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JEAN-PAUL KEPPENNE

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ABSTRACT

This contribution presents a short description of the EU fiscal surveillance mechanism as well as of the Fiscal Compact, and of their recent evolution as well as a discussion of their strengths and weaknesses.

Keywords: euro area, Fiscal Compact, fiscal surveillance, Stability and Growth Pact.

Jean-Paul Keppenne is Director at the Legal Service of the European Commission

E-mail: **jean-paul.keppenne@ec.europa.eu**

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1. General principles

A mild system of surveillance of national fiscal policies:

The fiscal governance that applies to the Member States of the European Union is firmly enshrined in the EU Treaties themselves. Those rules are part of a broader set of provisions on the Economic and Monetary Union. Union's economic policy coordination is regulated by Articles 2(3) TFEU and 5(1) TFEU and further detailed in a separate chapter (120 TFEU to 126 TFEU) which is included in a joint title dedicated to the 'economic and monetary policy'. Regarding fiscal policy, since the entry into force of the Maastricht Treaty, the Member States are subject to a mild system of coordination. Member States keep conducting their own fiscal policy, particularly the adoption of the budgets and the exercise of the taxation power. They thus remain largely sovereign with regard to the conduct of their budgetary policies and the Union has no competence to interfere directly in this area by acting in place of the national authorities. Notably, no veto right is provided and the Union could not somehow prevent the adoption of national budgets. However, the Union and its institutions are entrusted with strong surveillance competences over the Member States and this top-down fiscal control has dramatically increased since the financial crisis of 2008.

Specific procedures and specific actors:

The Treaty provisions dealing with fiscal policy, the so-called Stability and Growth Pact, contain relatively few substantive provisions. They mainly put in place a number of specific procedures for the surveillance of the Member States' policies. The EU fiscal policy coordination relies on specific instruments and procedures that depart from the usual rules regulating the application of EU law.[1] In the area of fiscal policy, the Member States are not subject to directly applicable provisions of Union law that could be enforced by national administrative or judicial authorities. Moreover, the coordination framework concerns solely public authorities and does not confer any rights to individuals which the national courts would be bound to protect.[2] Neither Articles 121 and 126 TFEU nor the applicable secondary law contain provisions that could be directly invoked by individuals, at least in actions for annulment.[3] The existence of a set of derogations as well as the large margin of discretion conferred on the institutions imply that it is only through specific

[1] Namely the infringement procedure and the direct application by national courts.
[2] In that sense, see judgment of 24 October 1973, Case 9/73, *Schlüter*, paragraph 39.
[3] See order of the General Court of 27 November 2012, Case T-541/10, *ADEDY a.o. v. Council*, rejecting as inadmissible an action for annulment against Council decisions 2010/320/EU and 2010/486/EU addressed to Greece.

decisions taken by the institutions that the discipline may be implemented for which national judges are in principle not concerned. Experience shows that the EU institutions have largely made use of this discretionary power. The evolution of the economic situation and the broader political landscape have considerably affected over time the way the substantive provisions are implemented. The legal framework is not seen as a static set of rules to be mechanically applied to any given event but as a flexible system of governance driven by long-term macroeconomic purposes.

The Union institutions are in the first line for applying the rules. The Treaty entrusts the Council and the Commission with the responsibility to coordinate and monitor the fiscal situation of the Member States. The Council is the main body in charge: "responsibility for making the Member States observe budgetary discipline lies essentially with the Council."[4] This reflects the willingness of the Member States to keep joint control of this coordination instrument. As recognized by the Commission in its 2015 Communication on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact"[5], "[t]he Pact is a rule-based system [...] where the Commission proposes and the Council decides." With its right of initiative based on a thorough assessment of the conduct and of the fiscal situation of the Member States, the Commission has nevertheless a considerable influence on the implementation of the surveillance framework. In particular, when the Commission refrains from acting, it has the last word and prevents the Council from expressing its views on the situation of the Member State concerned. There is subtle interaction between the two institutions both in the design of this policy and in its implementation. A good example is the respective positions of the two institutions regarding the so-called "flexibility" within the SGP: on this issue, the Commission adopted its own Communication in January 2015 and the Council quickly followed with a slightly different approach in its own "Commonly agreed position on flexibility within the SGP".[6] By contrast, at the stage of the implementation of the rules, over the past few years, the Council has usually endorsed the Commission's proposals or recommendations without substantive modifications.

In October 2015, the Commission established an Independent European Advisory Board, entrusted with the task of assisting the Commission for the fulfilment of its competences of economic policy coordination.[7] The mission of this Board is to contribute in an advisory capacity to the exercise of the Commission's functions in the multilateral fiscal surveillance. The Board is to provide to the Commission an evaluation of the implementation of the Union fiscal framework, in particular regarding the horizontal consistency of the decisions taken and implementation of budgetary surveillance, cases of particularly serious non-compliance with the rules, and the appropriateness of the current fiscal stance at euro area and national level. In this evaluation, the Board may also make suggestions for the future evolution of the Union fiscal framework. The Board also advises the Commission on the prospective fiscal stance appropriate for the euro area

[4] Judgment of the Court of Justice of 13 July 2004, Case C-27/04, *Commission v. Council*, paragraph 76.
[5] COM (2015)12 of 13 January 2015.
[6] Published as Annex 15 in the 2018 edition of the Commission's Vade Mecum on the Stability and Growth Pact: https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition_en
[7] Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board, OJ L 282, 28.10.2015, p. 37.

as a whole based on an economic judgement. While it was originally established for internal advice to the Commission, the first public reports issued by the Board show that it is keen to play a bigger role in the implementation and design of the EU fiscal rules.[8]

Low degree of judicial review:

There is a relatively low degree of judicial control over the implementation of the EU provisions. First, Member States and institutions are reluctant to go to court. Second, the discretion conferred upon the institutions would in any case imply a limited standard of judicial review. The initiation of the infringement procedure before the Court of Justice is also largely excluded since Article 126(10) TFEU excludes most measures adopted under the excessive deficit procedure from the competence of the Court. At the time when this system was set up, it was considered that the specific set of sanctions provided under this excessive deficit procedure was sufficient and that it was more appropriate to reserve its application to political institutions, namely, the Commission and Council. A complementary control by the Court was therefore considered superfluous, if not inappropriate. However, experience has shown that the political institutions could not establish a credible practice in the use of these sanctions. As a result, the idea to restore full competence for the Court of Justice has sometimes been put forward, including by the Commission itself.[9]

Applicable rules:

The EU fiscal governance is based primarily on the so-called Stability and Growth Pact (SGP). More recently, an additional set of rules has been developed through secondary Union law and intergovernmental instruments. That latter set of rules aims to create directly within the national legal system of the Member States some form of *internal* control and internal substantives rules, thus interfering with the national institutional framework that governs fiscal policy. This second set of rules, which is not explicitly provided for by the Treaties, goes beyond the mere "coordination" process that was originally envisaged. We discuss it later in this Chapter.[10]

The SGP is the budgetary pillar of the Economic and Monetary Union. It is the name usually given to the Treaty and secondary law provisions that regulate the monitoring of the Member States' fiscal situation by the Union Institutions in the form of external control of their fiscal policies. This external control takes the form of peer pressure, recommendations and ultimately, sanctions. We refer to it as "external" in the sense that it does not interfere directly with the conduct of the fiscal policy within the Member States. This external control is based on the EMU governance and is explicitly envisaged by the TFEU. The primary law provisions related to the surveillance of the fiscal policies of the Member States can be found in Articles 121 and 126 TFEU, as well as in Protocol No 12. While these legal provisions have remained largely unchanged over the years, their significance has greatly evolved through their inclusion within a broader set of secondary law rules. The SGP was originally constituted of three additional elements: a resolution of the European Council[11] and two Council Regulations, No 1466/97 and No 1467/97, adopted for the

[8] https://ec.europa.eu/info/sites/info/files/2018_efb_annual_report_en.pdf
[9] See section 4.3 of the Commission Blueprint on a deeper and genuine EMU, COM 777(2012) of 30 November 2012.
[10] See section 3 below.
[11] OJ C 236, 2.8.1997, p. 1.

implementation of Articles 121 and 126 TFEU. Specific rules apply to the United Kingdom. This Pact reinforces the substantive and procedural fiscal provisions contained in Articles 121 and 126 TFEU.[12] The SGP has two arms, a preventive one, tracking the structural fiscal position of the Member States, and a corrective one, of a more nominal nature. All Member States are subject to the "Preventive arm" of the Pact, while the "Corrective arm" only applies to those Member States whose financial situation is a source of concern for the Union.

Article 121 TFEU refers generally to the coordination of the Member States' economic policies, but the Council focused its application on the surveillance of their fiscal policies through the adoption of Regulation No 1466/97. Together Article 121 TFEU and Regulation No 1466/97 form the Preventive arm of the SGP, which is mostly based on secondary law provisions. Going beyond the requirements of Article 126 TFEU and the famous 3% deficit limit, it provides for a commitment of the Member States to respect a mid-term objective of a budgetary position close to balance or in surplus in order to prevent the application of the corrective arm of the SGP. It also organises a regular annual surveillance exercise of the fiscal situation which applies to all Member States.

On the other hand, the Corrective arm is regulated by Article 126 TFEU laying down the so-called excessive deficit procedure, together with Protocol No 12 annexed to the Treaties on the excessive deficit procedure and Regulation No 1467/97. This procedure is not regular and does not apply to all Member States. It is activated only when the available information shows that a Member State's fiscal position is becoming unsustainable by reference to the reference values provided by the TFEU.

The Commission and the Council are responsible for implementing the SGP enjoying, according to the case law, a degree of "discretion".[13] On the basis of experience and expertise, their margin of appreciation has been framed over time through the more precise and predictable parameters of soft law instruments. These instruments represent the common understanding of the respective rules within the Council and/or the Commission. They aim to provide predictability to Member States and to ensure horizontal consistency in the assessments made by the Institutions. As a result, they must in principle be respected by the institutions unless compelling justifications to justify any derogation exist.

