Europe’s public investment gap, exposed by the polycrisis. How a cash-based approach to fiscal policy hinders the revision of the Stability and Growth Pact

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Abstract

This paper examines the European Union’s responses to the ‘polycrisis’ moment of the early 2020s, focusing on the EU’s efforts to amend its fiscal framework, the Stability and Growth Pact (SGP) to allow for more public investment. This period was marked by a number of immense, interwoven shocks from extreme climate events, through a global pandemic and associated supply chain disruptions, to Russia’s invasion of Ukraine. While recognizing the need for sustained high levels of public investment to respond to these shocks, meaningful change continued to be limited by the EU’s austere fiscal rules and an anti-investment bias. Despite being aware of this contradiction, institutions have struggled to overcome it. This article argues that the EU's process of rethinking fiscal rules is hampered by a fundamental ideational bias: a failure to account for physical capital as saving. This cash-based conception of saving – which can be traced back to Germany’s ordoliberal economic thinking and cameralistic accounting tradition – is inherent in the EU's fiscal framework and dominates the political debate over fiscal reform. The paper traces this bias in the SGP framework and the discourse surrounding its revisions, including the SGP revision process launched in 2020. It argues that the cash-based approach to saving distorts the politics of public investment: the focus on a nominal anchor capturing net financial lending (or the budget balance) as opposed to saving in an economic sense confounds narratives about fiscal responsibility, generational fairness, and time inconsistency. Furthermore, the political framing of these reforms starts from the financing side rather than the positive goal of providing public goods. It concludes by offering a quick look at EU-level fiscal capacities as a possible way out of the impasse.

Keywords: public investment, fiscal policy, Stability and Growth Pact

Introduction

‘Polycrisis’ is the buzzword of the early 2020s. It is used to describe multiple, interlocking shocks that have rocked the global economy, from the escalating ecological breakdown to the COVID-19 pandemic and its disruptive impact on supply chains, and Russia's invasion of Ukraine (Tooze 2022). The European Union’s executive arm, the European Commission, have been formulating a flurry of policy strategies to address these challenges, a common theme being the need for significantly higher *public investment*. Investment boosts are called for in areas such as green technologies and renewable energy, more resilient supply chains, defense capacities, and more. However, public investment remains a weak spot for the EU (Cerniglia and Saraceno 2020,

Sandbu 2022). Fixed capital formation has been alarmingly low for a decade, barely covering the wear and tear, and leaving Europe vulnerable to the above listed challenges. One reason for this is Europe's well-documented austerity bias (e.g. Blyth 2013, Matthijs and McNamara 2015, Matthijs 2016), strongly influenced by German ordoliberal ideas (e.g. Brunnermeier *et al.* 2016), and baked into EU fiscal rules. European decision-makers have long recognized this contradiction and have taken steps to address it. In 2020, the EU launched a reform process of the Stability and Growth Pact (SGP) framework, explicitly linking the investment gap to fiscal rules. The same year, a landmark investment package called “Next Generation EU” (NGEU) was adopted as a response to the COVID-19 shock. Many initiatives of earlier years, like the European Investment Plan of 2015 (also known as the Juncker Plan) also indicated that the EU’s public investment gap has not gone unnoticed (Ban 2017). Why has it failed to produce a meaningful turnaround in public investments, then?

This paper argues that the EU's process of rethinking fiscal rules and allow for a significant rise in investments is beset by a fundamental ideational bias: a failure to account for physical capital as saving, undermining public investment. This cash-based conception of saving can be linked to German ordoliberal thinking, and the cameralistic accounting tradition, and is inherent in the EU’s fiscal framework, which focuses on a nominal anchor capturing net (financial) lending or the budget balance instead of saving. The investigation traces this ideational bias in the SGP framework and the discourse surrounding its manifold revisions since its inception, including continuous calls for a ‘golden rule’ (i.e. the exclusion of net public investment from deficit calculations). It follows the SGP reform debate until April 26, 2023, the legislative proposal of the European Commission for a revised framework.[1] The analysis finds that the bias distorts the political debate over of fiscal reforms – confounding narratives about responsible budgeting, generational fairness or time inconsistency. Furthermore, the political framing of these reforms starts from the financing side, rather than the positive goal of providing public goods: specifying what society needs and transparently laying out how much those needs would cost.

