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The EU's Economic Policy Architecture after the Ratification of the Fiscal Treaty

by Jorgen Mortensen

EMU: One money, many fiscal policies

Despite the resistance by some Member States, the European Union in 1990 started the process that would lead to the adoption of the European Monetary Union (EMU). A Conference of the Representatives of the Governments of the Member States (the EC term for the inter-governmental conference) convened in Rome on 15 December 1990 to adopt by common accord the amendments to be made to the Treaty establishing the European Economic Community with a view to achieving political union as well as reaching the final stages of economic and monetary union.

When the ultimate limit for passing to Stage 3 (1 January 1999) was approaching, some member states became increasingly concerned with the possibility of irresponsible budgetary behaviour by governments once admitted to the EMU club. The need for establishing rules of the game once inside the EMU was recognised by the Madrid European Council in December 1995 and reiterated in Florence six months later. An agreement on the main features was reached in Dublin in December 1996 and a final agreement on the text of this so-called Stability and Growth Pact was reached on 7 July 1997.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, adopted in March 2012 entered into force in January 2013 was presented as a reinforcement of the Stability and Growth Pact. The present Brief argues that this new Treaty does not seem to offer a definitive solution to the problem of finding the appropriate budgetary-monetary policy mix in the EMU and that it may complicate some aspects of the economic policy governance in the Eurozone.

Policy rules as a complement to soft coordination: SGP

Broadly speaking, the Security and Growth Pact (SGP) stipulates the need for observing the Maastricht criteria even after joining the EMU. It provides specific guidelines for the process of deciding whether or not an EMU member country runs an excessive deficit. The SGP also goes considerably beyond the Maastricht Treaty by giving the Council the authority to impose sanctions if a participating Member State fails to take the necessary steps to bring an excessive deficit to an end. Whenever the Council decides to impose sanctions, it is 'urged' to always require a non-interest bearing deposit in accordance with Article 104 (11). It is again 'urged' to convert a deposit into a fine after two years unless the excessive deficit has, in the view of the Council, been corrected.

However, an institutional crisis in the European Union emerged in 2004 as the result of the ECOFIN Council's failure to "jump the obstacle" and impose sanctions against France and Germany in accordance with the Excessive Deficit Procedure provided for in the Maastricht Treaty's article 104, the associated protocol, and the Stability and Growth Pact. The crisis can be seen as a symptom of a latent and lasting conflict between two equally valid features of the construction of the Union:

1. The need to ensure a high degree of consistency, notably in the medium and long run, between monetary and budgetary policy; and
2. The principle of "subsidiarity," which can be taken as the theological argument for assigning full authority in the fields of fiscal affairs and social policy to the national (or regional) governments.

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The need to ensure consistency between budgetary and monetary policy can, from the point of view of economic analysis, be based on the argument that in the long run, monetary and budgetary policy cannot be considered completely independent policy instruments. There can be little doubt that a prospective build-up of public debt in proportion to GDP in the long run will put enormous pressure on monetary policy and make it increasingly costly for the economy to keep inflation under control. The monetary authorities' concerns about the long-term sustainability of budget balances of EU member states are therefore legitimate. This potential conflict was seemingly "forgotten" in the 1990s and in the early years of the 2000s, but it came out of hiding with the financial and economic crisis of 2007 and onwards.

The search for more rigorous rules

Under strong influence of the emerging public debt crisis, policymakers discussed the incorporation of aspects of a reinforced Stability and Growth Pact[1] into the EU Treaties at the European Council meeting on December 9, 2011. Only the United Kingdom was openly opposed to the proposal, and this veto effectively blocked the incorporation of the reinforced SGP rules into the EU Treaties, as unanimous support from all Member States is required to bring about a change in the treaty[2]. This gave rise to the adoption of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union on 2 March 2012. It was adopted by 25 Member States (the UK and the Czech Republic opted out). As a sufficiently large (12) number of partners had ratified it, the Fiscal Stability Treaty did in fact come into force in January 2013.