The most important among these soft law instruments are the following:

- the so-called "Code of conduct", informally agreed between the Commission and the Council: this Code is entitled 'Specifications on the implementation of the Stability and Growth Pact and Guidelines on the format and content of the Stability and Convergence Programmes'. Its successive versions have been endorsed by the ECOFIN Council. This Code of conduct is regularly updated. In particular, it contains a methodology for calculating the Member States' medium term objective (MTO) as well as a definition of 'economic good times' for the application of the Preventive arm, and a clarification of the conditions for

[12] The Amsterdam European Council Resolution on the SGP of 17 June 1997 and the Report of the Economic and Financial Affairs Council on "Improving the implementation of the Stability and Growth Pact", endorsed by the European Council in its conclusions of 22 March 2005, also form part of the Pact.
[13] As confirmed by the Court of Justice in Case C-27/04, *Commission v. Council*, op. cit., paragraph 80.

abeyance and guidance on assessing 'effective action' for the application of the Corrective arm;[14]

- The Commission's and Council's texts on the flexibility of the SGP;[15]
- More recently, in December 2016, the Council endorsed an agreement reached at the Economic and Financial Committee, which aims to improve the predictability and transparency of the SGP.[16] This agreement provides for a stronger focus on the expenditure benchmark and further clarification mainly regarding the Preventive arm.[17]

A number of other informal guidance documents endorsed at services' level by the Council and/or the Commission, also complements the Pact. They are analytical or assessment papers that generally remain confidential. Since 2013, the Commission has published on a yearly basis its Vade Mecum on the Stability and Growth Pact.[18] This document is no more than a technical document, prepared by the Commission's services (Directorate-General for Economic and Financial Affairs, DG ECFIN). It provides a detailed and updated description of the applicable rules and their implementation by the Commission and the Council. It aims to increase transparency and explain the rules in a structured and pedagogical way. It is interesting to note that this document evolves year after year, even when no formal amendment of the legal framework occurs. This clearly shows the importance of the soft law rules informally agreed and changed overtime through discussions between the Commission's services and the Member States' representatives (mainly within the EFC). The fact that this Vade Mecum exceeds 200 pages also illustrates the complexity of the applicable set of rules.

Recent evolutions:

The SGP has been formally amended twice since its inception. The first amendment occurred in 2005 with a view to making the Pact more "intelligent" by taking better into account economic circumstances and country-specific characteristics. While these changes allowed a more tailor-made application of the rules, at the same time they increased the complexity of the Pact and augmented the degree of discretion of the institutions, thus decreasing the predictability of the rules.

The financial crisis that erupted in 2008 has made clear that it was not sufficient to focus solely on the fiscal position of the Member States. The further modification of the rules has therefore extended the scope of the Union surveillance beyond the mere budgetary surveillance, in particular through the adoption of the macroeconomic imbalances procedure. However, the fiscal

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[14] The latest version dates from May 2017: http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf
[15] See above footnotes 6 and 7.
[16] http://www.consilium.europa.eu/media/22629/st15205en16.pdf
[17] Published as Annex 16 in the 2018 edition of the Commission's Vade Mecum on the SGP: https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition_en and as annex 3 to the May 2017 Code of Conduct: : http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf
[18] For the 2018 version, Institution Paper 075 of March 2018. This paper exists in English only: https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition_en

surveillance remains the main pillar of the Union coordination policy and has been further reinforced through the adoption of the so-called Six-Pack.[19] The changes aim mainly to enforce fiscal discipline on Member States at an earlier stage; they include a new set of financial sanctions, a new expenditure benchmark complementary to the change in the structural balance and a new procedure under the Preventive arm in case of significant deviation from the adjustment path towards the MTO.

Fiscal surveillance is also increasingly used to foster structural reforms in the Member States. A so-called structural reform clause had been included in the SGP in 2005 but its application was extended by the Commission through In its Communication on the flexibility of the Stability and Growth Pact.[20] The Commission clarified how it would accept deviations from the Pact in the case that a Member State implements structural reforms. Therefore, under the guise of budgetary monitoring, the Communication on the flexibility of the SGP allows the Institutions to have a say as regards the structural reforms to be undertaken by the Member States.

Another striking evolution is the development of a set of euro area-specific rules. When the Maastricht Treaty was adopted, the provisions on the coordination of the economic policies of the Member States did not differentiate between euro area and non-euro area Member States. It was expected that all Member States would quickly fulfil the conditions for joining the euro area. Thus, the SGP applies across all Member States without any exception. Experience has shown, however, that the interdependence between the members of the Monetary Union was much stronger and that a reinforced set of rules was needed; hence Article 136 TFEU was introduced by the Lisbon Treaty and a set of rules was adopted on the basis of this provision to increase the surveillance of the euro area Member States.[21]

Effectiveness of the SGP:

The experience so far can help to identify some deficiencies of the Pact. First, compliance with the rules has been disappointing. Once Member States joined the euro area, there was no perceived risk of being effectively sanctioned and the financial markets did not exercise the expected pressure on the individual Member States. This contributed to mixed results[22] while the EU Institutions have also implemented the rules in a soft manner.

Second, in order to grasp the economic situation correctly, the complexity of the Pact has increased over time to such an extent that only a small group of experts could claim to

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[19] Within the EU framework the legislator adopted the so-called Six-Pack in 2011, a set of five Regulations and one Directive, to reinforce and enlarge the surveillance of the economic and fiscal policy of the Member States (OJ [2011] L 306). Two Regulations amend the preventive and corrective arms of the Stability and Growth Pact, i.e. Regulations No 1466/97 and No 1467/97. A third Regulation sets up a new "excessive imbalance procedure". Two other Regulations [(EU) No 1173/2011 and No 1174/2011] are addressed to euro area Member States only. They create new mechanisms of financial sanctions against euro area Member States in order to reinforce the effectiveness of the surveillance of their economic and budgetary policies. Finally, a Directive provides certain provisions for the fiscal framework of the Member States.

[20] See above footnote 6.

[21] See below Section 2.E.

[22] de Streel, Alexandre, EU Fiscal Governance and the Effectiveness of its Reform, in: M. Adams, F. Fabbrini and P. Larouche (eds), Constitutionalization of European Budgetary Constraints: Comparative and Interdisciplinary Perspectives, Hart, 2014, 85-104, 95.

understand the whole edifice. The nominal value contained in Protocol No 12 has no strong economic justification. It makes more sense to ensure the sustainability of public finances over the medium term through the monitoring of the structural deficit, net of one-offs. However, this is based on complex and uneasy calculations.[23] Over recent years, many voices have raised concerns regarding that trend and calls for simplification have been made. A recurring demand is to differentiate between public expenditure for productive investment and other expenditure. This has started to take shape through the 'flexibility' of the SGP. It is expected that a review exercise will be launched in the coming years.

Third, a suitable balance between discretionary power for the EU institutions and predictability for the Member States remains to be found. Due to the complexity of the facts to be determined and of the economic analysis to be performed, these provisions necessarily leave a substantial margin of appreciation to the Commission and the Council.

Fourthly, the Preventive arm of the Pact has been reinforced to such a level that there might be situations where a Member State benefits from a more lenient treatment in EDP rather than out of it. This could lead to paradoxical situations, in some extreme cases, of Member States slightly missing the EDP targets voluntarily and thereby remaining within the Corrective arm in order to avoid the harshness of the Preventive arm.

Fifth, the SGP suffers from a lack of national ownership. The national authorities do not take on board the rules and do not see the system as constraining their choices or else only do so to an insufficient degree. For this reason, the idea of complementing the external control of the SGP by an internal control within each Member State has been recently developed.[24]

2. External control: the Stability and Growth Pact (SGP)

A. The preventive arm of the SGP

Legal basis and main features:

The Preventive arm is based on Article 121 TFEU and Council Regulation No 1466/97 of 7 July 1997, on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, as amended. Article 121 TFEU does not contain any explicit reference to the surveillance of the fiscal situation of the Member States and only refers to their economic policies in general. However, Regulation No 1466/97 made operational the implementation of this Article to the fiscal policy of the Member States. Regulation No 1466/97 was amended twice, by Council Regulation (EC) 1055/2005, of 27 June 2005 and Regulation (EU) 1175/2011 of the European Parliament and of the Council of 16 November 2011. For the euro area Member States, the additional provisions of Regulation 473/2013 also apply.[25]

The objective of the Preventive arm of the SGP is to promote sound and sustainable public finances in the Member States. Compliance with the Preventive arm should avoid the opening of

[23] Ibidem, 96.
[24] See below section 3.
[25] See below section 2.E.

the excessive deficit procedure (the Corrective arm). From a procedural point of view, the Preventive arm applies to all Member States (other than those under a macroeconomic adjustment programme[26]), irrespective of whether they are in the excessive deficit procedure (Corrective arm) or not.[27] It involves an annual assessment of Member States' programmes by reference to the substantive rules contained in particular in Article 5 of Regulation No 1466/97.

The Preventive arm is built on one main concept, the 'medium-term budgetary objective (MTO)'. Progress of the Member States towards this MTO is measured with two "tools", the change in their structural balance and the 'expenditure benchmark'. The Commission and the Council make an overall assessment, taking into account both those elements, which allows them to enjoy a degree of discretion.

The MTO is specific to each Member State. It is the budgetary position target, set in structural terms, supposed to ensure sustainable finances over time. By setting a budgetary target in structural terms – i.e. cyclically adjusted and net of one-off and other temporary measures – the Preventive arm of the Pact aims to ensure that the underlying fiscal position of Member States is conducive to medium-term sustainability, while allowing for the operation of the automatic stabilisers. The country-specific MTOs are set taking into account the respective debt levels, the country-specific sustainability challenge posed by the costs of an ageing population and the specific dynamics of the automatic stabilisers. The MTOs are presented by the Member States themselves and the Commission assesses whether they are sufficient to ensure sustainable finances over time. The MTOs should be set to provide a safety margin with respect to the 3% of GDP deficit limit and ensure sustainability or rapid progress towards sustainability.[28] Regulation No 1466/97 further specifies that euro area and ERM2 Member States must have an MTO that corresponds to at least -1% of GDP. The MTOs are updated every three years, taking into account the latest economic and budgetary costs of ageing.[29] For Member States that diverge from their MTO, an appropriate adjustment path towards it should be defined and adhered to. This path should follow an annual improvement of the budget balance, higher in economic good times and more limited in economic bad times, with 0,5% of GDP as a benchmark for euro area and ERM2 Member States.[30] For Member States with debt in excess of 60% of GDP or with pronounced risks of overall debt sustainability, a faster adjustment path, i.e. above 0.5% of GDP, is expected. Since 2016, the "Commonly agreed position on flexibility within the SGP" endorsed by the ECOFIN Council[31] clarifies and specifies the required annual adjustments – the so-called matrix of requirements – to take the economic cycle as well as the debt level and sustainability needs of each Member State more adequately into consideration. However, already in the autumn 2017

[26] See Article 10(1) of Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ L 140, 27.5.2013, p. 1.

[27] From a substantive point of view, for Member States in EDP, the attention is put on compliance with the EDP guidance.

[28] Article 2a of Regulation No 1466/97.

[29] Article 2a(3) of Regulation No 1466/97.

[30] Article 5(1) of Regulation No 1466/97.