The paper sets out to explain this puzzling gap between the EU’s investment pledges and its self-imposed fiscal constraints. It proceeds in four sections. (1) It starts by discussing the cash-based conception of saving, (2) then the empirical section goes on to trace this ideational bias in the SGP framework, and the discourse around its manifold revisions since its inception. The analysis traces the 2020 SGP reform debate until April 26, 2023, the final legislative proposal of the European Commission. (3) The subsequent argument, flowing from the first one, outlines how the cash-based approach to saving distorts the politics of public investment in the EU. (4) The concluding section casts a quick look on EU-level spending, as a possible way out of the underinvestment conundrum.

[1] The legislative proposal marked the start of the negotiation process with co-legislators. While it is not yet possible to analyze the reform itself (it is an avenue for further research), the policy debate leading up to it offers ample relevant material for this specific research question.

(1) How a cash-based conception of saving undermines investments

The argument presented here posits that EU fiscal rules' inherent bias against public investment stems from a narrow and cash-based conception to saving, that is detached from its economic substance (see, also: Polyak 2023). This bias can be traced back to a particular layer of German ordoliberal thinking that has received less scrutiny in the rich literature on the topic. A lot of attention has been devoted to the moral intuitiveness of austerity and saving as an individual and social virtue, that is particularly strongly anchored in Germany and the EU's Northern, self-proclaimed 'frugal' member states (Blyth 2013, Matthijs and McNamara 2015, Haffert 2016, Fratzscher 2022). It is less clear, however, when and how saving in *physical capital* got excluded from the moral category.

The disconnect stems from the fact that the cash-based approach to saving, and the statistical metrics attached to it, do not account for physical assets as a form of saving. This approach equates public sector saving with net (financial) lending or a budget surplus, even though net lending it is not saving, but saving *minus investment*. A focus on balanced budgets is supposed to prompt governments to save – but it also prompts them to squeeze investment.

This bias against investment is strongly linked to the particular accounting tradition Germany has – cameralism or cash-based accounting, as opposed to double-entry bookkeeping or accruals-based accounting (Sternberg 2020). The main difference between the two systems is *the time* when transactions are recorded. Cameralistic accounting tracks cash movements, recording the point in time when cash is received or paid out. This has important implications for investments. For example, if a public body invests in a physical asset, the expense is frontloaded: the full cost is included in the year of purchase, and there is no depreciation in the following years. It is easy to see how this can create an incentive against investment – it would need to be covered by a tax increase in the same year. In contrast, accrual-based accounting records expenses as they are incurred, independently of cash movements. Spending on a physical asset would not be recorded directly at full cost, but gradually, as it depreciates over their lifecycle. So the taxes to finance the investment could also flow in gradually, over multiple years. The cameralistic cash-based approach is a direct reflection of the fallacy outlined above: it treats spending on a physical asset equivalently to spending on cosumption.

The economic core of the concept of saving is laid out very clearly by the 'endogenous money' school, a strand of economic thought spearheaded by economist Michael Kumhof (e.g. Kumhof *et al*. 2020, Jakab and Kumhof 2019).[2] A key insight emphasized in their work is that in everyday language, saving is associated with the accumulation of financial assets, i.e. it is defined as *income not spent*. But in economics, saving is quite different. It is not a financial, but a real economic phenomenon – as Borio and Disyatat put it: "[s]aving, as defined in the national accounts, is simply *income (output) not consumed*." (2011, p. 1)

[2] It is important to stress that endogenous money scholars address a different phenomenon (the relationship between saving and bank lending), but their starting tenets have important implications for the investment problem as well – and their points have therefore filtered into debates over the origins of global current account (or saving-investment) imbalances (e.g. Klein 2020, The Economist 2020).

A quick glance on the national accounts equation (Figure 1) captures the logic –

PUBLIC SECTOR	**WHOLE ECONOMY**
Rev	Y^{disp}
– G	– C
$\mathbf{S^{gov}}$	**S**
– I^{gov}	– I
net lending ^{gov} (ESA budget balance)	**net lending** (CA+KA)

Figure 1. Net lending in the national accounts

In case of the public sector, saving (S^{gov}) equals the government's revenues from taxes and other sources (Rev) less government consumption (G). Net lending, or the government budget balance equals saving *minus investment*. If a government accumulates physical capital, it does not decrease public saving. It does decrease net lending, however. We can also capture net lending and saving on the level of the whole economy (including households and firms). Here, it is the current account (CA) balance that is often associated with virtuous saving (Polyak 2022), even though, analogously to the public sector, a CA surplus is not saving but an excess of saving *over domestic investment*.

