the necessity to respect emission targets and to give ourselves the means to do so, and at the same time considering economic sustainability. The current risk is that without any climate rules the establishment of a concrete decarbonisation strategy, the legally binding objectives of emission reduction become impossible to reach. With very constraining new fiscal rules and only temporary NextGenEU funds, we could end up in a situation where economic sustainability is the priority and supported in the short term, but climate sustainability is sacrificed. In the longer run, this could even end up threatening the EU’s economic sustainability due to the cost of more pronounced climate change.

It is essential to have an open debate on the size of the bill and its distribution. This will allow us to avoid adopting a chaotic and uncoordinated financing strategy that is damaging in economic, climatic, and political terms.

2. Negotiating symmetric rules

The aim of the negotiation would not be to create rules without thinking about the means to achieve them, otherwise we risk falling into the trap of the fiscal rules: regular suspensions and, ultimately, inapplicability. The negotiations will have to address two aspects: (i) the resources for the transition and (ii) compliance with the objectives.

2.1. Objectives for the negotiations

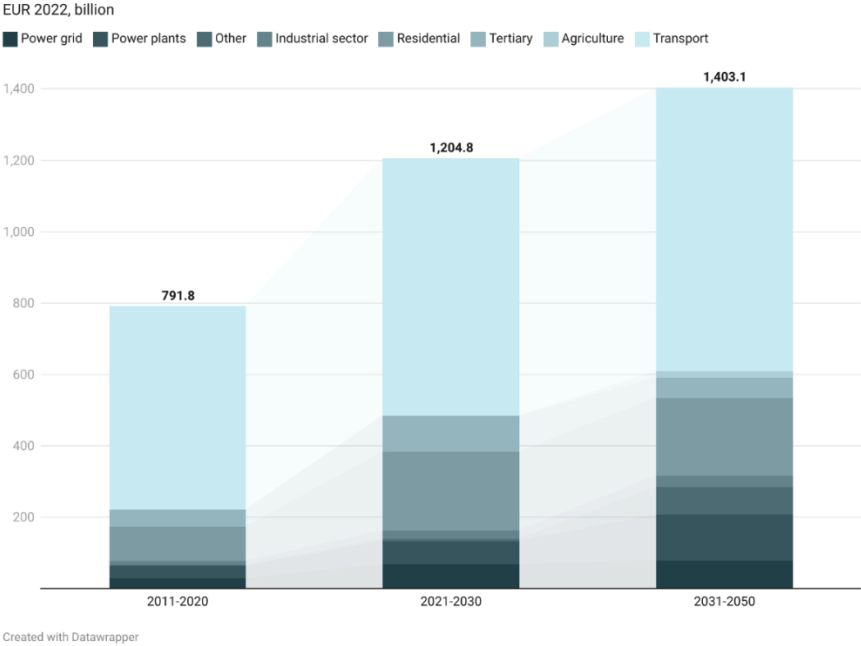
2.1.1. Estimating the needs

The first objective of the climate rule negotiations will be to agree on the size of the total envelope needed to finance the green transition in the EU.

¹ Voir Viennot M. (2023). [La protection sociale a-t-elle besoin de la croissance ?](#), *L'Économie politique*, 2(98), 55-64.

Available assessments quantify the Union’s additional investment needs as substantial but not insurmountable, at between 2 and 3% of GDP annually until 2050 (see Figure 4). While there is a lively debate about the appropriate methodology, there is a scientific consensus on the approximate size of additional investment needs.

Figure 4 – Annual investment needs in the EU



Source: European Commission.

2.1.2. Which distribution?

Once there is an agreement on the total amount of resources that need to be mobilised in the EU, the question of their source and destination constitutes a second negotiation objective. The challenge is to create and disburse the funds in a manner that is simultaneously efficient and equitable among economic actors at different geographical levels.

The question of how to spend the resources has been the subject of several granular analyses investigating the needs in different (sub-)sectors. The transformation of the energy system (renewable energy production and power grid), buildings (renovations for energy efficiency), and transportation (electrification of the vehicle fleet) make up the lion’s share of investment needs as seen in Figure 4.

On the financing side, there needs to be debated about the share of the bill for the green transition that should be allocated to the EU-level and which part falls on to the Member States. Following the principle of subsidiarity, EU-level fiscal responsibility should only apply to investments that are best done at the Union level.

