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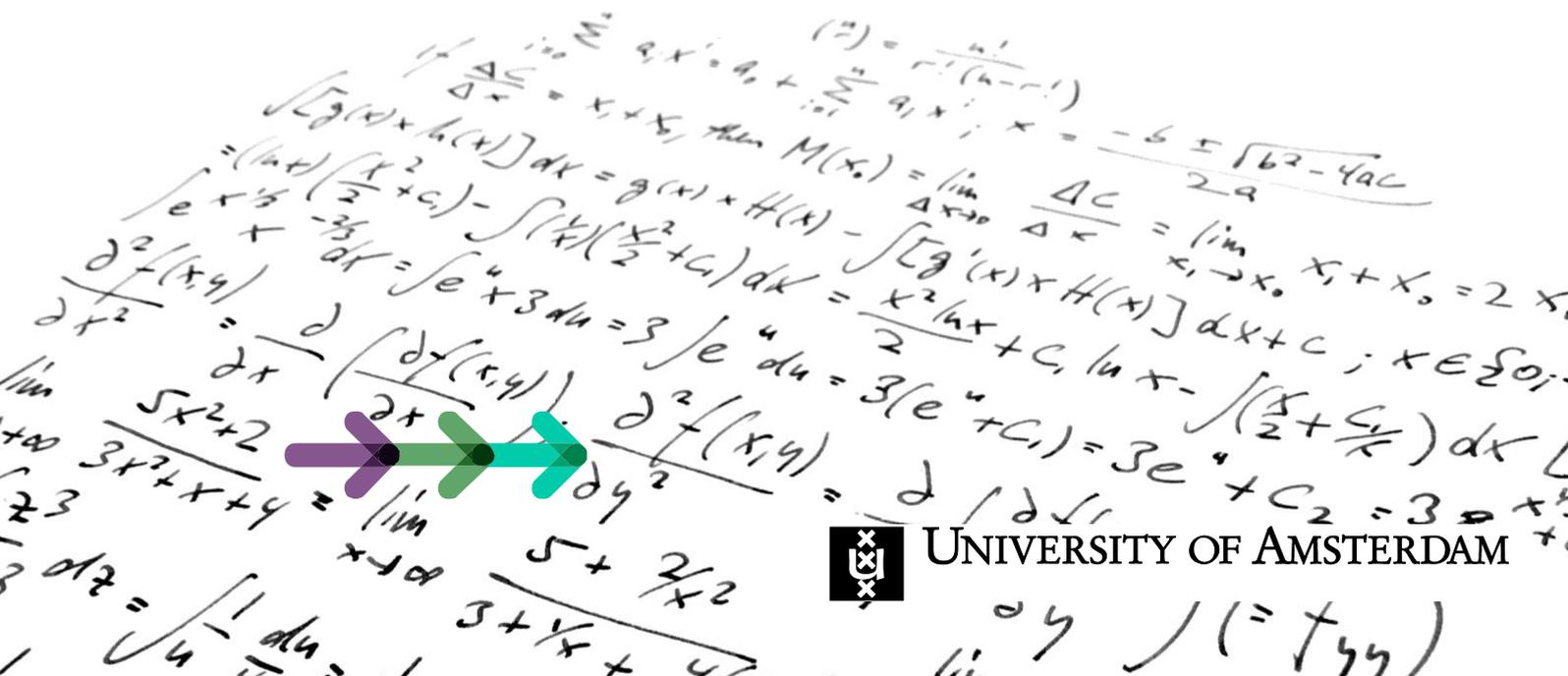
Set in stone? Conflict and continuity over the European Union's measurement of government debt

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ABSTRACT. The Maastricht definition of government debt constitutes a central pillar of the European fiscal governance architecture. When EU member states agreed on the definition as part of the euro convergence criteria, they took a narrow approach to debt. The 2008 financial crisis and later the euro area crisis forced governments to engage in large debt-increasing bank bailouts, revealing gaps in the debt definition. Growing dissatisfaction with the outdated Maastricht indicators opened a window of opportunity for reform but the debt definition remained unchanged. We explain this puzzling indicator inertia by drawing on historical institutionalism. Examining the conflictual history of the EU's debt measure, we show how the revision of the debt definition failed precisely due to its political charge and centrality in the EU fiscal surveillance framework. It also demonstrates that this path dependence enabled the European Commission to establish new fiscal sustainability indicators accounting for the implicit liabilities not captured by the narrow debt definition.

Word count: 10 442



Introduction

Government debt measures generally serve to gauge the fiscal soundness of a country's public finances. But in the European Union (EU) their importance goes beyond being a thermometer of fiscal sustainability, because they are deeply entrenched in the EU polity. Maastricht debt is a key anchor of the European fiscal governance architecture. Hence, governments in the euro area face strong incentives to keep any additional debt off their balance sheets – not just because they want to keep their refinancing costs in the financial markets low, but also because they hope to avoid the reputational costs associated with violating the Maastricht reference value of 60 percent debt to GDP ratio.

The 2008 financial crisis and later the euro area crisis forced member states to engage in massive bank bailouts, which threatened to increase their debt-to-GDP ratios drastically. As the EU's official statistical office, Eurostat assessed the impact of these rescue operations on public debt levels. Given the political charge of debt figures, conflict ensued between member states, EU institutions, and statisticians about appropriate measurements. Not only high-debt member states put pressure on Eurostat to bend the rules in their favor – also fiscally conservative and traditionally frugal ones like the Netherlands lobbied in that direction. Yet Eurostat resisted these political pressures. As a result, member states intensified their exchanges with Eurostat to develop a better grasp of how to limit the impact of their bailout policies on their debt and deficit level (Gandrud and Hallerberg 2016).

This article focuses on Europe's political fights over its debt measure. We submit that debt is a more political concept than commonly appreciated. No self-evident definition exists. Most international organizations differ with regard to the methodological choices underpinning debt measurement. The EU's debt definition is the result of political deliberation and intergovernmental bargaining at Maastricht. EU member states agreed the specific parameters in the early 1990s as part of the euro convergence criteria, and they later enshrined them in the Stability and Growth Pact (SGP). Since then, the Maastricht debt indicator has remained largely unchanged despite frequently levelled criticism. How can we explain this puzzling indicator inertia? Why did member states fail to agree on widening the debt definition to provide a more accurate picture of their public finances when they had the chance to do so?

We advance an explanation rooted in historical institutionalism that highlights path dependence (Pierson, 1996, 2004). Debt measures are locked in, not despite their political and contestable character, but because of it. The 'switching costs' related to changing the debt



definition were potentially high (Lindner 2003). More specifically, it was the deep entrenchment of the debt measure within the EU fiscal governance architecture that would have made change so cumbersome and led to indicator inertia. Despite governments' misgivings about the debt measure, collectively they steered clear of any reform because of the potential knock-on effects for the EU fiscal surveillance regime at large. A rise in the overall debt levels above the entrenched 60 percent debt-to-GDP would have violated the reference value, thus increasing the risk of being sanctioned for non-compliance with the fiscal rules. In a nutshell, the institutionalized political commitment to a highly salient indicator trumped the concerns raised by statistical experts and some governments. What is measured by the Maastricht debt definition turned into a stand-alone policy goal: to avoid an increase in the debt level at all costs. We introduce the concept of indicator goal displacement to describe this phenomenon. In sticking to the narrow Maastricht debt definition, member states paradoxically widened the opportunities for other indicators to feature more prominently in the EU fiscal surveillance framework. We call this process of adding indicators on top of existing ones indicator layering. For example, because implicit liabilities related to pension costs were excluded from the debt definition, the European Commission created a new sustainability indicator S2 to take these costs into account (Berti 2018).