The provisions of the Treaty may be summarised as follows:

- The budgetary position of a "contracting party" must respect a country-specific medium-term objective as defined in the SGP with a lower limit of a "structural deficit" of 0.5% of GDP but with the time-frame fixed with due account of country-specific sustainability risks.

- The lower limit for the structural deficit may be increased to 1% once the public debt is lower than 60% of GDP.

- The speed of reduction of the deficit is fixed at one twentieth of the gap between the actual deficit and the limit.

- In the case of failure on behalf of a contracting party to comply with the recommendation, a procedure may be launched with the Court of Justice which can impose a sanction not exceeding 0.1% of its GDP.

In addition, the Fiscal Stability Treaty stipulates some more formal rules of governance. Article 16 states that within five years of entry into force, on the basis of an assessment of the experience with its implementation, the necessary steps shall be taken to incorporate the substance of the Fiscal Stability Treaty into the legal framework of the European Union.

The only really significant innovation of the Excessive Deficit Procedure is the assignment to the European Court of Justice of the responsibility of deciding whether or not to sanction a Member State for having an excessive deficit

However, Article 8 of the Fiscal Stability Treaty stipulates that if, on the basis of the Commission's assessments, taking into account the observations from the country concerned, the latter has failed to comply with its obligations, the "matter will be brought to the Court of Justice by one or more Contracting Parties". And where a Contracting Party, independently of the Commission's report, considers that another Contracting Party has failed to comply with the provisions, it may also bring the matter to the Court of Justice. In fact, according to Article 8, if, on the basis of its own assessment or that of the European Commission, a Contracting Party considers that another Contracting Party has not taken the necessary measures to comply with the judgment of the Court of Justice, it may bring the case before the Court of Justice and request the imposition of financial sanctions following criteria established by the European Commission in the framework of Article 260 of the Treaty of the Functioning of the European Union.

Involving the Court of Justice as a tool of reinforcement

The inter-governmental nature of the Fiscal Stability Treaty is also made evident by the fact that the Commission, despite its important role in the preparation

1. As presented by the Directorate-General for Economic and Financial Affairs of the European Commission, the Stability and Growth Pact (SGP) is the EU's concrete answer to concerns regarding the continuation of budgetary discipline in the EMU. Adopted in 1997 as indicated above, the SGP strengthened the Treaty provisions on fiscal discipline in the EMU foreseen by articles 99 and 104, and the full provisions took effect when the euro was launched on 1 January 1999.
2. For more see Broin, Peadar: The euro crisis: The fiscal treaty – an initial analysis, Working Paper 5 of the Institute of International and European Affairs (Dublin 2012).

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of reports and conclusions as regards the existence of an excessive deficit, is not as such entitled to bring a case before the Court of Justice. However, as regards the Eurozone countries, Article 7 stipulates that it is an "obligation" of members to support the proposals or recommendations submitted by the European Commission if it considers that a eurozone Member State is in breach of the deficit criterion in the excessive deficit procedure. This obligation, however, shall not apply if a qualified majority is opposed to the decision proposed or recommended.

Another issue is, however, to what extent the Fiscal Stability Treaty, due to its inter-governmental nature, can be expected to entail a modification of the roles of the EU institutional pattern and, notably, the role of the European Parliament. In this respect, Article 13 of the Treaty stipulates that the European Parliament and the national parliaments of the "contracting parties" will together determine the organisation and promotion of a conference of representatives of the "relevant committees of the European Parliament and representatives of the relevant committees of national parliaments in order to discuss budgetary policies and other issues covered by this Treaty".

What remains to be seen is, however, also the reality of legal procedures initiated when a "Contracting Party" actually makes use of the provisions in the Treaty and puts a case before the Court of Justice. At stake here is the Court's interpretation of the provisions in Article 3 and, notably, how the Court will decide on the definition of the annual structural balance of the general government as being the "cyclically-adjusted balance net of one-off temporary measures" and even more the definition of "exceptional circumstances" in paragraph 3, point 'b'.

Under normal circumstances, the Court cannot be expected to have the in-house expertise to arrive at an "independent" estimate of the structural budget balance of the country concerned and must therefore, at least initially, rely on the estimates of this balance prepared by the Commission. However, the country brought before the Court, not least to avoid paying the penalty and the accompanying stigmatism, may argue that the Commission's estimates do not fully take into account its "special circumstances".