[31] Published as Annex 15 in the 2018 edition of the Commission's Vade Mecum on the SGP: https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition_en

fiscal exercise, the Commission took the view that it was entitled to use its discretion and, if necessary, depart from the commonly agreed matrix.[32] In all cases, revenue windfalls and shortfalls should be taken into account.

The Regulation allows a Member State to deviate from its normal adjustment path towards its medium-term budgetary objective in two cases, by taking into account the implementation of structural reforms and investments and the impact of adverse economic events:

- The so-called "structural reform clause": Member States implementing major structural reforms may deviate temporarily from the MTO or the adjustment path towards it, if those reforms have positive budgetary effects in the long-term, including by raising potential growth.[33] The Member State must remain in the Preventive arm, an appropriate safety margin with respect to the 3% of GDP deficit reference value must be preserved and the budgetary position should be expected to return to the MTO within the programme horizon. The Commission and the Council have both provided further guidance on this through their respective texts on the flexibility within the SGP.[34] When assessing the stability and convergence programmes (the SCP), the Council accepts the temporary deviation from the MTO or the adjustment path towards it, following a proposal from the Commission based on an overall assessment of the situation of the Member State concerned. If a Member State fails to implement or reverses the agreed reforms, the temporary deviation from the MTO or from the adjustment path towards it will no longer be considered as warranted. The Commission considers that growth-enhancing public investments aiming at major structural reforms, may also, under certain conditions, justify a temporary deviation from the MTO or from the adjustment path towards it.[35] The view of the Commission is that the temporary deviation under the structural reform clause need not to be directly linked to the actual budgetary costs of the reform.
- The impact of adverse economic events: Since the Six-Pack reform of the Stability and Growth Pact in 2011, the Commission and Council may take into account two categories of events. They have never relied on the first category, which refers to "periods of severe economic downturn for the euro area or the Union as a whole". The second category concerns an "unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government".[36] When such an event is present, Member States may be allowed temporarily to depart from the targets, provided that the temporary deviation results from an unusual event (this requires an element of exceptionality, in order to avoid a multiplication of such circumstances and to minimize the risk of moral hazard), is outside the control of the Member State, with a major impact on the financial position of the general government (there has never been any quantification, formal or informal, of the degree of financial impact requested for the activation of the

[32] See Annex 19 of the 2018 edition of the Commission's Vade Mecum on the SGP for a detailed explanation: https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition_en
[33] Article 5(1), 7th sub-paragraph, of Regulation No 1467/97.
[34] See above section 1.
[35] See Flexibility Communication, op. cit. at footnote 6, paragraph 2.2.
[36] Article 5(1), last sub-paragraph, of Regulation No 1466/97.

clause) and does not endanger fiscal sustainability in the medium term. The clause is activated on the basis of individual case-by-case assessments. Typically, that clause had been considered to apply in the case of events such as natural disasters. In recent years, the incremental budgetary costs related to the exceptional refugee inflows towards the Member States and security costs to tackle the terrorist threat in specific Member States were considered as 'unusual events' capable of activating the clause.

Member States must also respect a so-called expenditure benchmark which sets an upper limit for the net growth of government expenditure. In substance, expenditure growth must not be higher than revenue growth. Member States adhering to their MTO must ensure that government expenditure grows at most in line with a medium-term rate of potential GDP growth – which is the rate that ensures adherence to the MTO over time – unless any excess growth is matched by discretionary revenue measures yielding additional revenues. Member States on the adjustment path towards the MTO must ensure that their expenditure grows at a rate below that medium-term rate of potential GDP growth – the difference in growth rate is known as the convergence margin – unless the excess growth is matched by additional receipt from discretionary revenue measures.[37] This does not limit or determine the size of government spending. All that is required is that any excess expenditure growth over the benchmark rate is funded by equivalent discretionary revenue-increasing measures

Procedure:

Regulation No 1466/97 sets up a specific yearly procedure in order to allow the Commission and the Council to perform both an ex ante and an ex post surveillance of the fiscal situation of the Member States. This annual procedure has evolved over time with the progressive establishment of the European Semester, which broadly corresponds to the first six months of every calendar year. Adherence to the MTO or the adjustment path towards it is the cornerstone of the budgetary analysis. It is assessed on an ex post basis for the past year, an in-year basis for the year that is underway and on an ex ante basis for the following three years.

The Regulation determines the information that the Member States must communicate to the Commission and make public within a binding deadline (in April each year).[38] It contains two separate but parallel sets of rules for the euro Member States (section 2) and the non-euro area Member States (section 3) respectively. The euro area Member States must transmit annually their so-called "stability programmes" while the non-euro must transmit their "convergence programmes" (together "the stability and convergence programmes" or "SCP"). A range of economic and budgetary data must be included in the SCPs, as set out in the tables annexed to the Code of Conduct on the SGP.[39] The programmes must in principle cover five years, namely the preceding year, the current one and the next three years.[40] The forecasts contained in the SCPs must be prepared in a sound and realistic manner, consistent with the requirements of Directive 2011/85/EU on the requirements for budgetary frameworks of the Member States, and should

[37] Article 5(1) of Regulation No 1466/97.
[38] Article 4 of Regulation No 1466/97.
[39] Annex 1 in the latest version from May 2017: http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf
[40] Article 3(3) of Regulation No 1466/97.

therefore be based on the most likely macro-fiscal scenario or on a more prudent one.[41] Euro area Member States[42] must also base their Stability Programmes on macroeconomic forecasts produced or endorsed by an independent body.[43]

The Council and the Commission must examine the programmes within at most 3 months from their submission.[44] The Council may, if necessary, adopt an opinion on the programmes. If it considers that the objectives and the content of the programme should be strengthened with particular reference to the adjustment path towards the MTO, it invites the Member State concerned to adjust its programme, acting on the basis of a Commission recommendation.[45] In the past, these 'opinions' were adopted by the Council as self-standing opinions. Since the setting up of the European Semester, these 'opinions' are nowadays integrated into the so-called 'Country Specific Recommendations' (CSRs). The "fiscal" opinion that the Council may address on the basis of Regulation No 1466/97 has thus become a regular feature of the annual Semester. Under a constant practice, it is now the first recommendation (the 'fiscal recommendation') of the broader "country-specific recommendation" (CSR)[46] which is addressed by the Council to each Member State in July. The CRSs addressed to Member States that already adhere to their MTO do not contain a specific 'fiscal recommendation' and the annual 'fiscal recommendation' for Member States that are under the EDP is limited to a confirmation that the EDP recommendations they have previously received should be respected.

The analysis of budgetary policy in the SCPs aims to deliver, for each Member State, an overall assessment of compliance with the requirements of the Preventive arm, in terms of being at or on the adjustment path towards the MTO, on an ex post, in-year and ex ante basis. The assessment of compliance contains three key elements: Is the MTO set at an appropriate level? Is the Member State at the MTO or on the adjustment path towards the MTO, by considering the position of the structural balance? Are expenditure plans in line with the expenditure benchmark?

Building on the possibility of a Commission warning, as provided for in Article 121(4) TFEU, the legislator has also put in place an additional procedure in case it is observed that a Member State has significantly deviated from its obligations (the so-called "significant deviation procedure").[47] The purpose of the Significant Deviation Procedure is to ensure that the Member State concerned returns to an appropriate adjustment path towards its MTO, ultimately correcting the occurred significant deviation. It is also an early warning to prevent the Member State from slipping into an excessive deficit. Compared with the EDP, the significant deviation procedure presents two differences. Firstly, it looks at deviations from the MTO or the path towards it, not at proximity to the 3% deficit criteria (therefore, failure to address a significant deviation procedure does not

[41] Article 3(2a) of Regulation No 1466/97.
[42] For euro area Member States, a set of additional rules have been put in place through the Six Pack as a strong complement to the Preventive arm (see below section 3).
[43] Article 4(1) of Regulation (EU) 473/2013.
[44] Article 5(2) of Regulation No 1466/97.
[45] Articles 5(2) and 9(2) of Regulation (EC) No 1466/97.
[46] The CSRs are based not only on Regulation No 1466/97 (as far as its "fiscal" dimension is concerned; usually the first recommendation included in the CSR is the fiscal one) but also on Article 121 TFEU (that legal basis is the basis for more structural recommendations) and, when relevant, on the 'macro-economic imbalances' Regulation (EU) No 1173/2011, as well as on Article 148(4) TFEU for labour market recommendations.
[47] Articles 6(2) and 10(2) of Regulation No 1466/97.

necessarily imply the opening of an EDP). Secondly, it is a short-term procedure that is supposed to produce its full effect over a short period of time (between seven and eight months) and which cannot be put "in abeyance" like the EDP. The Significant Deviation Procedure consists of the following steps:

- If a significant deviation from the adjustment path towards the MTO, including the assessment of compliance with the expenditure benchmark, is observed, the Commission must address a warning to the Member State concerned, thereby launching the procedural steps under Article 121(4) TFEU.[48]
- At the same time or very shortly after, the Commission must adopt a recommendation for a Council recommendation.
- Within one month from the warning, the Council must examine the situation in the Member State and adopt the recommendation recommended by the Commission under Article 121(4) on necessary policy measures, including a new adjustment path towards the MTO. The Regulation leaves some discretion to the institutions regarding the content of the measures that may be recommended to the Member State concerned. The Council recommendation must set a deadline of no more than five months for the Member State to address the deviation. If the situation is particularly serious and warrants urgent action, the deadline can be reduced to three months. On a proposal from the Commission, the Council makes its recommendations public.[49]
- Following the Council recommendation, the Member State in question must report to the Council on action taken, within the set deadline.[50]
- If the Member State takes effective action, the Commission will inform the Council accordingly.
- If, by contrast, the Member State fails to take appropriate action within that deadline, the Commission will immediately recommend the Council to adopt, by qualified majority, a decision establishing that no effective action has been taken. The Commission may recommend the Council to adopt a revised recommendation under Article 121(4) TFEU on the appropriate measures to be taken.[51] For euro area Member States, the imposition of sanctions in the form of an interest-bearing deposit are possible at that stage.[52]
- If the Council does not adopt the decision on no effective action, and the lack of appropriate action by the Member State in question persists, the Commission will make a new recommendation for a Council decision on no effective action within one month of the previous one. That new recommendation will be subject to reverse simple majority voting in the Council, meaning that a majority of Member States must vote against its adoption in

[48] First sub-paragraph of Articles 6(2) and 10(2) of Regulation No 1466/97.
[49] 2d sub-paragraph of Articles 6(2) and 10(2) of Regulation No 1466/97.
[50] 3rd sub-paragraph of Articles 6(2) and 10(2) of Regulation No 1466/97.
[51] 4th sub-paragraph of Articles 6(2) and 10(2) of Regulation No 1466/97.
[52] See below section 2.D.

order for it not to be adopted. If there is no majority against the Commission recommendation, the Council decision is adopted.[53]

Because of the wording of Regulation No 1466/97, the institutions seem to have a legal obligation to initiate the first two steps of the procedure (the Commission's warning and the Council's recommendation) when the conditions are met. By contrast, at the next stage, the Council seems to have a discretionary power in the adoption of the decision on non-effective action, recommended by the Commission.