The literature on macroeconomic indicators has drawn scholarly attention to the fact that statistical standards are essentially 'sediments of political struggles' (Mügge 2020, 11). Indicators can exhibit a remarkable stickiness but can also become performative when they trigger dynamic processes with unintended consequences (Muller 2018, 169-71). As they take on 'a life of their own' feedback loops ensue between indicators and politics (Espeland and Sauder 2012; Desrosières 2015; Coyle 2017). This article adds a new dimension to the politics of debt and deficit indicators in the EU and furthers our understanding of how the crisis has affected the EU's fiscal surveillance framework. It offers important insights in light of the sharply increasing government debt levels related to the COVID-19 pandemic. It builds on over 20 interviews with stakeholders at Eurostat, the European Central Bank, the European Commission and the OECD, as well as on extensive analysis of official documents by these institutions.

In what follows, we first introduce three theoretical concepts related to indicators - indicator inertia, indicator layering and indicator goal displacement - building on historical institutionalism. We then highlight some definitional and methodological challenges pertaining to the measurement of government debt and deficit. We next discuss three empirical cases of governments' bank rescue operations (the French rescue fund, Dutch ING, Belgian Dexia) and their impact on debt and deficit indicators. They show the rigid



application of the statistical rules. Only in the case of the French rescue fund did Eurostat invoke the financial crisis as a reason for not classifying it as a governmental entity. In the other two cases, Eurostat did not give in to the objections of the respective government and the rescue operations were recorded as either debt- or deficit-increasing. Dissenting expert opinions, uncertainty related to the financial crisis and political pressure explain why France was more successful in influencing Eurostat's decision than others. The empirical evidence shows that governments opposed Eurostat's interpretation of the statistical rules and put political pressure on national statistical agencies and Eurostat to interpret the rules leniently. Eurostat largely resisted these pressures and governments started to deepen their exchanges with statistical agencies to better anticipate the impact of their rescue mechanisms on debts and deficits. When a window of opportunity opened to reform the debt measurement, a proposal by Eurostat was rejected by EU member states collectively. The indicator inertia enabled the European Commission to devise new indicators related to fiscal sustainability.

A Historical Institutional Theory of Indicators

A recurring puzzle in the indicator literature is why some indicators are frequently adjusted, whereas others exhibit a remarkable path dependence. Despite tremendous societal and technological progress, some indicators are resistant to change and still reflect the interest constellation at the time of their creation. This raises the question which factors drive indicator change. An interest-driven rational choice perspective would argue that indicators are updated whenever the balance of interests changes. But even extremely prescient actors cannot account for all unforeseen future contingencies that might have an influence on a certain indicator. Many indicators defy the efficiency logic because better ways of measuring are available but the indicator has not been updated in meaningful ways. We argue that solving this puzzle requires to take a thorough look at the historical roots of indicators.

Historical institutionalism (HI) examines the temporal dimension of how institutions affect the behavior of individuals and political outcomes (Hall and Taylor 1996; Pierson 1996; Hacker 2004; Streeck and Thelen 2005). It is well-suited to shed light on the evolution of rules in the context of the EU. A key concept in historical institutionalism is path dependence: the difficulty of deviating from a path taken at an earlier juncture even if there may be good reasons to change course (Pierson 2004; Thelen 2009). Over time, sequences become self-reinforcing through different causal pathways (Mahoney 2000). For example, institutions can become so embedded in political interactions and taken for granted that they are no



longer actively questioned (Hall and Taylor 1996; Mahoney and Thelen 2010). Moreover, an institution can persist because its benefits outweigh the costs due to organizational dependencies, its perceived legitimacy, or because the institution has functional consequences for a larger system (Mahoney 2000).

HI not only furthers our understanding of how institutions persist despite inefficiencies – it also provides guidance on how to understand institutional change. HI distinguishes four types of institutional change: displacement, layering, conversion, and drift (Hacker 2004; Streeck and Thelen 2005; Mahoney and Thelen 2010). Displacement occurs when old institutions lose their position to new ones. Layering describes a process whereby new elements are added to already existing institutions. Conversion happens when an institution is redirected to new objectives. Finally, drift takes place when old institutions deteriorate. European integration scholars have applied these concepts to understand the European response to the euro area crisis (Salines, Glöckler, and Truchlewski 2012; Gocaj and Meunier 2013; Verdun 2015; Moschella 2016).

Verdun (2015) has observed that the reforms in response to the euro area crisis like the six- and two-pack layered new provisions on top of the existing SGP. Salines, Glöckler, and Truchlewski (2012) show that the incremental change in the EMU governance structures between 2007 and 2011 can be best captured by the HI concepts of layering, conversion and path dependence. Moschella (2016) shows that the layering of the new crisis management rules was key to explaining the shifting preferences of the ECB and the Commission regarding a potential Greek debt restructuring and fiscal consolidation. Savage and Verdun (2016) show how Eurostat's surveillance and monitoring capacity has been strengthened by the Greek and euro area crisis.

We conjecture that these HI concepts can be usefully applied to macroeconomic indicators and enhance our understanding of the political dynamics underpinning them. Following the rule of thumb postulated by Muller (2018, 153), we expect that 'what gets measured is what is most easily measured'. Mügge and Linsi (2020) have labelled the prevailing professional norm among statisticians to narrow the room for discretionary judgment in statistical systems 'certitude'. They argue that certitude – next to other norms like comparability, continuity, and coherence - can instill a bias in favor of maintaining the status quo rather than exploring innovative statistical standards that would better reflect the new economic realities.

We hypothesize that indicator inertia is partially a function of the embeddedness of an indicator in a network of other indicators. Put differently, if a change in the settings of a specific indicator would have large ramifications for a host of other indicators, it will be much harder to change such a systemically important indicator. For instance, a change in



the deeply entrenched Maastricht debt measure would have knock-on effects for the whole European fiscal surveillance framework. Other indicators that are less consequential are obviously easier to change. Thus, the switching costs of deeply entrenched indicators are higher.

Statistical standards can also become sticky because they are enshrined in treaties or because statisticians prefer not to disrupt long statistical time-series (Van Wijk 2001; Bos 2011; Mügge 2019). Practical concerns like data availability, resource and time constraints, the ease of measurement and other technical factors can contribute to the path dependence of measures (Balassone and Franco 2000). Mügge (2019, 97) has pointed out that harmonized statistics as tools of cross-country comparison are particularly important when multilateral agreements are tied to a sanction mechanism like the one enshrined in the SGP. When a macroeconomic indicator becomes an arbiter of distributive conflict such as the Maastricht debt measurement, the chances that it will flexibly adopt are even slimmer.