While saving *flows* are often erroneously equated with budget deficits, saving *stocks* are often erroneously equated with public debt. The right metric capturing the sum of all past saving flows is the government's *net worth* (all financial and non-financial assets minus liabilities). The full public balance sheet is not a commonly available statistic yet, but it is getting more widespread. New Zealand, Australia and Iceland were among the first adopting the approach, and Eurostat has also requested EU governments to do so. While in Germany, there is no available data for the federal state's physical asset stock,[3] the Netherlands, for instance, prepares highly sophisticated estimates, with a detailed breakdown of non-financial asset categories from 'civil engineering works' (roads, railways, bridges, highways, airport runways, harbors, tunnels) to 'oil and gas reserves' (Statistics Netherlands 2022). While valuation problems do emerge, transparent estimates on public assets provide a better guide for sound financial management.

[3] The Federal Ministry of Finance has been duly criticized for this deficiency by the Court of Auditors. (Bundesrechnungshof 2022)

Compared to a focus on debt stocks, a public balance sheet allows decision-makers to draw very different conclusions. For instance, if public policy has its mind set on saving, issuing debt for public investment should not be a worry. Accumulating physical capital is a form of saving, so in the balance sheet, it offsets the issuance of public debt. Debt-financed investment only decreases saving (and result in a smaller financial net worth), if only financial assets enter the asset side, and physical capital does not. If both financial and physical assets are accounted for, as a debt-financed investment increase occurs, liabilities increase, but assets increase by the same amount. Net worth remains unchanged, but the balance sheet expands. Blocking debt-financed investment is not an inclination towards saving – it is rather an ideological preference towards a 'leaner' public balance sheet.

The moral appeal of saving is often linked to a microeconomic analogy in political discourse, likening state budgets to frugal housewives (Matthijs and McNamara 2015, Haffert 2016, Jacoby 2020). The main reason these parallels are misleading is their disregard towards fallacies of composition. The paradox of thrift, as John Maynard Keynes pointed out, is that one's spending is another one's income. So if all want to save at the same time, no one will be able to save, since there would be no income to save from.

However, in this case, it is *not* the microeconomic analogy that introduces the cognitive bias. On the contrary, making sense of the investment gap is the rare case in macroeconomics, where a microeconomic analogy would be helpful, because neither households, nor firms tend to only concentrate on their financial net worth (excluding physical assets). When a family takes on mortgage debt to buy a home, they normally would not treat the cost as a one-off expense that wipes out their savings. They would rather interpret their savings to be 'stored' in a physical asset, and usually expect that asset to increase in value. When a firm takes on a loan to invest in a new technology, i.e. buy and install new, more efficient machinery, the value of the machinery enters their balance sheet on the asset side, and the firm's net worth does not decrease. Again, the capital investment is expected to yield returns.

There are reasons for the prevalence of this cash-based approach. Non-financial assets are more difficult to value and measure, the government rarely has an 'inventory' of bridges, airports, motorways and the likes. Also, non-financial assets are illiquid. However, the opposite case can be argued just as (or even more) convincingly: physical assets are associated with inherent value in a way financial assets are not. Because of the illiquid nature of physical assets, storing public wealth in them is the ultimate disciplining device– a transfer to future generations that can only be undone in a very cumbersome way. While financial assets can be sold off at any time, physical capital like infrastructure is quite literally set in stone.

(2) Tracing the cash-based conception to saving in the Stability and Growth Pact and its reform process(es)

The Stability and Growth Pact, created in 1997[4] to strengthen the enforcement of deficit and debt limits established by the Maastricht Treaty, reflects the biased conception of saving that is outlined above. The two nominal anchors at the heart of the Pact – a 3% ceiling on the government deficit to GDP ratio, and a 60% ceiling on the government debt to GDP ratio[5] – are both tied to metrics that capture the government's *financial* asset position, and disregards *physical* assets (accumulated through public investment). The following section gives a short overview of SGP revisions throughout the years, focusing on the main milestones, from the perspective of public investments.

Critiques of the Pact's anti-investment bias have been present from the outset. During the first comprehensive reform process that led to the 2005 amendment of the SGP, Olivier Blanchard and Francesco Giavazzi (2004) addressed this problem in no uncertain terms, calling the prevailing accounting method 'a serious error' and 'an obvious mistake,' and argued that the Pact should be improved through a 'proper accounting of public investment.' Proper, for them, meant 'applying the rules of the Pact to the budget inclusive of nominal interest payments and of capital depreciation, but excluding net investment.' As they explain (2004, p. 3)–

> A private company does not attribute the entire cost of an investment project to a single year's accounts. Investment implies future returns: its cost should thus be distributed over time as those returns accrue.

