Comments on the revision procedures for EU fiscal rules

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1. Introduction

There is a broad consensus that EU budgetary rules should be revised. This view was already held widely prior to the Covid 19 outbreak and continues to be held widely today, perhaps even more broadly due to the damages that were, and still are being caused by this pandemic.

This issue arises as a matter of urgency because the moratorium which suspends the application of the rules in question is scheduled to expire at the end of 2022.

The purpose of this note is to examine the procedures available to modify the fiscal rules in question and the extent to which it is possible to enact such interventions without amending the present EU Treaties.

Three intensely-debated topics will be expounded below: (i) the tresholds of 3% and 60% of GDP for deficit and debt respectively (henceforth the 3% and 60% values) , (ii) the annual reduction of 1/20th of the debt exceeding 60% of GDP and (iii) the so-called "Golden Rule", i.e. the subtraction of public investments from the calculation of deficit and debt in government budgets.

2. The 3% and 60% values

A) *The Law*

The 3% and 60% values are set forth by Art. 126.2 TFEU and Protocol no. 12 of the Lisbon Treaty (henceforth Protocol 12). Art. 126.2 TFEU requires

Member States to uphold "budgetary discipline" and establishes that their government deficit to GDP ratio, and their government debt to GDP ratio, may not exceed determinate reference values, subject to derogations which are of no relevance for present purposes. Art. 1 of Protocol 12 sets the aforementioned reference values to 3% and 60% for deficit and debt respectively.

Art. 51 TEU expressly provides that the protocols annexed to the Treaties form an integral part thereof. It follows that the provisions of Protocol 12 are primary EU law, analogous in all respects to the others found in the Treaties and that, in principle, they should be considered subject to the same revision regimes. These are the ordinary revision procedure under Art. 48. TEU paras. 2-5 and the simplified revision procedures found in paras. 6-7 of the same provision. Arguably , Protocol 12 could be amended by way of the simplified procedure under Art. 48.6, applicable to primary rules on internal policies and actions of the Union.

Nevertheless, it may be queried whether and to what extent these revision procedures might be supplemented and, possibly, derogated by the second paragraph of Art. 126.14 TFEU (henceforth Art. 126.14(2)). Notably, this provision specifies that the Council, acting unanimously, can "adopt the appropriate provisions which shall then replace" Protocol 12.

Precisely charting the scope of application of Art. 126.14(2) is of obvious interest. Albeit simplified, the Treaty revision procedure under Art. 48.6 TEU requires ratification by all Member States pursuant to their respective constitutional provisions. By contrast, Art. 126.14(2) simply requires a unanimous Council resolution, which implies the assent of all Member State governments, yet dispenses with the complex process of national ratifications.

B) *Comments*

There are no legislative or judicial precedents to clarify the issue under consideration. Regarding the former, Art. 126.14(2) (formerly art. 104C, par. 14(2)) was the legal base for one of the two legislative acts at the core of the Stability and Growth Pact (SGP), namely Regulation 1467/97 of July 7, 1997, subsequently amended in 2005 (Regulation 1056/2005), and again in 2011

(Regulation 1177/2011, which is part of the so-called Six Pack). However, Regulation 1467/97 did not amend Protocol 12, rather stating in Recital (1) that its provisions, along with Protocol 12 (formerly 5), constitute an integrated system of rules for the application of Art 126.14(2). Regarding judicial precedents, it appears that neither the ECJ nor the General Court have so far examined the scope of application of Art. 126.14(2).

In the absence of relevant legislative or judicial indicia, the issue under consideration lends itself to three alternative solutions. According to the first, a distinction should be drawn between substantive rules, such as the 3% and 60% values , and procedural rules of Protocol 12. The legislative power vested in the Council by Art. 126.14(2) would only allow for the modification of the latter, not the former. For the revision of substantive rules, recourse to the simplified revision procedure under Art. 48.6 TEU would always be necessary.

A second solution takes the opposite path by focusing on the letter of Art. 126.14(2), which expressly authorizes the replacement of the Protocol without limitations. Leveraging this broad textual formulation, the Council should be afforded the power to amend any provision of Protocol 12, including the 3% and 60% values.

A third solution might construe the text of Art. 126.14(2) even more broadly. It could be hypothesized that this provision empowers the Council not only to modify the values in question, but also to introduce new criteria which may link to economic parameters other than the GDP of Member States.

What are the respective merits of these three solutions? In my view, the third should be dismissed. The criteria for determining budgetary discipline based on the ratios of deficit and debt to GDP are set out in Art. 126.2(2) TFEU. The Protocol is referred to only as the source for the predetermined reference values that these ratios must not exceed. Thus, a modification of the criteria themselves cannot prescind from the, albeit simplified, Treaty revision procedure under Art. 48 TEU.

The remaining two solutions are more tenable. In support of the first, it can be argued that Protocol 12 is designed to "lay down the details of the excessive deficit <u>*procedure*</u> [*emphasis added*] referred to in Article 126 of the [TFEU]", as stated in its first recital and as is clear from its very title. From this perspective, the values of 3% and 60% for the deficit and debt GDP ratios should be viewed as substantive rather than procedural rules, which are anchored to Art 126 TFEU, although contained in Protocol 12. This analysis would lend support to the conclusion that any modification of these values would fall outside the powers vested in the Council under Art. 126.14(2).