Our indicator fixation can have unintended consequences. Muller (2018, 169) argues that it leads to a 'diversion of effort to what gets measured'. Bank bailouts vividly illustrate how efforts get diverted towards designing complex bailout schemes only to avoid an increase in the debt to GDP ratio. Such behavior might be politically rational but questionable from an economic point of view (Matthijs and Blyth 2018). An excessive focus on keeping the Maastricht debt level below 60 percent of GDP might not automatically result in prudent fiscal policy. Drawing on HI, we define indicator goal displacement as a process that occurs when the measurement object of the indicator becomes the policy goal itself. Debt reduction has turned into a stand-alone policy goal, but this was not the original purpose when the debt definition was agreed. Thus, the concept of indicator goal displacement incorporates the performative features of indicators.

In addition, we define indicator layering as a process whereby new indicators are added on top of existing indicators. Indicator layering is a response to outdated indicators that fail to adjust in light of unforeseen contingencies. Drawing on Muller (2018, 171), who argued that in response to 'faulty metrics' organizations can institute 'rule cascades', we posit that organizations and statisticians can also start to devise a host of new indicators - what we term indicator cascades - layered on top of each other to account for the missing pieces of the puzzle that are not yet incorporated in the existing indicators. For instance, the European Commission created a fiscal sustainability indicator (S2) to measure the fiscal risks related to pensions and ageing societies. This would not have been necessary if we would have a wider debt definition in Europe that accounts for the implicit liabilities created by the different pension systems.



A Primer on Debt Measurement Issues

In this section we will review measurement issues related to government debt and deficit statistics. In sketching out different debt measurements, we reveal the difficult trade-offs that are inherent in such a fuzzy statistical concept (De Vlieger and Mügge 2020). The Maastricht way of debt measurement is only one option among many. Definitions of government debt can vary substantially across countries and international organizations. The chosen definition and measurement methodology affect in turn the size of a country's debt and deficit. These differences can be substantial. For example, the 2017 government debt of France was 124 percent of GDP according to the OECD, but 98.5 percent of GDP according to Eurostat. Comparing the same sources, Italy's debt was 22 percentage points higher according to the OECD. This divergence persists when looking at different years, different organizations and different countries, and arise from conceptual problems in measuring government liabilities (see Blejer and Cheasty 1991, for the deficit; Irwin 2015; Bloch and Fall 2016, for government debt). Three definitional and methodological challenges are particularly relevant for government debt and deficit: (1) the delineation of government, (2) the coverage of liabilities, and (3) the valuation method used (Irwin 2015).

First, determining whether an entity belongs to the government or to the broader public sector can be a challenge for statisticians. The boundaries between the government, the public and the private sector can be blurry. While statisticians use criteria such as ownership and control in their assessments, it is often unclear who ultimately bears how much risk and to which governmental entity debt should be attributed.

Second, the coverage of liabilities included in government debt also varies across countries and organizations. Not all public liabilities automatically count as government debt and it is a complex question to identify those liabilities that should be included. Liabilities can be direct or contingent (Brixi and Schick 2002). A direct liability, such as a loan, entails an obligation by the government to repay at maturity. In contrast, contingent liabilities are uncertain. They depend on the occurrence of a future event, such as government guarantees that are only activated when called upon. The most disputed category of liabilities concerns pension obligations. Many governments operate pay-as-you-go schemes, under which current workers pay for current retirees. They can pose serious threats to fiscal sustainability. Yet, it remains a moot point whether these should be included in government debt as the government always has the theoretical option to reform the pension system and to cut pension payouts to lower future costs.



Third, the appropriate valuation of debt is another conceptual ambiguity and one of the key causes of the stark differences in global debt figures. Three main valuation options exist: face value, nominal value and market value. The face value of a liability is the value stated at issuance. The nominal value is the face value plus accrued interest, while the market value is the price at which a liability was most recently traded (Bloch and Fall 2016). The latter value can diverge substantially from the other two measures when a country's perceived default risk increases and its interest rates rise as a consequence. Which of the three valuation methods is the most appropriate during a period of intense market stress is contested. In the following section, we discuss three empirical cases of governments' bank rescue operations (the French rescue fund, Dutch ING, Belgian Dexia) and Eurostat's role in deciding how they would affect debt and deficit indicators.

Indicator Goal Displacement: Bank Bailouts in the EU and the Measurement of Debt

When the EU definitions of debt and deficit were written, budgetary systems and measuring methods differed widely across countries. Thus, a common definition of government debt was seen as desirable (Sverdrup 2006). The main decisions were made in the Monetary Committee (now the Economic and Financial Committee) in cooperation with DG ECFIN, which provided proposals and input (Dyson and Featherstone 1999; Verdun 1999). Data availability was key for making pragmatic measurement choices. A narrow definition of debt was needed to achieve comparability across EU member states (Interview Pieter Stek, former member of the MC). Eurostat was largely sidelined when the original definition of Maastricht debt was agreed. Decision-making power was concentrated in the hands of politicians and bureaucrats from national governments and ministries. Eurostat can provide advice on how to resolve technical measurement questions, but it always requires political backing for its decisions.

The application of the SGP is an issue for politicians. Now, whether this expenditure should be considered or not for the purpose of the application of the Stability and Growth Pact is not an issue for Eurostat. It is an issue for DG ECFIN in Brussels and for the other ministers of finance. Our job is to make sure that the figure for deficit and debt is correct. How this figure will be used and interpreted is not our job. (Interview Luca Ascoli, statistician at Eurostat)



The 2008 financial crisis and its aftermath directed attention towards member states' debt sustainability. Many governments bailed out ailing financial institutions by providing capital injections or by creating specific entities to take over troubled assets (also known as 'bad banks'). As the financial crisis morphed into the euro area crisis, EU governments had to cope with fast-rising debt levels, soaring interest rates and impaired financial market access. As a result, debt became 'an immediate imperative' (Mabbett and Schelkle 2016) and the statistical accounting rules governing debt suddenly carried weight. The central issue has been the impact of bank rescue operations on government balance sheets. It was not always clear whether the rescue operations affected government debt or deficit, as it depended on ownership, risk and control – issues that lie in a grey area and involve discretionary judgment. Eurostat increasingly had to interpret the impact of these rescues. On several occasions, governments worried about their rising debt and deficit levels tried to challenge Eurostat's interpretation of statistical rules on the delineation of government. The French, Dutch and Belgian cases discussed below show how debt measurement ambiguity played out during the period 2008-2012 and how governments tried to shape measurement decisions to keep debts off their balance sheets. They highlight the heightened politicization of debt measurement triggered by bank bailouts and illustrate the stickiness of the statistical rules.