This is the so-called 'golden rule' framework, which distinguishes between consumption and investment, and targets *saving* instead of government net lending/borrowing (or the budget balance). The main criticism against the golden rule is that it gives governments room for misuse, as they would strive to define all expenditures as investment. There are also many options to define the deductible expenditures (for an overview of different formulations, see: Reuter 2020, p. 29).

The 2005 amendment did not take the golden rule proposal on board, and continued to count net investment towards the deficit. There was even less appetite for change in the next round of revisions – which happened in the context of the Eurozone crisis of the early 2010s. The crisis was (mistakenly) diagnosed as a sovereign debt crisis (e.g. Blyth 2013, Matthijs and Blyth 2015, Schelkle 2017, Mody 2018, Tooze 2018), and member states were forced to embark upon stringent fiscal consolidation paths. The Six-Pack (2011), Two-Pack and Fiscal Compact (2013) amendments to the SGP doubled down on the debt reduction focus.

Europe's decade of austerity weighed down heavily on public investment. As the structural budget balance steeply climbed upwards, net investments declined from 1% of EU GDP to 0%, and to negative territory even in 2014-16 (Figures 2 & 3).

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[4] Its preventive rules entered into force in 1998, followed by the corrective rules in 1999.
[5] Article 104c (*Treaty on European Union* 1992)

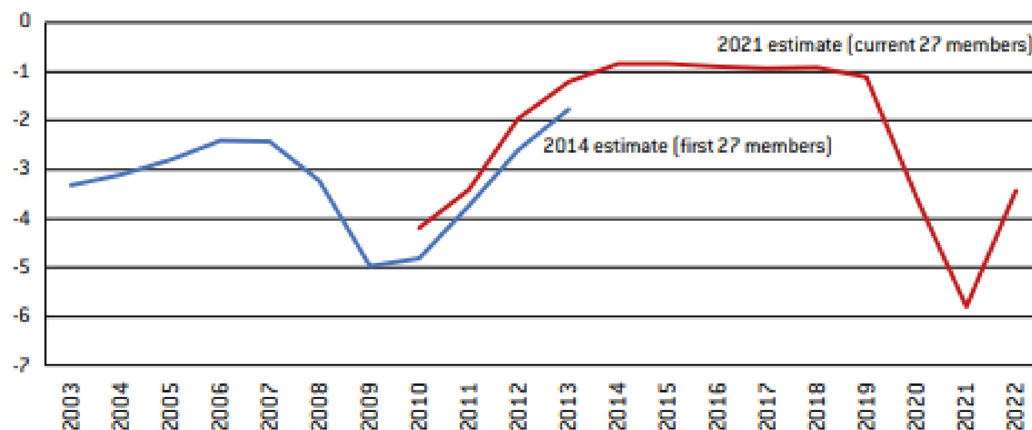

Figure 2. Structural budget balance in the EU (% of potential GDP). Source: Darvas and Wolff (2021, p. 4).[6]

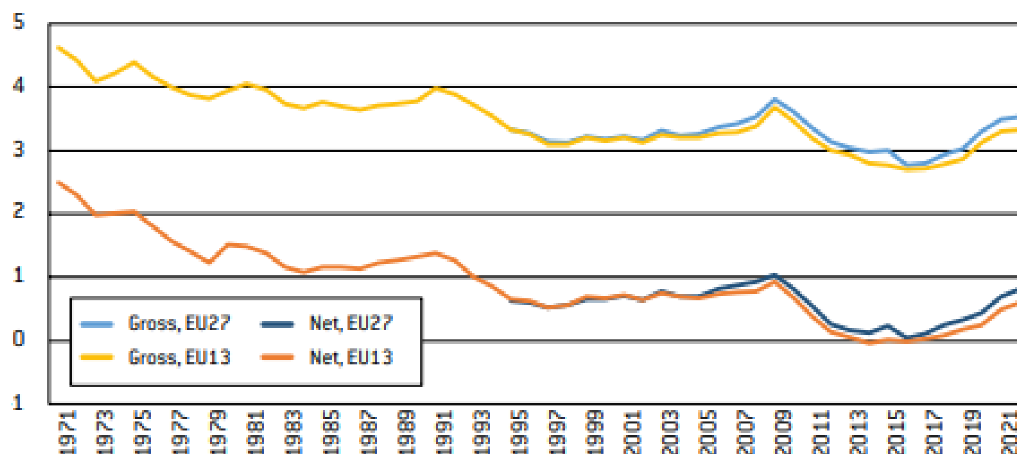

Figure 3. Gross and net public investment in the EU (% of GDP), 1971-2022. Source: Darvas and Wolff (2021, p. 4)[7]

Amidst the pro-cyclical fiscal tightening, Bariero and Darvas (2014) show how public investment was the expenditure category that suffered the most. The collapse was especially stark in the most vulnerable member states on Europe's Southern periphery, further aggravating the depression.