My first inclination was towards this thesis. However, *re melius perpensa*, it seems to me that the broad textual formulation of art. 126.14(2) is decisive, as the letter of the law contains neither exceptions nor qualifications regarding the parts of Protocol 12 susceptible to modification. It can be also argued that the decision to include the quantification of the Art. 126 TFEU reference values to Protocol 12 was a conscious choice precisely to spare them from the cumbersome strictures of the Treaty revision procedures. Thus, there should be no obstacle to recognizing that it lies within the Council's power to vary the 3% and 60% values, and it is reasonable to believe that the ECJ would not follow a different approach, if the matter were brought to its attention.

*2. **Debt relief***

A) The Law

Art. 126.2 TFEU stipulates that if the government debt to GDP ratio of a Member State exceeds the prescribed 60% value, it must diminish and approach this threshold at a satisfactory pace.

For many years, in effect until the financial crisis of 2007-2009, European institutions focused primarily on monitoring government deficits rather than debt. This is evidenced by the fact that the aforementioned Regulation 1467/97, which implemented Art. 126 TFEU, made no mention of government debt either in its original version of 1977 or in the amended version of 2005. Government debt came to the legislative fore only in 2011 with Regulation 1177/2011 of the Six Pack, which - as already mentioned - further amended Regulation 1467/97. Art 2(1a) of the consolidated text introduced a quantitative criterion for the reduction of excessive debt. More particularly, it established that excess debt reduction is considered sufficient and appropriate, as required by art. 126.2 TFEU, if it is equal to 1/20th of the differential between debt and the 60% reference value, on an annual basis (henceforth the 1/20 requirement).

An analogous rule is included in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union of March 2, 2012 (the so-called Fiscal Compact). For present purposes, it is unnecessary to review the reasons why recourse was made to an international agreement outside the EU legal framework for the Fiscal Compact. The fact remains that this treaty largely reproduces EU budgetary rules, including those in the SGP. In particular, Art. 4 of the Fiscal Compact reproduces unaltered the 1/20th requirement.

The presence of two distinct legal sources – one an EU legislative act, the other an agreement under international law – establishing the 1/20th requirement, engenders a conundrum concerning the modification of this rule. It is necessary to investigate whether amending only one of these two sources of law (i.e. Regulation 1467/97 as amended), is sufficient to alter the 1/20th requirement or whether it is necessary to also revise the other source (i.e. the Fiscal Compact).

Clearly, this issue is not without significance. Regulation 1467/97, as a legislative act of the Union based on Art. 126.14(2) TFEU, came into force by unanimous decision of the Council and can be amended in the same way. On the other hand, the Fiscal Compact came into existence by the classic procedure of treaties under international law, including ratification by the signatory States. An amendment of Art. 4 of the Fiscal Compact would then require national ratifications. The question is thus whether the more onerous process of amending the Fiscal Compact can be avoided.

B) Comments

In principle, the answer to the question under consideration should be in the negative. In the presence of two formally distinct acts, which belong to two different legal systems, events affecting one should be irrelevant for the other. For present purposes, an amendment to Regulation 1467/97 should take effect within the EU law framework, leaving the Fiscal Compact and its effectiveness under international law completely unaffected. Thus, a decision of the Council based on Art. 126.14(2) and aimed at easing the 1/20th requirement, should have no bearing on the corresponding provision of the Fiscal Compact.

It is readily apparent, however, that such an outcome would be highly problematic. The same sovereign entities, the Member States, would be required to comply with two different debt management rules, since they are subject to both Regulation 1467/97 and the Fiscal Compact.

Yet, such an anomalous situation, which is entirely unrealistic in substance, can be overcome also in law. Although the Fiscal Compact is distinct from EU law, it is closely coordinated with it. This is clear from Art. 2 of the Fiscal Compact, which states that "this Treaty shall apply insofar as it is compatible with the Treaties on which the European Union is founded and with *European Union law* [*emphasis added*]". It should be noted that this provision expressly refers not just to the founding Treaties of the European Union but also to EU law as a whole, thus expressly including EU secondary legislation.

The preceding reasoning lends strong support to the conclusion that the rules on debt reduction included in Article 4 of the Fiscal Compact remain applicable insofar as they are consistent with Regulation 1467/97. They must be disapplied if such conformity is lost, following an amendment of Regulation 1467/97. Moreover, close consideration of Article 4 of the Fiscal Compact suggests that a reading may be possible which avoids the more drastic step of disapplication. In mentioning the 1/20th requirement, Art. 4 of the Fiscal Compact states " as provided for in Article 2 of Council Regulation (EC) No 1467/97 [...]". This textual formulation supports the proposition that this provision automatically and permanently defers to Regulation 1467/97, whereby any amendment to this EU legislative act must be understood to be incorporated into the Fiscal Compact *ipso facto*.