In all Council legal acts in the context of the significant deviation procedure, only euro area Member States vote on decisions concerning other euro area participants, and the vote of the Member State concerned is not taken into account in any case. The Council submits a report to the European Council on all decisions taken.

So far, the Commission has initiated the significant deviation procedure only against non-euro area Member States, namely twice in 2017 against Romania[54] and in 2018 against Romania[55] and Hungary.[56] A potential weakness of this procedure is that it risks turning into repetitive game, since the escalation to EDP is subject to other conditions (see above).

B. The corrective the excessive deficit procedure

Legal basis and main features:

Article 126 TFEU contains a specific procedure for the avoidance of excessive deficits in the public finances of the Member States. Today, that provision must be read together with Regulation (EC) No 1467/97 on speeding up and clarifying the excessive deficit procedure, as amended twice, and, for euro area Member States, Regulation No 1173/2011.[57]

The rule is that excessive deficits must be avoided, even if there is no monetary financing. The Treaty contains a sophisticated procedure under which the Union Institutions, namely the Commission and the Council, check the deficit and debt levels of the Member States. Deficits are supposed to stay below 3% of the GDP and debt levels should normally remain below 60% of the GDP or decline at a satisfactory pace. The EDP ought not to be thought of as being part of the normal budgetary procedure in the Member States. It follows a specific and irregular timeline that is not aligned with the steps of the Semester and depend heavily on the economic situation. The number of Member States under an EDP fell from 25 in 2011, at the height of the crisis, to just one in 2018.

The Corrective arm of the Pact implements the steps set out under Article 126 TFEU and Protocol No 12 on the Excessive Deficit Procedure. The current reference values on which the deficit and debt criteria are based are defined in Protocol No 12. The inclusion of the EDP in the Treaties gives a quasi-constitutional status to that procedure as well as to the reference values on which it is

[53] 5th sub-paragraph of Articles 6(2) and 10(2) of Regulation No 1466/97.

[54] Council Recommendation of 16 June 2017, OJ C216, 6.7.2017, p. 1; and Council Recommendation of 5 December 2017, OJ C 439, 20.12.2017, p. 1.

[55] Council Recommendation of 22 June 2018, OJ C223, 27.6.2018, p. 3.

[56] Council Recommendation of 22 June 2018, OJ C223, 27.6.2018, p. 1.

[57] See below section 2.D.

based. Article 126(14) TFEU nevertheless allows Protocol 12 to be replaced by a Council decision taken unanimously. Its second subparagraph allows the adoption of provisions replacing the Protocol on the excessive deficit procedure annexed to the Treaties, by unanimous decision of the Council. According to its third subparagraph detailed rules and definitions may be adopted for the application of the provisions of that Protocol. The EDP procedure is set out in Council Regulation (EC) 1467/97 and its subsequent amendments. It is interesting to note that Regulation No 1467/97 was adopted on the basis of the second subparagraph of Article 104c of the Treaty establishing the European Community (now Article 126 TFEU) even though it was not replacing the Protocol but only 'speeding up and clarifying the implementation of the excessive deficit procedure'. For that reason, when as part of the Six-Pack it was decided to amend this regulation, the same procedure requiring unanimity within the Council was followed.[58] Details relating to the implementation of the EDP are further specified in the Code of Conduct on the SGP, revised for the last time in May 2017[59]. Even if that text has no legal value per se, it is nevertheless an important instrument for interpreting the legislation, given that it is supposed to reflect the common view of the two institutions that are responsible for applying the EDP.

The reference values:

The Corrective arm comprises the various "steps" that should be taken when Member States' deficits or debt levels are considered excessive. The obligation for Member States to avoid "excessive government deficits", as mentioned in Article 126(1) TFEU, must be understood as covering both deficits and debts, since paragraph 2 of the same Article makes clear that the budgetary discipline is based both on a deficit criterion and on a debt criterion. Consequently, the notion of "deficit" throughout all the paragraphs of Article 126 should be understood as referring to the deficit and/or the debt of the Member State concerned.

The assessment is based on "reference values" set up in Protocol No 12 for deficit and debt levels. In both cases, non-respect of those values does not necessarily lead to the Member State being placed in EDP, as other factors may be taken into account. With regard to the deficit, it is considered as problematic if its value is greater than 3% of GDP, unless either the ratio has declined substantially and continuously and has reached a level close to 3%[60] or the excess is only exceptional and temporary. Article 2(1) of Regulation 1467/97 further determines whether an excess may be considered exceptional and temporary. With regard to the debt, the reference value corresponds to a debt in excess of 60% of GDP and not sufficiently diminishing towards that level. Article 2(1a) of Regulation No 1467/97 further defines the notion of "sufficient diminution". The debt requirement was operationalised with the 2011 amendment of the SGP – commonly referred to as the Six Pack – through the so-called debt reduction benchmark. At that time, a number of Member States were already in EDP and, consequently, had their fiscal consolidation paths already defined. In order to ensure that those Member States had time to adapt their structural adjustments to comply with the new debt benchmark, Article 2(1a) provides for a

[58] Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97, OJ L306, 23.11.2011, p. 33.
[59] http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf
[60] There is no formal definition of the meaning of a level being "close to 3%" but according to a constant practice, a difference of more than 0.5% is no longer close.

transition period of three years after the correction of their excessive deficit. During that period, those Member States must make sufficient progress towards compliance with the debt benchmark rather than actually be compliant with the formula that applies outside the transition period.

Evolution of the EDP:

We will only recall the key steps in the evolution of the EDP over time, without examining in detail its successive features.[61] The original EDP entered into force on 1 January 1999 in the beginning of the third stage of EMU, and the Commission quickly opened a number of excessive deficit procedures, in particular concerning Germany and France. However, when the Commission proposed the Council to adopt decisions stating that those two Member States had not taken effective action, in accordance with Article 104(8) TCE (now Article 126(8) TFEU), the Council did not adopt those decisions but rather a set of conclusions holding the excessive deficit procedures in abeyance. Following an action initiated by the Commission, the Court of Justice delivered its judgment on 13 July 2004.[62] The Court decided that failure by the Council to adopt the decisions recommended by the Commission did not constitute an act that is challengeable under an action for annulment but it annulled the Council's conclusions. That judicial episode prompted a revision of Regulation No 1467/97 with the adoption of Regulation 1056/2005 which increases the "flexibility" in the implementation of the EDP.

The financial crisis that started in 2008 put some extra pressure on the application of the EDP. While the EDP was initiated against many Member States, the flexibility of the legal framework was stretched to its maximum to avoid stepping up and imposing sanctions on the Member States. The Commission generalized multiannual deadlines for the correction of excessive deficits and allowed Member States not to undertake consolidation in the first year(s) of the correction period.

Thereafter, the EDP has been again reinforced through the so-called "Six-pack" legislation that entered into force in December 2011.[63] The new rules aim at strengthening the SGP in order to prevent unsustainable fiscal positions, and to correct such positions promptly, should they emerge. The reform affects both the Preventive arm of the SGP - the procedures to promote surveillance and coordination of economic policies and ensure that excessive deficits are avoided - and its Corrective arm. New enforcement mechanisms, including financial disincentives and fines, apply to non-compliant euro-area Member States. Moreover, the "Six-pack" introduced new provisions regarding the debt criterion of the SGP. It is now possible to initiate an EDP on the basis of the debt criterion alone.[64]

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[61] For a detailed description, see Lastra, Rosa, and Louis, Jean-Victor, European Economic and Monetary Union: History, Trends, and Prospects, Yearbook of European Law, Vol. 32, N° 1 (2013), 57-206, 112-119.
[62] Case C-27/04, *Commission v. Council*, op. cit.
[63] Regulation 1177/2011 amending Regulation No 1467/97, op. cit. at footnote 58.
[64] In addition, the Six-Pack introduced a new Macroeconomic Imbalances Procedure (MIP). See below section 3.

General comments on the procedure:

As stated by the Court of Justice, the EDP is a procedure "in stages".[65] Those "stages" (or "steps" according to the usual Commission's terminology) are set out in Article 126 TFEU and are further specified in Regulation No 1467/97. A few preliminary comments are warranted:

- First, the steps provided for by Article 126 TFEU are successive in the sense that they must be followed one by one in the right order. The institutions are not allowed to move to a step that is not the consecutive one in the procedure.[66]
- Second, the Regulation establishes detailed arrangements and successive deadlines for that procedure, which are largely based on the assumption that an excessive deficit must be corrected in the year following its identification.[67] However, in practice, many excessive deficit procedures have been multiannual, thus making it more difficult to apply strictly the Regulation.
- More generally, the idea of "speeding up" has often not been respected. This is partly due to the fact that there is no fixed deadline for each and every step in the procedure (for instance there is no fixed deadline for the adoption of a 126(3) report by the Commission). Moreover, the deadlines are not always binding (for instance the Council must open an EDP "as a rule" within four months of the reporting dates established in Regulation No 479/2009[68]). Overall, one has to recognize that the "speeding up" pursued by Regulation No 1467/97 has not been fully achieved. However, the Court of Justice confirmed that expiry of EDP deadlines do not preclude the institutions from acting.[69]
- All the steps of the excessive deficit procedure as described below may apply to euro area Member States. By contrast, for non-euro area Member States, the procedure stops with a Council decision based on paragraph 8 of Article 126 TFEU. The coercive means for remedying excessive deficits envisaged at paragraphs 9 and 11 of that Article do not apply to them.[70] For that reason, when the Council decides, in accordance with Article 126(8) TFEU, that a non-euro area Member State has not taken effective action, it may only address to it a revised recommendation in accordance with paragraph 7 of that Article.
- The provisions applicable to euro area Member States must be read together with the more recent rules of Regulation No 1173/2011, which provide for financial sanctions at earlier stages of the EDP. However, to date, the Council has not activated such sanctions nor the ultimate steps of the EDP also leading to sanctions on the Member States concerned, because the Commission has not submitted any such proposal to the Council.
- Voting arrangements within the Council are governed by Article 126(14) TFEU and Article 139(4)(b) TFEU. Moreover, Article 7 of the Treaty on Stability, Coordination and Governance

[65] Case C-27/04, *Commission v. Council*, op. cit., paragraph 77.
[66] On one occasion, though, the Council went directly to paragraph 9 of Article 126 TFEU without adopting first a 126(8) decision on non-effective action but it would no longer be possible to do so under the current legal framework (Council Decision 2006/344/EC of 14 March 2006, OJ L 126, 13 May 2006, p. 20).
[67] See Article 3(4) of Regulation No 1467/97.
[68] Article 3(3) of Regulation No 1467/97.
[69] Case C-27/04, *Commission v. Council*, op. cit., paragraph 33.
[70] Article 139(2)(b) TFEU.

in the EMU imposes on the euro area Member States the obligation under public international law to support the Commission's proposals or recommendations under the EDP that are related to a breach of the deficit criterion (though not of the debt criterion). That obligation of unanimous support can only be waived if it is established, through a pre-vote, that a qualified majority of those Member States opposes the decision that is proposed or recommended.