[6] Data: Bruegel based on the May 2014 and the May 2021 AMECO datasets. Note: the latest May 2021 AMECO includes estimates and forecasts for 2010-2022, so we include the May 2014 AMECO which also includes earlier estimates.

[7] Bruegel based on the May 2021 AMECO dataset. Note: EU13 is the aggregate of the first 15 members of the EU except the United Kingdom and Luxembourg. The forecasts for 2021-2022 include the impact of NGEU.

The self-defeating nature of investment cuts – hurting long-term growth, and consequently, also debt sustainability – was only one of the major concerns. In the decade after the financial crisis, most of the advanced world experienced what Keynes called a 'liquidity trap' (1936, see also: Hicks 1937). Demand was chronically weak, and output was below potential, but central banks could not push real exchange rates sufficiently low to stimulate growth, as nominal interest rates hit the zero lower bound. Many economists (e.g. Christiano *et al.* 2011, Delong and Summers 2012) argued that fiscal policy is especially effective in a liquidity trap, since the otherwise present crowding out effect is absent (interest rates do not increase). Studies estimated large fiscal multipliers and argued that deficit-financed fiscal expansions pay for themselves. Europe's dogged adherence to austerity in this period, squandering an immense amount of unused potential that can never be recovered again, and that could have been utilized to build for the future – is truly baffling.

Meanwhile, proposals calling for some version of a golden rule were raining down on EU institutions from academics, think tankers, and more (e.g. Barbiero and Darvas 2014, Truger 2015, Bénassy-Quéré *et al.* 2016, European Fiscal Board 2019). In a resolution of 8 October, 2013, the European Parliament joined the chorus. In the text, the EP–

> invites the Commission to report on the scope for possible action within the boundaries of the existing EU fiscal framework in order to address further the issue of separating current spending and investment in the budget deficit calculations so as to avoid public investments with long-term net benefits being calculated as negative

The Commission did not act on these recommendations, but did take timid steps of its own to accommodate investments, signalling sensitivity towards the problem. For instance, it introduced an investment clause, allowing members under certain conditions (e.g. deficits below 3%), to exclude the national co-funding portion of EU-funded investments from deficit calculations.

The 2014-15 round of revisions wrapped up with a Commission communication titled 'Making the best use of the flexibility within the existing rules of the SGP,' and encouraged member states to make use of the fiscal room for maneuver allowed within the framework (European Commission 2015). But as the European Fiscal Board (2019, p. 6) remarked in its assessment, this flexibility came much too late, as recovery was already underway.

This particular revision process also included a more explicit move towards investments. Then-Commission President Jean-Claude Juncker launched his flagship 'Investment Plan for Europe' (also known as the Juncker Plan) in November 2014. While the initiative clearly shows that the underinvestment problem was front and center on EU policymakers' agenda, the Juncker Plan received ample criticism as a vehicle to give a meaningful investment boost. The money provided by the European Fund for Strategic Investment (EFSI) instrument amounted to a meager 21 billion euros, and through co-financing and de-risking private financing, it was supposed to 'mobilize,' 'trigger,' 'unlock,' or 'leverage' 315 billion euros worth of overall

investment, through a 15-fold multiplier. As the European Court of Auditors pointed out in its assessment (2019), there were methodological issues with the estimation of the investment projects that were realized as a direct impact of EFSI funding (and would not have been, otherwise). The Plan, however, has traded out a direction of travel for the European Commission: if member state fiscal authorities are constrained and there is little appetite in the capitals to relax fiscal rules, the EU-level can jump in and drive investments.

A new comprehensive revision of the SGP finally started in 2020, but it was almost immediately discontinued because of the COVID-19 pandemic. The shock prompted EU institutions to activate the SGP's general escape clause so that governments have more fiscal leeway to fight the downturn. The SGP reform process resumed in October 2021 with a consultation – and yet again, one of the most influential interventions came from Olivier Blanchard and co-authors (2021). They proposed to scrap fiscal rules altogether, and substitute them with fiscal standards that consist of qualitative recommendations grounded in country-specific analyses of debt sustainability paths.