In order to arrive at a balanced conclusion, the Court and the country concerned may therefore need to call in experts from outside and it is possible that, in the end, the Court's decision may not support the Commission's views or those of the Contracting Party having brought the case before the Court. To arrive at a purely judicial definition of a "structural budget balance" and "special circumstances" might thus create a rather unique precedence for a decision concerning a key economic variable, normally subject of economic cleavages and scientific and political debates but at the end normally left to the validation of economists and policy makers.

Recognition of the need to ensure a high degree of consistency between budgetary and monetary policy should, however, not be interpreted as an argument in favour of assigning increased discretionary competences to the Council in the field of budgetary policy, at least not in the foreseeable future.

Admittedly, views differ with regard to the existence or the gravity of the "democratic deficit" within the EU's decision-making procedures. Allowing the Council to take binding decisions in fiscal affairs would be against the normal assignment of legislative powers to the elected parliament. At the level of the EU, such competences should therefore only be transferred from the national parliaments to the European Parliament. While such transfers may well take place in a more distant future, this is not to be counted upon as a way to ensure consistency between budgetary and monetary policy.

The Maastricht criteria, the protocol, the SGP and the Fiscal Stability Treaty do not involve any transfer of discretionary competence to the Council and consequently do not run counter to the normal democratic functioning of the EU institutions. From the point of view of the legal status, the provisions contained in these acts are equivalent to rules frequently found in federations putting a cap on allowable budget balances or obliging regional authorities to keep expenditure within the limits of available resources. The Treaty provisions, the SGP and the Stability Treaty may therefore be considered valid attempts to obtain an appropriate trade-off between the need to ensure long-term consistency between budgetary and monetary policy and respect for the principle of subsidiarity.

Conclusions

The entry into force of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union does not significantly modify the assessments concerning the implications of the Maastricht Treaty and the Stability and Growth Pact. It does however provide a slightly modified excessive deficit procedure and, in sharp contrast to the Maastricht Treaty and the SGP, it stipulates a direct involvement of the European Court of Justice. In this way, it

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attempts to fill the judicial vacuum recognised in the Court's cancellation of the Council decision to suspend the excessive deficit procedure as regards the French and German deficits in 2003-2004.

In addition to introducing a slightly more specific constraint on budget balances, the main purpose of this inter-governmental treaty was, in fact, to attempt to fill the legal void demonstrated by the excessive-deficit procedure against France and Germany. The future of the excessive-deficit procedure in fact depended on the Council's unlikely adoption of a Commission proposal to sanction a Member State in a situation of excessive deficit.

However, transferring the final decision as to whether or not a "Contracting Party" is in fact in a situation of excessive deficit and whether it should be sanctioned by a fine to the Court of Justice of leaves serious questions open: On what criteria should the Court take this decision in case there is disagreement about the nature of the deficit and the route to be followed towards reducing this deficit? Given the exceptionally large number of excessive-deficit procedures now under way (twenty), some apprehension about how these procedures will unfold from 2013 to 2016 and beyond is understandable.

All in all, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union does not seem to offer a definitive solution to the problem of finding the appropriate budgetary-monetary policy mix in the EMU. This problem was already identified in the 1989 Delors report, and it has been regularly brought up ever since. More recently, the problem has been seriously aggravated due to the crisis. Furthermore, the implementation of this Treaty may, under certain circumstances, contribute to an increase in the uncertainties as regards the distribution of the competences between the European Parliament and national parliaments and between the former and the Commission and the Council.

This E-brief is based on Jorgen Mortensen's presentation at the EUROFRAME Conference 2013 "Towards a better governance in the EU?" held in Warsaw on May 24th, 2013.

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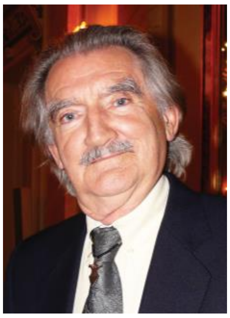

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