- Finally, Article 10a of Regulation No 1467/97 provides for a system of "surveillance missions" by the Commission in the Member States in EDP.

Publicity of the procedure:

The Treaty does not say much about the public nature of the EDP documents. Moreover, because of their non-legislative nature, those documents do not benefit from the special publicity applicable to legislative documents. While Article 126 TFEU provides for a confidential procedure in principle[71], a practice of full transparency has progressively developed over time in order to increase the peer pressure effect. The first formal trace of that transparency dates back to the 1997 Resolution of the European Council.[72] Today almost all EDP documents are available on the Commission website. Regulation No 1467/97 and the Code of Conduct have made the EDP public, with the objective of increasing the pressure on the Member States concerned. The public nature of the EDP documents allows the so-called "economic dialogue" with the European Parliament "to discuss Council decisions under Article 126(6) TFEU, Council recommendations under Article 126(7) TFEU, notices under Article 126(9) TFEU, or Council decisions under Article 126(11) TFEU". It is also the basis for the so-called 'comply or explain' rule, which means that the Council must explain its position publicly if it deviates from the Commission's recommendations or proposals.

Steps in the procedure:

According to Article 126(2) TFEU, the Commission monitors the development of the budgetary situation of the Member States and of the stock of their government debt. The Commission exercises that task by using statistics notified on a regular basis by the Member States.[73]

Following a breach of the deficit criterion, identified on the basis of outturns (ex post) or plans (planned deficit), or following a breach of the debt criterion identified on the basis of outturn data (ex post), the Commission must prepare a report pursuant to Article 126(3) TFEU. The Code of Conduct clarifies that the Commission shall always prepare a report when certain conditions are met. The Commission may also prepare a report if it is of the opinion that there is a risk of an excessive deficit or debt in a Member State. In the report, the Commission assesses the case for launching an EDP, based on a consideration of all factors pertinent to such a decision. Article 2(3) of Regulation No 1467/97 provides a non-exhaustive list of such factors and gives the Commission a large margin of discretion as regards the relevant factors to be taken into account.

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[71] See paragraphs 7 and 8 of Article 126 TFEU.

[72] « The Member States [...] 2. are invited to make public, on their own initiative, the Council recommendations made to them in accordance with Article 103 (4); [...] 6. are invited to make public, on their own initiative, recommendations made in accordance with Article 104c".

[73] See below section 2.C.

As a second step, Article 126(4) TFEU requires that the Economic and Financial Committee (EFC) formulates an opinion on the Commission report. The EFC must adopt its opinion within two weeks of the adoption of the Commission's report.[74] It adopts those opinions in an informal way and does not make them public.

Following the Commission's report and the ensuing opinion from the EFC, if the Commission considers that an excessive deficit exists or may occur, it issues an opinion addressed to the Member State concerned under Article 126(5) TFEU. At the same time, and unless there is simply a risk of excessive deficit[75], the Commission adopts a proposal for an Article 126(6) TFEU Council decision on the existence of an excessive deficit as well as a recommendation for a Council recommendation based on Article 126(7) TFEU. The Commission must also inform the European Parliament.[76]

The Council adopts the 126(6) decision and the 126(7) recommendation at the same time. It acts by qualified majority and without taking into account the vote of the Member State concerned (Article 126(13) TFEU). Regulation No 1467/97 provides that the Council has an obligation to decide on the existence of an excessive deficit within a certain deadline.[77] The adoption of the 126(6) decision by the Council is usually referred to as the "opening of the EDP". The decision that an excessive deficit exists means either that an excessive deficit is reported or that it is planned by the Member State concerned. To date, the EDP has never been opened for a planned breach of the debt criterion alone. The discretion of the Council and the Commission when deciding to open or not an EDP is limited by the specifications of Article 2(4) of Regulation No 1467/97.

The opening of an EDP may have additional specific consequences for a euro area Member State. The Commission must recommend that a sanction be set in the form of a non-interest-bearing deposit if the Member State has already lodged an interest-bearing deposit under the Preventive arm or in case of "serious non-compliance with the budgetary policy obligations in the SGP". [78]

The 126(7) recommendation sets a time limit to correct the Member State's public finance imbalances and to be compliant with both the deficit and the debt requirements. It contains annual deficit targets both in nominal and in structural terms which are linked by an underlying macroeconomic scenario set on the basis of the Commission forecasts. The targets must be consistent with a minimum annual improvement of at least 0,5% of GDP as a benchmark, net of one-off and temporary measures.[79] It is worth noticing that sometimes the 126(7) recommendations contain a budgetary target for the final year that is set at a level slightly below -3%, in order to guarantee an effective and lasting achievement of the correction within the requested deadline. In the past, the Council recommendation also contained a quantification of the policy response required to attain those targets, in terms of the total amount of measures to be taken (the required fiscal effort). Since 2016, the recommendation is supposed to be formulated in terms of the expenditure benchmark, which corresponds to a maximum growth

[74] Article 3(1) of Regulation No 1467/97.
[75] In which case the procedure stops at the Commission's opinion.
[76] Article 3(2) of Regulation No 1467/97.
[77] Article 3(3) of Regulation No 1467/97.
[78] See below section 2.E.
[79] Article 3(4) of Regulation No 1467/97.

rate of expenditure.[80] The Council fixes for the Member State concerned a maximum deadline for effective action. According to Regulation (EC) No 1467/97, that deadline should be within six months, or within three if the situation is judged to be particularly serious. The Council also establishes a deadline for the correction of the excessive deficit.

Following the Council decision under Article 126(6) TFEU and the adoption of the Article 126(7) TFEU recommendation, the Member State must show that it has taken action to address its excessive deficit within the deadline set in the recommendation. The Member State must make its report public.

Following the expiry of the three- or six-month deadline given by the Council, the Commission must undertake a first assessment, which looks at whether the Member State is on track to correct its excessive deficit, i.e. if it has taken effective action, following the submission of the Member State's report on action taken. The Commission and the Council have agreed a complex methodology for assessing whether a Member State has taken effective action, implying in particular a so-called "careful analysis".

Depending on the outcome of that assessment, the procedure may be held 'in abeyance' or stepped up. The procedure is held in abeyance if the Commission considers that the Member State acts in compliance with the Council's recommendation.[81] The Commission must inform the Council accordingly and does so in practice by addressing a communication to it. Thereafter, an EDP 'in abeyance' is subject to continuous monitoring by the Commission. However, Regulation No 1467/97 does not provide specific deadlines within which the Commission must make a new assessment. The Commission may activate again the procedure if its monitoring shows the Member State not to be on course to comply with the recommendation.

With the Two Pack, the continuous monitoring for euro area Member States is based – on a request by the Commission – on regular reports submitted by them every six months. At any point in the EDP process, the Commission may issue may issue an autonomous recommendation if it perceives a risk of non-compliance with the deadline to correct the excessive deficit.

The 2005 reform of the SGP introduced, among other matters, a possibility of extending the deadline for correcting the excessive deficit without necessarily stepping up the EDP. That novelty, referred to as 'conditional compliance', can be found in Articles 3(5) and 5(2) of Regulation No 1467/97 and remained unchanged after the 2011 reform of the SGP. As long as a Member State is judged as having taken effective action, it may be issued with revised Article 126(7) recommendations, including the possibility of extending the deadline for correction, if unexpected adverse economic events with a major impact on public finances impede its ability to correct its excessive deficit by the deadline initially recommended, despite its action. Consequently, a Member State can stay in the same stage of the EDP as long as it remains on the structural adjustment path by taking effective action. Such extensions have been frequently

[80] See the EFC opinion as Annex 17 of the 2018 edition of the Commission's Vade Mecum on the Stability and Growth Pact: https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2018-edition_en

[81] On one occasion, the Commission took a more ambiguous stance. It decided that the procedure against France should be held in abeyance because it was not established that there was no effective action [COM (2015)326]. This position was criticized in Council.

granted over the last years, given the impact of the financial crisis that started in 2008. The Institutions have not quantified the notion of "major impact on public finances". In practice, if a Member State complies with the recommended expenditure benchmark while not meeting the nominal target, it is simply assumed that "unexpected adverse economic events…" have occurred. The extension of the deadline should be "by one year as a rule".[82] However, in practice, the Commission has frequently either recommended to the Council extending the deadline by more than one year or adopted consecutive one-year extension proposals. A similar extension is also possible "in the case of a severe economic downturn in the euro area or in the Union as a whole". The scenario is referred to as the 'general crisis escape clause', because it applies irrespective of whether the Member States have delivered the required fiscal effort or not. It has never been applied until now.

If the Commission considers, at the end of the six-(or three-)month deadline for effective action, that the Member State concerned has not taken effective action, it must recommend to the Council to adopt a decision stating the lack of effective action in accordance with Article 126(8) TFEU. The Council must adopt its decision "immediately after" the expiry of that deadline for effective action and report to the European Council accordingly.[83] Thereafter the Council and the Commission continue regularly monitoring the Member States in EDP and must step up the procedure whenever they do not act as recommended.

For euro area Member States whose EDP has been stepped up, the Council, together with the 126(8) decision on non-effective action, also issues a notice under Article 126(9) TFEU. The notice mirrors the Article 126(7) recommendation since it includes a time limit for correcting the excessive deficit as well as annual nominal and structural balance targets, which are linked by an underlying macroeconomic scenario. In addition, the notice contains a series of measures – and the corresponding timetable for their implementation – that are conducive to the achievement of the nominal and structural targets. For euro area Member States, a Council decision stating the lack of effective action is also the next trigger for the imposition of sanctions in the form of a fine corresponding to 0.2% of GDP in the preceding year as a rule.[84] For non-euro area Member States, following an Article 126(8) decision stating a lack of effective action, the Council simply addresses to them revised Article 126(7) recommendations.