France

The French government was unhappy with its national statistical institute's decision that its bank rescue fund Société de Financement de l'Economie Française (SFEF)¹ should be classified as a government entity, meaning that any funds provided or loans made to financial institutions would count as government debt. While there was majority private ownership (66 percent), the French national statistical institute (INSEE) concluded that the SFEF was a government entity as the risks ultimately lay with the French state which owned a 34 percent stake and even had a veto right over SFEF's final decisions (Lefebvre 2009). This meant that €13 billion would be counted towards the country's government debt. INSEE asked Eurostat for support and sought consultation from the Committee on Monetary, Financial, and Balance of Payment Statistics (CMFB). The CMFB gathers senior representatives from Eurostat, national statistical institutes, national central banks and the ECB (Savage 2005, 62-5; Savage and Howarth 2018, 224). It is one of the most important standard-setters for statistical methodologies and has a crucial mediation role for EDP-related issues. If Eurostat and a national government cannot agree on the appropriate

¹ For an elaborate description of the politics of the French approach to crisis resolution see Jabko and Massoc (2012).



classification of a particular item, either party can request a CMFB consultation. In such cases, all participants will be asked to give their opinion. While advice from the CMFB is not binding for Eurostat, its final decision is usually in line with the CMFB's opinion (see Eurostat 2013b). Thus, INSEE hoped to strengthen the case for reclassification as both the French government and central bank were advocating the opposite. After intense discussions among central bankers and statisticians, the CMFB advised Eurostat to classify the SFEF as a government entity. But for the first time since the establishment of the CMFB in 1991, Eurostat decided not to follow its advice. In the press release accompanying the July 2009 decision on 'the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis', Eurostat wrote: 'In reaching today's decision, Eurostat has paid particular attention to an appropriate recording of risks under the unique circumstances of the financial crisis' (Eurostat 2009). It is notable that Eurostat did not invoke existing rules as it had done in the past but instead invoked extraordinary circumstances in order to justify its decision. However, former Director-General of Eurostat Radermacher insisted that the final decision was taken on statistical grounds rather than being influenced by political meddling (Interview Walter Radermacher). The arguments put forth in the CMFB opinion did not persuade Eurostat. The exclusion of guarantee schemes was warranted to preserve the statistical consistency of the debt figure over time. Yet, Radermacher pointed out that it is generally important for the preparation of decisions in official statistics to have a precise knowledge of the political context, the views of the Commission and the French authorities and the volatile financial environment (Interview Walter Radermacher). Overall, a combination of dissenting expert opinions, uncertainty and political pressure have influenced the final decision.

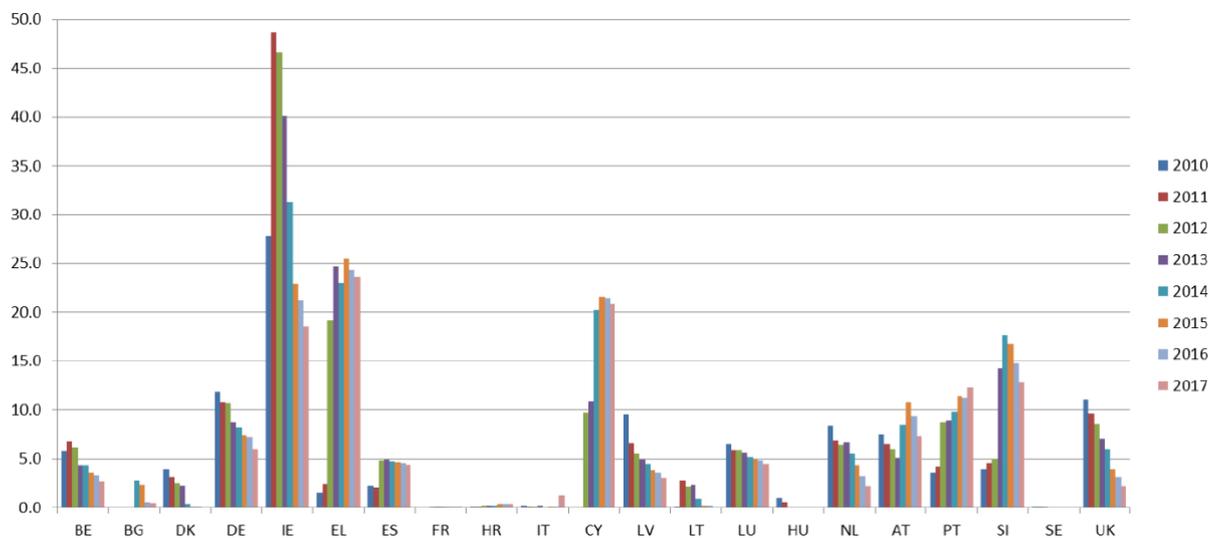
The Netherlands

The Dutch government took issue with an accounting decision made by its national statistical institute, the Central Bureau of Statistics (CBS, Centraal Bureau voor de Statistiek). In 2009, the Dutch government took over asset-backed securities on US mortgages from ING bank for a sum of €21.6 billion. This would not affect either government debt or deficit, the government assured parliament (Tweede Kamer der Staten-Generaal 2009). The CBS evaluation of the transaction confirmed that it did not affect the deficit, but that it did count towards government debt. The transaction would raise government debt by approximately 5 percentage points. Figure 1 shows the impact of governments' bank rescue operations on Maastricht government for selected EU member states and the UK. This meant that the Netherlands, for the first time since 1999, had a government debt ratio above 60 percent of GDP. The Ministry of Finance pressed the CBS to reconsider or at least to postpone the press release of its decision. The government even tried to bypass the CBS and contacted Eurostat



directly counter to established procedure which is that the statistical office acts as the gatekeeper for any contacts with Eurostat. The CBS and Eurostat were highly displeased by the actions of the Finance Ministry. Ultimately, the Dutch government's request to Eurostat to reconsider their interpretation of the rules was unsuccessful. Eurostat referred them back to the CBS on the same day the request was filed. The Ministry of Finance begrudgingly accepted CBS's opinion (Interview anonymous).

Figure 1: Impact of governments' bank rescue operations on Maastricht government debt (% of GDP)



Source: Eurostat (2018, 8)

Belgium

In the case of Dexia, there was strong political pressure to change the delineation of government. In November 2012, France and Belgium committed themselves to yet another bail-out of Dexia, a bank co-owned by the two countries. They agreed to inject €5.5 billion capital. 53 percent of this sum (€2.9 billion) would be provided by Belgium and the remainder by France (€2.6 billion). When the rescue operation was announced, the Belgian finance minister said that he 'hoped that EU authorities would allow Belgium and France to exclude the capital injection from their 3 percent budget deficit targets' (Fontanella-Khan and Carnegy 2012). Eurostat disagreed and concluded that the injection had to be included in the budget deficit. This meant that the Belgian budget deficit would increase from 3 to 3.7 percent of GDP, well above the 3 percent threshold. The Belgian government sought to reverse



Eurostat's decision, exerting pressure on Eurostat and the Commissioner responsible for Eurostat. It even asked ambassadors in other European countries to speak to ministers of finance in the hope of convincing Eurostat. François Lequiller, head of Eurostat's government finance statistics unit at the time, recalled that the director of Eurostat even received a call in which he was pressured to reverse the decision (Interview François Lequiller). Another senior statistician from Eurostat described the situation as follows:

That was political involvement. [...] We took a decision, it was not accepted by the political level I would say in Belgium. There was big, big pressure so we did a CMFB consultation. I think it was even us asking for it and then, I mean, the process was clearly outside the political process. (Interview with government finance statistician at Eurostat)

Ultimately, the campaign of the Belgian government was unsuccessful. On March 19, 2013, Eurostat informed the Belgian government of its final decision that the bank recapitalization of Dexia would need to be included in the deficit (Eurostat 2013a). To explain why France was more successful than Belgium and the Netherlands in getting its way, we need to take into account the sequencing of events, the persuasiveness of the statistical arguments and political power. France is one of the most powerful EU member states and has the capacity to influence EU institutions. When the SFEF case was decided during the height of the financial crisis, Eurostat was willing to use its discretionary judgment given the deep uncertainty, its own expert views and French political pressure. However, it also needed to preserve its independence and ensure that it would not set a bad precedent for others to follow. Thus, subsequent governments had a tougher time to convince Eurostat to follow their preferences.

Eurostat and the euro area sovereign bailout funds

This section illustrates the concept of indicator goal displacement empirically. It shows how the debt indicator's performativity has turned it into a stand-alone policy goal. Governments learnt from their failed attempts to exert political pressure on Eurostat and increasingly began to consult Eurostat on the impact of a given operation on their Maastricht debt levels before taking action. This in turn accelerated the performative effects of the debt indicator. If the ex-ante assessment was not in line with their preferences, they could amend their plans so that the governmental balance sheets would not immediately be affected. In June 2010, the euro area member states agreed on a crisis response: the European Financial Stability Facility (EFSF) (Gocaj and Meunier 2013; Moschella 2016). The intergovernmental special purpose vehicle could provide financial assistance to troubled member states by issuing member state-guaranteed bonds with a total lending capacity of €440 billion



(Gandrud and Hallerberg 2016). Much to the chagrin of its architects, Eurostat ruled that the EFSF would affect the debt levels of the participating member states. Later when the European Stability Mechanism (ESM) was designed, European leaders did not repeat their past mistakes (Tesche 2020). To ensure that ESM contributions would be treated differently, decision-makers obtained advice from Eurostat during the negotiations on the amount of paid-in capital the ESM required in order to be classified as a stand-alone institution. Eurostat gave Brussels a number and that number was accepted (Lequiller and Ecalte 2018, 149).

The European sovereign bailout funds show how a debt measure can become performative. Their design features were decisively influenced by the Maastricht debt measurement. If governments would have measured government net debt instead of gross debt, the bailout funds would have been designed in a different way. This is because net government debt takes into account governmental financial assets. The advantage of net government debt as compared to the Maastricht gross debt is that it would be unaffected if it 'takes over both liabilities and assets of the same value from a financial institution's balance sheet' (Eurostat 2014a, 10). For instance, financial assistance provided by the member state-guaranteed EFSF would have had no effect on net government debt, whereas it increased the Maastricht debt measure (Eurostat 2014a, 16-7). In a similar fashion, net government debt would not respond to the creation of 'bad banks' in the way that a government gross debt measure does.

Despite their deepened cooperation with Eurostat, governments continued to engage in creative rule interpretations. According to Eurostat statistician and former CMFB secretary Carsten Olsson: 'They found ways to go around the rules. That's a question about paying some extremely expensive consultants to be able to read the manual'. Aragão and Linsi (2020) label this strategy that exploits the deeply engrained ambiguities of statistical concepts without engaging in outright interference in the data or the methodology as 'indicators-management through indirect means'. According to statisticians, this is a common practice. François Lequiller described a meeting with the Greek statistical office amid the country's troubles:

It was not the Greek experts who were leading the discussion, it was the City of London. Then we realized, it was 2013, the Greek government was still paying lawyers, fiscal lawyers, in the City of London to give them advice on the way to present the data. (Interview François Lequiller)

Member states were discontent with the measurement of government debt during the crisis. In their eyes the statistical rules limited the scope for the emergency policies they deemed



necessary. Governments first tried to actively influence Eurostat's decisions and later sought its advice to keep their government debt figures low.

The examples above illustrate what we have termed indicator goal displacement. Over time, the debt indicator had turned into a policy goal in itself. Thus, reducing debt or preventing it from rising above the 60 percent Maastricht threshold became the paramount policy objective regardless of the economic effects (Matthijs and Blyth 2018). Interestingly, this holds true not just for high-debt member states like Belgium, it even applied to fiscally frugal countries like the Netherlands. Yet, as the next section shows, governments were unwilling to revisit the definition of debt.

The Protocol (No 12) on the excessive deficit procedure of the Treaty on the European Union defines 'debt' as the 'total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government' and 'deficit' as 'net borrowing'. The Protocol No. 12 stipulates that debt and deficit calculations are based on the European System of National Accounts (ESA), which provides rules and classifications for national accounts and the compilation of measures of economic activity. Many well-known economic indicators are derived from the System of National Accounts (SNA), among them GDP. A new version of the SNA appeared in 2008, requiring a revision of ESA (ESA 2010) and the updating of regulation 479/2009. Eurostat spotted an opportunity to re-open the debt definition. Eurostat advanced two proposals: (1) a change of the valuation method of debt and (2) the inclusion of a new liability - trade credits and advances. Both seemingly minor changes were conceptually very important because they would have affected the level of debt. First,

Maastricht debt is measured at nominal value, which is normally defined as the amount that the debtor has to repay to the creditor at any point in time. Nominal value, which is not affected by movements in market interest rates, should in principle reflect both repayments of principal and interest accrued but in the case of Maastricht debt nominal value is specifically defined in Council Regulation (EC) No 479/2009 as face value, which is equal to the contractually agreed amount that the government will have to refund to creditors at maturity. Face value is thus different from nominal value as it excludes accrued and not yet paid interest from the liability. (Eurostat 2014a, 7)

The Maastricht debt valuation methodology relies on the face value which reduces the volatility of the debt valuation because it is unaffected by changes in current market interest rates. Eurostat proposed to change this back to nominal value to include accrued interest