The effort must also be divided between the public and private sector. In the 2010s, public spending accounted for 15% of all investments in the EU economy and a bit more for climate-related investments ([European Commission, 2023](#)). However, the ratio between public and private investment needed strongly depends on factors like industry, geography, or technology. Given the required speed boost in the transition and the uncertain geopolitical situation, public investments may need to step up to ensure competitiveness and resilience in the EU economy.

2.2. What design for the climate rules?

In practice, fiscal rules have been poorly applied. Historically, their goal was to promote fiscal responsibility in Europe in a context of possible spillovers of fiscal crises or because it could lead the ECB to monetise debt and cause inflation. Since the implementation of the Stability and Growth Pact, they have been repeatedly violated by Member States and have not prevented fiscal crises (Blanchard, Leandro & Zettlemeyer, 2021¹). Moreover, while many economists are convinced of the general effectiveness of fiscal rules to reduce deficits (see the review of empirical evidence in Brändle & Elsener, 2023²), they also worry that they might have a bias against public investments (Blanchard & Giavazzi, 2004³; Bome, 2019⁴). The negotiation of new fiscal rules, which began in 2021, was supposed to make them more adaptable to each country's specificities, notably thanks to a debt sustainability analysis, and enhanced ownership by Member States. The new fiscal rules do not seem likely to achieve these objectives, in part because they are too complex to be even fully understood even by experts and remain very rigid⁵. **However, the strength of the fiscal rules, and their most problematic aspect, is that they create re-anchor an austerity doctrine in the political debate.**

As mentioned before, we should consider new rules in addition to the current fiscal rules, despite their drawbacks. The current fiscal rules are the result of lengthy negotiations, and it would be unrealistic to think of changing them soon. If, as Poterba (1997)⁶ insists, fiscal institutions can act as a constraint on the behaviour of political actors, then they can also be used to ensure that fiscal rules do not come at the expense of green investments. These additional rules could take various forms.

¹ Blanchard O., Leandro A. & Zettlemeyer J. (2021). [Comment réformer la discipline budgétaire européenne ?](#), *Commentaire*, 2021/2 (174), 295-308.

² Brändle, T., & Elsener, M. (2023). [Do fiscal rules matter? A survey on recent evidence](#), *WWZ Working Paper*, No. 2023/07.

³ Blanchard, O. & F. Giavazzi. (2004). [Improving the SGP through a proper accounting of public investment](#), *CEPR*.

⁴ Bome, P.R.D. (2019). [Fiscal rules and the intergenerational welfare effects of public investment](#), *Economic Modelling*, Vol. 81, pp. 455–470.

⁵ Discours de Philippa Sigl-Glückner at the European Parliamentary week 2023 – Plenary session: Review of the EU economic governance framework – exchange of views, at February 28th 2023.

⁶ Poterba, J. M. (1996). [Do Budget Rules Work?](#) *NBER Working Paper*, w5550.

2.2.1. Result-oriented obligations

Climate rules could create result-oriented obligations. Just as fiscal rules impose a certain fiscal trajectory on Member States, climate rules could, for example, impose a carbon emissions trajectory with the implementation of adjustment plans if Member States deviate from this long-term trajectory. The fact that, since 2018 and the Effort Sharing Regulation, European regulations have started to provide for differentiated reduction targets for each Member State, allows to create carbon budgets and appropriate reduction trajectories.

2.2.2. Means-oriented obligations

Climate rules could create means-oriented obligations. To ensure that green investments are made, rules could be used to set investment trajectories in decarbonising sectors not covered by the ETS. For example, we could imagine a rule that would look like the “2% rule”, encouraging Member States to invest so that an average of 2% of their GDP is invested (public and private financing) in the green transition until 2050. These rules would have the advantage of recognising the limited control Member States have over emissions in the short term, but also their agency in promoting the green transition¹.

The ideal climate rule could even combine both characteristics by adding a carbon budget approach to a dynamic rule that imposes an investment level (as a percentage of GDP) when the carbon trajectory is too far from the target.

However, the question of calibrating climate rules is too serious to be left in the hands of economists alone. It is necessary to consider the factors that caused the failure of fiscal rules in Europe: their excessive rigidity and lack of credibility. This implies making the flexibility and ownership of these rules by the countries a priority. At a minimum, a structure similar to the output gap working group could be set up to adapt these rules over time, and close consultation between different actors will be key in determining them.