Following a notice under Article 126(9) TFEU or a revised Article 126(7) TFEU recommendation, an assessment of whether a Member State is on track to correct its excessive deficit, i.e. if it has taken effective action, can again lead to either maintaining/putting the procedure in abeyance or to a decision on a lack of effective action. With the Two Pack, the regularity of the reports to be submitted by euro area Member States increases to every three months when subject to a notice under Article 126(9) TFEU. The possibility of revising the notice or the recommendation and extending the deadline also remains, as long as the Member State is found to have taken effective action but has faced unexpected adverse economic circumstances with a major impact on its public finances.

[82] Article 3(5) of Regulation No 1467/97.
[83] Article 4(1) of Regulation No 1467/97.
[84] See below section 2.E.

Where the Commission concludes that effective action has not been taken to comply with the requirements of an Article 126(9) notice, the procedure is stepped up to Article 126(11) TFEU for euro area Member States. Under that step, the Council may apply or intensify different measures listed in Article 126(11) TFEU: obligation to publish additional information before issuing bonds and securities, invitation to the EIB to reconsider its lending policy towards the Member State concerned and financial sanctions in the form of non-interest-bearing deposit or fine. Regulation No 1467/97 has reinforced that rule by providing for an obligation for the Council to impose a fine within a certain deadline when the conditions are met.[85] For as long as the Member State continues not to comply with its notice under Article 126(9) TFEU, it faces in principle an annual fine equal to 0.2% of its GDP in the preceding year plus a variable component determined by the magnitude of its excessive deficit, up to a maximum of 0.5% of GDP.[86] However, in practice, the Council has never stepped up the EDP to the Article 126(11) step and has thus never imposed such sanctions.

For non-euro area Member States, a new decision under Article 126(8) followed by a new recommendation under Article 126(7) is undertaken for as long as the Member State is not on track to correct its excessive deficit and has not taken effective action.

In accordance with Article 126(12) TFEU, the last step of the EDP is the abrogation when the excessive deficit has been corrected. The Code of Conduct clarifies that the excessive deficit must be corrected in a durable manner and the correction must be confirmed by outturn data. In all cases, abrogation requires a correction of the deficit that is lasting and compliance with the debt reduction benchmark on a forward-looking basis. The Council adopts the abrogation decision under Article 126(12) TFEU by a qualified majority vote, based on a Commission recommendation.

C. Reporting of deficit and debt data

General Principles:

A key element for the proper implementation of the Stability and Growth Pact is the availability of complete, reliable, timely and consistent data concerning the fiscal situation of the Member States. In the absence of such data, the Commission and Council cannot effectively ensure the control of the fiscal situation of the Member States. The case of Greece which misrepresented its data over a long period perfectly illustrates that issue. For that reason, the Union has put in place and reinforced over time a system of notification and assessment of national data, in particular data on government debt and deficit reported under the Excessive Deficit Procedure (hereafter the 'EDP statistics'). The legislator has also put in place a system of financial sanctions in case of manipulation of EDP statistics.[87]

Member States must notify EDP statistics to the European level. According to Article 3 of Protocol No 12 on the excessive deficit procedure, they have an obligation to report to the Commission their planned and actual deficits and the level of their debts "promptly and regularly". The central legal framework for the production and notification of EDP statistics is Regulation No 479/2009 of

[85] Articles 6(2), 7 and 11 of Regulation No 1467/97.
[86] Article 12 of Regulation No 1467/97.
[87] See below section 2.D.

25 May 2009, on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community. That Regulation, as amended by Council Regulation (EU) No 679/2010 and Commission Regulation (EU) No 220/2014, develops further the notification obligation of the Member States. While these legal provisions refer explicitly only to the Excessive Deficit Procedure, the Commission use the data collected on that basis for the purpose of fiscal surveillance of the Member States in general, including for the Preventive arm of the SGP.

Responsible authorities:

At national level, the national statistical authorities are responsible for ensuring that reported data complies with legal provisions. According to Article 16 of Regulation No 479/2009, Member States must ensure that the actual data reported to the Commission (Eurostat) are provided in accordance with the principles established by Article 2 of Regulation (EC) No 223/2009. In that regard, the responsibility of the national statistical authorities is to ensure the compliance of reported data with Article 1 of this Regulation and the underlying ESA 2010 accounting rules. Those national statistical authorities must be provided with access to all relevant information necessary to perform those tasks while they are accountable and must act in accordance with the principles established by Article 2 of Regulation (EC) No 223/2009.

At the Union level, in the specific context of the EU fiscal surveillance system and of the excessive deficit procedure (EDP) exercise, the Commission is responsible for regularly assessing the quality both of actual data reported by Member States and of the underlying government sector accounts compiled according to the European System of Accounts. It is also responsible for providing the data to be used for the EDP. Within the European Commission, that task is undertaken by the Directorate-General of Eurostat, acting on behalf of the Commission. Eurostat benefits from a particular status of professional independence within the Commission.[88] Commission Decision 97/281/EC establishes the institutional setting of Eurostat and the way it operates within the European Commission. The legislature also guarantees its existence and independence.[89] Eurostat fulfils its coordination role as set out in Regulation (EC) No 223/2009. Eurostat is assisted by a Committee on monetary, financial and balance of payments statistics established by Council Decision 2006/856/EC of 13 November 2006. It conducts its mission in conformity with the Code of Practice for European Statistics, which provides in particular for professional independence, objectivity and impartiality. It maintains a continuous dialogue with all relevant institutions in the Member States, and provides in particular for bilateral advice for specific past and future transactions. Eurostat also maintains a permanent dialogue with users through the interface of the European Statistical Advisory Committee. In addition, Eurostat has sole competence within the Commission for the statistical methodological basis on which the data for the EDP are compiled. Eurostat undertakes regular visits to Member States, during which the EDP statistics data are reviewed, as well as the implementation of the national accounts rules

[88] The status of Eurostat, combining integration within the Commission and functional independence, can be compared with the status of the European Antifraud Office (OLAF).
[89] See, in particular, Articles 6 and 6a of Regulation (EC) No 223/2009 of the European Parliament and of the Council of 11 March 2009 on European statistics.

(ESA 2010) and Eurostat's other methodological documentation relating to the government sector.

Applicable rules:

The Commission (Eurostat) provides the data for the fiscal surveillance. When doing so, it may express a reservation on the quality of the actual data reported by the Member States and make those reservations public.[90] The Commission (Eurostat) may also amend actual data reported by Member States and provide the amended data and a justification of the amendment where there is evidence that actual data reported by Member States do not comply with the requirements.[91] Eurostat makes a regular use of that power and Member State are probably entitled to challenge the validity of such decisions before the Court of Justice.[92] Finally, Eurostat has received investigative powers with a view to reinforcing budgetary surveillance in the euro area.

Regulation No 479/2009 requires that Member States report EDP-related data to Eurostat twice per year, at the end of March and the end of September. Member States must also inform the Commission (Eurostat) of any major revision in their actual and planned government deficit and debt figures already reported, as soon as it becomes available. The data must be reported in harmonised tables designed specifically to provide a consistent framework. On that basis, Eurostat publishes deficit and debt data on a quarterly basis

The definitions of 'government', 'deficit' and 'investment' are laid down in Article 2 of the Protocol on the excessive deficit procedure by reference to the 'European System of Integrated Economic Accounts' (ESA), which was replaced by the European system of national and regional accounts in the Community, the so-called 'ESA 2010'.[93] Therefore, the EDP statistics are strongly linked to ESA. European Government Finance Statistics differ from the budget or public accounting presentations, which are national-specific in terms of their scope of entities and the applicable principles for recording transactions.

The notification applies to the planned and actual government deficits and to the level of debts.

The EDP debt is defined in Article 1(5) of Regulation No 479/2009 as the total general government consolidated gross debt at nominal value outstanding at the end of the year. General government consists of central government, state government (if applicable), local government and social security funds (if applicable). Consolidation refers to the exclusion of government debt held as assets by other general government units. Gross debt is consolidated both within and between sub-sectors of general government, implying that general government gross debt is less or equal to the sum of subsectors debt. Substantial consolidation amounts occur for example for social security funds' holdings of government bonds.

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[90] Article 15(1) of Regulation No 479/2009.

[91] Article 15(2) of Regulation No 479/2009.

[92] See inadmissibility order of 5 September 2006 in Case T-148/05, *Comunidad autônoma de Madrid,Madrid, infraestructuras del transporte (Mintra) v. Commission*. See also Case T-177/06, *Ayuntamiento de Madrid et Madrid Calle 30 SA (Madrid) v. Commission* and Case T-403/06, *Belgium v. Commission*. The General Court closed the latter case by a simple order following the withdrawal of the Belgian application.

[93] Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community.

Following the provisions of Article 9 of Regulation No 479/2009, as amended, in 2014 the new ESA2010-based EDP Inventory of the methods, procedures and sources used to compile actual deficit and debt data and the underlying government accounts has been adopted. All Member States are required to complete that EDP Inventory. Availability of detailed and comprehensive EDP Inventories is of vital importance for the quality assessment of the EDP statistics and the Government Finance Statistics (GFS) data and for identifying possible risks in their reliability and thus of the government deficit and debt data.

D. Financial sanctions as enforcement mechanism

EDP financial sanctions:

For Member States in EDP, Article 126 TFEU and Regulation No 1467/97 substitutes the usual infringement procedure before the Court of Justice with a system of financial sanctions. Regulation No 1467/97 provides for an obligation for the Council to impose a fine against a non-compliant Member State within a certain deadline when certain conditions are met.[94] For as long as the Member State continues not to comply with its notice under Article 126(9) TFEU, it faces in principle an annual fine equal to 0.2% of its GDP in the preceding year plus a variable component determined by the magnitude of its excessive deficit, up to a maximum of 0.5% of GDP.[95] That system, however, has never been activated. One of the reasons is that it provides for sanctions at a very late stage in the EDP, when the financial situation of the Member State concerned has already deteriorated.

For that reason, the legislator has set up a whole new set of financial sanctions for the euro area Member States, as part of the so-called Six Pack. Regulation No 1173/2011 provides for financial sanctions both in the Preventive arm and the Corrective arm of the SGP. In order to increase the automaticity of those mechanisms, the Commission is under the obligation to recommend to the Council the adoption of those sanctions within a certain deadline. Moreover, the sanction is “deemed to be adopted by the Council” unless it decides by a qualified majority to reject the Commission’s recommendations within 10 days (the so-called ‘reversed qualified majority voting’).