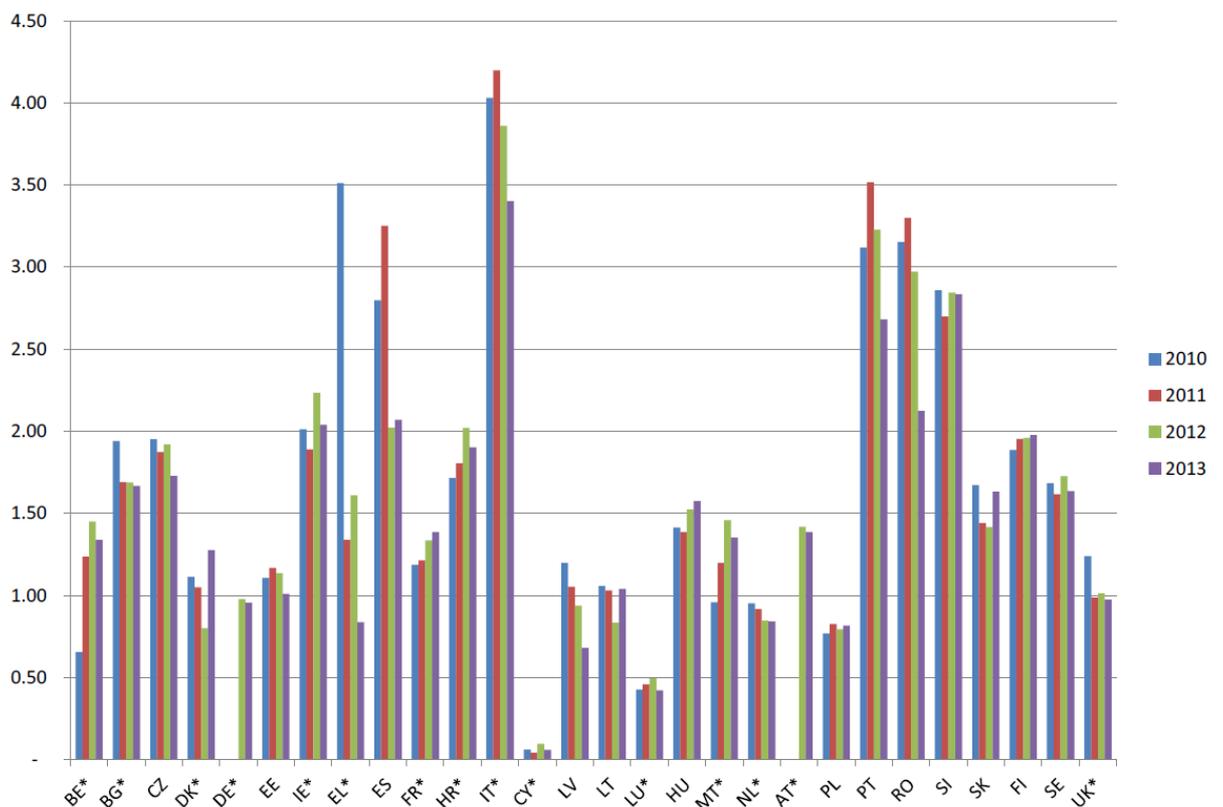
(interest due but not yet paid). It felt that this was a more appropriate valuation methodology. The existing valuation methodology discriminates against the issuance of so-called 'zero coupon bonds'. These are bonds that do not generate any interest rate payments and therefore trade at a deep discount. They only generate a profit when the entire face value is redeemed at maturity. Zero coupon bonds could be an attractive option for member states experiencing intense financial market pressures to lower their short-term debt servicing costs. The Maastricht debt, however, is increased by the full face value of a zero coupon bond even though the bond trades at a discounted price (lower nominal value) until it is fully repaid at maturity. According to the Maastricht debt statistics, government debt containing a substantial amount of zero coupon bonds might create the impression of fiscal unsustainability when it might actually be sustainable. This can create perverse incentives for governments to substitute zero coupon bonds with high coupon bonds with a lower face value only to achieve better debt optics. For this reason ESA2010 recommends that 'the difference between the issue price and the redemption price [face value] be treated as interest to be accrued over the lifetime of the security' (Cornejo Pérez, Diz Dias, and Hartwig Lojsch 2015, 19). There are two reasons for the specific choice to treat the price difference between face value and nominal value of a zero coupon bond as interest. First, 'holding gains or losses normally involve an element of risk, which is not the case for zero-coupon bonds. All information is known in advance and is certain. Second, the market itself considers these price differences as interest when calculating the yield on these bonds. Moreover, the treatment as holding gains or losses would have meant that these price differences are not recorded in the deficit' (Glatzel 1998, 97).

Second, Eurostat proposed to include trade credits and advances in the Maastricht government debt definition. 'Trade credits and advances payable are unpaid (usually short-term) liabilities of government resulting from transactions in goods and services. While the expenditure relating to trade credits is included in ESA government expenditure in line with the accrual principle (and thus impacts the Maastricht deficit), the stock of trade credits and advances payable are not included in Maastricht government debt' (Eurostat 2014b). Eurostat's insistence on including trade credits and advances was a reaction to 'governments' fiscal gimmickry' (Koen and van den Noord 2005) during the 2008 financial crisis and the euro area crisis. Governments were increasingly turning to handing out trade credits – purchasing goods and/or services without immediately paying for them – to create implicit liabilities that do not show up on the government's balance sheet (Eurostat 2012; Deutsche Bundesbank 2018, 61). Trade credits are a form of short-term debt that tend to increase during times of financial stress when there is pressure to prevent the debt to GDP ratio from rising (Interview François Lequiller). Many international organizations include



trade credits in their definition of debt. Eurostat's opinion was that trade credits were increasingly being used as a substitute for standard borrowing via capital market (without showing in the official numbers). Figure 2 shows that in some countries like Italy, Spain, Greece, Portugal, Ireland, Romania and Slovenia unpaid invoices amounted to between 2 and 4% of GDP between 2010 and 2013. Thus, Eurostat worried that this heterogeneity could undermine the comparability of government debt and deficit data across the EU (Eurostat 2012).

Figure 2: Stock of trade credits and advances payable in 2010-2013 (% of GDP)



Source: Eurostat (2014b)

Eurostat's proposal was first discussed in statistical working groups, where it received a favorable treatment. Some statisticians, among them the Dutch representative, advocated going a step further: the inclusion of all other accounts payable according to the debt definition (European Commission 2013). But when the discussion continued at higher levels



of EU policymaking, the issue became more contentious. The CMFB increasingly felt that the timing to propose this reform was not right:

a number of Members highlighted that in this period of implementing of new standards (ESA 2010 and the pertaining edition of the Manual on Government Debt and Deficit), stability should prevail over potential genuine improvements to the definition of Maastricht debt, such as the inclusion of trade credits. (CMFB 2014)

Eurostat officials managed to table their proposal in the Economic and Financial Committee, the advisory committee of the Economic and Finance Ministers Council (ECOFIN). However, a majority of member states rejected the proposal. Changing the definition of debt was just not an option even if there were substantive reasons for reform. A professional debt manager reminded Eurostat's representatives that they were not discussing a statistical issue but a political one, and that debt is not a statistical but a political and administrative concept (Interview Denis Besnard, former statistician at Eurostat). Several statisticians present felt that the deliberations had reached a dead end. Why? According to Walter Radermacher, former Director-General of Eurostat from 2008-2015: 'Well, if you change the methodology you always have winners and losers. Simple answer' (Interview Walter Radermacher). Figure 2 shows that especially euro area debtor countries would have seen their debt to GDP ratio increase if trade credits would have been included. A rising debt level would have implied that member states would have violated the EU's fiscal rules.