The European Commission's first proposal on the main principles of the reform was published in November 2022. As a motivation to change the rules and leave member states more room for public investments, the text makes an explicit nod towards a polycrisis-related need for 'sustained high' investment (2022a, p. 4) –

> The green and digital transitions, the need to ensure energy security, as well as social and economic resilience, and to build up defence capabilities will require sustained high levels of investment in the years to come. The COVID-19 crisis and the Russian invasion of Ukraine have also made these common priorities more visible and urgent. High levels of investment will be needed to achieve a fair twin transition (green and digital), increase social and economic resilience (including through upskilling and reskilling), increase territorial cohesion, reduce energy dependencies, and increase defence capabilities, both at the national level and in support of Europe's common priorities. ... These objectives call for investment by corporations and households, but also for higher public investment, backed by a good composition and quality of public finances.

Public investment is the European Commission's widely shared prescription to the polycrisis, also mirrored in a host of policy strategies and legislation. The European Commission's favorite buzzwords, like 'resilience building,' 'digital sovereignty,' or 'strategic autonomy' mostly boil down to investment tasks: invest in renewables and green technology to reduce emissions and break free from Russia (see the European Green Deal and the 'Fit for 55' package[8]); invest in supply chains to tackle critical bottlenecks such as semiconductor shortages (see the New Industrial

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[8] E.g. 'Fit for 55': delivering the EU's 2030 Climate Target on the way to climate neutrality (European Commission 2021a)

Strategy or the Chips Act[9]); invest in military defense to deter Russian aggression (see the initiatives to reinforce the defense industry[10]).

While the political ambitions are set out very clearly, the instruments to create much needed fiscal space to implement them, are much less stratightforward. The SGP reform proposal pledged to make the rules more growth and investment friendly and correct pro-cyclicality (while also simplifying the too complex and intransparent framework). Overall, the proposal took a few steps towards the Blanchard et al. idea of 'fiscal standards,' and also the spirit of the golden rule. Instead of the myriad of numerical rules and targets, the new framework is built around multi-year debt reduction paths based on debt sustainability analyses (DSAs) for each member state, negotiated on a bilateral basis. Importantly, the DSA-based framework eliminates the '1/20 rule,' which required heavily-indebted members to decrease 1/20th of the difference between their actual debt ratio and 60% every year. The speed of adjustment is determined by the initial debt level of the member state.

From our perspective, the key incentive is that if member states commit to investments corresponding to the abovementioned common European strategic interests and growth-enhancing reforms, they can negotiate an extension of the adjustment period (the maximum time debt levels need to start declining) – from four to seven years.[11] This would (under certain conditions) create more fiscal space for member states to invest. The proposal is a carefully crafted compromise that is, on the one hand, adamant to keep the 3% deficit and 60% debt targets anchored in the Treaty, and rejects an explicit exemption for net investments. It does, on the other hand, soften the focus on a steep reduction of public debt, and hence, moves away from the approach centered on financial net worth, taking physical assets more into account.

There are reasons to doubt that the new framework will be effective to deliver a meaningful boost in investments. As Johannes Lindner and Nils Redeker (2023) point out, without additional leverage on the Comission's side to incentivize member states, the proposal is likely to fall short of its goal to bring public investment in line with green transition targets and other ambitions. The authors draw attention to a serious shortcoming: while we saw that public investment was also inadequate in countries with fiscal space, the new SGP framework "has nothing to offer to member states that do not or cannot apply for an extension (such as those with a low debt challenge)." They proposed two main avenues for improvement. Firstly, more clarity on the additional fiscal space that member states can get in exchange for investments and reforms, while also broadening the scope of beneficiaries. Secondly, explicit carve-outs for climate and energy related public goods provision. The main criticism against the golden rule is that it's prone to misuse because of the uncertain nature of exemptions – narrowing it down to climate-related spending tackles this problem.

[9] E.g. Updating the 2020 Industrial Strategy (European Commission 2021b); A Chips Act for Europe (European Commission 2022c)
[10] E.g. EU to reinforce the European defence industry (European Commission 2022b)
[11] 'Q&A: new economic governance rules fit for the future' (European Commission 2023)

While the Commission's first proposal drew ample criticism for not going far enough, Germany's Finance Ministry (2023) pushed back against it in a so-called non-paper for going too far. The German position disapproved of the too much discretion the DSA-based analysis left for both the Commission and member state capitals, and pushed for reintroducing numerical 'safeguards' for minimum debt reduction of at least 1% per year, targeted at members with a high debt challenge (and 0.5% for members with a medium debt challenge). The Commission's main instrument to safeguard public investments took a serious hit by the German non-paper. It assessed the four to seven year adjustment period too generous in case of highly indebted members, and proposed cut it to zero – an idea duly dismissed as 'near-absurd' by Olivier Blanchard (2023).