In the Preventive arm, an interest-bearing deposit amounting to 0.2% of its GDP is imposed on the euro area Member State which receives a Council decision establishing that it failed to take action following a so-called ‘significant deviation procedure’.[96] While the default is for the deposit to equal 0.2% of GDP, the amount may vary. In order for such an adaptation to occur, the Member State in question must issue a reasoned request to the Commission within ten days of the Council decision on non-effective action. Following the receipt of that request, the Commission may recommend that the Council reduces the amount or cancels the interest-bearing deposit. The interest-bearing deposit will bear a rate of interest which reflects the Commission’s credit risk and the relevant investment period. It will be returned to the Member State with the interest accrued, once the situation that led to a decision of non-effective action relative to the Council recommendations under Article 121(4) TFEU no longer exists. The Council decision to return the

[94] Articles 6(2), 7 and 11 of Regulation No 1467/97.
[95] Article 12 of Regulation No 1467/97.
[96] Article 4 of Regulation No 1173/2011.

deposit and the accrued interest is taken on the basis of a Commission recommendation, although the Council may amend that Commission recommendation by qualified majority voting. If, however, a Member State enters the Excessive Deficit Procedure having lodged an interest-bearing deposit, the default situation will be for that deposit to be turned into a non-interest-bearing deposit following the Council decision on the existence of an excessive deficit.

In the Corrective arm of the SGP, sanctions are also provided for euro area Member States. Where the Council adopts a 126(6) TFEU decision that an excessive deficit exists, the Member State concerned must lodge within the Commission a non-interest bearing deposit amounting to 0.2% of its GDP in the preceding year.[97] If the Council decides under 126(8) TFEU that a euro area Member State has not taken effective action, the Member State must pay a fine amounting in principle to 0.2% of its GDP in the preceding year.[98]

Those sanctions are, in principle, to be activated much earlier than those provided for in the TFEU and they are more automatic. That system has been used twice so far, in the case of Spain and Portugal. After the Council adopted decisions for those two Member States stating that non-effective action was taken concerning the EDP, it adopted on 8 August 2016 decisions on the basis of Regulation No 1173/2011 but the gesture remained symbolic: the Council decided that a cancellation of the fine of 0.2 % of GDP was warranted.[99]

Statistical fines:

Regulation No 1173/2011 sets up a system of financial sanctions against euro area Member States that intentionally or by serious negligence misrepresent deficit and debt date. That Regulation is complemented by Commission Delegated Decision 2012/678/EU of 29 June 2012 on investigations and fines related to the manipulation of statistics as referred to in Regulation No 1173/2011.[100] In accordance with that system, the Council may impose on Member States fines that are effective, dissuasive and proportionate to the nature, seriousness and duration of the misrepresentation they have committed. The amount of those fines cannot exceed 0.2 % of GDP of the Member State concerned. Under Article 14 of Commission Delegated Decision 2012/678/EU, the amount of the fine is established using a two-step methodology. First, the Commission determines the reference amount, which shall be equal to 5 % of the larger impact of the misrepresentation on the level of either the general government deficit or the debt of the Member State for the relevant years covered by the notification in the context of the excessive deficit procedure. Second, the Commission may modify that reference amount upwards or downwards taking into account a number of factors.

The procedure for imposing a fine contains the following steps:

- First, the Commission adopts a decision initiating the investigation in accordance with Article 8(3) of the Regulation when it finds that there are serious indications of the existence of facts liable to constitute a misrepresentation of deficit or debt data. The General Court has confirmed that such act is a preparatory measure that does not adversely

[97] Article 5 of Regulation No 1173/2011.
[98] Article 6 of Regulation No 1173/2011.
[99] Council Implementing Decisions (EU) 2017/2350 and (EU) 2017/2351, OJ 2017 L 336, pp. 24 and 27.
[100] OJ L 306, 6.11.2012, p. 21.

affect the Member State concerned. An action for annulment against such a decision is, therefore, inadmissible.[101]

- Thereafter, it conducts the investigations necessary when it finds that there are serious indications of the existence of facts liable to constitute a misrepresentation. It may request the Member State to provide information and it may conduct on-site inspections and access the accounts of all government entities at central, state, local and social-security level. On that basis, the Commission adopts a report containing the result of its investigation. The Commission, where it exercises that power, must respect fully the rights of defence of the Member State concerned. More specifically, it must take into account any comments submitted by that Member State during the investigation and hear it before submitting a proposal for a decision to the Council, so that the proposal is based only on facts on which the Member State has been able to comment.
- Second, upon completion of the investigation, the Commission recommends the Council to adopt a decision imposing a fine and the Council decides on that recommendation by qualified majority of the euro area Member States and without taking into account the vote of the Member State concerned.

The Council has imposed statistical fines on euro area Member States on two occasions. On 13 July 2015 the Council adopted Implementing Decision (EU) 2015/1289 imposing a fine of EUR 18.93 million on Spain for the manipulation of deficit data in the Autonomous Community of Valencia.[102] By judgment of 20 December 2017, the Court of Justice rejected the action for annulment submitted by Spain against that decision.[103] In May 2018 the Council imposed a fine on Austria for manipulation of debt data in Land Salzburg.[104]

E. Reinforced fiscal surveillance in the euro area

The financial crisis of 2008 has shown that stronger coordination was needed between the members of the monetary union. It has led to a completely new system of binding measures and sanctions for the euro area Member States, adopted on the basis of Article 136 TFEU.

The Lisbon Treaty has introduced new provisions in the Treaties in relation with the euro area, in particular Article 136 TFEU. [105] The determination of its scope raises fundamental issues related to the very nature of the euro area: Is Article 136(1) TFEU only a variation of the usual method of open coordination envisaged in Article 121 TFEU? Or does it confer more intrusive competences to the Union as regards the euro area Member States? In the affirmative, how far can the Union intrude into national sovereignty? In the academic circles the majority has at the beginning

[101] Case T-676/14, Order of 3 September 2015, *Spain v. Commission*.
[102] OJ L 198, 28.07.2015, p. 19, and corrigendum at OJ L 291, 7.11.2015, p. 10.
[103] Case C-521/15, *Spain v. Council*.
[104] OJ L 137, 4.6.2018, p. 23.
[105] On Article 136 TFEU see the "Institutional Report" prepared by the author in Neergaard, Ulla, and Jacqueson, Catherine, Danielsen, Jens Hartg (eds.), The Economic and Monetary Union: Constitutional and Institutional Aspects of the Economic Governance within the EU, XXVI FIDE Congress, DJOF Publishing, Copenhagen, 2014.

advocated for a literal, hence restricted, interpretation of Article 136(1).[106] According to that reading, Article 136(1) provides for nothing more than a kind of enhanced cooperation between the euro area Member States. Article 136(1) TFEU could be seen, therefore, as a mere procedural provision, simply facilitating within the euro area the use of existing Union competences. It would not be a proper legal basis allowing the adoption of additional measures. That restrictive interpretation is, however, disputable because it leaves Article 136(1) without much benefit. Therefore, and also because the euro area crisis required an urgent response, the Union institutions have made a more dynamic and teleological interpretation of that provision. They considered that Article 136(1) was a proper legal basis allowing the adoption of measures of a new nature, which could not have been adopted otherwise.[107] That interpretation can be supported by the objective of the provision (ensuring the proper functioning of EMU) and the nature of the envisaged measures (to strengthen the coordination and surveillance of the budgetary discipline of euro area Member States). Binding measures going further than what is envisaged by Articles 121 and 126 are, therefore, possible on that basis provided that they remain adequate and proportionate.

As a first step, through the Six-Pack, the legislator adopted a new system of additional fines against non-compliant euro area Member States, in particular for breach of the fiscal rules of the SGP.[108] In 2013, two Regulations based on Article 136 TFEU applying only to the euro area entered into force. Although those Regulations – commonly referred to as the Two Pack – do not add to the SGP policy requirements, they bring about important changes to the surveillance cycle as far as euro area Member States are concerned.

Regulation (EU) No 472/2013 of 21 May 2013 strengthens the economic and budgetary surveillance of euro area Member States experiencing or threatened with serious difficulties with respect to their financial stability. It streamlines the requirements placed on financially fragile countries and embeds those provisions in the Union framework for policy co-ordination and surveillance. In particular, for Member States under a macroeconomic adjustment programme, it suspends the reporting requirements under the SGP and integrates the budgetary targets of the programme into the applicable recommendations and decisions under the SGP. By doing so, the Regulation also repatriates within the ambit of the European Union most of the management of the conditionality linked to intergovernmental financial assistance programmes and previously carried out by the 'Troika' without clear legal framework. With those provisions, if a euro area Member State requests financial assistance, its macro-economic adjustment programme will be prepared by the Member State concerned on the basis of an agreed procedure. That procedure reflects more or less the past practice (intervention of the troika, for instance) with a view to bringing it within the institutional framework of Union law. The Commission must inform the European Parliament during the preparation and implementation of the programme. Approval of the programme by the Council is also required. Exchanges of views between all parties may be

[106] Ruffert, Matthias, The European debt crisis and European Union law, Common Market Law Review: 1777-1806, 2011, 1800 ff; Calliess, Christian, From Fiscal Compact to Fiscal Union: New Rules for the Eurozone, Cambridge Yearbook of European legal studies, 2011-2012: 101-117, 103.
[107] In favour of an extensive interpretation, see the European Parliament resolution of 12 December 2013 on constitutional problems of a multitier governance in the European Union (2012/2078(INI)).
[108] See above section 2.D.

organized both before the national and the European parliaments.[109] Hence, it becomes very difficult to argue that the Commission's negotiating and monitoring activities are carried out completely outside the Union context and that they are therefore beyond the scope of the European Parliament's political control as guaranteed by the EU treaty. The European Parliament will hold the executives, and in particular the Commission, accountable for their conduct, including in respect of surveillance. The Regulation foresees that the Parliament has to be informed, in a timely manner, of not only decision-making but also the outcome of the economic surveillance process. The European Parliament can also organize debates in the context of an economic dialogue with other Union institutions as well as the Member State concerned. In parallel, because most financial stability decisions are crucial for the Member States themselves and their national constituents, the Regulation foresees that national Parliaments will have to be duly informed. The national Parliament of the assisted Member State may for instance invite representatives from the Commission to come and discuss the implementation of the adjustment programme. All in all, it may be considered that this legal framework has been relatively quickly put in place in order to achieve a sufficient level of democratic control over the management of the conditionality linked to financial assistance programmes. If, in accordance with that Regulation, the Council were to decide that the beneficiary Member State does not comply with policy requirements contained in the adjustment programme, that Union decision would dramatically affect the disbursement of assistance to that Member State under the intergovernmental programme.