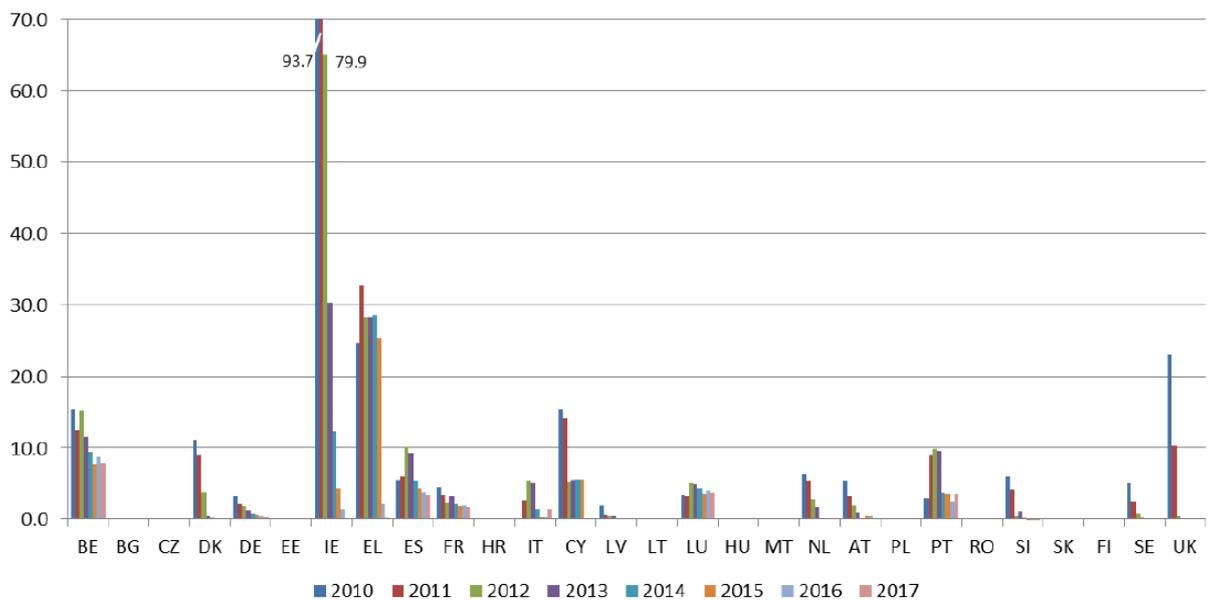
The Maastricht definition of debt was so deeply rooted in European political life that it had become almost impossible to change. The switching costs were prohibitive because of the knock-on effects that any change of the debt definition would have had for the EU fiscal surveillance framework. As François Lequiller describes: 'When you are in Europe, when people think debt, they think Maastricht. There is no question, all will give you the figure of Maastricht debt, so it is completely installed'. Politicians do not want to change the definition although they understand the issues at stake:

In one of the meetings that I attended at one point, the chair sort of said 'we had a discussion in the 90s about debt, we don't want to open this Pandora's box'. They achieved a compromise at the European level, they don't want technicians to come and create problems. They can understand if you talk to them, understand your position, but then, as a group, they know it will lead to discussions. (Interview François Lequiller)



The fear was that re-opening the Treaty protocol would have led to permanent conflict: countries would have come with other proposals and arguments why more and more things should be changed. Former Director-General of Eurostat Radermacher confirmed that this was one of the key reasons that prevented reform (Interview Walter Radermacher). The debt definition remained unchanged also because the existing one was politically convenient for member states. Preserving the status quo enabled all member states to prevent a rise in their debt to GDP ratios at a critical juncture. While Eurostat did not convince member states to include trade credits, it managed to achieve incremental rule change. Since 2012, a recorded trade credit has to be reclassified as a Maastricht debt-increasing loan when the following two conditions are met: 'when key terms of the contract are renegotiated and when the creditor transfers its claim to a third party without recourse' (Deutsche Bundesbank 2018, 61; Eurostat 2012).

Figure 3: Level of contingent liabilities (% of GDP)



Source: Eurostat (2018, 11)

Furthermore, in July 2013 Eurostat decided that it would add a new 'supplement on contingent liabilities and potential obligations to the EDP related questionnaire' in response to the Council Directive 2011/85/EU that formed part of the 'six-pack reform' (Eurostat 2013b). This new questionnaire would ask for data related to guarantees, off-balance sheet public private partnerships (PPPs) and non-performing loans. Eurostat explicitly highlighted that



the publication of the data would be accompanied by explanations ‘that the data on contingent liabilities and potential obligations should not be directly added to the Maastricht indicators’ (Eurostat 2013b, 2). The fact that Eurostat collects and publishes this supplementary data shows its concern for the high risks that can potentially build up off balance sheet (see Figure 3). Thus, the Maastricht indicator inertia has triggered an indicator cascade. It gives Eurostat a legitimate reason to expand its own surveillance capacity by creating new indicators.

Indicator Layering: The Consequence of a Narrow Government Gross Debt Definition

This section shows how the remarkable path dependence of the debt definition has created an opportunity for the European Commission to fill the gap. A narrow debt definition enabled the Commission to widen its fiscal surveillance through the creation of new indicators that cover the blind spots not included in the Maastricht debt definition. The unintended consequence of indicator inertia was that it triggered indicator layering. Thus, the Commission relied on alternative channels to incorporate threats to fiscal sustainability in its framework – by layering new provisions, rules and mechanisms onto the existing fiscal framework. In doing so, indicator inertia becomes even more likely because the layered indicators feed back into path dependence by further raising the switching costs.

Two developments in the EU fiscal surveillance framework are particularly noteworthy. First, the debt criterion has gained in importance over time with the most recent overhaul of the fiscal rules doubling down on this trend by operationalizing the debt reduction rule and allowing for the possibility to open a debt-based EDP (European Fiscal Board 2019). Second, because of the narrow debt definition, the Commission was able to widen its indicator toolbox. If the debt definition did not accurately account for fiscal sustainability risks, then alternative indicators needed to be developed. Both these developments were self-reinforcing in the sense that the more knock-on effects a change in the debt definition would have, the less likely it would be that the definition would be revisited. This is why we observe both a remarkable path dependence with regard to the debt definition and simultaneously a panoply of new indicators developed by the European Commission.

The 3 percent deficit and the 60 percent debt reference values remain Europe’s best-known quantitative benchmarks. At the same time, they are embedded in a more complex and evolving web of fiscal surveillance mechanisms that have been subject to frequent reforms over time (Schelkle 2009; Heipertz and Verdun 2010; Chang 2013; Buti and Carnot 2012;



Mabbett and Schelkle 2016). The euro area crisis ushered in another comprehensive overhaul of the fiscal surveillance framework. It exposed major weaknesses in the existing fiscal governance system, which had been unable to prevent the build-up of fiscal and macroeconomic imbalances within the euro area (Buti and Carnot 2012; Mabbett and Schelkle 2016).