2.3. How to enforce the climate rules

To ensure the enforcement of the climate rules, two types of mechanisms could be considered:

- i) One based on the Stability and Growth Pact: threatening Member States that do not comply with the rules with a fine;
- ii) One based on the Regional Development Fund or the Cohesion Fund by suspending access to funding in case of non-compliance.

¹ Investment rules might take many forms, from simple rules requiring a given level of public investments to more direct administration of what these investments should be. Rules could be broken down by sector, precise about a particular sharing of the burden between the public and private sectors, or they could remain agnostic as to the form these investments should take.

If the rules are credible, there could also be a stigma effect associated with non-compliance that would encourage Member States to adhere to them.

2.3.1. Financial penalties

Under the Stability and Growth Pact, countries can be subject to an Excessive Deficit Procedure (EDP), which can ultimately lead to fines if the country does not take effective measures to correct the deficit. Fines can amount up to 0.5% of the country's GDP. However, in practice, fines and financial penalties under the SGP have been sparingly used. The EU has often preferred to use the threat of sanctions as a deterrent, rather than actually imposing fines on Member States. Furthermore, during significant economic crises, such as the financial crisis of 2008 and the COVID-19 pandemic, the EU chose to suspend the fiscal rules temporarily.

The rare implementation of fines reflects the EU's preference for negotiation and corrective action plans over punitive measures, but it could also be considered that, outside of crises, the general orientation of the rules always reverts to austerity as the “normal” policy. As mentioned, this creates an austerity bias even if the fines are not applied.

2.3.2. Suspension of EU funds

Another way for the EU to ensure compliance with rules and regulations is through the Cohesion Fund, which aims to promote development across the Union by reducing disparities between various regions. The enforcement mechanism has been the withholding of funds in case of violation of the Union's core values. Notable examples involve Hungary and Poland. In recent years, EU institutions have raised concerns about the rule of law in both countries, arguing that government actions in these countries threaten democratic principles and the rule of law. In 2020, the EU introduced a new mechanism that ties the disbursement of EU funds to the adherence to the rule of law. **Using the same principle, the withholding of a European Climate Fund could serve as a model for the enforcement mechanism of climate rules.**

Did it work? Hungary's government has made several legal and policy adjustments in attempts to comply with EU demands. For example, in response to the threat of a €7.5 billion suspension of EU funds, Hungary agreed to a package of 17 anti-corruption reform measures. Poland also passed a new law to improve judiciary accountability, aiming to release €35 billion in EU funds (COVID recovery fund) frozen over judicial reforms concerns. These examples show that the EU's control over significant financial resources can be effective leverage. It should be noted that both Hungary and Poland have strongly opposed this mechanism, arguing that it infringes on their national sovereignty, and have engaged in legal and political battles. However, these tensions might be related to the very political nature of those reforms. This could therefore serve as an even better enforcement mechanism for the climate rules.

Moreover, this mechanism could be set up for climate rules because it would be directly linked to specific funds, whose use would be consistent with the conditions of violation. Indeed, negotiating for symmetric rules would ideally result in defining a financing package at the European level.

2.3.3. What governance?

A final mechanism to ensure compliance with the rules could be to ask Member States to submit reform and investment plans to the Commission that they would need to adhere to meet their emission targets. This document could resemble the Stability Programme (PSTAB) and would be reviewed by the European Commission. We could also set up independent climate institutions (like the Independent Fiscal Institutions), that would evaluate those programmes, monitor them, and have an advisory role. Ultimately, given the uncertainty surrounding the estimation of the effect of transition policies, financial penalties would be more based on the non-compliance to this plan rather than the failure to meet emission targets.

Conclusion

Today, an implicit choice has been made in favour of fiscal sustainability over climate sustainability. Designing symmetric would allow for a re-evaluation of this prioritisation. However, as we begin implementing sustainable European policies, it is imperative to learn from past mistakes, particularly from those made regarding fiscal rules. This is a crucial element to avoid establishing rules that lack credibility, democratic legitimacy, or impose unattainable constraints on nations. Therefore, jointly negotiating the [creation of a European Climate Fund](#) and these climate rules is central. It will be essential for the credibility of the rules to find a good balance between giving the Member States the means to reach carbon reduction objectives and sanctioning them when they delay their reforms. Failing to properly calibrate these two constraints could force us into emergency actions and the implementation of a “shock therapy”: a massive reallocation of public spending towards green transition expenditures (sacrificing our social models) or the introduction of significantly higher carbon taxes.



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