The second text of the Two-Pack is Regulation (EU) No 473/2013 of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit for the Member States of the euro area. That Regulation complements the surveillance cycle for all euro area Member States by setting up a common budgetary timeline and at the same time increases the reporting and monitoring requirements for Member States under EDP. Building on Directive 2011/85/EU, Regulation 473/2013 also gives independent fiscal institutions a key role in preparing and monitoring macroeconomic forecasts and budgetary decisions and in supervising the operation of national fiscal rules. According to the common budgetary timeline, euro area Member States must notify to the Commission and the Eurogroup their so-called draft budgetary plans by 15 October. At the same time, they must make public their draft budget. As a result, the Commission has the opportunity to express its opinion on Member States' fiscal planning before the adoption of the annual budgets by the national parliaments, thus increasing the pressure on the governments to correct their plans. The specification of the content of the draft budgetary plans is set out in a harmonised framework established by the Commission in cooperation with the Member States. In practice, Member States that do not have a government with full power in place, because of their electoral cycle, must notify a 'no policy change plan' by mid-October, on which the Commission adopts a first opinion. Thereafter, the Member States must send an updated plan as soon as the new government is in place and the Commission adopts a further opinion. In principle, the Commission must adopt its opinion on those plans at the latest by the end of November of the same year. The purpose of the Commission's review is to ensure that national budgets are consistent with the economic policy

[109] Regulation No 472/2013, Article 7.

guidance issued in the context of the SGP and the European Semester. However, in case of an exceptional situation of particularly serious non-compliance with that guidance, it may ask the Member State to notify a revised draft budget. So far, the Commission has used that power only once, with regard to Italy in October 2018. As regards the content of the Commission's opinions, the logic of the procedure implies that the Commission remains bound by the indications given by the Council in the CSRs adopted in July of the same year. The Regulation also provides that the national budget must in principle be adopted by 31 December. A complex relationship exists between the Two-Pack and the measures agreed by the Member States outside the framework of the EU Treaties. Regulation No 473/2013 incorporates some elements of the TSCG[110] into Union law, such as the creation of independent forecast authorities, the obligation for Member States in excessive deficit to draw up economic partnership programmes detailing structural reforms necessary to ensure an effective and lasting correction of the deficit, and the ex ante coordination of debt issuance plans.

3. Internal control: emerging trends

Beyond the mere fiscal surveillance framework established by the Treaties, the Union and Member States have recently embarked on a new policy of harmonization of national laws in the budgetary field. The idea was to complement the rules-based fiscal framework at Union level by binding provisions at the national level to increase national ownership of fiscal rules. That new set of rules should foster sound budgetary policies in the Member States and act as a lasting mechanism against the emergence of excessive deficits. As a first step, the Council adopted a Directive requesting Member States to adapt their national fiscal frameworks. Thereafter, the Member States went further, through the conclusion of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the TSCG). The TSCG requires the transposition of a balanced budget rule in national law as well as correction mechanisms and the establishment of independent authorities. Regulation No 473/2013 also imposes the establishment of independent fiscal councils with an extensive monitoring role.[111] The Commission has also recently proposed to integrate the content of the TSCG within EU law.

The putting into place of such a system of internal control through measures of Union law is challenging. The Union legal framework was not built for such a system. In particular, the Treaties provide no explicit bases for harmonization measures in the field of economic policy.

A. Directive on Budgetary Frameworks of the Member States: an embryo of harmonization

As part of the November 2011 legislative package that amended the SGP, the Council adopted Directive 2011/85/EU of 8 November 2011, on requirements for budgetary frameworks of the Member States, which had to be effectively incorporated into national budgetary processes following a two-year transposition period. That directive sets out essential requirements on national budgetary frameworks.

[110] On the TSCG see section 3.B below.
[111] On this Regulation, see above section 2.E.

Council Directive 2011/85/EU lays down detailed rules concerning the characteristics of the budgetary framework of the Member States. As stated in Article 1, those rules were considered necessary to ensure Member States' compliance with the excessive deficit procedure. The use of the third subparagraph of Article 126(14) TFEU as a basis for the adoption of a Directive is an interesting element. It was indeed not obvious that that provision was a sufficient legal basis for harmonizing national budgetary procedures with the goal of assuring "uniform compliance with budgetary discipline" (recital 28 of the Directive). It is also striking that the United Kingdom was exempted from the obligation to have in place numerical fiscal rules because of its partial exemption as set out in Protocol No 15 to the Treaties (recital 17 and Article 8 of the Directive).[112]

B. Fiscal Compact

At the height of the financial crisis, the euro area Member States agreed that an enhanced level of discipline was necessary. In particular, following the German model, the Member States attempted to move from the existing external discipline (especially the excessive deficit procedure) towards an "internalization" of the fiscal discipline within each Member State through the adoption of commonly agreed domestic rules. During the December 2011 meeting of the European Council, objections raised by the United Kingdom prevented the adoption of those rules at Union level, given the need for unanimity within the Council. That project was therefore continued on an intergovernmental basis, through the conclusion of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), a treaty of international public law concluded between 25 Contracting Parties, all of which are EU Member States. They parties concluded the TSCG on 2 March 2012, which entered into force on 1 January 2013.

The most important aspect of the TSCG is the so-called "Fiscal Compact" by which 22 of the 25 contracting States (the 19 euro area Member States as well as Denmark, Romania and Bulgaria) agreed to incorporate a budget-balanced rule in their national legal framework. According to these provisions contained in Title III of the TSCG, Member States must include a binding "balanced-budget" rule in cyclically-adjusted terms (also called the 'Golden Rule') directly in their constitutional order or in provisions binding upon the budget authorities. According to that rule, Contracting Parties must have their budgetary position in balance or in surplus, with a lower limit for the structural deficit of 0.5% of GDP, which can become 1.0% of GDP for Member States with a debt level significantly below 60% of GDP and with low risks for the long-term sustainability of public finances. That Treaty also provides, in Article 8, the possibility for any of its Contracting Parties to bring a case to the Court of Justice in case it considers that another party has not complied with that "transposition" obligation. The substance of that obligation to have a balanced-budget is relatively close to the pre-existing rules of the Stability and Growth Pact. It mirrors the requirement found at the heart of the Preventive arm of the SGP, namely the medium-term budgetary objective. However, that set of rules presents a real novelty because of its specific status. The Golden Rule is supposed to form part of the constitutional basis of each

112 The United Kingdom has managed to be exempted from quite a number of Union law instruments, for reasons that are not always easy to justify from a legal point of view (see for example the exemption from macro-conditionality in the Structural Funds Regulation).

participating Member State. From a democratic point of view, that evolution can be seen from two very different perspectives. On the one hand, it could be considered that those provisions have been imposed through a hasty and non-democratic negotiation process and that they unduly constrain the sovereign rights of the national parliaments to decide on budgetary issues. On the other hand, since that Treaty was ratified by each national assembly of the Contracting Parties, in accordance with their national procedures, it can be seen as a strict but nevertheless democratically endorsed rule.

Article 8 of the TSCG also invited the Commission to produce a report on the measures adopted by the Contracting Parties and the Commission delivered its report in February 2017.[113] It concluded that all Contracting Parties had put in place binding and permanent balanced budget rules in their domestic legal orders, albeit with different degrees of precision.

Integration of the Fiscal Compact within EU law

The Parties considered that that intergovernmental approach should be provisional and agreed to seek integration of the substance of the TSCG into Union law at most within five years of the date of its entry into force, i.e. by 1 January 2018 (Article 16 of the TSCG). Following on that objective, the Commission adopted on 6 December 2017 a proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States.[114] Those provisions follow a teleological approach. They do not mechanically duplicate the provisions of the Fiscal Compact but request the Member States to adopt a framework of numerical fiscal rules ensuring that their annual budgets comply with a medium-term objective which itself ensures that the ratio of government debt to GDP does not exceed 60% of GDP or approaches it at a satisfactory pace. The Member States should also have a fiscal planning for the term of the national legislature and independent national bodies should be competent for assessing the adequacy of and compliance with that fiscal planning. The discussion on this proposal within the Council have never really started and the prospect of an adoption in the near future appears very low.

4. Conclusion

At the time of writing this short contribution, the fiscal rules of the European Union are faced with new and dramatic challenges. On the one hand, for the first time, a founding Member State, member of the euro area, is openly rejecting the fiscal guidance provided by the Union.[115] On the other hand, concrete work is ongoing for reinforcing the role of the European Stability Mechanism and to that effect for shifting surveillance competences from the Commission to this intergovernmental body as regard euro area Member States.[116] Sitting in the middle, the

[113] C(2017) 1200 of 22.2.2017.
[114] COM(2017) 824 final.
[115] See the letter of the Italian Minister of Finance at: https://ec.europa.eu/info/sites/info/files/economy-finance/letter_to_vd_and_pm_-_22-10-2018.pdf
[116] See the Euro Summit statement of 29 June 2018 and the letter by Eurogroup President Mário Centeno to European Council President Donald Tusk ahead of the Euro Summit of 29 June 2018, at: http://www.consilium.europa.eu/en/meetings/euro-summit/2018/06/29/

Commission is criticized on both accounts… for conflicting reasons. It would be responsible for imposing unnecessary austerity measures to Member States and, at the same time, it should lose part of its surveillance competence to the benefit of the ESM because it is allegedly too flexible in the implementation of the rules of the Pact…

We disagree with both criticisms. It is true that the state of affair regarding the Italian budget reveals that a tension may exist from time to time in a system where national governments remain individually competent for raising taxes and deciding on public spending while the guidance concerning the balance of their budgets is collectively assumed at the European level. Some commentators want to present this situation as a democratic crisis, with a European Commission allegedly trying to impose technocratic rules to elected national governments. They call for the Commission to bow to the outcome of decisions democratically adopted at national level.[117] We do not share that simplistic view. Member States decide themselves within the Council on the guidance given to each of them with regard to their fiscal trajectory. They take these decisions acting by majority rules, in practice most of the time by consensus. The Commission implements this guidance under the political scrutiny of the European Parliament. This is a necessary mechanism within a monetary union. In any case, there is nothing unusual for a country to remain bound towards external partners by long-term decisions even this is not fully in line with its internal electoral calendar.

It is nevertheless true that the more decisions of this kind are taken at a high level, far away from the citizens, the more it is important to have in place a robust and transparent system of democratic accountability.[118] Therefore, we are convinced that an effective way forward cannot be entrusting the task of fiscal surveillance of the euro area Member States to a non-transparent body broadly similar to the International Monetary Fund, protected by full immunities and acting with no jurisdictional control and no effective parliamentary scrutiny.

[117] See for instance Paul De Grauwe at : http://escoriallaan.blogspot.com/

[118] Improvements are certainly possible as far as the functioning of the European Union is concerned. It is the responsibility of the Member States themselves, their governments and their citizens to initiate such changes. See for instance Anne-Laure Delatte at : https://voxeu.org/article/fixing-euro-needs-go-beyond-economics

CENTRO STUDI SUL FEDERALISMO
Piazza Arbarello 8
10122 Torino
Italy

Tel. +39 011 670 5024
Fax. +39 011 670 5081
www.csfederalismo.it
info@csfederalismo.it