Threats to fiscal sustainability became an important theme, especially the cost of ageing societies resulting from pensions and long-term healthcare costs. The Ageing Working Group was established in 2000 to make projections of these costs well into the future. The 2005 reform of the SGP also paid more attention to these future risks. A major innovation of the 2005 SGP was the introduction of country-specific medium-term objectives (MTOs) that took into account differences across countries in their economic fundamentals and risks to public financial sustainability, especially risks associated with demographic changes. The reform linked MTOs to public debt and ageing costs, marking the end of the one-rule-fits-all approach. The new country-specific MTOs encompassed three components: (1) the budget balance stabilizing the debt to GDP ratio at 60 percent given a country's potential long-term growth; (2) a debt-reduction effort for governments with debt above 60 percent; and (3) a proportion of the adjustment needed to cover the present value of the future increase in age-related expenditures. The MTOs thus sought to reduce debt levels to the Maastricht threshold and partially frontload the cost of ageing.

Because country-specific objectives were expressed in structural terms (corrected for the impact of cyclical fluctuations in a country's business cycle), the role of DG ECFIN also became more important in the process. Eurostat remained in charge of the calculation of headline debt and deficit indicators, but the methodology and calculation of structural indicators and MTOs was the responsibility of ECFIN. In 2006, the Commission published its first triannual Fiscal Sustainability Report, identifying challenges faced by member states and risks across time horizons, building on the Ageing Report. As the report's analysis fed into the SGP and MTOs, it could give a country more or less fiscal leeway. The current country-specific recommendations related to the SGP, pensions, healthcare and long-term care under the European Semester also build on the findings of the Fiscal Sustainability Report. The Commission's Communication on flexibility has provided additional incentives for governments to pursue structural reforms (European Commission 2015). Moreover, if a government undertakes structural pension reforms that lead to a reduced projection of its age-related expenditures, the country's MTO will be decreased creating more fiscal space in turn. Arguably, if the implicit liabilities related to pension spending would be included in the debt definition, the complexity of the fiscal surveillance framework could be reduced significantly. However, the narrow debt definition enabled the Commission to play a larger



role devising new indicators to gain a comprehensive picture of a member state's public finances.

The Commission realized that a narrow focus on the traditional Maastricht government gross debt was not sufficient to capture the multiple dimensions of fiscal sustainability. The crisis had revealed that no good measure of short-term fiscal stress was available making it harder to distinguish between normal and exceptional times. Consequently, the Commission developed three fiscal sustainability indicators (S_0 , S_1 , S_2) that were designed to detect sustainability challenges over the short-, medium-, and long-run. The latter two can be disaggregated into sub-components to identify which factors (i.e. fiscal stance at the start of the projection and/or pension, healthcare and long-term care related spending) present obstacles to fiscal sustainability (Berti 2018). This provides the Commission with an analytical toolkit to fiscally x-ray member states and to give detailed policy advice based on a country-specific fiscal risk profile that takes account of implicit liabilities related to ageing societies. It is important to note that the Commission defines fiscal sustainability always in relation to reaching the 60 percent debt to GDP ratio but has also frequently changed the definition of the S_1 indicator in its Fiscal Sustainability Report (Berti 2018, 241). Our theoretical framework explains why these frequent changes were possible in the case of the S_1 indicator but not in the case of the Maastricht debt indicator. Changing the S_1 indicator does not have the same political consequences for the EU fiscal surveillance framework in terms of potential sanctions. This lack of embeddedness in a network of other indicators makes it more adaptable and vulnerable to change. At the same time, the Maastricht debt indicator is nested within the fiscal sustainability indicators highlighting its systemic importance. In sum, the evolution of the EU fiscal surveillance framework illustrates what we have termed indicator layering. As a result of the stable debt definition, the Commission has layered new rules and indicators on top of the existing fiscal framework, which in turn has increased the switching costs for an updated debt definition making indicator inertia even more likely.

CONCLUSION

This article has asked why we have not seen any meaningful changes to the definition of debt since the Maastricht Treaty. The statistical complexities of measuring debt have always been known to statistical experts, but their political ramifications have only fully been revealed to politicians long after they were codified. New challenges and threats to fiscal sustainability arose that revealed the gaps in the original debt definition. During the 2008 financial crisis many governments bailed out financial institutions in distress by



creating ‘bad banks’, providing liquidity or guarantees. When the various bailout structures threatened to affect their debt levels, governments tried to prevent this by challenging the statistical accounting decisions of their national institutes and Eurostat.

A window of opportunity opened to rewrite the debt definition, but member states collectively shied away from any meaningful reform. Eurostat’s reform proposals were rejected. Due to the ramifications for the EU fiscal surveillance framework it had become practically impossible to implement changes to the debt definition. The switching costs had become prohibitive because the debt indicator is so deeply entrenched in the EU polity that the status quo is unlikely to change. Within a historical institutionalist approach, we have shown the indicator inertia of the definition of Maastricht debt in the European Union. The debt indicator has turned into a policy goal itself (indicator goal displacement). Governments are extremely concerned about any potential increase of their debt levels. They have good reasons for their debt aversion because it could increase their debt servicing costs if financial markets judge that the debt has become unsustainable.

The stickiness of the debt indicator is largely a function of its embeddedness in the EU fiscal surveillance architecture. EU member states decided on the indicator in the early 1990s, following arduous political negotiations. Governments wanted to avoid a repeat of this process cognizant that a major conflict would have been afoot. With the definition of debt locked in, the European Commission was in a position to expand its own indicator toolbox to incorporate the fiscal sustainability risks. It has layered new rules and indicators onto existing ones by incorporating age-related expenditures such as pension costs in the medium-term objectives (indicator layering).

In principle, indicator layering has made it more difficult to change the definition of debt because the potential knock-on effects have become even greater. However, the effects of the COVID-19 pandemic have increased the debt to GDP ratio of many euro area member states above 100 percent further distancing them from the 60 percent Maastricht debt target. This could lead to a comprehensive overhaul of the EU fiscal framework and the quantitative Maastricht debt target might be adjusted or even completely abandoned. If so, we would enter a new period of indicator drift, in which the indicator inertia of the Maastricht debt measurement would have ultimately contributed to the withering of its importance. Regardless of the pandemic, budgetary debt and deficit indicators will continue to play a central role in EU politics in the future. Although the measurement of debt is often taken for granted in scholarly research on the EU’s governance framework, both the measurement and definition of debt are fraught with conceptual challenges. This article has sought to shed



some light on the political dimensions of the measurement of debt and its consequences for EU policymaking.



INTERVIEWS

Interview Pieter Stek, former member of the MC, 23-03-2017, Wassenaar, the Netherlands

Interview Luca Ascoli, statistician at Eurostat, 30-03-2017, Luxembourg

Interview anonymous, 16-01-2017, Paris, France

Interview senior statistician from CBS, 26-10-2018, Den Haag, the Netherlands

Interview François Lequiller, 19-10-2018, Paris, France

Interview government finance statistician at Eurostat, 23-03-2017, Luxembourg

Interview Carsten Olsson, statistician at Eurostat, 04-04-2017, Luxembourg

Interview Denis Besnard, former statistician at Eurostat, 18-10-2018, Paris, France

Interview Walter Radermacher, former DG at Eurostat, 23-11-2018, Amsterdam (Skype interview)



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