In its final legislative proposal published on April 26, 2023, the Commission made clear concessions to Berlin, and did reintroduce numerical safeguards over and above the DSA-based analysis. For members with deficits above 3%, the legislative proposal foresees a 0.5% debt reduction target (that is lower than the German proposal, but a numerical target on debt nonetheless). For all member states, growth of primary net expenditure will be limited to medium-term output – which is expected to put a constraint on spending, and consequently, on public investments.[12] Overall, both the SGP framework itself and the policy discourse around it reflects the cash-based approach to saving, and a consequent anti-investment bias. In principle, even the German side agrees with the aim of boosting public investments, but when it comes to the actual rules, they always backpedal to stringent limitations based on a cash-based approach to saving. Although the anti-investment bias has been addressed several times throughout the years, proponents of a different approach have so far failed to achieve meaningful headways.

(3) The distorted politics of public investment

Treating investment equivalent to dissaving introduces significant distortions in the political debate around fiscal rules. The following short section summarizes this dynamic, highlighting three aspects.

Firstly, regarding public investment as dissaving obscures the moral politics around it. In the moralizing discourse of European political economy – explored in depth by Matthijs and McNamara (2015) in the context of the creditor-debtor divide – governments who successfully maximize their *financial* net worth, while grossly neglecting physical assets are framing their position as responsible, frugal and future-oriented. This is very odd, given the classic formulation of Musgrave (1939) in public economics, where intergenerational fairness is linked to the 'pay-as-you-use' principle. It argues that fair generational distribution is debt-financed investment, as it constitutes a setup where what is used by future generations will be paid by future generations. In the German domestic debate, an increasing number of voices are contesting the absurdity of using future generations' interests to justify decaying infrastructure or underinvestment in the green transition (see the NGO FiscalFuture, advocating for public

[12] *Note: The analysis traces the 2020 SGP reform debate until the April 26, 2023 legislative proposal of the European Commission; this is the start of the negotiation process with the co-legislators which may or may not deliver the reform.*

investment in the name of future generations). If the conception of saving is limited to financial assets only, future generations are set to inherit a pile of paper promises, rather than a sustainable economy or a liveable planet.

Secondly, the investment = dissaving fallacy introduces is a similar distortion in the 'rules versus discretion' debate; the argument that politicians have time-inconsistent preferences skewed towards inflation, and are better off binding themselves with rules (Kydland and Prescott 1977, Barro and Gordon 1983). If investment is regarded as a form of dissaving, it follows that politicians may be inclined to invest excessively. Therefore, rules need to limit their discretion and to put constraints on overspending. If investment would be viewed as a form of saving (a means to transfer wealth to future generations), the same logic would point to the risk of politicians who do too little investment. In view of the last decade's chronic underinvestment problem, also in member states with more than adequate fiscal space, this latter diagnosis sounds more plausible. Remaining in the ordoliberal rules-based frame, an alternative would be a rule to incentivize public investment– with rewards for meeting certain investment targets, rather than punishment for exceeding them.

Thirdly, if investment is regarded is dissaving, the political framing of spending programs will be more focused around funding, rather than the positive goal of providing public goods. This is a crucial point in the EU's case. This framing makes it difficult to specify the needs of European citizens and the cost of meeting them, and only consequently turning to the fiscal trade-offs involved on the funding side. What is clear from the analysis above, is that the EU has committed to providing public goods, but there is a tension between this pledge and the fiscal space it leaves itself to deliver on these promises.

A meaningful boost in investments requires fiscal spending, and part of this spending requires borrowing. However, policymakers in both EU-institutions and the capitals often obscure or outright deny this trade-off. One way they do this is by not providing a clear estimate of the overall investment required to implement a policy initiative. If there is a numerical estimate (e.g. in case of the EU Green Deal), what also needs to be determined is the 'division of labor' between the public and the private sector. The conventional understanding assumes a mix of public and private funding, with public funds (a lower ratio) used to leverage private investment (a higher ratio). E.g. in case of the 'Fit for 55' package, the EU's set of legislative proposals to deliver on the European New Deal target, Darvas and Wolff (2021) estimate of a public-private ratio of 1:4 to 1:5. However, EU institutions have been criticized for working with unrealistic assumptions about the amount of private investment that an additional euro of public spending can "unlock" or "leverage." (See the discussion on the Juncker Plan above.)