In any case, the answer to the question under consideration is that the 1/20 requirement can be amended by way of a Council resolution under Art. 126.4(2) without the need for a parallel modification of the Fiscal Compact.

4) The Golden Rule

A) The Law

Art. 126.2 TFEU does not allow for the subtraction of public investment expenditure from the calculation of budget liabilities when articulating EU budgetary discipline, as well as its notions of government deficit and debt. However, there is partial acknowledgement of the Golden Rule in Art. 126.3 TFEU. This provision specifies that, if a Member State fails to comply with its obligations under Art 126.2, the Commission must prepare a report that documents relevant shortcomings but also take into account the extent to which "government deficit exceeds government investment expenditure". This indication is taken up and developed in Regulations 1466 and 1467/97, as well as in the Commission Communication of 13 January 2015 on the flexibility of the SGP (henceforth the 2015 Communication).

Article 5 of Regulation 1466/97 (consolidated text) provides, *inter alia*, that in examining government budgets, the Council and the Commission must take into account "[...] the implementation of major structural reforms which have direct long-term positive budgetary effects, including by raising potential sustainable growth, and therefore a verifiable impact on the long-term sustainability of public finances". With regard to Regulation 1467/97, Recital (11) of the original text reiterates that the Commission must consider "government investment expenditure" in its examination of Member State budgets. In the current text, this point is expanded upon under Art. 2.3, which states that particular attention must be paid to "financial contributions […] achieving the policy goals of the Union".

The 2015 Communication devotes the entirety of its paragraph 2 to "Clarifications Regarding Investments". First, the Commission finds that certain public investments can be considered equivalent to the structural reforms referred to under Art. 5 of Regulation 1466/97. Second, conforming with and implementing Art. 2.3 of Regulation 1467/97, the Commission lists several types of investment which must be deemed (albeit under strict conditions) exempt from the EU budgetary discipline rules. National expenditures for projects co-financed by the EU within the framework of structural and cohesion policy and trans-European networks, as well as projects co-financed by the European Fund for Strategic Investments are all included in this list.

These legislative elements engender a query analogous to that considered above for the 3% and 60% values. It is necessary to investigate whether a fuller legislative recognition of the Golden Rule requires amendments to the Treaties through the ordinary or special revision procedures, or whether, and if so to what extent, it is sufficient to make recourse to EU secondary legislation or even a para-normative source such as a communication from the Commission. These reform avenues present markedly different degrees of complexity. At one end of the spectrum, the onerous and politically complex national ratification procedures for Treaty amendments; at the other, a simple pronouncement from the Commission. In between these two extremes lies the possibility of a unanimous decision of the Council.

B) Comments

Indubitably, a revision of the Treaties would be the optimal avenue to incorporate fully the Golden Rule into EU law. However, the legislative developments described above show that the Golden Rule already exerts some influence on the interpretation and application of EU budget rules even under the current Treaties. This leads me to believe that this influence can be further extended, without amending the Treaties.

As indicated above, certain State investments co-financed by the Union already enjoy some exemption from the EU budgetary discipline . Monitoring at European level ensures that these investments are actually carried out and that current expenditures are not passed off as qualified investment. By way of analogy, this same exemption regime could be extended to all investments for projects co-financed or monitored by the Union, even beyond those expressly mentioned by the Commission. For example, investments related to the Green Deal and the Digital Deal could all be deemed to fall under that exemption regime, including those outside the NGEU or those intended to continue beyond the expiry of the NGEU.

In the 2015 Communication, the Commission specifies that the flexibilities contained therein merely interpret, rather than modify, the provisions of the SGP (including Regulations 1466 and 1467/97). It is also clear that the Commission deems these flexibilities, and the SGP rules on which they are based, compatible with the Treaties. Within this framework, normative developments that embody the Golden Rule should be feasible, either through simple interpretative intervention emanating from the Commission or through legislative modifications of the SGP.

This is no small achievement. Nevertheless, only a revision of the Treaties could lead to an adoption of the Golden Rule which generally exempts all Member States' investments from EU budgetary discipline rules.

5) Final remarks

As emphasised throughout this note, a revision of the Treaties would be the optimal approach to amending EU budgetary discipline rules. Nevertheless, there are no insurmountable legal obstacles to the modification of these rules without revising the Treaties.

This has been argued by reference to both the 3% and 60% values, as well as a fuller legislative recognition of the Golden Rule. Similarly, it was posited that revising the 1/20th requirement does not need a burdensome revision of the Fiscal Compact, pursuant to the general rules of international law .

The legal basis for these interventions is found in the legislative power attributed to the Council by Art 126.14(2) TFEU, combined with the interpretative function of the Commission. This circumvents the onerous national ratifications required both for a modification of the Treaties and the Fiscal Compact. This is no small feat. It should must be marked, however, that the Council can only act if there is unanimous assent from all national governments, which in turn must first consult their parliaments. As for the Commission, even if pressed by the European Parliament, this institution can hardly overcome oppositions from the Council .

Difficulties thus persist, yet there is a strong impetus to modify extant EU fiscal rules. The presence of a legal pathway to carry out these interventions without a revision of the Treaties undoubtedly facilitates this urgent undertaking.