Zooming in on the public portion, there is the additional question of whether it is the member state or the EU level that should invest. The final section briefly explores EU-level instruments.

(4) Is EU-level spending a way out of the underinvestment conundrum?

Financial Times columnist Martin Sandbu (2023) formulated the European Union's under-investment woes as a trilemma: the EU wants more investments, strict national budget rules, and no common spending all at the same time, but it is only possible to have two out of the three. As Sandbu explains, ramping up public investment can be achieved through member state-level budgets – but also through common EU-level spending. Given the explicit focus on common, EU-level priorities, a larger EU-level fiscal capacity, with dedicated funds, has often been proposed as a possible way out of this impasse.

The precedent to pursue this direction was set by the Next Generation EU (NGEU) fund– the landmark EU-level instrument of 750 billion euros (500 bn in grants and 250 bn in loans), created to jointly mitigate the fallout from the COVID-19 pandemic, and establish a redistribution scheme to support harder-hit members. For the first time in this magnitude, NGEU has been financed by common EU borrowing. Its flagship instrument, the Recovery and Resilience Facility nudges member states towards investments and reforms, in a very similar fashion the Commission's SGP reform proposal sets out to do. NGEU's priorities are also closely connected to the policy aims listed above, including the green and digital transitions and energy security.

It is clear that for some political actors, NGEU – an explicitly temporary instrument – was a foot in the door, and a blueprint for similar funds, financed by new rounds of joint borrowing. In September 2022, Commissioner Thierry Breton called for a 'European Sovereignty Fund' to back up Europe's industrial and defense ambitions, which he framed as a response to the geopolitical and industrial competition posed by not only Russia and China, but also the United States. Breton urged to 'get serious about financing' and 'finance this Fund through common debt, like we successfully did with NextGeneration EU.' To tackle the climate emergency, multiple ideas for an 'EU Climate and Energy Security Fund' have also been floated (e.g. O'Connell *et al.* 2023).

Ramping up investments through common EU-level spending would dissolve some of the political obstacles outlined above. It is very clear from the narratives of EU policy-makers, that they do start from the politically expedient starting point, namely the type of public goods they pledge to create (as opposed to starting from the fiscal constraints). The reason for this is plausibly, that EU-level spending is something new that needs to be justified, and the EU's common response to the polycrisis provides a good excuse to strengthen EU-level capacities. The other problem common EU spending would remedy (and which often comes up in EU officials' speeches) is safeguarding a 'level playing field,' i.e. making sure that member states with bigger fiscal space do not get an advantage compared to more fiscally constrained ones, which is important as they compete on the same EU single market.

On the other hand, common EU-level spending would require a level of fiscal risk-sharing and solidarity that some member states are vocally reluctant to undertake – and the European Commission (apart from some dissonant voices like Commissioner Breton's) did not pursue this avenue in its reform proposals.

Conclusion

This paper shed light on the puzzling gap between the EU's remarkably ambitious investment pledges as a response to the 'polycrisis' – and its self-imposed fiscal constraints undermining these pledges. It argues, that the EU's enduring inability to reform its fiscal rules is linked to a particular layer of German ordoliberal economic thought, the cash-based conception of saving. It goes on to examine how this idea distorts the politics of public investment in the EU. Empirically, the analysis sets out to find discursive evidence of the anti-investment bias in the Stability and Growth Pact, and the policy debates surrounding its revisions, including the SGP reform debate launched in 2020.

The investigation unveils that the cash-based approach to saving has hindered more public investment-friendly fiscal rules in the EU, and suggests that EU-level spending may offer a way out of this underinvestment conundrum, but comes with another batch of political difficulties. Overall, this paper provides insights into the challenges facing the EU in achieving its investment goals.

The article seeks to contribute to the literature through two main avenues. The first pertains to Germany's ordoliberal economic thought and its significant influence on EU decision making, which has garnered significant scholarly interest, particularly in the aftermath of the Eurozone crisis (Bonefeld 2012, Blyth 2013, Jacoby 2014, Young 2014, Matthijs 2016). The article adds another layer to these accounts, with its focus on the cash-based conception of saving, that is both an important building block of ordoliberal thinking and somewhat contradictory to its tenets. The paper also has links to the research agenda on the politics of economic statistics (Linsi and Mügge 2019, Mügge 2022) – examining the biases and misconceptions embedded in efforts to measure and capture savings. Deconstructing these measurements, frameworks and debates is a valuable approach to gaining insights into the European Union's quest to tackle generational challenges, while often showing reluctance to confront the fiscal costs associated with these ambitions.

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